

# UK Supreme Court upholds CAT's assessment of Ofcom's *08x numbers* determinations

Graham Read QC and John Townsend

## Introduction

For the first time, the UK Supreme Court has had the opportunity to consider Ofcom's powers under the UK telecommunications regulation regime which was introduced by the Communications Act 2003 (the 2003 Act).<sup>1</sup> The *08x numbers* appeal arose out of a dispute between BT and the four principal mobile network operators (the MNOs) about the charges payable by them to BT in respect of the termination on BT's network of calls to 080, 0845, and 0870 numbers. These numbers are non-geographic numbers, part of the Number Translation Services (NTS), which essentially allow non-geographic calls to be switched to geographic numbers hosted on the network of providers like BT. The background to the use of these numbers and BT's charges are considered further below. The Supreme Court, the sole judgment of Lord Sumption being endorsed by all other members of the court, upheld the 'careful analysis' of the Competition Appeal Tribunal (CAT)<sup>2</sup> and overturned the decision of the Court of Appeal, which had previously reversed the CAT's decision.

In this article we briefly discuss in turn the decisions of Ofcom, the CAT<sup>3</sup>, the Court of Appeal<sup>4</sup> and the Supreme Court and consider their reasons. Given the detailed scrutiny which has been accorded to these disputes and the fact they were ultimately considered by the highest court (which only considers matters of 'general public importance'), the implications of the judgment are significant in both understanding the 2003 Act itself and the UK court's underlying assessment of the EU framework within which Ofcom must operate. (The EU framework is contained in five separate Directives referred to normally as the 'Common Regulatory Framework' – the CRF.) Whilst the precise parameters of the Supreme Court's judgment may require further clarification, the decision has made clear that Ofcom's powers are carefully prescribed and do not give unlimited powers to intervene.

## The disputes and Ofcom's determinations

The disputes all evolved from the charging structure which BT sought to introduce for terminating the *08x* calls and so it is necessary to give some of the background to these charges. Essentially a

caller on one of the MNO's networks would call the specific *08x number*. This call would 'originate' on the MNO's network. As *08x numbers* are generally hosted on fixed line providers' networks, like BT, the calls originated by the MNO would be 'terminated' on the fixed line provider's network. The payment flows for these calls depend upon the precise nature of the NTS number. For example, 080 calls were originally intended to be free to caller. In that case, the operator of the 080 number in question (often some form of helpline which wanted the callers to it not to be charged) whose service was hosted on BT's network, would normally pay BT an amount for hosting the service and BT would then pay the call originator, such as the MNOs, part of that payment. The position was normally different for 0845 and 0870 numbers since the caller was expected to be charged for the call. In those circumstances the originating operator (such as the MNOs) would charge the caller and pay some of the money on to the terminating operator (such as BT) who in turn would pay some of the money to the agency hosting the number.

However the MNOs generally did not include *08x numbers* in their standard call packages and would charge their own customers an additional fee for the call. Profit maximisation by the MNOs had led to MNOs charging up to 40 pence per minute, even for 080 numbers (despite consumers generally believing such calls to be free). Ofcom had become concerned about this and was itself engaged in an investigation into 'Simplifying non-geographic numbers'. The fixed line operators (who hosted the *08x numbers*) were very concerned about consumers finding themselves charged significant amounts of money for calls to these *08x numbers*. In essence higher charges by the MNOs were confusing and discouraging consumers. This led to the NTS services that fixed line operators were hosting being undermined and consequently their profitability to the fixed line operators being diminished.

In order to address this issue, BT introduced a pricing system called 'ladder pricing'. This ladder pricing was somewhat novel.<sup>5</sup> It essentially meant that the more that the MNOs charged their customers for calls to *08x numbers*, the more BT charged that MNO for actually terminating the call on the MNO's behalf to that *08x number*. The system was designed in a series of pricing

stages (ladders) in order to ensure that competing MNOs would not know the precise price any other MNO was charging for the call (and so seek to avoid competition issues). When BT notified the MNOs that it was introducing this ladder pricing, as BT was permitted so to do by the contract it had with the MNOs<sup>6</sup>, each of the MNOs raised a dispute with Ofcom.

Under sections 185-191 of the 2003 Act, Ofcom has powers to resolve such disputes between communications providers. These powers reflect the requirements imposed on Member States by the CRF in article 5(4) of the Access Directive<sup>7</sup> and article 20 of the Framework Directive.<sup>8</sup> Prior to amendments to the 2003 Act which were introduced in 2011, Ofcom had extremely limited discretion to refuse a dispute once it was referred to Ofcom. Unless the dispute had not properly crystallised (for example because the parties had not properly discussed the matter between themselves before referring the matter to Ofcom) or some alternative means for resolving the dispute (within the prescribed short timeframe) existed, Ofcom had to accept and determine such a dispute. (Even after the 2011 amendments, Ofcom's discretion is still limited in certain instances).

Under section 190(2) of the 2003 Act, Ofcom is given specific (but expressly limited<sup>9</sup>) powers for resolving the dispute. Ofcom can make a declaration setting out the rights and obligations of the parties to the dispute, give a direction fixing the terms or conditions of transactions between the parties, impose an obligation on the parties to enter into a transaction between themselves on terms and conditions and also has an ancillary power to require payments or repayments to be made 'for the purpose of giving effect to a determination'. Those powers had to be exercised consistently with the requirements of EU law as, for example, is made clear in section 4 of the 2003 Act. In particular article 8 of the Framework Directive sets out the basis upon which national

regulatory authorities such as Ofcom should carry out their regulatory tasks (one of which is dispute resolution). One specific issues in the 08x numbers case was precisely how wide ranging these powers actually were.

One feature of the dispute was that none of the parties to the dispute had had any form of relevant *ex ante* regulatory obligation previously imposed upon them. Although there was a national telephone numbering plan (which for example stated that calls to 080 numbers were intended to be free to caller) this could not be used as a means by Ofcom to control prices. Similarly there was no significant market power (SMP) obligation that had been imposed either upon BT or the MNOs in any previous market review directly bearing upon the issue of 08x call pricing. This was to be a significant feature in the subsequent CAT Judgment.

Because BT had first introduced its ladder pricing for 08 numbers (supposedly free phone numbers) that dispute was referred to Ofcom first and Ofcom determined the matter in February 2010. By the time the dispute in respect of 0845 and 0870 numbers was dealt with in a determination dated 10 August 2010, the evidence, and Ofcom's thinking had evolved. As a result much of the focus in the subsequent appeals was on that determination, but the issues related also to the 080 determination as well. However, both Ofcom's determinations (ie (1) 080 numbers and (2) 0845 and 0870 numbers) adopted the same analytical framework for assessing the matter, based on three principles, all of which Ofcom considered had to be satisfied.<sup>10</sup> In each determination Ofcom concluded that not all of its three principles were met and held that it was 'not fair and reasonable for BT to apply the new termination charges', though, the conclusions on the three principles were different between the two determinations. We summarise the principles and conclusions from the 0845 and 0870 final determination<sup>11</sup> in the table below:

Regulatory Principle	Ofcom's Conclusions
1. The mobile operators should not be denied the opportunity to recover their efficient costs of originating calls to 0845/0870 numbers hosted on BT's network.	Principle 1 was met because BT allowed the mobile operators to obtain a sufficiently large retention on 0845/0870 calls relative to their retention on geographic calls.
2.(a) The new charges should provide benefits to consumers taking into account: <ul style="list-style-type: none"> <li>(i) the impact on retail 0845/0870 call prices (the direct effect);</li> <li>(ii) the impact on service providers and through improved services to the callers, ie consumers of 0845/0870 calls (the indirect effect); and</li> <li>(iii) the impact of the overall MNO offering to its customers (the mobile tariff package effect); and</li> </ul> 2.(b) The new charges should avoid a material distortion of competition among: <ul style="list-style-type: none"> <li>(i) Termination communications providers;</li> <li>(ii) Transit operators;</li> <li>(iii) Originating communications providers in retail services; and</li> <li>(iv) MNOs in wholesale sales to mobile virtual network operators.</li> </ul>	2.(a) Ofcom considered principle 2 had a number of different effects but ultimately found that this principle was not met in particular: <ul style="list-style-type: none"> <li>(i) Ofcom found that BT's ladder pricing was likely to incentivise the MNOs to reduce their 0845/0870 call prices. However the magnitude of this 'direct effect' was uncertain;<sup>12</sup></li> <li>(ii) The precise outcome of the indirect effect was not clear;</li> <li>(iii) The effect on other MNO prices caused by the MNOs using revenue for originating calls on 0845/0870 numbers (the waterbed effect or mobile tariff package effect) was likely to be negative;</li> <li>(iv) The overall effect therefore was uncertain as to whether there would be a benefit or not to consumers.</li> </ul> 2(b) As regards competition, Ofcom found in certain areas the risk of distortion was likely to be 'low' (eg between communication providers). However in other areas there were 'concerns' which were not clear cut. <sup>13</sup>
3. The charges should be reasonably practicable to implement.	Ofcom considered that BT's proposed termination charges were 'complicated' for other communication providers to implement and could have 'unintended and unforeseen consequences'.  Accordingly principle 3 was not met. <sup>14</sup>

## The appeals to the CAT

Although the MNOs had been successful in Ofcom's determinations (ie setting aside BT's price charges), EE still appealed on the basis that Ofcom's reasoning was flawed. EE argued that, if ladder pricing was allowed, (i) it would not result in 'cost orientated pricing' and would therefore be improper and (ii) it would have been an improper policy preference by Ofcom and essentially 'price control' through the back door. Both these arguments were essentially rejected by the CAT.<sup>15</sup> These arguments were taken no further in the appellate process and so the CAT's judgment on these points remains definitive.

Whilst broadly accepting the approach Ofcom had adopted, BT appealed contending that Ofcom had misapplied the principles and reached the wrong conclusion.<sup>16</sup> Under sections 192 and 195 of the 2003 Act the appeal by the tribunal was to be decided as an 'appeal on the merits'.<sup>17</sup> The tribunal therefore conducted a detailed analysis of the evidence, and a wide-ranging assessment of Ofcom's role. In the course of the hearing before the CAT much economic evidence was adduced as to the precise economic effects. The conclusions about this evidence was dealt with at various stages throughout the judgment of the tribunal. Having heard all the material though CAT found as a matter of fact that principles 1 and 3 (as defined above) were satisfied. In respect of principle 3 this reversed Ofcom's finding in the 0845 and 0870 determination (though not Ofcom's finding in the 080 determination).<sup>18</sup> This point was not challenged on appeal.

Principle 2 was less clear cut. The CAT considered 11 'potentially relevant factors' (one of which was the issue of practicality, principle 3, referred to above).<sup>19</sup> Some of these factors were dismissed as irrelevant, for example BT's motivation in introducing the lower pricing and the review which was ongoing by Ofcom into NTS numbers.<sup>20</sup> It dealt with other factors in some considerable depth, for example the precise magnitude of the direct effect, which it held could not be ascertained<sup>21</sup> and the precise nature of the 'waterbed effect' the size of which it was again held could not be ascertained.<sup>22</sup> The CAT essentially agreed with Ofcom's analysis save in respect of three specific issues.<sup>23</sup> These three factors were:

- 1 BT's rights to change the agreement;
- 2 The regulatory obligations and duties on the parties (which as already explained above were absent); and
- 3 The effect on competition.

In particular the CAT held that

*the introduction of the [ladder pricing] would not have the effect of distorting competition ... What is more we consider the imposition of a stringent test for the introduction of price changes by BT itself has the effect of distorting competition, by placing a restraint on pricing freedom not only on BT, but on any other terminating CP which might wish to introduce similar pricing structures ...<sup>24</sup> Likewise the CAT considered BT's contractual rights were important.<sup>25</sup>*

The fact that Ofcom found the whole of the 'welfare assessment' to have been inconclusive should not have prevented the pricing change introduced by BT in light of BT's private law rights and the finding that disallowing the price change might act as a fetter on competition.<sup>26</sup> Based on this the CAT found that all the factors in the case, when properly assessed, led to the *opposite* conclusion

to that which Ofcom had reached and the CAT reversed Ofcom's determinations allowing BT's appeal.<sup>27</sup>

## The Court of Appeal

The MNOs appealed to the Court of Appeal (Lloyd LJ, Etherton LJ and Elias LJ). An appeal to the CAT is an appeal on the merits whereas an appeal to the Court of Appeal can only be on a point of law.<sup>28</sup> Despite the CAT being a 'specialist tribunal' set up precisely to deal with complex economic issues, the Court of Appeal rejected the CAT's analysis. Although the Court of Appeal is always under immense time pressures, it is always dangerous for courts to opine on a complicated sector like the telecommunications sector without a full understanding of all the issues involved. For example, it is perhaps rather unfortunate that the Court of Appeal should have rejected the CAT's analysis, when as Lloyd LJ himself noted, the Court of Appeal had not actually heard proper argument on what an appeal on the merits to the CAT means<sup>29</sup> (and it follows, how that might have impacted on the CAT's conclusions). Essentially the Court of Appeal decided that the CAT and the tribunal had 'identified the wrong question ... [and] came to the wrong answer ...'.<sup>30</sup> The Court of Appeal rejected each of the three factors that the CAT had considered Ofcom itself had failed properly to take into account (ie the absence of any regulation, the contractual rights and the potential detriment to competition).<sup>31</sup>

However, underlying the Court of Appeal's approach was a more fundamental issue, namely that Ofcom, in the dispute resolution process, enjoyed very wide powers of regulation. As Lloyd LJ indicated at paragraph 81:

*To my mind there is a good deal of force in the submission made on behalf of Ofcom that the Tribunal's emphasis on commercial freedom or on the absence of ex ante regulation is essentially very similar to the approach adopted by Ofcom in the TRD case, which the Tribunal in that case described as a fundamental error.*

The CAT in the 08x numbers case was therefore perceived to have placed an unduly restrictive fetter on Ofcom's powers. If the Court of Appeal's decision had stood that would inevitably give Ofcom more latitude in restricting commercial freedom in dispute resolution cases.

## The Supreme Court's assessment

The Court of Appeal's approach was resoundingly dismissed by the Supreme Court. Lord Sumption in his judgment spent some time setting out and considering the CRF and their objectives. Lord Sumption noted that:

*The dispute functions of Ofcom have often been described as regulatory ... it is unquestionably true that the dispute resolution functions of the national regulatory authorities are part of the regulatory scheme ... but the description of dispute resolution as "a form of regulation in its own right" is apt to mislead without some analysis of what is meant by it.<sup>32</sup>*

Thus Ofcom was performing a mixture of adjudicatory and regulatory functions and the terms of the contract 'are the necessary starting point for this process.'<sup>33</sup> Clearly, the regulatory scheme did and could impact upon the contractual term, but as Lord Sumption noted 'this does not mean that Ofcom can do what

it likes. It is bound to start from the parties' contractual rights and may override them only if that is required by the article 8 [Framework Directive] objectives.<sup>734</sup>

In addition to giving emphasis to contractual rights, the Supreme Court was concerned as to the potential anti-competitive effect of Ofcom controlling prices in this way. As Lord Sumption noted:

*The Court of Appeal's second reason for thinking that it was for BT to demonstrate positively that there would be consumer benefits from the proposed changes to the charging structure was that they disagreed with the CAT's emphasis on the anti-competitive effect of preventing the introduction of innovative charging structures. The Court of Appeal did not suggest that it was economically mistaken. For they considered that too much weight had been attached to it by the CAT. In their view, this was a matter of regulatory policy.<sup>35</sup>*

This was completely rejected by the Supreme Court as 'wrong'. The Supreme Court considered that the CAT's analysis (ie that the effect of not allowing BT to introduce innovative charging structures was itself anti-competitive) was important and added 'It was a factual judgment which [the CAT] was perfectly entitled to make. It was, moreover, an economic judgment by an expert tribunal which had received a substantial amount of additional evidence, including economic evidence.' The Court of Appeal, on appeals only of law, was simply not entitled to overrule the CAT's judgment in the way that the Court of Appeal had.

Therefore of the three factors which the CAT had found were not

properly taken into account by Ofcom<sup>36</sup> two were completely upheld by the Supreme Court (contractual rights and the potential anti-competitive of not allowing innovative pricing). As regards the third (the absence of any finding of significant market power on BT) the Supreme Court did not regard it as crucial and considered it 'irrelevant to the question on which this appeal turns, namely whether BT must positively demonstrate consumer benefit if they are to justify the proposed charges'.<sup>37</sup> The issue therefore as to the relevance of SMP condition or its absence remains for another day. In conclusion it is safe to say that the Supreme Court was unimpressed by the Court of Appeal's underlying emphasis on the width of Ofcom's regulatory powers and the error of the CAT interfering with them on an appeal on the merits, concluding 'There was no justification for the Court of Appeal to set aside the careful analysis of the CAT on a matter lying very much within its expertise.'<sup>38</sup>

**Graham Read QC**  
**John Townsend**  
**Devereux Chambers**

*(Graham is listed as one of the leading telecoms Silks in the legal directories for telecoms and has been involved in many recent telecoms appeals, including the 08x numbers case itself in the Competition Appeal Tribunal and the Court of Appeal. John worked in-house at the Competition Commission and Ofcom before specialising in telecoms at Devereux, which is one of three sets for telecommunications regulatory work listed in the Legal 500 2014)*

## Notes

- 1 *British Telecommunications plc v. Telefonica O2 UK Ltd & Others* [2014] UKSC 42.
- 2 [2014] UKSC 42 at para 51.
- 3 Reported at [2011] CAT 24.
- 4 Reported at [2012] EWCA Civ 1051.
- 5 [2011] CAT 24 at para 215: 'As was common ground, BT's "ladder" pricing for the termination of 080, 0845 and 0870 calls...was novel, and so raised novel questions.'
- 6 See for example para 36 of [2014] UKSC 42.
- 7 Directive 2002/19/EC. This has now been removed by Dir 2009/140/EC and the powers entirely contained in art 20 of the Framework Directive.
- 8 Directive 2002/21/EC.
- 9 Section 190(1) of the 2003 Act.
- 10 These three principles were suggested to emanate from six principles of pricing and cost recovery which Ofcom previously had employed in previous disputes. These six principles are set out in para 161 of [2011] CAT 24, being 1. Cost causation, 2. Cost minimisation; 3. Effective competition; 4. Reciprocity; 5. Distribution of benefits; and 6. Practicality.
- 11 See *Determination to Resolve a Dispute between BT and each of Vodafone, T-Mobile, H3G, O2, Orange and EE about BT's termination charges for 0845 and 0870 calls*, final determination, 10 August 2010 at para 1.18. See also para 20 of [2014] UK SC42.
- 12 See para 9.23 of the determination.
- 13 See para 9.42 of the determination.
- 14 See paras 4.36 and 9.49 of the determination. This conclusion was different to the one in the earlier 080 determination in February 2010.
- 15 See for example paras 231-33 and 237-38 of [2011] CAT 24.
- 16 See for example para 4 of [2011] CAT 24.
- 17 See s 195(2) of the 2003 Act.
- 18 See for example para 408 of [2011] CAT 24.
- 19 See para 198 of [2011] CAT 24.
- 20 See para 416 of [2011] CAT 24.
- 21 See para 344 of [2011] CAT 24.
- 22 See para 364 of [2011] CAT 24.
- 23 See para 418 of [2011] CAT 24.
- 24 See para 442 of [2011] CAT 24.
- 25 See para 444 of [2011] CAT 24.
- 26 See for example para 447 of [2011] CAT 24.
- 27 See para 450 of [2011] CAT 24.
- 28 See s 196(2) of the 2003 Act.
- 29 See para 90 of [2012] EWCA Civ 1002.
- 30 See para 96 of [2012] EWCA Civ 1002.
- 31 See paras 75 and 104, 86-90 and 105 and 77-81 and 102 of the respective judgments of Lloyd LJ and Etherton LJ at [2012] EWCA Civ 1002.
- 32 See para 31 of [2014] UKSC 42.
- 33 See para 38 of [2014] UKSC 42.
- 34 See para 38 of [2014] UKSC 42.
- 35 See para 45 of [2014] UKSC 42.
- 36 See para 418 of [2011] CAT 24.
- 37 See para 48 of [2014] UKSC 42.
- 38 See para 51 of [2014] UKSC 42.