



Ofcom's Consultation

**Draft determinations to resolve
mobile call termination rate disputes
between T-Mobile and BT, O2 and
BT, Hutchison 3G and BT and each
of Hutchison 3G, Orange and
Vodafone**

**BT Response
(Non-Confidential version)**

24 May 2007

BT would welcome comments on this response. Comments should be addressed by e-mail to Neena Rupani at neena.rupani@bt.com



Draft determination to resolve mobile call termination rate disputes between T-Mobile and BT, O2 and BT, Hutchison 3G and BT and BT and each of Hutchison 3G, Orange and Vodafone

BT's response to Ofcom's Consultation published 10 May 2007

Executive Summary

- BT is disappointed that Ofcom has failed to grasp the opportunity to conclude that termination charges for calls to 3G handsets of up to three times the level of charges for 2G handsets are an unreasonable cost for BT's customers to incur.
- BT believes that Ofcom has made a number of factual and legal errors in its assessment of the disputes between BT and the five MNOs.
- BT considers that Ofcom has failed to properly construe the nature and extent of the end to end connectivity obligation ("e2e Obligation")¹, ✂✂✂.

Introduction

Ofcom has a duty to strike a balance between the interests of the mobile network operators ("MNOs") and the interests of end users calling mobile phones. BT believes strongly that the proposals in Ofcom's draft determination strike the wrong balance, with the result that users of fixed phones in particular are significantly over-charged for calls to 3G handsets from which they derive no benefit. More specifically, BT is disappointed that Ofcom has failed to grasp the opportunity to conclude that termination charges for calls to 3G handsets of up to three times the level of charges for 2G handsets are an unreasonable cost for BT's customers to incur.

BT believes that Ofcom has made a number of factual and legal errors in its assessment of the disputes between BT and the five MNOs. In particular, it believes that Ofcom has failed to properly construe the nature and extent of the e2e Obligation, ✂✂✂.

BT's comments on the draft determination are set out in more detail below:

¹ The obligation imposed on BT by Ofcom in its statement of 13 September 2006 entitled *End-to-end connectivity*.



- Part I: Factual context of the disputes
 - Part II: Approach to dispute resolution
 - Part III: Assessment of reasonableness
- ✂✂✂

In light of the short timetable for consultation, BT's comments focus principally on Section 6 of the draft determination, which sets out Ofcom's analysis and reasoning for its conclusions in the draft determination.

Part I: Factual context of the disputes

BT has some concerns about the factual context on which Ofcom has based its conclusions in the draft determination. In particular, BT believes that:

- Ofcom's declaration of the rights and obligations in the dispute between BT and T-Mobile and BT and O2 are based on inflated figures that over-compensate the MNOs; and
- Ofcom's understanding of the factual circumstances surrounding the dispute between BT and H3G is incorrect, and this has led Ofcom to determine H3G's charges on the wrong basis.

BT deals with each of these factual inaccuracies, in turn, below.

A. Figures used in Ofcom's declaration in the dispute between BT and both T-Mobile and O2

In the case of the dispute between BT and T-mobile, T-mobile's dispute resolution request asked Ofcom to determine that BT accept one of two OCCNs. The following is from part (F) of section 1.1 in the draft determination:

"(F) on 21 December 2006 T-Mobile referred a dispute with BT to Ofcom for dispute resolution requesting a determination that BT accept either T-Mobile's OCCN of 5 July 2006, or, in the alternative, T-Mobile's OCCN of 1 December 2006"

Similarly, in the case of the dispute between BT and O2, O2's dispute resolution request asked Ofcom to determine that BT accept one of two OCCNs. The following is from part (H) of section 1.2 in the draft determination:

"(H) on 16 February 2006² O2 referred a dispute with BT to Ofcom for dispute resolution, requesting a determination that BT accept either O2's OCCN of 3 July 2006, or, in the alternative, O2's OCCN of 30 November 2006"

² Ofcom should note that the dispute resolution request was submitted on 16 February 2007. The draft determination states that the submission was 16 February 2006.

Despite these requests, Ofcom's proposals for the disputes between BT and each of T-mobile and O2 determine that BT should accept both OCCNs. Given that BT's understanding is that the second OCCNs contained an uplift in order to recover additional revenues, which arose from BT's rejection of the first OCCNs, Ofcom's draft determination gives both MNOs a windfall.

If Ofcom is minded to determine the disputes in favour of T-Mobile and O2, the rates that should actually apply should only be from one of the two OCCNs, not both.

B. Misunderstanding of the factual circumstances surrounding the dispute between BT and H3G

At (F) on page 10 of the draft determination and paragraphs 6.77 to 6.92 and 6.10 to 6.114 of the draft determination, Ofcom relies on the increased Mobile Call Termination ("MCT") charges proposed by H3G on 22 November 2006. However, H3G did not issue those charges pursuant to an OCCN. The dispute between BT and H3G is founded on the OCCN issued by BT to H3G on 17 August 2006, which was rejected by H3G on 30 August 2006. BT, consequently, believes that Ofcom should confine itself to the consideration of BT's OCCN when determining the dispute between H3G and BT.

Part II Approach to dispute resolution

A. The legal framework

BT does not propose to deal at length with all the relevant legal provisions applicable to the dispute resolution process in the response. BT feels, however, that it should mention the following:-

- Pursuant to Article 20 of the Framework Directive ("FD") and sections 185 to 190 of the Communications Act 2003, Ofcom is subject to a duty to resolve disputes between communications providers. In carrying out that duty, Ofcom must use its discretion to take decisions which achieve the Community objectives in Article 8 of the FD and section 4 of the Communications Act 2003.
- Ofcom's dispute resolution powers are conferred by section 190 of the Communications Act 2003. Such powers include not only the power to make a declaration setting out the rights and obligations of the parties but also two general "price control" powers to give a direction which: (i) fixes the terms and conditions of transactions between the parties to the dispute (section 190(2)(b) of the Communications Act 2003); and (ii) imposes an enforceable obligation on the parties to enter into a transaction on the terms and conditions fixed by Ofcom (section 190(2)(c) of the Communications Act 2003).

- Importantly, Ofcom has powers to impose pricing obligations relating to interconnection not just under Article 8 of the Access Directive (“AD”) in respect of operators that possess significant market power (“SMP”) but also in the context of resolving interconnection disputes (including pricing disputes) under Article 5 of the AD.³

BT does not, therefore, consider that there is anything in the statutory framework that restricts the exercise of Ofcom’s powers to determine the disputes.

B. The draft determination

Within the draft determination, Ofcom appears to regard its powers as being limited to those emanating from its narrow interpretation of the e2e Obligation imposed on BT on 13 September 2006. In applying its powers, which it has defined narrowly, Ofcom proposes to determine that the MNO’s charges, which are either currently in place or have been requested, are reasonable.

BT considers that there are at least three problems with this approach.

- **Firstly**, in the case of each of T- Mobile, O2 and H3G, Ofcom has failed to specify the proper amount of the charge that those MNOs were allegedly entitled to charge; instead it has simply directed the payment of adjustments by BT.

Ofcom’s powers to specify the amount of adjustment payable under section 190(2)(d) of the Communications Act 2003 are contingent upon a prior “*determination... of the proper amount of a charge*”. For this reason, in its referral of the disputes on 22 January 2007, BT requested Ofcom to determine what the reasonable level of the charge should be for each MNO. In practice, a declaration setting out the level of the charges that Ofcom considers to be reasonable would also be more transparent for the parties to the disputes and avoid confusion.

- **Second**, Ofcom has misinterpreted the e2e Obligation by adopting an overly narrow construction of its nature and extent. As a result, BT believes that Ofcom has failed to properly apply its powers arising in the context of that obligation.

The e2e Obligation cannot be seen as a “one-way” obligation imposed on BT when it relates to a bilateral relationship. Interconnection, by its very nature, involves a reciprocal relationship where the parties have mutual rights and obligations. BT cannot be obliged to purchase termination services yet have no ability to ensure that the terms and conditions including price are set at proper levels. Condition 1.2 of the e2e Obligation expressly provides for Ofcom to direct such terms and conditions (including charges) as it considers to be reasonable. However, in the draft determination Ofcom refuses to accept that it has any ability to assess the

³ Case 1047/3/3/04 *Hutchinson 3G UK Limited v Ofcom* [2005] CAT 39, paragraphs 129 to 134.

reasonableness of such MCT charges, whether as part of the e2e Obligation or more generally. It has, therefore, misapplied the e2e Obligation.

- **Third**, Ofcom's focus on the e2e Obligation has resulted in its failure to properly consider its wider, and more general, dispute resolution powers, including:
 - (i) the need to resolve sector wide pricing disputes between operators. In particular, in this case, all the MNOs are in dispute with BT over the charges for 3G termination;
 - (ii) determining a fair and reasonable MCT charge under Article 5(1) of the AD;
 - (iii) imposing SMP price control measures on the MNOs under Article 8 of the AD, including transparency and cost orientation obligations; and/or
 - (iv) intervening under Article 5(4) of the AD on its own initiative or at the request of the parties to secure the objectives of Article 8 of the FD.

In conclusion, BT's referral of the disputes on 22 January 2007 requested Ofcom to resolve the disputes under section 185(1) of the Communications Act 2003, which incorporates a wider range of powers than those arising purely under the e2e Obligation, by specifying the proper amount of the MCT rates to be charged by the MNOs. BT repeats here its request that Ofcom exercise its powers under Article 5 of the AD (and other regulatory parameters) and, as part of the resolution of the disputes, consider its findings from its most recent MCT market review⁴ into the final determination.

Part III Assessment of reasonableness

A. Dispute resolution process

At paragraph 6.54 of the draft determination, Ofcom suggests that it "*does not consider it appropriate to use the dispute resolution process as a substitute for (or in a manner that is inconsistent with) decisions already taken under the appropriate regulatory processes for addressing the question of significant market power*". This approach is not, consequently, adopted in the draft determination.

⁴ Ofcom's *Mobile Call Termination Statement*, published 27 March 2007 as the conclusion to its review of the market(s) for supply of MCT – see http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement/statement.pdf. Even if BT does not agree with all of Ofcom's analysis, this would appear to be a good benchmark to use as a starting point for assessing reasonableness.

In raising this dispute, BT was not suggesting that the MNOs should be retrospectively regulated or price controlled. Rather, BT was simply questioning the reasonableness of the charges for 3G termination, with multiples of up to three times that of 2G termination rates. In particular, Ofcom published information as part of its most recent MCT market review, in March 2007, that indicated that the cost of 3G termination is significantly lower than the rates charged by the MNOs. In light of this, it would not be disproportionate for Ofcom to consider its market review findings in the decision making process as regards the disputes.

B. Approach to assessment of reasonableness

Ofcom suggests, in paragraph 6.51 of the draft determination, that there are three approaches it could use to assess the reasonableness of the charges in the context of the disputes:

- (i) Set strictly cost based charges (such as would be derived from cost benchmarks to set efficient charges as part of a charge control); and/or
- (ii) Develop an understanding of the extent to which BT obtains gains from trade on the basis of the disputed charges; and/or
- (iii) Undertake a benchmarking analysis of relevant comparators and draw conclusions as to a reasonable termination charge based on those benchmarks.

BT's comments on the above three approaches, and the conclusions drawn by Ofcom, are set out below.

(i) Cost based assessment

In its referral of the disputes to Ofcom, BT set out its complaint that the MNOs were charging excessive rates for the 3G element of the blended rates, which it believed to be significantly in excess of the costs of MCT. Specifically, BT asked Ofcom to resolve the disputes by resolving a reasonable price for 3G MCT.

In the draft determination, Ofcom has refused to carry out a detailed cost based assessment. At paragraph 6.40 of the draft determination, Ofcom justifies this position by reference to its assumption that "*it is only necessary to focus on the blended rate*". From this position, Ofcom assumes that it only has to look at "*...(the output of the way in which the blended charge has been calculated), not the way in which the blended charge was in fact calculated (in particular the underlying 3G charge)*". At paragraphs 6.45, 6.47, 6.52 and 6.53, Ofcom goes on to state that there is no need to carry out a strictly cost based assessment for the purpose of the e2e Obligation. It does not, however, provide any reasoning for the limitation on its powers in this way. BT cannot see, however, how this position is consistent with Ofcom's duties under the Communications Act 2003 or the FD, and requests that Ofcom carry out such an assessment.

(ii) Gains from trade assessment

In paragraph 6.57 of the draft determination, Ofcom states that “*Given the purpose of the e2e Obligation on BT, which is to ensure that connectivity is achieved, Ofcom considers that it is reasonable to require that BT purchase call termination from the MNOs in dispute so long as it obtains gains from the trade.*” Paragraph 2.11 states that a charge is found to be reasonable as long as “*BT makes a profit from connectivity with each MNO*”.

BT is concerned that this gains from trade test provides no real protection for retail customers from the setting of excessive MCT charges because it is solely concerned with whether BT can earn a margin on the service in question. Adopting Ofcom’s logic, the test means that provided BT can make a gain from trade, either at its existing prices or if it were to put its prices up, then the higher charge requested would be viewed by Ofcom as being reasonable. ~~XXX~~, it follows that no termination charge would ever be considered to be unreasonable under the gains from trade test proposed by Ofcom.

(iii) Benchmarking analysis

It is notable that in the draft determination, Ofcom relies on the benchmark of the regulated 2G termination charges and not the regulated 2G and 3G charges imposed following the conclusion of its most recent MCT market review.

In its March 2007 Statement, Ofcom proposes to regulate the 3G MCT charges which are the subject of the disputes. For H3G, Ofcom has concluded that 3G call termination charges should be capped at 8.5ppm in 2007/8 and fall to 6.0ppm over the subsequent 3 years. The statement also shows that costs are uniformly lower for “2G/3G operators” (i.e. the other four operators). In other words, an initial benchmark is directly to hand from the extensive modelling work Ofcom has carried out in its review of 2G and 3G costs for the MCT market review. In light of this, BT is surprised that Ofcom has refused to draw any parallels with its cost findings in its MCT market review in the draft determination.

At paragraph 6.65 of the draft determination, Ofcom also refuses to draw comparisons with MCT charges in other countries, because they are based on difficult parameters and unreliable. This position must be questioned, however, when the international comparison of interconnection charges is a widely-used practice and Ofcom has the resources of the European Regulatory Network at hand.

Finally, BT considers that, even using the 2G regulated rates as a comparator, Ofcom’s approach is flawed because it uses the blended rate, rather than looking just at the 3G element. ~~XXX~~. BT finds it remarkable that such charges should be deemed “reasonable”.

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Conclusion

BT considers that, when determining the disputes, Ofcom has not properly applied its powers arising in the context of the e2e Obligation as well as its wider, and more general, dispute resolution powers. BT, therefore, requests Ofcom in its final determination to:

- (i) declare the exact level of charges that Ofcom considers to be reasonable on the basis of the OCCNs at issue;
- (ii) exercise its wider dispute resolution powers including those under Articles 5(1), 5(4) and 8 of the AD;
- (iii) consider its findings from the MCT market review; and
- (iv) undertake a detailed cost assessment of the 3G element of the blended MCT charge.

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