IN THE COMPETITION APPEAL TRIBUNAL

Case Nos. 1205-1207/3/3/13

Victoria House,
Bloomsbury Place,
London WC1A 2EB

21st November 2013

Before:
THE HON. MR. JUSTICE ROTH
(The President)
STEPHEN HARRISON
PROFESSOR COLIN MAYER

(Sitting as a Tribunal in England and Wales)

B E T W E E N:

BRITISH TELECOMMUNICATIONS PLC Appellant

- and -

OFFICE OF COMMUNICATIONS Respondent

AND B E T W E E N:

(1) CABLE & WIRELESS WORLDWIDE PLC
(2) VIRGIN MEDIA LIMITED
(3) VERIZON UK LIMITED Appellants

- and -

OFFICE OF COMMUNICATIONS Respondent

AND B E T W E E N:

(1) BRITISH SKY BROADCASTING LIMITED
(2) TALKTALK TELECOMMUNICATIONS GROUP PLC Appellants

- and -

OFFICE OF COMMUNICATIONS Respondent

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

H E A R I N G D A Y TWELVE

A P P E A R AN C E S

Mr. Rhodri Thompson QC, Mr. Graham Read QC, Ms. Sarah Lee, Mr. Ben Lynch and Ms. Georgina Hirsch (instructed by BT Legal) appeared on behalf of the Appellant, British Telecommunications PLC.

Mr. Meredith Pickford and Mr. Julian Gregory (instructed by Herbert Smith Freehills LLP) appeared on behalf of the Appellants (1) British Sky Broadcasting Limited and (2) TalkTalk Telecommunications Group PLC.

Ms. Dinah Rose QC and Mr. Tristan Jones (instructed by Olswang LLP) appeared on behalf of the Appellants (1) Cable & Wireless Worldwide plc, (2) Virgin Media Limited and (3) Verizon UK Limited.

Mr. Pushpinder Saini QC, Ms. Kate Gallafent, Mr. Hanif Mussa and Ms. Emily Neill (instructed by the Legal Department, Office of Communications) appeared on behalf of the Respondent.

THE PRESIDENT: Good morning. Mr. Pickford?

MR. PICKFORD: I was simply going to say, there was an issue raised about the lateness of our submissions. Obviously we sent a letter to the Tribunal. I apologise for that, and I hope everything is in order.

THE PRESIDENT: We have also had a letter from BT regarding something, Mr. Pickford, in your closing submissions. Perhaps you can help me on that because I think we should sort this out at the outset. If one looks at your closing, I think it is on p.18, para.46. You refer to Mr. Robinson saying BT had received of the order of £232 million more than FAC. You then in 46.1 say that over the three year period the charges for other services were £450 million a year. Then you say that this to total over recovery to the tune of around £600 million. Where does the 250 come from?

MR. PICKFORD: I think that may be a typo. I think it probably should be ----

THE PRESIDENT: 232, should it not?

MR. PICKFORD: -- the 232 figure, yes. These are all relatively approximate, it should be the 232.

THE PRESIDENT: Even so, so you have added them up and taken off 95 and you get to 600. Then you say in 46.2 that Sky's is much larger, and that the figures there set out - which figures are you referring to?

MR. PICKFORD: That is the figure in the evidence from TalkTalk during the administrative process. That is the figure marked in ST1-3 at tab 12.

THE PRESIDENT: What I do not follow is this: Mr. Robinson's evidence was that the £232 million is over the whole period?

MR. PICKFORD: That is correct. There is no change in relation to the £232 million. Would it help, Sir, if I have explained what the issue is and how it has arisen?

THE PRESIDENT: You say the £232 million is over the three years, or the dispute period?

MR. PICKFORD: It is actually over the dispute period, so it is actually over four years.

THE PRESIDENT: So that is right?

MR. PICKFORD: That is correct.

THE PRESIDENT: What you say is that the other figure ----

MR. PICKFORD: The figure that is wrong is effectively the £450 million figure that was taken from the TalkTalk submissions in response to the Ofcom consultation on the dispute determinations.

THE PRESIDENT: That was the basis on which the figure was put to Mr. Myers, is it not?

MR. PICKFORD: That is correct, Sir, yes.

THE PRESIDENT: You are now saying that it was put on an incorrect basis?

MR. PICKFORD: That is correct, Sir.

THE PRESIDENT: I really do not think you can - he has not had a chance to comment on that. There has been no opportunity for anyone else to consider that, nor for any re-examination of Mr. Myers on that point. It is obviously a very substantially different figure. You may wish to address us on it, but our feeling is that it is really not appropriate to introduce that at this stage. I would add, before you comment, although the figure you seek to put forward is obviously striking, the substance of your argument is, I think, not affected by this figure.

MR. PICKFORD: That is entirely correct, Sir. It is unaffected, and if I could just explain our position. Obviously, I put forward figures to Mr. Myers on my understanding of what the £453 million figure in the TalkTalk submissions meant. On its face it does appear to me a total figure. I was then told on Sunday by Mr. Heaney, who read the transcript of that cross-examination, that it was not, in fact, a total figure, as I had understood and as appears on the face of it, it was an average figure. In those circumstances, I felt that the appropriate thing to do was at least to explain the fact that the figure that we were previously relying upon was wrong. I quite accept that it is a matter for the Tribunal what weight it wants to attach to the figures. I put my point to Mr. Myers based on my understanding of it. We cannot go over that again. I was not trying to pull the wool over anyone's eyes. It was important to explain that there was, in fact, an error. If I continued to make my submissions on the basis that that was, in fact, what that figure meant, I would effectively be misleading the Tribunal. As I said, I quite understand it is a matter of weight, but it did seem important to at least draw the error to the attention of the Tribunal. That is all we are doing.

THE PRESIDENT: I think one can say that it was put on the basis of £600 million, but Sky/TalkTalk in fact say that, through an error, that figure is understated.

MR. PICKFORD: The other point just to make about it is that the new figure can actually be derived from figures that are all in the documents. It is not a new figure that is, as it were, evidence from Mr. Heaney. It is simply taking figures from the various RFS and applying those calculations to them. That is what we say in relation to that.

THE PRESIDENT: Equally, BT might have a lot to say about it.

MR. PICKFORD: They might.

THE PRESIDENT: We cannot spend two hours exploring the figures at this point. We can substitute for 46.2 that, in fact, through an error you consider that the figure is substantially higher and leave it at that. I think the assertion that it is about £1.8 billion is not one that we can accept at this point.

MR. PICKFORD: I understand, Sir.

MR. READ: Just to be clear, BT has, of course, in respect of Sky and TalkTalk's case put forward a number of reasoned submissions in its closing submissions about all of this material being far too late at the stage it is being introduced, and we set that out at paras.578, onwards, in our closing submissions.

I do not want to take any more time up on it, because I am very conscious of the time limits that are imposed upon the parties today, so I will say nothing further at this stage.

THE PRESIDENT: Yes, but we thought it is important, given the letter from those instructing you, to clarify this point right at the outset. Mr. Read, if we deal with it in the way I suggested, namely that Sky/TalkTalk in closing said that, through an error, the figure they submitted is higher and is an understatement, but we make no finding on that at all. It is just that they made that comment.

MR. READ: It is just that they do state in terms in para.47 of their closing submissions that it is the best evidence before the Tribunal, but there we are.

THE PRESIDENT: I have made it clear that we are not accepting that statement of £1.8 billion. It is simply that they have said that, through an error, the figure of £600 million is an understatement.

MR. PICKFORD: Sir, just for your note, the error and how it arose during cross-examination is explained more fully in footnote 109, which is annex A.

THE PRESIDENT: Yes, I saw that. Annex A, equally, is going to fall with 46.2, because that goes together. So Annex A is disregarded.

MR. PICKFORD: Of course. There was a suggestion of a lack of proprietary ----

THE PRESIDENT: No, it is not suggested that ----

MR. PICKFORD: -- by BT and certainly that was not ----

THE PRESIDENT: We are not suggesting it was an intention to mislead anyone.

MR. PICKFORD: We were simply doing our best given what we are told at, unfortunately, rather the eleventh hour.

THE PRESIDENT: Yes. Mr. Saini?

MR. SAINI: Sir, I have got a confession to make, first of all, which is that in the time available I have read BT and Sky's and Ms. Rose's closing submissions once and, given their length, very quickly. I confess I have not absorbed every point, and I am going to do my best in the time that I have got to address what I believe are the principal points and to seek to explain to the Tribunal why essentially this is a straightforward case, despite the volume of material...

I should also say that I am slightly alarmed by the fact that the point that we have just been addressing appears in footnote 140 something. There are similar points, in particular in relation to matters appearing in Mr. Pickford's closing submissions, which were never put to Mr. Myers, and particular documents that were never put to him. What I am going to do in the interests of time is by the end of the day just provide a list of those, rather than taking up time with those. There are a multiplicity of points, not just in Mr. Pickford's skeleton, but also in the skeleton of BT, which are completely new. I am just not going to have time to deal with them orally. What I am going to try and do is deal with the eight grounds - that is six grounds from BT and two grounds from Sky - in the most effective way possible.

Before I start on BT ground 1, I just need to say something about the position of Ofcom on the witnesses, and in particular could I ask the Tribunal to take up Mr. Pickford's closing submissions at p.5. We have not addressed this issue in our closing submissions, but it is appropriate that we indicate our position. Unlike the position taken, certainly by Mr. Pickford, and I am not sure if it is taken by the other parties, our submission is that all of the experts in this case gave honest evidence, they did their best to assist the Tribunal, and although they have firm views, no criticism can be attached to any of them. I include within that Dr. Maldoom, Dr. Houpis, Mr. Harman and Mr. Myers, who gives evidence both as an expert and partly as a factual witness. Therefore, we do not associate ourselves with any of the observations made by Mr. Pickford, some of the critical observations made in relation to BT's experts.

I should just say the same thing about Mr. Robinson. We did not cross-examine him, but we again say that he was an honest witness doing his best. Also Mr. Holt, I am reminded by Ms. Rose.

THE PRESIDENT: You have made it clear, all witnesses.

MR. SAINI: All witnesses, with no exceptions, no one is to be criticised. I must, must take exception to what is said in paras.12 to 15 of Mr. Pickford's skeleton in relation to Mr. Myers. There is a criticism there, perhaps a muted criticism of Mr. Myers. Mr. Myers provided, we submit, honest evidence, genuinely held views, and although he is criticised in para.14 for his understanding of the 2004 report, as you will hear from me in due course, we say that Mr. Myers' understanding of the 2004 report, and in particular the critical paragraphs, that is not an understanding of an economist, it is an understanding that anyone would gain from reading those paragraphs. I will deal with that in more detail when we get to Sky ground 1.

So the basic introductory point is that we are not inviting the Tribunal to make any critical

comments in relation to any of the witnesses.

MR. PICKFORD: Just for avoidance of doubt, we are not impugning any of the witnesses' honesty at all. We obviously make certain criticisms of Dr. Maldoom's evidence, but not in relation to dishonesty whatsoever.

MR. SAINI: If I can go then immediately to BT Ground 1, and I was hoping on Tuesday that we could deal with this very quickly but unfortunately, given that BT have repeatedly said in their closing submissions and also in the cross examination of Mr. Myers that they do not understand our case in relation to Ground 1 I do need, with some care, to go back to that. The case in relation to Ground 1 is very important because, in our submission, not only does Ofcom's position dispose of Ground 1, but it also determines Ground 2 and largely Ground 3 against BT.

At the risk of repetition we need to go back to basics in relation to Ground 1 and the sole issue before this Tribunal is whether when construing Ground 1, connections and rentals are to be aggregated. The Tribunal is not concerned with other potential services or components. Our submission is simple, if one takes out the statutory materials, the legislation bundle, which is bundle E of the core bundles, and if I could ask the Tribunal please just to go to the condition again, which is divider 12, which is at the back of the final statement where the condition is set out, p.44.

The Tribunal already has on board the term "network access" is a statutorily defined term and p.40 makes clear that the statutory definitions are to apply unless the contrary is indicated. So we are all agreed, and I believe this is common ground, that network access for the purpose of Condition HH3 is defined as in the Statute. But, as I submitted in opening, there are two matters the Tribunal needs to focus on when considering any particular service or component.

First, is there a charge offered, payable or proposed, and I believe it is now common ground, but my friend will tell me if I am wrong, that there is a charge offered, payable or proposed, for connections and rentals separately. Secondly, that must be for network access.

While we are in that bundle, I will go, I hope for the last time, go to the definition of network access, within divider 5, at p.35.

THE PRESIDENT: Yes, you have showed us this.

MR. SAINI: Absolutely. My friend is suggesting there is something unclear about our position. We do not accept it is unclear, and that is why I need to put it on the record. Our position is that connections and rentals separately amount to network access within the expanded

definition within s.151(4), and we submit that that definition makes clear that component or items - I am sorry page ----

THE PRESIDENT: It depends whether one is looking at the original Statute ----

MR. SAINI: Yes, either on p.51 or p.36. It is s.151(4), and I need to make our position clear that if you have a "component" - using a neutral word for the moment - and it is something used within network access, but in itself it could not provide you with connection because you need other items, that component nevertheless falls within the definition of network access. I omitted to show the Tribunal in opening a passage of the PPC case where exactly the same submission was made at that time by Mr. Read in relation to trunk. You will recall that in PPC the issue was whether or not there were terminating segments and trunk segments, and Mr. Read was there arguing that trunk segments, which was the issue in the PPC case, were not network access because, as was common ground, trunk on its own would not give you connectivity, you need to buy something else. But exactly that argument was rejected, based on the definition by the Tribunal in the PPC case, and I should just draw that to your attention, Sir. It is within the same bundle E at divider 9, at p.65 of the Judgment, para. 225, where it says:

> "BT sought to contend (eg in paragraph 124 of its Notice of Appeal) that the provision of trunk services alone could not amount to the provision of 'Network Access'. If the definition of Network Access were confined to meaning 'interconnection of public electronic communications networks' there might be some force in this, but it is plain that 'Network Access' has a much wider meaning than this, extending to (for example) 'any apparatus comprised in such a network or used for the purposes of such a network or service'. It plainly can include a 2 Mbit/s trunk segment without other segments that make up the circuit."

One could just substitute within that paragraph for "trunk" "connection or rental". So we submit ----

THE PRESIDENT: No, we have got the point.

MR. SAINI: If that is the clear construction in relation to BT Ground 1, before turning to BT Ground 2 one has to ask, and this appears to be the nub of Mr. Thompson's argument at least, can one avoid that construction by reference to the fact that in the 2004 LLMR separate sub-markets were not defined for connections and rentals.

We submit, first of all, that whatever was in the 2004 LLMR it would not be a legitimate exercise in construction of a public law instrument to ignore the plain meaning which followed from the statutory definitions, but aside from that Mr. Thompson's point is a bad

one, because as is clear all that the 2004 LLMR did was establish that BT had SMP in a particular market, the AISBO market, and then it imposed Condition HH3 for any items of network access which fell within that market. It is clear that new products could be introduced within the AISBO market, they would still fall ----

THE PRESIDENT: We have not heard yet from BT, at the moment I do not follow why you need a separate market and a separate charge because on that basis BES 100 has to be a separate market from BES 1000 and it clearly is not.

MR. SAINI: Sir, you have my submissions; I will not say anything further in relation to BT Ground 1. Just one final issue which is there is a whole list in Mr. Thompson's skeleton argument of other types of component, say, where they are throwing down the gauntlet and they are saying: "If that is your case, Ofcom, what about all these other things?" I believe it is para. 91 but someone will tell me if I am wrong, where they talk about other items, such as: initial circuit, subsequent circuit, fibre charges, cancellation charges.

There are two answers to that. First, this Tribunal is not concerned with looking at what might be the position as regards other components; we are just concerned with connection and rental. There may be a different position. What the Tribunal would have to do is to look at each of these individual items and consider whether or not they fall within the extended definition of s.151. So I simply say to the Tribunal you do not need to get into that, what may be the position as regards other components.

Mainlink, for example, if the Tribunal were interested in it, we would say does definitely fall within the definition of network access, but these other items, initial circuits, or additional charges for fibre, one does not need to get into that, so I will turn now to BT Ground 2.

Our primary submission is that whatever the economic arguments may be for aggregating connection and rental one cannot use those arguments to divert one from the clear construction that the Tribunal should arrive at under Ground 1. It remains unclear to us because there is a difference in position between the notice of appeal and the skeleton argument, what BT's main argument is on Ground 2. Is it a free-standing argument that whatever the construction is in relation to Ground 1, the Tribunal should be diverted from that construction because of these economic arguments, or is the argument that these arguments under Ground 2 support their arguments under Ground 1?

Our primary submission is none of the arguments are relevant, and there is a lot of time spent in evidence and in the skeleton arguments discussing the evidence on Ground 2. If one clears it all away one thing that is clear on the basis of the evidence of all of the

witnesses is that connection and rental are separately economically meaningful. One can disagree as to the extent and relevance of the difference, but it is not the position of BT, as I understand it, that there is no economic significance, and I do need to go back to the Determination now because for the first time it appears to be being suggested in BT's skeleton argument that what I suggested in opening was undisputed, in fact, is disputed. You will recall that in opening I took the Tribunal to confidential tables which showed the different purchasing patterns.

THE PRESIDENT: Yes, the confidential tables.

MR. SAINI: That is right, and I am not going to discuss the figures but, as I understand the position, and someone will give me the reference to this - I think it is in one of BT's annexes to their skeleton argument - they are asserting that they do not accept these tables, and one can see them, the body of them appears at p.71, the explanation begins at p.70 in the Determination.

If we look at BT's closing at para. 116, what is said there is:

> "BT does not accept the analysis of circuits conducted by Ofcom in the Determination."

If this is intended to refer to these particular tables then we do not understand the basis upon which these are disputed. The footnote refers to Mr. Coulson's report, which refers to a circuit duration assessment, but we do not understand Mr. Coulson to be disputing, in that part of his report, these particular tables, and whatever Mr. Thompson or Mr. Read have to say about this we are proceeding on the basis that there is not a factual dispute in relation to the variation in proportions of connections and rentals by customer.

It may be that BT have got a different point. May one go to para.167 of their closing. I say this because it is not clear to us what the factual dispute is. This passage does refer to those tables at 8.2. It is there suggested: "(a) The variation in average lengths of circuits between CPs is not significant, contrary to the position as suggested by Figures 8.2-8.6 of the Determination." The figures in 8.2 to 8.6 are not disputed as I understand it, those charts. Whether or not it is significant is a matter of assessment. But just looking at those tables at pp.71 and 72, even a crude assessment would suggest that there is a significant difference in purchasing patterns.

I know that Ms Rose deals with it at some length in her skeleton argument and she may deal with it orally. Our overriding submission is that BT's arguments in relation to BT ground 2 do not get off the ground because once the construction is clear these points do not matter. In so far as they do matter, it appears to be common ground (although one can argue about significance) that connections and rentals are separately meaningful.

I am going to move on to BT ground 3. This will take a bit more time because it is quite difficult to see exactly what BT is saying in ground 3. Although it has the heading "Legal Certainty" there is a bag of other complaints within ground 3, and I need to deal with each of them within the time I have got.

The principal complaint appears to be that Ofcom was obliged, in advance, to specify that it was going to treat connections and rentals separately. That is the principal complaint. And that Ofcom has conducted itself, it is said, in a way which indicated that it was not going to treat connections and rentals separately. That is the nub of the complaint before we come to the individual complaints.

We say that the entirety of ground 3 starts from the wrong place. That is because there was no obligation upon Ofcom to explain to BT what the construction of Condition HH3 was. That is a matter of law, and we submit the construction is clear. BT's complaint appears to be: you should have told us that construing Condition HH3, we should understand that to mean connections and rentals assessed separately. But it is really for BT to understand what the condition says. It is not at all obscure. That is the first point.

The second point, sir, undermines the entirety of ground 3. It is that it is not BT's case that it set its prices at any time based upon any representations or conduct by Ofcom. I said in opening (and it was not contradicted by Mr. Thompson) that BT are not asserting any form of legitimate expectation. That being the case, it is quite difficult to see under which legal head these complaints are advanced, because if BT are not setting their prices to be cost oriented on the basis of a representation by Ofcom, what exactly is the juristic or legal nature of this complaint?

Just to identify the particular items which are relied upon as some form of statement of Ofcom's position (although it is not said that there was any legitimate expectation flowing from this) there appear to be three particular items relied upon. First of all, it is the fact that in the early years, in the RFS for 2005 and 2006, BT was not reporting connections and rentals on a disaggregated basis. The second point is the approach that Ofcom took in the 2009 LLCC when it set the price control for the future. The third point is a letter from 2010.

Dealing with each of those points in turn. We are going to look the RFS in more detail later when I address Sky's ground 1. The threshold point in relation to the RFS is that the RFS and the reporting obligations do not determine the meaning of the cost orientation condition. As is clear, the degree of specificity in the RFS changed over time in response to representations from various parties. But more importantly, sir, it is not (I emphasise this, not) BT's case that when it was reporting aggregated figures in its 2005 and 2006 RFS, it was also at the same time, when working out its prices, deciding to aggregate connections and rentals for the purpose of cost orientation. That is not their case.

Equally, in relation to the 2009 LLCC, it is not their case (although this is towards the end of the period of complaint) that after 2009, when they saw that Ofcom, for the forward looking price

control, was aggregating, they were then setting their prices on an aggregated basis. There is no evidence of that.

Similarly the 2010 letter (someone will tell me the precise date of the letter), it is not their case that they were relying on that letter from 2010 onwards and proceeding on the basis that aggregation thenceforth was OK.

These points are, without being disrespectful, written in sand. They are general, hypothetical complaints which might have some traction if they were the basis for some reliance, but they were not relied upon. In fact, what seems to have happened (and this only emerged in the candid evidence of Mr. Coulson) is that there was simply no communication between those preparing the RFS – in other words, the regulatory arm of BT – and those who were setting the prices. It is not surprising in those circumstances, sir, that BT cannot advance a case based upon the reliance. I am reminded that the date of the letter is 6th December 2010.

We say that the absence of any reliance is fatal to BT's general case based on legal certainty. But then aside from that I said there was a kind of ragbag of complaints under ground 3 and I need to deal with those, because ultimately the Tribunal will need to with these in its judgment. May I ask the Tribunal to look at our closing skeleton and to go in particular to p.20 first of all. We have identified that there are a range of complaints. The first complaint is one about averaging, that Ofcom should have undertaken some averaging.

We say that in relation to the general averaging complaint, Mr. Myers gave very clear and compelling evidence that averaging was not considered appropriate because it might, in his words (which we have quoted at para.31 p.20) "render a false conclusion". However, the underlying principle, which suggests averaging is a logical thing to do, that was applied, which is Ofcom was considering the position across various years.

Then there are separate complaints which we have set out at p.23, which are complaints in respect of four particular products over certain years. It is quite important here to be careful in assessing what the legal complaint is by BT. We say that in respect of each of these complaints Ofcom made a decision on the facts, and crucially (and this is the point that in certain of these occasions of the four it was not put to Mr. Myers and we have identified in our skeleton argument this point) Ofcom was saying to BT: please explain to us that in this year, which might be an aberrant year, you appear to have exceeded DSAC by a certain level; please give us some evidence to explain why; is there some extenuating circumstance?

The evidence, which was fully set out in the Determination, shows that BT was not able to come up with any extenuating circumstance, other than one common feature which always appears, which is: please let us aggregate. But for the reasons which I have already addressed you upon, aggregation was not possible.

What BT are effectively asking the Tribunal to do on these four occasions now is just second-guess Ofcom on the facts. The way they have dressed that up, in an attractive way, is to say that: you have

got to let us off some time, because if you do not let us off some time you are being mechanistic in your approach. But we say, with respect, that is an unfair criticism because we were not being mechanistic, given that in the Determination we were positively asking BT for evidence as to why they should be forgiven in these particular years. So we submit there is neither an error of law nor an error of fact here.

It is also important to bear in mind, and I am going to come to this when I address Mr. Pickford's arguments, that the approach of the Tribunal in *PPC*, which BT does not seem to be disagreeing with in this case (and I emphasise this point), was that if there is pricing above DSAC that is intrinsically excessive and it requires an explanation. Therefore it was very much for BT to come up with an explanation as to why it should be excused. It is not an answer, which seems to be Dr. Maldoom's position, to say that actually DSAC in itself is either arbitrary or inherently uncertain. Once you have decided to apply a test you have got to follow through on the consequences of that test having been failed.

Sir, I want to next address BT Ground 4, which contains a variety of accounting complaints, and it is important, before I go into the detail of those, to ask the Tribunal to go to p.30 of our closing skeleton where we set out our position in relation to adjustments to the RFS, because these points are very relevant not only to BT's Ground 4 but are also relevant to Sky Ground 2, which is the RAV adjustment. My friends will correct me if I am wrong, but as I understand the position of each of the parties, they accept that the framework of para.52 is an appropriate framework when one is looking at adjustments to the RFS. It is certainly no part of either Sky or BT's appeal that that is an inappropriate framework. Obviously they can disagree as to how the particular principles in the framework apply, but I do not believe that it is the position of any of the parties that the framework in itself is inappropriate.

It is also important to underline the point, which I believe was accepted by BT's witnesses (and this is both Mr. Coulson and Dr. Maldoom), that the RFS provide the only visibility - which is, I believe, the term that I used when I was asking the questions - as far as outsiders are concerned, the CPs. We have set out that evidence at p.34, para.57, and, in particular, Ms. Rose's cross-examination. So the starting point must be that there is a presumption that the RFS will be adhered to, and a provision of the RFS will be adhered to.

With that introduction, it is appropriate to look at the separate cost adjustments and if one goes, please, to p.36, para.59 there are essentially four matters. One is excess construction costs; the second is transmission equipment costs, and then there are two items under the heading of "provisioning costs", so there is a level issue and an allocation issue.

The first question is the question of excess construction costs, but there is an important

underlying principle which we have identified between para.62 and 65, and this is probably the first case in which this issue is going to be addressed. It is clear, on the basis of the Court of Appeal's decision, that new evidence can be admitted and, without opposition from anyone, new evidence has been admitted before this Tribunal. But that does not answer the distinct question, which is what should the Tribunal do with that evidence. In particular, there is an important consideration, which is that parties in BT's position should be encouraged to deploy the entirety of their case with accurate information during the administrative phase. In particular, if the information which BT seeks to put before this Tribunal was information which was to hand during the administrative phase it should be rare that that information should be put before a tribunal on appeal and taken into account. That is going to be particularly important, Sir, when we look at some of the methodology issues in relation to transmission equipment costs and provisioning costs, but, just dealing with PCCs, first of all, there was an exchange I had with the President at the start of the case. This is a case (see p.38, para.68-71 of our skeleton) where there appears to have been an error by BT. BT was asked to provide a figure and we have set out at footnote 17 the chronology of events. It is important to bear in mind here, Sir, that the response which led to the information being provided was a response to a s.191 notice. That is a formal notice requiring BT to give information to Ofcom which Ofcom is then going to use in the course of this dispute resolution. BT now say there was an error. We are not saying that there was no error there. We are accepting that the information they are now putting forward is accurate information. But it would be very easy for this Tribunal to say, "Well, this is a minor matter. Let us just rely on the new information". But one needs to step back and look at the consequences both for this case and for regulation generally. We say that if BT wants to persuade this Tribunal to allow it to rely upon the new information it has to explain why the mistake was made. We submit it has not explained why the mistake was made. If there is not any such threshold question then what is going to happen is that whenever new information comes along a party will appeal a dispute resolution determination and say, "Well, actually I know that I cannot say this Determination was wrong in law but I have got this new information and I want it corrected". We are saying that is not impossible but there is a burden which BT has to discharge of explaining why the error occurred. We say it is notable that, other than asserting in their skeleton argument, "Well, there is an error", that no good reason has been advanced in this appeal, either by way of argument or evidence, to explain why the error should be corrected.

Transmission equipment costs, which is the next matter, is more complex. Here there was

evidence from Mr. Coulson, and we submit that we have fairly summarised that evidence between paras.72-83, and I should seek to explain why we say, in this particular case, the Tribunal should not allow the new methodology to be put forward by BT. Mr. Read suggested, in opening the case, that there was some obscurity as to the particular methodology which Ofcom had used in making the adjustment to transmission equipment costs. The Tribunal will recall, dealing with it in as lay terms as possible, that there was a need to find a method of converting charges which were depreciated over various years into charges which could be taken into account of in P&L for particular years. That is the very, very broad issue. There are various ways in which one could do that. That is not disputed. Ofcom asked BT for the methodology BT used in its RFS and Ofcom expressly used that methodology (see para.77 (1)). So contrary to what Mr. Read was saying in opening, this is not a case of some obscure methodology where BT were only after the event, after some deep investigation, able to work out what Ofcom had done. The evidence of Mr. Coulson and the documents that we put to him made it clear that he provided the relevant information and methodology to BT.

THE PRESIDENT: To Ofcom?

MR. SAINI: I am sorry. That he, on behalf of BT, provided the relevant methodology to Ofcom, and what he was effectively saying was that that was clear to him but it may not have been clear to other people within BT. If I could ask you, please, to look at para.80, where we set out in full the very candid answer that Mr. Coulson gave. A straight question was put to him that the source of the relevant paragraph of the draft Determination was him, and that it was clear that "the methodology that Ofcom wanted you to adopt was a methodology based on depreciation and MCE on the same basis as the RFS. Is that correct?" So, with respect to Mr. Read, it was not at all unclear to BT, certainly not unclear to Mr. Coulson who was the main point of contact between BT and Ofcom, as to what the methodology was. So we submit that in circumstances where Ofcom has made clear what the methodology is, BT does not respond to it and, indeed, the author of the methodology is BT's Mr. Coulson, it cannot be right for BT then to be allowed to put forward yet another methodology for the purposes of this appeal. It is common ground, Sir, that the methodology that is now being put forward by Mr. Coulson is completely new.

Sir, in respect of transmission equipment costs, we respectfully invite the Tribunal not to get into the issue of whether the methodology which is now put forward, the new methodology put forward by BT, is better than the methodology that was used by Ofcom for the simple reason that BT had every opportunity to correct Ofcom, if it thought Ofcom was making an

error, and indeed Ofcom used a methodology provided by BT at that time. So there is no need for the Tribunal to roll up its sleeves, to start looking at whether or not the new methodology is better. It is certainly not suggested by BT, or indeed by Mr. Coulson, that the methodology that was used by Ofcom was in any way perverse or irrational; completely unreasonable. It is just that they have come up with something which they think is better.

I am going to turn then to the first head of provisioning costs. This is quite important again because, although the Tribunal may say and BT said the figures are relatively modest, there is an important issue of principle here. So, as the Tribunal will recall, there are two issues on provisioning costs. One is the level of provisioning costs and the second is the allocation of provisioning costs in a particular year. As to the level, putting it in very, very broad terms (we deal with this in our closing skeleton between paras.88-110), the very broad issue is as follows. For certain years it looks like the level of provisioning costs allocated to Ethernet services was low and Ofcom itself recognised that. I do want the Tribunal to look at this because there are some rather unfair criticisms made of Ofcom's Determination in this regard. If you would please go in Bundle B, that is the Determination bundle, to para.13.357 at p.309. At 13.357 Ofcom was accepting the position that the provisioning costs appear to have increased significantly in the later years - one can see 2009/10 figures - than in the earlier years. One can infer from 13.358 that evidence was requested from BT to explain why is it that those provisioning costs are low in the earlier years and high in the later years.

What happened then, and this is quite important, is that after the Final Determination and in the course of preparing this appeal, Mr. Coulson, who by that stage has moved to Ernst & Young, is sent off to look at the Aspire system, which is a computer system within BT, to work out what has happened to those provisioning costs. He accepted, again very candidly and honestly, that there is no reason at all why during the administrative phase BT could not have provided that information. We have quoted at para.92, p.44, his evidence, and underlined the relevant part. If I may quote the very last passage of his evidence there, he says:

> "… and I asked BT to provide Aspire downloads to provide that information to me. It actually wasn't a very difficult job for BT to provide that."

So they had the information, but they did not provide it.

Putting that point to one side for the moment, there is a second issue which arises here, which is that under the methodology, even if BT is now allowed in principle to re-allocate these costs from other services to Ethernet, a very important issue of principle, which is that

again, putting it in summary terms, those costs would have been claimed somewhere else, and those costs were claimed, again it appeared in the evidence of Mr. Coulson, against other copper services. We have set out again the relevant evidence at p.45, para.103, and Mr. Coulson accepted that those other copper services were regulated. Therefore, BT would have got a credit for the costs in relation to those other services. The price control for those other copper services would have been configured on the basis that those costs were part of BT's reasonable costs for those services.

THE PRESIDENT: Yes, I think we have got the point. You say it fails, I think it is step 4 of the framework methods.

MR. SAINI: Indeed, and then it just comes down to the question ultimately of, how much difference did it make. It is a *de minimis* point. You say it is a *de minimis* point, so many million out of many billions, but it still underlies a point that an earlier regulatory decision was made giving credit. We say again that whatever may be the materiality of the impact, it would be improper, applying the RFS, to allow this type of shifting of costs.

Then the fourth and final point, upon which again the position of BT is rather puzzling - this is the allocation of provisioning costs in a particular year - and here while we have that Determination open it is actually dealt with on the same page. If one goes to the top of p.310, 13.361, BT had allocated provisioning costs to rentals rather than connections.

It is again puzzling to see on what basis BT asked the Tribunal to intervene in this case. BT have a discretion as to how it was going to allocate these costs. It allocated them in a particular way. The only reason that appears to be being advanced now for changing the allocation - I know BT will not accept this - is that "If we can switch the allocation now, we are going to have to pay less by way of overcharge". That is the reality. That is the only reason why they want to do the shifting. There is no other reason.

THE PRESIDENT: All the arguments in this case are being advanced for that reason one way or the other.

MR. SAINI: Absolutely, but one could understand it if there was a point of principle, such as in relation to provisioning costs they say, "Actually, we should have allocated these provisioning costs from other copper services to Ethernet, we did not do that". It is difficult to see what the point is here, other than, "Can we please allocate these costs?" It appears to be common ground that BT could allocate these costs one way or another under the discretion they have. They have decided to allocate their costs in this particular way as between connections and rentals, and now they want to move it. You ask, "Why is that? Why do they want to move it?" It appears to be nothing other than ultimately, "Let us do

this, please, let us move away from what we have done because it will reduce the overcharge". We say that is not a principled basis for making the shift.

Certainly under the methodology BT would need to show that it was obviously inappropriate for Ofcom to hold BT to its original allocation. They do not appear to be suggesting that.

We say, Sir, that in relation to each of the accounting complaints the Tribunal should not allow BT the indulgence of a departure from their RFS and in particular the indulgence of allowing an error to be corrected.

I want to now turn to BT ground 5, which again has somewhat changed, given the way that Mr. Thompson puts his arguments. I am going to say this so that it is absolutely clear that we are dealing with what we understand BT's argument to be.

The primary argument that we understand BT is putting forward in relation to ground 5 is that the power to order repayment only operates as regards payments which are made after Ofcom is seized of a dispute.

I should say, first of all, just dealing with this primary argument, that it is not clear to us, and this is not a criticism, what BT means by "seized of a dispute". Does it mean the date upon which a dispute is sent to Ofcom, or does it mean the date upon which Ofcom decides to accept the dispute? The Tribunal will be familiar that those are not the same dates.

THE PRESIDENT: You have a table in your closing?

MR. SAINI: Yes, so it is not clear on the primary case. The secondary case, which Mr. Thompson calls the "compromise", appears to be as follows: if one looks at both the Framework Directive and the Access Directive, and it may be useful just to take those out now, the argument appears to be that the power to award repayments only applies if the relevant condition, the cost orientation condition, is enforced at the time Ofcom is making its decisions. So if one looks at the Access Directive, Article 13.3, which is in divider 1, which provides:

> "Where an operator has an obligation regarding the cost orientation of its prices …"

etc. Mr. Thompson is arguing that what the European legislator here was doing was when it was giving NRAs the power to require adjustments, it was only giving the NRA the power to require adjustments when there was actually in force at the time the NRA was making its decision an obligation. So the argument goes, as we understand it, that all of the relevant cost orientation obligations in this case were repealed (for want of a better word) in 2008 and replaced. Therefore, as regards those obligations which were repealed in 2008, there is

no power to require any adjustment of prices. That is, as I understand it, the compromise argument.

Just dealing with the two arguments as they are, as to the first argument, as we said in opening, there is nothing within any of the Directives, or indeed within s.190, to support this form of temporal limitation. Indeed, we would say that the logical consequence of Mr. Thompson's argument is the Court of Appeal's decision in the *PPC* case was wrong and Mr. Thompson suggests that Ofcom accepted in opening that the Court of Appeal's decision may have been *per incuriam*.

I do not really know what *per incuriam* means, but I need to deal with that, because we do not accept -----

THE PRESIDENT: I do not think he accepted that. I think I do know what *per incuriam* means, but I do not think you made any admission of that at all.

MR. SAINI: I just need to make it clear, and it is useful just to have open BT's closing in relation to this. It is within appendix D, the first page, and it is said in para.2:

> "Counsel for Ofcom did not support that submission, apparently accepting that BT's case was a legitimate ground of appeal but any inconsistency between BT's ground 5 and the approach of the Court of Appeal could be regarded as a plea of *per incuriam*."

Let us just get rid of the words "*per incuriam*", because my understanding of that generally is that it means a case has been wrongly decided, or decided without reference to an appropriate authority. All I was accepting was the particular argument being made by Mr. Thompson, the particular argument based upon these Directives, was not an argument that was advanced, I believe, by Mr. Vajda on behalf of BT at that time in the *PPC* Court of Appeal case. That is all I am accepting. So it is a new argument, but the logical consequence of the argument would be that the Court of Appeal's decision was wrong.

Just going back to the argument on the merits, as I have submitted just a few moments ago, and as we submitted earlier, it is not suggested by Mr. Thompson that within the express language of the provisions of either the Access Directive or the Framework Directive, there is any support for this temporal limitation - his primary argument, the argument based upon the dispute being one in respect of which there is a power to award repayment from the moment that Ofcom is seized.

The secondary argument, the compromise argument, before coming to the language, on which Mr. Thompson relies, we say that it has a very odd result which should ring an alarm bell. The odd result is that once the dispute lands on Ofcom's desk, if at that date the

relevant obligation happens to be in force, still then one can go back without limit as to time, which Mr. Thompson says is one of the problems with Ofcom's approach, which is no limit as to time, yet if it lands on Ofcom's desk the day after a condition has been repealed, however egregious the overcharging Ofcom has no power to order repayment. It is a very, very odd consequence.

That having been said, we say that this compromise argument is not actually supported by the language, so when Article 13(3) says that where an operator has an obligation it is clear that BT did have an obligation. The fact that the obligation may now on a future date have been replaced by a different obligation, or replaced completely, does not mean it did not have an obligation.

THE PRESIDENT: Can you help me on the other converse odd result that is asserted in BT's closing, which is that Ofcom itself, in the absence of a dispute, it said could not investigate it, even if it comes to the view that there was, as you put it, 'egregious overcharging', could not do anything about it once the obligation has ceased to apply. He says that is the way the Statute works reflecting the Framework.

MR. SAINI: We do not accept that, Sir.

THE PRESIDENT: That is what I want to know. Can you help me on the basis, on what statutory basis can Ofcom - if you say that is wrong - while the obligation is in force, or after it has expired take steps, because that is asserted in terms. He says it would be very odd if a third party, through a dispute could get a repayment which Ofcom in enforcing the obligation could not order. The enforcement provisions for the obligations are rather 'elaborate' is perhaps a kind word ----

MR. SAINI: If one goes back in bundle E to the Communications Act at tab 5 ----

THE PRESIDENT: Yes, it is at p.22, s.94?

MR. SAINI: That is right, Sir, it is s.94 (1). Section 94(1) is clear in its terms:

> "Where OFCOM determine that there are reasonable grounds for believing that a person is contravening, or has contravened, a condition set under section 45 …"

If it is the submission of Mr. Thompson that that refers to a condition which ----

THE PRESIDENT: I think it is what follows. The only enforcement - when I say it is "elaborate" it has to first go through this procedure, serving a notification which, as you see in subsection (2) has to specify the period during which the person has "an opportunity of doing the things specified".

MR. SAINI: We would simply say that is not exclusive. So clearly there may be some conditions which are extant at the time where the remedy can be future looking, so if there is a

requirement, for example, to supply a particular CP one can say, but that cannot be a provision which excludes remedial action for a past infringement.

THE PRESIDENT: Well, it has to cover remedial action for past infringement.

MR. SAINI: Yes.

THE PRESIDENT: That is subsection (3)(c).

MR. SAINI: Yes.

THE PRESIDENT: So is that how it would work, they would say: "You have contravened, we think you have overcharged so much, you must remedy that by making a payment within a certain period."

MR. SAINI: Indeed.

THE PRESIDENT: That is step one. Then you give chance for representations.

MR. SAINI: It is useful to note subsection (8) on the facing page as well, which concerns notifications, and provides:

> " A notification under this section—
>
> (a) may be given in respect of more than one contravention; and
>
> (b) if it is given in respect of a continuing contravention, may be given in respect of any period during which the contravention has continued."

which contemplates that there may be not just a continued contravention but what one might call an 'historic contravention'.

THE PRESIDENT: Yes, I think it is not said that there cannot be historic contravention, but must the obligation which has been contravened, still be in force.

MR. SAINI: With respect, that is putting a gloss on these sections. It would be surprising if there were some limitation built in here which would prevent a notification being given which required a remedy in the form of a payment. There is clearly nothing in the language, we would submit, in s.94 which limits it in that way.

THE PRESIDENT: So you say it is remedying the consequences ----

MR. SAINI: Indeed.

THE PRESIDENT: -- of the notified contravention.

MR. SAINI: Indeed, and there are potentially two forms of relief that will be there. One could be payments in respect of historic contraventions and also directions in respect of future behaviour.

There is just one final point I want to address in this regard which is at the substrata of all of my friend's arguments in relation to Ground 5 namely that there is something odd about the lack of a limitation period, and a similar argument that was made to the Tribunal in the PPC

preliminary issues case. Our submission there was there is no limitation period as regards past payments, but that is not to mean that Ofcom cannot, in an appropriate case, decide - bearing in mind its statutory objectives and the Framework - that it would be inappropriate for there to be a grant of any relief.

THE PRESIDENT: It might be the sort of circumstance falling within the Court of Appeal's special circumstances.

MR. SAINI: Indeed, and one of the themes that appears again in my learned friend's closing is that one generally finds limitation periods, and the lack of a limitation period here suggests perhaps there is not the power to go back, but in fact in large areas of law, particular in equity, there is not a statutory limitation period for equitable relief, but that does not mean that the court does not apply principles in deciding whether or not relief should be provided in respect of what might be called a stale dispute. So there may be a case, if a dispute lands on Ofcom's desk 20 years after some overcharging, Ofcom may well decide that it would not be consistent with the Community objectives to award a repayment even if there was a finding of overcharging, so it is not completely at large.

THE PRESIDENT: I suppose now Ofcom could just refuse to entertain the dispute under the new regime.

MR. SAINI: Indeed, under the new regime. The new regime does provide that but the finding was under the old regime, the ability of the power of Ofcom to refuse was very limited.

THE PRESIDENT: Very limited, yes.

MR. SAINI: I want now to address Ground 6, which is the discretion in ordering repayment, and there are three essential parts to our response to BT's skeleton argument. The first part is that this Tribunal is bound by the approach set out by the Court of Appeal and I believe that Mr. Thompson accepts that, and he criticises us for saying that the approach set out by Lord Justice Etherton we have somehow wrongly construed that as creating some form of presumption. We say that that is exactly what he says. Therefore it is for BT to displace the presumption that there should be repayment. That is the starting point.

The second point we make is that the main body of BT's case in relation to Ground 6 was advanced through Mr. Maldoom's evidence in relation to incentives. What his evidence came down to was the following proposition. His position was that when Ofcom came to determining whether or not there should be repayment it should effectively, in my words, second guess the findings that it had made of breach, that somehow it should say: " Although we found there was a breach, that was done on rather, let us say, "arbitrary evidence" - maybe one way that Mr. Maldoom may put it - and therefore somehow that

should affect our decision. We say that that is an illegitimate approach. The principled approach is to make a robust decision as to whether or not they had been overcharging, but they are not to second guess the correctness of that decision when deciding to order repayment.

The third main point I want to make is in relation to incentives. We submit that it is clear that unless BT is required to repay the sums that it has overcharged there will be no incentive upon it to comply with its cost orientation obligations. The big point that is now focused upon in Mr. Thompson's closing is that there are other incentives which have the same effect and, in particular, there is the fact that there may be civil claims out there. It is right that there may be civil claims out there and may create incentives, but everyone knows how difficult it is to pursue a civil claim. What is interesting is, and this is not a criticism of my learned friends, in some re-examination they sought to feed Dr. Maldoom this point. They wanted him to say: "Actually, there is this other incentive based on civil proceedings", but he did not, rightly, take the bait, but this is something that BT now relies upon. We say the fact that there may be civil proceedings hardly provides the same incentive effect. We say that this Tribunal would need some very convincing evidence before it allowed the presumption of repayment to be displaced.

I should also say, while dealing with this Ground 6, although it is not directly relevant on Ground 6, it appears to be being suggested by BT that Ofcom has not taken a position as to the jurisdiction to award interest. I hope it is clear that it is our case that there is a jurisdiction to award interest ----

THE PRESIDENT: Yes.

MR. SAINI: We say that is part and parcel of the power to order repayment. I have cantered through that pretty quickly. I am going to turn now to Sky's ground 1. Before I do that, may I ask if there are any questions in relation to any of the BT grounds which I can address?

THE PRESIDENT: No, you can go on.

MR. SAINI: Sky's ground 1, which is the aggregate FAC test as against DSAC, as the Tribunal is aware there are five broad matters that we rely upon in response to this FAC test. The first is that irrespective of the merits of this FAC test or the Houpis test, we say that to use this test would be in direct contradiction to Ofcom's decision in the 2004 LLMR not to impose a price control. Secondly, we say it would be contrary to good regulatory practice for Ofcom to depart from the DSAC test and impose this unknown additional aggregate FAC test. Thirdly, we submit that in the light of the decision of the Tribunal in the *PPC* case, the

DSAC test is in fact the correct test to use when deciding whether or not there has been over-recovery of common costs. I will need to explain that in a bit more detail.

Sky's case proceeds on a false basis that DSAC is not a test which is aimed at preventing over-recovery of common costs, that it has some other purpose. We submit that is exactly what it is intended to do. It may be very generous. That is a decision made when using that test. I will need to explain why what is said by Mr. Pickford about what the *PPC* was decided on is actually wrong when one looks at that case.

THE PRESIDENT: I understand, it seems to me, two distinct points. Namely, what the *PPC* case decided and whether the DSAC test – of course it imposes a ceiling, but I thought it was accepted that it will permit, or could permit if all prices are at DSAC, multiple recovery of common costs.

MR. SAINI: That is accepted. The fourth point is that it would be inconsistent with the nature of ex ante regulation, SMP regulation, to adopt a hindsight approach to assess the regulatory balance struck by Ofcom in the 2004 LLMR. Here I have very much in mind the large amount of evidence which has been adduced by Sky and TalkTalk as to the potential over-recovery of common costs, be it £300, £600 or £1.2 billion. That is all very interesting, but we submit it is not appropriate for that evidence to be assessed in considering what in 2004 was the correct regulatory balance. Fifthly, we submit that it is not appropriate for this Tribunal, when considering the merits of the Houpis test as against DSAC, to start getting into an interesting debate about which cost measure promotes economic efficiency because this Tribunal is not engaged in the type of exercise that, for example, Ofcom was engaged in in 2008 when it was designing a charge control and conducting an economic analysis of the different approaches. We submit it would be inappropriate for this Tribunal to conduct that form of economic analysis when deciding on the meaning of the cost orientation condition imposed in 2004.

Those points will all be familiar to the Tribunal, but one point which the Tribunal has not been addressed upon yet, and I submit it is important and I say it is important because of the questions that the Tribunal asked of Mr. Myers at the end of his evidence (I was not there but I read the transcript) – is just in relation to the DSAC test and whether or not it would have been open to Ofcom to apply a different test from DSAC, and why is it that Ofcom is saying (as I said in opening) that we had to apply DSAC – or it could have been for BT to come up with a different test, but if we were going to apply a test it was DSAC. The Tribunal asked Mr. Myers some questions. Mr. Myers referred to the *PPC* case. But there is some important material that I need to show the Tribunal in relation to DSAC. It is

referred to by the Tribunal in *PPC*, but it is right that rather than just showing you the paragraphs I show you the underlying documents.

Please could the Tribunal be provided with what look like bulky documents but we are only going to look at a few pages. Look at the primary account documents. These documents are in very similar form every year. I hope you have got one bundle, which is the primary accounting documents, and the other one which is the long run incremental cost model. There are two things in the bulldog clips.

THE PRESIDENT: This is the two BT documents?

MR. SAINI: Two BT documents, and these documents - I picked 2005 but I could easily have picked any year in the period from 2005 until the dispute ends. My learned friend will correct me if I am wrong, but I do not believe that in the respects I am going to show the Tribunal this afternoon there is any material difference. I will just pick the documents from the very start of the period so there can be no dispute.

THE PRESIDENT: We had better put these in. Additional documents seems to have got up to 47. 47 for the Cost model and 48 for the primary accounting documents.

MR. SAINI: It may be that they are already in the bundle somewhere else. Mr. Pickford may be able to show us them elsewhere.

MR. READ: I simply say that I am not in a position to correct Mr. Saini on whether these are the same in other years because I do not know.

MR. SAINI: They are mainly directed to BT.

THE PRESIDENT: Yes, these are BT documents.

MR. SAINI: Before I go to the body of these documents --

MR. READ: They will be virtually the same. There obviously will be some adjustments from year to year, depending upon the specific methodology but they will be the same.

MR. SAINI: I will just explain the context in which these documents became relevant in the *PPC* case, because they are relevant to some of Mr. Pickford's arguments. At one stage in the *PPC* case, but (Mr. Read will correct me if I am wrong) by the end of the *PPC* case BT had given up on this point, at the centre of the case was the question of DSAC: was DSAC an appropriate measure, and also did BT know about DSAC? That was at the heart of the case. By the end of the case, as the Tribunal recorded in *PPC*, BT had fallen back to a position where they accepted they knew about DSAC and that Ofcom were applying it as a test of cost orientation as regards a condition in exactly the same terms as Condition HH3. Obviously, BT had its arguments about whether or not it was appropriate. So by the end of *PPC* BT had agreed, and the Tribunal had found, that the relevant condition there was

policed or applied using DSAC, and BT knew about that.

Just to make that point good, if we deal with the primary accounting documents first of all, could I ask the Tribunal please first to go to p.(i), the primary accounting documents, the fourth paragraph in. Here BT are explaining both the framework, the new directives, and they go on to discuss in the following pages those markets in which they have been found to have significant market power.

THE PRESIDENT: You are in pages (i) and (ii) of the primary accounting documents?

MR. SAINI: Yes.

THE PRESIDENT: The larger, the introduction?

MR. SAINI: Introduction, that is right. I was just going to show the Tribunal what this is. There is a description of the EU regulatory framework, and then over the page a description of the markets in which BT has been found to have SMP, etc. Then could I ask the Tribunal, please, to go to p.(vii) under accounting documents. At item 5 you will see that one of the things that the primary accounting documents contain is the long run incremental cost LRIC methodology, which means the long running incremental costs principles, procedures and processes which form the framework under which long running incremental costs are determined by BT: "The document sets out the principles followed to derive the long run incremental costs". But then going immediately within the body of this document to that particular methodology, which in real numbers at the bottom of p.47 of 101 (going quite a few pages in), 5.2: "This section covers the following areas: LRIC definitions, costs conventions, stand-alone costs, fixed common costs, cost volume relationships and floors and ceilings." I emphasise the words "floors and ceilings". Then if one goes to those floors and ceilings, p.55 there is a reference to what DLRIC is. Could the Tribunal just read those four paragraphs at p.55. (Pause to read) It may be useful to go over the page as well, just to read the last paragraphs at the top of p.56. The only point I am making here is that here, BT is acknowledging --

THE PRESIDENT: Give us a moment to just read it.

MR. SAINI: Certainly. (Pause to read)

THE PRESIDENT: Yes.

MR. SAINI: So that is the way in which the … but just going a few pages over, we do not need to look at these various tables, DSAC as well is then described on p.58 at para.5.3.5, where it says:

> "A similar approach [that is similar to DLRIC] is taken with stand alone costs in order to derive ceilings for individual components…".

Perhaps the Tribunal can read that, the part that says:

"The economic test for an unduly high price is that each service should be priced below its stand alone cost…", etc.

THE PRESIDENT: (After a pause): Yes.

MR. SAINI: So the context of this, Sir, is that, going back to the *PPC* case, it is not surprising that the Tribunal rejected BT's submission that they never knew about DSAC.

THE PRESIDENT: Just before you go back, these two documents, which are BT documents, are what? They are documents provided to Ofcom?

MR. SAINI: They are provided to the industry and so they are published every year and they are available both to Ofcom and to the industry. I am not going to refer you ----

THE PRESIDENT: Is that by reason of one of the obligations?

MR. SAINI: Indeed, so one can see that ----

THE PRESIDENT: Which obligation, just to tie this down?

MR. SAINI: It may be that those behind me -- There is a particular obligation I have at the back of my mind which requires the publication of a PAD and also ----

THE PRESIDENT: Yes, it goes with the RFS, does it not?

MR. SAINI: Indeed.

MR. READ: Sir, if it is any assistance, Mr. Dolling deals with the ----

THE PRESIDENT: Yes, he referred to the fact that the RFS has all these other things attached.

MR. READ: Yes, and it is set out. In fact, he actually exhibited a later version of the PAD to his witness statement so it can be ascertained there.

THE PRESIDENT: But I still would find it helpful to see the actual ----

MR. SAINI: There certainly is an obligation. We will need to find it for you, Sir. There is an obligation.

THE PRESIDENT: The 2004 obligation.

MR. SAINI: I think those behind me are looking for it.

THE PRESIDENT: Yes.

MR. SAINI: So it is not surprising then, in the context of these documents, which were published by BT themselves, that the Tribunal rejected the assertion that DSAC was not known about as a test of cost orientation and, indeed, I believe Mr. Myers said in his evidence, in cross-examination, that the concept of DSAC was actually, the wording "DSAC" was a wording of BT's invention.

THE PRESIDENT: Yes, he did.

MR. SAINI: I am told it is in the PAD itself, p.74.

THE PRESIDENT: OA19.

MR. SAINI: OA19. It is important, because this all goes to this question of Ofcom departing from DSAC, and Mr. Pickford's case is that there was no reason why Ofcom cannot depart from DSAC, it is relevant then to look at the RFS. If I can take the RFS from 2007, which is in BT7, to see how these DSACs worked. At Tab 11 we have the Current Cost Financial Statements for 2007. Within that, it is a lengthy document, but if you please go to p.39 within that, which is Section 3. You will just need to turn the page round. Could I just preface what I am going to say here by indicating that, whatever may be on this document, it looks like whoever was preparing these documents was not communicating what was going on here to those in the pricing area, which comes from Mr. Coulson's evidence, because when one looks at p.39 you will see that this is the review of the access markets, the AISBO market, and, it is rather small writing, but if you look under "market summary", Sir, do you see that right at the top?

THE PRESIDENT: Yes.

MR. SAINI: "Purpose of statement to provide more detail on financial performance and first order tests of compliance with cost orientation and non-discrimination obligations". Do you see that, Sir?

THE PRESIDENT: Yes.

MR. SAINI: So BT itself was regarding what appears on this page as being a first order test of compliance with cost orientation and non-discrimination obligations. Then if one goes to the body of the document, if one looks at the very first entry for the year ended 31st March 2007:

> "Service
>
> Internal wholesale and Lan extension services 10Mbit rental".

And if one goes along one sees "Average price", "FAC" and then "Unaudited LRIC floor" and "LRIC ceiling". Those are DLRIC and DSAC. So here BT is simply following through on what it was saying it was going to do in its Primary Accounting Documents. One can see actually on these pages, and indeed there are other examples of this in the other accounts, that if someone within the regulatory department was looking at this carefully they might realise there is a bit of a problem in terms of where the price was compared to the ceiling. But that is not the point of me showing you this at this stage. The point is to meet Mr. Pickford's submission, which is that there is nothing wrong now with applying a new aggregate test. One thing that is absolutely clear, Sir, is that BT's understanding (see the PAD and see the accounts) was that Ofcom and BT were looking at cost orientation

through the eyes of DSAC. What they were not doing, unsurprisingly because no one had suggested this, is applying some form of aggregate FAC test, "the Houpis test", because that did not appear on the scene until Frontier Economics, in the course of the administrative process.

PROFESSOR MAYER: If one looks at this table, it does report FAC as well as the DSAC.

MR. SAINI: Indeed.

PROFESSOR MAYER: So how are you concluding that therefore we know that BT was not applying a FAC test?

MR. SAINI: We submit, in the light of what I have just shown the Tribunal in the Primary Accounting Documents, BT considers that the floor and ceiling are set by DLRIC and DSAC. That is why they were reporting those. It is fair point to say they were also reporting FAC, but what Ofcom has done is they are applying the floor and the ceiling and they have been using FAC as a cross-check as well, which is what Mr. Myers explains. I am sorry, Ofcom using FAC as a cross-check, which is what we did in the Determinations. So the first order test is has DSAC been exceeded, but we will also then look at what is the FAC figure.

THE PRESIDENT: They seem to recognise ----

MR. SAINI: Indeed.

THE PRESIDENT: -- here, under the heading of "cost orientation", that DSAC is a ceiling.

MR. SAINI: Indeed.

THE PRESIDENT: Even though they then do the average price by reference to FAC and not DSAC.

MR. SAINI: Professor Mayer's point, with respect, is completely right, but they are also reporting, and indeed it is audited, FAC is audited, but that is because ----

THE PRESIDENT: And DSAC is not.

MR. SAINI: Indeed, but Ofcom is very interested in FAC, certainly not the aggregate FAC in the form of a Houpis test, which is something completely different, but FAC is very important as a cross-check. Mr. Pickford's position appears to be this, and I hope I am not summarising it unfairly, he says, fair enough, Ofcom appear to be applying DSAC, and it is hard to disagree with that given these documents and also a wing of BT ----

THE PRESIDENT: I am sorry, BT?

MR. SAINI: BT appear to be applying DSAC here, or a wing, I will call it "a wing" of BT, which is the people who are putting together these documents, appear to be applying DSAC because that is what Ofcom has prescribed (see the PAD), but all bets are off because, in

fact, when one looks at the pricing, the people doing the pricing, they were not really concerned about DSAC. Therefore why is Ofcom being so kind of them and saying, "We will assess you as against DSAC", when, in fact, the wing of BT that was doing the pricing was giving no attention to DSAC? That appears to be effectively, in a rather inelegant way, the way that Mr. Pickford puts his case, and factually he is right in this sense, which is that Mr. Coulson's evidence makes it clear that, whatever these figures were saying, no one was really actually that bothered about, on a day-to-day basis, making sure that DSAC was being adhered to. That, however, is not something which allows Ofcom, as a responsible regulator, to say, "Because you have not applied the test which you thought you were applying, or we thought you were applying, we are now going to apply some completely new test". We submit it would not be appropriate, as a matter of responsible regulatory practice, to adopt this "all bets are off" position, which is that, "Because you have not adhered to the test we thought you were applying, we are going to apply a completely new test". That is not appropriate. Equally, it is not open for the Tribunal to, on the hoof now, start applying an appropriate test. The Tribunal cannot do something which Ofcom, as a responsible regulator, would not be able to do.

THE PRESIDENT: I do not think that is Sky's primary submission. I think their primary submission is that actually BT should have realised, based on the other Ofcom documents, prior to 2004 and the lack of specificity in the 2004 Statement or Review, that it would be a test that prevented multiple recovery of common costs and therefore a test based on FAC plus mark-up. I think that is their primary submission.

MR. SAINI: Indeed. Sir, we will come back to that in more detail but there are two answers to that. First of all, it is absolutely clear that from 2005 onwards, when these conditions are biting, BT does not understand that to be the position, because the Primary Accounting Documents would not be in those terms and equally the RFS statements would not be in those terms. There are a number of ways of applying the cost orientation provision. Ofcom have decided, and BT have understood to have decided, to adopt DSAC, and putting aside whether or not it is a generous test for the moment, and that is the understanding of BT at the time. Secondly, Sir, and I am going to develop this point in more detail, we submit that to adopt the particular type of test that Mr. Pickford puts forward, and what seems to be their primary argument, that a particular type of test to prevent over-recovery of common costs, would be inconsistent with the decision in 2004. I am going to ask you to go back to the 2004 LLMR but I need to make one fresh point, which is that there is no dispute between Ofcom and Sky in relation to one particular point, that Condition HH3 itself does

not prescribe any particular test. So, subject to appropriate forewarning, one could interpret Condition HH3 in accordance with some form of FAC or aggregate FAC test, but equally, we say, one could interpret it as a matter of regulatory choice as being operable using a DSAC test.

THE PRESIDENT: Is that quite right, Mr. Saini? It does not prescribe any particular test, that is clear, otherwise this argument would not get off the ground one way or the other, but it does say an appropriate mark-up for the recovery of common costs. So if the test chosen allows a mark-up that is demonstrably inappropriate, that then would be contrary to the condition.

MR. SAINI: Indeed, but the word "appropriate" has to be given some relevance here. There are different views, different regulatory choices, as to what will be appropriate - what is an appropriate mark-up of common cost in particular market circumstances? We submit that DSAC ----

THE PRESIDENT: It is not completely open-ended?

MR. SAINI: No, not at all, not at all. I am going to come back to a point which I mentioned when I started to deal with this particular ground, ground 1 of Sky, which is the *PPC* case, but just taking things in order, if we, first of all, go to the 2004 LLMR, divider 12, p.169 or 19 in the manuscript. There has been much debate about para.7.63, but one thing is absolutely clear, there is no doubt that, is that a price control was not imposed in 2004, and you have our submission that the net result of the Houpis test is a price control, because, putting aside the issue of escape clauses - we will come back to those in a moment - this is effectively a price control where the price is not set in advance, it is basically based on outturn costs. We submit that ----

THE PRESIDENT: I am puzzled. That is what cost orientation is, is it not? It is a price control, in one sense, you are stopping ----

MR. SAINI: -- let us call it is a "costs cap", let us use that for the moment. The result of the type of price control, for example, adopted in 2008 was effectively an RPI minus X control for a basket of services. If one calls that, for the purposes of argument, a price control, there is clearly distinction between a decision to take that regulatory course and a decision to just impose a cost orientation obligation. As the Tribunal is aware, in 2004 an express decision is made, that as regards these AISBO services a price control is not going to imposed - that is what it says in 7.63 - but a cost orientation obligation is going to be imposed. I am using "price control" there in a particular way. That decision is taken and then that decision is modified in 2008 where, as regards low bandwidth, it is decided that just the cost orientation obligation which was imposed in 2004 is not enough, it has not worked. Therefore, in

addition to cost orientation in 2008 we are going to impose a price control, the RPI minus X price control.

Our primary submission, Sir, is that Dr. Houpis's test, which is an outturn form of price control, the decision to interpret Condition HH3 using that test will be directly contrary to the decision made in 2004.

THE PRESIDENT: What do you mean by an "outturn form of price control"? Price control is not outturn based. Price control is *ex ante*, as you described, RPI minus X. The Houpis test is an outturn test which is a cost orientation *ex post* test. It is just a lower level.

MR. SAINI: Indeed, but with the net result that a cap is imposed. A hard cap is imposed based upon aggregate FAC.

PROFESSOR MAYER: This is what I find a little bit puzzling. I do not understand why the fact that it is the imposition of an outturn FAC means that it is, therefore, a price control. It is clearly not an *ex ante* price control, but why are you suggesting that the mere fact that it is based on FAC means that we should interpret it as being a price control?

MR. SAINI: Because *ex ante* price controls are based on FAC. Indeed, the game is given away, Sir, by the acceptance by Mr. Pickford and Dr. Houpis that in 2009, when an explicit price control, the RPI minus X price control, was imposed that does the work that they want the cost orientation condition imposed in 2004 to be doing. It "fills the space", in Mr. Pickford's words.

PROFESSOR MAYER: With due respect, the fact that a price control in 2008 does the work of FAC outturn cost control does not mean that one should therefore imply that an outturn FAC cost control is a price control.

MR. SAINI: It may be just a question of terminology. If we put aside ----

THE PRESIDENT: You are placing a lot on terminology, you are saying that it is impermissible because it would be a price control.

MR. SAINI: Within both the 2004 and 2008 reviews, a distinction was drawn between cost orientation, which is Condition HH3 and price control, which is what is rejected in 7.63. We submit that to interpret cost orientation in 2004 as being policed or supervised according to Dr. Houpis's test would effectively be to impose a form of price control.

THE PRESIDENT: That is what we do not understand.

MR. SAINI: Because the result of it is that BT is given no flexibility because within the basket which Dr. Houpis has devised it is not allowed to go above the aggregate FAC, and if it does do then it has got to provide some countervailing argument elsewhere. So it has that effect.

THE PRESIDENT: It is a much tighter cost orientation.
MR. SAINI: Indeed, absolutely.
THE PRESIDENT: Why is it price control? Indeed Sky put to Mr. Myers some other cost orientation documents from Ofcom where, in those cases, it is suggested that the level in cost orientation was FAC. So it is not inconsistent with cost orientation?
MR. SAINI: Not at all, and a prime example is the *Kingston Communications* case where Condition HH3 was applied using FAC, but there is an express decision made there because Kingston are saying, "We would like, because we do not have the cost accounting systems that BT has, to observe this condition using FAC". Ofcom say, yes.
THE PRESIDENT: I understand that.
MR. SAINI: So there is a distinction there.
THE PRESIDENT: Therefore, it is not inconsistent with cost orientation to say that it should be based on FAC?
MR. SAINI: I said at the outset that it is not our submission that Condition HH3 cannot be policed using a FAC standard. The question is a separate one, which is, would it be open to Ofcom, given what it decided at para.7.63, to adopt that standard? We say, given what is said at 7.63 and given BT's apparent understanding of how it was meant to be observing cost orientation, namely the PAD documents, the accounts, it would be inconsistent with those facts for this Tribunal, or indeed Ofcom, to say, "We are actually now going to do something new and different". There has been no forewarning of that.
THE PRESIDENT: I understand the forewarning point on the PAD documents which you have showed us of BT's understanding. We have moved on to a different point, which you are saying, as I understand it, irrespective of those documents, the decision not to impose a price control precludes using FAC as the benchmark for cost orientation. That is what I have understood you to be saying.
MR. SAINI: Yes, because we submit that the net result of the Houpis test is the same as the form of price control which was rejected at 7.63 and then was, in fact, imposed in 2008.
PROFESSOR MAYER: Let me just pose the following: supposing that it is always the case that DSAC equals FAC plus a particular margin, were you saying that imposition of FAC is then fundamentally different in this regard from the imposition of DSAC?
MR. SAINI: I am sorry, I did not hear the first part of the question.
PROFESSOR MAYER: Suppose that there is a fixed difference all the time between DSAC and FAC, why are you saying that the imposition of one is very different from the other?
MR. SAINI: On that hypothesis there would not be a difference, but we do know that FAC

provides much less flexibility.

PROFESSOR MAYER: I understand it is a lower ceiling.

MR. SAINI: Indeed.

PROFESSOR MAYER: In your terms it is still a ceiling, just like FAC.

MR. SAINI: Indeed, it is a ceiling, yes, it is just a different ceiling. Part of the reason why DSAC has been chosen, and this is describing Mr. Myers' evidence, and was investigated in the *PPC* case, was that it provides a lot of flexibility. So it is a deliberate policy choice. We know, with the benefit of hindsight, that perhaps that flexibility has been abused because there may well have been very substantial over-recovery, but the decision to allow that flexibility is deliberate. It is not an accident.

THE PRESIDENT: When you say "abused", we are not talking about the fact that they have gone over DSAC. Clearly that is an abuse. If BT priced all its services at DSAC that would not be an abuse.

MR. SAINI: It would not necessarily be an abuse. Perhaps "abuse" is the wrong word. Perhaps, and this is what happened in 2008 and I think Mr. Myers was candid with his evidence in this regard, in 2004 Ofcom should not have been as optimistic as they seemed to be in 7.63, and perhaps in 2004 they should have gone straight for the type of price control which they imposed in 2008.

It is important to note as well that Ofcom were not completely wrong because one knows that the policy decision they made in 7.63 did have this benefit, which is that by 2008 as far, far as high bandwidth was concerned there was competition. So they were able to decide there was not any SMP there.

A deliberate decision was made that the form of tight control that a FAC based test would require was not going to be adopted, because Ofcom, in the lexicon of Ofcom, that type of FAC control is a price control in contra distinction to a simple cost orientation obligation with flexibility.

THE PRESIDENT: You say that type of ceiling would be a price control, but what about the 2001/2002 documents on cost orientation?

MR. SAINI: In particular circumstances Ofcom has been explicit as to the way it is going to interpret cost orientation obligations. My point is in 2004 it decided that it was not going to interpret cost orientation as a form of price control. What is particularly notable, Sir ----

THE PRESIDENT: I think, using the term 'price control' is slightly confusing you. In 2004 it is not going to interpret cost orientation as being applied according to a FAC ceiling, using a FAC ceiling.

MR. SAINI: That is probably a better way of doing it. I should also say that this idea of price control and cost orientation is not something that Ofcom has just invented, it is in the statutory scheme, it is in the Communications Act, a distinction is drawn between cost orientation and price controls. So there are two different measures of techniques.

THE PRESIDENT: They are, and you have made the point that one is ex ante and the other is ex post based on outturn.

MR. SAINI: Indeed.

THE PRESIDENT: That is the fundamental conceptual difference.

MR. SAINI: Yes.

THE PRESIDENT: And one imposes a fixed ceiling with the scope for the undertaking that is subject to the obligation to reduce its costs and make higher profits. That is the conceptual difference. What I am struggling with a little is why, because it is cost orientation, the ceiling has to be - I do not think you are even saying "has to be" DSAC ----

MR. SAINI: No.

THE PRESIDENT: -- you are saying the default position, as it were, is DSAC unless otherwise specified, that is what you are saying.

MR. SAINI: Indeed. What is important, Sir, it has not been suggested to BT, indeed, there has been no evidence called by Mr. Pickford's clients that the other CPs, when they were looking at the 2004 LLMR were all believing that cost orientation was to be interpreted according to some form of FAC ceiling. There is no evidence to that effect. The only way that Mr. Pickford gets there is by cobbling together a selection of historical documents, which suggest no more than in some circumstances Ofcom has decided to interpret cost orientation using FAC, that is not a controversial proposition. The question is: what did it do in this particular case?

Can I also just disagree slightly with one point that the Tribunal has made? In our submission this FAC is a form of ex ante price control because it is actually a price control across all of BT's services. As one steps back from it what is happening here is that within the basket Mr. Houpis has picked, BT is not allowed to go above aggregate FAC, but if it does it has to control its prices in advance elsewhere. So it is, in fact, a form of ex ante price control.

PROFESSOR MAYER: Well, no, because it is still not based on predicted cost, it is based on outturn cost.

MR. SAINI: Subject to that, but it is requiring BT to be predicting the maximum level of costs it is going to be permitted. Obviously the costs are not prescribed as in the form of an explicit

price control, not prescribed in advance but that is a fair point, sir.

While we are on 7.63 can I just deal with another point, which is that the way that Mr. Pickford and Dr. Houpis sought to head off the rejection of a price control in 7.63 is that they came up with a very creative reason why a price control was not imposed, and that was, we submit, rather far-fetched. That reason was, ignoring the rest of 7.63, which the Tribunal observed on the first day of this hearing was really about Ofcom wanting to encourage competitiveness in the wholesale market. They say: "No, no, no, the reason why a price control was not that, but in fact because Ofcom could not predict what the price should be, could not work it out." We say that has no basis in 7.63.

What is going on in 7.63 is very clear, and I am putting it in a way perhaps an economist would not put it, but a lay person would put it, which is that we do not want a tight ceiling on costs in advance, which is what price control is, because we want to encourage competition at the wholesale level, and that is what is going on in 7.63. It is certainly not a paragraph that supports Dr. Houpis' position that a price control is being rejected because of the difficulties of predicting in a new market what the price should be.

THE PRESIDENT: It is slightly odd, that paragraph. It seemed to me, as I said at the time, a more natural meaning is that it is referring to competition in the wholesale market, but it comes after quite large sections of the review where it is pretty clear that Ofcom did not think that was really a very relevant consideration because the prospects for that were negligible.

MR. SAINI: True, but they do say in 7.63 they want to see what is going to happen, they want to see what the impact is of the cost orientation obligation as regards competitors of the market. It is hard to read that any other way other than they are hoping that there will be a stimulation of some wholesale competition here.

There is also the other point as well, which I should have made when I was addressing the question of what BT would have understood, and what Ofcom's understanding was about the importance of DSAC - we made this point in our skeleton argument - that not only is the FAC aggregate test a completely new test, one that has never been suggested before, but the escape clauses are ever developing and we submit that it is telling that Dr. Houpis in his evidence was at various points suggesting that this might be a good test for the Tribunal to declare for the future, accepting that perhaps it was not clear to BT that it was going to be assessed against this standard.

Whatever Mr. Pickford may say about the historical documents where a FAC kind of test has been applied in interpreting cost orientation, he is certainly not able to point to any

forewarning on the part of BT that it was going to be a FAC aggregate test with these escape clauses. These escape clauses are a bit of a moving feast, every time one looks there is another one.

PROFESSOR MAYER: Can I just clarify one thing that I think you are saying, and that is that the justification for using cost orientation of pricing rather than a price control is that it is hard to predict what the costs are going to be.

MR. SAINI: That was put forward by Dr. Houpis.

PROFESSOR MAYER: And you are saying that is not a justification?

MR. SAINI: Theoretically it could be a justification, but we say that is not why, in 7.63, a price control is not being used. I believe Mr. Myers was cross-examined on this issue as well. He said - if I recall correctly - that Ofcom does not have any difficulty, it does its best, if it has to work out what a price control will be it will do that. That is not a reason that they rely upon for not imposing a price control.

THE PRESIDENT: I think he said that can be a reason, I thought, but he said it was not the reason here because it says price control is not necessary, it is not that a price control would be difficult or problematic, but says it is not necessary.

MR. SAINI: Indeed.

THE PRESIDENT: And I think he put a lot of weight on that.

MR. SAINI: I accept theoretically it could be a relevant consideration, but that one could not know.

Could I just address a further point in this regard now, which is what was being decided in the PPC case?

THE PRESIDENT: Before you move to that, can you just help me really on what was the status or character of Mr. Myers' evidence on that? He was asked at the very beginning did he have a role in the 2004 LLMR and he did - he was, I think, the economic director of the project.

MR. SAINI: Yes.

THE PRESIDENT: But then later, I think in answer to Mr. Pickford he also explained that he is giving evidence in two capacities: as expert and explaining Ofcom's thinking. When he was questioned in detail by Mr. Pickford about 7.63 is it right he then said that he actually does not recall what the reasoning was for specifically choosing cost orientation and not price control but he was looking at what he said and interpreting the language.

MR. SAINI: Indeed.

THE PRESIDENT: So he was not actually giving evidence.

MR. SAINI: No, I do not believe he can give evidence given what he said about what the actual reasoning was. He is doing his best looking at the language.

THE PRESIDENT: So in that he is an expert like the other experts.

MR. SAINI: Indeed. In a sense, just as a matter of transparency, it is probably appropriate for this Tribunal to proceed on the basis of public documents, and what one gets from the public documents rather than what may be some reasoning within Ofcom which is not disclosed in the public documents. It would not be appropriate for Ofcom to say: "We know it says this, but actually back at the office we were thinking something else which never made it on to paper", that would not be appropriate.

We submit that the understanding of para. 7.63 that Mr. Myers has explained is the natural understanding of 7.63, it accords with the language.

THE PRESIDENT: Before we go to PPC, although you refer to them as "historical" documents if we go to the 2004 LLMR, I do not know if it is the bit that is in this bundle E, but if we go to BT3 where we have the whole thing, they do on p.183 - it is in the extract - at 7.139 they do refer to the 2002 backhaul Direction and suggest that what is being proposed here is carrying that forward consistently, providing continuity. 7.139 refers to the LLU backhaul Direction obliged to provide backhaul at cost oriented prices, among other things. Then 7.143:

> "Carrying forward this relatively recently introduced piece of regulation will add to the certainty in this market provided by continuity of the market conditions under which BT and other communications providers currently operate."

So that suggests that perhaps it is not irrelevant to look at the LLU backhaul Direction in conjunction with this document to assist in understanding it. It is not just an historic document?

MR. SAINI: That is a fair point, Sir, except one needs to look at then how did BT and Ofcom behave after the 2004 LLMR in terms of going forward and applying cost orientation?

THE PRESIDENT: Well, there is the behavioural point ----

MR. SAINI: Indeed.

THE PRESIDENT: -- but if we are seeking just to interpret the 2004 condition and its meaning on its face in the light of the 2004 review and the public documents, as at that time, I think one can, in the light of this, look at that 2002 Direction which does say something - unlike the 2004 review - about the relevant cost standards because, as we know this document and the Condition is silent as to the actual standard. But if one looks back at the LLU Direction which is, I think, if I am right, at tab 42 of additional documents 2, and within that tab at

p.60. Annex D. This is the direction by Oftel. The direction starts at p.58 and at p.60 are the paragraphs dealing with cost orientation.

MR. SAINI: Sir, I am looking at the wrong document.

THE PRESIDENT: It is the final direction on LLU backhaul services.

MR. SAINI: I have it now, sir yes.

THE PRESIDENT: At p.60 paras.18 to 22 it refers to the condition of the licence, recital of what was then the directive, and then gives Oftel's view of the interpretation of the requirement for prices to be cost oriented. Then we have the relevant paragraphs 21 and 22 saying, as I understand it, in para.21 if it is an effectively competitive market or a market moving towards competitive market structure, then it would be DLRIC to DSAC. Stand alone cost ceilings it was explained refers to DSAC not SAC, I think. At 22: if, by contrast – there are various caveats but it says: "minded to interpret it as a LRIC with some allowance for common cost recovery". So if that document is relevant and to be read as assisting the interpretation of the 2004 review, and given that it is clear that Ofcom's review is that the AISBO market is not effectively competitive, it might indicate that one is not looking at DSAC. That is the question. I will leave you with the question, Mr. Saini. It is one o'clock. That is relied on by Sky/TalkTalk. We will resume at 2 o'clock. Just one moment. (Pause)

PROFESSOR MAYER: Perhaps I could just indicate an issue that I would like to turn to after lunch, and that is in regard to the very helpful table that was provided to the Tribunal by Mr. Myers in regard to the ROCE rates of return, and looking at the rates of return in relation to the various measures of price adjustments that could be made. In particular, I would be interested in your views as to what is the relevant benchmark against which those rates of return should be assessed? There is a column which shows BT's cost of capital, but there is a question as to whether, given the emerging nature of these markets, one should perhaps allow for a higher rate of return against which to look at those ROCEs. So that is an issue that I would like to pursue after the break.

MR. SAINI: Yes, sir, I understand.

THE PRESIDENT: We will say 2 o'clock.

Adjourned for a short time

MR. SAINI: Sir, I was going to address your questions in relation to the LLU backhaul Direction. You were on p.60 and you drew my attention to paras.21 and 22 in additional documents bundle tab 42, that is where we were.

THE PRESIDENT: Yes.

MR. SAINI: I believe you were putting to me, sir, that 21 appears to be a DSAC test and 22

appears to be some form of FAC test. I believe the point that Mr. Pickford is running is as follows: that we were wanting to continue effectively the approach here and that the relevant Ethernet market here falls within 22 rather than 21, because it is not effectively competitive.

Our submission, sir, is a threshold submission in relation to para.21 that it is not clear that 21 is referring to DSAC. There were some questions of Mr. Myers in this regard and he gave his interpretation. Ultimately, his interpretation is no better than anyone else's. In our submission, 21, when it refers to a price between long running incremental costs and stand-alone costs ceiling, but then crucially, subject to any relevant combinatorial test, is not referring to DSAC, because DSAC is meant to be a test which replaces combinatorials. So it is referring there to true SAC. A true SAC would obviously be too generous. That is why you also need to satisfy relevant combinatorial tests.

THE PRESIDENT: I take your point, first of all, that stand alone costs ceiling may be a true SAC but following through what you have said, subject to any combinatorial test, is not DSAC a proxy or substitute for the application of combinatorial tests?

MR. SAINI: That could be, but equally, sir, DSAC could be the system (and in our submission it is) for dealing with the last words of para.22 which is working out an allowance for common costs recovery. DSAC is a means of achieving an appropriate way of providing for common costs recovery without doing combinatorials. But I put it no higher than this, sir, and I emphasise because I have looked at Mr. Myers' cross-examination on this, he has offered an interpretation. There is equally an alternative interpretation that 22 could be satisfied using DSAC, which is LRIC with some allowance for common costs recovery (because that is what DSAC tries to do). But I take your point, sir, that you could read 21 in the way you have articulated to me as also suggesting DSAC. I put it no higher than the position not being clear. I make that submission bearing in mind that I can make whatever submissions I would wish as a matter of language, but Mr. Myers himself said in his oral evidence that it was not clear. That is the highest I can put it.

But there is a more important point here, sir, which is that if it is Mr. Pickford's case that he is in para.22 territory, para.22 on his interpretation is effectively a FAC test, but that is not the test that he is proposing. He is proposing a hybrid test which is DSAC plus over and above that, FAC. So the test that is being proposed by Dr. Houpis is a separate test completely, it is a combination of DSAC plus FAC. But there is an ambiguity there.

There is also a further ambiguity (which does not ultimately help you, but I need to identify what it is). If you can go to Mr. Pickford's skeleton argument where this point comes from,

p.63 para.169. Here he quotes from the longer version of the LLMR, BT4. I do not ask you to turn it up because the part I wanted is quoted by Mr. Pickford at 169. There at subparagraph 4 it says:

> "The Licensee shall ensure that its charges for LLU Backhaul Services (as set out in the Annex to this Direction) are consistent with its charges for those elements which are common to LLU Backhaul Services and Partial Private Circuits …"

Mr. Pickford is relying upon the Partial Private Circuits reference there, but you will be aware that the charges for Partial Private Circuits were regulated in two different ways. So within Partial Private Circuits there were terminating segments which were regulated by an explicit price control, a FAC-based price control, and part of Partial Private Circuits were trunk which were regulated by a cost orientation condition in the same form as HH3.

This only goes, sir, to underline the point that there is an ambiguity here. A more important point is that even if one can pick parts of the regulatory history and say that it is possible that Ofcom were suggesting that it would police a cost orientation condition in a non-competitive market using FAC, the fact is that neither Ofcom nor BT understood that to be the position, even if one might suggest they could perhaps have worked it out.

Sir, before turning to *PPC*, I was going to address Professor Mayer's question just before the adjournment. As I understood it, Professor Mayer was querying the figures that had been submitted by Mr. Myers in response to Mr. Pickford's schedule. These are the return on capital employed figures, which we just pull out in additional documents 2 tab 36. All these are obviously return on capital employed relative to FAC, these figures. This may not be a direct answer to Professor Mayer's question. If I have understood it correctly, it is clear that the return on capital employed, when one compares it to BT's weighted average cost of capital, they are substantial, these returns, there is no doubt about that. But it would be or could be a necessary by-product of the decision made in 2004 to impose cost orientation rather than a price control in the sense I have been describing, that encouraging competition at the wholesale level may have meant that the entrants and BT may earn returns on capital employed relative to FAC which are very high. It may follow.

PROFESSOR MAYER: Can I just pursue that a bit further. If one looks, for example, at Part 3 of the tables, they refer to return on capital calculated in relation to actual revenue less overcharge where the overcharge is computed in relation to DSAC. So this is with the headroom that is built into DSAC?

MR. SAINI: Indeed.

PROFESSOR MAYER: So the question that I posed to you before the break was: in looking at

that column what is the relevant cost of capital against which one should be comparing those numbers? My impression, from what you just said, was that one should be comparing them against the column after column 1, or part 1, the rest of BT WACC where the cost of capital recorded there is roundabout 12%?

MR. SAINI: That is right.

PROFESSOR MAYER: So what the table seems to be suggesting is that even if you give the relatively generous allowance associated with DSAC in determining what the right revenues should be, the return that has actually been earned is substantially in excess of what I have taken to be your description of the appropriate cost of capital?

MR. SAINI: Yes, but that may be a by-product of the particular decision taken in 2004, which is earning high returns, higher returns than the average cost of capital.

PROFESSOR MAYER: But I did pose the question to Mr. Myers last week whether or not the nature of this market justified the use of a higher cost of capital, perhaps on a fair bet basis. As I recall, his response to that was that while in principle that might be relevant, in this particular case it did not apply.

MR. SAINI: That is a fair summary of the position, sir, yes. That is certainly what Mr. Myers said. Obviously, putting himself back in 2004 is difficult, but he does not say that that was a consideration taken into account.

Sir, I was going to address the *PPC* case next because it is important that we correct what we submit is a misunderstanding or misinterpretation of that case.

THE PRESIDENT: Just before we get to *PPC*, the use of the FAC by Ofcom, sometimes referred to as a cross check, but provided that the price for an individual service was at DSAC, or treated as it should have been at DSAC, then looking at FAC was no longer relevant?

MR. SAINI: That is right, because the approach that Ofcom adopted was that it used DSAC as the first order test. So if the first order test was passed, the enquiry stopped. But the cross check was to deal with BT's complaint that although it had failed DSAC there was some inherent unfairness in finding overcharging. So in order to look at the fairness to BT there was consideration of the FAC figure.

PROFESSOR MAYER: Sorry, can you just explain a little bit more. When you say there was consideration of the FAC figure, what happened after that consideration?

MR. SAINI: Does it look like the rate of return you are earning is very high? You failed DSAC, and does it look like the rate of return you are earning is very high compared to your weighted average cost of capital?

PROFESSOR MAYER: My interpretation of the table that we have just been looking at is the

answer you would give to that question is yes.

MR. SAINI: Yes.

PROFESSOR MAYER: But then what would you do on that basis of having answered the question in the positive?

MR. SAINI: We would be confirmed in our view that the first order test was failed and that we are going to carry on through and find an overcharge there, but using DSAC as the ceiling crucially, not using FAC was the ceiling.

PROFESSOR MAYER: So not concluding that therefore pricing in relation to DSAC may be over-generous?

MR. SAINI: Concluding that using DSAC as a first order test of cost orientation that was breached, yes. Sir, if I can ask you ----

THE PRESIDENT: On that table ----

MR. SAINI: I am going to go back to the table.

THE PRESIDENT: Mr. Myers' table at Tab 36 of the additional documents and the returns there which you have accepted are very substantial compared to the rest of BT, and Mr. Myers having said that there is no particular justification, 'fair bet' justification, for having much higher returns, the Condition, of course, says an appropriate return on capital employed. The appropriate return, as Ofcom interpreted it in 2004, was not the return on the rest of BT's WACC. I thought it was.

MR. SAINI: The fact is that one has ----

THE PRESIDENT: I do not see how this is an appropriate return.

MR. SAINI: One has to look at it this way. Ofcom is deciding not to impose a price control (I am using that as a term of art). It is deciding to go for a less intrusive form of regulation, which is cost orientation, and it wants to encourage competition at the wholesale level. It may well be that in those circumstances BT earns more than its weighted average cost of capital. That is something that Ofcom goes into with its eyes open. That does not mean that it is inappropriate. What has happened, and I think Mr. Myers was candid in his evidence in relation to this, is that when one looks, with the benefit of hindsight, at the actual returns they are very high and it may be that Ofcom, back in 2004, should have been stricter and should not have accepted this looser form of regulation. But one cannot undo the decisions that were made in 2004. It would not have been known in 2004 that necessarily these higher returns would follow.

Sir, I was going to turn to the *PPC* case ----

THE PRESIDENT: If it would not have been known that these higher returns would follow, what

return there would be, and that is why the Condition says it should be no more than an appropriate return.

MR. SAINI: Indeed, but it may be, Sir, appropriate to allow more than one would allow on a price control when one is trying to encourage wholesale competition.

PROFESSOR MAYER: But I cannot see how that can follow if one starts off from a presumption of saying that the reasonable rate of return is 12%. The whole point about allowing for cost controls is to say that there is a measure of uncertainty on cost but that on reviewing whether or not there is compliance with cost orientation pricing, then presumably one has to relate it back to what one believes the relevant cost of capital is? Or am I misinterpreting it?

MR. SAINI: Sir, I do not accept that in 2004 -- This table of Mr. Myers', which is responding to what Mr. Pickford has put forward, sets out what the rates of return are and does not suggest that in 2004 Ofcom was deciding that any rate of return in excess of the weighted average cost of capital would be inappropriate.

PROFESSOR MAYER: No, I understand that you are not precisely necessarily bringing the rate of return back to the cost of capital, but one perhaps might sense a feeling of concern that there is such a deviation of the rates of return from the cost of capital.

MR. SAINI: I accept, and Mr. Myers accepted, the returns have been substantial. There is no doubt about that. But that simply follows, we say, from the particular regulatory intervention we took in 2004. What we know is that Ofcom perhaps, as it did in 2008, should have been stricter.

Sir, I was going to turn to the *PPC* case and deal with it as quickly as possible. If I could pick up my skeleton argument at p.85, para.225, and it might also just be worth having the *PPC* case open, which I believe is in Bundle E. The point we make at para.225 is that the DSAC test is intended to deal with both the structural and the level aspects, so it is not just a control on the structure of pricing, which is what Mr. Pickford was suggesting, but it also controls the level of common costs. It may well allow a generous potential recovery of common costs, but it is intended to control the level of common costs, and that is exactly the point that the Tribunal were dealing with in *PPC*. If I could ask the Tribunal, please, to go to *PPC* at Tab 9, at p.24, Mr. Pickford's argument proceeds on the basis that it is unreal that the Tribunal in *PPC* was not aware that there was an issue about ensuring that there would be no over-recovery of common costs. They make the position clear at 82 to 84, that the search is for a measure which is going to prevent, or seek to prevent, over-recovery of common costs, and they decide ultimately that DSAC does appropriately achieve that.

Crucially, however, they reject FAC as an appropriate test. If you could go just ahead, at p.85, please, at 286(2) ----

THE PRESIDENT: When they reject FAC -- I have read that paragraph and re-read it -- it was not quite clear to me what the argument was, because BT was obviously not arguing for FAC.

MR. SAINI: No.

THE PRESIDENT: Ofcom was not arguing for FAC.

MR. SAINI: Yes.

THE PRESIDENT: So how did this ----

MR. SAINI: It arose because ----

THE PRESIDENT: You were in the case so you can help us with how it came about.

MR. SAINI: It arose in this respect, which is the experts were agreed that there were a range of different potential ceilings, if I can use a neutral word, and DSAC was one and FAC was also one. Ofcom had rejected FAC in the course of its Determination because it was simply too tight. That was the basis upon which those observations were made at 286(2), but it is fair to say, Sir, no one was positively arguing for FAC or an aggregate FAC in the form that Mr. Pickford is arguing for now. But they did recognise, and the point was not lost on them, that FAC could not have been appropriate because it was too tight. It is also the case, and this is a very important point to bear in mind, that it was suggested by Mr. Pickford in opening that the *PPC* case was very special because the only issue in the *PPC* case was one service, but you would have seen ----

THE PRESIDENT: And you make the point that, in fact, the control was on a number of services ----

MR. SAINI: Indeed.

THE PRESIDENT: -- and for that one, is it not ----

MR. SAINI: Yes.

THE PRESIDENT: -- and the others passed the DSAC test.

MR. SAINI: Absolutely.

THE PRESIDENT: So it was a DSAC and if it had been a FAC test then you would have had to apply it to all of them.

MR. SAINI: You have the point, Sir.

THE PRESIDENT: So the fact that they are only considering the one, but the relevant test would be a test to apply to all of them.

MR. SAINI: Yes. So there are a number of services in issue which shared common costs, very

similar to the present case. If I can deal finally with the ----

THE PRESIDENT: Was the point made, you say it was raised by the experts, that using DSAC, going back to what they considered the Tribunal to have asked at para.83, did have the potential for multiple recovery of common costs?

MR. SAINI: There is no doubt, because it follows as a matter of mathematical logic, that everyone was aware that DSAC will allow you -- if everything is priced at DSAC it will allow you over-recovery of common costs, but what Ofcom was saying there, and saying here as well, in response to a complaint from BT that this was a very tough standard, that in fact it is very generous because it gives you so much headroom. But it was not lost on anybody that it was generous in that respect and it may be, Sir, and I say this before turning to the RAV adjustment, that in a future cost orientation review, which we know a cost orientation review is being conducted at the moment, that the industry may say that this DSAC test, which hitherto has been adopted by Ofcom, is too generous to a company such as BT with SMP. That could happen. But the right way to deal with that is in the course of a consultation process rather than this Tribunal legislating on the hoof, as it were, without meaning any disrespect, and deciding whether, going back to 2004, cost orientation should be measured according to an aggregate FAC standard.

Given the time, I am only going to say one word before going to the RAV adjustment in relation to efficiencies, and I am going to say it in a sentence, which is that -- it may be slightly more than a sentence -- there has been an active argument between Dr. Maldoom, Dr. Houpis and Mr. Myers as to whether or not DSAC or FAC promotes one or other of the efficiencies more or less. So Mr. Myers and Dr. Maldoom have argued that the DSAC test may promote dynamic efficiency but perhaps at the cost of static efficiency. Dr. Houpis takes a different view but again we submit it is not appropriate for the Tribunal, when deciding which is the appropriate cost measure, to undertake the kind of economic analysis that the experts have been engaged in because again that is a matter for a future looking cost orientation review. There are, and I think ultimately Dr. Houpis accepted this, not from me but in response to a direct question from the President, that there are legitimate different views amongst expert economists as to whether one or other measure might promote dynamic efficiency at the cost of static efficiency or the other way round.

I have gone over my time but I am just going, in 4 minutes, try and deal with the RAV adjustment by referring to my skeleton argument at p.91. The issue is relatively straightforward here, Sir, and it comes back to two issues. One is a policy matter and, secondly, the RFS. Paragraph 239, p.91. It is common ground that Ofcom has not required,

as a matter of policy, a RAV adjustment to BT's accounts during the period which covers the complaints which are before this Tribunal in the appeal. Ofcom has decided for the future (see para.244, p.92) to apply a RAV adjustment to Ethernet services on 1st October 2012. Prior to that date it never indicated that it would apply a RAV adjustment but, having actively considered the matter, it would not be consistent with appropriate regulatory practice for Ofcom now, nor indeed the Tribunal, to apply such a RAV adjustment. It would literally be moving the goalposts.

THE PRESIDENT: Not literally!

MR. SAINI: Perhaps not literally! That is all I have to say about that, Sir, and I am sorry I have slightly gone over my time, but I started slightly late.

THE PRESIDENT: We did interrupt you quite a bit. Thank you very much, Mr. Saini.

Mr. Thompson, will this be a double act again or indeed a trio?

MR. THOMPSON: Yes, it will be a double act. What we were proposing, since we basically have a two hour slot and a one hour slot, is that I will deal with grounds 1, 2, 5 and 6, and Mr. Read will deal with grounds 3, 4 and interest. Given that the Tribunal has the FAC/DSAC issue in mind, BT was not really proposing to say anything about it, but since the matter is fresh in everyone's mind can I just say a few short things about that. First of all, the Tribunal may remember referring to our letter in starting this, and one issue we raised in the letter was that paras.157 to 176 of Sky's closing appeared to us to be new and not correspond to anything that was pleaded. So we do have a general concern, and in particular the document that you, Sir, put to Mr. Saini that that was not a document we think was put to any of the BT witnesses. I think it was only put in just before Mr. Myers gave his evidence. So we feel we do have a procedural concern about how this issue has arisen, so I would just like to make some short points and give you some references.

First of all, we do make a point at paras.567 to 570 of our closing that many of these issues were fully addressed in *PPC* and clear conclusions were reached.

Then on the points of substance, first of all, the relationship between FAC and a charge control, we understand the point that is made, and it is a point that Dr. Houpis made, that conceptually there is a difference between his test and a charge control. As we understand it, Ofcom's point is really that it was well known in 2004 that cost orientation meant DSAC and DLRIC floors and ceilings, and that charge controls were well understood as being a form of RPI minus X control, leading to FAC over the period of charge control, and having beneficial incentives for the regulated firm to reduce its costs.

By contrast, an aggregate FAC test pre-empts such a charge control by forcing BT to price

effectively at FAC from day 1, and is, in that sense, more restrictive than a charge control, as understood by Ofcom, and eliminates the incentive effects, and also eliminates the flexibility in relation to the recovery of common costs that Mr. Myers placed great emphasis on both in his witness statement and in his evidence.

THE PRESIDENT: You are making two quite different points. One, you say it is well understood that cost orientation was based on DSAC ceiling, by contrast with price control where the RPI minus X formula was intended to reach what was an estimate of ----

MR. THOMPSON: Of FAC at the end of the period.

THE PRESIDENT: That is a statement that that was well understood. The evidence for that is what?

MR. THOMPSON: That is the point we were making, that that was what the exercise that was gone through in *PPC* with a degree of pain, and I think Mr. Read is more of a connoisseur of what happened in that case than I am, and obviously Mr. Saini has already said that. There was a question mark about how it all worked, and I think Miss Gallafent took Mr. Myers to some evidence in re-examination, and findings were made by the Tribunal. There is a history to this from BT's point of view, but that was the conclusion that the Tribunal in its findings in *PPC*, and that is clearly the position that Mr. Saini, and certainly we would particularly support him in saying that an aggregate FAC test was not understood by anyone to be the relevant test back in 2004.

PROFESSOR MAYER: If I could just follow on, I think it would be helpful for the Tribunal to have some independent evidence on this that goes beyond *PPC*, or perhaps lies behind *PPC*, because, as the President indicated earlier on, there was not the same emphasis on FAC as there has been in this case.

MR. THOMPSON: Yes. This has to some extent blown up, so it may be that, since we have this overnight opportunity, we can maybe take that opportunity in the morning if that would be helpful.

THE PRESIDENT: Yes. By "evidence" we do not mean further witness statements, it is just, as we have received the document from Ofcom, in fact the BT documents, the PAD documents, today, if there is anything similar in BT on this that would be helpful. You can consider that overnight.

MR. THOMPSON: I think Mr. Read certainly knows more about it than I do. I do not know if he can deal with it now.

MR. READ: Sir, I think the problem having, as Mr. Thompson said, gone through this at huge length in the PPC case, there was an enormous amount of evidence on a lot of the

documents that you have tangentially looked at in the course of this hearing, which were ploughed all over in witness evidence, and indeed Mr. Myers' evidence because he deals with the point at some length in the witness statement that he put in for the *PPC* case, which you do, in fact, have.

THE PRESIDENT: We have got that, yes.

MR. READ: Perhaps I can show you very briefly one particular passage which is in DF2, tab 12, p.13. I should say that this was in response to several witness statements from BT, including I think from Mr. Coulson, from recollection, because Mr. Coulson was in that case, but was not actually called to give evidence in the end, but certainly there were others. One can see from para.25 that he sets out some of the background to the various documents and how they developed, and of course one would need to see those documents in some depth in order to understand the process, and then he goes on in para.29 where he makes the point which he actually made in evidence here, that in fact part of the problem with all these documents is that there is a confusion of terminology that goes on through it.

As you can see from para.30, and this is absolutely crucial, throughout all the documents there was a distinction being drawn between what I call a proper stand-alone ceiling, i.e. the costs of a market entrant entering assuming all its costs incurred on the single product being with combinatorial tests, because that was quite an important issue in the *PPC* case. BT was saying that it had actually effectively come up with a SAC figure and attempted some combinatorial tests, and they got shot down.

So whenever one sees the phrase being used in the documents that they are, in fact, relating to combinatorial tests it is in that context of a true stand-alone ceiling cost rather than the DSAC test that is actually being involved. He goes on and deals with it at some length over the following paragraphs. As you can see, for example, when one gets to table 1, which is on p.18, there was a quite detailed comparison being done of what the various benchmarks would be, including stand-alone ceiling, including true LRIC, DLRIC and FAC and DSAC. My point is simply this, Sir, that it would be certainly wrong for this Tribunal to assume that the issues of FAC, the issues of DSAC and the issues of true SAC plus combinatorial testing were not gone through and piled over at some considerable length.

MR. SAINI: Can I just add one thing, while you have that document open, and this is in relation to Professor Mayer's question: if one goes to p.503 of this bundle, para.56 of Mr. Myers' statement, there was a table setting out the rate of return relative to FAC. You can see they were very, very substantial there as well.

THE PRESIDENT: Yes, thank you, that is helpful.

MR. THOMPSON: I was simply going to refer you, on the issue of the relationship between FAC and a charge control, to a passage in the expert evidence of Dr. Maldoom in his second report, which is at CBD, tab 4, paras.124 to 126. I do not know that it is necessary to turn it up. He essentially makes the points that I was making about RPI minus X as against cost orientation set at a FAC level.

THE PRESIDENT: Can you just give me the reference again?

MR. THOMPSON: Yes, it pp.40 to 42 of the witness statement, which is at CBD, tab 4, paras.124 to 126, and he concludes:

> "The application of the condition and the lack of headroom/glide path afforded by the FAC based test is clearly more restrictive than the way that periodically reviewed charge controls are operated in practice."

That is the sort of factual point.

I was going to make two other points. Mr. Read has already shown you Mr. Myers' first witness statement in *PPC*, and I was simply going to make the point, first of all, about endorsing Mr. Saini's point about really regulatory certainty, but elements of the Houpis test were, and I think remain, unclear, and clearly were not known by BT at the relevant time. We obviously put some of this to him in cross-examination. There are really three elements: first of all, the exceptions and the escape clauses; secondly, the groupings; and thirdly, issues of practicality, certainly if they are addressed going back over nearly a decade, as to BT's overall recovery and whether or not that was or was not reasonable in various different markets. It appears to us that certainly retrospectively that would be a wholly impractical test for anyone to embark on.

So those were those points.

Finally, in relation to the LLU backhaul document that we looked at , I simply wanted to refer the Tribunal to the fact that that issue is set in a legislative context, which is Recital 10 to the predecessor Directive 97/33, and that is at authorities 2, tab 42, and there there is reference to LRIC and SAC, and just to endorse what I think Mr. Read was saying by reference to Mr. Myers, those are Euro concepts of LRIC and SAC and I would submit that they are, as it were, true LRIC and true SAC, not DLRIC and DSAC. So that was simply by way of background.

THE PRESIDENT: Yes, I think that Recital is referred to in the passage in the backhaul Direction.

MR. THOMPSON: It is referred to if somebody could hand it to me.

THE PRESIDENT: This is AD 2, tab 42, p.60, para. 19, it quotes the Recital, and gives some

support therefore to what Mr. Saini said a short while ago that the reference in para. 21 to stand alone cost ceiling is to true SAC.

MR. THOMPSON: That is the point I was making, yes. That is, as it were, a Euro rather than an Ofcom concept.

THE PRESIDENT: Yes.

MR. THOMPSON: Simply on the brief discussion of 'fair bet' Mr. Read simply reminds me that that was an issue that was expressly addressed by Mr. Myers and I would refer you in particular to p.85, lines 21 to 29 where he says that even if one is addressing the cost of capital there may still be issues in relation to fair bet.

THE PRESIDENT: Page?

MR. THOMPSON: Page 85, lines 21 to 29.

THE PRESIDENT: Of what?

MR. THOMPSON: Day 11 transcript. It may, indeed, have been in answer to questions from Professor Mayer.

If I can now go across to BT's own appeal. I am going to address the four Grounds I have mentioned and essentially simplify what the issue is in each case.

In relation to Ground 1 I would submit that the issue is: what is the scope of HH3.1?

On Ground 2 the issue comes down to how should the issue of connections and rentals have been addressed?

In relation to Ground 5 the question is what is the temporal scope of Ofcom's power to order payments under s.190 (2) (d)? Under Ground 6 what are the relevant factors for the exercise of Ofcom's discretion under s.190 (2) (d)?

In relation to Ground 1, which we address at pp. 12 to 36 of our closing document, our position we would submit is a simple one. We say that the Tribunal and Ofcom should follow the market definition and the theory of harm specified in the legislation, individual WES and BES services and excessive pricing, not margin squeeze, on the relevant market. We refer you in that respect to Article 13(1) of the Access Directive, and ss.78(1), 87(1), 87(9) and 88(3) of the 2003 Act, and we say that those points are clear and that the jurisdiction of Ofcom rests on its market definition and on the theory of harm identified in s.88(3) of the 2003 Act corresponding to Article 13(1) of the Access Directive.

We secondly say that Ofcom should have followed the guidance of the Tribunal in PPC at paras. 215 to 217, where the Tribunal found that it was very clear that the cost orientation obligation applied to clearly defined markets, and here the market was clearly defined as AISBO wholesale services at all bandwidths from 2004 to December 2008 and to AISBO

wholesale services up to 1Gigabyte from December 2008 onwards.

Thirdly, we say that Ofcom should have applied a conventional approach to the construction of commercial documents and, in particular, to the construction of Condition HH1, which refers to that network access, which must be reasonably requested in writing and the obvious meaning of that is the contractual document which one finds at BT17 tabs 2 and 3, which expressly set out a request for, in that case, a BES service, but it might equally have been a WES service.

We also say that this is confirmed by an overall reading of the conditions and, in particular, the reference to the reference offer in Condition HH4, which makes no sense if it is confined to a connection or a rental, or to some element of a WES or BES service, that makes perfect sense if it is a WES or BES service. It might be worth just looking at that. That is at tab 12 of core bundle E. If one looks at p. 494, the charge has to be full network access covered by Condition HH1, and then when one looks at Condition HH1 you find:

> "Where a Third Party reasonably requests in writing Network Access, the Dominant Provider shall provide that Network Access."

So it has to be something specific provided to the response to the request in writing, and we would say that that means it must be a unitary something, it is not a whole lot of different things, it is something particular, and that is entirely consistent with HH4, which sets out a specific set of requirements of what the dominant provider must do, namely:

> "shall ensure that a Reference Offer in relation to the provision of Network Access includes at least the following:
>
> (a) a description of the Network Access to be provided …
>
> (b) the locations of the points of network access …
>
> (c) the technical standards for Network Access …"

And these things, in BT's submission, make perfect sense in relation to the WES and BES service, but make no sense in relation to elements of that service.

THE PRESIDENT: We have not actually seen a reference offer, have we? We have seen an application for one, the form which you ask for one, and we have seen BT's standard terms and conditions.

MR. THOMPSON: As we understand it, the reference offer is effectively constituted by the product handbook which one finds at BT 17, tab 4. At tab 3 you will see the application, which we rely on as the written application for the relevant form of network access.

Then, in terms of fulfilling the obligation in 4, we take it to be the product handbook which was published in 2007 in this form, and then it sets out how it works and the nature of the

services that are provided and, in particular, on p.3 under 3.1 you will see a description of the product.

THE PRESIDENT: Yes, but the reference offer, under HH4.2(f) must include the relevant charges which the product handbook, of course, does not.

MR. THOMPSON: If I can refer you to Mr. Jones' statement, it is explained I think at the front of that bundle, or in CBC whichever is more convenient.

THE PRESIDENT: It would be helpful if there was a sample reference offer somewhere in all these bundles.

MR. THOMPSON: I think it is most helpful if one looks at paras. 9 et seq of the statement of Mr. Jones, which he was not, I think, cross-examined on, except perhaps very briefly by Ms. Rose, but he sets the matter out at paras. 9 to 14.

THE PRESIDENT: In his first statement?

MR. THOMPSON: In his first statement, at the front of that bundle or in CBC2, I think.

THE PRESIDENT: Paragraph?

MR. THOMPSON: Paragraph 9 et seq.

THE PRESIDENT: The price list is part of the reference offer. That is para. 9.

MR. THOMPSON: Yes.

THE PRESIDENT: And the price list, of course, states a separate price for connection and for rental.

MR. THOMPSON: Yes.

THE PRESIDENT: And those are charges therefore specified in accordance with HH4.2F

MS. ROSE: It is also the case in Mr. Jones' witness statement that the contract is part of the reference offer, para. 11, and you will recall that at clauses 12.5 and 12.6 of the contract there is separate reference to the rental charge and the connection charge in the contract.

THE PRESIDENT: What I struggle with, Mr. Thompson, where this gets one, even if the network access, to take your point, is the BES 100 service - without going back to the statutory definition, Mr. Saini's point about components and elements - let us assume that is the network access referred to in HH3.1, which you said read consistently with HH4.2, each and every charge payable, or proposed for that network access must be cost oriented.

MR. THOMPSON: Yes, but it is not for every type of network access; it is for the network access covered by HH3.1.

THE PRESIDENT: It is, but each and every charge for that.

MR. THOMPSON: Yes, but it is not each and every charge for each and every element; it is for the thing itself.

THE PRESIDENT: Yes, and for the thing itself there is a charge payable called the connection charge, and a charge payable called a rental.

MR. THOMPSON: Yes, but that is not the thing itself. The thing itself is the BES or WES service.

THE PRESIDENT: That is what you are paying for, but you have to pay several charges to get it, even if they are always payable. Let us assume they are all always payable (not quite the case, but assume that).

MR. THOMPSON: But it does not say each and every charge for each and every service comprised of the network access; it says each and every charge for the network access, which is the BES or WES service. That is the point we are making.

THE PRESIDENT: If, to get my BES service, I would have to pay £1,000 at the beginning and – forget the BES service, to get a telephone line and a telephone service at my home I would have to pay £200 at the beginning for the connection and then £25 every quarter on account of rental, then each and every charge payable (which has to be reasonably derived from costs) would be the charge for the connection and the ongoing charge for rental, the quarterly charge. The thing I am getting is use of the telephone line, but there are several charges I have to pay, distinct charges.

MR. THOMPSON: But if one looks in that sense, then you do get into what in my submission really is the somewhat crazy world of things which are not network access at all being still charges for network access in that sense. You start with the WES/BES service and since we have the contract open, I do not know if you have got bundle 17 still there?

THE PRESIDENT: Yes.

MR. THOMPSON: At bundle 17 tab 2 --

THE PRESIDENT: It is clause 12 on p.10 which is headed "Charges and the parties".

MR. THOMPSON: Yes. What I was going to show you, sir, was para.2.7 that if you terminate early you still have to pay charges for the remainder of any minimum period. Those charges could hardly be described as charges for network access because the contract is finished, but you have still got to pay those charges but you are not getting anything for that. But that cannot be a charge for network access within Condition HH3.1. To make any sense of it, it has got to be for the service itself. Otherwise, just anything that is a charge might not be network access at all.

THE PRESIDENT: That may not be, because that is when you are no longer getting the service.

MR. THOMPSON: But it is not just any old thing that happens to be in the contract; it has got to be for network access, otherwise also you get this crazy world of the reference offer would

have to be for – I do not know -- you would have to produce a reference offer for that. You have actually got to pay for something. What you are paying for is the circuit.

THE PRESIDENT: Yes.

MR. THOMPSON: The next point I was going to make is that as we had understood it, until this case arose Ofcom seemed to take a similar view to that of BT. We looked at the *Energis* case briefly, and we looked at the question in relation to THUS complaint. The *Energis* case is at BT14 tab 41. You will recall that this was the Determination that was effectively stayed pending the outcome of the LLMR 2004 and where Ofcom then almost immediately issued a Determination which was said to be in line with its conclusions in the 2004 review. That is para.1.2.

If you look at Section 3 the Legal Framework there is a very straightforward analysis of the network access issue and the statutory definition. I think it is probably enough just to look at 3.7:

> "The products requested by Energis are services, facilities or arrangements within the ordinary meaning of those words."

So Ofcom simply looks at the product itself, the different LES services and says they are all forms of network access and there is none of this, what we would say is, slight jiggery pokery about other sorts of elements being forms of network access; it is just a straightforward analysis of these products being forms of network access. There is nothing about connections and rentals, or little bits and pieces, access construction costs being forms of network access, it is just a totally straightforward analysis.

Likewise, at p.29, when you come to the actual Determination you have six products listed in para.1 and then para.2 says: " The charge for the network access products listed in paragraph 1" and then it goes on with the familiar wording. Again, it is a totally straightforward approach. In my submission, it is obvious that that wording simply slots in where the "each and every charge" wording is into HH3.1. If one wants to use the wording of each and every, you say each of those six products, and every instance of it, must comply with cost orientation and that makes perfectly good sense.

THE PRESIDENT: I thought you said it was stayed, this Determination, is that right?

MR. THOMPSON: If you look back to tab 39, it is something I went to briefly with Mr. Myers.

THE PRESIDENT: Yes, you did. I was trying to remember.

MR. THOMPSON: It was opened in July 2003 and closed in September 2004, so it did not take the four months; it took something over a year, but that was because the LLMR 2004 came in between.

THE PRESIDENT: So after the LLMR came out and the conditions were imposed – what I am just trying to get my head round is how the obligation on BT in this Determination that you have just shown us in Annex 1 fits with the SMP obligations on BT imposed as a result of the LLMR. Why did they need a separate one?

MR. THOMPSON: This was a dispute or complaint that certain retail products, LES products, were not available on a wholesale basis and Ofcom sat on this while the LLMR 2004 was going on and then you see at Determination 1 came to the conclusion that these six products should be supplied on a wholesale basis within 60 days. I will be corrected if I have got it wrong, but I assume those six products then effectively slotted into the LLMR 2004 regime as forms of wholesale AISBO service.

THE PRESIDENT: So then those products would be subject to this obligation here in the Determination Annex 1?

MR. THOMPSON: Yes.

THE PRESIDENT: And also BT, in respect of them, would have to apply the obligations imposed as a result of the LLMR more generically, is that right?

MR. THOMPSON: Yes. I have forgotten, I am afraid, what the CES significance is. I think the LES ones effectively became WES. I do not know whether CES became BES. I would have to confirm that.

THE PRESIDENT: I think that is something different. I think WES was new.

MR. THOMPSON: Then the second document, which we also went to briefly with Mr. Myers, is at BT16 tab 10. We see this document in various iterations because it is used as the template for BT's reply. This is a request to BT for information under s.135 of the Act. So it is an information request. There are three specific requests in relation to cost orientation effectively looking at present, future and past charging. So 4 is current charges; and then it says "for each and every WES and WEES product" and then 5 says "proposed charges for each and every WES and WEES product" and 6 says that BT has satisfied its ex ante cost orientation obligation HH3 in relation to each and every WES and WEES product. So again, Ofcom appears to take the same straightforward approach that the relevant product is the WES or WEES product, and it is each and every one of those products; it is not each and every fiddling charge for some service comprised; it is the actual product itself.

There has been a certain amount of to-ing and fro-ing about whether people have changed their positions. We say that both Ofcom and, it seems to be mainly, Cable & Wireless, Virgin and Verizon have taken the lead on this one. We say that their position has indeed shifted about and it is difficult to understand. It was originally an unreasoned reliance on

each and every charge as if that was the full answer to everything and that is basically how one finds it in the Determination and in Mr. Myers' original statement, combined with a general reference to the wide scope of network access.

With respect, we would say that is a hopeless approach because it did not specify clearly what the charge was for nor which form of network access was specified in the condition. Indeed, we say that Ofcom has never really clearly identified what the charge is if it is not for a WES/BES service as defined in the market definition. One finds, indeed, a revealing slip in Ofcom's closing where they quote the Condition as being for network access covered by Condition HH3.1 rather than 1.1, and, indeed, Mr. Saini, I think, has never engaged with the meaning of HH1 and did not engage with it today. That was also the case in the Decision, where HH1 is not even cited.

There seemed to be two bases in the skeleton argument for Ofcom and the first seemed to be each and every charge for anything comprised in network access. We would say that does not really make any sense. The charge must be for network access covered by Condition HH1. If it is not a form of network access at all it is clearly not caught by HH1 or HH3.

Then the second basis was that network access extended to catch anything necessary if not sufficient for network access. We put this to Mr. Myers and it emerged that that was really hopeless because none of the elements on which Ofcom or Cable & Wireless, Virgin or Verizon were in fact necessary, and Dr. Myers admitted that and that he could not understand what Ofcom's case was on the point. That was transcript Day 10, p.15, lines 14-23, and that point seems to have been abandoned by Ofcom in its closing. We would say that is not just a misunderstanding. If you can get the network access without the relevant element at all then it clearly cannot be network access and, as the evidence shows, you can buy a WES circuit outright. You can build it yourself or you can rent it without incurring any material upfront costs. So that, in fact, neither a connection nor a rental are actually necessary for a WES service. So there is very serious problems in the necessity argument, which was the only argument that Mr. Saini put in opening but which he now seems to have abandoned.

So we put the test like this. What is the charge for? It must be for a form of network access and it must be a form of network access that is identified in Condition HH1 and that is consistent with the forms of network access identified in the other conditions. We say it is not good enough if it is not a form of network access at all and it is not good enough if it is a form of network access but it is not identified in HH1 or the other conditions. We say that applying that approach the answer is simple. It is a charge for a WES or BES service as

identified in BT's reference offer and the contractual documents.

Counsel for Cable & Wireless, Virgin and Verizon tried to suggest that BT's position is incoherent in relation to main link connections and rentals, but the point is manifestly a bad one. BT's point on main link under Ground 1 is that Ofcom did not define a separate market for main link. On the contrary, they specifically considered the issue with a separate backhaul market and decided not to define it as a separate market in the 2008 Market Review, and one finds that at paras.5.33 to 5.44, BT5, pp.62-64. We say that it follows from that that Ofcom could not have imposed a condition, for example, HH3.1 imposing cost orientation on main link because they had not defined it as a separate market. We say it would be very strange if they could *sub silentio* impose such an obligation as part of an overall condition relating to wholesale AISBO services.

BT's point about connections and rentals is separate from the point about main link, because we say that Ofcom could not have defined a separate market for connections and rentals. They are like a snail in its shell or the deposit for a lease and the rental payments on that lease. They are not a separate thing from the WES or BES circuit.

THE PRESIDENT: How does it work? If a CP, to get the service, needs not only connection and rental but also main link, because of its situation/location/distance away from the connection, then main link is part of the charge for network access ----

MR. THOMPSON: Yes.

THE PRESIDENT: -- which has to be all together cost orientated?

MR. THOMPSON: Yes. I do not think we need to go to it, but you may remember in the Annex 12 document for the 2008 consultation, Ofcom did three exercises. It looked at the connection charge; it looked at the rental charge, and it looked at the overall charge, including main link, and we would say that it was that third one that was relevant for this condition.

Then a final point, which is relevant to Ofcom's argument that the scope of HH3.1 reflects a need to restrict price inflexibility -- you may recall para.8.57 of the Decision which Mr. Saini took you to in opening -- we address that in Appendix C of our closings at paras.4-12 and 25-30. The point we make on that is that DLRIC and DSAC floors and ceilings were certainly not intended to constrain price signalling or flexibility and they would be hopelessly unsuited to do it. The origin of price floors and ceilings appears to be the 1997 Oftel Guidance which one finds at ST1-3 Tab 16, p.32. It starts at p.31 under the heading "Floors and ceilings", and C.1:

> "… Oftel would consider a good first order test of whether a charge is unreasonable or

otherwise anti-competitive to be whether the charge in question falls within a floor of long run incremental cost and a ceiling of stand-alone cost".

If one then looks at C.7 and C.8 you see that their purpose is to prevent either excessively low pricing or excessive pricing. So, in my submission, it is straightforward from a competition law point of view, that what these requirements are intended to do are to constrain effectively predatory or exclusionary pricing or excessive or exploitative pricing on a relevant market. As I put to Dr. Houpis and Mr. Myers, the product DSAC test is an eminently suitable test. It is not the only test but it is a possible test for a regulator to adopt as a proxy for a constraint on excessive pricing on a relevant market. But it is not at all a suitable test to constrain price inflexibility and you will recall the cross-examination of Dr. Houpis by reference to his para.3.12 in, I think, his [third] report where he points out that DLRIC to DSAC is probably a multiple of 2.5 and so one could certainly give very strong price signals under a floor and ceiling regime of that kind.

Secondly, I will address Ground 2. How should the issue of connections and rentals be addressed? Contrary to the apparent understanding of Ofcom and the CPs, this is an issue that is centrally relevant to all three of the issues identified at p.3, para.6-7 of BT's closing, the issues of scope, compliance and repayments. This was a point we made not only in Grounds 3 and 6 of the notice of appeal but also in our skeleton argument at paras.59-79. The issue has been addressed in great detail in the evidence and that evidence is collated, at some length, at pp.37-83 of our closing.

So, first of all, in relation to scope, our analysis is as above. Connections and rentals were effectively a snail and a shell or the deposit and rental payments on a lease. Neither of them make any sense as an independent form of network access and the point is reinforced by the witness and expert evidence on self-supply and cost allocation. In reality a BES/WES circuit is in substance a piece of capital equipment comprising electronics, fibre and duct. The fact that it has to be installed and linked to a fixed network is no different from any other such product, such as a television or a washing machine. The capital costs are incurred upfront, as one sees from the build option, and then paid for either out of cash or loan finance or an upfront charge or a rental to a customer. Costs and charges for connections and rentals have only limited economic meaning in that they can and have varied widely as the relevant costs are shifted between the two services. This point was extensively debated with Mr. Harman and accepted by Mr. Myers.

Turning to the issue of compliance, we say there are two core issues. First of all, the commercial reality and, secondly, legal certainty. So far as commercial reality is concerned,

we would say that the initial decision to purchase or self-supply a WES or BES circuit is a commercial decision taken on a conventional whole life costing basis. The potential BT customer assesses the best option by reference to its retail customers' needs, in the WES case, or its own projected business needs, in the BES case, each of which is typically for a period of well over a year. Once that decision is taken the normal position would be that the circuit will be retained for the projected period, unless there is a material change of circumstances. As such, the one year BT minimum term, which does not in any event preclude early termination as one can see from clause 2.7, is in general irrelevant both to the initial purchasing decision and to any renewal decision. BES and WES contracts are evergreen contracts where decisions are made, first of all, on purchase and, secondly, where there is a material change to the commercial basis on which the circuit was purchased. That is why it makes little sense to consider individual monthly rental services outside the minimum term. The balance of connections and rentals is simply a factor that is taken into account in the overall commercial assessment. Whatever balance is struck by BT, there will be winners and losers. For example, companies who change circuits regularly, are capital constrained or expanding rapidly will tend to favour lower connections and relatively higher rentals. Other companies buying long-term may be content either to self-supply or they may have a preference for relatively higher upfront costs. That is an entirely normal regulatory issue which one could see, for example, in the cost of a stamp or the distribution costs of industrial water as one finds in the *Albion* case, some plants were closer and some were further away from the relevant water source.

Ofcom's general position is that it is pro-competitive for suppliers to judge the balance for themselves, up to a limiting case of Ramsey pricing determined by relative price elasticity rather than underlying costs. One sees that in our appendix C paper, and it was also said by Mr. Myers at para.87 and 122(b) of his witness statement.

The averaging approach of Ofcom in the 2009 charge control LLCC was a perfectly reasonable approach to address such an issue spreading the connection costs over the average length of the contract, and thereby smoothing the effect of up-front costs. There is nothing in Mr. Myers' evidence, or the Decision, to show that this approach was wrong, and likewise the approach is adopted by Mr. Harman in the first report as perfectly reasonable. This point is highly relevant to the repayments issue and to the proportionality of Ofcom's approach to that question.

The position in relation to renewals or replacements essentially repeats the original acquisition decision, apart from the fact that it is assumed, *ex hypothesi,* that the customer

already has a BT circuit. That will be a factor tending to favour the status quo, both at the wholesale and the retail level, but any consideration of change will be on the same whole life costing basis as considered above, so the alternative arrangements to which Mr. Myers refers are in practice further build or buy decisions involving up-front costs and future rental costs.

So far as transfers, and so on, are concerned, they are relatively marginal issues and in so far as no connection charges were levied, either at all or in the relevant period, they would fall out of account in any event. Overall Ofcom produced no evidence to support its concerns over pricing distortions and Mr. Myers himself admitted that he considered the arguments were finely balanced for aggregation and disaggregation.

Turning to the issue of legal certainty, we made a number of points in our ground 3 relevant to connections and rentals, but most important is the simplest. Up until July 2009, it was clear that Ofcom took the view that compliance with cost orientation could be addressed by averaging connections over a period of three years. The importance of this is threefold. First of all, as a matter of construction, Ofcom cannot now say that the wording of Condition HH3.1 clearly precluded this approach to compliance, and we refer in this respect to the *Gondrand and Garancini* case, and we quote the relevant part in para.3(a) of appendix C. It may be worth turning that up briefly.

THE PRESIDENT: What is the reference?

MR. THOMPSON: It is in our closing submissions. At the back there are two appendices. Appendix C should say Note on legal certainty and pricing flexibility, and then if you go to the bottom of the first page it says:

> "First, the principle of legal certainty requires measures imposing burdens on undertakings, particularly financial burdens, to be clear, so that undertakings can understand and take account of these burdens:"

Then reference to the *Gondrand and Garancini* case, and then the quotation:

> "Even assuming that the interpretation advocated by the Commission is in accord with the logic of the system of monetary compensatory amounts …"

so it is assuming that the Commission is correct in construing the document:

> "… nevertheless it is for the Community legislature to adopt the appropriate provisions. The principle of legal certainty requires that rules imposing charges on the taxpayer must be clear and precise so that he may know without ambiguity what are his rights and obligations and may take steps accordingly."

Then it goes on:

> "'The rules in question are obviously unclear as is apparent inter alia from the fact that even the competent customs authorities originally interpreted them in the same way as the respondent in the main action …"

So the first point is that it is obvious that Ofcom itself considered that connections and rentals could be aggregated up to at least July 2009, over five years after the condition was imposed.

We say that the point is particularly important where Ofcom is applying its new approach on a retrospective basis, and we refer to the points at paras.(b) and (c) of the same part of the document, and that it is particularly important where it involves financial burdens, and one sees that from the fourth point, the *Stiftung* case, the imperative of legal certainty must be observed all the more strictly in the case of rules liable to have financial consequences. Mr. Myers conceded that neither he nor Ofcom was in a position to justify the change of approach on the basis of any evidence.

Finally, Ofcom did not provide any alternative clear guidance within the dispute period, either before or after July 2009 that could have enabled BT to address the issue of compliance on the disaggregated basis that Ofcom now favours. One sees that from the material set out at paras.15 to 20 of the same annex, if one turns through, and this is material I went through with Mr. Myers in relation to the contact between Mr. Jones and Miss Wray and Ofcom, and its various publications over the period.

One final point on compliance is that an objection that has been taken to BT's approach generally is that BT should be held to decisions reflected in its regulatory financial statements. However, Mr. Myers accepted in cross-examination that this issue was irrelevant to the aggregation of connections and rentals, which is simply the adding together of two numbers, either in a single year or with a connection figure spread over a number of years - that was day 10, p.55, line 4, p.56, line 3. Such aggregation does not involve any alteration of the figures themselves, as Ofcom's own practice in the 2009 demonstrates.

Turning finally to the significance of the approach to connections and rentals to the issue of the repayments which we dealt with at para.44.93 of our notice of appeal, first of all, we say the issue was not properly considered in the Decision (and that is para.15.63.3), where there is a reference to a counter-restitution analysis. We say this is not a counter-restitution analysis, it is simply a practical analysis intended to address the commercial reality of the situation, a matter that Ofcom should have taken into account in the exercise of its discretion. Given that CPs purchase on a whole life costing basis, and by reference to the prices offered, not the underlying costs, the relevant question is whether an aggregated

approach to the repayments issue would or would not be fairer than a disaggregated approach.

Mr. Myers accepted that Ofcom had no evidential basis to say the LLCC 2009 approach was wrong. On that basis, how can it be fair or proportionate to assess BT's liability to make payments to its competitors on a more restrictive basis? Further, as addressed in the cross-examination of Mr. Myers (day 10, p.45), there is an obvious risk of windfall benefits where BT has charged relatively low connections and relatively high rentals which in fact reflects desirable flexibility in the interests of its customers, and contrary to its own interests on both the upstream and the downstream market with the consequence that a customer has been charged in aggregate what it expected to pay on a whole life costing basis. You may recall the cross-examination of Mr. Myers about the 10, 10, 7, 11, 11 example, and whether it was fair for somebody who had projected the cost to be 40 and in fact had paid 40 to recover three on the basis that their rental charge was higher than they had anticipated, or even if they had actually been charged less than they expected or the costs had been more than they had been charged, they would still recover sums. I will not go into the detail of it, but it was cross-examination of Mr. Myers on day 10.

We say that Ofcom's 2009 approach or Mr. Harman's alternative approaches all avoid these anomalies and are notably fairer than the disaggregated approach in the Decision.

Then finally, and it is a point that Mr. Harman was at pains to emphasise, this aspect of the case is not a matter of no repayment or that aggregation should permit excessive pricing of rentals over an extended period. The purpose of Mr. Harman's approach was simply to assess the impact of aggregation on two aspects of a charge for a single service on the basis that those two aspects were, in reality, relative to what were in very large measure the same underlying costs for providing that service.

Turning now to ground 5, the temporal scope of Ofcom's power to order payments under s.190(2)(d). This issue is addressed at pp.145 to 165 of BT's closing submissions, para.393 to 464. The policy issues relevant to this matter were addressed in some detail in my opening remarks some weeks ago, and I do not propose to repeat them. I just make three distinct points. First, contrary to Ofcom's understanding, this is a genuine case of retrospective action. The effect of Ofcom's decision to order repayments has the effect of reopening commercial transactions that were concluded many years ago between substantial commercial parties. The assessment of compliance is a different matter, and can, in principle, be conducted on a historic basis. An administrative order to BT to adjust prices levied and paid in 2006 and to make repayments to its customers by reference to such

adjustments is a radical exercise of public power on a retrospective basis requiring concluded transactions to be reopened many years after the relevant services and payments have been made by agreement, and it should be assessed as such.

Both under English law and under EU law, the issue of retrospectivity is taken very seriously and is not permitted unless clearly stated and justified, and I refer to the two authorities at appendix C, paras. 3(b) and (c).

Secondly, we say the point is particularly stark in relation to the period before 8th December 2008 for two reason: first of all, the relevant condition had not been in force for over four years before the direction for repayment was made, and one sees that at para.12 of the 2008 s.46(1) notification, which is at B5, p.368, and also the date of the Determination was December last year.

Secondly, and this is significant, Ofcom had itself closed a dispute during the 2004/08 review period on the basis that the issues raised in that dispute would be addressed in the sub market review, and one sees that at BT16, tab 17.

Then the third point, and that does, to some extent, go back to points I made in opening, is that the effect of Ofcom's orders is to cut across the provisions made by Parliament in s.104 of the Communications Act, s.167 of the Enterprise Act and the Competition Act, s.47(a) and (b), and the requirements laid down by the courts under those provisions and under the common law, and it thereby deprives BT of any of the procedural protections that those alternative remedies provide without any alternative or equivalent protections having been specified either by the EU legislator or by Parliament. We say these are important questions for the Tribunal to have in mind in considering the temporal scope of the power that has no clear basis in the CRF and that has been used to require BT to make payments to its direct competitors running to tens of millions of pounds.

Mr. Saini mentioned this briefly this morning, but the lack of any apparent restriction on the temporal scope of Ofcom's dispute resolution powers, including presumably s.190(2)(d) was a factor that the Tribunal recognised as problematic in the PPC's Judgment on preliminary issues. I think it is worth looking at that just briefly, it is core bundle E, tab 7. It is right at the end of the Judgment, p.36. The Tribunal says this:

> ".. this final point does raise an important question going the other way. Suppose CP-2 did not refer its dispute with CP-1 to OFCOM on date T+100, but on date T+1000? What control is there against late disputes being referred? Mr Saini QC for OFCOM frankly conceded that there was no jurisdictional control in respect of such conduct, but that this might be a factor to be taken into account by OFCOM

when determining the dispute."

That reads somewhat hollowly now, in that so far as the LLMR 2004 we are now somewhat passed T+3000 and there is no indication that Ofcom is prepared to exercise any discretion to think that enough is enough or that this is now getting a bit late, even when one is outside the limitation period laid down in the Limitation Act for civil claims.

I now turn to the legal issues because the question of temporal scope necessarily involves consideration of the legal basis.

THE PRESIDENT: When you say the Limitation Act these disputes were referred in 2010 and some of them go back to 2004, maybe a month would be out, perhaps, or less, and I think some of the others, the Altnets go back to 2006, I think - is that right - so they would be within the Limitation Act.

MR. THOMPSON: Yes, I think the point I was thinking of - I was going to come to it in a moment, but we can go to it now - it is at 122 of Ofcom's closing submissions. At 123 Ofcom says its position is it has power to direct repayment from the start of the period of the overcharge in each case, and in the table above you will see the allegations go back to 2004, but as I understand from Mr. Saini he is not suggesting that there is any guarantee that if a dispute now was brought going back to 2004 that it would be viewed as out of time. So we are now almost a decade on ----

THE PRESIDENT: There is no guarantee, but we are not concerned with such dispute, we are concerned with these disputes and just if you are drawing analogy with how harsh this is because there is no limitation period as you would find in a statute, on these disputes it would meet the limitation period, say, for perhaps a few weeks in the statute. So whether Ofcom might, in a case that was eight or nine years old, say: "This is too stale or", in any event, now that the law has changed they have greater liberty to say: "Such an old dispute we do not regard as priority". So it is a slightly theoretical point, is it not?

MR. THOMPSON: No, it may not arise in this case, but this case clearly ----

THE PRESIDENT: They have said that they might, in an appropriate case, regard that as a reason not to order repayment. What might be an appropriate case, I do not know; clearly they think these are not, and on these cases the ordinary limitation period would not bite. That is the only point I am making.

MR. THOMPSON: Yes. I think the only point I am making is that there is no defined basis for any restriction. Obviously, Mr. Saini referred to the principles of laches in equity, but they are fairly well defined and they, in some respects are more restrictive than the limitation.

THE PRESIDENT: You say that this is a statutory scheme and it is slightly odd if any question

of extreme delay is just left to the discretion of Ofcom.

MR. THOMPSON: Yes, obviously I say something more than that in that I say that it is, as it were, a ghost of the statutory scheme because there is no actual scheme, there is nothing there. It is all a matter of inference in the CRF, there is absolutely nothing ----

THE PRESIDENT: Well, statutory scheme in s.190.

MR. THOMPSON: There is that provision, so we are now looking at what is ----

THE PRESIDENT: What it means.

MR. THOMPSON: -- the legal basis of it.

THE PRESIDENT: You say look at the legal basis of it. We are not, are we, we are having to apply it, we cannot disapply it. I thought you were saying it has to be interpreted in accordance with the CRF?

MR. THOMPSON: Yes.

THE PRESIDENT: And therefore it should be given a restricted interpretation. We cannot say it has no legal basis, therefore we ignore it.

MR. THOMPSON: As far as s.190(2)(d) we are interpreting it. But, as I understand it, it is common ground, and it is certainly a finding in the PPCs in the Court of Appeal, that this is a regime under the CRF and is to be interpreted in accordance with the CRF.

THE PRESIDENT: Yes.

MR. THOMPSON: All I am saying is that in the CRF there is nothing about this, and so it is all a matter of inference.

I addressed this matter briefly in opening, and that is pp. 18 to 20 of day one. It is set out in more detail at paras. 418 to 454 of our closing, but I will take the points as shortly as I may. The first point is we say that any power in dispute resolution to impose specific payment obligations on BT can be no wider than those enjoyed by Ofcom in own initiative proceedings, and we rely on two specific provisions, the original Article 4(4) of the Access Directive, which is right at the front of core bundle E. My recollection is, possibly wrongly, the Tribunal considered that this was the basis for the PPCs' case as a matter of EU law but, in any event, one sees that with regard to access and interconnection:

> "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)."

In my submission it would be very strange if the empowering in the third line was of different scope depending on whether or not the national regulatory authority was acting of its own initiative, or effectively as a dispute resolution body. So that is the first point. The second point is in Article 20 of the Framework Directive which, if you go to the back of tab 3, you find the amended provision. We rely, in particular, on the second sentence of 20(3), which is:

> "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 …"

In my submission that is fairly obviously a restriction on the imposition of obligations by the NRA and I made the point that in para.2 of our reply the French and German versions use the expression "can impose" so it is clearly to do with legal power in our submission. Ofcom relies on Recital 32 and says that that gives some guidance as to what this means. One finds that at p.37:

> "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."

Ofcom makes the point that those obligations can apply to the NRAs themselves. That is quite clearly not the same as Article 23, second sentence, which is concerned with obligations imposed on undertakings, so in my submission that does restrict the powers of the NRAs in relation to the obligations they can impose on undertakings. We say there is nothing strange about that. We say, indeed, it would be absurd if a disputing CP could demand that Ofcom confer a benefit on it that Ofcom would have no power to confer in the absence of a dispute. For example, it would be ridiculous if an undertaking could demand that an SMP obligation could be imposed in the context of dispute resolution without SMP having been demonstrated or Ofcom having decided on its own that that was not appropriate and, indeed, that is not entirely a hypothetical possibility because in *The Number* case that the Tribunal will find in core bundle E, tab 8, the issue there was whether or not BT could be compelled to supply data at marginal cost which would be a classic SMP or dominant type obligation and that was being put forward as a matter of dispute resolution, but the whole point was that the powers were defined by the legislation.

This may seem a fairly ----

THE PRESIDENT: It would be strange if Ofcom could require BT to do more in resolving a dispute than it could on an initiative investigation. That is why I was asking Mr. Saini about what Ofcom could do if there were no dispute, but Ofcom itself considered that the cost orientation obligation had been breached, leading to overcharging.

MR. THOMPSON: Yes, indeed.

THE PRESIDENT: And he took me, or we went, perhaps in conjunction, to the provisions in the Act as to how that could be enforced.

MR. THOMPSON: Indeed, I was going to take the Tribunal to the Authorisation Directive which addresses this very question at Article 10.

THE PRESIDENT: It is the Authorisation Directive which is ----

MR. THOMPSON: Yes, that is at tab 2.

THE PRESIDENT: Which is one we have not really looked at?

MR. THOMPSON: We looked at it right at the beginning because it is the controlling provision in terms of the NRAs which one finds in Article 3(2) and 6(2) if you recall, that was the point that arose in *The Number* case.

THE PRESIDENT: Yes.

MR. THOMPSON: That is where the strict control over the powers of the NRAs comes from. One finds that Article 10(1) provides a power to seek information, so that is effectively like our s.135 information request. Then 10(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 the opportunity to state its views…"

Then the enforcement provisions are at 3 and 5. It gives powers for the relevant authority to take "appropriate and proportionate measures aimed at ensuring compliance". In fact, it is somewhat clearer in the amended text. I do not know if the Tribunal is looking at that or at the original.

THE PRESIDENT: I was looking at the original, but the amended text of Article 10 after the pink.

MR. THOMPSON: Yes, it is p.12. You will see at 10.3 that the power is "the power to require the cessation of the breach referred to in paragraph 2 either immediately or within a reasonable time limit". So it is a prospective power to compel cessation. So that clarifies the position. Then there are penalties that can be provided to enforce that.

THE PRESIDENT: It is several things, is it not: power to require cessation, appropriate measures to ensure compliance, that will include dissuasive financial penalties.

MR. THOMPSON: Yes. I am assuming compliance means compliance with the requirement to cease.

THE PRESIDENT: Why is it not compliance with the obligation, not just the requirement to cease the breach, but compliance with the underlying obligation that has been breached?

MR. THOMPSON: 10.2 it is in the present tense: the NRA finds an undertaking does not comply, the undertaking has the opportunity to state its views within a reasonable time limit, so you are then moving forwards in time. Then there is a power to require the cessation of the breach, and again there is a period of time to cease, and "shall take appropriate proportionate measures aimed at ensuring compliance". I am assuming that the power in 3 could not be exercised before the undertaking had been notified and given an opportunity to state its views.

THE PRESIDENT: Yes. I think that is right, but it is very odd if, given that one of the obligations can mean, on a measure of cost or price control, if the undertaking has breached the price control substantially but then stops breaching, that the authority can then do nothing about the breach that has been concluded; it can only act if the breach is continuing, would it not?

MR. THOMPSON: This really feeds into my whole case that this is a prospective regime, which is not really surprising, given that it is all about access.

THE PRESIDENT: Except that it may be a regime about access, but as a sanction to ensure compliance, or an incentive to ensure compliance rather, it is normally desirable to have a sanction for failure to comply, not simply a power to order you to comply in the future. Otherwise, you lose nothing by failing to comply; you just get away with it until eventually someone complains or the authority intervenes and then thereafter you are made to comply; but the past has all been to your benefit.

MR. THOMPSON: I am not sure we got there, but I think that is why I was going to take the Tribunal to the 27th recital to this directive which addresses this issue in terms.

> "The penalties for non-compliance with conditions under the general authorisation should be commensurate with the infringement."

Then there is an issue about proportionality and then it says:

> "… 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."

The point I was trying to make in opening was that given Ofcom's case it is very surprising that this really very ferocious that Ofcom is seeking to enforce here is not mentioned at all in the 27th recital. What is mentioned is an action for damages, which is indeed precisely what is provided for at s.104 2003 Act.

THE PRESIDENT: So on this basis you can never order repayment; you can only order that the prices are brought in conformity for the future?

MR. THOMPSON: We perhaps should look at Article 13.3 which is a specific provision to be construed strictly giving powers to the NRAs.

THE PRESIDENT: This is back in the Access Directive.

MR. THOMPSON: That is in the Access Directive. Ms Lee just pointed out that in fact in 10.5 of the Authorisation Directive there is a specific provision in relation to repeat offenders which allows penalties to be imposed even after rectification.

THE PRESIDENT: Yes, but that is a penalty going beyond any overcharge?

MR. THOMPSON: It is, yes.

THE PRESIDENT: That is a penalty, is it not?

MR. THOMPSON: Article 13.3, you will recall, imposes a burden of proof on the operator, then it gives a power to the NRAs to use a different cost accounting method from those used by the undertaking. Then it says that NRAs may require an operator to provide full justification for its prices and may, where appropriate, require prices to be adjusted.

The point we make (and we have been looking at it) is where there is a retroactive power it is expressly identified in the Authorisation Directive.

THE PRESIDENT: I am trying to cut through it. You say that is prospective, do you not?

MR. THOMPSON: Yes.

THE PRESIDENT: Yes, so it follows that is why I am raising the point I made. It means that the dominant undertaking with SMP, subject say to price control, has no real incentive to keep to the price control; it might as well charge more for as long as it can get away with it because the worst that can happen, on your interpretation, if either on its own initiative or through a dispute it eventually gets caught, and then all it has to do is lower its prices to the requisite level for the future. But what it has charged in the past, there is nothing the regulator can do; it is just subject to potential civil action? That is what you are saying: the only sanction is it can have an action for damages.

MR. THOMPSON: In my submission, that is not the primary sanction. The point that I was

exploring with Dr. Houpis and Mr. Myers, the primary sanction and indeed the primary obligation of the NRA is to monitor the situation and, where it considers the body to be in breach, to take enforcement action. And both under the CRF and under the domestic regime Ofcom has really very wide powers, equivalent to its competition law powers to enforce conditions.

THE PRESIDENT: How does it enforce the condition in terms of any financial penalty, or any financial consequence for the overcharging in the past on your analysis of the legislation?

MR. THOMPSON: Part of our case on legal certainty is that Ofcom has effectively been fully informed from the end of 2006 on undisputed evidence from Miss Wray.

THE PRESIDENT: You say Ofcom could have found out and could have done it, but suppose – as on your own case – you have been overcharging, aggregating and so on, connections and rentals -- on your own expert's calculation not so much but it is still a substantial overcharge – if the regulator (you may say) overlooks it or fails to act, there is no financial consequence other than a potential exposure to a civil claim. There is nothing the regulator can do.

MR. THOMPSON: You might say that the regulated and the regulator are in it together. The regulator has all the powers that it needs to monitor the situation and to enforce. That is how this regime is structured. If it does not do that, it cannot, as it were, come along afterwards and exercise administrative powers which are not provided for in the legislation to catch up what it possibly should have done in, say, 2007 when indeed it was seised of a complaint on this very issue.

THE PRESIDENT: Suppose it says to BT in 2005/2006 I think you are overcharging; you are not complying with cost orientation and BT says yes we are and this is not straightforward. No-one here would pretend that looking at all these costs and analysing them and checking them as so on is a simple exercise, so it takes four months to work out, at the end of which (and indeed as you pointed out under the regime the regulator has to serve the notice and give a chance for representations) the regulator decides: we were right; they have been overcharging. But that whole period of the investigation, which I thought you had accepted at one point there could be a requirement to repay but on the construction of the legislation you are now advancing there is no power to direct any kind of retrospective payment; it is all prospective only. So even the duration of the investigation and the period for representations, they get away with it.

MR. THOMPSON: No, I quite clearly accepted in opening that for the period of the investigation the requirement is (if one looks at 13.3):

> "National Regulatory Authorities may require an operator to provide full

justification for its prices and may, where appropriate, require prices to be adjusted."

So on my reading, and I think I put it to him in terms, supposing on 1st January 2014 Ofcom says to BT, "Justify your prices", but it takes six months for that to work its way through, the justification is still on the prices as at 1st January 2014 and the adjustment is at 1st January 2014. It is the same issue.

THE PRESIDENT: So the adjustment can be retrospective, is potentially retrospective ----

MR. THOMPSON: Otherwise the process would never get started and as time went on you would be justifying further prices but the two march in parallel. You say, "Justify your current price list", and then that is what BT has to do.

THE PRESIDENT: Why can it not be its prices last year?

MR. THOMPSON: We looked at Article 10 of the Authorisation Directive and the whole tenor of this regime being respective, and, in my submission, that is the natural reading.

THE PRESIDENT: Yes.

MR. THOMPSON: I see the time. I would just like ----

THE PRESIDENT: I have interrupted you. The Court of Appeal's order in *PPC* was then wrong because, of course, that was a retrospective payment.

MR. THOMPSON: Yes, the issue of the temporal scope -- I do not think 13.3. I think there is a reference to 13.3. I think Mr. Saini said they had found a slot for it or something. As I understand it, what it was was that it was purely a verbal point that I understand Ms. Rose made, the word "adjustment".

THE PRESIDENT: Yes, but the conclusion there was that an order for repayment, going back quite a number of years in that case, should ordinarily be made.

MR. THOMPSON: Yes.

THE PRESIDENT: You say that is almost fundamentally misconceived because actually there was no power ever to do that.

MR. THOMPSON: The actual order was wrong but the grounds of appeal did not raise ----

THE PRESIDENT: The reasoning was wrong as well.

MR. THOMPSON: I am not sure that is right, Sir, because the issue about discretion is a general one and does not have anything about the temporal scope in it, and the other two points were points about the particular facts of PPCs and the ----

THE PRESIDENT: How far did this go? On this reading of it, can Ofcom even investigate a breach going back prior to the date on which the matter was raised?

MR. THOMPSON: I think that is a point you raised with me in opening and which we have tried

to address in the note of appeal. I think we made it pretty clear that we think that that is wrong but that we do not propose to challenge it for these purposes, because what we are challenging is the specific obligations within 23 which is something different. That is the positive obligation to repay and we say that that is something which is ----

THE PRESIDENT: But still it is important to understand the implication of the argument. Would you say then, on this analysis, they should not therefore even have power to investigate a prior breach that has concluded?

MR. THOMPSON: If you ask me candidly what the legislation means then that is what I think.

THE PRESIDENT: That would follow, does it not?

MR. THOMPSON: Yes.

THE PRESIDENT: So they should never have accepted this dispute at all?

MR. THOMPSON: The power is to effectively seek justification of current pricing, yes. That sits with the enforcement powers in Article 10 of the Authorisation Directive.

THE PRESIDENT: There was a challenge to Ofcom's acceptance of these disputes, was there not?

MR. THOMPSON: There was. It was on different grounds. It is because of the negotiations being ongoing effectively.

THE PRESIDENT: Have we got that judgment?

MR. THOMPSON: I do not think it is in the papers.

THE PRESIDENT: In the authorities bundles.

MR. THOMPSON: While we are on this, there is the point about this falling within the Access Directive and that the powers of the NRAs to resolve disputes in ways that might involve repayments are, I submit, in Articles 5 and 12 as well as 13, but that is simply by way of context. But it relates in particular to the *TRD* case, which I think was not under 13.3 or cost orientation but I think under Article 5.1 of the Access Directive. In my submission, both those provisions are naturally read in a prospective sense in that they are effectively dealing with access issues where there has been a failure to agree terms of access. We do rely on the cases we have already looked at briefly, the *Saloumi* case and the *Goed Wonen* case for saying that EU law means against retrospectivity unless it is specifically set out and justified. We would say that it is notably absent in this case. There is no reference to it in the 27th recital; there is no reference to it in the text of the Access Directive, and there is the point we have made throughout that powers such as 13.3 are to be strictly construed under the authority of *The Number* case, and we would say on a strict construction this would not include a retrospective power.

THE PRESIDENT: Yes.

MR. THOMPSON: I do not know whether the Tribunal wishes me to briefly deal with that other point, which I have called the "compromise solution" of the issue in relation to the period up to 8th December 2008? Mr. Saini showed you Article 13.3 but he did not show you the wording of the amended Framework Directive and, in particular, the wording "existing obligations".

THE PRESIDENT: This is the argument that the obligation had been repealed, is it?

MR. THOMPSON: It is. It is a point that I mentioned briefly in opening and the reason why it has really come up is because of the abuse challenge, if I may put it that way, in that Ms. Rose said this is basically a rehash of PPCs, but at least in this respect it is not because *PPCs* was a case within a single review period and so on this the relevant obligation was still in force, whereas in this case the issue relates to a substantial extent to an obligation that was repealed now almost five years ago and the point that arises in relation to the amended wording of the Framework Directive is that it says:

> "In the event of a dispute arising in connection with existing obligations under this Directive".

And Mr. Saini did not seek to explain how an obligation that was repealed in 2008 could still be an existing obligation. In a way that is the short point.

I do not know how long the Tribunal wishes to sit tonight. I have some points on Ground 6 and that would then give Mr. Read a clear run to make sure we have time in the morning.

THE PRESIDENT: Can you do them in 10 minutes?

MR. THOMPSON: I will do my best, Sir.

THE PRESIDENT: You will then have to stop. Yes.

MR. THOMPSON: So this is an issue on what are the relevant factors for the exercise of discretion under 192(d) assuming that that is a live issue, as it were. We address it at pp.166 to 187 of our closing submissions. The first point is that we adopt the approach of the Court of Appeal in *PPCs* that this is a discretionary judgment to be made in the light of the EU statutory scheme, including the general principle of EU law and, in particular, the principles of proportionality and legal certainty. That is para.480 of our closing submissions. But we do not accept that the judgment of the Court of Appeal, read as a whole, raises any presumption that a restitutionary approach based on the overcharge should be adopted. On the contrary, the Court of Appeal specifically rejected such an approach at para.80, which has also been rejected by the Court of Appeal as an appropriate approach even where an undertaking seeks damages for a proved infringement of competition law

(that is the *Devenish* case, Tab 35 of authorities bundle 2). We submit that Ofcom's general approach appears to be ----

THE PRESIDENT: I do not understand how para.80 of the Court of Appeal judgment is relevant to this.

MR. THOMPSON: I am taking it slightly quickly, Sir. The starting point was the Tribunal in *PPCs* starting from a restitutionary approach, which is at 338(2) of CB-E9, p.102. That then led to a subtle debate involving no less an expert than Professor Burrows about whether or not a counter-restitutionary approach ----

THE PRESIDENT: Yes, but if one just looks at how the Court of Appeal in the lead judgment says the discretion should be exercised, the critical paragraph is 84, is it not, surely? This is Tab 11.

MR. THOMPSON: In my submission, the critical paragraph is actually 83, where Mr. Saini is arguing for an all or nothing discretion and then, in the middle, the Court of Appeal, in my submission perfectly correctly, says:

> "In exercising its remedial powers Ofcom will be acting as a regulator giving effect to the statutory regime and therefore to the objectives of the CRF. That is not consistent with comparing all or nothing power in Ofcom. It is however consistent…"

And in my submission this is the core finding.

> "… with a discretion to make such order for repayment as will best achieve the objectives of the Act and the CRF on the particular facts of the case".

So, in my submission, that is a classic description of a multi-factorial discretion subject to statutory objectives and, for good measure, the general principles of EU law. So it is ----

THE PRESIDENT: And then they go on:

> "The discretion under section 190 plainly must be exercised in a principled way with a view to achieving those objectives".

Being the objectives you just referred to.

> "The starting point must be in a case of overcharging in breach of an SMP condition to order repayment of the amount of the excess charge".

MR. THOMPSON: I have no objection to it being the starting point because you have carried out a compliance exercise and you have come up with a number, say £10 million, so not surprisingly you start with £10 million.

THE PRESIDENT: It is not about the figure. You start with an order that that must be paid back, to order repayment of the £10 million, and it is up to the payee, i.e. your clients, to show some good reason why not.

MR. THOMPSON: Yes, but it does not take away from the fact that this is a discretionary exercise with a whole lot of factors feeding into it, which is where the Court of Appeal started.

THE PRESIDENT: Yes, it is up to you to show all kinds of reasons why not. But that is all that is meant by a presumption.

MR. THOMPSON: I think all I mean is that that should not be taken as being anything other than a full administrative discretion.

THE PRESIDENT: It is up to you to show good reasons, and unless you can then the repayment order should be made. That is what they are saying.

MR. THOMPSON: If it is simply that you have got a discretionary decision and one factor is clearly the overcharge, and if there is nothing else then that is what you do, then no problem. But there is no presumption about what other factors may bear on this question. I think it is one of those points that lawyers may be interested in. I am not sure that it will go to the substance.

I think the first point I would mention is the issue of proportionality, which is specifically identified as a relevant principle, both at Article 8.4 of the Access Directive --

THE PRESIDENT: But it has got to be something on the facts of this case, has it not, why there should be a lesser repayment or no repayment, something in what has happened here whereby you satisfy Ofcom (and having failed to do that, say they should have been satisfied and satisfy us) that there should be no repayment. It is not about looking at the statutes or the directives. We bear those principles in mind, but there has got to be some reason here, a good reason, why there should not be a repayment.

MR. THOMPSON: Yes, but with all due deference to the Court of Appeal, they cannot write out the principles of EU law which are binding on the NRAs and which include the principle of proportionality which is set down in the legislation itself. There is nothing to say that that principle should be given no weight. This goes to the point that you, sir, raised to some degree with Dr. Houpis which we discussed about the existing incentives of BT and that, to some extent, goes back to the points we were discussing just now.

THE PRESIDENT: It has been affected by the evidence that I think came after Dr. Houpis, namely that those responsible for pricing in BT seemed to have no contact with the regulatory affairs department which is seeking to work out what the DSAC and FAC and whatever other cost measures are relevant, for the various services was. It is clear on the evidence that the people who were pricing did not bother to contact them to find out. That is the evidence of Mr. Coulson.

MR. THOMPSON: Yes, sir, but equally, the uncontested evidence of Miss Wray and Mr. Jones is that they had meetings on a regular basis with Ofcom, explained what their position was, gave full information to Ofcom, and they formed certain impressions about what Ofcom's priorities were in 2006 and 2007, and Ofcom looked at this matter in the summer of 2007 in the context of a dispute and closed its file on the basis that these matters would be resolved in 2008. They then issued a document at the start of 2008 indicating that there were a number of different ways of ensuring cost orientation, and they then entered into negotiations with BT which led to, I think, 30% reductions in BT's prices in 2009, a cost control, and a further 17% reduction for BES 1000 which Ofcom itself adopted as the measures that it chose to implement in order to reflect its concerns over cost orientation. That is all set out in Appendix C to our submissions, paras.15 to 17 and 21 to 24. In my submission, those issues fall to be taken into account as well in deciding what, in the exercise of its discretion, Ofcom should have done.

The wider issue of incentives were fully debated between the various experts and the Tribunal. BT's position is set out in its closings, but in brief summary we take the view that the analysis at paras.15.54 to 15.65 of the Decision is wholly inadequate and fails to take account of or address numerous relevant legal and factual issues, and as such it should be set aside by the Tribunal and replaced by a full analysis of the issues as they appear to the Tribunal in the light of its overall appreciation of the facts, and the extensive witness and expert evidence that it has received.

I am conscious of the time. Mr. Read will address you on the issues of grounds 3 and 4 in the morning. Interest, there is obviously an EU issue of interest, but I will not detain the Tribunal with it now. I think you have our written submissions on it.

There is one point of information about the *Energis* case. Paragraph 4.38 of the *Energis* case explains that these products will fall within the AISBO market, so I think it is broadly speaking what I said this morning. If it is not, we will correct that.

THE PRESIDENT: 4.38?

MR. THOMPSON: Yes. Thank you.

THE PRESIDENT: Thank you.

MR. THOMPSON: I am afraid that has been a bit of a gallop.

THE PRESIDENT: You have done a very full and long day. We will resume at half past 10 tomorrow.

Adjourned until 10.30 a.m. on Friday 22nd November 2013