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Case No: C3/2014/4203, C3/2015/0439, C3/2015/0440 & C3/2014/4185

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE COMPETITION APPEAL TRIBUNAL
1205/3/3/13, 1206/3/3/13 & 1207/3/3/13

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 04/05/2017

Before:

LADY JUSTICE ARDEN
LORD JUSTICE LLOYD JONES
and
LORD JUSTICE SALES

- -

Between:

C3/2014/4203 C3/2015/0439 C3/2015/0440	**British Telecommunications plc** **-and-** **(1) Office Of Communications** **(2) Sky UK Limited** **(3) TalkTalk Telecom Group plc** **(4) The Altnets:** **Cable And Wireless Worldwide Limited** **Virgin Media UK Limited** **Verizon UK Limited**	**Appellant** **Respondents**

and Between:

C3/2014/4185	**TalkTalk Telecom Group plc** **-and-** **(1) Office Of Communications** **(2) British Telecommunications plc** **Gamma Telecom Holdings Limited**	**Appellant** **Respondents** **Intervener**

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Rhodri Thompson QC, Graham Read QC & Georgina Hirsch (instructed by **BT**) for **BT**
Pushpinder Saini QC, Kate Gallafent QC, Hanif Mussa & Emily Neill (instructed by **OFCOM**) for **OFCOM**
Meredith Pickford QC (Instructed by **Herbert Smith Freehills LLP**) for **TalkTalk** and **Sky**
Dinah Rose QC & Tristan Jones (instructed by **Towerhouse LLP**) for **The Altnets**

Hearing dates: 6th - 9th March 2017

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JUDGMENT APPROVED

Lady Justice Arden delivering the judgment of the court**:**

GLOSSARY

2003 ACT	COMMUNICATIONS ACT 2003
AD	ACCESS DIRECTIVE 2002/19/EC
AISBO	ALTERNATIVE INTERFACE SYMMETRIC BROADBAND ORIGINATION
AuD	AUTHORISATION DIRECTIVE 2002/20/EC
BES	BACKHAUL EXTENSION SERVICES
BCMR	BUSINESS CONNECTIVITY MARKET REVIEW 2008
CCA	CURRENT COST ACCOUNTING
CP	COMMUNICATION PROVIDER
CRF	COMMON REGULATORY FRAMEWORK
EPMU	EQUI-PROPORTIONATE MARK UP FOR COMMON COSTS
FD	FRAMEWORK DIRECTIVE 2002/21/EC
HH3.1	THE COST ORIENTATION OBLIGATION
LRIC	LONG RUN INCREMENTAL COST
LLMR	LEASED LINES MARKET REVIEW 2004
MNO	MOBILE NETWORK OPERATOR
MS	MEMBER STATES OF EU
NRA	NATIONAL REGULATORY AUTHORITY
OFCOM	OFFICE OF COMMUNICATIONS
PPCs	PARTIAL PRIVATE CIRCUITS
ROCE	RETURN ON CAPITAL EMPLOYED
SIA	STANDARD INTERCONNECTION AGREEMENT
SMP	SIGNIFICANT MARKET POWER
WACC	WEIGHTED AVERAGE COST OF CAPITAL
WES	WHOLESALE EXTENSION SERVICES
SAC	STAND ALONE COST
DLRIC	DISTRIBUTED LONG RUN INCREMENTAL COST
DSAC	DISTRIBUTED STAND ALONE COST
FAC	FULLY ALLOCATED COST

Introduction

1. There are before the court an appeal by British Telecommunications Plc ("BT") and an appeal by TalkTalk Telecom Group Plc ("TalkTalk") against different parts of orders made by the Competition Appeal Tribunal ("CAT") as a result of a determination on 1 August 2014 of three appeals to the CAT. The appeals to the CAT were against a decision by the Office of Communications ("Ofcom") dated 20 December 2012 entitled *Disputes between each of Sky, TalkTalk, Virgin Media, Cable & Wireless and Verizon and BT regarding BT's charges for Ethernet services: Determinations and Explanatory Statement* ("the Determination").

2. This is the judgment of the court, to which all its members have contributed. The section on grounds 1 and 2 of BT's appeal was primarily drafted by Sales LJ; the section on ground 3 of BT's appeal was primarily drafted by Lloyd Jones LJ; and the section on TalkTalk's appeal was primarily drafted by Arden LJ.

3. Ofcom's Determination was made in respect of disputes referred to it under the competition regime governing the telecommunications market set out in the Communications Act 2003 and the EU Common Regulatory Framework ("CRF"), comprising the Framework Directive (2002/21/EC – "the FD"), the Access Directive (2002/19/EC – "the AD"), the Authorisation Directive (2002/20/EC – "the AuD") and certain other Directives. The FD establishes a regulatory framework; the AD governs access to electronic communication networks; and the AuD governs the authorisation of electronic networks and services. These Directives were amended by Directive 2009/140/EC, but it is common ground that for the purposes of these appeals it is appropriate and more convenient to focus on the 2003 Act and the CRF Directives in their unamended form.

4. BT, as the successor to the national telecommunications monopoly provider, has a significant Ethernet (data transmission) infrastructure in place. BT offers various Ethernet facilities at set prices to other communications providers ("CPs"), such as Sky UK Ltd ("Sky"), TalkTalk and the CPs referred to as "the Altnets" (comprising Cable & Wireless Worldwide Plc, Virgin Media UK Ltd and Verizon UK Ltd). Also included among the CPs is Gamma Telecom Holdings Ltd ("Gamma"), which was given permission to file written submissions on the appeals.

5. The present appeals are concerned with those parts of the market for Ethernet services known as the AISBO market. AISBO is the acronym for 'alternative interface symmetric broadband origination.' The AISBO market is a wholesale market within which CPs purchase access to BT's Ethernet infrastructure and services in order to sell their own telephone and broadband services delivered over that infrastructure to retail customers, in competition in that retail market with BT and other CPs. The AISBO facilities provided by BT include Wholesale Extension Services ("WES"), which connect large end-users, such as banks, to a CP's network via BT's infrastructure, and Backhaul Extension Services ("BES"), which provide much of the infrastructure between a CP's core network and the retail customer's local exchange. The AISBO market is distinct from the TISBO ('traditional interface symmetric broadband origination') market.

6. BT offers AISBO facilities at a number of different bandwidths (i.e. data transfer speeds). CPs which require an AISBO line request one from BT, which sends an engineer to the site to install the equipment to establish the necessary connection. CPs may be billed by BT for, among other things, a one-off connection charge, line rental and a "main link" charge for establishing a link between two exchanges. More detail about this can be found in the CAT's judgment and does not need to be set out here.

7. Under the 2003 Act and the CRF, an undertaking which is found to have significant market power ("SMP") in a market within the telecommunications field may be subjected to regulatory controls, known as SMP conditions, in relation to its pricing and the terms on which it offers its services to others. In 2003, the then regulator of the telecommunications market, the Office of Telecommunications ("Oftel"), commenced a review of the retail leased lines, symmetric broadband origination and wholesale trunk segments markets, to identify and analyse relevant markets, determine whether undertakings had SMP in any markets and if so to set SMP conditions. Oftel's review was taken over by Ofcom, which succeeded it as regulator, in the course of 2004.

8. On 24 June 2004, Ofcom issued its final form Leased Lines Market Review ("the 2004 LLMR"). This was a substantial document which included analyses of various markets and the extent of market power within them. Ofcom identified BT as having SMP in the AISBO market. It imposed Condition HH3, entitled "Basis of Charges", as an SMP condition on BT as the Dominant Provider in that market, as follows:

> "HH3.1 Unless Ofcom directs otherwise from time to time, the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition HH1 [i.e. including AISBO services] is reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed.
>
> HH3.2 The Dominant Provider shall comply with any direction Ofcom may from time to time direct under this Condition."

9. HH3.1 is a form of regulatory control known as cost orientation, which requires a reasonable relationship to be maintained going forward between the costs of a service provider with SMP and the prices it charges for its services. It is a less intrusive form of regulation than a price control condition, whereby the regulator uses information about the historic costs of a service provider with SMP to impose maximum prices which it may charge for its services in the future.

10. In 2008 Ofcom carried out a further market review, resulting in it issuing the BCMR. In that market review Ofcom concluded that in the part of the AISBO market for high bandwidths, competition had developed and BT no longer had SMP. Accordingly, Condition HH3 was discontinued in relation to that part of the AISBO market. It continued in place for other parts of the AISBO market, which constituted a distinct market.

11. Between 2010 and 2012 various CPs complained to Ofcom that BT's charges for its AISBO services in 2004 to 2011 were excessive and in breach of Condition HH3.1. Ofcom accepted this dispute under the relevant provisions of the 2003 Act and the CRF. It carried out an investigation with representations from all affected parties, leading to the Determination of December 2012.

12. In the Determination, Ofcom found that BT had indeed failed to comply with its obligations under Condition HH3.1. It had used a method of attempting to justify its prices in relation to its costs which Ofcom did not regard as appropriate and which was excessively generous to BT. Ofcom considered that a different methodology of cost orientation should be used, a version of what is known as Distributed Stand Alone Cost ("DSAC"). Ofcom therefore ordered BT to make substantial payments back to the CPs which had been overcharged in this way in the period covered by their complaints. Ofcom did not, however, order payment of interest in relation to the payments to be made by BT to the CPs.

13. On the issue of payment of interest, Ofcom considered that clause 12.3 of the relevant contracts between the CPs and BT led to the conclusion that no interest should be paid, because Ofcom considered that they had made deliberate provision in that clause

to rule out payment of interest in a situation where the regulator required a repayment to be made. Clause 12.3 states as follows:

> "If a refund is due to the Communications Provider by BT (unless that overpayment results from information provided by the Communications Provider which is not attributable to information provided by BT), the Communications Provider may charge daily interest on late repayments in accordance with the Late Payment of Commercial Debts (Interest) Act 1998 for the period beginning on the date on which the parties agree BT shall make the repayment and ending on the date BT actually makes payment. If any charge is recalculated or adjusted with retrospective effect under an order, direction, determination or requirement of Ofcom, or any other regulatory authority or body of competent jurisdiction, the parties agree that interest will not be payable on any amount due to either party as a result of that recalculation or adjustment."

14. BT, Sky and TalkTalk (acting together) and the Altnets then all appealed against different aspects of the Determination to the CAT. BT's grounds of appeal included the submissions that (i) Ofcom had no power under the relevant legislation to order repayment of sums paid before any dispute arose ("BT's prospective regulation ground") and, further and in the alternative, (ii) Ofcom had violated the EU law principle of legal certainty by ordering the repayments in circumstances where it had not previously suggested that the cost orientation methodology being used by BT was wrong ("BT's legal certainty ground"). Sky and TalkTalk's grounds of appeal included the submissions that (i) Ofcom had erred in using DSAC as the relevant cost orientation methodology, and on proper application of Condition HH3.1 should have used another methodology known as Fully Allocated Cost ("FAC") which was more beneficial from the CPs' point of view and would have resulted in orders for higher repayments ("the DSAC issue"); and (ii) Ofcom should have ordered the payment of interest ("the interest issue"). The Altnets also appealed on the interest issue.

15. For the most part the CAT upheld the Determination, although it allowed the appeals by the CPs on the interest issue and allowed part of BT's appeal on a ground which is not material for present purposes. On the interest issue, the CAT considered that clause 12.3, on its proper construction, purported to exclude payment of interest, but ruled that if the provision were applied with that effect it would be inconsistent with the achievement of the relevant regulatory objectives under the legislation, so interest should be awarded (see [301]-[315]). The CAT ruled against BT in relation to BT's prospective regulation ground and BT's legal certainty ground, and BT appeals to this court in respect of both those grounds. BT also appeals in relation to its defeat in the CAT on the interest issue. The CAT ruled against Sky and TalkTalk on the DSAC issue and TalkTalk (but not Sky) appeals in relation to that issue.

16. In relation to the appeal on the interest issue, the Altnets, Sky and TalkTalk support the reasoning of the CAT and also say, by way of respondents' notices, that on proper interpretation of clause 12.3 it does not purport to preclude payment of interest in relation to an order by Ofcom that BT make repayments in respect of its overcharging. In relation to TalkTalk's appeal on the DSAC issue, BT joins with Ofcom in resisting that appeal and also, by a respondent's notice, argues that TalkTalk's argument is contrary to proper application of the EU law principle of legal

certainty, by reason of positive indications which BT says Ofcom has given BT from time to time that DSAC is the appropriate cost orientation methodology in this context.

17. There is a significant area of overlap between BT's prospective regulation ground and the interest issue. The thrust of the case for Ofcom and the CPs in answer to BT's prospective regulation ground is that the CRF gives powers to a national regulatory authority to take action to ensure that its regulatory measures are effective and that CPs do indeed obtain the benefits which such measures are supposed to confer upon them, including power to order repayment of sums which are overcharged by the undertaking with SMP. Similarly, the CPs contend that the CRF contemplates that the effective measures that a national regulatory authority is authorised to take include a power to grant interest, both to ensure that BT as the undertaking with SMP is properly incentivised to abide by the SMP condition imposed on it and to ensure that the CPs obtain the full economic benefit which that SMP condition was supposed to confer on them.

18. There is also a significant area of overlap between BT's legal certainty ground and TalkTalk's appeal on the DSAC issue. One of TalkTalk's submissions is that on proper construction of Condition HH3.1 in the context of the 2004 LLMR the condition indicated that, having regard to the regulatory aims of Ofcom in imposing it, an FAC cost orientation methodology was required; whereas BT's legal certainty ground involves the submission that Condition HH3.1 was not itself clear as to how cost orientation should be carried out and other indications given by Ofcom led BT to believe that it was entitled to adopt a particular form of methodology involving aggregation of costs.

The legislative framework

19. The CRF is the EU regulatory regime which is then implemented in domestic law by the 2003 Act, so we begin with the CRF. As explained above, we focus on the relevant provisions in their unamended form. This was the form in which they applied throughout most of the period of overcharging by BT and it is common ground that the amendments made to those provisions do not have any material impact on the analysis of the issues which arise on this appeal. Ofcom (previously Oftel) is the UK's national regulatory authority for the purposes of the CRF.

20. Both the CRF and the 2003 Act contemplate that there may be three kinds of legal proceeding arising out of breach of an SMP condition by a service provider with significant market power: (i) a private law action by a CP or end-user for damages or other relief brought in the ordinary courts for what in English law would be termed a breach of statutory duty; (ii) regulatory action taken by the national regulatory authority on its own initiative with a view to remedying any breach and imposing a penalty; and (iii) resolution by the national regulatory authority of a dispute between a CP or end-user and the service provider with SMP which is referred to that authority. It is helpful to bear this scheme in mind when reading the relevant provisions and in considering the issues which arise on the appeal. The present appeals deal with proceedings falling within category (iii), as they arise out of the exercise by Ofcom of its dispute resolution powers.

21. The provisions of the CRF Directives which are of particular relevance are as follows:

The Framework Directive

Recitals

> "…
>
> (32) In the event of a dispute between undertakings in the same Member State in an area covered by this Directive or the Specific Directives, for example relating to obligations for access and interconnection or to the means of transferring subscriber lists, an aggrieved party that has negotiated in good faith but failed to reach agreement should be able to call on the national regulatory authority to resolve the dispute. National regulatory authorities should be able to impose a solution on the parties. The intervention of a national regulatory authority in the resolution of a dispute between undertakings providing electronic communications networks or services in a Member State should seek to ensure compliance with the obligations arising under this Directive or the Specific Directives.

…

Chapter III – Tasks of National Regulatory Authorities

…

Article 8

Policy Objectives and Regulatory Principles

> 1. Member States shall ensure that in carrying out the regulatory tasks specified in this Directive and the Specific Directives, the national regulatory authorities take all reasonable measures which are aimed at achieving the objectives set out in paragraphs 2, 3 and 4. Such measures shall be proportionate to those objectives.
>
> Member States shall ensure that in carrying out the regulatory tasks specified in this Directive and the Specific Directives, in particular those designed to ensure effective competition, national regulatory authorities take the utmost account of the desirability of making regulations technologically neutral.
>
> National regulatory authorities may contribute within their competencies to ensuring the implementation of policies aimed at the promotion of cultural and linguistic diversity, as well as media pluralism.
>
> 2. The national regulatory authorities shall promote competition in the provision of electronic communications networks, electronic communications services and associated facilities and services by inter alia:

(a) ensuring that users, including disabled users, derive maximum benefit in terms of choice, price, and quality;

(b) ensuring that there is no distortion or restriction of competition in the electronic communications sector;

(c) encouraging efficient investment in infrastructure, and promoting innovation; and

(d) encouraging efficient use and ensuring the effective management of radio frequencies and numbering resources.

3. The national regulatory authorities shall contribute to the development of the internal market by inter alia:

(a) removing remaining obstacles to the provision of electronic communications networks, associated facilities and services and electronic communications services at European level;

(b) encouraging the establishment and development of trans-European networks and the interoperability of pan-European services, and end-to-end connectivity;

(c) ensuring that, in similar circumstances, there is no discrimination in the treatment of undertakings providing electronic communications networks and services;

(d) cooperating with each other and with the Commission in a transparent manner to ensure the development of consistent regulatory practice and the consistent application of this Directive and the Specific Directives.

4. The national regulatory authorities shall promote the interests of the citizens of the European Union by inter alia:

(a) ensuring all citizens have access to a universal service specified in Directive 2002/22/EC (Universal Service Directive);

(b) ensuring a high level of protection for consumers in their dealings with suppliers, in particular by ensuring the availability of simple and inexpensive dispute resolution procedures carried out by a body that is independent of the parties involved;

(c) contributing to ensuring a high level of protection of personal data and privacy;

(d) promoting the provision of clear information, in particular requiring transparency of tariffs and conditions for using publicly available electronic communications services;

(e) addressing the needs of specific social groups, in particular disabled users; and

(f) ensuring that the integrity and security of public communications networks are maintained.

[The reference to "Users" in Article 8 includes the CPs: see the definitions in Article 2.]

Chapter IV – General Provisions

Article 20

Dispute resolution between undertakings

1. In the event of a dispute arising in connection with obligations arising under this Directive or the Specific Directives between undertakings providing electronic communications networks or services in a Member State, the national regulatory authority concerned shall, at the request of either party, and without prejudice to the provisions of paragraph 2, issue a binding decision to resolve the dispute in the shortest possible time frame and in any case within four months except in exceptional circumstances. The Member State concerned shall require that all parties cooperate fully with the national regulatory authority.

2. Member States may make provision for national regulatory authorities to decline to resolve a dispute through a binding decision where other mechanisms, including mediation, exist and would better contribute to resolution of the dispute in a timely manner in accordance with the provisions of Article 8. The national regulatory authority shall inform the parties without delay. If after four months the dispute is not resolved, and if the dispute has not been brought before the courts by the party seeking redress, the national regulatory authority shall issue, at the request of either party, a binding decision to resolve the dispute in the shortest possible time frame and in any case within four months.

3. In resolving a dispute, the national regulatory authority shall take decisions aimed at achieving the objectives set out in Article 8. Any obligations imposed on an undertaking by the national regulatory authority in resolving a dispute shall respect the provisions of this Directive or the Specific Directives.

4. The decision of the national regulatory authority shall be made available to the public, having regard to the requirements of business confidentiality. The parties concerned shall be given a full statement of the reasons on which it is based.

5. The procedure referred to in paragraphs 1, 3 and 4 shall not preclude either party from bringing an action before the courts.

The Access Directive

Recitals

> (1) … This Directive covers access and interconnection arrangements between service suppliers. Non-public networks do not have obligations under this Directive except where, in benefiting from access to public networks, they may be subject to conditions laid down by Member States.
>
> …
>
> (6) In markets where there continue to be large differences in negotiating power between undertakings, and where some undertakings rely on infrastructure provided by others for delivery of their services, it is appropriate to establish a framework to ensure that the market functions effectively. National regulatory authorities should have the power to secure, where commercial negotiation fails, adequate access and interconnection and interoperability of services in the interest of end-users. In particular, they may ensure end-to-end connectivity by imposing proportionate obligations on undertakings that control access to end-users….
>
> …
>
> (14) Directive 97/33/EC laid down a range of obligations to be imposed on undertakings with significant market power, namely transparency, non-discrimination, accounting separation, access, and price control including cost orientation. This range of possible obligations should be maintained but, in addition, they should be established as a set of maximum obligations that can be applied to undertakings, in order to avoid over-regulation. Exceptionally, in order to comply with international commitments or Community law, it may be appropriate to impose obligations for access or interconnection on all market players, as is currently the case for conditional access systems for digital television services.
>
> (15) The imposition of a specific obligation on an undertaking with significant market power does not require an additional market analysis but a justification that the obligation in question is appropriate and proportionate in relation to the nature of the problem identified.
>
> …
>
> (20) Price control may be necessary when market analysis in a particular market reveals inefficient competition. The regulatory intervention may be relatively light, such as an obligation that prices for carrier selection are reasonable as laid down in Directive 97/33/EC, or much heavier such as an obligation that prices are cost oriented to provide full justification for those prices where competition is not sufficiently strong to prevent excessive pricing. In particular, operators

> with significant market power should avoid a price squeeze whereby the difference between their retail prices and the interconnection prices charged to competitors who provide similar retail services is not adequate to ensure sustainable competition. When a national regulatory authority calculates costs incurred in establishing a service mandated under this Directive, it is appropriate to allow a reasonable return on the capital employed including appropriate labour and building costs, with the value of capital adjusted where necessary to reflect the current valuation of assets and efficiency of operations. The method of cost recovery should be appropriate to the circumstances taking account of the need to promote efficiency and sustainable competition and maximise consumer benefits.

Chapter II – General Provisions

…

Article 5

Powers and responsibilities of the national regulatory authorities with regard to access and interconnection

> 1. National regulatory authorities shall, acting in pursuit of the objectives set out in Article 8 of Directive 2002/21/EC (Framework Directive), encourage and where appropriate ensure, in accordance with the provisions of this Directive, adequate access and interconnection, and interoperability of services, exercising their responsibility in a way that promotes efficiency, sustainable competition, and gives the maximum benefit to end-users.
>
> In particular, without prejudice to measures that may be taken regarding undertakings with significant market power in accordance with Article 8, national regulatory authorities shall be able to impose:
>
> (a) to the extent that is necessary to ensure end-to-end connectivity, obligations on undertakings that control access to end-users, including in justified cases the obligation to interconnect their networks where this is not already the case;
>
> (b) to the extent that is necessary to ensure accessibility for end-users to digital radio and television broadcasting services specified by the Member State, obligations on operators to provide access to the other facilities referred to in Annex I, Part II on fair, reasonable and non-discriminatory terms.
>
> …
>
> 4. With regard to access and interconnection, Member States shall ensure that the national regulatory authority is empowered to intervene at its own initiative where justified or, in the absence of agreement

between undertakings, at the request of either of the parties involved, in order to secure the policy objectives of Article 8 of Directive 2002/21/EC (Framework Directive), in accordance with the provisions of this Directive and the procedures referred to in Articles 6 and 7, 20 and 21 of Directive 2002/21/EC (Framework Directive).

…

Chapter III – Obligations on Operators and Market Review Procedures

…

Article 8

Imposition, amendment or withdrawal of obligations

1. Member States shall ensure that national regulatory authorities are empowered to impose the obligations identified in Articles 9 to 13.

2. Where an operator is designated as having significant market power on a specific market as a result of a market analysis carried out in accordance with Article 16 of Directive 2002/21/EC (Framework Directive), national regulatory authorities shall impose the obligations set out in Articles 9 to 13 of this Directive as appropriate.

3. …national regulatory authorities shall not impose the obligations set out in Articles 9 to 13 on operators that have not been designated in accordance with paragraph 2.

In exceptional circumstances, when a national regulatory authority intends to impose on operators with significant market power other obligations for access or interconnection than those set out in Articles 9 to 13 in this Directive it shall submit this request to the Commission. The Commission, acting in accordance with Article 14(2), shall take a decision authorising or preventing the national regulatory authority from taking such measures.

4. Obligations imposed in accordance with this Article shall be based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of Directive 2002/21/EC (Framework Directive). Such obligations shall only be imposed following consultation in accordance with Articles 6 and 7 of that Directive.

…

Article 13

Price control and cost accounting obligations

1. A national regulatory authority may, in accordance with the provisions of Article 8, impose obligations relating to cost recovery

> and price controls, including obligations for cost orientation of prices and obligations concerning cost accounting systems, for the provision of specific types of interconnection and/or access, in situations where a market analysis indicates that a lack of effective competition means that the operator concerned might sustain prices at an excessively high level, or apply a price squeeze, to the detriment of end-users. National regulatory authorities shall take into account the investment made by the operator and allow him a reasonable rate of return on adequate capital employed, taking into account the risks involved.
>
> 2. National regulatory authorities shall ensure that any cost recovery mechanism or pricing methodology that is mandated serves to promote efficiency and sustainable competition and maximise consumer benefits. In this regard national regulatory authorities may also take account of prices available in comparable competitive markets.
>
> 3. Where an operator has an obligation regarding the cost orientation of its prices, the burden of proof that charges are derived from costs including a reasonable rate of return on investment shall lie with the operator concerned. For the purpose of calculating the cost of efficient provision of services, national regulatory authorities may use cost accounting methods independent of those used by the undertaking. National regulatory authorities may require an operator to provide full justification for its prices, and may, where appropriate, require prices to be adjusted.
>
> 4. National regulatory authorities shall ensure that, where implementation of a cost accounting system is mandated in order to support price controls, a description of the cost accounting system is made publicly available, showing at least the main categories under which costs are grouped and the rules used for the allocation of costs. Compliance with the cost accounting system shall be verified by a qualified independent body. A statement concerning compliance shall be published annually.

Authorisation Directive

Recitals

…

> (3) The objective of this Directive is to create a legal framework to ensure the freedom to provide electronic communications networks and services, subject only to the conditions laid down in this Directive and to any restrictions in conformity with Article 46(1) of the Treaty, in particular measures regarding public policy, public security and public health. …
>
> (7) The least onerous authorisation system possible should be used to allow the provision of electronic communications networks and services in order to stimulate the development of new electronic

> communications services and pan-European communications networks and services and to allow service providers and consumers to benefit from the economies of scale of the single market. …
>
> (15) The conditions which may be attached to the general authorisation and to the specific rights of use, should be limited to what is strictly necessary to ensure compliance with requirements and obligations under Community law and national law in accordance with Community law. …
>
> (17) Specific obligations which may be imposed on providers of electronic communications networks and services in accordance with Community law by virtue of their significant market power as defined in Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive)(7) should be imposed separately from the general rights and obligations under the general authorisation. …
>
> (27) The penalties for non-compliance with conditions under the general authorisation should be commensurate with the infringement. Save in exceptional circumstances, it would not be proportionate to suspend or withdraw the right to provide electronic communications services or the right to use radio frequencies or numbers where an undertaking did not comply with one or more of the conditions under the general authorisation. This is without prejudice to urgent measures which the relevant authorities of the Member States may need to take in case of serious threats to public safety, security or health or to economic and operational interests of other undertakings. This Directive should also be without prejudice to any claims between undertakings for compensation for damages under national law. …

Article 1

Objective and scope

> 1. The aim of this Directive is to implement an internal market in electronic communications networks and services through the harmonisation and simplification of authorisation rules and conditions in order to facilitate their provision throughout the Community.
>
> 2. This Directive shall apply to authorisations for the provision of electronic communications networks and services.

…

Article 3

General authorisation of electronic communications networks and services

> 1. Member States shall ensure the freedom to provide electronic communications networks and services, subject to the conditions set

> out in this Directive. To this end, Member States shall not prevent an undertaking from providing electronic communications networks or services, except where this is necessary for the reasons set out in Article 46(1) of the Treaty.
>
> 2. The provision of electronic communications networks or the provision of electronic communications services may, without prejudice to the specific obligations referred to in Article 6(2) or rights of use referred to in Article 5, only be subject to a general authorisation. The undertaking concerned may be required to submit a notification but may not be required to obtain an explicit decision or any other administrative act by the national regulatory authority before exercising the rights stemming from the authorisation. Upon notification, when required, an undertaking may begin activity, where necessary subject to the provisions on rights of use in Articles 5, 6 and 7.
>
> 3. The notification referred to in paragraph 2 shall not entail more than a declaration by a legal or natural person to the national regulatory authority of the intention to commence the provision of electronic communication networks or services and the submission of the minimal information which is required to allow the national regulatory authority to keep a register or list of providers of electronic communications networks and services. This information must be limited to what is necessary for the identification of the provider, such as company registration numbers, and the provider's contact persons, the provider's address, a short description of the network or service, and an estimated date for starting the activity.

…

Article 6

Conditions attached to the general authorisation and to the rights of use for radio frequencies and for numbers, and specific obligations

> 1. The general authorisation for the provision of electronic communications networks or services and the rights of use for radio frequencies and rights of use for numbers may be subject only to the conditions listed respectively in parts A, B and C of the Annex. Such conditions shall be objectively justified in relation to the network or service concerned, non-discriminatory, proportionate and transparent.
>
> 2. Specific obligations which may be imposed on providers of electronic communications networks and services under Articles 5(1), 5(2), 6 and 8 of Directive 2002/19/EC (Access Directive) and Articles 16, 17, 18 and 19 of Directive 2002/22/EC (Universal Service Directive) or on those designated to provide universal service under the said Directive shall be legally separate from the rights and obligations under the general authorisation. In order to achieve transparency for undertakings, the criteria and procedures for imposing such specific

> obligations on individual undertakings shall be referred to in the general authorisation.
>
> 3. The general authorisation shall only contain conditions which are specific for that sector and are set out in Part A of the Annex and shall not duplicate conditions which are applicable to undertakings by virtue of other national legislation.
>
> 4. Member States shall not duplicate the conditions of the general authorisation where they grant the right of use for radio frequencies or numbers.

…

Article 10

Compliance with the conditions of the general authorisation or of rights of use and with specific obligations

> 1. National regulatory authorities may require undertakings providing electronic communications networks or services covered by the general authorisation or enjoying rights of use for radio frequencies or numbers to provide information necessary to verify compliance with the conditions of the general authorisation or of rights of use or with the specific obligations referred to in Article 6(2), in accordance with Article 11.
>
> 2. Where a national regulatory authority finds that an undertaking does not comply with one or more of the conditions of the general authorisation, or of rights of use or with the specific obligations referred to in Article 6(2), it shall notify the undertaking of those findings and give the undertaking a reasonable opportunity to state its views or remedy any breaches within:
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> - one month after notification, or
>
> - a shorter period agreed by the undertaking or stipulated by the national regulatory authority in case of repeated breaches, or
>
> - a longer period decided by the national regulatory authority.
>
> 3. If the undertaking concerned does not remedy the breaches within the period as referred to in paragraph 2, the relevant authority shall take appropriate and proportionate measures aimed at ensuring compliance. In this regard, Member States may empower the relevant authorities to impose financial penalties where appropriate. The measures and the reasons on which they are based shall be communicated to the undertaking concerned within one week of their adoption and shall stipulate a reasonable period for the undertaking to comply with the measure.

> 4. Notwithstanding the provisions of paragraphs 2 and 3, Member States may empower the relevant authority to impose financial penalties where appropriate on undertakings for failure to provide information in accordance with obligations imposed under Article 11(1)(a) or (b) of this Directive or Article 9 of Directive 2002/19/EC (Access Directive) within a reasonable period stipulated by the national regulatory authority.
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> 5. In cases of serious and repeated breaches of the conditions of the general authorisation, the rights of use or specific obligations referred to in Article 6(2), where measures aimed at ensuring compliance as referred to in paragraph 3 of this Article have failed, national regulatory authorities may prevent an undertaking from continuing to provide electronic communications networks or services or suspend or withdraw rights of use.
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> 6. Irrespective of the provisions of paragraphs 2, 3 and 5, where the relevant authority has evidence of a breach of the conditions of the general authorisation, rights of use or specific obligations referred to in Article 6(2) that represents an immediate and serious threat to public safety, public security or public health or will create serious economic or operational problems for other providers or users of electronic communications networks or services, it may take urgent interim measures to remedy the situation in advance of reaching a final decision. The undertaking concerned shall thereafter be given a reasonable opportunity to state its view and propose any remedies. Where appropriate, the relevant authority may confirm the interim measures.
>
> 7. Undertakings shall have the right to appeal against measures taken under this Article in accordance with the procedure referred to in Article 4 of Directive 2002/21/EC (Framework Directive).

22. We have set out provisions of the CRF in some detail because the outcome of BT's appeal turns primarily on them. The CRF has been implemented into domestic law by the 2003 Act, but no party suggests that it is not possible to interpret the relevant provisions of the Act so as to give proper effect to the provisions of the CRF.

23. Section 45 of the 2003 Act sets out the power of Ofcom to set conditions governing provision of communications services and access to facilities, including an SMP condition (section 45(2)(b)(iv)). Ofcom's powers under section 45 include a power to revoke or modify conditions (section 45(10)(e)). Conditions can only be imposed, or modified, so as to apply prospectively: see *Vodafone Ltd v British Telecommunications plc* [2010] EWCA Civ 391, in particular at [34] and [40].

24. This reflects the scheme of the CRF, which makes provision for *ex ante* conditions to be imposed on authorisations to provide communications services: see in particular Recitals (25) and (27) of the FD and *British Telecommunications Plc v Telefonica O2 UK Ltd* [2014] UKSC 42 (known as the *08x Numbers case*), [5]. The scheme of the CRF also reflects the general principles of legal certainty and legitimate expectation in EU law, which also inform the interpretation of EU legislative instruments. The

regulation of the market to ensure proper competition is supposed to allow market participants to be able to make commercial decisions (both as to what services to provide and what services to buy) by reference to prices which are declared in advance of transactions, and are to be set in advance without distortion as a result of the SMP of any market participant.

25. For BT's prospective regulation ground, BT seeks to contend that the same approach applies in the context of action by Ofcom to grant a remedy when a dispute is referred to it under the scheme of the CRF and the 2003 Act. For reasons we give in the discussion of this ground of appeal below, we do not accept this contention. As Mr Saini QC for Ofcom submits, there is a fundamental difference between the power to impose conditions in relation to provision of services in the first place (which is indeed a power which can only be exercised *ex ante*, or prospectively) and the regulator's powers when it addresses the different question of how breaches of an SMP condition should be remedied or penalised, which involves the regulator looking at what has happened in the past and fashioning appropriate relief or an appropriate penalty to deal with that unlawful action in the past by the person subject to the SMP condition.

26. Section 87 governs the setting of SMP conditions. Section 87(9) provides that SMP conditions may include conditions imposing on the dominant provider

> "(a) such price controls as Ofcom may direct in relation to matters connected with the provision of network access to the relevant network, or with the availability of the relevant facilities;
>
> (b) such rules as they may make in relation to those matters about the recovery of costs and cost orientation;
>
> (c) such rules as they may make for those purposes about the use of cost accounting systems; and
>
> (d) obligations to adjust prices in accordance with such directions given by Ofcom as they may consider appropriate."

27. Mr Thompson QC for BT sought to suggest that section 87(9) directly reflects Article 13(3) of the AD, and in particular that section 87(9)(d) directly corresponds to the provision in the last sentence of Article 13(3) which provides that national regulatory authorities "may, where appropriate, require prices to be adjusted". For the purposes of BT's prospective regulation ground, his suggestion was that this showed that the relevant power in both the statute and the AD for Ofcom to require prices to be adjusted was one which could only be exercised on a prospective basis.

28. We do not agree with this. Whilst it is true that Ofcom's powers under section 87 can only be exercised prospectively, section 87(9)(d) does not exhaustively cover the powers contemplated by Article 13(3): see section 190 of the 2003 Act, below. Nor does Article 13(3) exhaustively state the powers of a national regulatory authority under the CRF.

29. Section 94 makes provision for Ofcom, acting as regulator on its own initiative, to give notification to a person if it determines that it "is contravening, or has

contravened" a condition set under section 45, including an SMP condition. The notification has to specify, amongst other things, the period within which the person is to have an opportunity of "remedying the consequences of notified contraventions" (section 94(3)(c)).

30. If Ofcom is satisfied after affording an opportunity for representations that the notified person "has ... been in contravention" of a condition or has not taken such steps as it considers appropriate "for remedying the consequences of the notified contravention" of the condition (section 95(2)), section 95 provides that it may then issue an enforcement notification to impose a requirement to comply with the condition or "a requirement to take such steps for remedying the consequences of the notified contravention as may be so specified" (section 95(3)). Subsection (5) provides that there is a duty to comply with an enforcement notice, and subsection (6) states that such duty is enforceable by Ofcom in civil proceedings for an injunction, specific performance or "for any other appropriate remedy or relief". In addition, section 96 sets out a power for Ofcom to impose a penalty on the notified provider if it "has, in one or more of the respects notified, been in contravention of a condition specified in the notification under section 94" and has not taken the steps considered appropriate by Ofcom to comply with the notified condition and "for remedying the consequences of the notified contravention of that condition" (section 96(2)).

31. Section 104(1) provides, among other things, that the obligation of a person to comply with a condition set under section 45 "shall be a duty owed to every person who may be affected by a contravention of the condition …". Subsection (2) provides that a breach of that duty that causes the person to whom it is owed "to sustain loss or damage" "shall be actionable at the suit or instance of that person". Subsection (3) provides for a defence if the obligee took all reasonable steps and exercised all due diligence to avoid contravening the condition and subsection (4) imposes a requirement to obtain the consent of Ofcom for such an action.

32. Chapter 3 of the 2003 Act is entitled "Disputes and Appeals". Section 185 makes provision for references of disputes between different communications providers relating to the provision of network access (such as that between the CPs and BT in our case) and certain other disputes to Ofcom. This is an avenue of dispute resolution which supplements the possibility of an ordinary private law action for breach of statutory duty under section 104. Under section 186 Ofcom must decide whether it is appropriate for it to handle the dispute. Ofcom decided that it was appropriate for it to handle the disputes between the CPs and BT referred to it by the CPs in this case. Section 188 makes provision regarding the procedure for resolving disputes referred to and accepted by Ofcom.

33. Section 190 sets out, in relevant part, the powers which Ofcom has where it makes a determination to resolve a dispute referred to it, as follows:

"190 Resolution of referred disputes

> (1)Where OFCOM make a determination for resolving a dispute referred to them under this Chapter, their only powers are those conferred by this section.

> (2)Their main power (except in the case of a dispute relating to rights and obligations conferred or imposed by or under the enactments relating to the management of the radio spectrum) is to do one or more of the following—
>
> (a) to make a declaration setting out the rights and obligations of the parties to the dispute;
>
> (b) to give a direction fixing the terms or conditions of transactions between the parties to the dispute;
>
> (c) to give a direction imposing an obligation, enforceable by the parties to the dispute, to enter into a transaction between themselves on the terms and conditions fixed by OFCOM; and
>
> (d) for the purpose of giving effect to a determination by OFCOM of the proper amount of a charge in respect of which amounts have been paid by one of the parties of the dispute to the other, to give a direction, enforceable by the party to whom the sums are to be paid, requiring the payment of sums by way of adjustment of an underpayment or overpayment.
>
> …
>
> (8) A determination made by Ofcom for resolving a dispute referred … to them under this Chapter binds all the parties to the dispute.
>
> …"

BT's prospective regulation ground: Ground 1 in BT's appeal

34. BT submits that Ofcom's powers under the CRF and hence, as a result of conforming interpretation, under the 2003 Act, when a dispute is referred to it under section 185 of the Act, as contemplated by Recital (32) and Article 20 of the FD, are limited to imposing orders for repayment of over-charges in breach of the SMP condition confined to the period after the dispute was notified by a CP to Ofcom, or perhaps to the period after Ofcom accepted under section 186 that it should resolve such dispute. There is no express language in any provision of the CRF creating any power for Ofcom to go further than this. Mr Thompson contended that this approach to the CRF fitted with the general approach of *ex ante* regulation for which the CRF provides. It is, moreover, in line with the principles of legal certainty and legitimate expectations, since until the CPs notified disputes to Ofcom, BT had thought it was entitled to charge the prices it did and would have made commercial decisions in providing services and developing its business on the assumption that this was so. Further, there was no provision in the CRF for any limitation period to apply where a dispute was referred to Ofcom, so the inference should be that the remedy which Ofcom was authorised to impose in relation to such a dispute by way of ordering BT to repay excessive charges it had levied was confined to the period after BT was made aware of the complaints about those charges. The apparently wide powers of Ofcom in section 190(2)(d) of the 2003 Act must be read down accordingly, in line with the powers set out in the CRF.

35. In our judgment, BT's submissions must be rejected. The narrow interpretation of the powers of a national regulatory authority in the CRF which is proposed by Mr Thompson would undermine fundamental objectives of the CRF legislative regime and is contrary to the coherence of the scheme of the CRF.

36. Where a national regulatory authority imposes an SMP condition on a dominant provider in the market, as in this case, the imposition is intended to further the objectives of the CRF regime, to ensure that the dominant provider does not make inappropriate use of its market power to distort that market. The objectives of the CRF regime include promotion of fair pricing in the general public interest (covering both those who directly receive services from the dominant provider and pay it directly, as the CPs do here, and those who receive services the prices of which reflect what has been paid to the dominant provider, as the CPs' customers do) and specific protection of the rights of the direct customers of the dominant provider that the prices they have to pay properly reflect any SMP condition which has been imposed. In fact, the general public interest and the specific private interest of the direct customers (here, the CPs) run together.

37. Clearly, under the scheme of the CRF, where an SMP condition is imposed it is intended that it should be properly complied with by the dominant provider, since otherwise the objectives of the CRF regime will not be achieved. This is why SMP conditions are called "specific *obligations*" in Article 6(2) of the AuD, for example.

38. Similarly, Recital (15) of the AuD says that the conditions to be attached to a general authorisation "should be limited to what is strictly necessary to ensure compliance with requirements and obligations under Community law and national law in accordance with Community law": an SMP condition will not "ensure compliance" unless it is itself properly observed by the dominant provider.

39. Again, Article 10 of the AuD makes it clear that a dominant provider which is subject to an SMP condition must act in compliance with that condition. Article 10(1) imposes an obligation to provide information "to verify compliance" with such a condition. As in Article 6(2), Article 10(2) refers to an SMP condition as an "obligation", and it refers to "breaches" of that obligation by the undertaking subject to it, which the undertaking should "remedy". If the undertaking concerned "does not remedy the breaches", Article 10(3) provides that the national regulatory authority "shall take appropriate and proportionate measures aimed at ensuring compliance." This provision again indicates that an SMP condition is indeed an obligation which the undertaking must comply with; it also sets out a power in wide terms for the national regulatory authority to take action where it has been breached.

40. The importance of "compliance" with the obligations imposed under the CRF, including an SMP condition, is also indicated by Recital (32) of the FD. Article 8(2)(a) of the FD requires national regulatory authorities to promote competition by, *inter alia*, "ensuring that users … derive maximum benefit in terms of choice, price and quality" – an objective which would be undermined if a dominant provider subject to an SMP condition designed for that end could ignore it or was not properly incentivised to comply with it. See also Article 5(4) of the AD: national regulatory authorities are to be empowered to intervene "in order to secure the policy objectives of Article 8 [of the FD]".

41. Recital (14) of the AD also refers to "obligations" imposed on undertakings with SMP. Article 4(1) of the AD underlines the obligatory nature of compliance with an SMP condition: "… Operators shall offer access and interconnection to other undertakings on terms and conditions consistent with obligations imposed by the national regulatory authority …".

42. Article 13(1) and (3) of the AD refers to SMP conditions of cost orientation as "obligations". Article 13(2) provides that national regulatory authorities shall ensure that any pricing methodology which is mandated "serves to promote efficiency and sustainable competition and maximise consumer benefits", that is to say, shall ensure that it is effectively implemented to achieve those ends. Article 13(3) and (4) impose a burden of proof and obligations of provision of information on the dominant provider, in order to ensure effective policing of the compliance of the dominant provider with an SMP condition.

43. We have slightly laboured these points in order to answer BT's submission. We consider that it is obvious, under the scheme of the CRF, that SMP conditions imposed on a dominant provider are intended to be complied with.

44. Since SMP conditions are obligations for the dominant provider, and will only achieve their purpose if they are complied with, we consider that it is also obvious that under the CRF the national regulatory authority is empowered to take action to ensure that a dominant provider is properly motivated in economic terms to comply with such obligations. This means that the national regulatory authority is empowered under the CRF to take effective action in response to breaches of an SMP condition which lie in the past and which may only come to the attention of the authority (or to the attention of anyone detrimentally affected by them) some time after they have occurred. Were that not the case, a dominant provider would have an economic incentive to disregard an SMP condition in the hope that it might not be discovered, and knowing that even if its breach *was* eventually discovered, nothing could be done about it in so far as it had acted in breach of its obligation in the past.

45. It is because the regulator and other CPs or retail customers do not have ready access to the relevant information about the dominant provider's costs and the cost orientation methodology it uses, whereas the dominant provider does have that information, that Article 13(3) of the AD places the burden of proof about these matters on the dominant provider and also allows for national regulatory authorities to require it to provide full justification for its prices (and see Article 10(1) of the AuD). This is one practical recognition in the scheme of the CRF of what is an obvious imbalance of information in relation to relevant matters. The imbalance means that there is no guarantee that CPs, retail customers or regulators will detect failures by dominant providers to comply with their obligations under SMP conditions immediately after they occur. Therefore it is important that the CRF scheme allows for effective action to be taken if breaches of these obligations remain latent and undiscovered for a period.

46. Article 10(3) of the AuD sets out an obligation on a national regulatory authority to "take appropriate and proportionate measures aimed at ensuring compliance" with an SMP condition, which imports the power to take such action. A Member State may empower its national regulatory authority to impose financial penalties, as the UK has done by sections 94 to 96 of the 2003 Act. In our view it is clear from Article 10(2)

that in enforcement proceedings taken by a national regulatory authority on its own initiative, the authority may make a finding that the dominant provider "does not comply" with an SMP condition, and may require that provider to "remedy any breaches" so found. In context, the phrase "does not comply" means "is not in compliance with its obligations, now or in the past", hence the reference to remedying "any breaches" and "repeated breaches". Accordingly, the power in Article 10(3) includes a power to ensure compliance by providing a remedy and/or by imposing a penalty in respect of past breaches of an SMP condition which have come to light. In conformity with the CRF, sections 94 to 96 of the 2003 Act so provide. The reference to a "remedy" reflects the damage to the private interests of a CP or customer dealing with a dominant provider which has paid excessive prices because of that provider's non-compliance with an SMP condition, which as explained above run together with the public interest. The reference to financial penalties reflects the possibility that an award of a "remedy" may not fully reflect the public interest in securing compliance with a SMP.

47. Recital (32) and Article 20(1) of the FD contemplate that private parties like the CPs and BT here may engage in disputes with each other in connection with obligations imposed under the CRF (as does Article 5(4) of the AD), and Article 20(5) of the FD provides that the procedure for a national regulatory authority to resolve such disputes "shall not preclude either party from bringing an action before the courts". Thus the CRF contemplates that there may be a private action about matters such as excess charging in breach of an SMP obligation, which clearly may include claims for remedies in relation to breaches which occurred before the private law action was commenced. Section 104 of the 2003 Act provides for such an action to be brought if certain conditions are fulfilled.

48. Since the CRF contemplates that enforcement action taken by a national regulatory authority on its own initiative (including setting relevant remedies for breaches) may relate to past breaches of an SMP condition, and also that private law actions may do so, and having regard to the general objectives of the CRF regime for SMP conditions referred to above, it would be strange indeed if the dispute resolution procedure before a national regulatory authority could not deal with such matters. In fact, however, we consider that the language of Recital (32) and Article 20 of the FD points clearly to the conclusion that it can and does.

49. Recital (32) states that an aggrieved party in relation to a dispute relating to an area covered by the FD "should be able to call on the national regulatory authority to resolve the dispute" and that the authority "should be able to impose a solution on the parties." The language used is general, and there is no suggestion to be spelled out of it that only part of a dispute may be referred (i.e. that this procedure should not cover disputes about alleged breaches of an SMP condition which have occurred in the past) or that the "solution" imposed should not cover the entirety of the dispute. Indeed, it would not be a "solution" if it did not deal with the whole subject matter of the dispute. Further, the last sentence of Recital (32) states that in operating the dispute resolution procedure a national regulatory authority "should seek to ensure compliance with the obligations arising [under the CRF]", which for reasons given above requires that it take effective steps to grant a remedy for breaches of SMP conditions that have happened in the past and are now complained of by an aggrieved CP in the dispute. Article 5(4) of the AD supports this view.

50. This is all equally reflected in the language of Article 20. Article 20(1) provides that where a dispute is referred to it by an undertaking and is accepted by it the national regulatory authority "shall … issue a binding decision to resolve the dispute …". The dispute in question may include a dispute regarding past non-compliance with an SMP condition, and production of a binding decision to resolve that dispute requires the national regulatory authority actually to determine that dispute, granting an appropriate remedy for past over-payments resulting from a failure by the dominant provider to comply with an SMP condition. Article 20(2) uses the same language. Article 20(3) reinforces the point, since it provides that any obligations imposed to resolve a dispute "shall respect the provisions [of the CRF]", which include provisions requiring that the national regulatory authority shall ensure that effective measures are taken to ensure compliance: see, in particular, Article 10(3) of the AuD, Article 8 of the FD and Article 5(4) of the AD.

51. Mr Thompson for BT argued that there was no power set out in the CRF which would enable a national regulatory authority to award a remedy involving repayment of excessive charges made in breach of the SMP condition before the dispute was notified by a CP to BT, or perhaps to Ofcom. However, in our view, interpreting the CRF in line with the analysis above, the CRF plainly does create such a power, by one or a combination of any of Article 13(3) of the AD (as there is no reason to read the power of a national regulatory authority to "require prices to be adjusted" as confined only to requiring adjustment of prices for the future, and not in relation to the past); Article 8(1) and (2) of the FD, which state that national regulatory authorities have obligations, and so implicitly must have the powers to satisfy those obligations, and contrary to Mr Thompson's suggestion do not simply state general objectives with no separate power-creating force of their own; Article 5(4) of the AD, which states that national regulatory authorities must be empowered to intervene in order to secure the policy objectives of Article 8 of the FD; and, most particularly, Article 20 of the FD, for the reasons set out above.

52. Against this interpretation, Mr Thompson submitted that the absence of any reference to a limitation period in respect of the matters referred to a national regulatory authority under the dispute resolution procedure in Article 20 of the FD indicated that it (and the other provisions to which we have referred) could not relate to disputes about breaches of SMP conditions which occurred before notification by a CP of a dispute to BT, or perhaps to Ofcom. We do not agree. The CRF equally does not specify limitation periods in relation to enforcement action taken by a regulator on its own initiative, nor in relation to private actions between undertakings in the ordinary courts, yet these forms of proceeding may relate to past breaches of SMP conditions. In each case, the limitation on how far back in time it may be fair to go is given by general principles of EU law, including in particular principles of proportionality and effectiveness in the former and principles of effectiveness and non-discrimination in the latter. In relation to the principles of proportionality and effectiveness of remedy, the impulse to make awards in relation to very old breaches may well be found to be diminished by effluxion of time, and may be qualified at some point by other principles of EU law such as the principle of legitimate expectation. It is not necessary for us to spell out precisely how these principles would operate in this sort of situation, as no limitation defence was put forward by BT before Ofcom or the CAT. What is significant is that the EU legislator has considered that such general principles of EU law are a sufficient control in relation to action being taken in

relation to excessively stale claims; and therefore there is no reason to infer from the absence of a statement of a limitation period in respect of disputes referred to a national regulatory authority that the intention was that it should not have power to deal with historic breaches of an SMP condition in the course of resolving the dispute referred to it by the aggrieved undertaking.

53. It is clear that section 190(2)(d) of the 2003 Act confers a power on Ofcom, when it resolves a dispute referred to it, to order repayment of amounts overpaid by CPs as a result of past breaches by BT of the SMP condition in issue. As we have set out above, that is in conformity with the provisions of the CRF.

54. For these reasons, we dismiss BT's prospective regulation ground of appeal.

BT's legal certainty ground: Ground 2 in BT's appeal

55. There are two aspects to this ground of appeal. BT complains (1) that Ofcom was wrong in its Determination to disallow BT's use of a cost orientation methodology involving an aggregation of certain elements of its costs to a greater degree than the DSAC solution required by Ofcom, and (2) that Ofcom was wrong to require cost orientation by reference to annual periods, as compared with three year periods which BT would prefer.

56. Point (2) can be shortly disposed of. Section 195(2) of the 2003 Act provides that where the CAT disposes of an appeal from Ofcom, "The Tribunal shall decide the appeal on the merits and by reference to the grounds of appeal set out in the notice of appeal". BT failed to include point (2) in its notice of appeal to the CAT. Mr Thompson showed us a passage in BT's reply which appeared to refer to the point, but no application was made to the CAT for permission to amend BT's notice of appeal. Unsurprisingly, the CAT did not address this point in its judgment. It had no power to do so. Surprisingly, this is made a point of criticism of the CAT by BT. In our view, the criticism is misconceived.

57. The rule in section 195(2) is there for good reason. As even our limited review of the case over the four day hearing of this appeal has underlined, in complex competition cases like this the CAT can be confronted with a great deal of elaborate expert economic evidence and very extended, intricate legal submissions, not always clearly focused on the issues falling for determination by the CAT. It is important that the CAT can have confidence in the pleaded issues in the grounds of appeal set out in the notice of appeal as the relevant definition of the matters it has to decide, so as to maintain proper focus in its deliberations and in framing its judgment. The CAT has rightly in this case worked through the grounds in BT's notice of appeal and not strayed beyond them.

58. We turn to point (1). BT's submission here is that condition HH3.1 cannot be given effect in the way in which Ofcom determined it should be given effect, with justifications being available for connection fees and rental charges separately. BT contends that HH3.1 did not give fair notice that such an approach would be required. It also says that Ofcom gave indications over the years that it would regard other methods of demonstrating cost orientation as acceptable.

59. We reject BT's submissions under its legal certainty ground. The CAT's judgment at [122]-[148], where it rejected this ground, cannot be faulted. In our view, the starting point and, in reality, the finishing point in relation to this ground is the proper interpretation of condition HH3.1. It provided in terms that BT was subject to an obligation to secure that "each and every charge offered, payable or proposed for Network Access covered by Condition HH1 is reasonably derived from the costs of provision …". We agree with the CAT's ruling at [125] that Condition HH3.1 is clear on its face on this issue and that BT could and should have understood from it that when setting separate charges for connections and rentals, it was under an obligation to ensure (and to be able to demonstrate) that each of those charges was cost orientated. The cost orientation approach applied by Ofcom respected this principle. The principle of legal certainty was fully respected in Ofcom's Determination.

60. Indeed, in our view the principle of legal certainty is strongly against BT's submissions on this ground of appeal. If it was dissatisfied with Condition HH3.1, as imposed by the 2004 LLMR, it had a right of appeal to the CAT to dispute that it was a lawful condition, including by reference to the principle of legal certainty. It did not. Condition HH3.1 therefore took effect both as a statement of obligation in relation to BT and also as a statement of enforceable rights on the part of the CPs and others: see the provisions of the CRF and the 2003 Act referred to above, in particular section 104, which identify an SMP condition as an obligation of a dominant provider giving rise to rights of CPs and retail customers which they can seek to enforce. The principle of legal certainty therefore requires that Condition HH3.1 be given effect according to its proper interpretation, which is what Ofcom and the CAT have done.

61. BT cannot step outside this very straightforward analysis, as Mr Thompson sought to do, by pointing to other indications of a different approach which might be adopted by Ofcom in some other contexts, for three reasons. First, the other indicators on which Mr Thompson sought to rely do not affect the proper interpretation of Condition HH3.1, which as explained above is clear and is the governing issue on this ground of appeal. Ofcom only had to decide itself what cost orientation methodology should be used once it emerged that BT had been acting in breach of its obligations under Condition HH3.1 over a considerable period, which was not something Ofcom could have anticipated when it imposed Condition HH3.1. BT's own breach of its obligations necessitated an independent exercise of evaluative judgment by Ofcom as to the appropriate cost orientation methodology, as was an entirely predictable effect of the application of Condition HH3.1 in such circumstances. Ofcom had made no statement about how it would exercise its judgment in the case of a breach by BT of its obligations under Condition HH3.1, so it was foreseeable that Ofcom would exercise its judgment as it thought appropriate, within the proper ambit of what was set out in Condition HH3.1 itself. This is what Ofcom did.

62. Secondly, as the CAT noted at [126]-[130], BT does not suggest that Ofcom's approach in the Determination breached any legitimate expectation on BT's part, on which it relied in setting its charges. Condition HH3.1 gave BT some leeway to use a cost orientation methodology of its own choosing, so long as it was directed to justify "each and every charge" on a sufficiently individuated basis, which it could demonstrate as justifiable to the satisfaction of Ofcom. But BT made no attempt to do so, preferring to use a portfolio cost orientation methodology which, when challenged, was incapable of satisfying Ofcom as an appropriate methodology for use under

Condition HH3.1 and which BT did not seek to defend on its appeal to the CAT: [128] (save only in relation to 2006/2007, but the CAT gave particular reasons at [132]-[142] why BT's case in relation to that period was dismissed, in relation to which there is no appeal to this court). Therefore it fell to Ofcom to determine for itself the appropriate cost orientation methodology which should be applied on a properly individuated basis. Ofcom applied a DSAC methodology which was appropriately fact-sensitive, which the CAT characterised as "an entirely acceptable approach, within the regulatory judgment of Ofcom," with which the CAT should not interfere ([146] and [148]). We agree. As will appear from our determination of TalkTalk's appeal below, we do not consider that any submission in that appeal undermines this conclusion.

63. Thirdly, the extraneous materials to which we were taken by Mr Thompson did not contain any indication of how Ofcom would apply Condition HH3.1 if BT completely failed to respect its obligations under that provision, as it did. In fact, they did not even contain any indication, or at any rate any clear indication, of what cost orientation methodology Ofcom would expect BT to devise itself when setting out its own justification of "each and every charge" under Condition HH3.1.

64. According to the witness statement of Karen Wray for BT, dated 17 February 2013, paras. 44-61, BT provided Ofcom with some information about its costs in 2007, but Ofcom did not say anything to indicate what its own position might be. In Ofcom's consultation document for the BCMR, Ofcom stated at para. A12.21 of Annex 12 that "In principle a range of prices could be consistent with BT complying with its cost orientation obligations …". Mr Thompson took us to para. 5.90 of Ofcom's Leased Lines Charge Control Statement issued on 2 July 2009, in which Ofcom said it had estimated price cuts for certain BES services using a particular DSAC methodology and a three year period, but it stated in terms that this was "without prejudice to cost orientation" (i.e. BT could not rely on this as an indication of Ofcom's approach to cost orientation under Condition HH3.1). The point was repeated at para. 5.94. Mr Thompson also took us to an Ofcom determination of 14 October 2009 in relation to a dispute regarding BT's charges for partial private circuits, at paras. 5.91 and following. But this did not state that any particular DSAC methodology would be used by Ofcom for the purposes of application of Condition HH3.1. Instead, it emphasised how fact-specific and non-mechanistic Ofcom's approach had been in the context of that determination.

65. For these reasons, we dismiss BT's appeal on BT's legal certainty ground.

The Interest Issue: Ground 3 in BT's appeal

66. It is relevant to set out Ground 3 in BT's appeal, which is as follows:

> "The Tribunal erred in law when allowing the appeal of the appellants in Case 1206/3/3/13 and in Case 1207/3/3/13 (for interest to be awarded) and directing Ofcom (contrary to the Determination) to order BT to pay interest on the amounts of the repayments in paragraph 3 of Annex 1-5 of the Determination (as adjusted), in that
>
> (A) Ofcom had no jurisdiction under section 190(2), Communications Act 2003 to direct BT to pay interest on such sums; and/or

> (B) The Tribunal declined to have any, alternatively any proper, regard to Clause 12.3 of the contract between the respective parties, which term was an agreed term that had governed their commercial relationships for 8 years prior to Ofcom's Determination and which term provided for no interest to be paid in the event of Ofcom making an award for repayment by any of the parties."

The procedural history of these issues before the CAT

67. It is necessary to say something about the procedural history of these issues which is dealt with in detail in the judgment of the CAT at [280] – [285]. In its Determination, Ofcom decided not to award interest on the amount of the overcharge required to be repaid. Ofcom noted that the Disputing CPs had not previously brought a dispute or complaint regarding clause 12.3, although it had been in place for some years, and concluded that "the Disputing CPs have not provided strong and compelling evidence that clause 12.3 is not fair and reasonable such that we should intervene in the light of our regulatory objectives to set it aside" (Determination, para. 15.144). On appeal to the CAT the CPs lodged, with their notices of appeal, evidence concerning the circumstances of the negotiation of the contracts for the provision of BES and WES, maintaining that they had little choice at the time but to accept clause 12.3. Ofcom accepted that the CAT should have regard to this fresh evidence in considering whether interest should be awarded on the amount of repayment and anticipated that BT might wish to file evidence in reply. On that basis Ofcom expressly did not put forward any view on whether interest should or should not be awarded.

68. BT filed evidence giving its own account of the negotiations that led to clause 12.3. However, by its Statement of Intervention in the appeals of Sky/TalkTalk and the Altnets it maintained that Ofcom did not have jurisdiction to award interest under section 190(2)(d). In the alternative, if Ofcom did have such jurisdiction, BT supported Ofcom's decision in the Determination not to make such an order in this case. In its skeleton argument for the hearing of the appeals, dated 11 October 2013, Ofcom disputed BT's submission that it lacked jurisdiction to order interest but did not address the challenge to its decision not to make such an award.

69. On 25 October 2013, a few days before the start of the hearing of the appeals before the CAT, Ofcom issued its Determination in a dispute referred to it by Gamma and BT regarding the provisions in BT's standard interconnection agreement ("SIA") that specified the interest rate applicable to any repayments required between the parties as a result of a direction by Ofcom. Ofcom there made a declaration under section 190(2)(a) that the interest terms and the SIA were not fair and reasonable insofar as they related to payment of interest where Ofcom had made a Determination directing payment under section 190(2)(d). In an annex to that Determination, Ofcom gave guidance on the approach it would adopt to interest in the context of resolving the dispute. In opening Ofcom's case before the CAT in the present case, Mr Saini QC for Ofcom stated that Ofcom no longer sought to support the reasoning in the Determination in the present case concerning interest but submitted that the correct approach was that which it had set out in the Gamma Determination. Beyond that Ofcom made no submissions on that issue.

The decision of the CAT

70. In its judgment the CAT concluded that Ofcom had jurisdiction under section 190(2)(d) to make a direction in respect of interest. As to whether it was appropriate to make such a direction in the circumstances of the present case, the CAT considered that clause 12.3, on its proper construction, purported to exclude payment of interest, but ruled that if the provision were applied with that effect it would be inconsistent with the achievement of the relevant regulatory objectives under the legislation. It distinguished the observations of Lord Sumption in the *08x Numbers case* on the ground that that case was concerned with a competitive market, and concluded, applying the guidance in the Gamma Determination, that it was appropriate to award interest in the circumstances of this case. The CAT therefore made a *de novo* decision as to whether the direction under section 190(2)(d) should have included an award in respect of interest and remitted the matter to Ofcom to determine the appropriate rate and period of interest.

The appeal to the Court of Appeal

71. BT now appeals to this court on the grounds that Ofcom had no jurisdiction under section 190(2) of the Communications Act 2003 to direct BT to pay interest on the repayments ordered (Ground 3A) and that, in determining whether to make a direction to pay interest on the sums to be repaid the CAT failed to have proper regard to Clause 12.3 of the contracts between BT and the respective CPs (Ground 3B). BT submits on Ground 3A that section 190(2) does not expressly or impliedly give Ofcom the power to award interest and that there is nothing in the CRF which requires interest to be payable. BT submits on Ground 3B that the CAT's rejection of Clause 12.3 as having any relevant weight was a clear error of law.

72. Ofcom adopts the reasoning of the CAT on the issue of its jurisdiction to order the payment of interest and maintains its position of making no submissions on the issue of whether an award of interest should be made in these cases.

73. The Altnets submit that Ofcom has jurisdiction to make a direction in respect of interest and that the CAT did not err in law in finding that the relevant regulatory objectives, and in particular the desirability of avoiding any incentive to overcharge, were best met by such a direction. Furthermore, they submit that the CAT did not err in law in finding that the parties' contractual agreement regarding the payment of interest should be accorded minimal weight in the circumstances of these particular disputes.

74. The Altnets further submit, by way of respondent's notice, that on their proper interpretation the contractual terms agreed between the Altnets and BT had no bearing on Ofcom's power, or the exercise of that power, to award interest to the Altnets in this case.

75. BT has objected that it is not open to the Altnets to raise this issue on this appeal as it was not raised before the CAT.

76. Sky and TalkTalk adopt the submissions of the Altnets on Ground 3A and 3B and make further arguments in support thereof.

Ground 3A: Ofcom had no jurisdiction under section 190(2) of the Communications Act 2003 to direct BT to pay interest on the repayments ordered.

BT's submissions

77. BT's submissions on this issue may be summarised as follows:

(1) Nothing in the 2003 Act expressly gives Ofcom the power to award interest.

(2) There is no basis to imply such a power. On the contrary, section 190(1) expressly seeks to confine Ofcom's powers. This reinforces the need to adopt a restrictive approach against reading implied powers into the statute.

(3) Parliament has historically always included express powers to award interest where it has intended that such a power should exist. Failure to include such an express provision raises a further strong presumption against an implied power.

(4) The language of section 190(2)(d) demonstrates that Parliament only intended an "adjustment" of BT's prices and what had already been paid, not the award of a further, ancillary sum which was both distinct from the price and had never previously been paid.

(5) BT accepts that the 2003 Act must be construed in light of the CRF. However nothing in the CRF requires that interest be payable. On the contrary, the language of the CRF is restrictive, emphasising that a national regulatory authority's powers are strictly limited to those provided for in the CRF itself. Neither Article 8 nor Article 20 of the FD gives any free standing right to impose interest.

(6) The reasoning of the CAT in relation to a purposive construction and avoiding inconsistency is flawed.

The Altnets' submissions

78. On behalf of the Altnets, Ms. Rose QC submits that the CAT was correct to hold that section 190(2) grants Ofcom a power to direct that a party which has levied an overpayment should repay a sum which reflects both the principal figure and an amount in respect of interest. Such a power is provided for by the ordinary language of the statute and that interpretation is supported by the statutory purpose. It contributes to the effectiveness of the regulatory regime by ensuring that parties do not have an incentive to overcharge.

The interpretation of section 190(2)

79. In our view, the express words of section 190(2)(d) in their natural meaning - "to give a direction … requiring the payment of sums by way of adjustment of an underpayment or overpayment" - are clearly wide enough to confer on Ofcom a power to direct the payment of interest on sums overpaid. As the CAT pointed out, where, in a commercial setting, one party has held for a time a sum of money which it was not entitled to hold, the time value of money is part of the benefit obtained. If the permitted adjustment excludes the power to direct the payment of interest, the adjustment can be only partial. It is difficult to see any sensible reason why the

contemplated "adjustment" should be limited to the principal sum overpaid. The word "adjustment" has a broader meaning than simple repayment of the face value of the undercharge or overcharge. The principal sum and its time value are integral parts of the "overpayment", and in any event in this commercial setting the word "adjustment" is apt to cover what needs to be paid back to reflect the real economic value of the overcharge, namely principal and the interest necessary to reflect the time value of that money.

80. Contrary to the submission on behalf of BT, we can see no justification for limiting the meaning of "adjustment" to that which it might bear in the context of a national regulatory authority's *ex ante* powers. Here BT draws attention to Article 13(3) of the AD which states that a national regulatory authority "may, where appropriate, require prices to be adjusted" and section 87(9)(d) of the 2003 Act which provides that authorised SMP conditions include "obligations to adjust prices". This does not, however, support BT's case. It may be that in the circumstances of an *ex ante* direction to amend prices no issue of interest can arise. That, however, cannot have the effect of limiting the scope of that term when used in a context in which the issue does arise. There is nothing inherent in the word "adjustment" which limits it in the manner suggested.

81. On behalf of BT it is submitted that the words "by way of adjustment of an underpayment or overpayment" would be naturally understood as referring to the opening words of the sub-paragraph – "for the purpose of giving effect to a determination by Ofcom of the proper amount of a charge in respect of which amounts have been paid" – and that the adjustment therefore relates to the amounts actually paid and not a sum intended to reflect loss of use of an amount previously paid. However, as Ms Rose QC points out, the error of this approach is that Ofcom's power is a power to direct the payment of sums by way of adjustment of an overpayment, not a power to direct the repayment of "amounts actually paid".

82. In common with the CAT we do not find any additional support for our reading of this provision in the use of the plural "sums". This may or may not be intended to refer to principal and interest and there are undoubtedly other situations in which a single dispute could give rise to a direction to pay sums. Nevertheless, the plain meaning of the sub-section is clear.

83. Our reading of section 190(2)(d) is confirmed by the purpose of the provision. That is stated by the sub-paragraph itself to be to give effect to a determination by Ofcom of the proper amount of a charge in respect of which amounts have been paid. If Ofcom lacked the power to direct a payment in respect of interest, there could only be partial rectification of the situation and the provision would be incapable of ensuring compliance with SMP cost orientation obligations. Furthermore, if there were no power to make a direction in respect of interest, this would be an incentive to overcharge in the knowledge that a direction under this provision could not reflect the time value of the benefit received as a result of the overcharging.

84. This reasoning is sufficient to deal with BT's Ground 3A, since BT accepts that there is nothing in the CRF which *precludes* a Member State from legislating for its national regulatory authority to have a power to award interest in the present context. However, in our view there is a further compelling reason why Ground 3A must be rejected: a reading of section 190(2)(d) which permits a direction in respect of interest

is in fact *required* by the Directives which the statute is intended to implement. Recital (32) to the FD provides that in the event of a dispute between undertakings a national regulatory authority should be able to impose a solution on the parties and that the intervention of a national regulatory authority should seek to ensure compliance with the obligations arising under the Directives. Article 20(3) of the FD requires that the national regulatory authority shall take decisions aimed at achieving the objectives set out in Article 8. Article 8 requires Member States to ensure that in carrying out the regulatory tasks specified in the Directives national regulatory authorities take all reasonable measures which are aimed at achieving the stated objectives. Those objectives include promoting competition by ensuring that users derive maximum benefit in terms, inter alia, of price. A provision which did not permit a direction in respect of interest would only imperfectly give effect to the purpose and requirements of the Directives. As explained above in relation to BT's prospective regulation ground, the national regulatory authority must be able to resolve the entirety of a dispute in a manner compatible with the Directives. It must, therefore, be given the power to make a direction in respect of interest where that is appropriate in order to give effect to the policy of the Directives.

85. In the course of her oral submissions, Ms Rose drew attention to the practical deficiencies of a scheme of dispute resolution which did not permit a direction in respect of interest. Under the agreements between BT and the CPs, BT had the power to impose a price increase on 90 days' notice, subject to a contrary order by Ofcom. However, whether BT, in imposing a price increase, was complying with its obligations under condition HH3.1 is a matter which could not necessarily be detected by CPs at the time the price increase was imposed. Whether the prices were excessive would depend on BT's costs which can only be assessed in retrospect. BT's costs should become apparent, in due course, from BT's regulatory financial statements which it was required to produce not later than four months after the end of each financial year, although the figures were subject to adjustment thereafter. There would, therefore, be likely to be a considerable time lag between a price increase and the ability to refer a dispute to Ofcom. In the absence of a power to make a direction in respect of the time value of sums found to have been overpaid, the statutory scheme would be deficient in that it could never achieve full redress for those who have suffered the consequences of BT's breach of its obligations.

86. In the course of his submissions on the interest issue, Mr Read QC for BT developed a submission to the effect that prior to the decision of the House of Lords in *Sempra Metals Ltd. v. Inland Revenue Commissioners* [2007] UKHL 34; [2008] 1 AC 561 it must have been the perception of Parliament in enacting legislation such as the 2003 Act that unless legislation expressly provided for an award of interest the courts might not award it. Parliament had, therefore, expressly legislated on frequent occasions to provide for the recovery of interest because, otherwise, such interest might not be recoverable. Accordingly, it is suggested, the absence of an express power in section 190(2)(d) to make a direction in respect of interest demonstrates that that was not intended. Mr Read also bolstered his argument by referring to section 29(8) of the 2003 Act, which makes express provision to impose a requirement on Ofcom to pay interest on certain "amounts outstanding" which it owes the Secretary of State.

87. It seems to us, however, that the significance of *Sempra Metals* is that it brought to an end the unprincipled exception, in the case of interest losses by way of damages for

breach of contract to pay a debt, to the common law rule that damages are recoverable for losses caused by a breach of contract or tort. We do not consider that prior to *Sempra Metals* there was a general rule that interest was not recoverable in the absence of an express statutory provision. Similarly, in common with the CAT, we do not find any assistance in this regard in the other statutory provisions addressing entirely different situations to which counsel for BT have referred us. In any event, the language, purpose and context within the CRF of section 190(2)(d) make clear that such a power is conferred here.

88. Nor do we consider that section 29(8) assists BT on this issue. It is drafted in different language and applies in a different context from section 190(2)(d). It provides no answer to the reasoning we have set out above regarding the proper interpretation of section 190(2)(d).

89. Mr Read submits that the CAT has, in effect, implied a power to award interest in order to reinforce the deterrent effect of the repayment obligation provided for in section 190(2)(d) in cases of breach of an SMP condition. He submits that this involves an error of statutory interpretation because section 190(2)(d) is a provision of general application that is not limited to cases of overcharging in breach of an SMP condition. Accordingly, he submits, it would be wrong to supplement its construction by reference to a purpose that has no application to a substantial proportion of disputes equally subject to that provision. However, we do not consider that this is an implied power. Rather, the express terms of section 190(2)(d) are broad enough in their natural meaning to permit a direction which makes an adjustment in respect of the time value of an overpayment in an appropriate case. The fact that section 190(2)(d) also applies in other situations cannot be an objection to an approach which gives effect to the natural meaning of the provision and contributes to achieving the purpose of the legislation.

90. Finally in this regard we note, as did the CAT, that under section 190(2)(b) it would be open to Ofcom to give a direction fixing a term in a contract between BT and a CP as to BT's obligation to pay interest in the event that Ofcom found that there had been an overpayment. The CAT considered that if such a provision could be made prospectively for the payment of interest in that event it would be surprising if, in the absence of such a direction, Ofcom would be precluded from making a direction in respect of the payment of interest after the event. On behalf of BT, Mr Read submits on this appeal that this is a fallacious argument because it confuses the power to set conditions prospectively with a power to direct the payment of interest after the event. This reflects the more general submission by BT as to the regulatory scheme and its prospective effect which we consider to be unfounded, as explained above. The reality of the scheme established by the CRF is that its purpose requires that there be a power to make both prospective and retrospective directions in respect of interest. The words of the implementing statute are entirely apt to achieve that result. We agree with the CAT that the statute cannot have been intended to produce the inconsistent position for which BT contends. We also agree with the CAT that in this case it is appropriate to award interest in order to give proper effect to the legislative scheme and the relevant SMP condition, Condition HH3.1.

Ground 3B: The CAT failed to have proper regard to Clause 12.3

91. Ground 3B is concerned with the question whether, if the CAT had jurisdiction to make a direction in respect of interest under section 190(2)(d), it erred in doing so because it failed to take proper account of Clause 12.3 in the relevant contracts, set out in paragraph 13 above.

Is it open to the Altnets to take the point in their respondent's notice?

92. On 2 September 2015 the Altnets lodged a respondent's notice in which they invite this court to uphold the order of the CAT in relation to the matters the subject of Ground 3 on the alternative ground that Clause 12.3 does not on its proper construction apply to the circumstances of this case. They submit that the clause is concerned solely with what is contractually due between the parties and not with what Ofcom might decide to order on a dispute resolution. This matter was raised in the Altnets' skeleton argument before the Court of Appeal and included in the agreed list of issues to be determined by this court.

93. Late on the fourth and final day of the hearing Mr Read, on behalf of BT, submitted for the first time that it was not open to the Altnets to advance their submissions on this point because they had not raised this issue in their Notice of Appeal to the CAT. He sought to rely on section 195(2) of the 2003 Act, which as observed above had been prayed in aid by Ofcom in answer to part of BT's legal certainty ground. As there was no time to hear argument on this point in relation to the Altnets' respondent's notice, we invited further written submissions.

94. It is implicitly accepted by the written submission on behalf of the Altnets that the issue now contained in the respondent's notice was not raised as a clear distinct point in their Notice of Appeal, their Reply or their skeleton argument before the CAT or, to the extent that this was a matter for evidence, in any of their witness statements or expert reports. Nevertheless, it is clear that the issue was squarely raised before the CAT. It was raised by Ms Rose in her oral opening on Day 1 when it was expressly confirmed in answer to questions by the Chairman that the Altnets were taking this point (Transcript, Day 1, pp. 93-4). The point was then raised by Ms Rose with Mr Ewbank of BT, in the course of his evidence, and in the Altnets' written and oral closing submissions before the CAT (Transcript, Day 13, pp. 45-8).

95. None of the other parties raised any objection to the point being taken before the CAT. Had they done so, there would have been room for debate as to whether the point fell within the scope of Ground 1 advanced by the Altnets before the CAT, namely that "Ofcom erred in law and/or in the exercise of its discretion in failing to award interest" within which ground the Altnets had advanced several arguments why no weight should be attached to the express terms of clause 12.3. We note that the Competition Appeal Tribunal Rules 2003 (2003 No. 1372), the rules then in force, provided in Rule 8(4) that the notice of appeal shall contain "a summary of the grounds for contesting the decision, identifying in particular … a succinct presentation of the arguments supporting each of the grounds of appeal". It is debatable whether this is a new argument or a new ground. Had it been necessary, the CAT might well have granted permission pursuant to Rule 11(3)(c) to amend the Notice of Appeal to add this point as a new ground on the basis of exceptional circumstances. The point was raised at the outset of a long hearing and is inextricably

connected to the other arguments as to the effect of clause 12.3. The argument about the true interpretation of clause 12.3 is a pure point of law arguably within the scope of Ground 1. In substance, the CAT treated it as covered by the Altnets' existing grounds in their Notice of Appeal without requiring any amendment of those grounds, and in our view it was entitled under section 195(2) to proceed in that way. Accordingly, we consider that it is now far too late for BT to take this pleading point for the first time.

The scope of clause 12.3

96. We consider that the Altnets' submission as to the scope of clause 12.3 is correct. The clause makes contractual provision in respect of interest. The first sentence creates a contractual entitlement to interest, pursuant to the Late Payment of Commercial Debts (Interest) Act 1998, on a refund. The second sentence creates an exception. If a charge is recalculated or adjusted with retrospective effect by Ofcom in the manner described, the parties agree that interest will not be payable on any amount due as a result of that recalculation or adjustment. However, this is concerned solely with the contractual provision for the payment of interest and does not address at all the power of Ofcom to include a direction for interest in any award. That is a matter within the jurisdiction of Ofcom and a matter for Ofcom to determine in accordance with its statutory duties and objectives. The clause does not seek to preclude the parties from seeking an order from Ofcom that interest should be awarded as part of a direction following overpayment in order to reflect the time value of the sums paid. Indeed, that would be a most unusual provision and one open to challenge on grounds of public policy as attempting to fetter the powers of the regulator. In our view, the second sentence of the clause excludes a repayment direction by Ofcom from the contractual provision for interest and, as a result, avoids a situation in which interest would be payable on interest in a case where Ofcom has made a direction in respect of interest. In fact, therefore, on its proper construction, in the circumstances covered by the second sentence, clause 12.3 is intended to leave the question of interest to the regulator without the contractual arrangements regarding interest impinging on the regulator in any way at all.

97. For this reason, we consider that clause 12.3 has no bearing on the issue whether Ofcom should have made a direction in respect of interest. Ofcom erred in failing to appreciate this, and since there were powerful reasons for requiring the payment of interest in order to give proper effect to the regulatory scheme and the relevant SMP condition the CAT was clearly correct to hold that interest should be paid, even though it arrived at the conclusion by different reasoning. Nevertheless, it is appropriate to say something about the basis on which the CAT decided this matter.

The CAT's decision on Clause 12.3

98. The CAT approached this issue on a different basis, namely that clause 12.3 on its true construction purported to limit the circumstances in which it was open to Ofcom to make a determination in respect of interest as a result of a recalculation or adjustment. When approached on this basis, the decision of the Supreme Court in the *08x Numbers case* became of central importance to the competing submissions of the parties.

99. Before the CAT BT relied heavily on statements by Lord Sumption JSC in that case, with whose judgment the other members of the Supreme Court agreed, that the scheme of the Directives was essentially permissive in character and that it reflected the consistent emphasis in the Directives on respecting freely negotiated interconnection terms in a competitive market. Lord Sumption considered that when Ofcom was resolving a dispute about a proposed variation of charges under an existing agreement, it was performing a mixture of adjudicatory and regulatory functions and that the terms of the interconnection agreement were the necessary starting point for that process (at [33], [34]). In the present case before the CAT, BT submitted that, in the same way, considerations of commercial certainty required that clause 12.3 should prevail.

100. The CAT rejected that submission and distinguished the *08x Numbers* decision. We consider that it was correct to do so. As it explained, the present case concerns a dispute of a wholly different nature from those described by Lord Sumption. The present case is concerned with whether a party subject to an SMP obligation had complied with that obligation. Since the SMP obligation had been imposed pursuant to Ofcom's regulatory function, Ofcom was clearly exercising a regulatory function when resolving a dispute which concerned the proper interpretation and application of that obligation. The CAT continued:

> "Ofcom's determination of that question does not involve consideration of any terms agreed between the parties. It is only once that determination has been made, and Ofcom considers what direction to make under section 190(2)(d) for the purpose of giving effect to the determination, that the contractual terms agreed between BT and the disputing CPs are engaged. However, since the primary determination regarding compliance with the SMP obligation is the exercise of a regulatory role, we consider that in deciding what direction to make under section 190(2)(d) to give effect to that determination, Ofcom is also exercising primarily a regulatory function." (at [297])

101. Referring to Recital (32) of the FD, it considered that the question of whether or not to direct a payment of interest should therefore be determined according to what will best ensure compliance with the SMP obligations imposed under Article 13 of the AD and promote the objectives of Article 8 of the FD. It accordingly accepted the submission of the CPs that, in the circumstances of this case, clause 12.3 and the maintenance of commercial certainty were relevant only to the extent that they fed into these central objectives of the CRF.

102. The CAT noted that Lord Sumption's observation that there was a clear presumption in favour of respecting freely negotiated interconnection terms had been made expressly in relation to a competitive market. This was supported by his reference to Recital (5) of the AD which addressed the position "in an open and competitive market" and which should be contrasted with Recital (6) which refers to "markets where there continue to be large differences in negotiating power between undertakings, and where some undertakings rely on infrastructure provided by others for delivery of their services." Unlike the situation in the *08x Numbers case*, BT enjoyed SMP in the AISBO market at the time it entered into the contracts with the disputing CPs. Accordingly, the AISBO market was not a competitive market and the CAT did not consider that the *08x Numbers case* indicated any presumption in favour of the contractual provision in this case.

103. Although we differ from the CAT in our conclusion as to the scope and effect of clause 12.3, we consider that the CAT was correct in distinguishing the observations of Lord Sumption in the *08x Numbers case* on the significance of the contractual agreement. Those observations have no application in the circumstances of the present case.

104. Furthermore, we consider that, even on the assumption (which, as set out above, we consider is incorrect) that clause 12.3 bore the interpretation given to it by the CAT, the CAT was correct in its conclusion that the direction should have made provision for interest. As we have seen, the CAT concluded that the question of whether or not to direct a payment of interest should be determined according to what will best ensure compliance with the SMP obligations imposed under Article 13 of the AD and promote the objectives of Article 8 of the FD. It referred to the Gamma Determination in which Ofcom set out (at para. 3.15) three key potential objectives which an award of interest might seek to achieve:

(1) To avoid CPs having an incentive to set charges that are unduly high;

(2) To avoid CPs having an incentive to delay submitting disputes;

(3) To avoid distorting CPs' incentives to invest.

The CAT in the present case examined each of the three in turn. With regard to (1), it concluded that the incentives on BT were inadequate in this case and that the additional incentive to avoid overcharging that an award of interest provided was entirely appropriate. With regard to (2), it found that the prospect of interest had not operated as an incentive to delay referring the disputes to Ofcom. With regard to (3), it rejected BT's submissions as theoretical speculation wholly unsupported by any evidence. In the view of the CAT, not only did BT have SMP in the market for Ethernet services, but any consideration of commercial certainty was of minimal significance, given the fact that the conduct of BT indicated that it felt little incentive to comply with its cost orientation obligations in the pricing of its BES and WES products. The CAT had no doubt that the determination should therefore have included a direction to pay interest. There has been no challenge to this part of the reasoning of the CAT with which we agree.

Conclusion on the interest issue (BT's Ground 3)

105. For these reasons Ground 3 in BT's appeal will be dismissed.

TalkTalk's appeal: The DSAC Issue

106. This appeal is about the appropriate way to treat common costs under Condition HH3.1. The parties helpfully agreed that the issue on this appeal could be expressed in interrogative form as follows:

> Did the Tribunal err in law in finding that DSAC (distributed stand alone cost) was a sufficient cost test to apply in order to satisfy Condition HH3.1, properly construed?

107. As already stated, Condition HH3.1 provides:

> Unless Ofcom directs otherwise from time to time, the Dominant Provider [BT] shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition HH1 is reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed.

108. It is common ground that, when Condition HH3.1 was imposed, BT had a system for determining its costs on a LRIC basis and then determined a basis for determining common costs, which it instituted and reported to Ofcom.

109. Importantly, Ofcom and BT agreed that Condition HH 3.1 imported a cost standard based on DSAC, whereby BT was entitled to recover, with respect to each category of Ethernet services (i.e. the different services for BES, WES and mainlink), an appropriate mark up for the recovery of common costs based on the stand alone costs of Ethernet services, including recovery of the common costs of BT's overall business. The effect would be, were this approach adopted for BT's overall business, to allow multiple recovery of BT's costs that were common to that overall business. If BT had, instead, chosen an approach such as EPMU, it would have allocated only the due proportion of those common costs to each service and thus chosen a rate for which FAC could be a proxy.

110. Mr Meredith Pickford appears for TalkTalk, which is one of the communications providers to whom BT, through its Openreach division, sells wholesale Ethernet services. These services are provided in the wholesale AISBO market.

111. As we explain in more detail below, Mr Pickford submits that the multiple recovery of common costs could not be an "appropriate mark up" for the recovery of common costs within the meaning of Condition HH3.1. TalkTalk submits that there should be a FAC-based approach and that BT's charges across its Ethernet services generally should not exceed in aggregate FAC for all those services. If this approach had been adopted, there would have been a higher level of overcharge recoverable by the CPs.

112. TalkTalk's appeal has considerable attraction on its face. It is very doubtful whether multiple recovery of common costs would be permitted in other costs calculations, for example, for tax purposes or accounts that are required to show a true and fair view. But that was not the objective here, and we need carefully to consider the explanation for allowing recovery in this way and whether the wording permits it.

113. The place for us to start is the judgment of the Tribunal, and after that the submissions of the parties. Once we have done that we will set out our conclusions on this appeal.

Decision of the Tribunal on this issue

FOUR MEASURES OF COST

114. The Tribunal noted that there were four relevant measures of cost: LRIC, DSAC, SAC and FAC. Ofcom defined each of these measures in its Determination as follows:

> **Incremental cost** is the cost of producing a specified additional product, service or increment of output over a specified time period…. Another way of expressing this is that the incremental costs of a service are the difference between the total costs in a situation where the service is provided and the costs in another situation where the service is not provided.
>
> **Long Run Incremental Cost ("LRIC")** is the incremental cost over the long run, i.e. the period over which all costs can, if necessary, be varied.
>
> **Common costs** are those costs which arise from the provision of a group of services but which are not incremental to the provision of any individual service….
>
> **Stand Alone Cost ("SAC")** is the cost of providing that particular service on its own, i.e. on a stand-alone basis.
>
> **Distributed Long Run Incremental Cost ("DLRIC")** is a cost measure related to the LRIC of a component. Within BT's network, groups of components are combined together to form what is known as a "broad increment". Two of these "broad increments" are the core network (the "Core") and the access network ("Access"). The DLRIC of a component is equal to the LRIC of a component plus a share of the costs that are common between the components within the "broad increment" (which are known as "intra-group" common costs). The common costs are shared between the components by distributing them on an equi-proportionate mark-up (EPMU) basis. The sum of the DLRICs of all the components in the Core is equal to the LRIC of the Core itself. …
>
> **Distributed Stand Alone Cost ("DSAC"**) is a cost measure related to the SAC of a component. As described above, there are components within the "broad increment" of the Core. As an example the DSAC of a core component is calculated by distributing the SAC of the Core between all the components that lie within the Core. Each core component therefore takes a share of the intra-group common costs, and the costs that are common to the provision of all services. The sum of the core components DSACs is equal to the SAC of the Core….
>
> **Fully allocated cost ("FAC")** is an accounting approach under which all the costs of the company are distributed between its various products and services."

CHOICE OF METHOD OF COST ALLOCATION DEPENDS ON PURPOSE FOR WHICH COST INFORMATION IS TO BE USED

115. The Tribunal held that the choice of method for allocating costs depended on the purpose for which the cost information was being used (CAT judgment, paragraph [155]). FAC would be used to determine the performance of a service. However, where the purpose of obtaining the costs information was to provide an existing market participant a "sufficient inducement … to offer an additional service", costs could be calculated on the LRIC basis since it was already incurring common costs. A new entrant to the market would need to recover both common costs and incremental costs (CAT judgment, paragraph [156]).

116. To encourage entry into a market, the recoverable costs need to exceed the common costs and the LRIC costs. A new entrant to the market might combine different services. However it was difficult to apply a "combinatorial" approach to evaluating whether charges were excessive because of the possible permutations. Approximations of the cost had to be found, and one method used for this in telecommunications regulation was DSAC. The effect of DSAC was to attribute the business's common costs to a narrower group of services than it carried on. As a result, DSAC was in general in excess of FAC or LRIC, but not as high as SAC (CAT judgment, paragraphs [157] and [158]).

117. The Tribunal noted that Ofcom did not exclusively rely on DSAC. It considered that charges above DSAC might still comply with Condition HH3.1, but if the charge was below DSAC, Ofcom accepted that it complied with that Condition (CAT judgment, paragraph [159]). In other words, Ofcom did not consider that costs had to be limited to DSAC. Where costs exceeded DSAC, it allowed the difference to be recovered. Ofcom argued that its approach was supported by the Tribunal's judgment in the *PPCs* case ([2011] CAT 5) ("the *PPC* CAT judgment").

ROLE OF *PPC* CAT JUDGMENT

118. In the *PPC* case, in consequence of the 2004 LLMR, Ofcom had imposed a condition ("Condition H3.1") in the same form as Condition HH3.1 as one of the cost orientation obligations imposed on BT for partial private circuits ("PPCs"). Thereafter the Altnets submitted disputes to Ofcom, claiming that BT was overcharging them for PPCs in breach of its cost orientation obligations. Ofcom issued its PPC determination ("the PPC Determination") on 14 October 2009, finding an overcharge of some £41m. BT appealed from this Determination first to the Tribunal, and then to this Court ([2012] EWCA Civ 1051) ("the *PPC* CA judgment").

119. The Tribunal accepted that the supplier (BT) had to recover its common costs. The Tribunal made it clear, however, that it should not over-recover these costs. The Tribunal had accepted DSAC as the most practicable option (CAT judgment, para [162]). It accepted that FAC was inflexible. It could have been used but it would have imposed a single price on BT for its PPC services. The Tribunal considered that DSAC was "the best single measure" for determining whether Condition HH3.1 had been satisfied. The Tribunal further considered that it would not have been appropriate for Ofcom to impose FAC (CAT judgment, paragraph [162]). It rejected the contention that DSAC was intrinsically excessive and in breach of that Condition. The Tribunal's conclusion was that was precisely what Condition H3.1 required.

SUBMISSIONS MADE TO THE TRIBUNAL AND ITS JUDGMENT ON THE TALKTALK APPEAL

120. Ofcom emphasised the identical wording of the cost orientation condition that applied in the *PPC* case. It submitted that its use of DSAC in the present case was consistent with its approach in *PPC* and that, if TalkTalk's submissions were correct, then the PPC Determination would have been flawed.

121. TalkTalk submitted below that the CAT *PPC* judgment could be distinguished on the basis that DSAC was there applied to a single product.

122. The Tribunal rejected TalkTalk's distinction. As to the appropriate recovery of common costs, the Tribunal accepted that tables produced at a late stage in the hearing by Ofcom showed that the return on external revenues over the period 2005/6 and 2008/9 meant that BT was earning a return on its Ethernet services in relation to other customers of between 1 ½ and 2 times its normal cost of capital after deduction of the overcharge (CAT judgment, paragraph [168]).

123. The Tribunal accepted that there had therefore been over-recovery taking BT simply as a provider of both WES and BES, but held that in relation to potential entrants into either of those sectors there had not been over-recovery (once repayment for overcharging in relation to DSAC had been made). It held that by definition BT would not then have earned a return in excess of a normal return on cost relevant to potential entrants, namely DSAC on individual AISBO services, and it would have earned less than DSAC on some.

124. TalkTalk contended before the CAT that the multiple recovery of costs in this way could not be an "appropriate mark up for the recovery of common costs". However, that depended on the perspective from which appropriateness was being determined. In particular, FAC was appropriate for determining whether a company was earning a reasonable return across all its services. DSAC was appropriate for determining whether a firm will enter into the provision of a group of new services (CAT judgment, paragraph [170]). In the *PPC* CA judgment, Etherton LJ, with whom Rix and Lewison LJJ agreed, supported this approach in paragraph [68] of his judgment (CAT judgment, paragraph [171]). Etherton LJ said:

> "68 I do not accept that the principles and objectives of the CRF required Ofcom, in considering whether BT was in breach of Condition H3.1, to take into account the lower charges for the terminating sections of PPCs sold by BT. On the contrary, that would undermine the regulatory regime imposed in 2004 by way of *ex-ante* regulation. Although, as I have said, Mr Vajda argued the point as one of interpretation of Condition H3.1, the point is rather one of evidence and fact in the light of regulatory policy. The issue is what, for the purposes of Condition H3.1, was "appropriate" on the facts and in the context of the regulatory purposes of the Condition and the overall scheme of the Act and the CRF to which the Act was intended to give effect."

125. The Tribunal noted that TalkTalk's appeal raised a question as to the meaning of Condition HH3.1. The Tribunal accepted that that Condition must be interpreted

against the surrounding circumstances. The Tribunal adopted the approach it had taken in the CAT *PPC* case. It there held that the surrounding circumstances included only material available to the public at large, but excluding subsequently issued documents. Earlier documents might be relevant, but not if they stemmed from a period substantially before the issue of the document to be interpreted. So little weight would attach to Oftel's "Guidelines on the Operation of Network Charge Controls", published in 2001, on which Mr Pickford relies in his submissions to us. The most important document was the 2004 LLMR, and the evidence in it as to the nature of the AISBO market at that time (CAT judgment, paragraphs [171] and [173]).

126. The Tribunal considered that the basis on which Ofcom imposed the cost orientation obligation at the wholesale level and the AISBO markets in the 2004 LLMR was set out in paragraphs 7.10 and 7.54 of the 2004 LLMR respectively (CAT judgment, paragraphs [172] and [173]). The cost orientation obligation had been summarised in paragraph 7.61 of the 2004 LLMR (CAT judgment, paragraph [174]). Some respondents wanted a price control, but Ofcom explained in paragraph 7.63 why it rejected those calls. That paragraph had referred to "the competitiveness of the market". That meant the wholesale market in which BT had been found to have SMP (CAT judgment, paragraph [176]). If a new entrant to the market was needed to establish a competitive market, the prices had to be fixed at DSAC and therefore it was consistent with Ofcom's rationale of promoting competition in the AISBO market if Condition HH3.1 allowed costs to be determined at DSAC (CAT judgment, paragraph [177]). FAC was not appropriate unless the new entrant could replicate the same range of services as BT in order to benefit from the same economies of scale (CAT judgment, paragraph [178]).

127. The Tribunal rejected TalkTalk's argument that Ofcom did not consider it likely that there would be a new entrant into the market and cited various paragraphs in Annex B to the 2004 LLMR to support its argument (CAT judgment, paragraph [180]). The Tribunal found that the statements in Annex B were not inconsistent with the potential for some market entry at the wholesale level. Therefore Ofcom could consider how to promote the right conditions for encouraging competition. In the event, prospects were not fanciful, as following the 2004 LLMR, new entrants appeared in a limited segment of the wholesale market, namely that for high bandwidth AISBO services. In 2008, Ofcom found that BT did not have SMP in that market (CAT judgment, paragraph [181]).

128. The Tribunal considered that it was a matter of regulatory judgment for Ofcom to balance various different forms of economic efficiency and to determine the appropriate trade-off between the benefits of increased access-based competition in downstream markets and the potential for more competition in the wholesale AISBO market (CAT judgment, paragraph [183]).

129. TalkTalk then pursued an argument on the meaning of section 88(1) and (3) of the 2003 Act (CAT judgment, paragraphs [184] to [187]). The Tribunal also considered the practical difficulties in the proposed aggregate FAC test. In the light of our conclusions below it is unnecessary to consider this particular aspect of the Tribunal's judgment (paragraphs [188] to [195]).

130. Among the arguments which BT made before the Tribunal was its argument that the condition should be interpreted as requiring cost orientation of its charge for its services in aggregate and precluding the assessment of the cost orientation of those charges individually. The Tribunal rejected this argument. The starting point for interpretation was the language of Condition HH3.1 itself, which required cost orientation of "each and every charge offered, payable or proposed for Network Access". The overall conclusion of the Tribunal was that the cost orientation obligation should apply to each and every charge made by BT. It considered that this interpretation was supported by the way in which BT in fact levied its charges.

131. TalkTalk submitted to the Tribunal that the relevant statutory provisions meant that DSAC could not be used for determining the appropriate mark-up for the recovery of common costs. Under section 88 (1) and (3) of the 2003 Act, Ofcom could only set the condition where it appeared that there was a risk that the dominant provider (BT) might charge excessive prices or impose a price squeeze (that is to say, reduced its margins on the retail market so as to make it impossible for others to compete with it in a market in which it did not have SMP). The latter did not in fact occur in this case. The Tribunal did not accept this submission. In its judgment, the condition was imposed to prevent excessively high prices. However, that of itself was not sufficient. It had also appeared to Ofcom that the setting of Condition HH3.1 was appropriate for the purposes set out in section 88(1)(b). Those purposes included its promotion of efficiency. In the opinion of the Tribunal, section 88 permitted Ofcom to respond to the risk of excessive pricing by imposing cost orientation conditions designed to promote upstream entry into the market, thereby curtailing the power of the undertaking with SMP (CAT judgment, paragraph [186]). It followed that Ofcom did not have to impose an obligation that would immediately produce the lowest price. Accordingly, Condition HH3.1 satisfied section 88(1)(b). Therefore, applying cost orientation on the basis of DSAC was well within Ofcom's statutory discretion.

Submissions made in this Court

TALKTALK

132. Before the CAT in this case, the contention which is the subject of TalkTalk's current ground of appeal was put forward by both Sky and TalkTalk. But in this Court, TalkTalk alone pursues the point. For convenience, we will refer to the argument below as if it had been run by TalkTalk alone.

133. On Mr Pickford's submission, Condition HH3.1, as interpreted by BT and Ofcom, permitted BT to include in its charge for any service an inflated sum for common costs because it permitted BT to attribute to it the whole of the common costs allocable to the group of services of which that service formed part. The thrust of Mr Pickford's argument is that it can be shown from the 2004 LLMR that Ofcom's purpose in setting Condition HH3.1 was to prevent excessive prices in the wholesale market with the aim of encouraging the *purchase* of those wholesale services, which would lead to greater competition in the downstream retail market and lower prices to consumers. The Tribunal was therefore wrong to find that its purpose was to encourage the entry into the wholesale market and the *supply* of services by that new entrant (as a result of inflated charges in the wholesale market resulting from BT being able to make charges calculated by reference to an excessive amount of its common costs), and that was the basis on which it considered that it was within the

meaning of Condition HH3.1 for Ofcom to approve DSAC. Mr Pickford argues for this conclusion: (1) by examining the wording of Condition HH3.1; (2) by subjecting passages in the 2004 LLMR concerning the aims of regulation to a close reading.

(1) The wording of Condition HH3.1

Legal and factual matrix

134. TalkTalk submits that the condition must be interpreted in the light of the relevant legal and factual matrix, in particular the 2004 LLMR. Mr Pickford argues that once it is appreciated that the sole regulatory aim in imposing the condition was to reduce prices for the supply of wholesale AISBO services (i.e. in the upstream market) so as to encourage CPs providing services to end-users in the down-stream retail market and lower prices to those end users, the use of DSAC cannot be justified. The effect of the judgment of the Tribunal is that it was Ofcom's aim, or one of its aims, in 2004 in imposing the Condition HH3.1 to keep the price of AISBO services at an elevated level to encourage entry into the wholesale AISBO market. TalkTalk submits that that interpretation is wrong.

135. It is common ground that Condition HH3.1 is to be interpreted in the light of its language and relevant factual and legal matrix at the time of its imposition. The Condition is also a public law instrument. That means that the material used for its interpretation can only be that reasonably available to the public at large (*BT v Ofcom* [2011] CAT 5 at [202]).

136. In the present case the matrix included

    i) The legislative context for imposing the condition

    ii) The key statements in the 2004 LLMR explaining the aim of the condition and Ofcom's findings as to the likelihood of future market entry at the wholesale level

    iii) Further statements in the 2004 LLMR relating to PPCs, including the requirement for BES products to be priced consistently with PPC services and the regulatory obligations of Kingston Communications (Hull) PLC and certain regulatory documents published in the years preceding the 2004 LLMR.

137. Mr Pickford submits that the purpose of Condition HH3.1 was to prevent excessive pricing by an undertaking with SMP.

"Recovery" of common costs

138. Mr Pickford submits that the word "recovery" excludes the multiple recovery of common costs. He further submits that highly specific references are made to matters such as reasonable cost which indicate that the purpose of the condition was to prevent excessive recoveries. The word is also used in section 87(9) of the 2003 Act (permitting SMP obligations to include "rules … about the recovery of costs").

"Appropriate" mark up

139. Moreover, submits Mr Pickford, the word "appropriate" in its ordinary meaning means that the matter to be appropriate must be related to its specific context. For example, an appropriate technology for a developing country may be different from an appropriate technology for a highly industrialised country. The statutory context would include Article 13(2) of the AD, which requires that regulation must serve efficiency and sustainable competition and maximise consumer benefit. This provision is implemented by Section 88 (1)(b) (which provides that one of the matters which must be satisfied if Ofcom is not to be prohibited from setting an SMP condition falling within section 87(9) is that it appears to Ofcom that the setting of the condition is appropriate for promoting efficiency and sustainable competition and conferring the greatest possible benefits on the end-users of public electronic communications services). Section 88(3)(a) states that one of the purposes of a cost orientation provision is to avoid the risk of prices being set at an excessively high level.

(2) Close reading of the 2004 LLMR

140. In June 2004, Ofcom published its lengthy Review (the 2004 LLMR) on retail leased lines, symmetric broadband origination and wholesale trunk segments. Relevant extracts from the 2004 LLMR are set out in the Appendix to this judgment.

141. Mr Pickford submits that the 2004 LLMR did not state the purpose of Condition HH3.1, but it explained that the reason for imposing conditions was to encourage competition in a wholesale AISBO market and the related retail market and accepted that multiple recovery of costs would constitute excessive pricing.

Introduction to 2004 LLMR (Chapter 1)

142. The 2004 LLMR made it clear that there was a close relationship between the retail and wholesale markets. This is explained in paragraphs 1.28 and 1.29. Mr Pickford submits that paragraphs 1.28 and 1.29 showed that Ofcom's aim in imposing an obligation in respect of BT's wholesale AISBO services was to prevent excessive pricing in the retail market.

143. The 2004 LLMR had several chapters devoted to identifying the relevant markets. It made findings as to SMP. It then set out the costs and benefits of the SMP service conditions which it had imposed in the light of its SMP findings. Chapter 5 dealt with the conditions imposed in BT's retail market and chapters 6 and 7 dealt with conditions imposed in BT's wholesale markets (see paragraph 1.60).

144. Symmetric broadband origination was divided into traditional and alternative interface symmetric broadband origination (paragraph 2.170). At paragraph 2.257, the report noted that BT considered that bandwidth distinctions existed in the AISBO market. BT argued that the conditions of competition were likely to vary at the higher end of the market, that is for higher bandwidth circuits, due to the greater supply side substitution as communications providers were more willing to extend their circuits to

provide higher bandwidth/higher revenue circuits (paragraph 2.257). Ofcom did not however accept that there were different markets here.

Regulatory remedies for the wholesale AISBO market (Chapter 7)

145. According to Mr Pickford, at paragraphs 7.8 to 7.14, Ofcom again confirms that the aim of regulating BT's AISBO services is to prevent distortion in the retail market. Ofcom made specific reference to Oftel's guidelines on the imposition of access obligations under the CRF.

146. Likewise, on Mr Pickford's submission, the 2004 LLMR showed that Ofcom was seeking to promote competition in the retail market and thus lower prices at that level. This was particularly clear from paragraphs 7.10 and 7.54 of the 2004 LLMR. Ofcom intended to encourage CPs already in the market to purchase wholesale AISBO products from BT and combine them with their own networks so as to build out their own network infrastructure and introduce innovative retail products.

147. The Tribunal's decision turned on paragraph 7.63. Mr Pickford accepted that the AISBO market referred to in paragraph 7.63 was likely to be a wholesale market. As to the later reference to "the market", this could be a reference to the wholesale market, the retail market or both. Effectively, the Tribunal read that paragraph as referring to impact of Condition HH3.1 on competition in the wholesale market. Mr Pickford submits that this was erroneous. He submits that paragraphs 1.28 and 1.29 of the 2004 LLMR did not refer to this aim and that the Tribunal was wrong to conclude that this is what paragraph 7.63 meant. Ofcom was responding to the representations of bodies, including the UK Communications Telecommunications Association, that Ofcom should impose a charge control, which involved imposing an explicit pre-determined cap on BT's prices based on an estimate of future costs, and which was a less flexible method of controlling competition.

148. The second use of the word "market" is ambiguous. It could mean the wholesale market, or the retail market, or both. Mr Pickford submits that it should have the second or third meaning consistently with the passage headed "Aims of regulation" in paragraphs 7.8 to 7.14, as he interprets them. He submits that the first meaning would also be consistent with that interpretation. Nonetheless, he recognises that in its context in paragraph 7.63 the word "market", when used in the expression "the competitiveness of the market", might refer to entry into the wholesale market. However, this, he submits, would mean higher prices for the retail market and that would be inconsistent with the aims of regulation as stated in paragraphs 1.28 and 1.29, unheralded by what went before and acontextual. The last two points are connected: the 2004 LLMR had not previously suggested that the AISBO market was prospectively competitive so that the idea of new market entrants was not relevant. The 2004 LLMR did not recognise that there was a conflict between the objective of wanting to raise prices, so as to promote new entry into the market, and the objective of reducing prices in an attempt to incentivise the wholesale purchase of products. Moreover, there was no discussion of how that conflict had been reconciled or of its implications for BT's charges.

149. In any event, submits Mr Pickford, there is no evidence that DSAC would have promoted entry into the market. Ofcom's answer to this point in its skeleton argument is that it made no assumption that it would do so. The decision to permit

DSAC as the appropriate mark up for the recovery of common costs was in any event an economic assessment by it.

150. Mr Pickford further submits that paragraph 7.63, if it means that which the Tribunal held it means, does not satisfy the requirement for transparency in section 47(2) of the 2003 Act, and should be rejected for that reason.

151. Moreover, Ofcom found in Annex B to the 2004 LLMR that there was little scope for there to be a new entrant into the market.

152. The effect of the adoption of DSAC was to allow BT to use its dominant position to obtain a high price for its services. It had a ubiquitous network which already gave it an edge over its competitors. It also allowed it to use its existing network of infrastructure, for which it (unlike any new market entrant) did not incur any development costs.

153. Mr Pickford submits that in any event DSAC would not assist the new entrant because the new entrant would not have DSAC comparable to BT unless it offered services across the whole range of BT's services which were aggregated. Therefore the Tribunal's premise was unsustainable. We do not follow this submission. The new entrant could set a price up to the amount charged by BT. Unlike BT, it would not be regulated.

Application of the same Condition to PPCs and BES products

154. Ofcom applied FAC to the calculation of common costs in relation to charges for PPCs and BES products. PPCs are part not of the same market but of the TISBO market. Mr Pickford submits that Ofcom's approach to the recovery of costs was instructive because (i) the stated reason for adopting FAC in doing this was so as to keep prices competitive; (ii) the wording assumed that there would be no difference between charge control and a cost orientation obligation whereas the effect of Ofcom's interpretation of Condition HH3.1 is that BT is able to recover more than a reasonable return. This would appear also to be contrary to the statutory purpose of such an obligation (see section 88(3)(a) (summarised in paragraph 139 above).

155. Mr Pickford makes similar submissions about BES products. The charges for these products were specifically linked to the prices for PPCs (paragraph 7.139 of the 2004 LLMR).

Practicability

156. Mr Pickford submits that the approach of TalkTalk would be practicable. If the appeal succeeds, Mr Pickford submits that Ofcom would have to find an alternative method which met this Court's judgment and which was practicable.

OFCOM

157. Mr Pushpinder Saini QC, for Ofcom, submits that this Court should restrict its determination to the interpretation of Condition HH3.1. It should not intervene in the exercise by Ofcom of its economic judgment: see per Lord Sumption in the *08x Numbers* case at [46].

158. Mr Saini's primary submission is that the Tribunal correctly interpreted Condition HH3.1 as reflecting a concern of Ofcom, apparent from paragraph 7.63 of the 2004 LLMR, that it regarded the development of competition in the wholesale AISBO market as an important objective to be taken into account alongside a concern to foster competition in the retail market. Indeed, if competition were fostered in the wholesale AISBO market, that would in due course tend to reduce wholesale prices and hence promote competition in the retail market. On the footing that fostering the development of competition in the wholesale AISBO market was one regulatory objective referred to in the 2004 LLMR, then on the economic evidence available to it, the Tribunal correctly concluded that Ofcom could legitimately decide that DSAC was appropriate, not FAC.

159. Mr Saini submits that choosing the appropriate SMP obligation requires Ofcom to balance various objectives and it is not simply directed to imposing obligations that will reduce retail prices immediately. Thus Ofcom may respond to the risk of excessive pricing in the retail market by imposing regulatory control which seeks to enhance competition in the wholesale market and which, by creating a more competitive market, will lead to the avoidance of excessive prices over time. This, he submits, is permitted by section 88(1)(b) of the 2003 Act, summarised in paragraph 139 above. In fact, by the time of the next review in 2008, there had been sufficient entry into one segment of the wholesale market for Ofcom to find that BT no longer had SMP in relation to that segment (see the findings of the Tribunal at paragraph [127], above).

160. As to the wording of Condition HH3.1, Mr Saini submits that the word "recovery" in relation to common costs can on its natural meaning include the recovery of an amount of common costs which exceeds the proportion of total common costs specifically related to the service in question.

161. Mr Saini submits that Ofcom's interpretation of Condition HH3.1 and paragraph 7.63 of the 2004 LLMR is not acontextual, as argued by Mr Pickford. On the contrary, in the representations lodged by BT in the course of Ofcom's consultation prior to finalising the 2004 LLMR, BT contended that it was appropriate for Ofcom to have regard to the possibility of developing competition in the wholesale AISBO market. Those representations were available prior to finalisation of the 2004 LLMR to all undertakings with an interest in that market review, and the fact that this point had specifically been made in the debates leading up to the 2004 LLMR supported Ofcom's interpretation of paragraph 7.63 and the legitimacy of its having regard to the objective of fostering competition in the wholesale market when applying Condition HH3.1.

162. As to Mr Pickford's argument that Ofcom was concerned with purchasers of BT's services, Mr Saini points out that Ofcom was also concerned with downstream competition (see, for example, paragraphs 7.10 and 7.11 of the 2004 LLMR). There is no need for regulation to be in either the retail or the wholesale market. In this case, Ofcom had regard to the effects of different regulatory approaches on the wholesale and retail markets. Because of the relatively early development of the AISBO market, Ofcom wanted to adopt a flexible approach. Moreover, submits Mr Saini, as Ofcom did not intend that BT should be able to recover multiple costs, there was no requirement to disclose multiple recovery of costs in the 2004 LLMR. The

multiple recovery of costs occurred after the 2004 LLMR and, therefore, is not relevant to its interpretation.

163. Mr Saini submits that TalkTalk's reliance on paragraphs 1.28 and 1.29 of the 2004 LLMR was inappropriate because these paragraphs do not deal with the AISBO market.

164. Mr Saini submits that the ruling which Ofcom gave in relation to Kingston Communications plc ("Kingston") (see below) was in relation to its cost accounting. The Tribunal properly found that this ruling did not mean that it was inappropriate for BT to use DSAC.

165. As to the earlier documents on which TalkTalk relies, Mr Saini submits that these are not admissible on the interpretation of Condition HH3.1 and in any event do not assist on that point. We agree that these materials do not assist on the question of the interpretation of Condition HH3.1. Whilst they give some indication about the general approach of the regulators some time ago, the issue of the 2004 LLMR was a supervening event and it is that document, and the thorough review of the relevant markets which it contains, which provides the relevant context for interpretation of Condition HH3.1 so far as is relevant to TalkTalk's appeal. As the CAT pointed out at para. [81] of its Supplementary Judgment ([2014] CAT 20) in relation to TalkTalk's application for permission to appeal, "the condition was imposed as a result of the very full market review in the 2004 LLMR and accordingly … it is the explanation in that document, along with the language of the condition itself, that are the fundamental basis for construction of the condition." We agree. Once the meaning of the relevant part of the 2004 LLMR is properly understood, it is clear that Ofcom's approach to the interpretation and application of Condition HH3.1 was lawful and correct.

166. Mr Saini submits that TalkTalk has shown no error of law in the Tribunal's resolution of the question whether its alternative approach was practicable.

BT

167. Mr Read for BT, made many of the same arguments as Mr Saini. We do not intent to be discourteous but we do not intend to repeat those arguments unless there is reason to do so. Mr Read adopted the submissions of Mr Saini.

168. Mr Read is critical of the way TalkTalk conducted its case in the Tribunal. Moreover, BT is concerned it may have been prejudiced because some points were taken on which it would have wished to file evidence, had they been taken earlier. Without prejudice to the merits of those arguments, we do not deal with them in this judgment as no contentious factual issues arise for determination.

169. Mr Read submits that cost orientation conditions can only be set where there is a risk that prices may be fixed "at an excessively high level" (see Article 13.1 of the AD, implemented in sections 87 and 88 of the 2003 Act). So, on his submission in the context of a cost orientation obligation, prices in excess of FAC are not automatically to be considered excessive or inappropriate. BT submits that the issue is one of regulatory balance, as can be seen from paragraph 9.120 of the Determination:

> the overarching economic context to the use of DSAC for considering cost orientation is the regulatory balance to be struck between: (i) providing the regulated firm with enough price flexibility to cover its costs, including its common costs in an economically efficient manner; (ii) ensuring that this flexibility is sufficiently bounded to prevent the regulated firm from exploiting its market power to set anti-competitive, exploitative or otherwise unreasonable charges.

170. Moreover, submits Mr Read, Ofcom could not apply an overly stringent test after charges have been made and disputes have arisen since it would potentially put BT in breach of Condition HH3.1 despite its best attempts to comply.

171. The Tribunal commented in the *PPC* case as follows at paragraph [299]:

> It may be quite difficult for a regulated firm in the position of BT to ensure that its prices meet its cost orientation obligation, even if it has the firmest of intentions of doing so. This is for a number of reasons. Ensuring that common costs are allocated in a manner that meets regulatory requirements is not straightforward. The cost accounting – particularly in the case of a product like PPCs in a business with so many products and services like BT – is extremely complex and difficult. What is more, whilst no doubt a regulated firm can keep a month-by-month track of its costs and its prices, at the end of the day the conclusive figures (as published in the regulatory financial statements) will be retrospective ones. Equally, costs can and will fluctuate over time, sometimes quickly. Finally, the price may be less easily variable. As BT emphasised, it was not possible for BT to vary its prices for PPC services instantly: notice was required.

172. Mr Read submits that this provides another important reason why Ofcom should use a less stringent criterion than FAC when assessing cost orientation.

173. Mr Read gave us an insight into the applicable economic theory. However, the points that he made were in our judgment succinctly addressed by the judgment of the Tribunal and so we do not need to set this material out. Not unnaturally, BT, like Ofcom, relies on the judgment of the Tribunal in the *PPC* case. It also relies on the breadth of the regulatory judgment of Ofcom. Mr Read concludes that, contrary to TalkTalk's argument, there were good regulatory reasons for Ofcom to assess Condition HH3.1 by reference to DSAC, which the Tribunal, on the evidence before it, decided, on the merits, should not be overturned. He submits that it cannot now be overturned on a point of law.

174. Mr Read submits that Ofcom was entitled to assess costs under Condition HH3.1 in a different and less stringent way than it would do if it had imposed charge control.

175. Mr Read also submits that TalkTalk's aggregate FAC test would breach the principle of legal certainty. We do not need to go into these arguments as it was agreed that, if TalkTalk's appeal succeeded, the matter would have to be remitted to the Tribunal.

176. Mr Read submits that the language of Condition HH3.1 imports a degree of flexibility: see, for example, the expressions "reasonably derived", "appropriate mark-up" and "appropriate return" in Condition HH3.1.

177. Mr Read also submits that TalkTalk's FAC approach was impracticable.

178. BT has filed a respondent's notice which argues that this Court cannot disturb the basis of which charges were established under the 2004 LLMR after this length of time.

GAMMA (INTERVENER)

179. Gamma is the intermediate holding company of a group that provides predominantly wholesale telecommunication services on the UK market. It also has retail customers and sells products for the residential market via independent third parties. It is therefore both a competitor and a customer of BT. On 8 June 2016, Laws LJ made an order that Gamma should be able to file a statement of intervention in these appeals, which it has done. Gamma's interest in these appeals arises out of the fact that it has entered appeals against other decisions of Ofcom in the Tribunal, which we need not particularise.

180. Mr Read submits, with respect to Gamma's statement of intervention, that Gamma has misunderstood, in part, the scope of this appeal. He further submits that Gamma is wrong to suggest that BT's common costs might be loaded on to some services at the expense of others. There was no evidence to support this. Mr Read also submits that Gamma is wrong to suggest that the DSAC figures are not fully audited. The positions of Gamma and TalkTalk are not identical.

181. Gamma sets out the background to the Ethernet Determination by Ofcom. It also describes other matters concerned with BT in which it is involved. It sets out the legislative background which has already been set out above.

182. Gamma supports TalkTalk's submissions because it submits that a FAC measure offers the best yard stick by which to assess BT's compliance with a cost orientation obligation such as Condition HH3.1. Among other things, it submits a FAC-based check excludes the possibility of common costs being over-recovered in respect of any individual service. Gamma submits that it is necessary and appropriate to have FAC as a cross check on return on capital. In its view a FAC measure offers the best yard stick by which to assess BT's compliance with the cost orientation obligation. Furthermore, the Tribunal was incorrect to conclude that Condition HH3.1 was a measure whose purpose, or sole purpose, was to ensure upstream competition. Gamma submits that the Tribunal erred as to the purpose of Condition HH3.1 and had it not done so, it would have imposed a more rigorous metric.

183. Mr Saini points out that Gamma's own appeal relates to cost orientation obligations in a different market under a different market review and imposed where there was charge control: it is not TalkTalk's case that its situation is one in which FAC is appropriate. He submits that Gamma seeks to persuade this Court to differ from the reasoning of the Tribunal. He contends that Gamma seeks in its statement of intervention to raise points of law and fact which are not open to any party on this

appeal. It raises only general economic arguments which are not directed to the specific context of the 2004 LLMR.

THE COURT'S CONCLUSIONS ON TALKTALK'S APPEAL

184. For the several reasons given below, we would answer the issue set out in paragraph [106] above: No.

Matters of economic assessment

185. As a preliminary, but important, point, we accept the submission of Ofcom and BT that TalkTalk's submissions are liable to draw the Court into the area of the economic assessment. We are concerned only with a point of law, namely the true interpretation of Condition HH3.1 in the light of admissible material. As to matters of economic assessment by the Tribunal, which would include the Tribunal's findings on the economic purpose to be served by one method of cost allocation as opposed to another, we have well in mind the observations of Lord Sumption, with whom Lord Neuberger, Lord Mance, Lord Toulson and Lord Hodge agreed, in the *O8x Numbers* case at [46] about the Tribunal's assessment of the anti-competitive effects of restricting price changes:

> "46 … The Competition Appeal Tribunal was hearing an appeal by way of rehearing on the merits. Their conclusion about the anti-competitive effects of restricting price changes and the weight to be attached to it was a factual judgment which it was perfectly entitled to make. It was, moreover, an economic judgment by an expert tribunal which had received a substantial amount of additional evidence, including economic evidence. Since appeal lay to the Court of Appeal only on points of law, the Competition Appeal Tribunal's findings on the distortion of competition liable to result from the rejection of the new charging structure were not open to rejection on appeal."

186. The same must apply to economic assessments by Ofcom. Section 88 governs the setting of obligations. In our judgment, Mr Saini is right to submit that section 88 vests in Ofcom a considerable area for regulatory judgment as to what cost orientation obligations to impose in any particular situation. It is not for this Court to doubt the extent to which Ofcom's choice was supported by the economic factors or opinion at the time.

187. We will give one example here of economic or regulatory assessment. Mr Pickford submits that the recovery of common costs bears no relation to the costs the new entrant might in fact bear. But this was a matter for Ofcom to assess. A new entrant to the market would have to incur common costs of its own to enter the wholesale market. It was unlikely that they could be accurately forecast but it was at least foreseeable that they might be a larger proportion of its costs than of BT's because it could not spread them over the same volume of products or use established infrastructure. Moreover, a new entrant might also have only one product. Mr Pickford further submits that there is no obvious purpose in DSAC as it enables BT to be inefficient and to overcharge but there are other answers to that. But DSAC can be appropriate if there is a relevant objective to promote development of competition in

the wholesale AISBO market. Again, we consider that these are matters of economic judgment for the regulator.

188. Nonetheless TalkTalk's arguments raise a question of law about the meaning of Condition HH3.1, and that question must fall squarely within the jurisdiction of this Court.

Appropriateness of mark up for common costs: importance of purpose

189. In our judgment, the Tribunal was clearly right to say that the appropriateness of a method of accounting for common costs depends on the purpose for which that method has been adopted: see para. [68] of *PPC* CA, per Etherton LJ, set out above.

190. No doubt in general a regulator would not permit the multiple recovery of common costs. But the issue is whether Condition HH3.1 permitted this in the light of what Ofcom had said in the 2004 LLMR about the regulatory objectives which Ofcom wished to promote.

Meaning of paragraph 7.63 of the 2004 LLMR: does it refer to competition in the wholesale market?

191. The Tribunal found that the recovery of costs on the basis of DSAC was an appropriate basis for recovery of costs if the market was potentially competitive. So the question is whether paragraph 7.63 of the 2004 LLMR indicated that Ofcom took the view that the market was potentially competitive and if so whether it was referring to the wholesale or the retail market.

192. As to competitiveness, Mr Pickford submits that Ofcom was not expecting competition in the wholesale market. Mr Pickford submits that paras. B.433 and B.434 in Annex B to the 2004 LLMR show that Ofcom took the view that the wholesale AISBO market was not potentially competitive, at least in the short and medium term. It is said that BT enjoyed "economies of scope", meaning that it was able to spread common costs over a number of services, reducing the extent to which the costs need to be recovered from any one service. Certainly Ofcom took the view that it would be difficult for any other undertaking to break into the AISBO market and that is was unlikely to happen within the next two to three years. But, as we read those paragraphs, it did not rule out the possibility that another undertaking would if the conditions were right to enter the market.

193. In its representations for the purposes of the 2004 LLMR, BT made the point that there was scope for competition to develop in the wholesale AISBO market. We agree with Mr Saini's submission that this is part of the relevant context for interpretation of the 2004 LLMR. The relevant point in the 2004 LLMR in which Ofcom took this argument of BT into account is paragraph 7.63.

194. In our judgment, therefore, in agreement with the Tribunal, on a fair reading of paragraph 7.63 that paragraph does refer to potential competitiveness in the wholesale AISBO market. That is the natural meaning of the language used in the second sentence of paragraph 7.63. As Mr Read put it, the wording of that paragraph shows

that Ofcom was mindful of the "nascent nature of the market" and the need to encourage the development of new services. That seems to us to be the obvious import of the critical words in paragraph 7.63, which were:

> The AISBO market is in a relatively early stage of development and it is necessary to give time for the effects of the cost orientation obligation to impact on the competitiveness of the market…

The "AISBO market" referred to is the wholesale AISBO market; it is that market which is "in a relatively early stage of development"; and it is that market which is designated by the use of the definite article in the phrase, "competitiveness of the market".

195. This interpretation is reinforced by the immediate context referred to in paragraphs 7.62 and 7.64, namely that Ofcom set Condition HH3.1 having "considered the responses to the draft notification" which preceded the finalisation of the 2004 LLMR (paragraph 7.64) and that its decision regarding the form of SMP condition to impose was made after considering suggestions by some CPs "that a price control should be imposed on AISBO products", i.e. in the same round of responses (paragraph 7.62). It was in the course of giving its own responses and responding to those of others referred to in paragraph 7.62 that BT made the point that the wholesale AISBO market was in a state of development, with scope for growing competition in that market. Paragraph 7.63 is fairly and properly to be interpreted as reflecting this argument made by BT.

196. We thus consider that paragraph 7.63 is clear in its reference to the potential competitiveness of the wholesale AISBO market. On this interpretation of paragraph 7.63, use of the DSAC cost orientation methodology is potentially relevant in application of Condition HH3.1.

197. Mr Pickford submits that the next reference to "market" in the third line in the quotation from paragraph 7.63 just set out should be interpreted as to the retail market. It does not say in terms that it is referring to the wholesale market. Ofcom accepts that there had been no earlier reference in terms in the 2004 LLMR to competition in the wholesale market. As Mr Pickford's analysis showed, all previous references had been to the retail market. However, as we have observed, as a matter of ordinary language the word "market" refers to the wholesale AISBO market, and the context supports that interpretation. Since BT had raised this point in its representations it is not surprising that paragraph 7.63 should be read in this way. It is also of some significance that two bodies expert in this area, Ofcom and the Tribunal, have considered that it is natural to read the paragraph in this way.

198. Mr Pickford submits that the aims of regulation were effectively set out in paragraph 1.29 of the 2004 LLMR, and thus limited to the retail market. We do not agree. Ofcom was there dealing with what it saw as the major issue (that of excessive pricing in the retail market), but Chapter 1 was only an Introduction and the full treatment of the subject in relation to AISBO is to be found in Chapter 7, which is headed *Regulatory remedies – wholesale alternative interface symmetric broadband origination market*. Paragraph 1.29 cannot be taken to be an exhaustive statement of Ofcom's regulatory objectives in relation to the AISBO market. Promoting competition at wholesale level was a way of protecting retail customers from

excessive prices since it would mean that in the medium to long term retail customers would benefit from more vigorous competition on price between providers of wholesale AISBO services. In the context of complex analysis of competition effects, it is clearly possible for Ofcom to have more than one regulatory objective. If they are conflicting, Ofcom will have to take steps to balance them, but how it does so is a matter for its regulatory judgment.

199. The weight to be given to any particular objective will vary depending on the particular circumstances of the market and the respective weight given to different objectives which may be in tension with each other, having regard to those circumstances. Condition HH3.1 was obviously drafted to confer a degree of discretion on Ofcom in making evaluative judgments as to what might be appropriate in respect of cost orientation after weighing up relevant regulatory concerns in the particular circumstances of the market, as additional information became available and so on.

200. Mr Pickford submits that, if this is what Ofcom intended, it should, as part of its statutory obligations of transparency, have explained how it proposed to resolve any conflict between these objectives. But, as we see it, any such defect in the reasoning cannot affect the meaning of paragraph 7.63. In any event, Condition HH3.1 was clear in its effect: that Ofcom would have a degree of discretion moving forward in deciding what cost orientation methodology was appropriate. Since, as the Tribunal found and we consider to be correct, paragraph 7.63 indicated that one regulatory objective was promotion of the development of competition in the wholesale AISBO market, there was a sufficient, clear indication that this regulatory objective could be brought into account by Ofcom in the application of Condition HH3.1. The principle of legal certainty and the requirement of transparency in regulation were satisfied in this way.

201. Then Mr Pickford argues that the expression "the competitiveness of the market" in paragraph 7.63 should be read as a reference to competitiveness in the retail market, even if the AISBO market were the wholesale market because throughout LLMR, Ofcom had referred to the retail market. In our judgment, this explanation is unconvincing. The wording in a report of this size, complexity and importance would have been very carefully considered before finalisation. As noted above, Mr Pickford's submission on this is contrary to the natural meaning of paragraph 7.63, and that meaning is supported by the context in which it was written.

Relevance of Kingston

202. Kingston had SMP in relation to wholesale AISBO services in Hull. As Kingston is a smaller company, Ofcom considered that it would be unduly onerous for it to impose a cost orientation condition by reference to LRIC plus an appropriate mark up for common costs and so permitted Kingston to account for its costs on a FAC standard. The obligation on Kingston was in the same terms as Condition HH3.1. Mr Pickford argues that it is difficult to suppose that if Ofcom considered that it was appropriate to allow a more generous standard of common costs recovery to encourage new entrants into the AISBO market it would not have done so for Kingston as well.

203. In our judgment, this is a bad point. As is clear from the 2004 LLMR, Ofcom allowed Kingston to use a FAC methodology for its cost orientation as this would be easier

and less costly for a small operator like Kingston to do when preparing its regulatory financial statements. Ofcom specifically equiparated the cost orientation principle which it considered would be appropriate for BT with that which would be appropriate for Kingston, but indicated that for special reasons Kingston might be allowed to use a FAC methodology. For BT, Ofcom said in paragraph 10.11 of the 2004 LLMR that "BT must demonstrate that its charges are set on the basis of LRIC plus an appropriate mark-up for the recovery of common costs", which is a basis consistent with adoption of a DSAC methodology. But in paragraph 10.12, whilst Ofcom stated the principle that Kingston should likewise demonstrate that its charges were set on the basis of LRIC plus an appropriate mark-up for the recovery of common costs, it went on: "Ofcom has previously indicated elsewhere that CCA FAC can in certain cases be a good proxy for LRIC plus mark-ups", and stated that whether this would be acceptable in relation to Kingston's charges would be considered in the context of its financial reporting obligations. In its consideration of that point, Ofcom was prepared to accept that Kingston could use the FAC methodology as a proxy for LRIC plus mark-ups. Thus it is clear that Ofcom was not saying that the appropriate methodology for both Kingston and BT was FAC. On the contrary, it made it clear that the common principle should be LRIC plus mark-ups, but that in the particular circumstances of Kingston it would be allowed to use FAC as a proxy for LRIC plus mark-ups.

204. Mr Pickford made many points but we consider that we have addressed the principal points and we have no doubt that the Tribunal was right on what paragraph 7.63 meant. That leaves the question of what Condition HH3.1 permitted Ofcom to do.

Interpretation of Condition HH3.1

205. The language of HH3.1 speaks of "an appropriate mark up". The use of the indefinite article indicates that there might be a range of mark ups, any one of which might be regarded as "appropriate". It was clearly contemplated that there would be no one right answer and that the determining of the mark up would be a matter of judgment.

206. Mr Pickford places emphasis on the word "recovery". We accept Mr Saini's submission and consider that that word is neutral and that it cannot have the effect of limiting the amount of the common costs that can be added to other costs for the purpose of working out the charges that BT could make to the CPs or other customers.

207. The effect of Mr Pickford's approach is to restrict the maximum amount of common costs to those actually (and efficiently) incurred. Mr Pickford invokes in aid of his argument the fact that in relation to PPCs a stricter mark up for overheads was adopted. We do not consider that the reasoning in the 2004 LLMR on PPCs is of assistance, for the reason that Ofcom there decided to impose a charge control and not a cost orientation obligation (see paragraphs 6.106 and 6.114 of the 2004 LLMR). A price control is a more inflexible form of regulation than a cost orientation requirement, and in relation to PPCs the fact is that Ofcom was not concerned about that inflexibility, whereas in relation to BT's AISBO services it wanted BT and itself to have greater flexibility.

Other documents relied on by Mr Pickford

208. Mr Pickford also relies on a number of other documents published by Oftel and Ofcom in the years preceding the 2004 LLMR. Mr Pickford accepts that the appropriate approach to cost orientation may depend on the level of potential competition in the market. So, for example, in its *Direction on BT's supply of PPCs* (March 2001) at §§1.33 and 1.36, Oftel explained that, while setting prices close to DSAC might be permitted in a competitive market, where there is little competition, prices should be close to LRIC with only "some allowance" for common cost recovery. Mr Pickford submits that this is a case where there is little competition. But Ofcom considered that the wholesale AISBO market was in a relatively early stage of development and that competition was capable of developing (see paragraph 7.63 of the 2004 LLMR), and in that context it was entitled to endorse use of the DSAC methodology.

Alternative submission – DSAC inappropriate even if wholesale market potentially competitive

209. Mr Pickford submits in the alternative that if Ofcom did consider that the wholesale AISBO market was prospectively competitive, he is still able to contend that Ofcom had applied the wrong test for the recovery of common costs. But he specifically accepted that, if this was Ofcom's view of the market (as it was), he could not submit that the recovery of costs on a DSAC basis was irrational. He never amplified this alternative submission, and in our judgment it cannot succeed where his principal submission fails.

210. Since we reject Mr Pickford's main submission on the TalkTalk appeal, it follows that we are not concerned with any question as to the practicality of his approach.

BT Respondent's notice

211. It is also unnecessary for us to consider the legal certainty argument raised under BT's Respondent's notice.

Overall Conclusions

212. For the reasons set out above, we dismiss all of BT's grounds of appeal, i.e. those in relation to BT's prospective regulation ground, BT's legal certainty ground and the interest issue. We also dismiss TalkTalk's appeal on the DSAC issue.

APPENDIX 1

Extracts from the LLMR

> 1.28 In addition to retail leased lines this review will affect a range of other retail services. This category includes all retail services which use the wholesale input services that are part of the relevant wholesale markets i.e. symmetric broadband origination and trunk segments (see below). These include the following:
>
> * Symmetric broadband internet access;

* Virtual private networks;

* Other data services; and

* Mobile voice and data services

1.29 In relation to these services, Ofcom believes that the most pertinent issue in the context of the review is not whether they should be subject to retail regulation, but ensuring that any dominance found to exist in the provision of the relevant wholesale inputs cannot be exploited through charging excessive prices, so raising the costs of the retail services to end users, or leveraged into the provision of retail services to the determent of consumers. This issue concerning the scope of the wholesale access remedies is considered further in Chapter 6.

Aims of regulation

7.8 In Chapter 3 and Annex B of this document, Ofcom explains how it has reached the conclusion that BT currently continues to hold a position of SMP in some of the UK (excluding Kingston upon Hull) markets relating to leases lines covered by this review.

7.9 Article 16 of the Framework Directive provides that "where an NRA determines that the relevant market is not effectively competitive, it shall identify undertakings with SMP on that market…and...shall on such undertakings impose appropriate specific regulatory obligations…".

7.10 Regulation at the wholesale level is designed to address the problems which result from the existence of SMP in the relevant wholesale market. In particular it is designed to ensure that the SMP at the wholesale level does not restrict or distort competition in the relevant downstream markets or operate against the interest of consumers, for example through excessively high prices. Accordingly, Ofcom believes the wholesale regulation imposed in this chapter reflects its duties in section 4 of the Act. All of the conditions imposed by Ofcom will promote competition in the provision of retail leased lines and, as part of the implementation of the EC Directives referred to above, will assist with the development of the European internal market. In addition, each individual condition fulfils one or more of the other duties set out in section 4, as well as the tests set out in section 47 of the Act, as described in the discussion of the conditions below.

7.11 The application of regulation at the wholesale level also fits with the requirements of the Framework Directive, that NRAs take measures which are proportionate to the objective of encouraging efficient investment in infrastructure and promoting innovation. The introduction of regulation in wholesale markets will encourage communications providers to purchase wholesale products and combine them with their own networks where possible to create retail products in competition with BT's retail leased lines products and other services. This is preferable to retail regulation alone, which would by contrast tend to favour the purchase of BTs retail products and thereby lessen other communications

providers' investment in infrastructure and, through less competition, innovation.

7.12 It will also help to ensure that another objective of the Framework Directive is met, namely that NRAs take measures which are proportionate to the objective of ensuring users "derive maximum benefit in terms of choice, price and quality". Regulation at the wholesale level will, as noted above, help to increase the number of retail products available, and by increasing competition will help to ensure that price and quality are optimised.

7.13 In assessing the level of regulation to be applied in this market, Ofcom has also taken into account the Commission's SMP Guidance which state at paragraph 15 that regulation should aim to promote an open and competitive market, and at paragraph 16 that *ex ante* regulations should be imposed to ensure that an SMP communications provider cannot use its market power to restrict of distort competition on the relevant market or leverage market power on to adjacent markets.

7.14 Ofcom has also taken account of Oftel's guidelines on the imposition of access obligations under the new EU Directives (Imposing access obligations under the new EU Directives, www.ofcom.org.uk/static/archive/oftel/publicacations/ind_guidelines/acce0902.htm, referred to in this document as 'Oftel's access guidelines'). These describe the circumstances in which Oftel would consider the imposition of wholesale access obligations to be appropriate, give guidance on the nature of the wholesale products Oftel would expect to be supplied as a result of an obligation to provide access, and describe the conditions under which products should be made available.

Wholesale alternative interface symmetric broadband origination regulation 3:

Basis of charges obligations (cost orientation and a cost accounting system)

7.52 Section 87(9) authorises the setting of SMP services conditions imposing on the dominant provider rules concerning the recovery of costs and cost orientation. BT is currently required to provide certain wholesale interconnection services, including PCCs, at cost oriented prices. Under the cost orientation obligation, BT will be required to provide wholesale AISBO services at cost oriented prices, calculated on the basis of Long Run Incremental Cost (LRIC) and allowing an appropriate mark-up for the recovery of common costs. In other words, this obligation would add a requirement for cost orientation to BT's requirement to provide access.

7.53 The cost accounting obligation is discussed in Chapter 10, along with justification for the obligation against the various regulatory tests.

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

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

7.56 Ofcom therefore considers that it is necessary to apply a cost orientation obligation. The condition sets out that the charges for services should be reasonably derived from the costs of providing those services. It further states that the costs must be calculated on a forward looking incremental cost approach, and allowing an appropriate mark-up for the recovery of common costs including an appropriate return on capital employed.

7.57 The condition will apply across all services within this market. This means that the price of all services provided by BT in the market should be based on LRIC and allowing an appropriate mark-up for the recovery of common costs.

7.58 Ofcom confirms that all new services that are introduced into this market will also be covered by the same pricing rule. This is because new services in the same market would be expected to be subject to the same competitive conditions as existing services. This does not however mean that BT cannot recover costs appropriate to new wholesale services. The recovery of efficiently incurred costs for new wholesale services was discussed in paragraphs 2.23 – 2.25 of Oftel's access guidelines.

7.59 Although this condition will apply to all services in the market, and the expectation is that the treatment of new services under the condition will be the same as for existing services, there may be occasional expectations to this rule. This may arise where the new service is innovative and thus warrants a different regulatory approach. There are three ways in which such services can be dealt with.

i) The service may be so innovative that it falls in a completely new and separate market. In this case the appropriate regulatory obligations will be determined by Ofcom following analysis of this new market.
ii) The new service falls within the market but Ofcom determines that an alternative charging basis is appropriate. For example, a different charging basis may be appropriate for services offered during a trial.

iii) The new service falls within the market and the cost orientation obligation is applied, but there might be a range of prices which would be consistent with cost orientation given the uncertainty about the take up and future profitability of the service. In determining whether a charge is not cost orientated, Ofcom would consider whether the expected or achieved return on capital was excessive. In making this assessment, Ofcom will need to take account of the risk of the new service failing and the lost investment that would result. This therefore maintains and appropriate incentive for the communications provider to incest in new services and technologies.

7.60 The condition contains a clause enabling Ofcom to determine that a price need not be set on a forward-looking LRIC basis. This is particularly relevant to scenario ii) above where Ofcom determines that an alternative charging basis is appropriate. If BT wishes to set a price for a service in any of the markets on any basis than forward-looking LRIC, it must apply to Ofcom for permission to do this.

7.61 Ofcom considers that the cost orientation condition is justifiable and a proportionate response to the extent of competition in the markets analysed. It enables competitors to purchase services at a rate which will enable them to develop competitive services to the benefit of consumers, whilst at the same time allowing BT a fair rate of return which it would expect in a competitive market. The potential for a degree of flexibility envisaged in the approach to the recovery of cost of capital recognises that some investments will carry a higher degree of risk than others and does not remove incentives for the development of new services.

Responses to the draft notification – basis of charges obligations

7.62 Some communications providers suggested that a price control should be imposed on AISBO products, as Ofcom has done for TISBO products.

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

Conclusions – basis of charges obligations

> 7.64 Having considered the responses to the draft notification, Ofcom has concluded that a condition should be imposed in these markets in the form set out at Annex D [i.e. including Condition HH3.1]

Annex B dealt with the assessment of SMP. At B.423 to B.424, the report stated:

> Economies of scope
>
> B.423 Economies of scope arise in the AISBO market if the costs incurred in supplying AISBO can be shared with various other products. BT's economies of scope are likely to be greater than those of other communications providers. This is because BT offers a relatively large number of products and can therefore spread the costs of the AISBO common inputs over a larger array of products and services.
>
> B.424 One key example of economies of scope in the case of AISBO derives from the possibility of using duct to carry a range of products and services rather than just AISBO. Since the costs incurred by suppliers of AISBO for digging and laying duct are substantial, all communications providers try to take advantage of this and to maximise the number of products that can be supplied by means of the same duct. In assessing the importance of this potential scope economy for communications providers, it must be kept in mind that only the owner of the duct can take advantage of it. This means that with respect to the economies of scope derived from duct usage, BT is likely to have a significant advantage compared.
>
> Ease of market entry
>
> B.433 Barriers to entry are a strong feature of the AISBO market. As discussed above, substantial sunk costs are incurred by communications providers attempting to roll out duct and fibre to extend their networks to customer premises. While these sunk costs are lower if a communications provider is already supplying circuits at a certain premises, it appears to Ofcom that in many cases these sunk costs represent a substantial barrier to entry in the AISBO market.
>
> B.434 Alternative communications providers have supplied Ofcom with confidential cost data comparing, on a per km basis, dig costs with the prices of BT's retail LES circuits. These figures show that, by self-supplying SBO, communications providers are unlikely to be able to complete with BT's retail charges for LES circuits in many instances. For example, estimates supplied to Ofcom by communications providers concerning the feasibility of

> competing with BT's retail LES products can be higher than 10 years' worth of BT's revenues. This may be ameliorated to the extent that such dig costs could be spread over a variety of services. But, as discussed above, BT is likely to have a significant advantage over other communications providers in terms of economies of scope.
>
> **Absence of potential competition**
>
> B.435 "Potential competition" refers to the prospect of new competitors entering the market within the timeframe considered for the market review. In the context of AISBO, this refers to the prospect of self-provision by communications providers other than BT. The prospect of widespread entry by new firms appears to Ofcom to be limited. …

Annex C contained a cost benefit analysis for PPCs.