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**IN THE COMPETITION**  
**APPEAL TRIBUNAL**

Case No. 1146/3/3/09

Victoria House,  
Bloomsbury Place,  
London WC1A 2EB

20<sup>th</sup> October 2010

Before:

MARCUS SMITH QC  
(Chairman)

PROFESSOR PETER GRINYER  
RICHARD PROSSER OBE

Sitting as a Tribunal in England and Wales

BETWEEN:

**BRITISH TELECOMMUNICATIONS plc**

Appellant

– and –

**OFFICE OF COMMUNICATION**

Respondent

– and –

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

Interveners

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**HEARING**  
**(Partial Private Circuits)**  
**DAY ONE**

## **APPEARANCES**

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

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

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

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1 MR. READ: Good morning, sir. As you know, I appear on behalf of BT along with Mr.  
2 O'Flaherty and Mr. Lynch, and Ofcom is represented by Mr. Saini QC, Mr. Segan and Mr.  
3 Mussa, and the Interveners are represented by Miss Rose QC and Tristan Jones.  
4 As you are aware this is BT's appeal against the determination made by Ofcom in respect  
5 of partial private circuits under its dispute resolution powers contained within s.185 to 190  
6 of the Communications Act 2003. That determination is reflected, as I hope you will be  
7 well aware by now in a 240 page final determination in the second volume of the core  
8 bundle.

9 Sir, you obviously have, I hope, now a significant number of documents in terms of  
10 skeleton arguments that run to quite a few pages, and the pleadings obviously that set out  
11 the respective arguments of the parties in some considerable detail. We have agreed and I  
12 hope it has reached the Tribunal, a putative timetable, for how we are going to try and fit  
13 this within the allotted time period which I hope the Tribunal has no major observations on  
14 at this stage, because it is certainly the one that we are trying as best as we can to work to.

15 THE CHAIRMAN: No, no major observations, Mr. Read, but a couple of glossed comments, if I  
16 may? First of all, we wondered whether it would help the parties, and there is no need for  
17 you to give a response now, whether on some mornings we sat at 10 o'clock rather than  
18 10.30. We would, I think, speaking for all three of us not be able to do that tomorrow but  
19 we would be able to do it Friday and the whole of next week. So it may be that that way we  
20 can ensure that we stay within or ahead of the timetable.

21 Secondly, we think it is probably helpful for the Shorthand Writers if, whether we start at 10  
22 or 10.30 that we have a five minute break at around 11.30, just for fingers to be rested, and  
23 if perhaps those who are on their feet at the time could indicate an appropriate point and we  
24 will try to remember ourselves as well.

25 Finally, we did see your timetable and we have no specific comments except that whenever  
26 you are able to it will be helpful to have a named running order of witnesses simply so that  
27 we know which particular statements to re-read in which particular order when you know.

28 MR. READ: Sir, can I give you BT's because I have already given it to my opponents, so they  
29 know the running order and it is obviously appropriate the Tribunal should know that as  
30 well. Our first witness is going to be Mr. Budd, whose statements I think are in the core  
31 bundle at flags 10 and 11. The next witness will be Mr. Morden, whose statement I think is  
32 at tab 15. The third witness will be Mr. Pigott, whose statements are at tabs 16 and 17 in  
33 core bundle 1, and the final live witness will be that of Mr. Tickel, whose statements are at  
34 13 and 14 in bundle 1.

1 Mr. Coulson's statement obviously we also wish to be read, but neither of my opponents  
2 require him to actually appear.

3 The proposal then obviously is for Mr. Myers to be called next because obviously he is the  
4 factual witness for Ofcom, and finally there will be the interveners' factual witnesses. At  
5 the moment we believe that they will be limited to two, it may be that they get limited in  
6 due course to one, so hopefully that will save some time in any event within the context of  
7 that timetable.

8 THE CHAIRMAN: That is very helpful.

9 MR. READ: : I hope also that a glossary and an agreed product definition have reached you.

10 They have ended up in a rather peculiar position because they have actually gone into the  
11 authorities bundle. I will take you to them in due course and hope that they are there.

12 Obviously, they are documents that the Tribunal requested and we have obviously wanted  
13 to ensure that they get prominence. They are in the second authorities bundle at tabs 52 and  
14 53.

15 THE CHAIRMAN: I certainly have them in my core bundle as well.

16 MR. READ: I am grateful. So plainly there is a considerable amount of detail that has actually  
17 been raised both in the determination and in the respective pleadings. There is an extensive  
18 exposition of the issues in the various pleadings and indeed in the skeleton arguments. For  
19 that reason, sir, I am proposing to not necessarily go in depth over the arguments that are set  
20 out in those points. In opening what I do want to try and do is, firstly, stand back from this  
21 a bit and look at the overall points that are involved in this case and give an overview of it.  
22 Then what I want to do is to start looking in more detail at some of the material that may get  
23 lost in the welter of arguments that are actually there. Certainly, as far as BT's case is  
24 concerned, they are very important. In particular, I am thinking of the historical documents  
25 which have been referred to time and time again in the respective materials, which do  
26 require, in our respectful submission, some fairly detailed analysis. That is what I propose  
27 to do in due course.

28 The structure of this opening is going to be, firstly, to have a look at the overview, then to  
29 have a look at the product sold, then to look at the historical documents chronologically  
30 drawing out the points for each of the individual five grounds of appeal. Then finally, after  
31 having considered the issue of how those historical documents within the framework of law  
32 actually fit into this case, I will then come back to the individual grounds of appeal.

33 Can I give you an instance of what I may well not deal with in the course of this opening,  
34 certainly if it starts looking as though is going over my allotted time: for example, the issue

1 about an appeal on the merits and what that actually means. That is, firstly, canvassed at  
2 some length in the skeleton arguments; and secondly, sir, I think that the Tribunal is  
3 already fairly familiar with the various authorities and the issues that surround it, having  
4 determined already the preliminary issue in the 080 appeal. For those sorts of areas, sir, I  
5 am not going to get too subsumed in going through the detail again because it is there.  
6 Can I turn, first of all, to what essentially Ofcom has done in this supposedly swift dispute  
7 resolution process? It has investigated alleged breaches of BT's SMP cost orientation  
8 obligations and, we say, imposed on BT a punitive measure in order to incentivise BT in the  
9 future to meet its SMP obligations. That measure was to order BT to pay over to the  
10 interveners in respect of a four and a half year period and in respect of the 2Mbit trunk  
11 segment in excess of £41 million, which when you add in the interest comes to over £50  
12 million in total. That sum that was ordered to be paid represented 42.5 percent of the  
13 income that BT had received from the interveners for the 2Mbit trunk element that had been  
14 provided to them. We submit that on any view that is a truly colossal repayment. Ofcom  
15 also stated that they expected BT to pay other CPs not party to the disputes additional sums  
16 on top of those payments amounting to another £10 million. You can see these figures, sir,  
17 from table 7.8. I do not necessarily ask you to turn it up at this stage, but table 7.8 of the  
18 final determination which, for your reference, is at core bundle 2, tab 31, p.935.  
19 That is the decision that BT is challenging. BT says it is flawed in a number of respects.  
20 Can I just start by trying to draw out why we say those flaws are present, but by looking at  
21 six specific factors admitted by Ofcom and a further twelve factors that we say are highly  
22 pertinent. Turning to the six admitted points: first, Ofcom admitted that this was essentially  
23 an investigation of whether BT had breached its compliance with its cost orientation  
24 obligations over a number of historic years and investigated the matter back to 2004. That,  
25 we say, is quite clear from para. 3.1 of the final determination which is at CB2, tab 31,  
26 p.815. That is, of course, despite the fact - as you are already aware because the matter  
27 came up obviously in the preliminary issues hearing - that we say there is a carefully  
28 delineated process for dealing with just that sort of investigation set out in s.94 onwards of  
29 the Communications Act. I will not take you there because, obviously, you have been  
30 through it in the preliminary issues hearing. Secondly, Ofcom openly accepted that it was  
31 making its order in order to provide a deterrent effect. Ofcom, to use their phrase, accepted  
32 the interveners' proposition that the greater adverse financial implications for the regulated  
33 firm, the stronger the incentive to ensure future compliance. The reference for that is para.  
34 8.34 of the final determination (core bundle 2, para. 31 at p.941). Thirdly, Ofcom

1 admitted, certainly in the draft determination - and the figures have not significantly  
2 changed, so we say it is equally applicable to the final determination, Ofcom accepted that  
3 BT did not appear to have earned a reasonable rate of return on certain of the terminating  
4 segments. One sees that very clearly stated at para. 5.21 of the draft determination, the  
5 reference being BT1, tab 4, p.67. What this means is that the CPs, we say, who are to  
6 receive such a massive windfall for payment of some 42.5 percent of what they paid have  
7 received this despite having had the benefit of low terminating prices for the same period on  
8 which BT has not earned a reasonable rate of return. So, we say that is a third thing that is  
9 crystal clear from the determination process itself which Ofcom accepts. Fourthly, we say  
10 that although Ofcom claims that there was a clearly understood first order test - namely the  
11 DSAC test. It admits that there never had been any clearly defined second order tests for  
12 deciding whether those charges were cost orientated. In the final determination it sets out  
13 what it says are the second order tests and then proceeds to deal with them, para. 5.38 of the  
14 final determination, core bundle 2 tab 31, p.847. I should make a point about this because  
15 although Ofcom says there were no clearly defined secondary tests, as I hope I will show in  
16 due course, BT said “Actually, on the material you rely on, namely, the 1997 NCC  
17 Guidelines and the 2001 NCC Guidelines, those actually did have a very clearly defined  
18 secondary test, indeed, that secondary test was not just second in order, it was expressly  
19 stated to be the primary test” and I will come back to that when we look at those guidelines  
20 in due course.

21 What BT does say is that on Ofcom’s own admission there clearly was not a clear  
22 framework by which BT could know in advance of the final determination that what exactly  
23 it was to be tested against when any issue about alleged breaches of cost orientation was  
24 investigated. It is only in the final determination that we see secondary testing spelt out,  
25 and there are a number of examples we have given, volcanic ash and diabetes testing, in the  
26 course of the pleadings to try and illustrate how it is difficult, if not impossible to try and  
27 come up with a satisfactory assessment at the time you set the prices, because that is the key  
28 point in this case, that BT was setting the prices in 2004, 2005, 2006, which is now being  
29 complained about, yet BT submits it had no idea that the approach that Ofcom has now  
30 adopted in the final determination was going to be applied in assessing those prices. Sir, I  
31 see you have a question.

32 THE CHAIRMAN: Well not so much a question but more a flag that I hope will be dealt with at  
33 some point either when your are opening or through your witnesses, but it would be helpful  
34 to have clearly articulated what BT thought it was aiming for when setting prices in terms of

1 its SMP condition, because clearly everyone knew there was a condition to comply with,  
2 there is now a debate as to what that condition entails, but clearly BT ought to have had a  
3 view at the time of setting prices what its cost orientation obligation was. It would be very  
4 helpful to know, with some precision what BT was aiming for in prices.

5 MR. READ: It certainly is dealt with in the witness statements, sir, and the point that I do want to  
6 make about this is that one of the problems that BT had with this was that it was looking at  
7 the material from a number of different angles, and I will illustrate that as we go through the  
8 documents.

9 The core point being, and this is where we think the real dividing line is between the  
10 approach that Ofcom has adopted in the final determination that we say effectively having a  
11 pass/fail test – DSAC pass or fail – and what BT says is the position is that BT says you  
12 look at all the evidence, you do not just concentrate on one parameter for gauging whether  
13 you have passed or failed, you have to look at the whole thing in the round, which includes  
14 a whole series of factors and one of the key factors we will in due course be saying is  
15 relevant in that is whether or not there truly is any economic distortion going on in the  
16 market, because obviously I do not want to take this too far out of turn because one needs to  
17 go through the historical origins, I think, of how the PPCs were set up and the cost  
18 orientation obligation actually was instigated in order to see the parameters by which cost  
19 orientation was being viewed, certainly at the time in question and, in particular one needs  
20 to see, for example, what happened in 2005, the way that BT was presenting material to the  
21 Regulator then to get a handle on really the way that what BT was trying to do was to really  
22 look at the totality of the evidence and put the totality evidence there, rather than focusing  
23 on a singular fixed pass/fail test. I think that that in this case is really the battle line and,  
24 indeed, dare I say it the real sore point for BT in that it feels that what Ofcom has done is  
25 one test to the exclusion of everything else and, indeed, actually employed an analysis  
26 which has the effect of disregarding evidence right, left and centre, whereas what BT has  
27 always said is that one needs to look at the totality of it and all the evidence together. I will  
28 explore that more when we go through the documents, but there is one point in connection  
29 with this that I ought to make, which is that this is not a case where BT ever raised its prices  
30 in order to obtain more and more profit, the situation is that BT had its prices in 2004, in  
31 two specific instances it reduced them and it is a fact that obviously in real terms they have  
32 gone down. I think they went down by 18.8 per cent over the period in question and if you  
33 want that piece of evidence it is in para.25 of Mr. Morden's statement, which is at core  
34 bundle 1, tab 15, p.420.

1 I will discuss this in more depth because it is a fundamental point. We say that really the  
2 approach you should take as to how you gauge a cost orientation obligation is what, in  
3 reality this is all about, although there obviously are other factors like whether or not you  
4 should have even been into this sort of investigation in the context of the swift and basic  
5 process of dispute resolution. That was the fourth admitted point.

6 The fifth admitted point is that even if Ofcom's chosen method for analysing cost  
7 orientation is DSAC, it is only one way of allocating the costs, and this is another core point  
8 that I will keep coming back to. It is only one way of allocating the cost and, this is the bit  
9 that is admitted by Ofcom, it is perfectly possible for prices to be in excess of the DSAC  
10 ceiling, but still be cost orientated. That, we say, is an absolutely crucial point, because this  
11 is not a test that will definitively tell you the prices are not cost orientated. Perhaps I can  
12 just give you the references to this because this is such an important point, the first time I  
13 think it is mentioned is in BT's 5<sup>th</sup> June 2009 response, paras 43 to 47 and you can find that  
14 in BT1, tab 5.1, p.27. It is made clear in Mr. Budd's statement at para. 59, which is at CB1,  
15 tab 10, p.326, it is made clear in the annex to Mr. Pigott's first statement, which is at CB1,  
16 tab 16, p.465 and it is made clear in Professor Yarrow and Dr. Decker's second report, CB2,  
17 tab 26, and I think it is annex 1 to that which is at p.736.

18 Ofcom itself accepts that because it accepts in terms in the final determination that it is  
19 mathematically possible that if other prices are sufficiently below DSAC there may not be  
20 over recovery of common costs where individual prices are above DSAC, that is an  
21 admitted point in the final determination at para.5.61 which is in CB2, tab 31,p.853. As we  
22 will see, not only were some of the prices well below the DSAC ceiling, they were actually  
23 so low on terminating segments they were actually below the DLRIC floor, which of course  
24 on Ofcom's analysis is actually indicative of another allegation of non-cost orientation but  
25 in a different direction. That again, as we say, is a core point, because this DSAC test that  
26 is being employed is not a test that, at the end of the day, can say for sure that someone's  
27 prices, even though they are in excess of the DSAC ceiling are not cost orientated.

28 The sixth point is that even in this period when it is said that BT so significantly  
29 overcharged on its prices Ofcom admits that BT had significantly improved its efficiency.  
30 When it was looked at in 2004 by Ofcom's report, it was indicated that there was scope for  
31 efficiency and improvements, but when this matter was looked at in 2008 and 2009 it was  
32 said that BT was relatively efficient by the end of the period, and that is para.7.105 of the  
33 final determination, core bundle 2, tab 31, p.922. In fact, we say that does not actually do  
34 justice to the evidence because whereas in 2004 Ofcom's own commissioned study showed



1 that BT was 9 to 10 per cent less efficient than the top decile of US comparators. So you  
2 are looking at the top decile and it was 9 to 10 per cent less efficient.  
3 By 2009 BT was at least 6.8 per cent above the top decile of comparators. We say that that  
4 was a significant improvement in efficiency that was going on in the period when it is now  
5 being said that BT was massively overcharging on its trunk segment, so much so that it had  
6 to repay 42.5 per cent of the revenues it actually received in respect of the one segment. We  
7 say that is quite an important admission that is actually made because in our respectful  
8 submission those two facts do not immediately stack up, that you are having efficiency  
9 improvements going on in such a drastic way at the same time that BT is supposed to be  
10 overcharging to this high level of needing 42.5 per cent of the revenues to be repaid.  
11 Can I turn to the 12 additional matters that we rely upon. The first is, and this is a point that  
12 goes back, sir, in part to the question you asked me earlier, the material for the first order  
13 test, these DSAC ceilings, in fact have only become finally available many, many months  
14 after BT had already set the prices. What happens is that at the end of the year end there is  
15 a consultation that goes on by Ofcom as to how exactly BT should produce its regulatory  
16 financial accounts. There are then discussions, and eventually, somewhere between three  
17 and six months after the year end, the regulatory financial statements are produced. If you  
18 are looking at the prices that are relevant to that financial year that has just ended, you are  
19 actually having to go back to April of the previous year and look at the prices that were  
20 effectively being set then, because obviously the further you get into the financial year the  
21 less effect they are actually going to have upon that year. Of course, it is quite important in  
22 this respect to recognise, and it is a point made in the witness evidence, that BT cannot  
23 immediately change its prices. There is a time delay between it implementing the price  
24 change and that price change becoming effective because of the contractual terms that are  
25 laid out in the contract. So you do have the situation that BT is setting prices somewhere  
26 between 15 and 18 months before it knows what the DSAC ceiling is going to be for that  
27 particular year. Of course, one can say quite rightly, "That is all very well, but if you have  
28 got an extended period, if you have got two consecutive years or three consecutive years",  
29 then you at least know when you are setting your prices in April of, let us say, 2006, or let  
30 us say September 2006, what the prices would have been for the year end 31<sup>st</sup> March 2006.  
31 That would be okay if the DSAC ceilings were remaining constant. Unfortunately, because  
32 the DSACs are entirely dependent upon how you allocate the costs and various other  
33 factors, the DSAC ceilings move around from year to year. That is a point that, for your  
34 reference, is illustrated in para.79(c) of BT's reply, which is at core bundle 1, flag 9, p.281.

1 The consequence of that is that when BT is setting prices, if it was just exclusively relying  
2 upon DSAC ceilings, it would have to be working on information that was several years out  
3 of date and which it had absolutely no guarantee would in the future remain at those levels.  
4 We say that is a very significant factor when you consider whether you use the DSAC test  
5 as a pass/fail test in the way that Ofcom has actually looked at. Indeed, it goes back to the  
6 point you made earlier, sir, about how did BT set its prices. The short answer is that BT  
7 could not set its prices by reference to the DSAC ceiling. It could, of course, look at what  
8 the DSAC ceilings were for previous years and consider that in the round, but, in our  
9 respectful submission, it reinforces the point that you cannot have the reliance that Ofcom  
10 now say you should be placing on this test.

11 The second point that I want to make about this is that the DSAC test itself is not one  
12 founded in any test bed of economic theory. It is a simplified test that Ofcom considers  
13 relevant to apply to determine the cost orientation. Nobody doubts for one moment that a  
14 regulator ought to have the opportunity to implement simplified tests if that is going to  
15 make the process of regulation easier. The danger with putting too much weight on any  
16 particular test, when it has not been founded in a test bed of economic theory, is that you get  
17 very unfortunate consequences. There comes a stage where simplification is to the  
18 exclusion of actual proper determination. We say that is precisely the situation that has  
19 occurred here, that Ofcom has taken a test that does not have a basis in economic theory,  
20 has not been tested in economic theory. The obvious counterpoint to that is contestable  
21 market theory which plainly has had a lot of discussion over the years and a lot of  
22 consideration, and indeed has been applied in many instances. There is no evidence at all  
23 that any other regulator in the telecoms market or indeed in any other market has ever  
24 applied this test. There are one or two examples of regulators who have used more  
25 simplified tests in other areas, where the purpose of those tests would need to be explored,  
26 but DSAC is a test that Ofcom has effectively driven itself, and we say that that in itself  
27 ought to raise a question as to whether or not to put too much weight on it actually means  
28 that the regulator misses the true underlying point.

29 The third point that I want to make in this respect is that in so far as DSAC does have any  
30 origin, it is based on contestable market theory. It seems to us that when you have looked at  
31 the original draft determination and in particular annex 13, what was being said was that  
32 this was a test that had actually been derived from contestable market theory and that, in  
33 effect, it was something that was backed by that process.

1 That has changed in the final determination, I have to say, or we think it has changed  
2 anyway. The consequence of this is that having basically said it comes from a particular  
3 economic theory, and referred to it in the context of that particular economic theory, Ofcom  
4 then go out of their way to exclude any usual application of that theory in this case. This, of  
5 course, is the contestable market theory, true SAC, as opposed to distributed stand-alone  
6 costs and combinatorial testing.

7 I think it might perhaps be useful to illustrate this by referring to the draft determination.  
8 Sir, can I ask you to open bundle BT1, tab 4, and can I ask you to go to the back of that  
9 document at annex 13, which starts on p.141. I should add that this annex 13 is replicated  
10 to a degree in the final determination at annex 11, but there are some changes. But, if I can  
11 pick up at para. A13.8, there you can see that it talks about the concept of SAC - what I am  
12 calling true SAC - standalone costs, which has its origin in the theory of contestable  
13 markets. Then it goes on to set out what a contestable market is and deals with the highest  
14 price that a multi-product firm could charge for any good or service in a contestable market  
15 is given by the efficient SAC of that good or service. In other words, it is looking there, if  
16 you take what the costs of an entrant would be -- that would be the true standalone costs of  
17 that good or service to the multi-product firm. It then goes on to talk about SAC and LRIC.  
18 If I can pick it up at A13.10,

19 “There is substantial divergence between the SAC [that is, the true SAC as I am  
20 calling it] and the [true] LRIC at the individual product level provides a degree of  
21 flexibility in how common costs can be allocated and recovered. This is  
22 particularly the case for a multi-product firm, such as BT, in an industry where  
23 there are substantial common costs which are incurred to provide a range of  
24 products”

25 It then goes on to deal with the issue about how a multi-product company can earn a  
26 reasonable rate of return without providing scope for the firm to act in an anti-competitive  
27 or exploitive manner. If I can just pick it up at A13.12,

28 “Therefore, in deciding the reasonableness of a particular charge, it is likely to be  
29 necessary also to consider whether the prices for different combinations for the  
30 services are between the incremental and standalone costs of those combination on  
31 the services (the so-called ‘combinatorial tests’). Where all the different  
32 combinations satisfy the tests, then there is no over-recovery of common costs.  
33 Depending on the size of the product portfolio and the types of common costs, the  
34 number of combinatorial tests could be very significant. That would be the case

1 for PPC common costs as many of these costs relate to network infrastructure that  
2 is used for the provision of numerous different services by BT, including most of  
3 BT's voice telephony and broadband services".

4 We do not actually agree with that because if you look at the contestable market theory, as  
5 particularly propounded by **Baumol & Ors**. If you go back over the page at footnote 194  
6 you can see that it is **Baumol's** work on this subject that Ofcom is specifically relying upon.  
7 In fact, in various articles he indicates that you do not actually need to do all the testing. It  
8 is important to choose the testing you do need to do and for that to be specified - for  
9 example, by the regulator - so that everyone knows exactly where they can go forward on it.  
10 This is the next point at A13.13,

11 "Carrying out a significant number of combinatorial tests is clearly not possible in  
12 the timescales available to Ofcom for resolving the dispute".

13 Pausing there, we say that that actually is a key point when you come to decide whether or  
14 not this is the correct way of dealing with a dispute - an issue over breach of a cost  
15 orientation obligation – because if you are constraining it in a process which prevents you  
16 carrying out the core prescribed tests that an economic theory demands and you effectively  
17 prevent a party from being able to demonstrate whether it complies with those tests or not  
18 because you use the swift and basic process of the dispute resolution -- That says that  
19 actually you should have been using some other form of regulatory function in order to  
20 ensure that the serious allegation of a breach of cost orientation obligation was actually  
21 investigated properly. So, we do rely quite heavily on that when we come back to the issue  
22 about dispute resolution.

23 THE CHAIRMAN: Pausing there, is the problem of delay articulated in the context of DSAC as  
24 great a problem in the context of combinatorial tests?

25 MR. READ: If one was using combinatorial testing as the only methodology for dealing with the  
26 actual setting of the prices there is no doubt that there would be issues about getting figures  
27 together in time to actually set the prices at the time. BT is not saying that it was using  
28 contestable market theory and SAC ceilings -- true SAC ceilings and true LRIC ceilings as  
29 the methods for setting its prices. That is partly because BT does not actually accept that  
30 contestable market theory is necessarily the best way of judging these things anyway. But,  
31 if you are basing your pass/fail test on that theory, then we say you should at least follow  
32 the whole thing through and gauge whether or not there has been a past breach of cost  
33 orientation obligations by using the test that is actually set out -- laid out as being the  
34 correct way of finding out whether someone has passed or failed the combinations. The

1 difference - and this is quite an important difference between true standalone and true LRIC  
2 - is that there is no form of cost allocation methodology necessary in order to determine the  
3 true standalone cost ceiling because effectively you are looking at all the costs in respect of  
4 that particular product. Obviously you then have to look at other product combinations in  
5 order to see whether or not there is an excess going on. So, it really is a true pass/fail  
6 situation because either you are above SAC, in which case you have failed on a particular  
7 combination or you are below it, and unless you have passed on all those combinations that  
8 have been tested, then there is no proof that you are actually being cost orientated. In other  
9 words, it truly is a true pass/fail test. One strike and you are out, effectively. One failure of  
10 combinatorial and that is it. That is different to the distributed standalone costs because the  
11 distributed standalone costs all have to work on allocation of costs between different  
12 products, different components, we say, and you have to come through with some process  
13 for trying to divvy the common costs up. Of course, as this actually itself makes clear, fixed  
14 common costs are a significant part of what costs BT is actually entitled under cost  
15 orientation obligation to earn. So, how you divvy those costs up, how you allocate those  
16 costs really does become quite a crucial factor. I will come back to that when we have a  
17 look at the product.

18 Perhaps I should go back to where I was originally.

19 PROFESSOR GRINYER: Might I follow up on that point, please? I believe the position is that  
20 Ofcom argues at some point that there is a problem with combinatorial tests as exercised by  
21 BT in that the inclusion percentages are not clear and they were not sure how that occurred.  
22 Now, this is a matter of probably somewhat arbitrary allocation of costs within the  
23 combinatorial approach. Have I got it wrong?

24 MR. READ: I think it is fair to say, sir, that there can be a debate over how you conduct  
25 combinatorial tests. That is correct. But, the way in which BT was coming up with the  
26 inclusion percentages was as an attempt to prevent the argument that has been put back  
27 against BT - or certainly has been put back against BT - for saying, "Well, actually BT is  
28 looking at it from incurred costs rather than efficient costs. Contestable market theory  
29 requires you to use efficient costs. So, that is how the inclusion percentages come into it. It  
30 is not, if one likes, an allocation methodology in itself. It is an attempt to deal with the  
31 argument that it has to be efficient costs that are considered and not incurred costs. The  
32 difficulty that we have with that particular point being put against us by Ofcom is that, of  
33 course, DSAC itself is considered on the basis of incurred and not efficient costs. So, it  
34 really is a case of what is sauce for the goose is sauce for the gander in this case. We say

1 that although you can draw -- You are quite right that there has to be a degree of judgment  
2 in respect of how you deal with the inclusion percentages. It is, firstly, something that is  
3 absolutely true of DSAC as well as the combinatorial testing as well, but, secondly, it is not  
4 so much the allocation of costs itself that is important on this point - it is trying to make sure  
5 that no-one can criticise the combinatorial tests because they are based on incurred costs  
6 rather than on efficient costs. So, it was a conservative assumption, we say, on BT's part to  
7 try and make sure that its combinatorials could not be criticised. I hope that deals with your  
8 point, sir.

9 PROFESSOR GRINYER: Yes. Thank you very much.

10 MR. READ: Sir, if I can just round this off by going back to Annex 13. The next sentence was  
11 really the sentence that actually started all of this. A13.13,

12 "Therefore, an alternative methodology that proxies this [i.e. combinatorial testing]  
13 is necessary. One approach that has been adopted by Ofcom (and Oftel  
14 previously) in the context of the network charge control is the use of DSAC and  
15 DLRIC. This is also the approach that BT has advocated that we adopt in the  
16 submission of 14 October 2008."

17 Dealing with that last sentence first, that was not the approach that was advocated by BT.  
18 BT said: "Of course, DSAC is one thing you can throw into the equation but it is certainly  
19 not where you actually should be the singular focus of the way forward."

20 The second point is, as we say, it is not actually proxying combinatorials, it is not doing the  
21 same task as combinatorials at all, and it certainly is not a proxy which derives from  
22 contestable market theory itself and, indeed, later on Ofcom seems to accept that it is totally  
23 wrong to have used the phrase "proxy" here because when one comes to the main witness of  
24 Ofcom, Mr. Myers, he says himself that it is not a proxy and that it is all wrong for BT to  
25 have made a point about it being a proxy from combinatorial testing. Perhaps if we put that  
26 bundle away now, and if I ask you to open core bundle 2, tab 18 in that bundle is Mr.  
27 Myers' statement and if I can ask you to go to p.510, at para.75(b), at this part of his  
28 statement Mr. Myers is criticising Mr. Richard Budd – Mr. Budd is BT's economist, Mr.  
29 Myers is Ofcom's economist – and he is criticising Mr. Budd's statement because he is  
30 saying:

31 "There is a false premise in the Budd statement, because DSAC is an alternative to  
32 combinatorial tests, not a proxy and it is consciously a more restrictive test."

1 We may have to investigate in the evidence how that actually stacks up with Annex 13 and  
2 various of the other documents involved. But it seems to be Ofcom's case now that DSAC  
3 is not a proxy for combinatorial testing.

4 Sir, I will try and get through the remaining nine points that I wanted to deal with as shortly  
5 as I can. The next point that I wanted to make is that Ofcom's focus has been solely upon  
6 just one element of the product that is actually sold, namely the trunk element. That is  
7 despite the fact that trunk and terminating share common costs together and, as we say, the  
8 cost allocation can never be precise, and I will come back to that in a moment. One of the  
9 qualities of the whole of the way that Ofcom has dismissed certain parts of the other  
10 evidence is that it basically says that we are going to focus on one granular element when  
11 we are looking at the DSAC test because we are only going to focus it on the 2 Mbit trunk,  
12 we are actually going to ignore the fact that there may be a rate of low return on terminating  
13 segments. At the same time, it then criticises BT, when it is conducting its combinatorial  
14 tests for saying: "Oh no, you have focused them at far too granular a level, they have to go  
15 up and up and up the hierarchy in BT's common costs, and you have not just got to look at  
16 the core segment, you have to go beyond that and look at it in conjunction with the access  
17 segment". Perhaps I should just explain that obviously what you have is what might be  
18 termed a component, although I think BT has been criticised for using that, the various  
19 individual trunk elements and the various individual terminating elements. You have  
20 obviously got the next tier up which is the combination of those for the PPC as a whole, the  
21 circuit provided as a whole. You have then got the whole of the core network, which is  
22 effectively a combinatorial that BT did, and indeed is the very combinatorial that Ofcom,  
23 itself relied upon when looking at DSAC, because DSAC allocates costs on the basis of that  
24 combinatorial.

25 Ofcom then said the combinatorial testing you needed to do needed to go a stage beyond  
26 that and needed to look at the core and the access and other bits of BT together in order to  
27 tell you whether you passed or not. So on the one hand you have Ofcom saying the focus  
28 has to be down this end of the equation, exclusively on the 2Mbit trunk element of the  
29 product, but on the other hand saying we can disregard any combinatorial testing unless it is  
30 done up at a much higher level of aggregation.

31 Fifthly, we say that Ofcom really undertook no detailed investigation of economic harm,  
32 despite the fact – and we will come to this – in the 1997 guidelines indicated in terms that  
33 that should be the primary focus, and effectively Ofcom's skeleton argument makes clear  
34 that when you are looking at compliance you do not need to do any form of real competition

1 assessment, because that is all done at the time you set the *ex ante* obligation. We say that  
2 that really does put the cart before the horse and, worse than that, Ofcom with their pass/fail  
3 test say: “We will assume harm if you go above it, and having assumed that there is over  
4 charging going on we will see whether that has the potential for any economic effect  
5 elsewhere”. So it really is a bit like making the assumption and then saying, having  
6 assumed that there is overcharging, has that got a bad effect. It does not answer the core  
7 question in the first place: has there been overcharging and a breach of cost-orientation  
8 obligation.

9 Sixthly, we say that the issue of investigating the economic harm has to be gauged by the  
10 fact that Ofcom, and Oftel before it, believed that the trunk would be prospectively  
11 competitive, in other words other communication providers would come into that market.  
12 We say if that is the background to all of this then one of the first questions ought to be –  
13 and one of the most serious questions investigated – “Why have other people not entered  
14 the market?” Because it is, in reality, we say almost a self-evident proposition that if you  
15 are charging very high prices that are way above your actual costs it is likely that you will  
16 attract other entrants into the market and that was certainly one of the reasons when the  
17 obligations were being imposed why the terminating segments had a price cap but the trunk  
18 segments did not, because trunk was considered to be prospectively competitive. The  
19 reference for that is a point made in Professor Yarrow’s and Dr. Decker’s reports at paras.  
20 73 and 78, which is CB 2, tab 25, p.683.

21 The seventh point is we say that Ofcom indeed actually took its approach to ignoring any  
22 investigation of what is going on in the market and what is the effect upon competition to  
23 the length where it said “We are actually going to completely disregard the effects on the  
24 largest subsumer of trunk elements, because the largest subsumer of trunk elements is, of  
25 course, BT, its downstream division – retail and global divisions”. You do end up with the  
26 somewhat remarkable proposition that BT has been overcharging itself, or rather, I put it  
27 another way, the party that has been overcharging, been overcharged the most significant  
28 amounts is BT itself, and we say that that should really give a warning signal: How likely is  
29 it that BT would be actually discriminating against itself. The reason why this is important,  
30 and I will explain it very quickly here is obviously BT is the party that buys the longest  
31 elements of trunk, we say and the CPs, the other communication providers, provide what I  
32 think has been referred to in the witness statements as the “middle mile”, in other words  
33 they use relatively short connections between their own trunk services and the terminating  
34 elements that they wish to connect up to. So therefore, if there has been overcharging on



1 the trunk elements it works most against BT and is certainly not self-evident that BT would  
2 actually be discriminating against itself in this way.

3 The eighth point we make is that there is a considerable amount of other evidence that has  
4 been looked at that is simply dismissed by Ofcom for various reasons – there is almost a  
5 tick list for saying “No, we are not going to take this reason into account for in any way  
6 undermining the results we have reached by the pass/fail DSAC test” and that includes  
7 obviously the combinatorial testing; it includes international benchmarking, which again  
8 suggests that BT’s prices are not excessively high and in line with what you would expect  
9 with cost orientated suppliers. That was dismissed for a number of reasons, BT says that  
10 the reasoning unfortunately was that this actually conflicts with what the DSAC pass/fail  
11 test says, so therefore we have doubts about whether it is right or not.

12 Similarly, BT did a circuit analysis and, of course, the benefit of the circuit analysis is that it  
13 looks at the products actually sold which suggest that BT’s prices were not in excess of the  
14 cost orientation; and, secondly, that even on the worst case analysis they show that if there  
15 was overcharging it was nowhere near the scale that Ofcom suggests and it has ordered BT  
16 to repay. Again, there is all this body of evidence out there which is all pointing in the same  
17 direction, which all gets, if you like, ‘salami sliced’ by Ofcom by saying: “No, it is wrong,  
18 because of this, because of this, because of this”, but it is not focusing on the bigger picture  
19 and saying: “Does this actually suggest a nice simplified DSAC pass/fail test might not be  
20 giving the right answer?”

21 The ninth point I want to make is to focus on the rate of return because, as I have already  
22 mentioned, Ofcom itself concedes that on some of the terminating products BT was actually  
23 under recovering. We say that the rate of return on capital expenditure is quite clear that in  
24 fact BT was recovering less than its weighted average cost of capital which Ofcom had  
25 prescribed for it, which is obviously the exemplar of BT not earning a reasonable rate of  
26 return on its prices.

27 There may be a dispute about that but we say the evidence on that is pretty clear cut. We  
28 say it is quite clear from the figures that in fact it is much lower, and to give you a flavour  
29 of that, that is para. 31 of the notice of appeal where there is a confidential figure set out  
30 here, CB1, tab 4, p.15.

31 The tenth factor is that Ofcom took some 15 months to resolve this dispute under the  
32 dispute resolution process when it is supposed to be completed within the shortest possible  
33 time frame and, in any event, within four months. There might be an argument about the re-  
34 statement of BT’s accounts, but at very most that accounts for about four months because

1 Ofcom itself accepts that in October and November it had the relevant figures. There is a  
2 point in the skeleton argument unfortunately raised that in fact there were also problems in  
3 April. Well, (a) they have never been stated before, and (b) it completely conflicts with  
4 what was actually said in the final determination itself, and so you cannot put any weight  
5 upon that. So on any view, you have a process here that has gone on way beyond the four  
6 month process.

7 I am just going to deal very briefly with the last two points and then use that as a convenient  
8 moment to pause.

9 The eleventh point we make is that the issue that Ofcom actually adjudicated on, or the  
10 process by which Ofcom adjudicated on the issue, was not actually the dispute being put to  
11 it by the parties. When you look at the way that the CPs put their case, it is quite clear that  
12 their primary focus on any view was to look at PPCs as a whole to focus on the product  
13 actually sold; and secondly, to focus on the rate of return on fully allocated costs, the return  
14 on capital expenditure. Nowhere in the CPs' submission was there any mention, let alone  
15 any reliance, on DSAC, and there certainly was a very strong primary case that the focus  
16 should be on the PPC products as a whole, and not on this disaggregated base that Ofcom  
17 has actually indicated.

18 So again, it is a point that goes to the dispute resolution point. If you have the dispute  
19 before you, to what extent is it really right to then go through this extended process and end  
20 up coming up with a result that is completely different to the one that was put before it by  
21 the parties.

22 The final point that I make on this is that there is no evidence of the interveners, the  
23 communication providers, suffered any loss at all, we would say, certainly when the matter  
24 was before Ofcom in the determination, and there has been some evidence put in  
25 subsequently, but even that goes nowhere near establishing the sort of level of repayment  
26 that has been ordered in this case. That, of course, has to be looked at again in the context  
27 of the fact that CPs have benefited from the fact that they have had cheap terminating prices  
28 over the entire period. On the one hand, you have got the benefit of them getting the cheap  
29 terminating prices, but at the same time they are receiving this massive windfall back.

30 Would that be a convenient moment, sir?

31 THE CHAIRMAN: That would be, shall we say 11.40.

32 (Short break)

33 MR. READ: We say that when you take those six admitted points and 12 points all together you  
34 end up looking at something that says almost immediately that something has gone wrong.

1 If you are actually looking at a £50 million repayment, that is something like 42.5 per cent  
2 of the revenues actually earned, and you put it against all that combination, we say that  
3 immediately says something has gone wrong with the processes that Ofcom used and the  
4 conclusions that it has actually come up with.

5 Ofcom makes the complaint in its skeleton argument that effectively we are trying to  
6 introduce a new alternative ground by saying that because somehow the decision looks  
7 wrong that necessarily means that it must be overturned.

8 The point we do make in that respect is one can see that this links in with Ofcom's effective  
9 attack on what is the precise merit review that is carried out by the Tribunal. We say that in  
10 particular in this case you are entitled to look at the broader picture and consider it when  
11 you consider the individual grounds of appeal, because as BT made clear in numerous  
12 places in its skeleton argument these issues overlap. It is not simply a case of you can  
13 identify this strand here and it necessarily means that that is only relevant to that particular  
14 ground of appeal. If you want examples of that, para.7 of BT's notice of appeal, and  
15 para.44, making the point that the grounds are interlinked. In effect, the use of the pass/fail  
16 DSAC test is linked to the level of aggregation you look at. The more granular the focus,  
17 the more likely the DSAC test is going to give you the wrong answers. Likewise, the issue  
18 of combinatorial testing impacts on why were we prevented from doing the combinatorial  
19 testing? Answer, because Ofcom was saying that you cannot do it in the swift and basic  
20 process of dispute resolution.

21 We say that there is an enormous overlap between the grounds of appeal. It is well  
22 recognised that when you actually are considering whether a decision is right or wrong you  
23 are entitled to accept certainly – for example, in the field of judicial review – that one  
24 ground may overlap with another and their categorisation of trying to see whether the  
25 decision is right or ultimately wrong. If authority is needed for that there are some passages  
26 in the authorities bundle which I will take you to if it becomes a relevant point.

27 I do not want it to be thought that we are in any way backing away from the grounds of  
28 appeal we actually rely upon. What we do say is that if you look at the broader picture, the  
29 bigger picture, it immediately sets you thinking, "Has there been a regulatory failure on  
30 Ofcom's part in the way it approached this dispute?" You cannot ignore, we say, that  
31 framework when you come to judge the individual grounds of appeal.

32 Essentially, what we are saying is that Ofcom has looked at the individual trees and not  
33 appreciated the bigger wood above it. The other analogy we have used in the notice of

1 appeal at some point is that if you analyse the pixels within a photograph you do not  
2 necessarily see the picture that the photograph is actually painting.

3 So we do say that you need, in our respectful submission, to look at the bigger picture,  
4 because that is what Ofcom did not do. They did not do the sanity check of saying whether  
5 or not the prescribed methodology they actually come out with means that they, in fact, had  
6 reached the right result.

7 Sir, can I take you – and I am conscious of the time that it is taking, so I do not want to  
8 necessarily take you through everything that I was going to actually say – first of all, to the  
9 product that is actually sold, because this is quite an important starting point for gauging  
10 what Ofcom did in this case. There has been a glossary, as I have indicated, provided. Can  
11 I ask you to look at the second authorities bundle, tab 53. We have printed power point  
12 slides of the agreement as to what is actually a PPC is. That should be in the second  
13 authorities bundle, tab 53. Can I ask you to look very briefly at the second page in tab 53, a  
14 slide headed “What is a PPC?” As you can see, it is making clear that it is:

15 “... a ‘wholesale’ telecommunications service that provides connectivity between a  
16 CP’s customer’s site and a point of connection between BT’s and CP’s networks.”

17 We do say that is quite an important point because it is a link between the customer site and  
18 the CP’s network. It is, if you like, a logical projection between two specific points. That is  
19 illustrated also by the fourth bullet point making clear that it is the capacity between two  
20 points. The second bullet point:

21 “The PPC enables a CP to connect its customer’s site to the CP’s network and  
22 therefore provide service to that customer.”

23 Can I then ask you to look at the next slide which actually sets out in stylised form that link.  
24 You can see that there is a third party customer premises at one end on the left and then at  
25 the other end the other communication provider’s network node. These form the link  
26 between those two sites. It is effectively an end to end link between two specific  
27 geographical places. You can see there are a number of points that are on that diagram. In  
28 particular, you can see there is an SDH transmission cloud in the middle between the point  
29 of connection and the local serving exchange which, if you look down at the bottom of the  
30 page, you can see is the main link fixed charge with the heading “PPC”. You can see that  
31 that main link consists of the terminating and trunk elements. It is a point that is made in  
32 Mr. Morden’s statement that in fact the main link really is composed of a number of  
33 different parts, of which the terminating elements, as we know them, is one, and the trunk  
34 element is another.

1 As you can see, it is very much within a telecoms cloud, hence the cloud in the middle,  
2 which is also reflected on the next slide on p.4, which shows the same point.  
3 The reason why I particularly draw attention to this is because although logically these  
4 diagrams are showing that there is an end to end, if you like, connectivity between one point  
5 and other, the bit in the middle actually is not necessarily a straight line from A to B.  
6 Because it is going through that virtual cloud it does actually mean that some of the  
7 equipment that the terminating element is using is the same equipment as the trunk element  
8 is using. In fact, you may actually, as I understand it, have the situation where the same  
9 duct or cable takes the trunk element and then the terminating element out again, if you like.  
10 The reason why I draw specific attention to this point is because it is a key element of the  
11 product that is actually sold. It is sharing significant common costs between the respective  
12 elements. We say that is very important when we come to look at the whole issue about  
13 how reliable DSAC is as a test, precisely because although you may split it up into a trunk  
14 element and a terminating element often they can be using the same equipment, and  
15 certainly the equipment is being shared.  
16 The second point I want to take you to in order to illustrate this is the fact that PPCs when  
17 they are sold and they are billed are always sold as a PPC, as a circuit. They are not sold  
18 and billed as individual distinct services for trunk and terminating.  
19 One could have a debate, and BT has tried to eschew getting into a semantic debate over  
20 what is a component and what is a service, but the reality in this case is that the product that  
21 is actually sold and billed is the PPC.  
22 Could I ask you to put the authorities bundle away and get BT's second file. It is divided up  
23 not by specific numbers, it is divided up by various initials, and about a third of the way  
24 through there is a tab JM, which is Mr. Morden's statement. Can I ask you to go to his first  
25 exhibit, which is underneath the tab JM1. This is one of the two ways that the products are  
26 sold. The other product is effectively an electronic format. As you can see, what is actually  
27 asked for by the CP – this is the Partial Private Circuit Requirements Form – and what is  
28 given to BT is details of a handover site and the third party site. It is very much, as we were  
29 looking at in that diagram, from one end to another. As you can see, there is no  
30 specification within that for whether I want a terminating element, whether I want a trunk  
31 element, whether or not I want something different.  
32 Can I just ask you to go to JM3, which just shows the way it is billed. Again, it is billed  
33 very much as an individual total for the circuit actually supplied.

1 What BT says is there is no doubt that the practical level, the product level, what is actually  
2 going on here is that parties are buying a circuit from effectively A to B. There is no  
3 specific request to buy a particular trunk element or a particular terminating element.  
4 Obviously, when it ultimately comes to routing they may have to have elements of that  
5 involved, but that is not what is the core when it comes to the product and the billing.  
6 The second point that I want to make in respect of this is that whilst it is possible that a  
7 routing process may involve only a terminating element, there is no dispute in this case that  
8 the trunk element is only ever purchased with a terminating element. There is never any  
9 question of a trunk element being sold on its own. Effectively, if you like, a trunk element  
10 is like building a bridge to nowhere, because you need a terminating element to actually  
11 complete the set up.

12 There is some discussion in the final determination which is picked up in the notice of  
13 appeal where Ofcom says, “Yes, but we did actually suggest at one stage it may be possible  
14 for a trunk to be sold independently”. They would not rule it out, I think is the phrase that  
15 was actually used in the 2004 leased line market review. We say that is really something of  
16 an artificial blind because, okay, the possibility was mooted, but it has never happened; it  
17 has never been done. That is not what is going on in the market. In the market place trunk  
18 is only ever sold with a terminating element. Again, we say that is quite important. Indeed,  
19 it was a point that we think the disputing CPs, when they first raised this complaint,  
20 themselves recognised because they were suggesting that the product needed to be looked at  
21 -- PPCs need to be looked at in aggregate, precisely because that was effectively the product  
22 being sold. In our respectful submission, that is absolutely right. That is why it is wrong  
23 in this context to exclusively focus on the individual trunk elements. They are never really  
24 sold as an element in themselves. They are always sold in a direct relationship with a  
25 terminating element. Therefore, to artificially look down on, and focus on just that one  
26 element without looking at the rest of the elements with which it is sold is, in our respectful  
27 submission, completely wrong as a process for trying to get to the bottom of whether or not  
28 a price is cost orientated or not.

29 It is suggested, I think, in that context at various places, “Well, actually trunk is sold in  
30 variable proportions in comparison to terminating elements, i.e. may have longer or shorter  
31 segments. There is something in that in the sense that, yes, you can buy 4kms of trunk or  
32 you can buy 120kms of trunk, but that is not, in our respectful submission, the reality of  
33 what is going on here. Trunk is, in one sense, always sold in a fixed proportion in the sense  
34 that you have one element of trunk always with at least one element of terminating. In other

1 words it is one-to-one. It is never a trunk element on its own. In that sense it is a  
2 misleading metaphor to use, in our submission. In any event, it does not really get Ofcom  
3 home because certainly as we understand it, even when they were looking back at the 1997  
4 guidelines, in fact various of the components there were also sold in variable proportions.  
5 So, insofar as Ofcom seeks to use this as a means for justifying the differences between the  
6 approach in 1997 to the PPCs about how you should actually focus on the service rather  
7 than the individual elements or components as we say they in reality are. That is actually  
8 also true of the very document that they rely upon. That may be a point that will have to be  
9 explored in due course. The reality is that a focus that looks only at one element of the  
10 product being sold is, in our respectful submission, slightly pie-in-the-sky. It may be that  
11 you do have to have some regard to the individual trunk element being sold, but that is not  
12 the same as saying that the focus needs to be on the product as a whole - at least as well if  
13 not, as we would say, more so.

14 I think it would probably be sensible if I do just illustrate how the dispute was originally put  
15 forward. One can see that in the bundle I have just asked you to put away - BT1. This is the  
16 dispute on behalf of the interveners raised by this written document on 25<sup>th</sup> June 2008,  
17 indicating the way that they were asking Ofcom to resolve the matter. If you can look, first  
18 of all, at para. 2.2 you can see,

19 “The relevant products are Partial Private Circuit (“PPCs”). PPCs are generally  
20 composed of either just terminating segments or trunk and terminating segments  
21 providing a path between a third party building and the network of the PPC  
22 customer”.

23 We say that that is a major reason why, if you go on to para. 2.90, the CPs asked in terms,  
24 “For the purpose of this dispute referral, we request that Ofcom award  
25 compensation based on trunk and terminating segments in aggregate, i.e. based on  
26 BT’s over-recovery across PPCs as a whole (the first of the alternative positions  
27 outlined under each of the two scenarios). However, should Ofcom decide that this  
28 approach is not appropriate, we request that, in the alternative, Ofcom adopts one  
29 of the other approaches outlined”.

30 So, the primary case was focused on PPCs. There was an alternative case. You need to turn  
31 back in the document in order to see that alternative case which is set out at p.30, starting at  
32 para. 2.80, which ends,

33 “Ofcom should consider the position set out below as alternative submissions.

34 We consider two scenarios:

- 1 (1) BT is over-recovering on trunk and under-recovering on terminating segments;  
2 and  
3 (2) BT is over-recovering on both trunk and terminating segments”.

4 So, it deals with the first one, where BT is over-recovering on trunk and under-recovering  
5 on terminating segments, which we say is exactly the position here. There is argument  
6 about the accounts. Then they say,

7 “There are two possible approaches to applying the SMP conditions in this  
8 scenario:

9 2.82.1 The cost orientation obligation should be applied to trunk and terminating  
10 segments in aggregate, i.e. to PPCs as a whole. Any over-recovery should be  
11 calculated with regard to overall BT’s profitability on PPCs ----“

12 Then in 2 it puts the alternative supposition:

13 “The cost orientation obligation applies to trunk and terminating markets  
14 separately.”

15 It deals with that. Then at 2.83 it sets out its position.

16 “In favour of the first of these positions, it may be argued that [this is looking at  
17 PPCs in aggregate]:

18 2.83.1 BT does not sell trunk segments in isolation, rather it provides an end-to-  
19 end connectivity product ...’

20 2.83.2 Ofcom’s initial charge control was imposed despite BT’s objections to the  
21 underlying cost model (because Ofcom found BT’s alternative model even less  
22 plausible); given that there were uncertainties from the outset around the allocation  
23 of costs between trunk and terminating, the fairest approach is to consider PPCs in  
24 aggregate, which largely removes these uncertainties.

25 2.83.3 Considering PPCs in aggregate is the simplest approach”.

26 Then in 2.84,

27 “Should BT argue that SMP conditions apply to the markets separately, it may  
28 then be argued in favour of that second position ----“

29 Of course, BT never argued that the conditions applied to the market separately because BT  
30 from the very outset, when it put its response to the dispute in, made it absolutely clear that  
31 it fully agreed with the CPs that one should be looking at this in aggregate.

32 While you have this document open can I ask you to look at p.19? On that page one sees a  
33 diagram which you can see has SAC, FAC (Fully Allocated Costs) and then LRIC plus  
34 EPMU, and then, at the bottom, LRIC. You will note from that that there is no indication



1 whatsoever of DSAC or DLRIC. Whilst I do not want to have you juggling too many files  
2 at a time I would ask you to look in the core bundle at the final determination. This is in the  
3 second core bundle at Tab 31. You can contrast that with Ofcom's. A very similar  
4 representation of the position which is actually showing the point that the more granular  
5 focus, the further the ceilings and floors move apart. But, of course, the core point is that  
6 Ofcom's there specifically has DSAC and DLRIC in, whereas in fact the CPs never once, in  
7 the entire document referred once at any stage to distributed standalone costs ceilings.  
8 Their focus was on SAC, true SAC, and true LRIC. I draw your attention to that because it  
9 is quite an important point in our respectful submission that DSAC and DLRIC never  
10 featured in the way the dispute was put to Ofcom. What the disputing CPs were arguing  
11 about was over fully allocated costs and rate of return on capital. That was the way they  
12 were putting their case. I do not think I probably need to take you in detail through it, but  
13 that is a very important point.

14 Can I just finish my focus on the products sold by asking you to very briefly look at some of  
15 the material on how costs are actually allocated between the respective elements. I think  
16 this may be easiest to do by just asking you to look at BT3, tab 10.3, which is the report of  
17 Mr. Keyworth, who is an economist. This report was put to Ofcom at the time. I do not  
18 need to take it in any depth to some of the other points he is making. However, if I ask you  
19 to look at para. 11, p.4 -- It is making the point that:

20           "-- Ofcom originally defined the breakpoint between trunk and terminating  
21           segments as being BT's Tier 1 nodes with inter-Tier 1 traffic being classified as  
22           trunk ----"

23 Then in para. 12 he makes the point that the 2008 review actually changed. In para. 13 he  
24 makes the point,

25           "There is some arbitrariness, too, in the terms of the definition of trunk and  
26           termination for pricing purposes. Communications Providers buy PPCs, but these  
27           are divided into terminating and trunk segments to calculate charges. For this, a  
28           pricing algorithm is used. The calculation is based on a notional routing of a PPC  
29           and the fact is that any actual PPC may be routed by a different path altogether. I  
30           understand that this is to ensure that the price of the PPC does not depend on the  
31           way in which BT chooses to route the PPC. Indeed, it is quite possible that a  
32           'trunk service' will not use Tier 1 nodes at all, or be routed across Tier 1 network  
33           connections, although in terms of the regulatory classification trunk services are  
34           (currently) defined as those between Tier 1 nodes".

1 Then he picks up in para. 15,

2 “As Olswang’s note [the one we have just been looking at], there is a need for an  
3 allocation of certain costs (those which are fixed with respect to volumes and  
4 common across the two services) between trunk and termination segments, and that  
5 this allocation has been the subject of some uncertainty. This should caution  
6 against placing weight on separate service returns as these reflect a particular cost  
7 allocation procedure, with valid alternatives giving different results. Indeed, cost  
8 allocations issues which arise in this context have been recognised by Ofcom on a  
9 number of occasions.”

10 and then he sets out part of the 2004 final statement. It deals also with the 2005 initiative  
11 inquiry. He then looks at the 2008 business connectivity market, review over the page, and  
12 ends at para.18, I do not think it is necessary to take you through all those extracts, but  
13 concludes at 18:

14 “Consistent with the view taken by Olswang, I consider that these costs and  
15 revenue allocations issues strongly suggest it is appropriate to consider the  
16 combined returns in trunk and terminating segments when considering the issue of  
17 cost orientation. This perspective provides a more robust and reliable basis than  
18 considering trunk and termination separately, and is also consistent with Ofcom’s  
19 previous deliberations on the pricing of these services with respect to the period to  
20 which the disputes relate.”

21 We say that that is absolutely bang on point and dead right, that in fact it is one of the  
22 inherent problems with using a granular focus in the way that Ofcom has in this case, is that  
23 it ignores the fact that at that type of granular level it is coming down more and more to the  
24 exact allocation that one is using between the particular fixed costs. This is not something  
25 that BT is putting forward of its own, it is actually something that Ofcom itself accepts.  
26 There is necessarily no right or wrong way of allocating costs. They say in terms – I have  
27 asked you to put the file away so I will not ask you to get it out again, but at para. 11.6 of  
28 the final determination, which is in CB2, tab 31, p.1006, they say in terms:

29 “Because of the existence of significant common costs between BT’s activities,  
30 BT will only recover costs overall if at least some of its charges are above the true  
31 LRIC floor. However, there may be many different ways of attributing these  
32 common costs to different services, none of which may be uniquely correct or  
33 uniquely reasonable.”

1 We say that that is an underlying fundamental in the approach to this dispute and, in  
2 particular, the whole issue of where you put the focus on. If you are putting the focus on a  
3 granular level, and the more granular you actually do that, the more the risk is that the  
4 results are being distorted by the particular allocation of common costs and the problem is  
5 there is no definitive answer to how exactly you should allocate those common costs.

6 THE CHAIRMAN: It does make one wonder though why BT distinguishes in terms of pricing  
7 between the price for a terminating section and the price for a trunk.

8 MR. READ: Well the short answer – and I hope to draw this out by having a quick look at the  
9 regulatory financial statements – is that it is told to. These regulatory financial statements  
10 as I have already indicated are drawn up in consultation with Ofcom, and Ofcom puts the  
11 matter out indeed for public consultation as to how the costs should actually be allocated.  
12 Those regulatory financial statements are required, BT is required to give the figures for the  
13 individual parts, and there is no doubt that there is a very large amount of accounting  
14 material as to how to actually dig down in order to give some form of rules, methodology  
15 for how you go about allocating these costs.

16 What is very clear about it, and I will shortly take you to this, is that when you look at the  
17 regulatory financial statements, first, the level of aggregation that Ofcom wanted changed  
18 from year to year, and you will see that from 2005 to 2006, and secondly, BT was making it  
19 absolutely clear that one of the problems is the more granular the focus is, the harder the  
20 attribution of the common costs between them actually becomes. It is, in our respectful  
21 submission, an important point when it comes to considering the level of reliance you place  
22 upon the DSAC test, and it comes back to the point I was making earlier. BT is not saying  
23 that DSAC means nothing; of course it means something, it is there, it is a guide, but what it  
24 is wrong to do is then to convert it into a pass/fail test and use that as a basis for rejecting all  
25 the earlier material that is available.

26 Ofcom, in our respectful submission, start the whole process by saying that the DSAC  
27 ceiling is the ceiling above which BT should not go unless there are exceptional reasons.  
28 That ceiling is, I think, a very significant factor in determining it. That is the problem that  
29 lies at the heart of this appeal, because what Ofcom has done is they have taken a test that  
30 has limitations and then fundamentally given it a significance it really is not appropriate to  
31 give it certainly when the other material suggests something different.

32 PROFESSOR GRINYER: May I ask a question? We all accept in fact there is an arbitrary  
33 element in DSAC and the allocation of costs which Ofcom has mentioned and you have  
34 mentioned. Do you know whether any sensitivity analysis has been done? Instead of

1 looking at the extent to which the final result in DSAC is sensitive to marginal changes in  
2 the allocations?

3 MR. READ: I am not aware of any specific work that has been done on that. Certainly, it is quite  
4 interesting when you go through the figures, because you will appreciate, sir, in the context  
5 of this dispute that what happened – I have not taken you to this because of the time – the  
6 disputing CPs start off saying that actually BT’s fully allocated costs should be much  
7 higher. Ofcom comes along in the process of resolving getting to the draft determination  
8 stage and comes up with a shift in costs here and there – I think it is s.4 in the draft  
9 determination and s.6 in the final determination – BT points out some of the flaws in what  
10 Ofcom has done, so it goes through the next process of trying to reallocate costs which then  
11 end up with different figures, and what we do say this illustrates is you can go through this  
12 extensive process of reallocating costs and it has an effect on the figures. What I cannot lay  
13 my hands on at the moment, although I may be prodded in due course, is whether there has  
14 been any specific sensitivity analysis done on that equation. My understanding at the  
15 moment is not, but I may be told differently in due course.

16 Perhaps I could finish it off, sir, by saying that is the very reason that you should be looking  
17 at all these other factors precisely in order to get some sensitivity analysis actually on  
18 whether or not this DSAC ceiling is producing the right result.

19 If I can give you one example, in the process of the draft determination Ofcom go through  
20 a very long, complicated process of reallocating costs. We, in fact, say that that is why  
21 these determinations took so long because there was a massive process going on of trying to  
22 work out whether or not Ofcom should rely on BT’s regulatory financial statements and  
23 make adjustments for them. I can illustrate that if you want me to perhaps by the final  
24 determination, it may be easiest to see it there. But the result of that change that went on in  
25 the draft determination is that actually Ofcom’s reallocation of costs led to BT on all PPCs  
26 actually earning below its weighted cost of capital, those are the figures actually produced  
27 by Ofcom.

28 Ofcom then go through another process after BT says “you have the methodology wrong”,  
29 and that actually results in BT’s costs for all PPCs being marginally above weighted  
30 average cost of capital. What it does illustrate, in our respectful submission, is that if you  
31 go around chipping away at the cost allocations and the revenue allocations, you do end up  
32 with significant figures and it can have a significant result. So in the draft determination the  
33 return on capital expenditure for all PPCs was actually below weighted cost of capital. But,

1 when you come to the final determination and the figures have been re-jigged yet again you  
2 end up with a figure that is above the weighted cost of capital.

3 I do not know which bundle I have you looking at, at the moment?

4 THE CHAIRMAN: We are on BT3 at the moment.

5 MR. READ: I cannot demonstrate the point with BT3 very easily, but perhaps I can ask you to  
6 look at the final determination which is in CB2, tab 31, and ask you to look at p.869, and  
7 just show you what was involved in all of this process. You see there is a whole section on  
8 BT's costs of providing PPCs and the relevant base data and so on and so forth. I will not  
9 take you through all the detail of it, but if you look, for example, at para.658, p.878, you  
10 will see there, there is a heading: "Adjustments to the base data", and there is a very long  
11 list that comes out. I am looking at p.880: "Attributable costs and revenues", over the page  
12 at 881, "Customer local end equipment and infrastructure costs; above para.6.76: "Payment  
13 terms." Over on p.882 reference to "Resilient circuit costs". Page 883, above para. 6.91  
14 "Trunk distribution/rebalancing." "Next generation network costs", and then if one goes  
15 on, one sees at p.888 a specific consideration of the adjustments proposed originally by the  
16 interveners' forensic accountant, RGL, and you can see that very long table there. You can  
17 see at p.892 a table showing the impacts of the adjustments on ROCE.

18 If, in the more boring moments of this case, one wants to look at BT's views on what the  
19 effects of these adjustments were it is contained in Mr. Coulson's evidence who says "not a  
20 lot" effectively; that Ofcom went through all this very, very lengthy and detailed process  
21 which, in BT's submission that the reason why this determination process actually needed  
22 to take so long is that this was such a huge task that was being performed in terms of cost  
23 allocation methodology, the net result was not a great deal at all, but even on what was  
24 done, it did have a significant effect between the draft determination and the final  
25 determination as to whether BT on all PPCs was above weighted average cost of capital or  
26 below weighted average cost of capital. The cost allocation, lengthy time consuming  
27 process, it can have a significant effect on the figures as the all PPCs ROCE shows, and it  
28 certainly was a process that took up an enormous amount of time in the context of this  
29 dispute resolution. It comes back to what we say is the fundamental about all of this, that it  
30 is a very complicated process that goes on by having to allocate costs, for example, for the  
31 purposes of working out BT's DSAC ceilings for these individual elements and that is  
32 something that ought to wave a red flag about saying that you should not place too much of  
33 an emphasis on one single pass/fail test.

1 Sir, I am going to leap ahead, I think, through my notes and move at this stage on to a look  
2 at some of the historical documents that have been involved. Can I first of all ask you to go  
3 to the 1997 guidelines, and these are set out in BT's vol.3 which I hope is the volume you  
4 should still have with you. Can I ask you to go to BT 3, tab 12.1. These are the 1997  
5 Network Charge Control Guidelines. The starting point for this is that, of course, this was  
6 dealing with PSTN telephone calls, voice and I think data as well. It was looking  
7 specifically at the charges, because the context in which this was set was that prior to 1997  
8 the prices were set by a very complicated process by which effectively an interim price was  
9 put in and then an adjustment was made subsequently. Ofcom was at this stage trying to  
10 move away from that very prescriptive pricing process.

11 In looking at the public sector telecoms network it was setting out these guidelines as to  
12 how it was going to deal with those network charges.

13 There is one very important point about the origin of that, which is that the charges already  
14 were being controlled by Ofcom, because there had been this pricing control process that  
15 had been gone through previously. When one was looking at the charges for the PSTN  
16 network in this context they were already quite clearly cost orientated because of all the  
17 testing, etc, etc, that had gone on previously.

18 I should refer you very briefly to para.1.1. It sets out there what their purpose actually is,  
19 and you can see at the bottom bullet on that page:

20 "Dispute resolution, including guidance on how Oftel will assess complaints that  
21 charges or other terms and conditions are unreasonable or anti-competitive."

22 "Unreasonable" in that context was also quite plainly meaning cost orientated as well, and  
23 one can see that if one goes on later to para.3.5. There you can see there is explicit mention  
24 of condition 13.4 and 13.3. 13.3 was an assessment of whether the terms, including prices,  
25 were reasonable; and condition 13.4 was an assessment of whether the charge for each of  
26 BT's standard services is reasonably derived from forward looking incremental costs of that  
27 service – in other words, costs orientation.

28 So the context of these remarks, they are not being said simply in respect of any subsequent  
29 competition inquiry, they are being said specifically in the context of gauging whether or  
30 not BT's prices are cost orientated and gauging whether or not the prices are fair and  
31 reasonable.

32 If one looks down that paragraph at 3.5, one sees the explicit mention of what condition  
33 13.3 is and condition 13.4. Then it adds about half way down to the effect that a charge is  
34 not reasonably derived from forward looking incremental costs of the service. A first order

1 test will be whether the charge in question falls between its incremental cost floor and  
2 stand-alone cost ceiling.

3 The primary focus of an investigation of a complaint under 13.3 or 13.4, i.e. a complaint  
4 about cost orientation, will be the effect or likely effect of the charge on competition and  
5 consumers. That is a very important point, in our respectful submission, because this is the  
6 document, and its follow-up, the 2001 NCC Guidelines, that Ofcom says plainly laid down  
7 the first order test of DSAC. The very document itself is saying that it is only a first order  
8 test and that the primary focus of the investigation of a complaint will be on the effect or  
9 likely effect of the charge on competition and consumers.

10 What we say is really absolutely clear from this is that if anyone is suggesting that BT  
11 should have understood DSAC to be a first order test on the basis of this document, BT  
12 also very plainly should have understood that that was only a first order test by which we  
13 would say it plainly means an initial screening type of test, but the primary focus thereafter  
14 would be on the effect or the likely effect of the charge on competition and consumers. We  
15 say that is not really surprising because, if a regulator is going to embark upon a regulatory  
16 decision, that ought to be the guiding factor that is the result of that investigation. It  
17 determines how exactly the investigation should be conducted.

18 That is a point that is not just made there, because if one then goes on in the document to  
19 para.4.12 it says in terms that Oftel will generally regard a charge to be unreasonable, and  
20 of course that was one of the conditions on BT, if it is, or is likely to be, anti-competitive or  
21 exploitive:

22 "Oftel's approach to assessing prices for the purposes of judging whether they are  
23 anti-competitive is set out ... A first order test will be whether the charges fall  
24 between the cost floors and ceilings ..."

25 and the methodology for deriving that is set out in annex C to the guidelines. The primary  
26 focus still remains whether it is likely to be anti-competitive or exploitive.

27 We say that this document, which Ofcom places such emphasis on both in the draft  
28 determination and the final determination, is making quite clear what the primary focus is  
29 actually going to be. It is going to be upon whether the charge is affecting competition or  
30 affecting consumers.

31 I probably should take you to annex C, because this is part of the methodology. At  
32 paragraph C1, in general Oftel will consider a good first order test of whether a charge is  
33 unreasonable or otherwise anti-competitive to be whether the charge in question falls within

1 a floor of long run incremental costs and the ceiling of stand-alone costs. That is explained  
2 in paras.C3 to C5:

3 “A charge set below the floor could mean that BT was not recovering sufficient of  
4 its incremental costs of conveyance from the service and might indicate the  
5 possibility of anti-competitive behaviour. A charge set above the ceiling might  
6 mean that BT was recovering more than appropriate share of the full (or stand-  
7 alone) costs in providing conveyance, which would indicate possible abuse of a  
8 dominant position in the market for the service.

9 In investigating complaints about charges, Oftel would not apply the floors and  
10 ceilings test mechanistically. Floors and ceilings are an effective first order test for  
11 the likelihood of anti-competitive or exploitative charging. However, there may be  
12 circumstances in which charges set outside the band of floors and ceilings are not  
13 abusive, or charges set within the band are abusive. If asked to investigate charges,  
14 Oftel will seek to analyse the effect of the charge in the relevant market and will  
15 take a view on this based on the individual circumstances of each case.”

16 So again, we say it could not be clearer that what Oftel is saying at this particular point is,  
17 “We will consider what is going on in the relevant market, we will consider the effects on  
18 competition and the effects on consumers, the floors and ceilings tests are only a first in the  
19 sense of we will look at those first test, not the main test” or, to use the phrase that Ofcom  
20 used in the draft determination, “a ceiling that should not be departed from save for  
21 exceptional reasons”.

22 Can I then take you on to para.C6, it is talking about the control baskets, which is of course  
23 was the form of price capping that was actually being imposed at that stage:

24 “This is because the control is applied to the incremental cost of conveyance plus a  
25 **proportion** of common costs between access and conveyance apportioned on the  
26 basis of equal mark-ups. Ceilings are derived from the stand-alone costs of  
27 conveyance, i.e. the incremental cost plus **all** of the common costs between access  
28 and conveyance.”

29 So there it seems to be talking about true SAC rather than any form of distributed SAC.

30 When one comes on to para.C14, one can see that there is another phrase being talked about  
31 here. I think one needs to read C14 to C18 very carefully. I am minded not to read them  
32 out to you, sir, but to let the Tribunal actually just read them to themselves. (After a pause)  
33 Sir, what this seems to be dealing with, because this does seem to be the genesis of the  
34 distributed stand-alone costs ceiling, is that what is actually being suggested here is that you



1 can take the incremental for the whole of a particular part of your service, in this case the  
2 core increment, you obviously can derive from that a certain allocation of fixed costs as  
3 well as the incremental or non-incremental costs from that increment. You then divide it  
4 up, if you like, into components, and between the components you attribute a certain  
5 amount of cost from the fixed costs within the increment attributing it to each component.  
6 That then gives you a distribution of the stand-alone costs. What you then do is, when you  
7 come to analyse the actual ceiling for a service, you put the component elements together  
8 and then add up the DSACs of each of those component products. You see that in particular  
9 from para.C5, where it says in terms:

10 “The methodology derives floors and ceilings initially in terms of component costs  
11 but, to be used as a test for abusive charging, they will be applied to  
12 interconnection services (because interconnecting operators purchase services, not  
13 components) ----”

14 We say that is absolutely right and that it actually demonstrates that when you are looking at  
15 any product you should look at what the service is that is actually being bought, in effect, by  
16 the operator. We say that in this particular case that is the PPC as a whole -- this circuit as a  
17 whole. Ofcom deny that that is the interpretation to be taken from that because they say the  
18 trunk element is a service in itself. We say that is not right from this approach, but we may  
19 have to have a debate about that in the course of the evidence. But there is one further point  
20 that I do want to extract from this - that when you are looking at the DSAC ceiling for the  
21 individual services having taken your DSACs for components, added them up, reached the  
22 DSAC for the service in particular, the costs for that DSAC ceiling are all based, in effect,  
23 on a single combinatorial. That single combinatorial is the core network because that is the  
24 increment from which you have originally derived the allocation for fixed costs. That is  
25 quite an important point when one comes to consider the issues about combinatorial testing  
26 and whether DSAC is so much better, because effectively - as the evidence makes clear -  
27 DSAC is based upon one parent combinatorial and in this particular case it is the core  
28 combinatorial.

29 Sir, can I ask you to turn to the next tab, tab 12.2. This is the 2001 NCCN Guidelines. I  
30 will not take you in such depth through it because effectively the core passages that I have  
31 taken you to are the same. For example, if I can ask you to look at para. 3.1 on p.19 you see  
32 that that is mirroring pretty much 3.5 in the earlier version.

33 “Condition 69/1 of BT’s license requires that the charge for each of BT’s Standard  
34 Services should be reasonably derived from the forward looking incremental cost

1 of that service [costs orientation] ... interconnection on terms and conditions that  
2 are reasonable ... The primary focus of an investigation of a complaint under  
3 Condition 69.1 [costs orientation] will however be the effect or likely effect of the  
4 charge on competition and on consumers”.

5 So, the tests are very much the same. I do not need to spend a lot of time taking you through  
6 this document. But, I would ask you to look slightly earlier on, at p.16, para. 2.6. There you  
7 can see specific reference now to Partial Private Circuits. It refers to the 29<sup>th</sup> March 2001  
8 direction. Then it says at 2.63,

9 “Of tel is currently in the process of examining whether the PPC charges are cost  
10 oriented. Once Of tel has resolved this dispute, it will consider whether it needs to  
11 place charge controls on PPCs. If Of tel decides to impose charge controls on  
12 PPCs, it will consult on the most appropriate way to incorporate these controls  
13 within Network Charge Controls”.

14 The point we make about this is that Of com say, “Well, there you are. Reference to PPCs  
15 shows that these guidelines must have been understood to be applied to it”. We say that is  
16 not the case because actually what was going on was a separate process looking at PPCs  
17 which Of tel itself was saying, “We will consider how to bring, or not bring, within these  
18 charge controls the PPCs in the course of that process”. I will take you to the course of that  
19 process in just a moment. We say it is not self-evident. You cannot simply leap from this  
20 statement to saying, “Well, it must have been obvious to BT that these were going to govern  
21 the approach in respect of how you look at cost orientation for PPCs”. But, leaving that  
22 aside we still come back to the primary point which is that this document is making it clear  
23 that DSAC is only a first order test and that the key complaint, the key focus of any  
24 investigation - the primary focus of any investigation - will be on competitive competition  
25 and consumers and that it will involve an investigation of the market. So, we say it does not  
26 even support Of com’s approach in the final determination by putting the primary emphasis  
27 on the pass/fail of the DSAC ceiling.

28 Having made those points, can I ask you now to go to a separate file, to one of the  
29 defendant’s files, DF3, tab 4? This the national leased lines review conducted by Of tel,  
30 published in August 2000. The relevance of this document is that this is the start of the  
31 whole process of requiring BT to provide private partial circuits. Helpfully, somebody has  
32 print-stamped the bottom of the pages as you can see. I will refer to those ones. If one goes  
33 to p.3, which is internal 3, you can see that it is set out at S1 in the Summary that it is  
34 dealing with the leased lines and that it was the result of a November 1999 investigation by

1 Oftel in to the national leased line market. While we are on this document can I ask you to  
2 look at p.9? This is really just for illustrative purposes. Can I ask you to note just how  
3 much of this is actually devoted to a consideration of international benchmarking? We say  
4 quite rightly so because international benchmarking tells you a lot about what is the position  
5 on pricing within a particular moment. As you can see in para. 2.1,

6 “This work has two purposes in the context of Oftel’s effective competition review  
7 of national leased lines. Firstly, Oftel believes it is appropriate for it to set out in  
8 greater detail than it has done previously how it believes UK prices compare with  
9 those in other countries. This is necessary because of the number of  
10 representations have been received about the UK’s relative position in relation to  
11 this particular telecommunications service. Secondly, Oftel’s strategy sets out that,  
12 as part of an effective competition review of particular telecommunications  
13 services, it will seek to measure the outcomes for UK customers. One way in  
14 which this can be done is through international benchmarking”.

15 It is very clearly established that this was a sensible way of looking at prices. I could take  
16 you at some length through s.2, but you can see in the conclusions at p.16, 2.24 that,

17 “-- BT’s prices for leased lines are generally significantly higher than the pieces of  
18 the third cheapest EU country in almost all cases. However, BT’s prices are  
19 broadly in line with the European average. This suggests that UK customers who  
20 purchase at least some of their requirements from BT, as the overwhelmingly  
21 majority of customers do, are not getting the ‘best deal’, at least when compared to  
22 other European countries”.

23 The reason why I am referring to this is really to show just how much international  
24 benchmarking has in the past been used to a guide for indicating whether or not BT’s prices  
25 are too high or not.

26 Can I now ask you to jump ahead in the document, to Annex B, which is dealing with  
27 excessive prices and profits? B1 sets out how Oftel was looking at excessive prices here.

28 “Excessive prices for services are prices that are significantly above the relevant  
29 cost of providing those services. One approach to assessing excessive pricing is to  
30 consider whether the revenues from the relevant service or group of services  
31 exceed its standalone cost including an appropriate allowance for a reasonable  
32 return on capital”.

1 Then it sets out what a SAC is. But, it is plainly, in our respectful submission, looking there  
2 at true SAC and the reason why you can see that very clearly is that if you go on to B2 it  
3 says in terms,

4 “First, BT’s revenues from leased lines should not recover more than the SAC of  
5 leased lines which consist of LRIC of leased lines plus all the common costs that  
6 leased lines share with other services”.

7 That is obviously the definition of what I am calling true standalone costs and it is the  
8 antithesis of DSAC, where of course you are distributing the common costs between  
9 respective components. So, there is no doubt that Ofcom starts this process by looking at  
10 true SAC and true LRIC. Then it goes on and sets out whether BT has passed various tests.  
11 It appears to pass the test for the standalone costs tests for leased lines because revenues are  
12 considerably below the SAC of leased lines. Then it goes on to look at PSTN adjustments.  
13 Effectively what we say is that what is going on here is that there is a combinatorial process  
14 being gone through in order to see whether, having passed its initial SAC of a product, it is  
15 then actually going to pass the relevant combinatorials. If I can just ask you to turn over  
16 the page, you can see at B12, where they are considering the adjusted leased lines SAC test  
17 to other data services.

18 “Therefore, if BT were to pass the adjusted test set out above, there is a further test  
19 which BT would have to pass to show that its leased lines were not excessive ...  
20 The further test which is therefore required is to establish whether the combined  
21 revenues of leased lines, PSTN and Other Data Services taken together exceed the  
22 combined costs”.

23 So, that is a classic combinatorial test being done in respect of those elements.

24 We say, if you go back to B6 that there is a further combinatorial test being done in respect  
25 of PSTN services, but it is having to be adjusted because, as it says in B6,

26 “Ofcom believes that it is appropriate to deduct from the SAC of leased lines those  
27 common costs assumed to be recovered from PSTN services. This will reflect the  
28 fact that these costs are recoverable from PSN services and so it would not be  
29 appropriate for leased lines prices to be set at a level which recovered those costs  
30 again. B7 The SAC test adjusted for recovery of common costs from the PSTN  
31 will therefore include the LRIC of the leased lines and the common costs shared  
32 between leased lines and other services, minus the contribution to common costs  
33 allowed under the regulation of PSTN services”.

1 That is an adjusted combinatorial test. What it is not doing is distributing costs. So, it is not  
2 a DSAC test we are looking at there. So, OfTel at this stage in the context of the national  
3 leased lines review are going through classic standalone and combinatorial testing.

4 Can I ask you now to go back to BT3, to 12.8? This is the direction that you have seen  
5 referred to and actually comes out of the process by which leased lines and then PPCs were  
6 being considered as relevant for BT to introduce. Can I ask you to look at p.9, para. 1.6. I  
7 will not read it, but that shows you the process by which this forms part of, starting with the  
8 August leased line review, a mistake, for which I do not think we have a document in the  
9 bundle, which is the quality consultation, and then OfTel now proceed with this March 2001  
10 draft direction. If one goes to para. 1.31 one can see there that it is talking about the Terms  
11 and Conditions for the supply of PPCs. Then, over the page, it talks about the regulatory  
12 framework then in force for requiring that which was under the Interconnection Directive in  
13 the Interconnection Regulations, and the last sentence of para. 1.32: “In respect of such  
14 services BT is required to ensure that its charges are cost orientated.” So we are definitely  
15 talking here in terms of cost orientation. Paragraph 1.33:

16 “OfTel’s view is the appropriate interpretation of the requirement for prices to be  
17 cost- orientated cannot be considered in isolation from the extent of competition  
18 for the service in question. For example, if the provision of the service in question  
19 was effectively competitive or moving towards a competitive market structure  
20 then OfTel would interpret the requirement for cost orientation as meaning any  
21 price between the long run incremental cost (LRIC) floor and the stand alone cost  
22 (SAC) ceiling, subject to any relevant combinatorial and non-discrimination tests  
23 also being satisfied.”

24 Pausing there, that is plainly talking about true SAC and true LRIC because as we have seen  
25 previously that was what was being discussed in the context of the August 2000 review, but  
26 more to the point if one looks at para. 1.35 one sees a quotation from the recital 10 to the  
27 Interconnection Directive, where it says in terms:

28 “...whereas the level of [interconnection] charges should promote productivity  
29 and encourage efficient and sustainable market entry, and should not be below a  
30 limit calculated by the use of long-run incremental cost and cost allocation and  
31 attribution methods based on actual cost causation, nor above a limit set by the  
32 stand-alone cost of providing the interconnection in question.”

33 So there is no evidence whatsoever in this case, as I say, that any other Regulator, or any  
34 other Body has used a DSAC test before in the telecoms market, so therefore in our

1 respectful submission it is self-evidently correct that the Interconnection Directive was not  
2 talking about DSAC ceilings it is talking about true SAC, true LRIC and that is precisely  
3 what this document is itself talking about.

4 Then, going back to para. 1.33 it makes the point that:

5 “However, if by contrast the relevant economic market was not effectively  
6 competitive then Oftel will be inclined to interpret the cost orientation requirement  
7 to mean that prices should be set on a LRIC basis with some allowance for  
8 common cost recovery.”

9 So a very clear distinction between being drawn between a competitive market or  
10 prospectively competitive market and one where it is not effectively competitive.

11 If I can finally just ask you to look at para. 2.4, again it is setting out:

12 “Oftel believes that if there were a dispute under the Interconnection Directive  
13 concerning BT’s price of a PPC ...”

14 Of course, that is against the cost orientation:

15 “...or refusal to supply a PPC product, then it might be appropriate for Oftel to  
16 carry out a full competition analysis before reaching its conclusion.”

17 So again, emphasis on the competition analysis for dealing with disputes about  
18 interconnection. At 2.6:

19 “Oftel does however acknowledge that not all PPCs are terminating segments. In  
20 relation to the ‘competitive’ trunk, Oftel notes that in its August Consultation  
21 Document it has, subject to consideration of consultation responses defined this  
22 market as being prospectively competitive.”

23 That is a very important point, because the analysis that was going on at that time and,  
24 indeed, subsequently was on the basis that trunk was prospectively competitive, and when  
25 you come back to the tests in para. 1.33 that has an important bearing, we say, on how one  
26 is entitled to approach the issue of cost orientation. I think that is all I need to say on that  
27 document. I am sorry, I have probably gone on a couple of minutes longer than I hoped.  
28 Can I ask, Sir, what time would the Tribunal propose to sit to tonight? I am just conscious  
29 that I am probably going to slightly exceed my estimate because it has taken some time  
30 obviously to go through these documents, and I was wondering whether it would be  
31 possible tonight perhaps to sit to 5 o’clock to make up the time?

32 THE CHAIRMAN: Yes, we can do that.

33 MR. READ: I am very grateful, sir.

34 THE CHAIRMAN: Five past two.

1 (Adjourned for a short time)

2 MR. READ: Sir, just before the short adjournment I had taken you to the March 2001 Direction,  
3 which was giving the initial direction on the implementation of PPCs and the regulatory  
4 obligations on BT. What then happened was that BT offered PPCs as a product and almost  
5 immediately there were objections put in by a number of communications providers and  
6 that then led to a dispute being referred to Oftel. Can I take you to that dispute which is  
7 reflected in two documents, firstly a phase 1 document and a phase 2 document. Those  
8 documents, or extracts, occur in several places, but rather than have an extracted document  
9 there has been some additional documents filed with the court which contain the entire  
10 document, so can I ask you to look for the additional document bundle 1, which should be  
11 at the first divider, Phase 1 Direction on 14<sup>th</sup> June 2002. If one goes to p.4 of that  
12 document, para. 10 of the introduction, you see in fact that history being set out there, the  
13 March 2001 that we were looking at before the short adjournment; the BT standard PPC  
14 agreement and the request to determine the dispute in para. 12.

15 Then we see at para. 15, which I took you to earlier in the March 2001 document, Recital  
16 10 of the Interconnection Directive, which of course is there referring to what we call true  
17 LRIC and true SAC.

18 At para.16:

19 “The Director considers that the appropriate interpretation of the requirement for  
20 prices to be cost orientated cannot be considered in isolation from the extent of the  
21 competition for the service in question.”

22 17 If an interconnection service was provided in an effectively competitive  
23 market, or a market moving towards a competitive market structure, the  
24 requirement for cost orientation as set out by the Directive is any price between  
25 the Long Run Incremental Cost (‘LRIC’) and the Stand Alone Cost (‘SAC’)  
26 ceiling, subject to any relevant combinatorial and non-discrimination tests also  
27 being satisfied.”

28 I do want to make the point, because it seems to have been misrepresented, I think, when  
29 one comes to look at these documents in Ofcom’s skeleton argument, that we are obviously  
30 talking about true SAC and true LRIC here, we are not talking about DSAC and DLRIC  
31 ceilings and floors, and that is obvious if one looks, for example, at the reference to Recital  
32 10, and it is certainly obvious if you go back through the chain of what has actually been  
33 done in the course of this and, in particular, if you remember the true SAC and the true  
34 LRIC tests that were considered in, for example, the August 2000 Leased Line Review.

1 If I can ask you to look very briefly at p.11 you can see at S13 that, in fact, at this time the  
2 markets that were defined, although not absolutely the same as they end up being defined in  
3 2004, do reflect the distinction between high and low bandwidth terminating segments, and  
4 trunk segments, so this is not a markedly different scenario to the one that was occurring in  
5 2004. If one looks at S15 one sees in terms that the Director considers that BT has market  
6 power for high and low bandwidth leased lines.

7 “The Director considers that these markets are not effectively competitive and that  
8 effective competition is not yet in prospect. After considering further information  
9 submitted by B T after the consultation period, the Director still considers the  
10 market for trunk segments to be prospectively competitive.”

11 So one is bang back in the test that was propounded in para. 17 earlier on, namely, if you  
12 are looking at a prospectively competitive market Oftel will approach it by looking at true  
13 SAC, true LRIC and combinatorial testing. If you look at para. 4.50 on p.40 one sees the  
14 same thing being said again as regards cost orientation:

15 “The Director’s view is that the appropriate interpretation of the requirement for  
16 prices to be cost orientated cannot be considered in isolation from the extent of  
17 competition for the service in question.”

18 Then it sets out that it is likely to interpret the requirement of cost orientation as meaning  
19 any price between the long run incremental cost floor and the stand-alone cost ceiling,  
20 subject to any redolent combinatorial and non-discrimination test also being satisfied.

21 Again, absolutely clear that we are talking contestable market theory there, and true SACs,  
22 true LRICs, plus combinatorials.

23 The one thing you will not find anywhere mentioned in this document is any reference at all  
24 to the 1997 and the 2001 NCC Guidelines. You will remember when I took you to the 2001  
25 Guidelines, Oftel said in terms that they were considering the appropriate framework for  
26 gauging PPCs. Here is the appropriate framework within which they are considering PPCs,  
27 and here there is no mention whatsoever of the guidelines that Ofcom now said it was so  
28 obviously clear that these must relate to.

29 What we do say is that the concept that you actual look at the competitive effects that are  
30 going on when you are considering cost orientation, it is exactly the sort of test you should  
31 be applying if you are dealing with allegations of breach of cost orientation. That is a point  
32 not just made, we say, by these documents, it is also made by BT’s experts, Professor  
33 Yarrow and Dr. Decker, for example. who make it absolutely clear that when you come to a  
34 cost orientation issue you have to look at the effects upon the market and the competitive



1 effects and the effects upon consumers. We say that is all totally consistent with what Oftel  
2 was saying back in 2002.

3 The next document is the Phase 2 Direction, which is the next divider in that bundle, dated  
4 23<sup>rd</sup> December 2002. I think I probably do not need to spend a massive amount of time  
5 going through this particular point, because if one just looks at p.103, you see again the  
6 same observations, including that set out in the March 2001 PPC Direction, that effectively  
7 you have to look at the state of the market, and:

8 *“... if the provision of the service in question was effectively competitive or*  
9 *moving towards a competitive market structure then the Director would interpret*  
10 *the requirement for cost orientation as meaning any price between the long*  
11 *incremental cost floor and stand alone cost ceiling, subject to any relevant*  
12 *combinatorial and non discrimination tests also being satisfied’.”*

13 At that stage it is still the case that trunk costs are regarded as prospectively competitive.  
14 We say that there is a very clear inference from these documents about how PPCs were  
15 being considered. They were being considered in the context of, one, you need to look at  
16 the market; two, if the market is prospectively competitive you take true LRIC, true SAC  
17 and combinatorials as your benchmarks, your long-stops, call them what you want; and  
18 three, no indication at all that there is to be any reference back to the 1997 and 2001  
19 Guidelines.

20 We say that the inference we get from this is quite clearly that if one is looking at what  
21 Ofcom did in the final determination it is plainly not reflected in what was being said that  
22 PPCs were being introduced, and obligations of cost orientation were being put upon BT.  
23 In particular, there was not the suggestion that somehow or other the 1997 and the 2001  
24 Guidelines had to be rigidly complied with.

25 Can I now move on and briefly look at the regulatory financial accounts. These, as I have  
26 already indicated, are documents that are prepared by BT in response to requirements and  
27 consultations with Ofcom as to how they should be applied. Can I start by taking you to the  
28 third of the additional document bundles. This contains a set of the regulatory financial  
29 statements at the first tab, which may have a flag 5 against it, for 2005. Can I ask you to  
30 look at p.16 first, this sets out the Regulatory Financial Review, which I will come back to  
31 in a minute. It is the 2004 lease line market review and the final statement that was  
32 published in September 2004 of price caps on the terminating segments. It sets out the  
33 basis:

1 “As part of this series of reviews, Oftel and Ofcom published a number of  
2 consultation documents during 2004 and 2004 proposing changes to BT’s  
3 regulatory financial reporting to meet the new regulatory framework.”

4 The new regulatory framework is the leased line market review and the final statement. The  
5 regulatory financial reporting is a separate obligation, the precise origins for which are  
6 actually detailed in paras.13 and 14 of appendix 2 to our notice of appeal.

7 It goes on setting out the appropriate regulatory financial reporting obligation that was  
8 actually issued, and then adds:

9 “These proposals are intended to take effect for the year ended 31 March 2005  
10 Current Cost Financial Statements and have been implemented by BT.”

11 In other words, the accounts in this Regulatory Financial Statement reflect the regulatory  
12 regime that Ofcom had actually brought in in 2004.

13 At p.18 we see specific reference to Partial Private Circuit. Can I take you on to p.32 – so  
14 we have seen PPCs and price caps – where we see “Wholesale trunk segments”, the  
15 definition of trunk segments, and at the bottom of that page:

16 “The particular services provided are the same as described above symmetric  
17 broadband origination. The trunk market also includes core transmission of the  
18 [alternative interface SBO] services mentioned above. No stand alone trunk  
19 segment services were sold to third parties, although such a service may be  
20 requested at some point in the future.”

21 The short answer is, as it has not been requested in the future, no one has suggested that  
22 trunk segments should ever be sold on their own. (Pause) I will leave that for the time  
23 being. Can I then ask you to move on to -- I think if we start at p.105 we see an indication of  
24 how Ofcom, pursuant to that regulatory process that was described earlier in the accounts at  
25 p.16 -- We see how Ofcom have actually prescribed the way that BT reports. This is a  
26 TISBO broadband. It is a 65Kbit/s. That is the terminating segment. As you can see, each  
27 of the items has a component floor and a component ceiling and, in between, the FAC cost.  
28 Each of those components is prescribed a usage factor so that if one looks down and looks  
29 at partial and private circuits 64K/bit, you see that there are various usage factors which I  
30 think for the most particular are one, although there are various other bits as one goes  
31 further along. One sees then at the end the figure -- This is the column fourth in from the  
32 right which describes a floor. That figure is 1,728. We then have CCA fully allocated  
33 costs, which is the figure of 1,876, and a ceiling of 7,901.79. Then an average charge for  
34 the year. You can see that that has given us 820. The floor and the ceiling are effectively

1 the DLRIC floor and DSAC ceiling as calculated. Of course, you have the FAC in the  
2 middle. As you can see, for this particular item the charge at the end was well below the  
3 DLRIC floor. That, of course, is making the point very succinctly that if you do not look at  
4 the terminating and trunk segments in aggregate, it is the PPC that is sold, not only do you  
5 actually have demonstrable areas where BT is above that DSAC ceiling, you also have  
6 equally demonstrative elements of the terminating segment being well below the DLRIC  
7 floor - which, of course, in one sense is making the point that otherwise would be obvious if  
8 you divided the PPCs up into elements that BT is not making a proper rate of return - if that  
9 is what you do, if you do not look at them in aggregate.

10 Then if I can ask you to look at p.123, there you have Annex 34 which is dealing with  
11 wholesale trunk segment services. Now, you will note immediately that there is no  
12 division into a 2 M/bit trunk or the various other elements that Ofcom now produces. There  
13 is division into 2 M/bit length, 34 M/bit length and 140/155 M/bit length if you look at the  
14 columns on the top. But, this reflects those elements being treated as the component to  
15 which a usage factor is then applied in order to derive a figure for the service. So, when one  
16 looks to the end you see that for wholesale trunk service segments there is a floor from the  
17 fourth column in from the right of, I think, 105, a FAC of 126, a ceiling of 284, and an  
18 average cost for the year of 353.

19 The point we make about this is that it is actually showing the way that these regulatory  
20 financial statements are derived. It is along the lines, obviously, of the way that the NCCN  
21 Guidelines were creating the DSAC ceiling because, if you recall, they looked at the  
22 increment, divided it up into components and then, if you wanted to aggregate any service  
23 you put them all together. That is precisely what has happened here because we have got  
24 components that have been divided up and so in 2005, on any view the only service that one  
25 could possibly say related to trunk is for trunk as a whole. This is immediately after the  
26 cost orientation obligation is being proposed. It is part of the very same process by which  
27 Ofcom imposes that cost orientation. Ofcom itself is not looking at individual trunk  
28 segments in the way that it is considered in the final determination. Now, the point that we  
29 would make about all of this is that it is all very well saying, "Well, you have to focus on  
30 the individual granular levels", but if that is not even what Ofcom are doing at the time that  
31 it actually implements all this regime, it cannot be said to be so obvious to BT that this is  
32 what it was required to do -- that it was required to be focused on the individual trunk  
33 component, trunk element, whatever you call it, in determining whether those are floors or  
34 ceilings. The point that is absolutely clear about all of this is that here we are looking at 31<sup>st</sup>

1 March, 2005 - so these would have been produced certainly by September 2005 -- This is  
2 all information that is readily available to Ofcom. So, if in 2005 it really was so obvious  
3 that DSAC and DLRIC were true pass/fail test, then why on earth is Ofcom not raising  
4 concerns at this stage about the whole set-up? We will come back to those concerns  
5 because, of course, this is being produced bang in the middle of when Ofcom is actually  
6 going through an investigation into trunk segments. But, as I have already pointed out, if  
7 you look at the financial statements in respect of the terminating elements, you see that if  
8 you apply DSAC/DLRIC as a pass/fail test, BT has actually failed DLRIC on the  
9 terminating segments. That is, in our respectful submission, quite an important and critical  
10 point.

11 Now, it is fair to say that for the following year's regulatory financial statements there is a  
12 breakdown into more individual trunk segments. (Pause) Sir, before I leave the 2005  
13 regulatory financial statements there was just one other point that I wanted to draw your  
14 attention to at p.18. I have highlighted the wrong passage. I referred you, if you  
15 remember, to the partial private circuits note on that. Could I also just refer you to the  
16 costs of copper which is on there as well. You can just see from that that Ofcom issued two  
17 consultation documents in late 2004 concerning the valuation of the local access network  
18 assets, and so on, and so forth -- about the valuation of copper and up through the circuit  
19 prices, and so on and so forth. Then,

20 "These proposed changes are not reflected in the current costs financial statements  
21 for 2005 as they post date the end of the financial year ended 31 March, 2005.

22 Any material changes arising from the review will be reflected in future Current  
23 Cost Financial Statements."

24 I simply want to make the point that here you have an instance of the way that cost  
25 attribution is changing from year to year as it is reviewed, copper in fact is obviously a very  
26 large element in any cost attribution and if you revalue it, it simply demonstrates that you  
27 are actually changing the underlying fundamental cost which necessarily is going to impact  
28 on whether or not you can rely completely on the material provided in the regulatory  
29 financial statements for being the same the next year because if copper is being revalued  
30 then the effect of it is that that will have a serious effect on the statements for the following  
31 year.

32 Having made that point can I then ask you to go to tab 6 and can I start by asking you to go  
33 to p.182 where again we have reference to partial private circuits and you can see at the end  
34 of that paragraph:

1 “... a change in reporting to show costs and prices for trunk and transmission  
2 services on a radial kilometre basis to be consistent with published prices. In prior  
3 years these prices were converted to a route kilometre basis to align with the  
4 costing of the underlying circuits.”

5 Again giving you an idea of the sort of detail that has to go into estimating the figures. But  
6 then “Future development of costing methodologies”:

7 “The Final Statements and Notification continue to require increasing granularity  
8 in the Current Cost Financial Statements. When preparing financial statements at  
9 a very granular level it is not always possible to develop a directly cost causal and  
10 objective method of cost apportionment and these Financial Statements have been  
11 prepared on the basis of the methodologies BT considers to be the most  
12 appropriate. However, in respect of the very small Wholesale services within  
13 certain of the Wholesale markets, BT is aware that, in following the generic  
14 methodologies for attribution of common costs set out in the Detailed Attribution  
15 Methods, anomalies may exist in the year on year cost trends in certain services.  
16 However, costing methodologies and non-financial data sources will be subject to  
17 ongoing review, and where deemed appropriate, improvement.”

18 So it is actually here making the very point about the more granular you make the focus the  
19 more difficult it is that you actually end up being able to attribute the costs in a way that  
20 does not produce anomalies.

21 If we then look at p.135 this again is a page setting out the ceilings and floors for  
22 component floors. You will see that this year in fact Ofcom has now decided that there  
23 should be more segments given. So it seems a fair bet that the note we have just read is  
24 specifically applying to this particular more detailed granular view that Ofcom is now  
25 prescribing, and again you can see the same thing with the floors and the ceilings and the  
26 average costs, making it very clear that if anybody wanted to read these accounts and  
27 thought that DSAC was a bench mark against which BT should not exceed except in  
28 exceptional circumstances, then if you would take that view, as Ofcom says it does now,  
29 then there you are, it is showing it: March 2006, or when they were published, sometime  
30 before September 2006. None of this is hidden information, it is there for BT to see, it is  
31 there for its competitors to see. Of course, ultimately when a dispute is put in, it is not put  
32 in on the basis of the DSAC ceilings at all as we know from the CPs’ request that we  
33 actually saw earlier on.

1 I make all these points because, in our respectful submission it just reinforces the fact that  
2 when you look at the regulatory financial statements, yes, they do give you information  
3 about DSAC ceilings and DLRIC floors, but (a) that is obviously subject to all the issues  
4 about allocations of costs as the accounts themselves tell us; and (b) more to the point it was  
5 plain and obvious that if the DSAC ceiling and the DLRIC floor because, of course, we can  
6 see the way that the terminating segments are below the DLRIC floor, if that was the true  
7 pass or fail test then it was obvious to everyone in 2005 and 2004 and so on and so forth.  
8 So having made that point can I ask you now very briefly to just look at the position in  
9 2003/2004 and rather than take you to yet more accounts, can I ask you to go to core bundle  
10 1, tab 6 which is an appendix setting out some of the material that I have been dealing with  
11 today. But if I can ask you to look at pp.10, 11 and 12, within that is a table setting out the  
12 Regulatory Financial Statements for the year ended 31<sup>st</sup> March 2003 and the Regulatory  
13 Financial Statements for the year ended 31<sup>st</sup> March 2004, so this was all material that was  
14 available in the course of the market review process that was going on in 2004, and you can  
15 see from the colourings, which make it very easy to pick out, that the elements coloured in  
16 red are the elements that fall below the DLRIC floor. The blue elements are the ones that  
17 appear above the DSAC ceiling. What it is showing very, very clearly is that trunk  
18 segments appear to be above the DSAC ceiling, and the red terminating segments are below  
19 the DLRIC floor.

20 So all of this was information that was available to Ofcom when it was considering its  
21 market review, and if DSAC and DLRIC ceilings and floors were such crucial parameters  
22 by which cost orientation was going to be gauged, it is somewhat extraordinary that none of  
23 this is discussed in the context of the 2004 review.

24 At that point can I take you to the 2004 Leased Line Market Review, which is in the  
25 additional bundle I think vol.2. At tab 3 one sees the 2004 final statement and you can see  
26 it is a lengthy document running to 650 pages. Now, we have looked very hard and  
27 nowhere in there can we find any reference at all to the 1997 and the 2001 NCC Guidelines.  
28 So we say if these truly were so crucial documents in deciding how exactly how cost  
29 orientation was to be considered, then one might have expected to see their presence in this  
30 document, however, they do not, and of course we know from appendix 2 that I have just  
31 taken you to, and the figures that have been summarised there from the Regulatory  
32 Financial Statements that in fact at the time this was being written BT was well above  
33 DSAC for trunk segments and well below DLRIC floor for the terminating segments. So  
34 we do ask the question: if these floors and ceilings were such crucial parameters in gauging

1 whether the charges were cost orientated or not why was there not a specific reference to  
2 them somewhere within the course of this 650 page document?

3 The obligations that are imposed are towards the end of the document and they are in very  
4 similar form, but perhaps while we have it open I should take you to Condition H3 which I  
5 am told most helpfully is at 480. There we see the basis of charges obligation set out there,  
6 and of course it forms one of a package of SMP conditions imposed including the  
7 requirement to provide network access, a requirement not to unduly discriminate, and a  
8 requirement to publish a reference offer, and so on and so forth. So that is actually the  
9 obligations that were imposed, and we fully accept that that is imposed in respect of the  
10 trunk market that Ofcom has analysed in the course of this document. Likewise, I think  
11 condition G and onwards, at p.431 they are imposed in respect of terminating elements, and  
12 we see at p.439 the basis of charges there.

13 I will not obviously take you through all this document in great length but can I deal, while  
14 we are here, with one point that Ofcom relies upon in saying that this was all clear and  
15 obvious, and that is at p.340, and if one looks at B108 the heading is “Excess pricing and  
16 profitability” and it sets out:

17 “BT has provided a comparison of the costs regulated PPC services alongside the  
18 average price charged over the same period. Based on this information it is  
19 noticeable that, for trunk segments the prices charged for all identified  
20 bandwidths is well above the standalone cost ceiling as determined by BT.”

21 Then it sets out a LRIC floor and a SAC ceiling, it does not actually specify what it means  
22 by a LRIC floor and a SAC ceiling there, but it does in fact relate to the figures that one gets  
23 from the regulatory financial accounts. You remember that I took you to the tables in  
24 appendix 2 of BT’s notice of appeal, but if you look at those figures from that, you will see  
25 that they mirror the figures here, so in other words these are directly from the Regulatory  
26 Financial Statements for the year ended 2003.

27 Then it adds this:

28 “Ofcom is not familiar with the precise way in which the above figures were  
29 calculated by BT.”

30 That is a slightly surprising statement if the NCC 1997 Guidelines were so clear, but then it  
31 adds:

32 “At first sight though, the fact that BT was able to price trunk segments at a level  
33 that is a long way above the level of fully allocated cost, and also well above stand  
34 alone costs ...”

1 but it is not true stand alone cost it is DSAC ceiling.

2 “... is consistent with BT enjoying significant market power in this market.

3 Ofcom also notes that at such prices BT has still sold trunk segments with about 56  
4 per cent of terminating segments. This suggests that other CPs are unable to  
5 quickly switch the used trunk segments that are either self-provided or supplied by  
6 another competing operator. This is further reflected in BT’s charges for trunk  
7 segments ...”

8 Then it deals with the comparison of the per kilometre charges for PPC terminating  
9 segments. Then it adds at B112:

10 “The above data may not provide conclusive evidence on its own without further  
11 investigation. Nevertheless, it suggests that BT is able to price independently of its  
12 competitors, and as such is in a position of SMP.”

13 The first point I would make about this is that this discussion here does not in any way,  
14 shape or form, start talking about cost orientation obligations. It is talking about something  
15 different here. It is talking about assessment of significant market power because if you go  
16 back to p.320 it is dealing with the assessment of SMP, not whether or not there have been  
17 any breaches of any previous obligations or putative obligations.

18 To suggest that somehow this is clearly demonstrating that the DSAC ceiling and DLRIC  
19 floor are obvious parameters for cost orientation obligations does not follow. Indeed, if it  
20 was such an obvious point then one might expect to see the reference to the NCC  
21 Guidelines specifically within this section.

22 It is also pretty self-evident, we say, that Ofcom itself does not fully understand at this stage  
23 what is happening in terms of the calculation of the figures, and is leaving open at the end  
24 the question of whether or not it requires any further investigation. We say that although  
25 this does actually refer to the Regulatory Financial Statement figures it certainly does not  
26 provide any absolutely clear indication that DSAC and DLRIC are the obvious pass/fail  
27 tests for cost orientation. It is not set in that context, it is not set in the context of the 1997  
28 and 2001 Guidelines, and it certainly does not make the point that not only would therefore  
29 BT’s trunk pricing be failing the test of DSAC ceiling, BT’s terminating segments would be  
30 failing the DLRIC floor pass/fail test. So we say there is not much that can be drawn from  
31 that document.

32 Perhaps I should just finish with this bundle by dealing with what happened subsequently.  
33 The leased line market review basically imposed the various SMP conditions that we have  
34 had a brief look at and then it took the issue of price caps on terminating segments forward



1 in a consultation document that was published at the same time as this document. I do not  
2 think it is in the bundle, I do not think we necessarily need to turn that up.

3 If one looks at the final statement that comes out at the end of this process dated  
4 30<sup>th</sup> September 2004, which is at tab 4, one sees at p.3 the history of it. Then S4:

5 “On 24 June 2004 Ofcom set out its proposals to modify SMP services Conditions  
6 G4 and GG4 so as to control future prices for PPC terminating segments by means  
7 of an annual RPI-X% reduction.”

8 Then it sets it out:

9 “This document sets out Ofcom’s final decisions for the PPC terminating segments  
10 charge control.”

11 If I can ask you then to go to p.60 one sees what has actually been happening in the interim.  
12 At 6.4 there is specific reference to the fact that:

13 “... BT had provided Ofcom with a new pricing model for PPC terminating  
14 segments using Excel workbooks populated with the latest audited financial  
15 information ... Ofcom scrutinized that model as part of its assessment ...  
16 BT argued that the BT Pricing Model produced robust outputs for costs and  
17 charges, and felt that it provided the best basis for PPC charge control.  
18 Significantly on that basis that the current charges for PPC terminating segments  
19 result in a significant under recovery of costs.  
20 BT therefore proposed an alternative basis of charging which would lead to  
21 terminating segment charges which were more closely aligned with the outputs of  
22 its model by the end of the control period. Were this alternative accepted, BT was  
23 prepared to enter into a formal commitment to a voluntary price cap on trunk  
24 segment charges. The aggregate effect, taking trunk and terminating segments  
25 together, would have been beneficial to purchasers of PPCs ...”

26 There were responses to that and, for the sake of shortness, they are in appendix 2 of our  
27 notice of appeal, which is at CB1, tab 9. I do not suggest that you turn that up, but that is  
28 dealt with there.

29 Can I just ask you to go back in the document and see the conclusion that Ofcom finally  
30 reach in respect of that proposal, and that is at p.7, and you can see at S26:

31 “Prior to the publication of the consultation document, BT produced a model to  
32 derive individual charges ... Ofcom is currently unable to endorse BT’s model or  
33 its outputs due to uncertainty about the assumptions used in BT’s model and  
34 conflicting outputs (which indicated prices needed to rise) and profitability

1 information (that indicated that BT was recovering its costs). In addition, the most  
2 up to date accounting information provided by BT indicates that its overall  
3 profitability providing PPC services is currently in excess of its cost of capital and  
4 therefore does not provide compelling evidence of a need for increased prices.”

5 The core point about that is that BT’s proposal was specifically being rejected, firstly, on  
6 the basis that BT’s information did not satisfy Ofcom; but secondly, and this is really, we  
7 say, important, that if you look at PPCs as a whole they are making an adequate return on it.  
8 So again, we say it could not be clearer here that Ofcom is looking at PPCs as a whole.  
9 Even if that was not the intention, that is certainly the impression that BT was being left  
10 with, because in rejecting BT’s proposal, an important point about it was that you had to  
11 look at PPCs as a whole, and if you looked at that then its overall profitability was in excess  
12 of cost of capital.

13 We say that the documents themselves paint a very different picture to the way that Ofcom  
14 itself is now saying that this was all so obvious from the 1997 and 2001 Guidelines.

15 Can I conclude the historical investigation – I think “conclude” is probably putting it a little  
16 bit too early – by asking you to turn to BT’s second bundle, BT2, and can I ask you to turn  
17 to exhibit JM4, so it is about a third of the way in. You will remember we looked at  
18 Mr. Morden’s first three exhibits this morning. Can we now look at his fourth exhibit.  
19 What has happened in the interim is that Ofcom has opened an own initiative investigation  
20 under s.105 of the Communications Act into trunk charging. That was opened in June  
21 2005. This is BT’s response to that investigation. We say it is quite indicative information  
22 as to how at that stage BT thought the matter was being viewed. At para.3 it makes the  
23 point:

24 “BT only has a limited view of Ofcom’s investigation, but the context in which  
25 PPC prices have been regulated since their introduction in 2001 is much broader  
26 than what is visible to us of the current investigation.”

27 It then goes on to emphasise:

28 “We remain convinced that we have behaved reasonably in matters of PPC pricing  
29 but believe it is possible to draw inappropriate and incomplete conclusions from an  
30 investigation which does not have the correct scope.”

31 The scope of the investigation was trunk prices only, no investigation being opened in  
32 terminating segments as a whole. We say that paras.3 and 4 are making it quite clear there  
33 that BT is saying in terms that you have to look at a broader indication of what you focus on  
34 otherwise you end up with inappropriate and incomplete conclusions.

1 Can I then ask you to look at para.5a. you can see:

2 “Additional financial analysis [has been included] to support our view that PPC  
3 tariffs are cost orientated.”

4 So again making it clear that BT’s vista was very much on PPC costs as a whole being cost  
5 orientated.

6 Then at c:

7 “An examination of the consistent policy approach adopted by Oftel and Ofcom to  
8 regulate PPC pricing throughout the history of the PPC product. This policy had a  
9 consistent rationale which underpinned the launch of PPCs, the derivation of sub-  
10 PPC product markets, and explained why different regulatory treatment was  
11 applied to those sub-markets. The rationale applied by Oftel in the past is also  
12 broadly consistent with that adopted by Ofcom in its Strategic Review.”

13 If you recall, and if one goes back to the Phase 1 and Phase 2 documents in 2002 and if you  
14 go back to the original March 2001 direction, it was all making the distinction between  
15 trunk, which was prospectively competitive, and for cost orientation purposes should be  
16 viewed within the true SAC and true LRIC elements; and terminating which was being  
17 dealt with on a different point.

18 That was BT’s thinking, and that is made absolutely clear if one goes on to p.8 of the  
19 document, annex A, because there we see the very same material that in fact I took you to  
20 earlier relating to the Phase 1 and the Phase 2 Directions about this distinction between  
21 prospective competitive markets and non-competitive markets. In the case of prospective  
22 markets we were looking at LRIC and true SAC as the parameters, together with  
23 combinatorial testing.

24 So, BT very clearly was setting out what follows from the documents that had introduced  
25 the PPCs. Then if one goes back to para. 17 -- I think it is fair to say that if you look at, for  
26 example, para. 15 it is dealing with the sub-division between trunk and terminating  
27 elements. At para. 16,

28 “We are not aware that there is any meaningful market in the use of PPC trunk  
29 segments separately as a means of joining two terminating segments produced by  
30 an altnet ...

31 17. The current *visible* focus of the investigation appears to set this all aside, and  
32 point to a possible narrow test of compliance being used for Condition H3.

33 However, in due course the process adopted for the investigation will make the  
34 underlying motivation clearer, and it should be possible to see whether the

1 assessment of our compliance is being carried out in line with regulatory policy  
2 objectives or not. For us the primary test must in some sense be whether Ofcom's  
3 regulatory framework has constrained BT's return on wholesale products where  
4 the mechanism has created the correct regulatory incentives".

5 Then it sets out the document about avoiding regulatory creep. At para. 20,

6 "In the case of PPC price regulation we think we do understand the intention of the  
7 regulation. However, we are not aware of any information or analysis which  
8 explains why tightly price regulating a forward looking or retrospective  
9 hypothetical trunk market would correct any market failure or whether forward  
10 looking or existing retail or wholesale".

11 In our respectful submission, BT is making it very clear there that the origin of the PPC  
12 controls - and in particular the origins that are set out in Annex A - mean that you have to  
13 look at it in that framework and that it would be wrong now for Ofcom to take a narrow test  
14 of compliance based solely on Condition H3.

15 If you go back in the document you then see how BT has actually set out the way it has  
16 approached these prices. The point, of course, I do make about all of this is that this, if  
17 there ever was a moment where Ofcom was saying, "No. No. No. 1997 NCC Guidelines.  
18 Look at disaggregated elements only". That is the time to have said it. BT is making all the  
19 points here about saying, "You are looking at it from the wrong -- If you have a narrow  
20 focus, then that is wrong. That is not the background to the way these regulations were  
21 introduced". Then, if you go to para. 6 you will see in terms that BT starts from looking at  
22 the overall reported ROCE for PPC services for 2004/2005. It sets out that 'the trunk and  
23 terminating data can be summarised and analysed into high and low band width PPC  
24 categories as follows ----' So, it is very clearly in this document setting out PPCs as the  
25 product, albeit that it is being defined into low and high bandwidths.

26 So, that is the first way that BT indicates. Over the page, we see,

27 "We believe this data is strong indicative evidence that BT's PPC tariffs are not  
28 excessively priced and are cost oriented.

29 7. It is possible to further sub-divide the data into terminating and trunk elements  
30 and examine cost orientation at that level".

31 Of course, the point being made there is that BT is not the one trying to exclude different  
32 parts of evidence. It is simply saying, "Well, you can divide it up like this, and this is what  
33 you get". Again, you can see it is not divided up into individual elements but into TISBO

1 and trunk, and sets out the rate of return on capital. So, it is looking there very much in the  
2 case of rate of return on capital.

3 “The analysis shows that both TISBO and trunk tariffs fall within the illustrative  
4 price ceilings which pass the combinatorial test. This is a standard method of  
5 presenting regulatory cost data. It allows for a broader assessment of costs  
6 orientation simply basing tariffs on fully allocated costs. BT understands it to be  
7 an acceptable method to apply to PPC pricing”.

8 BT does, as I understand it, understand it to be an acceptable method, but only one of a  
9 number of methods, which is what this letter is actually indicating. Then, at 9, it goes on,

10 “At the product level, which is how wholesale customers actually buy and pay for  
11 products from BT, differential returns are observed, but, again, all tariffs are below  
12 the illustrative costs ceilings which pass a combinatorial test”.

13 So, BT is setting out very clearly in this letter, “Well, let us look at the data in a number of  
14 different ways - PPCs altogether, sub-divisions, return on capital expenditure, costs floors,  
15 costs ceilings with different ways -- What it is saying is that if you take the data in the  
16 round, we are passing. Now, that is what BT says in the context of this case is exactly what  
17 Ofcom should have done: it should have looked at everything in the round. It should not  
18 have concentrated exclusively on a pass/fail test for individual disaggregated components,  
19 elements, services - call them what you like. It should not be exclusively looking down to  
20 that level.

21 If ever there was a chance where Ofcom could have turned round and said, “Oh, that is all  
22 wrong. DSAC, for the individual granular element for trunk is the test by which we will  
23 gauge cost orientation”, then it is at this stage it could have done it. But, in fact, if one  
24 looks at what Ofcom actually did, it suggests something very, very different. Can I ask you  
25 at that stage to go to the next BT file, BT3, tab 12.4 This is Ofcom’s competition bulletin  
26 setting out Ofcom’s own initiative investigation at BT about PPC trunk charges. You can  
27 see that the case was opened on 20<sup>th</sup> June, 2005 and the case was closed on 15<sup>th</sup> December,  
28 2005. So, they have had BT’s letter for some considerable time by this point.

29 “Ofcom has decided to close this own initiative investigation into BT’s prices for  
30 its wholesale trunk segments because the concerns raised in the investigation  
31 transcend two markets and would be better dealt with on a forward looking basis  
32 within the next leased line market review ----”

33 We say it is as clear as anything from that that the approach that BT was putting forward in  
34 its letter of 12<sup>th</sup> August, 2005 - that in fact you should not be looking and having a singular

1 focus on that - was expressly adopted by Ofcom when it says that. Now, on any view it  
2 would have left BT, having had that letter sent to Ofcom, with the clear impression that  
3 Ofcom was not disagreeing with BT's analysis of it. It then goes on,

4 "During the course of the investigation Ofcom identified a number of concerns  
5 relating to the accounting treatment of PPC trunk segments. These concerns  
6 primarily relate to the way that core transmission costs are split between PPC  
7 wholesale trunk segments (which fall into Wholesale Trunk Segments Market and  
8 are regulated through basis of charges Condition H3) and PPC terminating  
9 segments (which fall into the TISBO Markets, and are regulated through the PPC  
10 terminating segments charge control for low and high bandwidths). Additionally,  
11 the derivation of reported revenues for PC wholesale trunk segments may not be  
12 consistent with the methodology used by BT for third party billing.

13 Any adjustment to the PPC wholesale segment costs could lead to an adjustment of  
14 costs reported in the low and high bandwidth TISBO markets and may therefore  
15 have an impact on the assumptions used in determining the PPC terminating  
16 segments charge control".

17 So, again, cost allocation and Ofcom saying in terms,

18 "This can impact on the terminating elements as well". Again, we say a very clear  
19 indication that Ofcom was looking at PPCs in the round and it certainly was not  
20 taking the disaggregated approach that it now states you have to follow. Then it  
21 goes on about the costs. "Ofcom has obtained a clear commitment from BT and  
22 agreed a project plan and timetable to prepare the data needed to quantify and  
23 correct the accounting problems identified. This analysis may lead to restated  
24 costs and revenues for PPC trunk services and a revised methodology for recovery  
25 of core transmission costs between trunk and terminating segments on a forward  
26 looking basis".

27 All of this was in the context of having very clear material in the regulatory financial  
28 statements as to whether the costs ceilings were being exceeded on trunk, and certainly the  
29 fact that BT was under the floors on the DLRIC. So, they had all this information available  
30 at the time. It is the information I took you to in Appendix 2. Yet, this is the response that  
31 comes out. I missed out reading a particularly important part of the letter. I do not  
32 necessarily say that you need to take the volume out again, but perhaps I can just read it to  
33 you and give you the reference? At para. 24,

1 “If it is Ofcom’s opinion that the policy and price regulation framework which has  
2 been consistently applied to PPC prices needs to be materially altered, then BT  
3 would view the forthcoming LLMR as the correct regulatory mechanism to carry  
4 out such a review. Up to date market analysis can be carried out and all relevant  
5 issues can be considered at the same time to form a coherent policy”.

6 Then, at para. 25,

7 “It is important to us that the investigation considers all information relevant to  
8 assessing cost orientation”.

9 Then, at para. 26,

10 “From BT’s point of view, Ofcom has had many opportunities to be more specific  
11 about PPC trunk prices, to set explicit rules about common cost markets, or ROCE,  
12 or to put them in a charge control. However, this policy was specifically not to do  
13 this for all the reasons explained above”.

14 So, that is paras. 24, 25, and 26 which I apologise for not having taken you to. However,  
15 we say that it makes the point even more forcefully that if Ofcom had actually at that stage  
16 thought that BT’s approach was wrong, that is the point at which Ofcom should have said  
17 so.

18 The market review does finally take place in 2008. But, can I just indicate that at the very  
19 stage that Ofcom were opening their investigation into this current dispute they were also  
20 considering another competition dispute, which is called NCCN500. I wonder if I can ask  
21 you to look at that? I think it is in the DF3, tab 12. Time is pressing a bit on me. I will not  
22 take you at great length through this document, but I would ask you to look at p.161 and  
23 look at what Ofcom were actually saying in the context of this. Paragraph 6.330 sets out the  
24 definition of SAC. Then at para. 6.331,

25 “The concept of SAC has its origins in the theory of contestable markets [the same  
26 **Baumol** passage]. A contestable market is one in which the complete absence of  
27 barriers to entry means that incumbent firms, even monopolists, are constrained to  
28 price no higher than average costs by the threat of entry. In the multi-product case,  
29 the incumbent also makes only normal profits overall. The price of each product  
30 must be above its incremental costs (otherwise the firm could increase profits by  
31 ceasing to produce that product, or would be vulnerable to an entrant producing all  
32 products except one)”.

33 Then it goes on to talk about the SAC service. You have to price a SAC ----

1 “-- because a price above this level would attract entry by a single product firm  
2 which would compete the price down to this level. It is therefore the maximum  
3 price consistent with the equilibrium in a contestable market and the absence of  
4 entry barriers. In the multi-product context, a price (significantly and persistently)  
5 above SAC might therefore be regarded as excessive”.

6 Because we are talking about contestable market theory here we are clearly talking about  
7 true SAC at this point in the document, and then it goes on 6.333

8 “Ofcom considered two methods of measuring the SAC of ANTS call termination.  
9 One method would use base data to derive from BT’s regulatory costing systems,  
10 these allow the production of measures of the incremental cost in the SAC of BT’s  
11 services as the use of a ‘first-order’ tests of anti-competitive (i.e. exclusionary or  
12 predatory) ...”

13 Now we are moving on to a distributed ceiling there and excessive pricing prospectively.  
14 “However, there are only two increments in the BT incremental cost model which is used to  
15 calculate them, the whole of the BT networks’ conveyance services, and the whole of its  
16 local access network. This means that the intra-network common costs, costs that are  
17 common to more than one core network service, but incremental to the core of the network  
18 as a whole, are included in the incremental costs of the various network services. The  
19 resulting measures of incremental costs and SAC known as ‘distributed incremental costs  
20 and distributed SAC will therefore normally be respectively above and below the true  
21 incremental cost and SAC measures based on defining each service as the relevant  
22 increment.”

23 So there is a very clear distinction being drawn by Ofcom between true SAC and DSAC.

24 “A finding that a price was above distributed SAC (DSAC) would not therefore be  
25 sufficient for a finding that a price is excessive, such a price can still be below true  
26 SAC.”

27 This is at the very stage that Ofcom are opening the investigation into BT’s pricing, and we  
28 say that they themselves at this point are recognising that excessive pricing cannot be  
29 determined simply by looking at DSAC but you have to, for the very reason that it may still  
30 fall below true SAC.

31 Ofcom say that you cannot rely on this because this is an investigation into competition  
32 matters, it is a Competition Act complaint and therefore there is a different methodology  
33 that actually needs to be applied when you are looking in the context of a dispute  
34 resolution.



1 The problem with that argument is that if you remember from the 1997 and 2001 Guidelines  
2 they were not drawing any distinction between competition complaints and dispute  
3 resolution, they were not making any distinction at all between allegations of abuse of a  
4 dominant position and cost orientation, they were merging them altogether and making  
5 quite clear that the primary focus should be on the effects on competition and on consumers.  
6 So we say it is no reason at all now to turn around and say that that is talking about a  
7 completely different situation because in our respectful submission the tests, certainly if you  
8 are going to the 1997 and 2001 Guidelines, are the same.

9 Just so that we are clear about this, BT is not saying that you have to mount a full  
10 Competition Act investigation if you are looking, for example, in dispute resolution or even  
11 probably in the context of an SMP compliance investigation. But what we are saying is that  
12 you cannot use that as a reason for saying that you ignore an analysis of competition and  
13 effects on consumers completely because all the material, both from the guidelines and the  
14 material before that and, indeed, we say from the expert evidence, plainly suggests that the  
15 primary focus of any such investigation into breach of cost orientation has to be focused  
16 upon what is going on in the market, what is the effect on competition and on consumers.  
17 Indeed, of course, it is a statutory requirement by virtue of the Communications Act and by  
18 virtue, for example, of Article 8 of the Framework Directive. So simply to divorce that  
19 analysis from the present situation is in our respectful submission just not possible. That  
20 analysis reflects Ofcom's own view at the stage that it first took on these complaints as to  
21 how to actually approach any investigation into overcharging in that way.

22 We say in fact the reality of what has gone on here is as this whole issue of cost orientation  
23 has come to the fore in the process of the dispute Ofcom perhaps not unnaturally has looked  
24 for a simplified way of trying to deal with it and that, as a result, is now why we have the  
25 focus on DSAC and DLRIC as being the pass/fail tests. That is certainly not what was said  
26 in the original documents leading up to this. It is certainly not what BT was told in the  
27 course of the 2005 investigation and we would say that in fact you get some flavour of just  
28 how unclear it was at the stage this dispute was opening and coming into the fore by  
29 looking at the review of the fixed and narrowband services wholesale market, which is in  
30 BT3.

31 If one looks at BT3 and goes to tab 12.7 we have an extract from the review of the fixed and  
32 narrowband wholesale market, which was published on 15<sup>th</sup> September 2009. If one goes to  
33 p.99 we see the heading up there: "The basis of charges" i.e. cost orientation and in 11.42:

1 “In the consultation we set out our proposal to oblige BT and KCOM to comply  
2 with a basis of charges condition. Throughout this Statement we have discussed  
3 both basis of charges and cost orientation, we use these terms interchangeably.”  
4 Then at the bottom of the page there is “Consultation responses”, and at 11.48 there is BT’s  
5 response, and 11.49:

6 “All other respondents agreed that Ofcom should impose cost orientation  
7 obligations on BT and KCOM in the markets listed in para. 11.42.”

8 At 11.50:

9 “There were mixed responses in terms of Ofcom’s approach to cost orientation.  
10 All other respondents generally agreed that Ofcom’s approach should be  
11 consistent across markets. However, some respondents indicated it was not clear  
12 what this approach is. Several respondents referred to the PPC dispute which (at  
13 the time of the consultation) was still progressing.”

14 At 11.51:

15 “There were a range of views on what appropriate cost orientation standard should  
16 be. One respondent said that Ofcom should use the LRIC model, in line with the  
17 Commission recommendation on call termination, other respondents supported a  
18 LRIC + EPMU model. BT said it could not comment on Ofcom’s approach  
19 without further detail.”

20 Then we find at the end of this document, at annex 14 at p.334 a specific annex dealing with  
21 Guidance on interpretation of cost orientation. There it sets out:

22 “This annex provides guidance in interpretation on the basis of charges obligations  
23 we have imposed on BT and KCOM in several markets.

24 The basis of charges condition states that charges must be on the basis of long run  
25 incremental costs plus an appropriate mark-up for costs which are common across  
26 products, and for recovery of the cost of capital. The general guidance on the  
27 interpretation of the basis of charges condition is as given by Oftel in Annex B of  
28 the NCC Guidelines.”

29 So there it is actually cross referring back to the 1997 guidelines that are there.

30 “We have also discussed these issues in an economic annex to a recent draft decision on  
31 PPC charges.”

32 And that, you will recall, is the draft determination annex that I took you to earlier today.

33 “In principle, a first order test of whether a charge on an individual service  
34 satisfies the basis of charges condition is whether it is below a floor based on a

1 long-run incremental costs or above a ceiling based on stand-alone cost. In  
2 practice, the first order test will check if the charge is between DLRIC and DSAC  
3 (where such cost information is available and sufficiently robust).”

4 Then it goes on to deal with various cases where it says how the cost orientation shall apply.  
5 I will not take you through the LRIC, it is a more detailed analysis on cost orientation. The  
6 first point we make on this is that if it was so blindingly obvious what cost orientation was  
7 actually going to be then it is fairly odd in our respectful submission to actually need to  
8 have an annex specifically on it incorporated into the document.

9 The second point we make about all of this is that it is being cross-referred very closely  
10 back to the draft determination and we say the reason for that is because effectively that is  
11 the process by which the importance of the pass/fail test in the DSAC was being  
12 determined, in the course of this very investigation.

13 The end result of this, and I am afraid I am going to have to ask you to look at another  
14 bundle, but the end result of this is at BT2 and again it is an exhibit to Mr. Morden’s  
15 statement, JM5. One can see from that that in fact Ofcom ended up withdrawing that annex  
16 because it wanted to consult further on this matter and therefore they were withdrawing it  
17 and intended to issue a consultation on the approach of interpreting cost orientation  
18 obligations in due course, which I do not think has been issued.

19 Again, we make the point that if it all was so obviously clear and certain, that is something  
20 that is completely inconsistent in the way that Ofcom has actually dealt with it.

21 I have come to the end of my historical analysis, and I will try and deal very quickly now  
22 with where this all takes us.

23 We say that you have to look at the approach to cost orientation that Ofcom has taken from  
24 its final determination and decide whether or not this is something new, this is a  
25 methodology that is new and has not been clearly stated previously. Indeed, we say you are  
26 entitled to ask yourself whether or not BT was entitled to believe that a different approach  
27 would be adopted in considering cost orientation, because if the approach was not made  
28 clear when BT was setting the prices and to give you one example, if BT believed that  
29 Ofcom would be looking at PPCs in aggregate then plainly what will have ended up  
30 happening is that BT will have set its prices on a basis, for example, that the PPCs are  
31 aggregated but now being told, or now stand the risk of being told that in fact you cannot do  
32 that, it is a disaggregated approach and therefore it has lost the opportunity to make any  
33 representations about increasing the terminating segment prices, because you will  
34 appreciate from all the material that I have taken you through BT’s contention has been that

1 terminating segment prices are too low, and the available information may actually suggest  
2 that if you look at the floors and the DSAC ceilings. What is absolutely clear is that looking  
3 at it now in 2010 and, indeed, in 2009 that BT was not earning a proper rate of return on its  
4 capital expenditure for those terminating elements.

5 It means that if BT was never properly informed of the DSAC pass/fail test and its focus on  
6 a disaggregated basis it has lost any chance of trying to correct the prices on the terminating  
7 segments, and it means that the end result is that BT has ended up not recovering its costs  
8 on the terminating segments and pricing well below a proper return on capital and yet is  
9 being forced to repay significant sums in respect of the trunk segments.

10 That is only a fair proposition if BT could properly have understood when it was setting  
11 those prices that that is the way that Ofcom was going to actually approach any allegation  
12 over the breach of a cost orientation condition. We say it did not. We say that the historical  
13 material quite clearly shows that in fact Ofcom and Oftel were suggesting a very different  
14 approach but certainly it was never made clear to BT at the time that Ofcom would take the  
15 approach it has now taken in the final determination.

16 There is a point that is made in several places by Ofcom, where they say that that is BT's  
17 hard luck for not having appealed the 2004 Leased Line Market Review. If it really thought  
18 that terminating prices were too low then it should have appealed and you cannot now allow  
19 BT to circumvent the regulatory process. However, that is, in our respectful submission, an  
20 obfuscation of the key point. If it was not made clear to BT what those obligations actually  
21 entailed, and BT could legitimately believe that the cost orientation conditions would be  
22 assessed at least in part by reference to the PPCs as a whole and by reference to the  
23 competition in the market, and it certainly was not aware of the crucial role that DSAC was  
24 to play, then BT could hardly be criticised for not appealing. If it believed that, in fact,  
25 Ofcom would approach this by looking at PPCs as a whole and not using DSAC as a  
26 definitive test, then it had no reason to appeal, because as far as it was concerned, if that is  
27 the aggregated approach that Ofcom wanted to take, well, that is the aggregated approach  
28 that Ofcom took.

29 So it is only if, sir, in our respectful submission, you can be satisfied that the methodology  
30 that Ofcom has now introduced was obvious at the time, it is right that, in fact, this final  
31 determination should stand in the way it does. We say there are three different ways you  
32 can look at this. Firstly, it is quite clear that consistency and transparency are an integral  
33 part of the requirements mandated on Ofcom by s.3 of the Act. Transparency is also  
34 obviously an express requirement of Article 3(3) of the Framework Directive. We say that

1 is really the be all and end all of the point, because if the Regulator is expected to be  
2 consistent and be transparent about the approach it is going to take, then if we are right and  
3 Ofcom has not, then it has breached its regulatory requirements by acting in the way it did  
4 in the final determination.

5 Over and above that, consistency is an established point, we say, in both European and  
6 English law. Again, and I can take you to the cases, I suspect that, given the time  
7 constraints my time would be better spent elsewhere. It is set out in our skeleton argument  
8 and it is set out in our notice of appeal and reply, that consistency is there and that that  
9 should be guiding the approach that Ofcom took in this particular case.

10 Secondly, there is the area of legitimate expectation. If BT's expectation was that Ofcom  
11 would approach the cost orientation obligation by looking at PPCs as whole, by looking at  
12 competition, and that being the primary focus – competition and consumers – in any  
13 investigation, then BT has a legitimate expectation to expect Ofcom to proceed in that way  
14 when it conducts its regulatory process under the dispute resolution. Again, we have set  
15 this out in para.39 of our skeleton argument. I will not develop it. For your reference, this  
16 is a point that BT was making nearly two years ago in its original October 2008 response,  
17 and I will give you the reference there. It is at para.95 in BT1/7/P34.

18 Again, there is the obligation of transparency. We say that is a factor that plainly impacts  
19 on here, because if they use a methodology that had not previously been agreed and settled,  
20 Ofcom had a duty to be transparent about the fact that it was introducing that methodology.  
21 We say that that is exactly the process that it is going through in the context of the  
22 narrowband market review where it introduced the annex 14 and then, because there were  
23 complaints about the need for consultation of it, it actually withdrew it, and that is the  
24 process that it ought to be going through if it is going to introduce some prescriptive  
25 methodology.

26 Again, to make the point clear, this is all a direct result of the way that Ofcom has used  
27 DSAC and the way it has approached this aggregated focus on the individual segments.  
28 Our case is not that this material does not have relevance, it is all evidence you can throw  
29 into the pot. The problem comes if you introduce it as a definitive, or certainly a very  
30 significant, methodology for judging these things. If you have elevated it from a simple  
31 piece of evidence that can be thrown into the equation, you have elevated it to a much more  
32 significant pass/fail test specific focus, and have done so so that you exclude other evidence.  
33 The clearest instance of this, for example, is BT's circuit analysis.

1 In the course of BT's responses it produced a circuit analysis which was actually  
2 concentrating on the specific elements of the product sold – in other words, it was looking  
3 at actual circuits that were actually sold and looking at whether or not they were above the  
4 DSAC ceiling. So instead of looking just at the hypothetical elements it was actually  
5 looking at the PPCs sold. Ofcom dismissed that in two paragraphs in the final  
6 determination by saying, "This is not appropriate because it is aggregating two markets". It  
7 is that, we say, blinkered view, myopic view, of excluding evidence that really creates the  
8 fact that it has introduced a very clear methodology that has not been properly and  
9 transparently been consulted upon.

10 We also say that the effect of what Ofcom has done is to introduce a new rule on cost  
11 orientation, or of modification under s.47.

12 Sir, we touched on that obviously when we were looking at the preliminary issues hearing,  
13 and given the time that I have taken so far I do not propose to take you at length through  
14 that process. What we do say, sir, very clearly is that there are two issues here that you  
15 have to look at. The first is, if Ofcom actually decided that this was a very clear  
16 methodology that amounted to a rule under s.87(9), and if that rule was only introduced in  
17 the course of the final determination, then we say it is an open and shut instance of the fact  
18 that this is something that has not been authorised by the Act. We understood from the way  
19 it was put at the preliminary issues hearing that that was an accepted proposition by Ofcom.  
20 They did not accept that it was a rule, and they certainly did not accept that it was  
21 introduced only in the course of the final determination. They did accept that if it was a  
22 rule, if you did hold it was a rule or a modification, and you held that that had only been  
23 introduced in the course of the final determination, then that necessarily would fall foul of  
24 s.87(9) and/or s.45 and 46 of the Act, and therefore it would be an unauthorised rule and  
25 modification. We are not quite sure, because that point seems to be challenged in Ofcom's  
26 skeleton argument, but we do say that it is another area where Ofcom, introducing a rigid  
27 rule, as we put it, has infringed the Act, and so that is another area where we say it needs to  
28 be consistent.

29 I am hesitating because I could probably go on for another two hours, but I am very  
30 conscious of the time in this, and I do not want to take you through legal argument if it can  
31 be best left until later for a final closing, particularly given the fact that it has been set out in  
32 some depth in our skeleton argument. I will be guided by you, sir, as to whether you want  
33 me to take you through it at any greater length than that or not.

1 THE CHAIRMAN: No, Mr. Read, I think that is very helpful and I think we can move on.

2 Thank you very much.

3 MR. READ: Sir, I am conscious of the fact that you wanted a break in the morning, and I am  
4 conscious also of the fact that we are going to sit until five o'clock. I do not know whether  
5 or not the Tribunal will want to rise at this point. It would certainly give me an opportunity  
6 to reflect on how best to condense my remaining submissions.

7 THE CHAIRMAN: Shall we rise for five minutes in that case?

8 (Short break)

9 MR. READ: Can I just raise three very brief points about dispute resolution? The first is that  
10 Ofcom seem to have raised a point which was not raised in the defence anywhere, that in  
11 fact BT is now time-barred from arguing the point under Rule 8 of the Competition Appeal  
12 Tribunal Rules. We say that that is wrong as a matter of law and has already been decided.  
13 That is the *Orange v. Ofcom* case of [2007] CAT 36. We do say it is rather telling because  
14 in that case it was Ofcom itself that was wanting to run the argument that issues about the  
15 appropriateness of dispute resolution and whether it should be adopted should be held over  
16 until the final result for the very simple reason that otherwise you would be having  
17 inconvenient appeals within two months of any acceptance of a dispute, regardless of the  
18 outcome of that dispute, and that was an unsatisfactory state. That is precisely what the  
19 *Orange v. Ofcom* case decided.

20 Secondly, we say obviously there are plainly very different routes by which Ofcom could  
21 have dealt with this matter. For your reference they are set out at para. 64 of our skeleton  
22 argument onwards. Those broadly mirror paras. 61 to 70 of our notice of appeal. So, we  
23 say the discretion was there for them to deal with it. We then also say that there are a  
24 number of factors that say that Ofcom should have used that discretion and that the way the  
25 approach is adopted in this case is an inappropriate use of the dispute resolution process.  
26 We set that out at para. 73 of our skeleton argument.

27 The only other point that I wanted to raise is that Ofcom itself plainly recognises that there  
28 is a discretion. Can I just ask you to look very briefly at BT3, 12.15? That is a letter to BT  
29 from Ofcom about a dispute involving Unicom and alleged mis-use of cancel other  
30 facilities. As you can see from the second page of that letter, Ofcom uses the alternative  
31 means provisions under s.186(3) to effectively decide it will not open the investigation. A  
32 substantial part of that is that there was some other regulatory means for dealing with the  
33 problem. So, we say there is an instance of it.

1 That is all I was going to say on dispute resolution at this stage. Can I then take you to  
2 economic harm, which I have spent quite a bit of time discussing already? I want to make  
3 clear where Ofcom start from in the final determination. Firstly, they say that there is no  
4 need to show any economic harm in order to demonstrate a breach of cost orientation. “It is  
5 not a pre-requisite” is what they say. That is para. 7.34 in core bundle 2, flag 31, p.908.  
6 they then very clearly start from the proposition that prices above DSAC are excessive. Just  
7 to illustrate this I think I ought to take you to core bundle 2 and the final determination at  
8 tab 31. Can I ask you to look at p.908? You can see at para. 7.34,

9 “We agree that it is not essential to demonstrate that economic harm has in fact  
10 occurred in order to demonstrate whether there has been overcharging. It is  
11 sufficient to establish that overcharging could potentially cause economic harm”.

12 But, then, at 7.36 you see the second problem, we say, within their approach:

13 “BT’s 2Mbit/s trunk charges have resulted in the Disputing CPs and/or their retail  
14 customers paying BT too much for these services, and therefore generating  
15 financial loss or harm to them”.

16 So the start of the whole process, we say, is that Ofcom assumes that any price above the  
17 DSAC ceiling is overcharging in the first place and that therefore they would go on to  
18 analyse any potential economic harm on the basis that there is overcharging in the first  
19 place. You see that very clearly at 7.38 and in particular the title above there where they  
20 say, “The financial impact of overcharging and its impacts on retail demand”. The problem  
21 is that they start this whole process from the assumption that if you have failed the DSAC  
22 ceiling test you are overcharging and therefore has harm been created? As a number of  
23 people comment - in particular, Professor Yarrow and Dr. Decker, particularly at para.69,  
24 p.68 in the case of their first report -- You have assumed the very thing that you need to  
25 consider in order to determine whether there is overcharging in the first place.

26 So, we say there were two fundamental flaws in Ofcom’s approach to economic harm and  
27 instead of it being a primary factor, as the guidelines suggest, what Ofcom actually did was  
28 basically put it as a very small add-on at the end and only looking on the assumption that  
29 BT was already overcharging.

30 I also in this context want to comment on one point that Ofcom does raise - which is to say,  
31 “Well, you do not need to do any real investigation of the actual effects on competition  
32 because that is the process that Ofcom did when it imposed the SMP condition in 2004”.  
33 Now, we say that that is wrong for a number of reasons. However, it does reflect the way  
34 that Ofcom have not undertaken in this final determination a proper consideration of



1 competitive effects and any effects on consumers. They would not need to be running that  
2 as an argument - that you do not have to carry out a very extensive investigation if that is  
3 what they have done. In the points I have already made earlier we say that their approach to  
4 economic harm was completely flawed.

5 We say it is wrong to simply say, “Well, we have considered competitive harm back in  
6 2004 and so therefore we do not need to do any major investigation into that”. Firstly, it  
7 ignores the very own guidelines that they are relying upon. It also ignores the fact that  
8 when Ofcom is setting the SMP condition they are focusing on a different set of questions -  
9 namely, market definition where the operator has SMP and then whether, in those  
10 circumstances, it is right to set an SMP condition. It is certainly not at that stage conducting  
11 an investigation into whether the operator has breached a condition and breached that  
12 condition several years after the original inquiry into the SMP condition.

13 Secondly, we say it completely ignores the fact that Article 8 mandates on a regulator the  
14 need when carrying out any of its tasks - and for this purpose dispute resolution is one of  
15 those tasks - the need to give major consideration to Article 8 of the Framework Directive -  
16 major consideration to adverse effects on competition and effects on consumers. We say  
17 that that approach that Ofcom was saying in its skeleton argument completely ignores that  
18 obligation. Can I just illustrate this point by asking you to go to the TRD appeal judgment  
19 which is at authorities bundle 2, tab 34 and if I can ask you to turn to para. 84 in the  
20 judgment you can see from that, that the way Ofcom approached the dispute in that case.  
21 At para. 88 it sets out what Ofcom had actually done.

22 “In other words OFCOM approached the dispute by asking itself whether, looking  
23 at the existing regulatory constraints imposed on the parties, there was any reason  
24 why BT (or H3G) should **not** pay the charges proposed by the MNOs. Any other  
25 considerations arising from OFCOM’s statutory duties were therefore relegated to  
26 the consideration of whether there were ‘overriding policy objectives’ which  
27 should be taken into account. This approach represented, in the Tribunal’s  
28 judgment, a fundamental error as to the task facing OFCOM in determining these  
29 disputes. OFCOM failed to recognise that dispute resolution is itself a third  
30 potential regulatory restraint that operates in addition to other *ex ante* obligations  
31 and *ex post* competition law.

32 89 The fact that dispute resolution is intended to be an additional form of  
33 regulation exercised in parallel with SMP regulation and general competition law  
34 is clear from the Common Regulatory Framework.”

1 And then it sets out article 5(4) and Article 23 of the Framework Directive, and then makes  
2 the point that “in resolving disputes to take decisions ‘aimed at achieving’ the objectives set  
3 out in Article 8’ and article 5(4) of the Access Directive.” So in other words the objectives  
4 in Article 8 are a core point of dispute resolution.

5 Then at para.99 one can see the conclusion:

6 “The Tribunal therefore holds that OFCOM erred in failing to appreciate that the  
7 objectives set out in sections 3 and 4 of the 2003 Act should have been central to  
8 its approach to interpreting and applying the section 185 procedure and to its  
9 assessment of the figures arrived at. It was not right for OFCOM to argue that  
10 because it complied with its statutory duties in carrying out the review which  
11 resulted in the 2004 Statement and applied the results of that Statement to these  
12 disputes, that it had therefore effectively complied with its statutory objectives in  
13 resolving these disputes.”

14 We say that that is the point here, that Ofcom simply cannot say that all this was considered  
15 in the context of an *ex ante* obligation and therefore we do not need to consider it. Article 8  
16 of the Framework Directive mandates the need to look at distortions in competition and  
17 avoid them, and effects on consumers and so, we say, that should have been fundamental in  
18 any investigation – added to which we say it is obviously consistent with the previous  
19 parameters with which Ofcom had previously set out, for example in the 1997 Guidelines.  
20 I have already made in the course of earlier submissions a number of points about the  
21 economic harm and the major points as to where we say that there is clear evidence there  
22 was no economic harm, and we say that there was nothing produced by the CPs themselves  
23 during the course of the dispute resolution process that suggested there was any economic  
24 harm. It is only very belatedly at this stage that we see any attempt by the interveners to set  
25 out and indicate what they say is the harm they have suffered. But, in any event, in our  
26 respectful submission, even if they were to be right in that contention it simply does not  
27 produce the £50 million worth of loss that it has been suggested that they have lost out on  
28 by being overcharged. At this stage I think that is all I am going to say on economic harm.  
29 Disaggregation – again we have set that out at some length and I have obviously at some  
30 length gone through it today. We say that this is symptomatic of the approach that Ofcom  
31 has taken in this dispute resolution. What they have done is ignore any evidence that might  
32 actually give them a better idea of what is going on by narrowly focusing on the  
33 disaggregated granular single segments that they have actually looked at and analysed in  
34 this particular case, the 2 Mbit trunk segment, and you see that very clearly from the final

1 determination, for example, the circuit analysis, which I have referred to earlier, they reject  
2 in two paragraphs in the final determination, para.7.134 and 7.135. If you still have the  
3 core bundle 2 to hand with the final determination in it, I just ask you to briefly look at the  
4 way they deal with it. We see under the heading: “Assessment of BT’s circuit analysis”, it  
5 is dismissed in two paragraphs. The second paragraph says:

6 “As we have discussed in detail in **Section 4** above, we do not consider it  
7 appropriate to consider PPC services in aggregate when assessing whether  
8 overcharging has taken place. Therefore, the circuit analysis is not a relevant  
9 consideration.”

10 Wholesale dismissal of what we say is a useful piece of evidence as to what is going on.  
11 The point about this is that that evidence – Mr. Budd deals with it in his first statement –  
12 shows that there is an absolutely significant difference between the results of that analysis  
13 compared to the results of Ofcom’s decision in this case to order such a massive repayment.  
14 So if nothing else he is saying there is something out of sync. in what has actually been  
15 done as the total result.

16 Likewise, I have already made the point that Ofcom completely dismiss any consideration  
17 of whether or not BT has failed to earn a proper return on capital expenditure on the  
18 terminating segments. That piece of material which they admit is completely discarded as a  
19 result of this disaggregated stance.

20 Ofcom raises effectively six arguments as to why it says disaggregation is the correct way  
21 forward. They are set out at para 4.19 of the final determination. Each one of those, we  
22 say, is misconceived, and that is dealt with in the evidence, and so I will leave that to be  
23 developed at that stage; it is at p.821, and you can see the six different reasons that they give  
24 summarised in that paragraph. We say each of those is flawed, and the reality is that these  
25 are reasons put up to salami slice the evidence which suggests something completely to the  
26 contrary that the DSAC pass/fail test is not, at the end of the day, producing the right result.  
27 So that is all I am going to say on disaggregation at this stage.

28 As regards DSAC obviously a number of the points I have made already in respect of this.  
29 First, there are a whole series of inherent problems with it including cost allocation,  
30 including the fact that you can be passing the DSAC ceiling. You will recall earlier that I  
31 gave you the references to the evidence that said that it is perfectly possible to be cost  
32 orientated but still in excess of the DSAC ceiling as indeed Ofcom itself admits in the final  
33 determination.

1 We say there is another aspect to this which is that not only if you are in excess of the  
2 DSAC ceiling may you well be cost orientated, but even if you have below the DSAC  
3 ceiling you may not be cost orientated. Indeed, as a result we suspect of our submissions  
4 that we put into the draft determination, Ofcom itself has recognised that because it has  
5 introduced into its so-called secondary tests a test whereby it has to consider charges below  
6 DSAC ceiling. It is not really a secondary test at all because if you have passed the first  
7 order test what it is really telling you is that the first order test does not give you the  
8 complete answer and again we say that that is just another illustration of the flaws that there  
9 are in rigidly relying on the DSAC ceiling.

10 Combinatorial testing – I want very briefly to deal with that because BT is not saying in  
11 terms: “Look, this is the way to do it”, but what it is saying is that if you are going to say  
12 something is not cost orientated and then somebody does a combinatorial test that suggests  
13 it is actually passing it, as BT did, then you cannot ignore that piece of evidence. Again,  
14 what Ofcom do in the process of the final determination is to dismiss it on a series of  
15 grounds that we say just really do not stand up to scrutiny, and I just want to explore those a  
16 little bit because it really reflects, in our respectful submission, the way that Ofcom has  
17 fastened on its pass/fail DSAC test and then when there is evidence to the contrary instead  
18 of saying: “Does that evidence actually support the conclusion that a nice simple DSAC  
19 pass/fail test is giving us, or is it suggesting that there is something that may be problematic  
20 with the pass/fail DSAC test?”

21 You will recall from the passage that I took you to in annex 13 to the draft determination,  
22 which I took you to earlier, that they rejected combinatorial testing expressly because they  
23 said it could not be done within the short time frame of the dispute resolution process.

24 What then happened was that BT actually, within the space of three weeks produced a series  
25 of combinatorial tests, which they put to Ofcom in the course of their response. What was  
26 said then in the final determination, and one can see that at para. 5.70 which is perhaps just  
27 worth turning up, was that there is a vast number of combinatorial tests that need to be  
28 done, and they set out the formula there. “For example, if 21 individual products shared a  
29 common cost, the number of combinatorial tests would be just over a million.” So again  
30 saying very, very clearly the reason for rejecting these is that you need to do masses of  
31 combinatorial tests.

32 If I can just ask you to take one of the respondent’s bundles at DF3 there is actually a  
33 chapter from “Toward Competition in Local Telephony” by the originator of the contestable  
34 market theory, William Baumol. If one just looks at the extract, I would suggest that this is

1 quite a useful extract to actually pick up what the horse's mouth, the contestable theory,  
2 says. We say that when you look at it there is no mention at all of anything like DSAC  
3 ceilings or DLRIC costs. It just does not feature.

4 Then if you look at p.80 it talks about short cuts and approximations. I will not take up time  
5 reading it, but what I do ask the Tribunal to note is that he is making very clear in that  
6 section that rather than requiring a regulated firm to perform a daunting task of calculating  
7 stand alone cost ceilings for every product, the way to deal with it is for the complaining  
8 parties or the Regulator to identify the particular product combinations which they believe  
9 the ceiling has violated. In other words, the vast number of tests is not an objection to  
10 combinatorial testing in itself, it is possible, within the regulatory context, to limit the  
11 number of tests.

12 BT in the course of its discussions with Ofcom – what had happened is that BT gave its  
13 response with the combinatorial testing and at that stage Ofcom and BT had a meeting and  
14 there was a discussion about whether or not combinatorial testing could be done. The item  
15 that comes across very, very clearly is that time and time again BT pressed Ofcom to tell  
16 them the tests that Ofcom said BT needed to do. Perhaps I can just give you the references.  
17 The first is that at a meeting of 1<sup>st</sup> July 2009 Ofcom raised a combinatorial test across BT's  
18 core services. That was Ofcom saying, "Have you passed this one?" BT actually provided  
19 it, it did pass. BT then asked specifically in its original submission for Ofcom to specify the  
20 test. After the meeting it then asked in correspondence again. I think it was no less than  
21 four times that BT asked Ofcom to specify which were the tests that Ofcom thought it was  
22 appropriate to do. Ofcom did not at that stage. Only subsequently, and in particular for the  
23 period that we are actually in in the preparation in the course of this litigation, do we find  
24 the tests being said to be very obvious, that you need to be doing them in bigger  
25 combinations, as I was explaining earlier today, right the way up the BT business across a  
26 much wider combinatorial area.

27 That of course runs completely contrary to the core SAC combinatorial that DSAC itself is  
28 based on, which is that core network, which is the one that Ofcom asked for BT to provide,  
29 BT did provide and it proves that BT passed it.

30 It also runs completely contrary to the way that Ofcom itself says that one of the reasons  
31 why you ignore ROCE is you do not want to return to rate of return regulation. If that is the  
32 case, doing the combinatorial on such a wide area effectively comes up almost to a return of  
33 rate regulation. So there are inconsistencies in the whole way that they have approached the  
34 issue of combinatorial testing.

1 There is a lot more detail that one needs to go through on combinatorial testing, but that no  
2 doubt will be explored in the course of the evidence. But we do say it is illustrative of the  
3 way that BT gives a piece of evidence, the first objection to many tests, the second  
4 objection, you have not done the right tests, but of course BT was specifically asking what  
5 tests should be done and so it is actually, in effect, being blocked out from doing what  
6 Ofcom now says are the right tests.

7 This actually has come down to the argument that is put forward in the skeleton argument of  
8 Ofcom, "You could have done the tests in the course of this litigation". Leaving aside the  
9 issue of quite how that might play out in view of Ofcom's stance, for example, on the 080  
10 appeal and the fact that you cannot have any evidence for determination that has not  
11 actually already been served on Ofcom at the time of the determination, leaving aside that  
12 slight inconsistency, we say that it is illustrative of Ofcom's overall approach that whatever  
13 BT does leads to BT being damned. If Ofcom provides combinatorial tests it is said that  
14 they are not adequate, but now BT is being criticised for not having provided combinatorial  
15 tests in the course of this litigation. We say that just reflects the whole unreal way that  
16 Ofcom has been approaching the evidence that BT keeps putting forward.

17 Sir, can I just ask you very briefly to look at the return on capital expenditure. A number of  
18 these figures are, in fact, confidential, so I am not going to refer to them as such. I think the  
19 easiest place to look at it is core bundle 1, and could I ask you to go to flag 10. If you look  
20 at p.309, para.11, you see the figure there as to what happens to return on capital employed  
21 if you look at the adjustment to reported revenues and costs as required by Ofcom for the  
22 period 2004 to 2009. I should add, because you will see it explored in the evidence, that  
23 that figure is based upon the assumption that BT has not only had to refund these CPs, but  
24 also refund BT downstream departments because obviously if BT has been overcharging the  
25 CPs it also necessarily follows that on a similar basis it has been overcharging itself. That is  
26 the figure you actually end up with.

27 There is a large dispute about the figures involved because what is said is that you cannot  
28 look at the repayment or the assumed repayment to BT Retail. Mr. Myers, on behalf of  
29 Ofcom, comes up with a series of figures in his statement where he suggests, in fact, the  
30 return on capital expenditure is higher. It is pre-supposed on the basis that you simply  
31 ignore the effect of Ofcom's decision in terms of what happens with BT Retail.

32 We say that that really shows again how blinkered Ofcom's approach is being. BT is  
33 subject to a non-discrimination obligation. Indeed, that was one of the complaints that the  
34 CPs originally raised. Yet, when you look at it, you realise that effectively Ofcom is saying,

1 “In the process of examining this, we completely ignore any effect that it may be having on  
2 BT, and we do not look at it in the round”.

3 To counter this, Mr. Budd has also looked at what happens if you take BT out of the  
4 equation. The figure for that is at p.311 in that same witness statement. There at table 1  
5 you see the approximate rates of return by BT and providing for PPCs before refunds. We  
6 say that those figures are pretty significant in themselves. Do not forget that BT’s weighted  
7 average cost of capital is somewhere around 12 per cent. At table 2 he then sets out what  
8 happens, just focusing on the provision of circuits to CPs, after the refunds. That can be  
9 seen in the table above para.16.

10 We say that this is all material that Ofcom just dismisses out of hand for various reasons. In  
11 our respectful submission, if you are looking at whether or not BT has complied with its  
12 cost orientation obligation, to ignore this type of material is really the antithesis of a proper  
13 investigation into what is going on and whether or not BT is actually overcharging, given  
14 the issues that necessarily are involved with a cost orientation obligation.

15 Sir, again, there is a lot more evidence on the whole of the DSAC tests but I am not going to  
16 necessarily deal with it at this stage.

17 I will now turn to the final part of our notice of appeal, which of course is the exercise of  
18 the discretion under s.190(2)(b). A lot of the points that have already been above apply  
19 even more forcefully when one is looking at this. It is admitted that there is a discretion as  
20 to whether or not to make the award. Therefore, even if Ofcom is right, and you do take a  
21 very narrow literalist view of what condition H3 actually involves so that you cannot look  
22 outside the immediate trunk market in any shape or form in order to consider what is going  
23 on, if you cannot do that in the course of resolving whether there has been a breach of the  
24 cost orientation obligation, you certainly can take that into account when you look at the  
25 exercise of the discretion under s.190(2)(b).

26 Indeed, there is an important point that we make in this connection, that it is subject to the  
27 duty of proportionality, i.e. a Regulator should not intervene unless it is truly proportionate  
28 to do so. The legal tests are set out at paras.53 to 58 of our skeleton argument. We say that  
29 Ofcom simply did not exercise any proper measure of appreciation in conducting that  
30 exercise. The starting point of Ofcom’s position is that basically anything in excess of  
31 DSAC should be ordered to be repaid, and that a prime motivation for doing that was that  
32 the greater the adverse financial implications for the regulated firm, the stronger the  
33 incentive to ensure future competition, which is the point made at para.8.34 of the final  
34 determination. We say that that is a plainly misconceived way of approaching the whole

1 issue in exercising that discretion. There are a whole series of other reasons why Ofcom  
2 should not simply have said anything in excess of the DSAC ceiling should be repaid. They  
3 are primarily contained in our skeleton argument and our notice of appeal so I do not  
4 propose to rehearse them at this stage. We say that, fundamentally, Ofcom started from  
5 completely the wrong starting point.

6 In very brief summary, those are the major points, the bullet points, the big points, if you  
7 like, in our individual grounds of appeal. Unless there is anything specifically further you  
8 wanted me to help you with at this stage I was proposing to end my opening there and at  
9 least give Ofcom some opportunity this evening to start their opening.

10 THE CHAIRMAN: Thank you, Mr. Read. I have nothing further. Mr. Saini, do you want to  
11 make a start?

12 MR. SAINI: Sir, I am content to start now but it may well be that I would suggest starting  
13 tomorrow morning if we are starting at ten. It has obviously been a long day. I am  
14 completely in the tribunal's hands.

15 THE CHAIRMAN: Tomorrow morning it will have to be a 10.30 start. Perhaps you could have  
16 half an hour?

17 MR. SAINI: Certainly. Sir, I am going to divide my submissions into four main parts. First of  
18 all I am going to identify for the tribunal what the dispute was; secondly, I am going to take  
19 the tribunal to the conditions; thirdly, I am going to provide an overview of Ofcom's  
20 methodology in resolving the dispute; then, fourthly, I am going to deal with four sub-points  
21 of detail. The sub-points of the detail under the fourth head are: (1) DSAC and its use; (2)  
22 the issue of aggregation; (3) combinatorials; and (4) the issue of economic harm.

23 If I can begin, first of all, with the nature of the dispute itself and ask the tribunal please to  
24 turn up the final determination, which is at the end of core bundle 2? At p.799, which is the  
25 first substantive page of the final determination, at para. 1.5 we have an identification of the  
26 nature of the dispute. It is clear there that Ofcom considered in the dispute it was going to  
27 consider both trunk and terminating charges (one sees that from the words in brackets) and  
28 also that it considered that the way in which it would address this dispute would be by  
29 considering whether or not the cost orientation obligation had been violated. As is clear  
30 from para. 1.5 this is how the dispute was formulated on 25<sup>th</sup> July, 2008. There was a  
31 further dispute which Ofcom accepted and resolved within the same parameters on 2<sup>nd</sup>  
32 December, 2008 from COLT. One sees that at para. 1.6. The tribunal will be aware that  
33 the decision to accept a dispute is an important statutory decision under the scheme.

34 Perhaps I can just turn this up for the tribunal because it will matter in due course. If one



1 goes to DF4, which is the statutory material, and in particular to tab 5, which is the tab  
2 containing the relevant extract from the Communications Act, and if one goes to s.186, in  
3 the bottom right-hand corner at p.26, there one sees that under s.186(4) that once Ofcom  
4 decides it has to accept a dispute it must publish that decision to the parties and the reasons  
5 for it, and inform each of the parties and the reasons for it, and the date of the decision in  
6 sub-section (5).

7 It became clear for the first time in considering BT's skeleton argument that aside from  
8 complaints about the process that was followed they are arguing that an error was made on  
9 2<sup>nd</sup> December, 2008 and on 27<sup>th</sup> August, 2008 when the dispute was accepted. We say - and  
10 this is a relatively limited point, but I make it just to put down a marker - that the time limit  
11 for challenging the decision to accept the dispute ran from that time. We do not accept that  
12 the case that Mr. Read referred to a short while ago, which suggests that time does not run  
13 from then, actually decides that time does not run from the time of acceptance of the  
14 dispute. That is a minor point in the context of this whole case, but I put down that marker  
15 because a lot of time is going to be spent in this case on assessing whether or not Ofcom  
16 should have accepted it. There may be a very straightforward answer to that, which is that  
17 Ofcom having accepted the dispute, there was a two-month time limit from that notification  
18 of its acceptance. It is common ground that BT does not challenge the decision within those  
19 two months.

20 If I can turn next, please, to the Condition itself? It is important that we take some time  
21 over this because it is not absolutely clear to me, having heard Mr. Read, what he accepts  
22 and does not accept about the Condition. He did take you to the Condition. I think he took  
23 you to it in the LLMR in ADB2. I will also use that reference, although it appears  
24 elsewhere. Could I ask the tribunal please to turn up ADB2. We will need to look at other  
25 aspects of this LLMR statement in some detail in due course, but if one focuses first of all  
26 on the Condition itself, which one finds at p.480 -- Condition H1 -- As I understood the  
27 position this morning - and Mr. Read will correct me if I am wrong - it is now accepted by  
28 BT that when reference is being made to the provision of network access Condition H3.1,  
29 that network access is access to trunk segments. A large part of our skeleton argument is  
30 spent on dealing with what we have understood to be the contrary position. I hope I am  
31 happy to say that it is now accepted that Condition H3 required BT to show that its prices  
32 for trunk segments were cost oriented.

33 MR. READ: I do not want to interrupt my learned friend at this stage, but it was one of the points  
34 that I did not perhaps spend as long as I could have done dealing with our position on

1 Condition H3. What I certainly do accept is that this is a condition focused upon the trunk  
2 market and therefore the trunk sections. I do not necessarily accept that network access in  
3 this context means trunk alone. I certainly do not accept that when you come to consider  
4 the cost orientation condition imposed in respect of the trunk market that you ignore what is  
5 going on with the terminating market as well. Now, I do not know whether that helps my  
6 friend or hinders him. But, that is BT's position - that network access does not per se mean  
7 network access confined to the trunk segment itself. But, I do fully accept that this  
8 condition is imposed in the context of trunk segments. Obviously that is an important point  
9 because one of the things that is being said against us is the fact that our interpretation  
10 makes a similar provision in the terminating segment in the G3 that I have already shown  
11 you otiose. Well, we do not accept that. I think, I hope that I have made it perfectly clear  
12 that we do accept that Condition H3 is focussed on trunk segments. That may, or may not,  
13 help my learned friend, but that is the way we are putting the case.

14 MR. SAINI: What slightly troubles me is the words 'focused on'. It seems to me that I am going  
15 to have to take the tribunal through both his condition and the meaning of network access  
16 and some further parts of the LLMR statement, just for the avoidance of doubt.

17 THE CHAIRMAN: I think that would be helpful, Mr. Saini.

18 MR. SAINI: Perhaps I can then begin by going back just one page, please, to the first condition  
19 that is relevant in this regard - Condition H1 at p.478? There it is stated that,

20 "Where a third party reasonably requests in writing Network Access, the Dominant  
21 Provider shall provide that Network Access. The Dominant Provider shall also  
22 provide such Network Access as Ofcom may from time to time direct".

23 I ought to emphasise H1.3,

24 "The Dominant Provider shall comply with any direction Ofcom may make from  
25 time to time under this Condition".

26 I am going to show you some of the directions that were made, but there is an over-arching  
27 point to make, which is that if one goes back yet one further page, to p.476, which is where  
28 these conditions all begin, all of the conditions that follow are specifically and expressly  
29 applied to the provision of wholesale trunk segments at all bandwidths. So, all of these  
30 conditions that we are looking at concern wholesale trunk segments. There is no mention  
31 here in these conditions of terminating segments. This is a free-standing set of obligations.  
32 This follows from a point of which the tribunal is well aware now that in deciding to make  
33 these conditions Ofcom had already concluded, without any appeal - no appeal - that there  
34 are two separate markets: one market for trunk segments and one market for terminating,

1 and -- but because the market conditions in those two separate markets are radically  
2 different two different systems of regulation need to be applied. So, for terminating  
3 segments there was a specific price control which will come across in due course - the RPI  
4 minus X price control - a very tight form of regulation, and for trunk segments, a different  
5 market, there was a basis of charges obligation in H3.1 - in other words, a general cost  
6 orientation obligation. So, two distinct markets. Two distinct schemes of regulation.  
7 Just while we are on p.476, sir, one sees the definitions there. I emphasise that I am going  
8 to come back to this point: that for the purpose of interpreting these conditions the first  
9 provision under para. 2 says that, the 'Act' means the 'Communications Act' . At para. 3  
10 on p.477,

11           "--any words or expressions used in these conditions will have the same meaning  
12           as in the Act".

13 I mention those point because when one seeks to identify what network access means,  
14 which may be disputed, one will need to go back to the Act.

15 If I can jump then back to p.480, which is to the specific condition that we are concerned  
16 with, which is Condition H3 -- What I am going to show the tribunal in due course is the  
17 fact that Network Access, which is referred to in the third line of H3.1, as defined by the  
18 Communications Act, will definitely include 2 Mbit trunk. Before we come to that, if you  
19 just focus, please, for a moment on H3.2:

20           "The Dominant Provider shall comply with any direction Ofcom may from time to  
21           time direct under this Condition".

22 There was such a direction made, which I do not think anyone has referred to so far.

23 Jumping a few pages ahead in this bundle to p.613, please? You will at the top of the page  
24 the headings, "Direction under H3 --" It is imposed in respect of wholesale trunk segments  
25 at all bandwidths. Could I ask you to skip over the recitals and go to the bottom of the page,  
26 to the very last sentence.

27           "The Dominant Provider shall provide Partial Private Circuits in accordance with  
28           Direction. This Direction shall only apply to the extent that the Dominant Provider  
29           provides a Partial Private Circuit which contains an element of a product or service  
30           which falls within the market for wholesale trunk segments".

31 Now, were there any doubt that Condition H3 applied to trunk segments on their own. The  
32 matter is put beyond doubt by this provision, but, just to complete this point, if one goes to  
33 the primary legislation, which is back in Bundle DF4, tab 5, p.22 of the extract, you will  
34 see, just after the first punch hole the definition of Network Access. "Network Access is to

1 be construed in accordance with sub-section (3)” Sub-section (3) is on the facing page.

2 You will see,

3 “In this chapter references to network access are references to:

4 (a) interconnection of public electronic communications networks; or

5 (b) any services, facilities or arrangements which:-

6 (i) are not comprised in interconnection; but

7 (ii) are services, facilities or arrangements by means of which a communications  
8 provider or person making available associated facilities is able, for the purpose of  
9 the provision of an electronic communication service ... to make use of anything  
10 mentioned in sub-section (4)”.

11 The tribunal can read sub-section (4). The point is that there cannot be any doubt that a 2  
12 Mbit trunk is a service that enables somebody to use an electronic communications network.  
13 I do not believe that is disputed.

14 This is important, sir, because as a matter of law - not as a matter of discretion - BT was  
15 obliged to show its charges for access to 2 Mbit trunk were cost oriented. Just while I am  
16 on that point saying that, as a matter of law they had to do that, you will already be aware of  
17 the point going back to Condition H3.1, if you go back to p.480 in AD2, it is a point the  
18 Tribunal will have in mind but it requires emphasis because it played an important part in  
19 the way that Ofcom approached matters. I would ask you, please, to underline the words in  
20 Condition H3.1, that it is for the dominant provider to secure and “the dominant provider  
21 shall be able to demonstrate to the satisfaction of Ofcom.” So the burden was always upon  
22 BT from day one to be able to demonstrate to Ofcom that it was complying with this  
23 conditional requirement. This is not the type of case as one sees in a traditional  
24 competition law *ex post* analysis where the burden is upon a Regulator to show that a  
25 regulated entity has violated competition law, for example, by charging excessive prices.  
26 The burden is upon the Regulator. Here we have a reversal of that, which is that BT had to  
27 show and be able to demonstrate that it was complying with the cost orientation obligation.  
28 That is very relevant because, as will happen as we go through the evidence in this case, as  
29 will be demonstrated it is unclear what BT was doing and it is actually pointed up by the  
30 question, sir, that you posed to Mr. Read early this morning, to which, with respect to him, I  
31 do not think there was an answer, which was: “What did BT think they had to do to comply  
32 with the cost orientation obligation?” and we do not have an answer to that yet.  
33 Clearly, they had an obligation to have done something themselves flowing from this  
34 condition. Just before leaving that point, and this is the last point I will make, if you have

1 DF4 open and if you would please go to tab 3 and p.10 within that (it actually starts at the  
2 bottom of p.9) it is Article 13 of the Access Directive but I would ask the Tribunal please to  
3 focus on Article 13(3) at p.10. If I may read it, and I would ask the Tribunal to underline  
4 this:

5 “Where an operator has an obligation regarding the cost orientation of its prices, the burden  
6 of proof that charges are derived from costs including a reasonable rate of return on  
7 investment shall lie with the operator concerned. For the purpose of calculating the cost of  
8 efficient provision of services, national regulatory authorities may use cost accounting  
9 methods independent of those used by the undertaking. National regulatory authorities may  
10 require an operator to provide full justification for its prices and may, where appropriate,  
11 require prices to be adjusted.”

12 That provision is relevant because it explains why under Condition H3, which is the  
13 primary provision that the Tribunal needs to focus on for these proceedings, when it came to  
14 implementing the Access Directive and, in particular, imposing this obligation the burden  
15 was put upon BT. This was not some anachronistic approach adopted by Ofcom. Ofcom  
16 was required to impose an obligation upon BT under which BT itself had to demonstrate  
17 compliance.

18 I will not go to it now, but I am about to go to some of BT’s own published accounting  
19 documents, but I will preface what I am going to say tomorrow when I say what I am  
20 hoping to show the Tribunal tomorrow are documents which demonstrate that from 2004  
21 onwards, in other words from the time that the condition was imposed, it was absolutely  
22 clear to BT that it had to calculate DSAC and DLRIC, publish those figures and BT itself –  
23 this is not something that Ofcom was saying – BT itself described those figures as being  
24 figures it was producing in order to demonstrate compliance with cost orientation  
25 obligations. Those are documents which Mr. Read has not shown you yet, but they will  
26 take some time to go through, therefore I am not going to press them upon the Tribunal  
27 now.

28 THE CHAIRMAN: No, that makes sense. Thank you very much, Mr. Saini. We will resume at  
29 10.30 tomorrow morning, and thereafter hopefully 10 o’clock on Friday.

30 MR. SAINI: I am grateful, sir.

31 (Adjourned until 10.30 am on Thursday, 21<sup>st</sup> October 2010)