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IN THE COMPETITION
APPEAL TRIBUNAL

Case Nos. 1151/3/3/10
1168/3/3/10
1169/3/3/10

Victoria House,
Bloomsbury Place,
London WC1A 2EB

4 April 2011

Before:

MARCUS SMITH QC
(Chairman)

PETER CLAYTON
PROFESSOR PAUL STONEMAN

Sitting as a Tribunal in England and Wales

BETWEEN:

BRITISH TELECOMMUNICATIONS PLC
EVERYTHING EVERYWHERE LIMITED

Appellants

– v –

OFFICE OF COMMUNICATIONS

Respondent

EVERYTHING EVERYWHERE LIMITED
VODAFONE LIMITED
TELEFONICA O2 UK LIMITED
HUTCHISON 3G UK LIMITED

Interveners (Case 1151)

BRITISH TELECOMMUNICATIONS PLC
EVERYTHING EVERYWHERE LIMITED
VODAFONE LIMITED
TELEFONICA O2 UK LIMITED
HUTCHISON 3G UK LIMITED
OPAL TELECOM LTD
CABLE & WIRELESS UK

Interveners
(Cases 1168 and 1169)

HEARING DAY ONE

APPEARANCES

Mr. Graham Read QC, Miss Sarah Lee and Mr. Richard Eshwege (instructed by BT Legal) appeared for the Appellant.

Miss Kassie Smith and Mr. Philip Woolfe (instructed by Regulatory Counsel, Everything Everywhere Limited) appeared for Everything Everywhere Limited

Mr. Javan Herberg and Mr. Mark Vinall (instructed by the Office of Communications) appeared for the Respondent.

Mr. Tim Ward (instructed by Herbert Smith LLP) appeared for the Intervener Vodafone Limited.

Mr. Robert O'Donoghue (instructed by Telefónica O2 Limited) appeared for the Intervener Telefónica O2 Limited.

Mr. Daniel Beard (instructed by Charles Russell LLP) appeared for the Intervener Cable & Wireless.

The Interveners Hutchison 3G UK Limited and Opal Telecom Ltd did not attend and were not represented.

1 MR. READ: Sir, if it please you, I appear on behalf of BT, and I have to say I feel rather like a
2 London bus in this instance because having been the only one around I suddenly find three
3 more have turned up in the form of three more Silks in this matter, and I am sure the
4 Tribunal will express their congratulations along with mine at Mr. Herberg, Mr. Ward and
5 Mr. Beard having been elevated ----

6 THE CHAIRMAN: Very much so, congratulations.

7 MR. READ: Can I introduce the other representatives in this case. I appear on behalf of BT with
8 Miss Lee and also Mr. Eshwege who is not here today but will make his presence felt
9 tomorrow. Everything Everywhere of course have another appeal in this matter along with
10 BT and are represented by Miss Smith and Mr. Woolfe. As you know, Ofcom is
11 represented by Mr. Herberg and Mr. Vinall, O2 of the interveners by Mr. O'Donoghue,
12 Vodafone intervening by Mr. Ward. Three, as we understand it are not attending and
13 neither are Opal, but Cable and Wireless are represented today by Mr. Beard.

14 Sir, can I turn to the question of the timetabling first because, as you will have seen, we
15 have tried to supply the Tribunal with a putative timetable as far as the parties can. There
16 has been some discussion which has been brought about as a result of the slightly
17 unexpected turn of events from the Court of Appeal decision on the preliminary judgment
18 issue as to what exactly the role Ofcom should play in an appeal to the Competition Appeal
19 Tribunal.

20 If I can say this: obviously there is a great concern I think by everyone in this case that this
21 case having been presented on a particular basis and proceeded on a particular basis, namely
22 that Ofcom would take a full role in it, that there should be no change to that position in this
23 case whatever may or may not happen in the future. Obviously we say in this case that it is
24 quite right and proper that in fact Ofcom should continue to have the main role. Obviously
25 the interveners concern is that if Ofcom does not take that role they have to take it over and
26 BT's corresponding concern is that if the interveners take it over then first, there is the
27 question of them going beyond the scope of their statements of intervention, but also
28 secondly, and it is a point that BT made at both the case management hearings in this case is
29 concern that there should not be any form of duplication going on between the respective
30 submissions. We have tried amongst ourselves to see if it is possible to resolve this. We
31 think it may in the end turn down to a matter of practicality rather than principle and so,
32 subject to what the Tribunal may have to say on the matter, our view is that perhaps the best
33 way forward is to see how it goes and if there is a problem deal with it at the time rather

1 than necessarily perhaps having an argument on principle at this stage which turns out at the
2 end of the day to be otiose.

3 THE CHAIRMAN: That was very much our view that we would see how things developed and,
4 if necessary, handle problems when they arise which hopefully they will not.

5 MR. READ: I am grateful for that indication, sir. Can I briefly turn to the bundles now just to
6 make sure that we all know exactly the bundles we are dealing with. Sir, you will have seen
7 that there are a series of core bundles that have been produced and those are the bundles
8 obviously that we intend primarily to refer to and they should be clearly marked, we hope,
9 as core bundles on them. They are actually in a designation of bundle A, B1, B2, C1 and
10 C2. They contain most of the important documents that are involved but unfortunately they
11 do not contain all of the documents that the parties will refer to, in which case it will
12 become necessary to refer to the respective appeal bundles.

13 We are grateful to the Tribunal for providing us with the list, as we understand it, of what
14 the Tribunal has and there was just one point I wanted to check on that list before I actually
15 start on my opening, which is this: we see from the list, and I am looking in particular at
16 items 13 and 14 on the list, that in fact there is reference to bundles DF1 and DF2 and so if
17 we have understood it correctly those, in fact, are the defences, not relating to the case
18 under which it has been listed but relating to the other two cases.

19 THE CHAIRMAN: Yes, 1169 and 1168.

20 MR. READ: I am grateful, sir. I just wanted to check on that so there was no confusion at a later
21 stage, and likewise the consolidated replies etc pertain to all three sets of appeals. Having
22 made those points, obviously, sir, you had detailed skeleton arguments and various
23 pleadings from all the respective parties, and so I do not propose to go through every point
24 of detail that is involved in this case, but as you are fully aware both BT and Everything
25 Everywhere (“EE”). We both have appeals, BT has one for each of the determinations, EE
26 has it for the 0845 determination.

27 Now, whilst there is some cross over between BT’s and EE’s appearance in that the focus is
28 necessarily upon Ofcom’s reasoning in the 0845 decision I propose in opening to
29 concentrate solely on BT’s appeals, (a) because I think that is right in principle, but (b) in
30 any event it seems to me that I can happily get on with my appeal without having to worry
31 too much about what is put in EE’s appeal, so I am going to concentrate for saving time
32 solely on the point of BT’s appeal.

33 What I intend to do in the course of my opening is really deal with seven different topics.
34 The first of these is to give a brief introduction as to how BT’s pricing works and the

1 background to these three appeals. Secondly, I then want to deal with a point that underlies
2 a considerable amount of the background to this case, which is that BT says there is a very,
3 very clear market failure with the existing price situation. Thirdly, I want to go very briefly
4 again to the respective disputes and a brief overview of how Ofcom reached its decision.
5 Fourthly, I want to deal with a series of overarching points in this appeal, firstly, relating to
6 the nature of the appeals before the Competition Appeal Tribunal, because that point still
7 seems to be active in this case, as it has been in previous cases. Then I want to deal with,
8 within that main topic, Ofcom's focus on human mobile network operators, consumers, and
9 then finally within that section I want to deal with the proper approach of Ofcom in dispute
10 determination. That is my fourth ground, an overview of the overarching points in these
11 appeals.

12 Fifthly, I want to then turn and look at principles 1 and 3. I think that those can be dealt
13 with relatively quickly, but they are obviously points that need to be discussed in a little
14 detail in order to see what the position is.

15 The sixth area that I want to look at is Principle 2, which involves two points. I am going to
16 look at it from two angles. The first of those angles is BT's modelling and the direct effect.
17 As I am sure you are aware, sir, the direct effect is the effect that BT's wholesale tariff
18 structure has directly on prices for MNO callers to the respective numbers. Sir, I am going
19 to look at it from that angle. Then I want to move on and look at it also from what we call a
20 welfare angle, an overall welfare angle point, because we say that in both of those two
21 categories Ofcom has made very serious mistakes, errors, in the way that it has actually
22 dealt with those matters in the determinations.

23 Then, finally, for my seventh area I want to just briefly round up with one or two points that
24 pertain specifically to the 080 appeal.

25 I am not going to deal with the appeals *seriatum*, if you like, I am simply going to
26 concentrate on what we see as being the key elements within the way that Ofcom has
27 actually approached the determinations.

28 Can I start with the introduction: as you are probably aware, NCCN stands for "network
29 charge change notice", and this hearing is obviously concerned with several network charge
30 change notices, or NCCNs, as they are usually called, that BT has issued, by which BT its
31 charges for the termination of 080 calls on its networks and for the termination of 0845 and
32 0870 calls respectively. I will set out a little later BT's contractual entitlement to do that,
33 because we say they were perfectly entitled to do it under the terms of their contract. The
34 080 calls form part of a category of calls known as number translation services or non-

1 geographic call services, they get called different things at different places – I do not think a
2 great deal matters on it. For example, in the most recent review by Ofcom in this area
3 called “Simplifying non-geographic numbers” they are simply designated as non-
4 geographic numbers. It does not matter as long as the underlying principle behind them is
5 actually understood. We say the essential feature is that callers call a non-geographic
6 number, that is a number that does not have a pre-fix code identifying the recipient’s
7 location. The network operator then translates the call into a geographic number operated
8 by a service provider (“SP”) and for your reference – I do not think you need to turn it up –
9 all of this is set out in BT’s 080 notice of appeal at paras 16 and 17, with bundle references
10 core bundle A, tab 2, p.10 and also in paras. 25 to 27 of the 0845 notice of appeal which is
11 at core bundle B1, tab 3, p.13. I should mention that throughout this I think to save time I
12 am going to refer to the first appeal as the 080 appeal, and the second appeal was the 0845
13 appeal, but of course it does not just involve the 0845 numbers it involves the 0870, so
14 unless I draw a positive distinction between 0845 and 0870 then when I am referring to
15 0845 I mean 0870 as well.

16 The calling structure for these calls is set out in a number of places, but it may be helpful
17 just to look at one of these and that can be found in the 080 final determination which is in
18 core bundle A, tab 1 at p.10. Sir, as you are aware there are no overall pagination
19 throughout these bundle, each internal tab has its own pagination so it is p.10 on the internal
20 numbering in tab A1. There there is a diagram provided at figure 1 showing the way that
21 the calls actually operate which is that the caller rings through to an OCP (originating
22 communications provider), it may or may not go through the transit provider, the call is then
23 terminated on the terminating communications provider network and they then supply t he
24 call to the NTS service provider and that sets it up. There are possible variations to this
25 which, for example, Mr. Kilburn refers to in his statement, paras. 12 and 13 at C1, 18 p.5 – I
26 do not think you need to turn it up. Basically, it is possible for there to actually be other
27 CPs at both ends of the chain namely before one gets to the originating CP you can actually
28 have a retailing CP who hands over to another network, and similarly at the other end of the
29 chain there may be a hosting CP where they fit in between the terminating CP and the
30 service provider at the end of the chain. But that basically is the chain.

31 We say there is quite an important point about this, it is unlike the normal geographic call
32 situation where you effectively have one customer, namely the caller at the end of the chain,
33 you do have another customer at the other end of the chain, the NTS service provider, and

1 so it is colloquially called “a two-sided market” – perhaps we will have a look at that a little
2 later.

3 BT contends and Ofcom accepts, the matter is disputed by EE and some of the interveners,
4 that Ofcom has a lawful policy preference that 08 calls should be free to callers because, for
5 example, of the importance of callers being able to access charitable or essential services for
6 free. For example, in relation to 08 calls the service provider usually provides some form of
7 helpline provided by charities, government agencies, or assistance such as RAC, AA and
8 again that has been detailed in our notice of appeal in the 080 case.

9 BT contends, and Ofcom we say also accepts that Ofcom has a policy preference that
10 retailers of 0845 0870 calls should treat those calls in the same way as they treat geographic
11 calls, that these lines are used to provide things like financial services, pre and post sales
12 inquiries, public sector services, etc, information services, and again we have set that out at
13 para.27 of the 0845 notice of appeal.

14 THE CHAIRMAN: And these policy preferences you say feed into the criteria that Ofcom uses
15 to determine whether a particular NCCN is or is not permissible?

16 MR. READ: Sir, absolutely. I think nobody disputes in this case that with the exception of one
17 or two points on BT, there is no form of direct regulation – perhaps I ought to qualify that
18 because there may be some regulation as to the need to actually supply or indicate whether
19 calls are actually going to be charged or not. But this is a policy preference and that is why
20 they have used the word “policy preference” because it is stated by Ofcom as being what it
21 would like to happen in the market, but we fully accept there is no SMP condition or other
22 condition imposed under the Act subject, as I say, to one or two peripheral matters, that
23 actually requires people to provide these calls for free or not, and that is one of the areas
24 that may or may not be dealt with under the review that is taking place at the moment. But
25 what we do say very strongly is that if you are actually looking at a dispute, and Ofcom has
26 laid down very clearly in the past its policy preference, but then Ofcom is entitled to and
27 indeed should take that into account, but when considering the fairness or reasonableness
28 of or whether or not, in fact, to intervene at all in the question of a structure like BT
29 introduced through its NCCNs. So we say it is a very clear preference that Ofcom has to
30 have regard to, certainly in the dispute resolution process, how it applies in other situations
31 may be a matter for other cases but for the dispute resolution process we say it is a very
32 clear preference that has to be considered.

33 THE CHAIRMAN: It is probably something you come to when you deal with your fourth topic
34 on the proper approach to dispute resolution but one of the questions that I hope all the

1 parties will help us on is precisely how one derives the criteria by which disputes under the
2 185 procedure are resolved, and indeed for you in particular, Mr. Read, how this policy
3 criteria, which you say does feed into the determination disputes how that meshes with the
4 contractual point that you make that BT is entitled, as a matter of strict contract, to issue
5 these NCCNs without, you would say, in inhibition at all. One of the questions, if I may say
6 so, that is slightly begged by your very helpful submissions is how that point integrates with
7 the point about a policy preference and other non-contractual criteria for resolving these
8 disputes. But do not let me take you out of your order.

9 MR. READ: No, no, when I come to my fourth section, which is dealing with the over arching
10 points that is the area that I was going to concentrate when dealing with the dispute
11 resolution issues.

12 Can I then just go back to the background to these disputes ----

13 PROFESSOR STONEMAN: Just before you do so, Mr. Read, could you clarify a point for me, it
14 is a factual point? The 0845 and the 0870 numbers, in a number of the documents they talk
15 about a “micro-payment system which goes with it”, can you tell me what that is?

16 MR. READ: Sir, I will try and do it briefly because I dare say there are different views about how
17 this should actually work, but we say that if you go back to the original OFTEL
18 interventions back in the late 1990s – 1996 and 1997 and slightly later than that – what
19 actually was being considered was that the 0845 and the 0870 should allow money to be
20 passed up the chain to the service provider, so that the service provider could actually
21 recover money in the course of the calls being made. In a sense, there is a two way of
22 payments going on. It might actually be helpful just to very briefly look at this, and
23 probably the best place to look at it is in bundle B1, tab 1, which is the 0845 final
24 determination. Sir, there is quite a helpful diagram from Ofcom within the course of this,
25 demonstrating the flow of payments. Could we go to para.2.24, p.17. There one sees the
26 potential payment chains that are going on showing the respective payment flows.
27 The background to this is that when 0845 and 0870 were first introduced they were all
28 subject to the same scheme, but as you are probably aware 0870 got treated slightly
29 differently in 2008/2009, and that is why the revenue share arrow at the top on 0845 is
30 there, i.e. the NTS service provider gets a revenue shares payment flow for 0845, but for
31 0870 it does not according to that, and that is because of the decoupling that took place in
32 2008 with the 0870 calls, which we will have a very quick look at later on.

1 Effectively, the concept behind the micro payments was that money could flow up the
2 Telecoms chain in order to benefit the NTS service provider. I hope that deals with your
3 point, sir.

4 PROFESSOR STONEMAN: So it is historical on 0870, but it is still in place on 0845?

5 MR. READ: At the moment, yes.

6 Can I go back and deal with the background to this dispute because obviously what BT says
7 is one of the key factors that is involved and has generated these disputes, which is the fact
8 that the mobile network operators, or MNOs, have effectively disregarded what we say are
9 the policy preferences and charged high prices for callers on their networks ringing the 080
10 and the 0845 and 0870 numbers. This, we say, is causing a major market failure. I say “we
11 say” because Ofcom, itself, as we will see in a little while, says it very clearly as well.
12 BT’s response to this was to try and seek to increase its termination charges, and in
13 particular to make the wholesale charges that it charged the MNOs dependent upon how
14 much the MNOs themselves were charging their retail customers, and that again with the
15 080 numbers.

16 Can I start with the 080 numbers. The position is set out in BT’s notice of appeal at para.21
17 (core bundle A, tab 2, p.11). The first point is that, unlike BT, which does not charge
18 anything for 080 calls, MNOs have charged a sum to the retail customer. They also used to
19 benefit from something called the NTS formula under which the terminating operator used
20 to pay a charge to the mobile network operator for the origination of the calls in order to
21 compensate the originator for not charging for that call. That origination charge was
22 entirely dependent upon the concept that under the NTS formula calls to 08 numbers were
23 going to be free, the originating communication provider was not going to charge the caller,
24 and therefore there was a payment that went back to the originating communication
25 provider paid by the terminating network operator or communications provider.

26 BT has been concerned for some time that the MNOs were, in fact, charging for 080, we say
27 freephone, calls. BT therefore served NCCN 911 with effect from 1st November 2008,
28 which stopped the payment to call originators for calls to 08 numbers hosted on BT’s
29 network. That is again set out in our notice of appeal at para.21 (core bundle A, tab 2,
30 p.12), and there are also references to this in paras.42 and 44 of Mr. Kilburn’s first
31 statement (core bundle C1, tab 17, p.14).

32 BT issued the first NCCN in this appeal, which NCCN 956, in relation to 080 numbers on
33 3rd June 2009 (I think I have given you the right date, sir, but we will check on that just to
34 make sure). In most respects, what it was actually doing was giving the OCPs, who were

1 charging for 080 calls, a termination payment. It was not entirely one way, because in fact
2 the MNOs or the originating CPs charged nothing for the call, BT would, in fact, pay the
3 originating CP for that call, and I will show you that in just a moment. However, if the
4 originating CP was actually charging 8.5p per minute or more then there was a charge back
5 the other way. Essentially, NCCN 956 set BT's termination charges according to a ladder
6 of bands, and the retailer, when it was setting its own charges, obviously would fall on one
7 of those bands, and the amount that it therefore had to pay BT for a termination charge,
8 depending upon which particular band it actually fell upon.

9 Perhaps, sir, I can illustrate this by taking you to bundle A, again 1, which is the 080 final
10 determination, p.21. This sets out the charging structure of NCCN 956. If one looks at
11 figure 3 one can see that the first line of the first row underneath the title row of that table
12 has note 1 next to it and on the next page it says:

13 "... if no retail charge is payable by the originating Operator's retail customers,
14 the charge set out opposite note 1."

15 In other words, this first row underneath the title is where the MNO or the OCP charges
16 nothing for the call. In other words, the call is actually genuinely free, and in those
17 circumstances, as you can see, it is BT who makes the payment back to the originating
18 communications provider.

19 As you can see, the next band, which is 2, covers the area between a retail charge of more
20 than zero but less than 8.5p per minute. In those circumstances, BT charges nothing, and
21 one can see that from the third row on that table, the second underneath the title row.

22 At the row with note 3, one can see on the right hand side that this covers the step in the
23 ladder, if I can call it that, between 8.5p per minute and less than 12.5p per minute. In those
24 circumstances, BT is charging 2p per minute in termination charges. So it goes on
25 according to the bands, finally ending up, as you can see at note 7, that if the retail charge
26 payable by the originating operator's retail customers is 27.5p per minute the charge is
27 calculated at 13p per minute. So it is a ladder scale and it has actually at one end a finite
28 end to it, i.e. at 27.5p per minute the charge does not go up any more. What it is showing is
29 that it is based entirely upon the charge that the originating communication provider itself
30 decides it should its customer for using the 08 number.

31 I hope that illustrates the charge in a little bit of detail, and one can put the 0845 final
32 determination away. One point that I should make because I, in the course of what I was
33 just saying referred to MNOs and OCPs, the charge applies to all originating
34 communication providers, but the reality is that it is only the MNOs who have actually

1 caught by this charge, which of course is, perhaps not unsurprisingly, why you see the
2 MNOs lined up against me, while I have some assistance from the line operators in their
3 interventions as well. But, I wanted to make that point, that it was not specifically target at
4 the MNOs, it is targeted against everyone, but it is dependent upon what level of charging
5 the originating CP decides to employ in its retail charges.

6 Now, for the 0845 0870 position, again, it is similar but not completely identical. The
7 MNOs, unlike — BT charges those calls for 0845 and 0870 to its customers at the same
8 rates as its geographic calls, but instead the MNOs in particular charge much higher rates,
9 much above what we say is the true geographic call costs and call charges for those
10 particular numbers. Because the 0845 and 0870 numbers are generally outside the bundle
11 of packages offered by the MNOs for geographic calls, so they sit outside the tariff bundle,
12 if you like. And we make that point I think in para.3 of our notice of appeal in the 0845,
13 which is at B1 tab.3 p.5, but in fact it is also referred to in Ofcom's own document, so I do
14 not think there will be much dispute about that. The originating CPs retain the money
15 charged, obviously, to its retail customers except for the sums that are paid down the line to
16 the terminating communication providers in order to meet the costs of terminating the calls.
17 Now, a further point that we say about this is that the charging by the OCPs to their retail
18 customers is supposed to be transparent and charges published, certainly in respect of 0845
19 calls, in accordance with general condition 14.1. Now, given this background, BT then
20 decided to issue two further NCCNs, 985 and 986, and those two are obviously also the
21 subject of this hearing. I think there issued on 2nd October 2009, and again it essentially
22 introduced a ladder system where the ladder elements were set at a slightly different level,
23 but the overall pattern of them was very similar to what had been done for the 080 ladder.
24 Perhaps I can just illustrate that by asking you to look at bundle B1 of the core bundle set at
25 tab.1 p.7. There one sees, in table 1.1, how the NCCN 985 — that is the one related to the
26 0845 numbers — works, and there is a point that there already was a fee being paid to BT,
27 and you can see that there is the fixed charge pence per minute which, in essence, was also
28 part of the micropayment system, I believe. But, as you can see, the ladders are slightly
29 different because the first ladder is from zero to 12.49 pence per minute, where the variable
30 charge is zero. So, it is only if an MNO charges at 12.5 pence per minute that this variable
31 charge begins to kick in: 2p for the step of the ladder between 12.5p and 17.49 pence per
32 minute, and so on and so forth as you see from the ladder. And 0870 numbers, again,
33 similar; but as you can see the ladder pricing is similar, although the fixed charges are
34 slightly different in the first place, which I think reflects the fact of the decoupling of the

1 micropayment system. I am not absolutely sure about that, but in any event there is the
2 fixed charge that is already there. We say that, of course, is part of the explanation for why,
3 instead of being pitched at 8.5 pence per minute, it has been pitched slightly higher because,
4 in each instance, what is, we say, beyond doubt about that is the fact that the 12.5 pence per
5 minute, we say, gives the MNOs a very large margin to cover their costs. I will come back
6 to that point in a minute.

7 I think it is being pointed out to me I may have been wrong about the — referring on the
8 micropayment system on those ladders, so “delete from the record”, as they say, anything
9 that I may have specifically said on that.

10 But the point, obviously, we do make, perhaps before one puts B1 away, I should just refer
11 you also to para.2.33 which is at p.19, where Ofcom sets out its various duties, and we will
12 come back to that a bit later. But, it says in terms at the end of para.2.33:

13 “... there are two types of consumer in the NTS value chain: the caller and the call
14 recipient”,

15 and that is quite an important point. It is the two-sided market that I was talking about
16 earlier on, and it is what really distinguishes this from the geographical situation, in that you
17 do have two customers sitting, one at each end of the chain, and that, we say, has very
18 important aspects to it — not least the fact that the service providers have no direct link
19 with the callers or, indeed, with the OCPs themselves, which is the point being made,
20 I think, in para.2.34; and, indeed, the fact that obviously the more that the SP end of the
21 equation has, the more likely it is that the SP will use this revenue to increase the usage and
22 quality of the service providers, as indicated in para.2.34. That is expanded upon in
23 Mr. Kilburn's statement in the 0845 appeal at C1, tab.18 p.8 for your reference. But it is, we
24 say, quite a core point when you come to assess what Ofcom were deciding.

25 For the sake of completeness — I have dealt obviously with the NCCN 956 and NCCN 985
26 and 986, but I should just mention, in case it surfaces in this case, that there was a further
27 NCCN 1007 which altered the ladder steps in relation to the 080 calls. It effectively
28 removed the ceiling. You will remember I showed you there was a ceiling on the ladder. It
29 effectively removed that and made some other alterations to it as well. Now, you will be
30 jolly glad to hear, I am sure, that that does not form part of this appeal. It has been subject
31 to a hearing before the Tribunal already on procedural issues, but, as the matter stands at the
32 moment, Ofcom has not yet issued a final determination on that NCCN. So, I do not think
33 it will feature at all in this appeal, you will be glad to hear.

1 So, the respective dates, which you probably have already, is that the final determination in
2 respect of NCCN 956 was published on 5th February 2010, and the final determination in
3 respect of NCCN 985 and 986 was published on 11th August 2010, and we have already
4 looked at both of those in the course of the opening.

5 Now, in both the final determinations, Ofcom's overall conclusion was that the parties
6 should revert to the trading conditions that applied before the NCCNs came into effect, and
7 that BT should make payments by way of adjustment for overpayments. The references in
8 the respective final determinations are A, tab.1 p.91; and B1, tab.1 p.181, but that was the
9 result, and I return to the basis upon which Ofcom came to that conclusion in a moment.

10 Can I just then very briefly deal with the stated preference. Again, I probably asked you to
11 put the bundles away. I am sorry if I have done that, but perhaps we ought to have a very
12 brief look at this in the respective final determinations. If I could ask you to look at
13 bundle A, we are at tab.1 which is the 080 final determination, and if I could ask you to look
14 at para.2.33, which is at p.13, there Ofcom sets out that:

15 "Our preference is that 080 calls ought to be free to the caller, and if they are not
16 free, that they are as close to free as possible".

17 It says that:

18 "This preference is consistent with our general duties",

19 And then it sets out various reasons why it says the preference is absolutely right. So, we
20 say there was not any doubt in the 080 appeal that there was a policy preference in favour of
21 080 calls being free. Likewise, in the 0845 dispute, again, Ofcom set out its very clear
22 policy preference and, again, perhaps I should take you to the specific passages in the final
23 determination. One can see that at file B1, starting at para.2.52 which is at tab.1 p.23.

24 THE CHAIRMAN: And when were these policy preferences first articulated?

25 MR. READ: We say they were very clearly originally articulated back in the 1990s. The origin
26 of them, of course, really lies in the fact that essentially, BT was being regulated over the
27 provision of these calls, but in the course of that Ofcom set out what it was intended these
28 numbers should actually have a preferred charging for. Obviously, one of the issues that
29 one would have to look at very carefully, is the OTS system and the fact that there is a
30 certain brand enhancement with certain numbers. So, for example, an 080 number that is
31 free has a certain brand enhancement, certainly as far as the SMPs are concerned, the
32 service providers, are concerned. If one then actually has people charging for those, so that
33 members of the public do not know that the 080 number is a freephone number, or cannot
34 be sure that it is a freephone number, then you have an effect on the brand overall of the 080

1 number; and that, we say, is one of the core flaws in the market, the market failure. There
2 is an externality that consumers can no longer be confident that what was understood to be
3 the charging structure for these particular numbers in fact is not what they are being
4 charged, and there are all sorts of things like bill shock, for example, where parties suddenly
5 find they have been charged very large sums of money for ringing what they thought was a
6 freephone number and finding out only when they get their bill that in fact they are being
7 charged a significant amount for it.

8 THE CHAIRMAN: Which is a matter that the MNOs will raise when they come to speak. But
9 would they not say that it is fine to have a policy preference, but one cannot have a policy
10 preference indirectly where one cannot actually impose an SMP condition and I understand
11 the MNOs to be saying that one cannot directly say “you must charge X for, let us say, an
12 080 number, well no more than X for an 080 number, because the mobile providers do not
13 have SMP.

14 MR. READ: That, of course, is correct if one were to assume, as indeed is suggested by, for
15 example, EE in their original notice of appeal although they may actually have railed back
16 slightly from that in their skeleton argument, but certainly one of their core arguments
17 throughout their notice of appeal is Ofcom has not regulated as previously, we have no SMP
18 condition and you cannot effectively bring in regulation through the back door.

19 THE CHAIRMAN: Well they go further, do they not? They say not only has Ofcom not regulate,
20 but they cannot in this particular instance regulate.

21 MR. READ: Well it is the difference, in our respectful submission, between regulation and
22 preference. You can certainly say that one party is not regulated for the purposes of a
23 particular matter in the telecoms sphere, but that does not actually mean that when one
24 comes to looking at an assessment between different parties as to how exactly the charging
25 should go that one completely ignores the fact that one has had a policy preference, and that
26 that policy preference has very good market competition underlying aspects to it, for
27 example, the brand enhancement that I have been talking about, but Ofcom has to
28 completely ignore that policy preference when it comes to dissolving the dispute between
29 the parties. This is quite a core point in our respectful submission and we had divined a
30 slight backing away by EE – I may be wrong about this, I do not want to get indignation
31 from Miss Smith – that in fact Ofcom was not required to completely forget about this
32 policy preference when it comes to resolving the dispute, it was a factor that had to be
33 brought into the equation. There may be an argument about how strong that factor does or
34 does not have to be, but we say you cannot, in the context of resolving a dispute between

1 two parties as to the contractual price that should apply between them, ignore the fact that
2 one of the core preferences that Ofcom wanted to set up in order to encourage things like
3 service provider enhancement, that that was being affected by the charging that the charging
4 that the MNOs were actually imposing upon their own customers. So in other words, what
5 we say very forcefully is that if Ofcom had to resolve a dispute and if, in the course of that
6 dispute, it is clearly recognised that there has been a failing of an original underlying policy
7 preference that Ofcom had, and that that failure is causing problems within the market, then
8 that is plainly in our respectful submission something that needs to be taken into account,
9 not least we would say because of course when Ofcom is carrying out the dispute resolution
10 process it is carrying the process out as regulator and, as regulator, it is bound to apply
11 things like, Article 8 of the Framework Directive, and Article 8 of the Framework Directive
12 has a very clear focus on Ofcom in resolving the dispute in carrying out its regulatory
13 function applying particular approaches in order to benefit the overall market, the overall
14 consumers and the overall users.

15 We say that if you are a regulator coming in to resolve a dispute like this between the
16 parties obviously one of the key factors is what the original policy preference was that we
17 had on this, and how has the fact of that policy preference not being kept to actually
18 affected the market. We say that obviously that is why Ofcom had to, and we say properly
19 at least paid lip service to, giving preference to that policy preference. Does that, sir, deal
20 with the point that you are raising? I am going to come back to this in a little while when I
21 come to look at the overarching points, because we need to explore in a little depth what
22 Ofcom's role as a regulator actually is, and I will go through that in a little detail later on.

23 THE CHAIRMAN: That is fine.

24 PROFESSOR STONEMAN: While you are stopped, some clarification. As we all know there is
25 no such thing as a 'free lunch', what does 'policy preference' mean? Does it mean
26 "whatever the cost of lunch we want this to take place?" Or does it mean that "there is some
27 cost beyond which we will not go in pursuing this policy preference?"

28 MR. READ: I think the answer to that, and it goes back to the point I was making slightly earlier,
29 that obviously in carrying out dispute resolution, intervening as regulator, Ofcom has to do
30 it in accordance with its specific regulatory duties, including in particular Article 8 of the
31 Framework Directive.

32 Plainly, we say that involves looking at the overall competition within the market, and as it
33 says in terms for users seeking to derive the maximum benefit for them. What that means
34 we say is that, yes, there may be, when one assesses the overall context of a policy

1 preference, arguments about whether someone is getting a free lunch out of this or not. But
2 we put it the other way around, we say it is actually the MNOs who are getting the free
3 lunch out of this because effectively by the use of a soft revenue they get from the 080 and
4 the 0845 calls, which is something, for example, experts like Professor Valletti make
5 reference to because of that soft revenue source as a result of 080 and 0845 numbers
6 effectively being an aftermarket ----

7 PROFESSOR STONEMAN: I think I have misled you by calling it a 'free lunch'. Basically
8 what I want to know is does the regulated preference take account of the MTPE effect?

9 MR. READ: We say it does not ignore it, obviously, because it is a factor that is there. The core
10 point about the MTPE, which I will come on to in due course, is that first, everyone in this
11 case, bar perhaps one person, accepts it is not 100 per cent. It also, if one looks at it, has to
12 be split down on the analysis that Ofcom actually carried out in its own determination
13 between separate elements of it, then I will come back to that in a little while. I do not
14 want to get too distracted by this at the moment.

15 PROFESSOR STONEMAN: No.

16 MR. READ: But the third point obviously is we say if there is a weighting to be done, Ofcom got
17 half way there by making the point that MTPE was not to have the same weight as a direct
18 reduction in call prices, for example, on the 0800 and 0845, 0870 numbers. So I am not
19 going to an extreme end as saying you ignore the MTPE, but it has to be properly brought
20 into the equation, and one of the things we say happened in this case is that although there
21 was lip service paid to giving the MTPE a lesser weight than the direct effect in fact what
22 actually happened, because of the way Ofcom set its analysis up, it actually made the MTPE
23 the major factor, the analysis was that it gave the MTPE far more of a force than it should
24 actually have done.

25 PROFESSOR STONEMAN: My interest was how BT looked at it, Ofcom may look at it
26 completely differently.

27 MR. READ: I am, sometime this afternoon, going to investigate this in a bit more detail, but for
28 the moment I will leave it like that, I think.

29 I think I had just taken you to the policy preference for 0845 and 0870, it is in paras. 2.52
30 down to 2.55, I will not necessarily read them out loud, but there you can see that for 0845
31 numbers, and 0870 numbers it makes it quite clear that Ofcom considers that it has a policy
32 preference that they should be treated in the same way as calls to geographic numbers.
33 You appreciate that O2 in its statement of intervention says that the policy preference set
34 out in the determinations was new and had not been set previously. It says in terms that in

1 fact the policy preference is non-existent and, indeed, it even goes to say that Ofcom's
2 reliance on it borders on the disingenuous, and those are set out in paras. 10 to 15 of O2's
3 statement of intervention, which I think is at B1, tab 9.

4 EE on the other hand, we do not apprehend that they are suggesting that the policy
5 preference does not exist, but they take the point that, as a matter of law, it is illegitimate for
6 Ofcom to give effect to this policy preference as a potentially determinative factor in
7 determining the *inter partes* disputes between the parties, and that is para. 134 of their
8 notice of appeal at B11 p.43.

9 We say that both of them are flawed, there is a great deal of detail that is set out about that
10 in Mr. Kilburn's and Mr. Fitzakerly's statements, which are at bundle C1, tabs 17 to 23
11 inclusive. At this stage I do not want to go into a great depth about it, we simply say that
12 both the contentions being put forward are wrong, but I would just before leaving this ask
13 the Tribunal to get out a bundle from the appeals bundles range and it should, on the
14 numbering system for the Tribunal, be bundle 13, it is the defence bundle of Ofcom vol.1 in
15 the 0845 appeals. If I can ask that you to go to 3.1, which is exhibit GM/2/3.1 it is the
16 exhibit to Mr. Myers, but it includes the "Simplifying non-geographic numbers review" that
17 I was mentioning earlier on and I will want to look at this in a little bit of depth quite
18 shortly, so I ask that you do not put this bundle away for the moment. I just wanted to
19 round this point about the policy preferences off by looking in particular at one of the
20 annexes, and in particular para. A2.56 of annex 2, which is at p.137. If one looks at A2.56
21 it says in terms:

22 "The NTNP indicates the prices that consumers may incur when calling different
23 number ranges and sets out some specific requirements which include specific
24 price guidance for BT, pricing guidance for all OCPs on some number ranges and
25 some price publication requirements that are applicable to OCPs.

26 * for 080 calls of all OCPs, there should be no charge to the customer
27 except where charges shall be notified to callers at the start of the call;

28 * 0845 calls for BT customers are required to be charged ... at BT's
29 Standard Local Call Retail Price inclusive of value added tax. 0845 calls
30 of other OCPs should also be charged at that OCP's local call price, but
31 other OCPs are not obliged to follow this policy preference and their
32 prices may vary.

33 * 0870 calls ... should be charged at no more than the caller would pay for a
34 call to a geographic number with calls to 0870 numbers counting towards

1 inclusive call minutes if the customer has remaining inclusive minutes and
2 included in any discount structure that apply to geographic calls, except
3 where call charges have been published in accordance with General
4 Condition 14.2”

5 I make this point because this is not something that Ofcom has just looked at for the
6 purposes of this dispute, it is something that colours the whole of their thinking throughout
7 their analysis of this particular area.

8 Can I now turn to what we say are the major market failings that are going on here as a
9 result of the charging that is currently going on, because an essential criticism that BT has
10 made throughout is that Ofcom failed to give proper weight to the fact there was a major
11 problem in the market for these numbers, and it is a point that is made at para.42 and
12 following of our notice of appeal (B1, tab 3, p.18) and paras.10-39 of BT’s reply (B1, tab
13 15, pp.4-12). Ofcom accepted in its own words in the 0845 FD that the MNO’s pricing was
14 sub-optimal and stemmed from a market failure. We do not need to turn that up, but that is
15 referred to at para.7.85 of the 045 final determination, B1, tab 1, p.96.

16 BT’s case is that, despite the fact that Ofcom suggests it actually took into account this
17 market failure, it, in reality, did not, and I will return to that in some depth when we look at
18 Principle 2 and the way that was applied. However, I want, first, to actually spend a little
19 bit of time looking at the very clear evidence of this market failure. This document,
20 simplifying non-geographic numbers, sets it out in some considerable detail as to what
21 exactly has been going wrong in the market. Can I ask you, first to go slightly earlier in the
22 document right at the beginning, to p.3, para.1.3 ----

23 MR. HERBERG: Sir, if I may, I do not wish to be pedantic, but I think, for the record, in fairness
24 it must be stated that this is a consultation and it remains ongoing. That is something that
25 should be made clear from the outset.

26 THE CHAIRMAN: Thank you.

27 MR. READ: Sir, it is a point I was going to actually make later on, that, yes, this is a consultation
28 document, but Ofcom has set out what it perceives to be the position. This is information
29 that, for the most part, was readily available to Ofcom when it was considering the 0845
30 dispute in August 2010. This was published at the beginning of December 2010. A lot of
31 this information, in fact, comes from material that was already ready, and so therefore we
32 say that this may be a consultation and its ultimate outcome may not yet be decided, but
33 when judging the 0845 dispute certainly, and we would also say the 080 dispute, this was
34 material and understanding that Ofcom had, and in judging the dispute it really has to take

1 the snapshot at the time it judges on the dispute and focus on the market failings that were
2 available at the time. That is precisely what Ofcom itself indicated, we say, 0845 final
3 determination where it, itself, refers to market failings. These are points that are identified
4 in BT's experts' reports as well, but I thought it would be helpful for you to see how the
5 regulator itself has put it. You can see in para.1.3:

6 "In 2009 ..."

7 So again this was material that was available –

8 "... revenues from calls (that is the amount paid by consumers for calls to non-
9 geographic numbers) were about £1.9 billion and accounted for around 12% of
10 the total call traffic volumes, and generated 10% of the total revenue.

11 Just under half of this revenue (around £900M) is retained by the phone
12 companies serving the calling consumers, with the remainder going to the
13 provider of the service being called and the phone companies who 'host' those
14 numbers (£1 bn). Only around 11% of calls to these numbers are from mobiles,
15 but because these calls are more expensive than calls from fixed lines, calls
16 from mobiles generate about a third (35%) of the revenues, from non-
17 geographic calls. Figure 1.2 shows how the revenues for 2009 from non-
18 geographic calls were divided among the different actors in the value chain."

19 You can see figure 1.2 there setting out how exactly it has been dealt with.

20 Then going on, if you look at 1.6:

21 "The evidence shows that there is little transparency and low consumer price
22 awareness. As a result, most consumers do not know with confidence the costs
23 of calling most non-geographic numbers. Even consumers' understanding of
24 080 numbers (freephone) is low. While 080 has always been free on all
25 landlines, in our most recent survey in 2010 only 46% of respondents claimed
26 they confidently knew that the price of a freephone call on a landline.

27 Confidence about prices of other number ranges is much lower."

28 And you can see from 1.8 the situation seems to be getting worse from the 2009 consumer
29 experience.

30 Then over the page it deals with the issue that I mentioned earlier about "bill shock". Then
31 1.11:

32 "Our preliminary view is that this lack of confidence, bill shock and over-
33 estimation is a consequence of complex charges and the relative infrequency
34 with which any individual consumer is likely to call these numbers."

1 At 1.14 it makes a point that is relevant to all of this, which is:

2 “Nor does the current system appear to work well for the companies being
3 called (or providing services by means of the call). High charges mean lower
4 volumes of calls (hence fewer customer calls to a business), and potentially less
5 revenue and, as a consequence, reduced incentives to provide new or innovative
6 services.”

7 This is one of the effects, we say – this is the brand enhancement issue, if you like – of if
8 the brand is diminished because of uncertainty about the caller then what happens is that the
9 demand for the SP services is reduced as a result, and we say that that is what is being
10 reflected there in 1.14.

11 Can I then ask you to turn to para.2.22 on p.18 where Ofcom sets out the fact that:

12 “The existing regime for the operation of Number Translation Services (NTS)
13 ... and other non-geographic numbers is under significant strain.”

14 Then it sets out in a little bit of detail the concerns.

15 Then at 3.7, p.33, it again makes the point about the decline as a result of consumer
16 dissatisfaction with the ranges, and so on and so forth, and I think makes the point again
17 with the money, and adds at 3.8:

18 “As a consequence, almost 50% of the total call revenues are retained at the
19 retailing and call origination end of the value chain, primarily through the high
20 prices of calling NGCS from mobiles.”

21 Paragraph 4.2, p.42, it makes the two-sided market point again, in that they are both callers;
22 and on the other side SPs, and at 4.4 it sets out the concerns that Ofcom has with three
23 related market failures, lack of price awareness, coordination between different elements in
24 the value chain, which Ofcom calls the “vertical externalities”, and:

25 “The impact of individual OCP (and potentially SP) behaviour on the reputation
26 and consumer understanding of individual number ranges and on the market as
27 a whole ...”

28 which Ofcom calls the “horizontal externalities”:

29 “... neither the SPs nor OCPs have sufficient incentives to take into account the
30 impact of their retail pricing on the reputation of an individual number range or
31 the non-geographic number system as a whole.”

32 I want to make one point while we are there at para.5.27 on p.64. You see there a request
33 by Ofcom to the OCPs about prices of calls, and one can see various figures being given by

1 the individual MNOs, and we say that it is quite clear in that instance certainly that Ofcom
2 had no problem getting figures from the MNOs as to the likely costs of those calls.
3 Can I then ask you to go slightly on in the document to p.93 where they talk in terms about
4 originating payment options. Then in 6.127 and these figures are, we say, quite relevant to
5 the inquiry:

6 “The origination payment could include a contribution towards mobile OCPs’
7 network common costs. Our initial assessment is an origination payment in the
8 region of up 2ppm (consisting of network costs of 1.8ppm and retail costs of
9 0.2ppm).”

10 Then it talks in 6.128 about obviously the different concept of marginal costs, where, of
11 course, no allowance is being made for any attribution of fixed costs of between 0.5p and
12 0.7p per minute. The reason why we say that those two figures are highly relevant in this
13 case is that when we come to the economic modelling, one of the issues about what the
14 modelling actually shows is what happens as you vary it according to the inputs. One of the
15 inputs is the marginal cost of calls. Indeed, if one goes back to all the various reports, one
16 sees that originally (I think back in Dobbs 3) they were working on the basis that the
17 marginal cost of calls for the purposes of the mobile network operators can be up to 5p per
18 minute. In fact, those figures are substantial over-estimations, as we see from the figures
19 here, because, in reality, they look to be in the region of 0.5 to 0.7p per minute.

20 Likewise, when one is coming to Principle 1, and whether or not Principle 1 is met in these
21 cases, and that obviously has a bearing on the 080 appeal, one again sees that, in fact, the
22 margin that BT had allowed the mobile network operators between, on the one hand, 8.5p
23 per minute, or 8.49p per minute, without being charged, was well and truly higher. It gave a
24 great margin between that and what seems to be the true costs of originating such calls.

25 I draw your attention to both those figures at this stage while we are going through the
26 document.

27 Can I illustrate a bit further by taking you to table A5.1, which is at p.276. That is a table
28 setting out the average retentions that are actually being made from the calls in pence per
29 minute for the respective numbers, and it includes on the second row down 080 and on the
30 fourth row down 0845, and the fifth 0870. You can see there is a sizeable average retention.
31 That is the retention after costs have been paid out down the chain. There is a sizeable
32 retention by the mobile OCPs and also there is a very large difference between the
33 retentions that the mobile OCPs are making and the fixed OCPs are making. Again we say
34 that that is (a) relevant to the question of what is going on in the market; and (b) we say it

1 does have a bearing on this question of Principle 1 and whether or not the OCPs would
2 make a sufficient retention.

3 Can I take you very briefly to A2.174, which is slightly earlier in the document at 135, and I
4 simply refer you to this to deal with the point that I made earlier, that if one looks one can
5 see that it seems that the majority of calls to 080, 0845 and 0870 are outwith the core
6 bundles, so they are not part, save in a few circumstances, of mobile tariff package as such.
7 Then can I take you on to p.175, and just draw the attention of the Tribunal because this is
8 where Ofcom set out a consideration of the waterbed effect, or what is also termed “the
9 mobile tariff package effect” and how it actually perceives the matter. And it refers there to
10 several of the empirical studies. But, if I can ask you then to move on to the concluding
11 part of that at para.A2189 on p.177, that paragraph is dealing with the two potential
12 implications of the tariff package effect. And then, starting at the bottom of p.177:

13 “So, even if OCPs may not make extra profits overall, by having to compete away
14 these profits (if the tariff package effect was complete), the impact of the market
15 failure on NGCs would translate in charges that are “too high” for that service and
16 “too low” for the other services. This would lead to a different, and an inefficient,
17 relative consumption of the two sets of services compared to a situation where the
18 market failure was not present. As a result, the structure of the prices does not
19 reflect either callers’ or SPs’ reference. Therefore, we believe that there is a
20 negative impact of the market failures in NGCs even in the presence of a complete
21 tariff package effect”.

22 And we say that is quite an important point, because the corollary of the mobile tariff
23 package effect is that there is, it means, an efficiency if you have a situation where core
24 prices here in the 080 numbers are high and the calls in the package are depressed as a
25 result, effectively the high calls from the 080 subsidise the lower calls in the bundle, you
26 already have a problem, and that is part of the market failure, in that one is subsidising the
27 other. If, subsequently, as a result of price changes, there is a change so that the package
28 bundle goes up in response to the 080X numbers going down, then that is not necessarily an
29 inherently bad problem, because all it is doing is correcting the over-consumption on the
30 right hand side of the equation by depressing the prices on the left hand side of the equation.
31 I will deal with that in a bit more detail but it is, we say, a recognition in Ofcom’s own
32 statement, that it is not simply a question of “Is there is there not a mobile tariff package
33 effect”; it is a question of “Well, was the position acceptable in the first place? Was there
34 in fact, as a result of the pricing structure that is in place, an over-consumption of services

1 going on on the other side of the equation? And it is the point that I was trying to explain,
2 perhaps not successfully, to Professor Stoneman earlier on when he asked me his question.
3 Can I, finally, on this point, take you to A221, p.186. And at this point in the document,
4 Ofcom are trying to calculate the potential magnitude of current consumer detriment. I will
5 not necessarily take you through all the workings of it, but you can see from table A2.220
6 how they actually tried to value this implication.

7 And then at para.A.227, for example, you see that this is not something new, this is the sort
8 of analysis that Ofcom itself was carrying out in 2005, and then further on, as one goes
9 through it one comes, on p.191, to Ofcom's actual estimation of current consumer
10 detriment, and it sets that out in some detail. At para.A2.239 it concludes:

11 "The derived detriment figure of £563M cannot be considered to be precise as it
12 depends on a number of assumptions based on limited evidence. However,
13 equally it is only based on a subset of the number ranges under investigation in
14 this review and, importantly, the detriment figure is based on only one aspect of
15 consumer harm, loss of demand, and does not take account of loss of access to
16 services, loss of innovation and other consumer harms. We consider that this
17 analysis, therefore, provides support for the view that the current consumer
18 detriment is likely to be substantial".

19 And we say that that really does emphasise the nature of the market failures that are going
20 on in the pricing of these numbers, which is a very clear fact that had to be borne in mind,
21 we say, when Ofcom were considering determination. So, can I, with that, ask you to put
22 the bundle DF1 away, because I hope not to have to come back to that.

23 THE CHAIRMAN: Thank you, Mr. Read. As you know, it is the practice of the Tribunal to rise
24 for five minutes in the course of the morning session. Would now be a convenient moment
25 for that?

26 MR. READ: Absolutely.

27 THE CHAIRMAN: Five to twelve, in that case.

28 (Short break)

29
30 THE CHAIRMAN: Just to finish off with one point that I wanted to make as a result of the
31 market failures, which is that in a sense, whether or not there is a policy preference, in
32 considering a dispute Ofcom has, in our respectful submission, to take very careful account
33 of what is actually going on in the market, because that is, we say, the regulatory obligation
34 it has upon it when it comes to investigate these matters. So, I would not want the Tribunal

1 to think that I am solely pitching BT's case on the basis of a policy preference. To the
2 contrary, we are saying that, even if you disregarded the policy preference, the very fact that
3 there is a failing going on in the market in the way that it is, is a factor that plainly has to be
4 weighed into the balance when one is actually considering dispute resolution. I will come
5 back to that when I look at the authorities on the point. But, I would not want it necessarily
6 to be assumed that everything was being focused on the policy preference. On BT's side, it
7 is not. It says that there are other very clear legitimate reasons why Ofcom ought to have
8 found in BT's favour.

9 Can I then just return to the background to these disputes. As you know, NCCN 956 was
10 introduced on 3rd June. Effectively, Ofcom accepted a dispute request from T-Mobile on
11 6th October 2009 and from the other MNOs on 16th November 2009. Ofcom issued a draft
12 determination in respect of NCCN 956 in the 080 case on 23rd December 2009 and as, sir,
13 you will be aware from the preliminary issues judgment, BT contends that up until that
14 point it was actually misled as to the scope of the dispute, and that may or may not be
15 relevant when we come back to the specific points on the 080 dispute at the end. But, the
16 reference to the fact that Ofcom now accepts that BT was misled is Mr. Buckley's second
17 statement of October 2010 at para.12, core bundle C2, tab.26 p.4, and of course that is what
18 forms the fourth ground of BT's appeal in the 080 notice of appeal.

19 The 080 final determination was issued on 5th February 2010 and the appeal was lodged on
20 6th April 2010. 958 and 956 were introduced on 2nd October 2009 and Ofcom accepted the
21 first dispute by Vodafone on 4th March 2010 and made the final determination on 11th
22 August.

23 In each of those disputes Ofcom decided that it would apply three principles to the dispute
24 and Ofcom introduced its three principles for dealing with dispute for the first time in the
25 080 draft determination. These three Principles were that: (1) the MNOs should not be
26 denied the opportunity to recover their efficient costs of originating calls to 080 or 0845
27 numbers hosted on the BT network ...”

28 And that was called Principle 1. Secondly, that:

29 “there should be material benefits to consumers in introducing the charges in the
30 NCCNs, and the absence of material distortion in competition...”

31 and that was the Principle 2. Thirdly, there was a Principle 3 that the introduction of the
32 charges should be reasonably practicable.

33 Can I make two brief points about those principles. First, Ofcom says that these principles
34 were clear and obvious from its six cost principles. We would simply refer to what the

1 Tribunal itself said in para. 102 of the preliminary issue judgment on the admissibility of
2 evidence that “we are a little more sceptical as to whether BT should have appreciated that
3 this was the case”, and we say that it is not obvious from the six cost principles that they
4 would necessarily reduce down into those three principles for the purposes of deciding the
5 dispute.

6 The second point is it is also now sought to be suggested that BT is challenging certain
7 aspects of the three principles, although its position prior to the 080 determination was that
8 it agreed with the fundamentals of the three principles, that is what Ofcom say in their
9 skeleton argument for this hearing. That is not correct for the reasons we have set out in our
10 notice of appeal at paras.75 to 77 in the 080 matter (bundle A, tab 2, pp.35 to 36) because
11 we made it clear certainly in respect of Principle 1 we did not necessarily in respect of 080
12 calls consider that to be the correct principle. I think at the end of the day BT’s position on
13 all of this, certainly the way that Ofcom has put its case forward is that probably the point of
14 principle about Principle 1 is not going to feature necessarily as heavily as it might
15 otherwise have done, because we say that it is quite clear on the actual facts that BT should
16 have passed Principle 1 in the 080 appeal, as indeed it has passed Principle 1 in the 0845
17 final determination.

18 That leads into what Ofcom actually found. First, they found that the MNOs had not been
19 able to confirm (in the 080 appeal) to BT that their average retail price to callers of 080
20 calls, accordingly without more information from the MNOs Ofcom was unable to conclude
21 that Principle 1 had been satisfied and therefore was recovering their efficient costs of
22 originating calls to the 080 numbers. That is how Principle 1 came into this equation. They
23 also held that Ofcom had been unable to identify sufficiently clear benefits to consumers
24 and the imposition of charges might have an effect on competition, and accordingly
25 Principle 2 was not satisfied.

26 Finally, they considered that the parties could reach a practical solution to the issues if
27 principles 1 and 2 had been decided in BT’s favour, and thus Principle 3 could, subject to
28 negotiation between the parties be satisfied. BT contends that the decision was flawed
29 because (a) Ofcom had not taken proper account of the overall merits of the disputes,
30 including putting improper onuses on BT, secondly, it applied Principle 1 inappropriately
31 and, in any event, Principle 1 was not necessarily so self-evident as Ofcom said. thirdly,
32 that it inappropriately applied Principle 2, and finally the misleading point about the scope
33 of the determination.

1 I am going to deal with those relevant points rather than *seriatim* in the course of discussing
2 the individual principles. In the 0845 determination Ofcom's final result was slightly
3 different because they there accepted Principle 1 was satisfied, but as regards Principle 2,
4 although they changed their position from the 080 final determination into accepting that in
5 fact prices were likely to go down, they still, for a variety of factors, including the mobile
6 tariff package effect, said that Principle 2 was not satisfied because of the uncertainties.
7 Finally, as regards Principle 3, Ofcom cited a number of practical difficulties at
8 implementation and said that they remained unresolved, for example porting at the OCP
9 end, and billing accuracy. They then held that more significance should be attached to these
10 problems because Principle 2 had not been met, and I will come back to that when we
11 explore Principle 3 in a little detail, but we say that in fact there was a bleeding over of the
12 two principles, that uncertainties in one were leading to rejection in another but, in any
13 event, Ofcom held that Principle 3 was not satisfied in the 0845 dispute, and again we say
14 the reasoning is flawed in that respect .

15 What I am going to do, after I have gone through the over arching points, obviously is to
16 look at Principle 1, Principle 3, and then go back to look at Principle 2 which we say is in
17 reality the core battle ground in this, rightly so we would say because the statutory tests that
18 rest upon Ofcom in dispute resolution require it to have a clear regard to competition and
19 what is going on in the market and the effect it is having on users of the various services, so
20 I am going to deal with those individually, the two appeals in each of those sections.

21 Before I turn to that, can I go to my next sub-category which are the overarching points.
22 The first, which I hope I can go through quite quickly is Ofcom's contention that where
23 there is an appeal on the merits effectively the Tribunal should still give a restrictive
24 interpretation to its appellate jurisdiction and effectively give a large element of deference
25 to the judgment that Ofcom has laid out in its determinations.

26 That is dealt with in paras. 8 to 11 of Ofcom's skeleton argument, and we have to say that
27 we consider there is a slight air of unreality about this, because there are still references to
28 the *dicta* of Lord Justice Jacob in the *T-Mobile* case in 2008, there are still references to *EI*
29 *Dupont de Nemours & Co* and all of those were actually arguments that were very
30 forcefully put to the Court of Appeal as a reason for Ofcom to exclude the evidence. The
31 skeleton argument for the Court of Appeal put forward by Ofcom could not have been
32 clearer that Ofcom's case was that that appeal had considerable significance for the
33 Tribunal's substantive jurisdiction in hearing appeals in both this case and generally. It also
34 relied heavily in para. 15 of its skeleton argument on that very *dicta* of Lord Justice Jacob.

1 Finally, a key plank, again set out in paras. 17 and 18 of Ofcom's skeleton argument for the
2 Court of Appeal it relied heavily on an analogy with CPR 52.11, of which, of course the
3 *Dupont de Nemours* case was one of the cases that was relied upon because that was just
4 such an appeal under the CPR 52.11.

5 All of those arguments were present in the Court of Appeal and we say all of those
6 arguments were effectively given almost zero traction by the Court of Appeal in considering
7 the case. So we really say this matter of what exactly is the scope of the Tribunal's
8 jurisdiction has been considerably resolved by the approach that was actually put forward
9 by Ofcom to the Court of Appeal and the fact that the Court of Appeal gave not traction to
10 the arguments that were actually being put.

11 THE CHAIRMAN: Yes, it seems to me to matter rather less, with all due respect to Mr. Herberg,
12 what he said in his skeleton before the Court of Appeal as what the Court of Appeal itself
13 said in the decision.

14 MR. READ: Yes.

15 THE CHAIRMAN: That is really what is important here.

16 MR. READ: I will take you very shortly to the case just to show that, but I would not want it
17 thought and, indeed, one sees it in the judgment, these points were all points that were being
18 put to the Court of Appeal, the argument was not being presented in some wholly different
19 way. The core point that was being put forward was that the appeal itself was an impact on
20 determining the Tribunal's jurisdiction and the judgment therefore has to be looked at in
21 that light.

22 Can I ask you to turn to the judgment itself which I hope I will now have the reference to,
23 file 3 of the authorities bundles and it should be at tab 40. I am going to spend some time
24 dealing with this point because it will be out of the way and I suspect I will have made all
25 my submissions on this point in the course of opening. Can I ask you to look at para. 58,
26 because there one does see the arguments that were being forward by Miss Rose, who
27 appeared on behalf of Ofcom in that case. She emphasised a number of features of the
28 statutory scheme:

29 "1. Ofcom is the primary decision-maker, and its position as such is recognised in
30 section 195 of the Communications Act 2003. The CAT may remit a decision to
31 Ofcom and give directions to Ofcom, but its role is essentially to review the
32 decision of the primary decision-maker. That was recognised in the passage cited
33 from the judgment of Jacob LJ.

- 1 2. As the statutory regulator, Ofcom’s role is not simply that of an arbitrator. It
2 has a positive statutory duty to consider the interests of consumers.
- 3 3. The purpose of an appeal is to provide a check on the way in which Ofcom
4 carried out its decision making. Ofcom’s proper role would be undermined if it
5 were open to an appellate body not merely to review Ofcom’s discharge of its duty
6 on the material available to it, but to make an independent decision on material
7 which Ofcom neither considered nor should have considered.”

8 They then went on to deal with speed and deliberately short timescales of the dispute
9 resolution process, and:

10 “7 If it is permissible for a disputing party to put fresh evidence before the CAT,
11 not only will the CAT’s judgment be made without the benefit of the material
12 having been considered by Ofcom, but the principle of swift adjudication would
13 be undermined and the period of financial uncertainty for the parties would be
14 extended for possibly a considerable time.”

15 Paragraph 59:

16 “I am not persuaded by these arguments that section 192(6)(a) is to be construed as
17 limited in the way that Ofcom contends.”

18 Then it deals with the task of the appellate body under Article 4 of the Framework
19 Directive, and at para. 62 he makes the very salient point: “Section 192 of the Competition
20 Act 2003 ...”, that of course, as I am sure you are aware is the section that deals with
21 appeals to the Tribunal and how they commence:

22 “... came into effect one month after the introduction of the CAT rules referred to
23 in section 192(3). Before the enactment of the Communications Act 2003 the CAT
24 had considered the question whether in appeals from the Director General of Fair
25 Trading under the Competition Act the parties were limited in the introduction of
26 new evidence.”

27 The Tribunal held that they were not in the *Napp Pharmaceuticals* case.

28 In that case the Tribunal referred to it as virtually inevitable that, at the judicial
29 stage, certain aspects of the decision were explored in more detail than during the
30 administrative procedure, and that it might be appropriate for the Tribunal to
31 receive further evidence and hear witnesses.

32 There are differences in wording between the Competition Act 1999 and the
33 Communications Act 2003, but the CAT has a similar function under both Acts.
34 The same Rules apply and Parliament must be taken to have been aware of the

1 approach taken by the Tribunal towards the determination of appeal from the
2 relevant Regulator.”

3 So there we are, in our respectful submission, the Court of Appeal specifically considering
4 the question of whether there is an overlap between the Competition Act and the
5 Communications Act 2003, accepting that Parliament had, if you like, buy-in at that stage to
6 the position under the Competition Act and observing that, in fact, that the decisions under
7 the Competition Act 1998 were applicable in this context.

8 Then if one goes on to para.64, one sees it being stated in terms:

9 “In *T-Mobile* Jacob LJ was not considering the issue with which the court is
10 presently concerned. The issue in that case was whether the proper method of
11 challenge to a particular decision of Ofcom was by way of statutory appeal or
12 judicial review.”

13 Then he made the observation about Article 4 of the Framework Directive. He was not
14 concerned with the scope of the evidence which the court might entertain either on a
15 judicial review application or a statutory appeal.

16 We say that that is making the very clear point that Lord Justice Jacob was not, when he
17 came out with that detail, considering the question of what exactly was entailed with an
18 appeal on the merits under ss.192 to 195, a point that I made previously to you, sir, and
19 indeed made to the Court of Appeal in that context, and we say that para.64 makes that
20 point very clearly.

21 Finally, can I ask you to look at paras.68 to 69, because that deals with the *Ladd v. Marshall*
22 argument which was based upon CPR 52.11. There you can see that there was a submission
23 that the similar types of principle that were applicable under *Ladd v. Marshall*, the
24 admission of evidence on appeals to the High Court or the Court of Appeal, of which, of
25 course, the *Dupont* case is one example. At para.69:

26 “There are significant differences between the procedure for determining a
27 dispute under the Communications Act 2003 and an ordinary civil claim. A
28 civil claim is ordinarily determined after a trial at which h witnesses give
29 evidence and can be cross-examined. A dispute under the relevant part of the
30 Communications Act 2003 is determined by Ofcom on paper. Whereas oral
31 examination of witnesses on a civil appeal is highly exceptional because there
32 should have been a proper opportunity for it at the trial, any oral examination of
33 witnesses in a dispute of the present kind will necessarily be at the appeal
34 stage.”

1 So it is making the point very forcefully there, we say, therefore, that the legal basis upon
2 which appeals to the High Court and the Court of Appeal are made, and therefore how one
3 should actually approach the description of the entity below is radically different in that
4 situation where you have an appeal to the High Court or the Court of Appeal to the situation
5 that you have here where you are considering the appeal from an administrative decision by
6 Ofcom, and we say that that is fully captured in paras.68 and 69.

7 Sir, we simply say that there is no force in any of the points that Mr. Herberg makes in his
8 skeleton argument about any restriction on the jurisdiction of the Competition Appeal
9 Tribunal to review this case on the merits.

10 We say that the position is, as has been set out in the *Vodafone v. Ofcom* case and the *H3G*
11 (*No. 2*) case. Perhaps I should briefly take you to the *Vodafone* case, which I think should
12 be earlier in this file at tab 31. Can I ask you to go to para.45 on p.20. This is a point that is
13 made in the *T-Mobile* or *TRD* appeal, as it is often known as:

14 “... considered appeals determinations made by Ofcom under section 185 ...
15 Ofcom argued before the Tribunal that, while determining the issue on the
16 merits as required under statute, the Tribunal should be slow to interfere where
17 errors of appreciation are alleged, as opposed to errors of fact or law.”

18 Then it set out paras.82 and 83 of the judgment, making the point:

19 “82It is [...] common ground that there may, in relation to any particular
20 dispute, be a number of different approaches which Ofcom could reasonably
21 adopt in arriving at its determination. There may be no single ‘right answer’ to
22 the dispute. To that extent, the Tribunal may, whilst conducting a merits review
23 of the decision, be slow to overturn a decision which is arrived at by an
24 appropriate methodology even if the dissatisfied party can suggest other ways of
25 approaching the case which would also have been reasonable and which might
26 have resulted in a resolution more favourable to its cause.”

27 Then it goes on to add, and this is the paragraph that always seems to get left out of the
28 various skeleton arguments:

29 ““But the challenges raised by the Appellants in these appeals are more
30 fundamental. It was not suggested by Ofcom that the points raised by the
31 parties were points which it had not been asked to consider during the
32 consultation process. The grounds of appeal go far beyond alleging errors of
33 appreciation ...”

1 Unfortunately, the rest of that paragraph is cut off, but I will come back to that when we
2 consider the *TRD* appeal in a moment, because it goes on to say in terms that this is not the
3 case to consider what exactly the measure of appreciation is.

4 Then the Tribunal goes on to say that:

5 “... the way in which the Tribunal exercised its jurisdiction is likely to be
6 affected by the particular circumstances under consideration ... There may be a
7 variety of entirely legitimate reasons why the amendment of the current sys ...
8 is a desirable aim ...”

9 - and so on and so forth. Then p.21:

10 “However it is still incumbent on Ofcom, in light of their obligations under
11 section 3 of the Communications Act 2003, to conduct their assessment with
12 appropriate care, attention and accuracy so that their results are soundly based
13 and can withstand the profound and rigorous scrutiny that the Tribunal will
14 apply on an appeal on the merits under section 192 of the Communications Act
15 2003.”

16 It then went on to deal with a submission by Mr. Saini saying that there was not a legal
17 standard of “robustness” as proposed by Vodafone. This was really in respect of a
18 sensitivity analysis that had been carried out. It then went on to hold:

19 “It is the duty of a responsible regulator to ensure that the important decisions it
20 takes, with potentially wide ranging impact on industry, should be sufficiently
21 convincing to withstand industry, public and judicial scrutiny.”

22 We say that there is not this large measure of appreciation that should be given to Ofcom, as
23 Ofcom seems to contend in their skeleton argument. Yes, there may be circumstances
24 where one may say that it is difficult to say this decision is not correct because there might
25 be some other solution to the problem, but the ultimate test for the Tribunal is: does this
26 decision stand up to profound and rigorous scrutiny? If it does, then plainly the Tribunal
27 does not overturn the matter. If it cannot stand up to that sustained scrutiny and it is in
28 effect considered to be incorrect, then the Tribunal, in our respectful submission, must, in
29 those circumstances decide against Ofcom in its final determination. We say that that is the
30 test to apply in this case.

31 I could take you to *H3G (No. 2)*, which I think is in file 2, tab 28, p.66. At p.66 the
32 Tribunal is considering the test for the Tribunal to apply, and then over the page at para.164,
33 the Tribunal make the point:

1 “However, this is an appeal on the merits and the Tribunal is not concerned
2 solely with whether the 2007 Statement is adequately reasoned but also with
3 whether those reasons are correct. The Tribunal accepts the point made by H3G
4 in their Reply on the SMP and Appropriate Remedy issues that this is a
5 specialist court designed to be able to scrutinise the detail of regulatory
6 decisions in a profound and rigorous manner. The question for the Tribunal is
7 not whether the decision to impose a price control was within the range of
8 reasonable responses but whether the decision was the right one.”

9 Again, we say that that is the correct test that one should apply in this case.

10 Sir, can I now turn to another area, which is Ofcom’s consumer focus. BT fully accepts that
11 in considering the matter as a regulator dispute between CPs Ofcom must have regard to the
12 interests of users and the impact on competition. That is what we say is mandated upon
13 Ofcom by Article 8 of the Framework Directive, which I will take you to in a moment. BT
14 made that crystal clear in para.63 of 080 notice of appeal, which is at A, tab 2, p.29.

15 Ofcom, we say, has taken an extreme stance by asserting that Ofcom is required to prefer
16 the interests of human consumers over those of service providers. This is a point that is
17 made at para.16.3 of Ofcom’s skeleton argument. It is suggested in that paragraph that it is
18 BT taking the extreme stance by saying that you have to weigh in to the balance the
19 question of both the service providers themselves, albeit that they are banks and businesses,
20 etc, etc, and others in the whole economic chain if one is to carry out a proper welfare
21 analysis.

22 We say it is Ofcom who are actually taking the extreme stance because it does not seem to
23 be disputed by the parties in this case that, as a matter of economics, one has to have a look
24 at the whole of the situation. Ofcom say that it has to have this focus on human consumers
25 as a direct result of its interpretation of the statutory obligations upon it. We say that there
26 is no legal requirement for such a focus. It portrays, in our respectful submission, a
27 misunderstanding on Ofcom’s part which has come into sharp focus in particular with
28 Mr. Myers’ explanation in his statement of how Ofcom reached the 0845 final
29 determination. We say that is the first point about it.

30 We say over and above that there is a further point, that even if it is right, even if Ofcom are
31 right about this point, it has not applied it properly, because what it has done is it has
32 concentrated on the MNO retail customers and those customers include not only the human
33 consumers using their mobiles, but also businesses as well, and indeed one of the issues
34 about what the average retail price is is that there are discounts given to business customers.

1 For example, if you have a bank or a business that is providing mobile phones for its
2 employees, in those circumstances it is a business that is contracting with the mobile
3 network operators in respect of the retail consumption.

4 So not only do we say that Ofcom have got it wrong, but even if it has got it right it has not
5 compared like with like. It has excluded the non-human service providers but included the
6 non-human business customers of the MNOs when weighing up the retail factor at the other
7 end and focusing on the retail consumers. We say that within its own analysis it has
8 actually made an inherent mistake. We say the analysis is wrong because the focus should
9 not be on human consumers. I hope I have set out the battle lines.

10 THE CHAIRMAN: I see that, but looking at the first stage, which is really a question of how one
11 precisely articulates the three principles on which BT has been judged in terms of NCCN
12 notice, are you saying that if Ofcom articulates its principle in a particular way, let us say to
13 include only human consumers, that that is a matter which this Tribunal can review, as it
14 were, on the merits and say, “No, that is wrong, you must look more broadly”?

15 MR. READ: The short answer is, yes, I would say that, because if the legal focus is not upon that
16 then the legal focus is not upon that and that is an error of law. There is another point to
17 this. This has only come into sharp focus as a result of Mr. Myers’ statement. It is set out
18 in some detail in an annex to Mr. Myers’ statement, particularly at paras.338 to 391.

19 If one looks at the final determination it is not clear and obvious that Ofcom have said, “We
20 will apply our focus solely to human consumers”. Indeed, in various places within the final
21 determination it actually talks in terms of the SPs being consumers. So it is not clear from
22 the way the principle was actually laid out within the final determinations that this was what
23 the focus was going to be. It has come, if you like, into sharp relief as a result of
24 Mr. Myers’ statement.

25 I hope that answers the Tribunal’s questions that, one, we say that if it is wrong in law, it is
26 wrong in law, and the Tribunal is entitled to say it is wrong in law to have applied this
27 focus; but over and above that we say that in any event it is not something that is clear from
28 the way the principles were actually laid out in the original determinations.

29 THE CHAIRMAN: Yes, I see the distinction you are drawing. I think that my focus is very
30 much on the first part of the answer which is, how is it said that, let us say, a focus simply
31 on human consumers is so clearly wrong in law? What are the criteria that we use to judge
32 so stark a conclusion?

33 MR. READ: Sir, I think to do this properly I probably need to take you to Mr. Myers’ statement,
34 first of all, which is at C2, tab 28. If one goes to p.115, para.388 onwards, one sees that he

1 lays out his basis for saying that, in fact, the consumer welfare standard should be
2 concentrated on the MNO consumers. I will not read it out entirely, but that is the
3 reasoning behind it, and he draws a distinction between consumer and producer surpluses.
4 I think it is necessary, once you have had an opportunity of seeing that, to then take you to
5 the **Grey Book**. I have not, I am afraid, in preparing for this case been able to see whether
6 all the sections have made it into the bundle. I think they have, it is file 1, tab 3 of the
7 authorities bundle. Can I ask you, sir, to look, first of all, at s.3(1). It sets out the general
8 duties of Ofcom, s.3, and 3(1):

9 “It shall be principal duty of Ofcom, in carrying out their functions –

10 (a) to further the interests of citizens in relation to communications matters;

11 and

12 (b) to further the interests of consumers in relevant markets, where appropriate
13 by promoting competition.”

14 So the first point that we make about s.3(1), which is what Mr. Myers is relying upon, is
15 that whereas the interests of citizens are unconstrained and unlinked, consumer interests in
16 s.3(1)(b) are specifically linked to the promotion of competition – “where appropriate by
17 promoting competition”. In other words, one simply, in our respectful submission, cannot
18 dictate from that that you can decouple the interests of consumers from the promotion of
19 competition. That is a very important point, in our respectful submission, because it does
20 not equate the interests of consumers completely with low prices. There may be important
21 reasons why higher prices may be required in order to promote competition. Indeed, I think
22 tangentially it raises its head in this case because in the mobile termination review in 2003
23 the MNOs were specifically allowed a higher charge in order to try and target certain
24 marginal customers – network externality charge – and I think it may or may not crop up in
25 the course of this case, but there certainly was an acceptance that in certain circumstances
26 low prices *per se* are not necessarily to be equated with overall benefits to consumers and
27 the proper appropriate promotion of competition.

28 We say that is specifically enforced when you look at s.3(2) where one of the specific
29 objectives is to promote in particular:

30 “the availability throughout the United Kingdom of a wide range of electronic
31 communications services ...”

32 Again, one cannot simply focus on s.3(1), and particularly 3(1)(b), without also taking into
33 account 3(2)(b), that in fact one of the objectives ought to be the availability throughout the
34 UK of a wide range of electronic communications services. Those services include the

1 services that the SPs themselves actually promote. Again, one cannot simply say the focus
2 has to be on consumers – human consumers, as Ofcom has it – to the detriment of
3 considering the overall availability of the provision of electronic communication services.
4 The point we make is that the telecommunications sector is an innovative area. Without
5 telecoms companies receiving monies for investment innovation will be stifled. It is a point
6 that, for example, Mr. Aspinall makes in paras.7 to 9 of his statement (C2, tab 49, pp.2-3).
7 If the focus is merely put upon human retail consumers no account, in our respectful
8 submission, will be taken of this important point.

9 Can I then take it a stage further and say, is the word “consumer” actually focused on
10 human consumers? Can I ask you to look on in the bundle to s.3(14), which is p.3 of the
11 material that we have before us, one sees there that “citizens” are defined as meaning
12 members of the public in the UK. That is “citizens” not “consumers”. So “citizens” plainly
13 are being defined as individuals.

14 We then look at what the definition of “consumers” is. If one goes right towards this tab –
15 one can see there has been a section in respect of s.405, and that starts on p.2 of 6 of the last
16 part in the bundle. If one goes to the end of tab 3, one sees that there is p.6 of 6, and goes
17 back to 2 of 6, I hope one should arrive at s.405. If one looks over the page at p.3 it has the
18 definition “consumers” ----

19 THE CHAIRMAN: Which refers on sub-section (5).

20 MR. READ: Yes. Eventually at p.5 of 6 we come to the definition of “consumers”:

21 “For the purposes of this Act persons are consumers ...”

22 and I emphasise the word “persons” there, because “persons”, as I am sure you are well
23 aware, sir, can mean corporate personality as well as individuals. There are recognised
24 definitions when one actually is wanting to refer to individuals – for example, natural
25 persons or individuals – but they use deliberately the word “persons”, which we say
26 indicates it is not a focus simply on human consumers, but the point is made even more
27 clearly when one looks at 5(a):

28 “persons to whom the service, facility or apparatus is provided, made available
29 or supplied (whether in their personal capacity or for the purposes of, or in
30 connection with, their businesses) ...”

31 So we say that that is completely the antithesis of defining “consumers” as “human
32 consumers”. It is plainly here, in defining what “consumers” are, referring to corporate
33 personality as well as human individuals. We say that that is clear from the Act itself.

1 It goes slightly further than that, sir, because if one goes back to the position under the
2 Framework Directive, which I think is at tab 8 – authorities bundle 1, tab 8 – Article 2 of
3 the Framework Directive does refer to consumers, and it does refer to consumers as being
4 private individuals. One sees that if one goes on to p.7 of 20, which is Article 2, and at (i),
5 about two-thirds down the page, one sees:

6 “‘consumer’ means any natural person ...”

7 and, in my respectful submission, if the Act had wanted to define “consumer” as a human it
8 would referred to them as a “natural person” and not a “person” –

9 “... who uses or requests a publicly available electronic communications
10 service for purposes which are outside his or her trade, business or profession
11 ...”

12 So if Ofcom had been concentrating on the word “consumer” in the Directive, they might
13 have been correct in that it applies to human consumers. The problem is that, when one
14 comes to look at the mandatory requirement on Ofcom when approaching any of its
15 regulatory tasks which is set out in Article 8. “Consumers” is not used as the core
16 benchmark for the task that the National Regulator is supposed to carry out. One sees that
17 at p.10 in this material, where it sets out:

18 “Policy objective and regulatory principles:

19 1 Member states shall ensure that in carrying out the regulatory tasks
20 specified in this Directive and the Specific Directives”,

21 and I pause there to say that it is clear from the *TRD* appeal that the regulatory tasks that are
22 involved there include the dispute resolution process, so there is no doubt at all that
23 Article 8 is a core factor that has to be complied with when Ofcom is engaged in the dispute
24 resolution process.

25 “the national regulatory authorities take all reasonable measures which are aimed
26 at achieving the objectives set out in paras.2, 3 and 4. Such measures shall be
27 proportionate to those objectives.

28 Member states shall ensure that in carrying out the regulatory tasks specified in
29 this Directive and the Specific Directives, in particular those designed to ensure
30 effective competition”

31 so, again, the emphasis is on effective competition]

32 “national regulatory authorities take the utmost account of the desirability of
33 making regulations technologically neutral”.

34 And then, in Article 8(2):

1 “The national regulatory authorities shall promote competition in the provision of
2 electronic communications networks, electronic communications services and
3 associated facilities and services”,

4 and, just pausing there, the emphasis is upon promoting competition in those services.

5 Again, we say that that means that when you are actually engaged in the dispute resolution
6 process you cannot just focus on what is happening on one particular group of human
7 consumers, you have to look at the overall effects on the promotion of competition within
8 the market. And then it goes on in 2(a) by saying, by inter alia:

9 “(a) ensuring that users, including disabled users, derive maximum benefit in
10 terms of choice, price, and quality”.

11 Now, it deliberately uses the word “users” rather than “consumers”. We say that is
12 absolutely clear that you cannot simply equate “users” with “human consumers”, because if
13 it was, it would have used the word “consumer” which is defined as the natural person. It
14 would not use the word “users”. And so therefore, when you are considering ensuring that
15 users derive maximum benefit in terms of price and quality, you are looking at any users of
16 the service, and that includes the banks and the businesses that actually provide the service
17 provider facilities. Also, perhaps I should add that 2(b) says in terms:

18 “ensuring that there is no distortion or restriction of competition in the electronic
19 communications sector”.

20 So, again, we are back, in our respectful submission, to one of the primary obligations that
21 Ofcom had in considering this matter is to over-view what the effect on competitions is
22 going on in the 080 and 0845 call market, not concentrating on one particular end of that
23 equation and the human consumers at that end. Finally, just to complete —

24 THE CHAIRMAN: Mr. Read, before you go off that, can I enquire, where you actually see that
25 Ofcom put the emphasis, I see that one of the things going on here is the regulatory
26 preference, and the regulatory preference is that a situation where the market failures are
27 corrected is better than a situation where the market failures are not corrected, and when
28 they are working out the benefits that come from correcting the market failure, of necessity
29 that takes into account the benefits that flow through to the service providers, the increase in
30 awareness, the brand image, etcetera, and so the benefits of going to the service providers
31 are included in that calculation. Where they are not included is in the calculation of the
32 indirect effects, which is something perhaps quite separate from the regulatory preference.
33 So, it seems to me that Ofcom is treating different groups of consumers when looking at
34 different questions.

1 MR. READ : The reason I am hesitating to answer that question is that it will take me quite a
2 long time to actually unpick what Ofcom actually did and did not do in the course of the
3 final determination; because one of the things we say is that they weighted the benefits all
4 wrongly. And the reason they weighted the benefits all wrongly is because, as we now see,
5 they had the focus on the human consumers as opposed to the SPs, and we say that is wrong
6 as a matter of law. But to actually unpick the various points that you have outlined is going
7 to take some time, and it is what I am going to try and do this afternoon. And so, if I can
8 park that question, I would rather park it until we come to look at the matter overall.

9 THE CHAIRMAN: All right. I am quite happy for you to park it, but the essence of the point is
10 that the regulatory preference does not exclude OSPs and the impact of pursuing the
11 regulatory preference, the benefits of that to the OSP are not excluded from the
12 consideration as to why they should have that regulatory preference. That is what your
13 people can look at after lunch, if you like.

14 MR. READ: As I say, I think it is a point I am going to come back to and deal with in any event,
15 and I think rather than take up time now trying to do it, I would prefer to continue with
16 concluding this point and then moving back to the over-arching point.

17 THE CHAIRMAN: That is fine. Do proceed on the point.

18 MR. READ: The final point that I wanted to simply draw attention to is that consumers do get
19 used in Article 8 and it gets used in Article 8(4)(b). It is basically dealing with a specific
20 area, that of:

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

25 So, again, we say that that is not particularly relevant in this equation. And the very fact
26 that the authors of the Framework Directive have deployed consumers in that limited sense
27 in Article 8(4) really emphasises the difference between users in Article 8(2)(a) and that it is
28 completely distinct and different from natural persons. I think that is probably all I need to
29 say on that but, as I say, we say, therefore, that it is a misguided focus as a matter of law.
30 Can I now then turn to the issue of Ofcom’s role under the dispute resolution process. And
31 the first point that needs particular emphasis in my respectful submission is the fact that the
32 intervention is as regulator. Ofcom is performing a regulatory task when it uses its powers
33 under s.190, and it is using them as regulator, not as arbitrator. That is not only clear, we
34 say, from the Act, but also from the common regulatory framework as well, although I do

1 not think I need to take you through that. And it is clear because it has been stated on a
2 occasions that in dispute resolution, Ofcom acts as regulatory. And I just briefly want to
3 take you to two cases, well, I will take you briefly to one case. The second case I am going
4 to spend a little bit more time on. But the first case is *H3G (No.1) v Ofcom*, which is at
5 2005 and I think it should be in volume 2, tab.25. If I can just briefly take you to paras.129
6 and 123 while I am on this case, para.129 at p.37 because this is the point that Ofcom in that
7 case were seeking to suggest that they had, in effect, the right to defer to other regulatory
8 processes rather than deal with the matter in the dispute resolution process, because they are
9 stating there, Mr. Roth as he then was was arguing that basically, there had to be some form
10 of regulatory decision before the dispute resolution powers kicked in. And that was rejected
11 in para.130 because effectively there was nothing within s.190 to suggest that SMP had to
12 be found before the regulator decided a dispute over price. But the issue there was whether
13 or not, effectively, Ofcom could ignore the dispute resolution process and leave the matter
14 for a further regulatory intervention, in this case the imposition of an SMP condition; and
15 the Tribunal was there saying, “No, that is not right. You have to deal with it within the
16 dispute resolution process”.

17 The way these arguments all came up was, of course, in the context of H3G’s arguments
18 that BT had countervailing buyer power because there was the dispute resolution process
19 that they could use. It is quite a complicated argument that one has to go through to
20 actually see how these points came up. But, the point being made very clearly, we say, in
21 paras.129 and 130 is that the regulator cannot simply say that it will not deal with a dispute
22 resolution process because it has to go through some other regulatory process. And, if I can
23 take you on, sir, to para.138(b) which is really dealing with the point that I took you to this
24 case for, it is dealing with the position, and this is at the bottom of the page, it is dealing
25 with what the mechanism of clause 13 under the standard interconnection agreement
26 actually was, and stating in terms, and this is in 138(b):

27 “The second answer lies in identifying just what the cl 13 mechanism is. It is not
28 actually a full third party arbitral mechanism of the kind one sees in, for example, a
29 rent review clause. The arbiter in cl 13 is the regulator. The regulator’s powers
30 are conferred and constrained by statute, and while Ofcom’s are extensive they do
31 not include the power to be a third party arbitrator. In truth cl 13 does not invoke
32 that latter sort of status. The sort of dispute that Cl 13 contemplates is a form of
33 interconnection dispute, which Ofcom would resolve as regulator ... and would be
34 a form of regulation. It therefore falls to be disregarded, as a matter of principle”,

1 and that is the point about dealing, how you weigh it into the equation.

2 Now, the two points that I would make about that are that clause 13 actually provided,
3 under the SIA, a specific provision for Ofcom, for the disputes between the parties about
4 prices to be referred to Ofcom. That is different to the situation we have in the present case
5 which is a clause 12 case, and I will come back to that in due course where there is no such
6 provision that actually requires Ofcom to effectively resolve the pricing dispute. But, the
7 point that is being made very very clearly there, we say, is that Ofcom, when it is resolving
8 the dispute, resolves it as regulator, not as some form of quasi arbitrator. And that is very
9 important in our respectful submission when you come to consider the whole issue of what,
10 the way that Ofcom intervened in this case. And, sir, I am conscious of the time, and I am
11 also conscious of the fact that where I am on my list of things to get through. Sir, can
12 I enquire whether the Tribunal might sit to five tonight, or whether that creates any
13 problems?

14 THE CHAIRMAN: Five o'clock.

15 MR. READ: I am very grateful, sir because I am obviously keen that I get finished today and that
16 we do not trail over into tomorrow.

17 THE CHAIRMAN: That would be helpful. Two o'clock.

18 (Adjourned for a short time)

19 MR. READ: Sir, can I just mention that I hope I will finish by 5 o'clock, but I may just trickle on
20 into tomorrow. I have discussed this with my learned friends and we think the position with
21 the witnesses now is in fact that we will probably be able to bring some of them into Friday,
22 certainly we are not going to be tight on this week if, as is likely, we dribble over into
23 Wednesday in any event with the openings. The problem, sir, I actually have is that
24 obviously having been asked several questions ----

25 THE CHAIRMAN: No, no ----

26 MR. READ: -- I want to take some time to actually go through them and make sure I am not
27 cutting my opening short by trying to finish by 5 o'clock today, so if I do trickle over it will
28 only be a trickle over and, as I say, the consequence will be that the openings from Ofcom
29 and EE will necessarily trickle over to Wednesday, but having talked to Miss Smith and Mr.
30 Herberg we do not think that that is going to cause any major timetabling issues.

31 THE CHAIRMAN: Well let us see how we proceed.

32 MR. READ: Can I take you straight away then to the second authority I wanted to refer to which
33 is the *TRD* appeal, which is at file 2 in the authorities bundle at tab 29. Can I ask first of all
34 to go to p.37 and very briefly finish off the point I started when we were looking earlier at

1 the *Vodafone* case where they quoted these two paragraphs as measures of appreciation, and
2 see the concluding words in para. 83:

3 “This is not, therefore, a case in which the Tribunal needs to explore further the
4 circumstances in which it is or is not appropriate for it to interfere with the
5 exercise by Ofcom of its discretion.”

6 So the point was being left open in the *TRD* appeal. Can I then take you on to para.89 and
7 you can see there at the bottom of p.39:

8 “The fact that dispute resolution is intended to be an additional form of regulation
9 exercised in parallel with SMP regulation and general competition law is clear
10 from the Common Regulatory Framework.”

11 Then it refers to Article 5(4) of the Access Directive:

12 “The fact that these two powers are included in the same provision indicates that
13 they are both intended to be regulatory tasks and not as in some way ancillary to
14 other regulatory functions or to general competition law rules.”

15 Then it goes on to deal with Article 23, which is dealing with disputes in that they have to
16 be aimed at achieving the objective set out in Article 8 and in any event the Act itself says
17 that Article 8 has to be taken into account.

18 “Article 5(4) of the Access Directive also refers to NRAs securing the policy
19 objectives of Article 8 of the Framework Directive.”

20 Article 5(4), I should just interpose there, is the dispute resolution procedure provided for in
21 the Access Directive where there was a dispute between communications providers, and
22 actually that Article is relevant in this case because, of course, this was a dispute between
23 communications providers about access and interconnection. So all of this, we say, is
24 completely on point, making it very, very clear that in fact it's an intervention as regulator.
25 Can I also touch on para. 93 where it says:

26 “We do not interpret either these specific recitals or the scheme of the CRF as a
27 whole as requiring or justifying Ofcom's approach in the case. That provision
28 does not mean that dispute resolution should be directed only at bolstering pre-
29 existing regulatory constraints imposed on specific parties but rather emphasises
30 that dispute resolution is an autonomous regulatory process which forms part and
31 parcel of the overall regulatory framework.”

32 Again, it is making the point in our respectful submission that dispute resolution is a third
33 autonomous regulatory method of intervening.

1 THE CHAIRMAN: I quite see that, Mr. Read, but what exactly does that mean? When one has a
2 defined dispute between two alternative view points as to a defined matter, and Ofcom has
3 to resolve it, does that mean that Ofcom can, as it were, formulate *de novo* a principle as to
4 why one party rather than another should win in this particular case, or does Ofcom have to
5 look at the rights and obligations as they subsist between the parties to the dispute?

6 MR. READ: The starting point we would say is because it is a regulatory intervention the
7 regulator should only intervene if it is proportionate for it to do so. It is a restraint on the
8 otherwise contractual position of the parties under the contract and therefore the
9 intervention using the powers under s.190(2) has to be exercised in a proportionate manner,
10 and that is a point I will come on to in a moment. So the starting point, we say, for all of
11 this is that a Regulator like Ofcom should not in these circumstances be intervening unless
12 it is clear that there is a regulatory reason for saying that the contractual mechanisms that
13 exist between the parties should be constrained, and that is the first point. The second point
14 is that, of course – and I was going to take you on to this in the TRD because there is some
15 discussion about this – Ofcom is not simply there to dealing with the position independent
16 of the fact that there is a dispute going on between the parties. There obviously is a matter
17 that needs to be adjudged, if you like, between the parties, but that judgment has to be
18 exercised in its capacity as a regulator and subject to the various constraints on it as to how
19 it should approach the task and, in particular, Article 8 of the Framework Directive. The
20 consequence of that, we say, is that it is not some form of arbitration route, a quasi arbitrator
21 that is actually deciding what is right between the parties, it is doing it in the context of
22 overseeing the regulatory position and then having to decide whether it should actually
23 intervene and use its powers under s.190 in the way it wants to.

24 In the course of doing that we do say that there is the potential for Ofcom to use the dispute
25 resolution as an alternative and autonomous means, if you like, of carrying out regulation.
26 So if, for example, it sees something it does not like, the it can use the dispute resolution to
27 achieve that end. That is a point that is within this case that I am taking you to because one
28 of the points that was squarely raised there is that Ofcom is not having to decide between
29 what party A on the one hand says about the level of the price and party B says should be
30 the level of the price on the other hand. It does not have, if you like, to find within the
31 range between the two different devices. It may well, and indeed has, decided to find well
32 out of the range because for regulatory reasons it considers it correct to do so.

33 THE CHAIRMAN: I can see clearly where there is a discretion, as it were, between alternative
34 resolutions to a dispute that a policy can feed in, but suppose there is a dispute between

1 party A and party B about the meaning of a clause in an agreement between them, and one
2 party says it means one thing and the other party says it means another, and Ofcom takes a
3 view that on the clear construction of the agreement it means party A is going to win, but
4 for very good regulatory reasons it would be better if party B won. In that case do you say
5 that the policy objectives can trump contractual construction of the agreement?

6 MR. READ: Certainly, if there are compelling regulatory reasons why Ofcom would intervene
7 then, yes, we do accept they do trump the contractual position. I would not want it to be
8 thought that BT is saying that because you have a contract the regulator can never intervene
9 as regulator if it considers that there are good regulatory reasons for saying “no” it should
10 not be decided in that fashion, but then you come back to what are the reasons the regulator
11 has put forward for the intervention?

12 The point that BT – it may simply be a question of where the burden actually lies, because
13 the point BT makes is that if you have an existing contractual framework and the regulator
14 intervenes into it, it has to actually intervene in a way that is consistent with the duties of
15 proportionality and with the other regulatory duties upon Ofcom before it can actually make
16 the intervention. That is really the point that these cases all make, which is that Ofcom’s
17 intervention is as regulator, it is not as quasi arbitrator or whatever, because otherwise if
18 you have that you would end up with just a third party arbitral clause which, of course, is
19 precisely what the H3G case said you could not do. I hope that really deals with the points
20 you were putting to me.

21 THE CHAIRMAN: That is fine.

22 MR. READ: Can I just conclude by looking at one or two other paragraphs? Can I make another
23 point on this while we are actually here at 96 and 97. This argument here was all part and
24 parcel of the argument being put forward by Ofcom that it should not have to take a
25 decision effectively on these particular disputes because it was all going to be reviewed in a
26 subsequent market review that was actually taking place at the same time, and the Tribunal
27 rejected that as a justification for effectively coming up with a short answer in the dispute
28 resolution process. We say that that is particularly relevant when you come to consider the
29 contention that seems to underpin Ofcom’s thinking in this case which is along the lines of
30 the MGS review might lead to some further change in the future and therefore we should
31 effectively defer to that. I accept that when you read the final determination there are
32 passages where Ofcom suggests that it still did not defer to the Simplifying non-Geographic
33 Numbers Review. However, we say when you look at the overall result that Ofcom
34 achieved that is effectively what happened, and that is not something that is permissible

1 following both the comment earlier on that I took you to in the H3G no.1 case and, in
2 particular, these paragraphs 96 and 97 where it is being indicated that no, Ofcom has to look
3 at the matter in the context of the dispute that it is actually facing.

4 The same point is made in para. 99 where Ofcom were trying to suggest the other way
5 around that it did not need to take a decision in dispute resolution that in any way might
6 conflict with its earlier decision in 2004 because the only question was whether or not it was
7 consistent with its 2004 decision. So in essence it is the same point put in a slightly
8 different way, namely, that if we already had some form of proper market review we do not
9 need to do another analysis for the purposes of dispute resolution. Both points were
10 rejected by the Tribunal in that case as the justification for effectively deferring to other,
11 more detailed, regulatory processes rather than properly deciding the matter in dispute
12 resolution.

13 Can I also ask you briefly to look at para. 105 and in particular towards the end of that
14 paragraph:

15 “ Thirdly, as we also describe below, Ofcom is entitled to, and should, use such
16 information as it has at its disposal from the exercise of its other regulatory
17 functions.”

18 We say that is quite important in the context of this case, where it plainly had a wealth of
19 detail that finally manifested itself in the Simplifying Non-Geographic Numbers and we say
20 that information should have been deployed properly in this case. So insofar as Simplifying
21 non-geographic numbers has a great deal of evidence, we say that is perfectly permissible to
22 use in the context of this dispute resolution and should have been used in the context of this
23 dispute resolution.

24 There are various other sections, para. 106, which again makes the point about such an
25 approach not amounting to using dispute resolution powers as an alternative means for
26 addressing SMP, making the point again that it is the third regulatory autonomous method
27 for intervention.

28 I just draw your attention to para. 112 because again it is the same point about the material
29 that Ofcom had, because it already had material in that case from a market review that was
30 going on at the same time and that it should have used that material in this case.

31 Can I then move on to para.177, that sets out general guidance for how to deal with dispute
32 resolution. I would make just one point about dealing with a consideration of why the
33 dispute has arisen. First, it is said in the context of a contractual term that specifically
34 required Ofcom to resolve the dispute and you will recall this is a case under para. 13 of the

1 SIA, we are dealing with para. 12. More importantly, if one looks over the page, it is stated
2 in terms; “The onus of the party proposing the variation”, we say it is the MNOs who are
3 here proposing the variation because we are entitled to do it contractually and they are the
4 ones who are saying “No, we do not like that, we want it varied”. But, in any event:

5 “The onus lies on the party proposing the variation to provide to the other party
6 and to Ofcom the justification for the change in the terms ...”

7 So the time that this case is saying you should look at it is when the justification is provided
8 to Ofcom. So in other words, the focus that there seems to have been in this case
9 throughout of saying that BT had no contemporaneous justification for this – we do not
10 accept it is right – but in any event it is the wrong time to look at it because the right time to
11 look at the justification is when Ofcom comes to weigh it and decide within the dispute as
12 to what exactly is the correct solution to the dispute resolution process. There is not some
13 sort of lock-in time that says if you have not come up with the answer that you are supposed
14 to come up with by the time you actually ask the other parties how you are going to deal
15 with these prices, that in fact somehow or other that is the lock point and you cannot
16 thereafter look at anything that happened subsequently. As it says there quite clearly and in
17 terms it is the justification provided to Ofcom in part of the dispute resolution process. That
18 is quite an important point given some of the arguments that are actually being put through.
19 So the rest of these paragraphs deal with the general approach that was being taken to
20 dispute resolution in the context of that case. The trouble with all these cases is that they do
21 tend to turn on their own particular facts as I think I have submitted to you in previous
22 cases, but those are the paragraphs if you want to see what the general dispute resolution
23 process is.

24 I have gone off at a slight tangent on other points because obviously I have the case open,
25 but I just want to conclude the point that Ofcom is intervening as regulator by making the
26 point again that the Court of Appeal was specifically being asked in the course of their
27 judgment on the preliminary issues matter, the exclusion of evidence, whether or not CPR
28 Part 52.11 actually applied and of course, as you have seen, part of their answer to that is
29 “No, because Ofcom are not acting as a court deciding the case between the parties as one
30 would have with something like, for example, an Employment Tribunal or something like
31 that, it is intervening as administrator and regulator, so that case as well, we say, supports
32 the very clear point that the intervention is as a regulator.

33 Can I turn very briefly to deal with the importance of the contractual position. I think I
34 have probably outlined it sufficiently, but it is a point that Ofcom itself recognises, because

1 in para. 52 of Ofcom's 0845 defence to EE's notice of appeal they say in terms that by
2 determining the dispute in the way it did, Ofcom intervened to prevent BT from exercising
3 its contractual rights in a particular way. Ofcom itself acknowledges that its intervention
4 was to prevent BT's contractual rights, so certainly as far as BT and Ofcom are concerned,
5 there seems to be no dispute that the intervention was to restrain something that BT was
6 entitled contractually to do, and for the transcript that reference is at B1, tab 4, p.21.
7 There is a considerable amount of complaint being made that somehow this is an unfair
8 contractual position because it means that BT can change prices without any contractual
9 restraint. Can I very briefly deal with that, because I do not want to take up too much time?
10 As Mr. Kilburn makes it absolutely clear in his statement, paras. 8 to 14 of his third
11 statement, which is at C1, tab 19, unfortunately there are no page numbers, but it is the third
12 page onwards. He makes the point quite clearly, first, this contract has been negotiated
13 over many years, it has been before Ofcom on a number of occasions, the terms have been
14 picked over on many occasions by the different industry players including the MNOs. It is
15 a standard contract that has been negotiated over many years.
16 Secondly, the contract has very clear delineated terms for changing the contract terms. It is
17 not a contract that is writ in stone, but it is one that has to be negotiated with the whole of
18 the industry and therefore it really is unfair to say "Well somehow or other BT have gained
19 an unfair contractual advantage in this situation." The contract is there, it has been
20 negotiated over time and if someone wants to change it they have to go through the
21 negotiation process. There is a good reason for that because it has effect not only on one
22 side of the equation but on several because BT may be terminating the CP, it may be
23 originating the CP, it may be transit CP, and so we say there are very, very good reasons
24 why the contract is the way it is, but that is it and the MNOs cannot complain that BT takes
25 the point "We can do this and you are the ones who are seeking to vary the prices by saying
26 they should be changed down, and referring the dispute to Ofcom." So insofar as it is
27 suggested that anyone needs the contemporaneous justification then it is not BT.
28 I think, sir, you have been provided, with the link to the Standard Interconnect Agreement,
29 which is openly available.

30 THE CHAIRMAN: Yes, we have, thank you.

31 MR. READ: I will not take you through it, other than to say obviously we are dealing with para.
32 12 of the main body of the Interconnect Agreement, not para. 13, that is the first point. The
33 second point, paras. 19 and 20, provide for the parties to amend the contract if they follow

1 the set procedure, and para. 30 expressly deals with how variations to the clear contractual
2 terms are to be made. So there is a very clear framework for how this contract works.
3 The other point that I would ask you to note, which is tucked away in one of the annexes,
4 but annex B does have some detailed provisions dealing with billing and how exactly billing
5 disputes are to be resolved, in particular it expressly recognises that systems may not always
6 be adequate, that is para. 2.2 of annex B, para.3.9 of annex B lays down a very clear
7 process of seeking to resolve any issues, dealing with billing information so basically an
8 escalation process that ends up ultimately with an independent expert being appointed to
9 deal with it. The same with para. 6, again the same matter. I make that point because it is
10 being suggested this is all very complicated, we do not know how this is going to work,
11 there may be lots and lots of billing disputes (this goes to the Principle 3 point). We say this
12 is not uncommon in the industry, that is why you have an annex such as Annex B.

13 Can I now very quickly deal with the question of proportionality? We do say that this is a
14 relevant consideration. Ofcom has intervened to use its powers as regulator under s.192 and
15 we say that if it does it, it has to do it in a proportionate manner, and that is the outcome of
16 the case in this area. Perhaps, sir, I can ask you to go to the *Tesco* competition case which
17 was decided in this Tribunal, which is in authorities bundle 3, tab 34. I think I can take this
18 very quickly by asking you to simply go straight to para. 135. 135 makes the point that any
19 consideration of proportionality cannot be divorced from the statutory context and
20 framework under which the remedy is being imposed, and we fully accept that as a point.
21 Then in para. 136 it goes on to deal with a summary of the proportionality principles as set
22 out in *R v Ministry of Agriculture, Fisheries and Food and Secretary of State for health, ex*
23 *parte Fedesa* and it sets out there the test which was laid down. At para. 137 it makes the
24 point:

25 “That passage identifies the main aspects of the principles. These are that the
26 measure: (1) must be effective to achieve the legitimate aim in question
27 (appropriate), (2) must be no more onerous than is required to achieve that aim
28 (necessary), (3) must be the least onerous, if there is a choice of equally effective
29 measures, and (4) in any event must not produce adverse effects which are
30 disproportionate to the aim pursued.”

31 We say the principle is very clear and we fully accept that it obviously has to be considered
32 in the context in which you find it, and so obviously in the context of dispute resolution one
33 may well take a different approach to proportionality than if one was, for example, dealing
34 with whether it is proportionate to impose an SMP measure for the like.

1 However, what we say Ofcom has actually done in this case is to ignore it almost
2 completely and Ofcom in its defence gets fairly close to that by saying that the observations
3 of the Tribunal to which BT refers do not provide formula directly applicable to the
4 determination of disputes.

5 We say that is wrong, we say it is a formula that applies. It may be that in the
6 circumstances of dispute resolution we would apply it in a different way but you still must
7 actually consider the issue of proportionality before you decide to intervene and impose a
8 regulatory restraint by your use of s.190(2).

9 Ofcom seem to say that it does not need to consider proportionality (para. 22 Ofcom
10 defence) because Ofcom's purpose is not primarily to pursue a regulatory objective of its
11 own, but rather to determine a dispute on reference from one of the parties affected (para.
12 22 Ofcom defence B1, tab 5, p.11).

13 We say that that is inconsistent with the line of cases that I have just been taking you to that
14 the intervention can only be as regulator within the dispute resolution process because that
15 is the basis upon which Ofcom is given the right to intervene in these disputes, it is not as
16 some form of arbitrator it is intervening as regulator, and if it intervenes as regulator then it
17 is clear, in our respectful submission, that proportionality should be taken into account.

18 At para. 26 of Ofcom's defence it goes on to say that there is already an inbuilt
19 proportionality because Ofcom is constrained how it may act in determining the dispute.

20 This of course is a reference to the provisions within the Act as to you must take on dispute
21 determinations, it has limited powers to suggest that it is sent off for alternative means, etc.

22 That again misses the point, in our respectful submission, that the intervention comes
23 through the power contained in s.190(2), because Ofcom must accept and indeed it has
24 accepted in previous cases, that that is a power, it is not an obligation it is a discretion as to
25 how it uses the powers that it has within that section.

26 If that is the case then its power to intervene is not constrained, it is a discretionary power
27 which has no element of inbuilt proportionality within it, so therefore Ofcom must go
28 through the proportionality test if, at the end of the day, it wants to intervene as regulator
29 and restrain BT's contractual procedures.

30 We say that Ofcom has gone wrong there by not actually considering whether it was
31 proportionate to restrain BT from its contractual entitlement. All of these things, the
32 question of the contractual entitlement, the question of restraint and so on, they all go to the
33 key point of where the burden lay, effectively, in making the case for changing, overriding
34 the NCCNs, and we say you cannot ignore all these factors when it comes to the weighing

1 task that actually has to be done at the end of it, and that as a result, if at any stage Ofcom
2 has effectively put an unfair burden on BT — and it is a complaint that we make in several
3 places in both the 080 notice of appeal and the 0845 notice of appeal — if it overlooked
4 relevant steps it ought to have taken, then it has imposed in our respectful submission far
5 too high an onus on BT to actually satisfy it, effectively, that BT’s charges are fair and
6 reasonable.

7 But, I do want to make the point, I would not want it thought that BT hangs its case on that
8 point alone. BT says, “Well, even if Ofcom is right about this, it still for it wrong”, for
9 reasons I am going to come on to when I discuss, in particular, Principle 2. But it is, we
10 say, an important factor.

11 Can I make two other points very quickly that I think I have already made by reference to
12 the TRD appeal. That is that Ofcom has got the duty to resolve the dispute at the time of
13 the final determination, and not leave it to a subsequent more detailed regulatory review.
14 And we say that although, it is an understandable inclination on the part of a regulator, that
15 it is better to look at all this in the context of a more detailed regulatory investigation, but
16 that is not, in our respectful submission, the correct way one should approach dispute
17 resolution. If you are going to intervene as a regulator to override particular contractual
18 rights, then you cannot effectively use as a justification for doing so, the fact that you would
19 like to deal with it at a later date, and I will come back to that, certainly when looking at
20 Principle 3 in a few moments.

21 The second point I want to make is that obviously information from other sources, when it
22 is available, should be used, and that is the point I was making on para.105 of the *TRD*
23 appeal and that is why, we say, the simplifying non-geographic numbers review is very
24 important in that context.

25 The final point that I want to make about the context of the dispute resolution powers is that
26 a core point on any decision that Ofcom takes is the fact that it needs to have transparency
27 as to how it has been done. It is a point we make in para.53 of our notice of appeal, where
28 we refer to the decision of the Competition Commission in the NTR case, it is set out at B1,
29 tab.3 p.23 in our 0845 notice of appeal. That is absolutely crucial, we say, in this case,
30 where Ofcom has effectively said it has weighted various factors in a particular manner, and
31 that it did, for example, pay attention to existing market failure and policy preferences. But
32 it is no good simply, effectively, to say “Well, we looked at it, but there still remains a great
33 deal of uncertainty”. A transparency in the decision making process means that Ofcom
34 actually has to give some indication as to how it approached the matter, and in particular

1 how it weighed all the various respective factors involved. And when I come back to
2 Principle 3 it is a criticism that I hope I will make good in taking you through the material.
3 Can I now turn to Principle 1, and I am going to take this very briefly, because I am
4 conscious that I do not want to be here tomorrow afternoon.

5 Obviously, in the 0845-0870 determination Ofcom held that Principle 1 was met. Now, we
6 almost say that is tantamount to have hoisted a white flag of saying it must be true for the
7 080 position as well. There is a dispute between BT and Ofcom as to exactly what Ofcom
8 decided in Principle 1 in the 080 final determination. It is more than a matter, I think, of
9 mere semantics, and I perhaps just very briefly ought to take you to it, which is vol.A1 at
10 tab.1 p.4. Paragraph 124 sets out Ofcom's conclusions, and one sees there that it sets out
11 very clearly that:

12 "We have not changed our view [from the draft determination] that in the present
13 circumstances the three cumulative Principles are not satisfied in either case. As
14 with our provisional conclusion, this is because" —

15 The reference to "either case", by the way, I should say, is the counter argument being put
16 forward by I think it is was T-Mobile, that BT should be paying them a charge.

17 And then, at (i) it says:

18 "The 2G/3G MNOs have not been able to confirm to BT their average retail prices for 080
19 calls. Without this info, we are unable to determine the level of the 2G/3G MNOs'
20 retentions. In turn, although the 2G/3G MNOs' headline prices are generally above their
21 efficient costs of origination, we are unable to determine whether their average retentions
22 are above or below this level".

23 Now, the point we make about this is that this is being discussed in the same paragraph as 2
24 and 3 which relate to Principle 2, which Ofcom said were not satisfied. So there is a
25 contradistinction between those three sub-paragraphs in 124 and what is in 125. We
26 conclude that Principle 3 could be satisfied in each case. We consider the parties could
27 reach a practical solution to these issues. So, Principle 3, it is quite clear from the
28 conclusion, is saying "No, we think that could be satisfied". Principle 2 is quite clear, it is
29 saying it is not satisfied. And one might assume from that paragraph that in fact Ofcom was
30 actually saying Principle 1 was not satisfied either. But that does not really matter whether
31 we are right or wrong. We accept that there are other paragraphs within the final
32 determination that can be read another way, that they were leaving it open. But, it does not
33 really matter because Ofcom's position, if we have understood it correctly, is that Principle
34 1 in the 080 disputes, they had not made their mind up because they needed more

1 information to do it. Now, we say that that was wrong as a matter of course, because there
2 are serious policy reasons why it is wrong to effectively say, “This is all too difficult,
3 therefore we are not going to conclude it is satisfied”, with the potential risk that you may
4 actually start restraining BT on a basis that the right information has not been provided by
5 the MNOs because it sends a very bad signal. That is the point that Dr. Maldoon, I think, in
6 one of his early reports made that this sends a very bad signal to the market because it says
7 that if you obfuscate you effectively will be able to see off some form of price changes that
8 you do not like.

9 But, in any event, we say “Well, this is a complete red herring to say that it could not be
10 concluded”, because we know, and we have seen it in the simplifying non-geographic
11 numbers, that 8.5p gives a very large margin on the actual costs of origination in this case.
12 And so therefore we say that Ofcom should have, instead of simply saying, “We’re not
13 sure”, should have actually said, no, of course it is satisfied. It may not, as I say, be the
14 most major point in this case because, at the end of the day, if you are with us on Principle
15 2, an absolute worst, as far as we are concerned, we are told it has got to be further
16 negotiation. But we say that it was actually wrong on Ofcom’s part to effectively duck the
17 issue by saying that in fact they were not convinced about Principle 2, and it might have to
18 be dealt with at a later stage. There was, in our respectful submission, either enough
19 information available that they should have dealt with it or, if there was not, then they
20 should not have used it as a justification because the only reason they did not have that
21 material was because it was not being supplied by the MNOs. And I think that is all I really
22 need to say about Principle 1.

23 Can I then turn to Principle 3. That required that the introduction of BT’s charges had to be
24 reasonable practicable to implement. Now, in the 080 final determination as we have just
25 seen, Ofcom held that they considered that the parties should be able to reach a practical
26 solution, but in any event they were going to leave that for the parties to subsequently
27 negotiate. And we say that that is plainly something that should have been applied, in our
28 respectful submission, to the 0845 final determination as well. What actually happened is
29 that in the 0845 draft determination, Ofcom did adopt the same stance as it did in the 080
30 determination. And of course that was at a stage when Ofcom were saying BT failed
31 Principle 2 because it was all too uncertain to see whether or not prices would decrease;
32 but, as regards Principle 3, that was still open to negotiation. But, of course, by the time the
33 supplementary consultation, BT is actually demonstrating a stronger effect in that Ofcom
34 now accept that prices will decrease as a result of the pulsar tariff structure, albeit that

1 Ofcom say that it is surplus to the magnitude of it. But in the interim, BT is losing on
2 Principle 3. Ofcom changes its view on Principle 3 and says, in terms that “No, we think it
3 may be too difficult to deal with. There are too many uncertainties, and therefore we do not
4 find that BT has satisfied Principle 3”.

5 That is obviously one incidence of the complaint we make in our 0845 final notice of
6 appeal, where we say that effectively, the closer BT got to the winning post, the more that in
7 fact uncertainties on other areas were erected as a further hurdle, and we do say that there is
8 a trait of that going on through the course of the determination process. But, be that as it
9 may, we do respectfully submit that, when you analyse Ofcom’s decisions on Principle 3,
10 they are diff in the way that they have actually presented themselves because, effectively,
11 what Ofcom allows it to do is to allow uncertainties in Principle 2 to bleed over into
12 Principle 3 and therefore effectively end up being, we say, double counted. And, can I ask
13 you to put away vol.A and go to vol.B1 which deals with the final determination in the 0845
14 dispute. It is at tab.1 in vol.B1, and if I can ask the Tribunal to go to p.171 one comes to the
15 assessment of Principle 3. I am going to come back to the early points in paras.9.44 on to
16 9.50, but can I pick up at para.9.51 Ofcom’s reasoning.

17 “Given a free choice, a policy development process (for example our ongoing
18 NGCS Review) would represent a more desirable approach to such a substantial
19 and important change with wide-ranging implications. However, we must resolve
20 this dispute now and do not consider that it would be appropriate for us instead to
21 wait until the outcome of the NGCS Review, as this would entail a significant
22 delay during which time the MNOs would continue to have to pay BT’s new
23 charges.

24 9.52 Nevertheless it is relevant that the NGCS Review, which includes policy
25 options beyond the scope of this Dispute, may implement a set of changes to
26 industry arrangements for 0845/0870 calls. We are therefore concerned about the
27 potential for a major and potentially disruptive set of changes in industry
28 arrangements to implement NCCNs 985 and 986, which may subsequently be
29 rolled back or substantially affected following the conclusion of the NGCS
30 Review next year”.

31 Now, the problem with this, in our respectful submission, is that the NGCS review,
32 simplifying non-geographic numbers review, is going to be concluded at the earliest in May
33 of this year, that is the time that Ofcom says in the consultation document that it will try and
34 reach a conclusion. Of course, even if it reaches a conclusion at that stage, there will

1 probably be a considerable period of time afterwards before the changes are actually
2 implemented. As you recall, the charges for BT's 080 charges were due to come in, I think,
3 in July 2009, and the changes for the 0845 and 0870 NCCNs were I think due to come in in
4 about October 2009. So, there will be, even if one accepts Ofcom's analysis on this, a
5 period of at least two years where BT is being prevented from charging what it wants to
6 charge because of potential concerns about the future NGCS review. And we say that that
7 is simply inconsistent with what the *TRD* appeal said in terms about the fact that — the fact
8 that you may have a market review going on at the same time does not mean that you
9 should hold back on adjudicating on the prices at this particular stage. And that is even
10 more so in this case because it is a much longer period, a period of upwards of somewhere
11 of two years. So, that is the first point.

12 The second point we make, and I will look at this probably a bit more, is that although the
13 NGCS review, although Ofcom says that it is not going to put it off to the NGCS review, it
14 is going to actually take a decision now, in fact when you look at what has happened with
15 the way that Ofcom has weighed the uncertainties, effectively it has shown a preference for
16 deciding the matter by future regulation rather than dealing with the matter now. And of
17 course that is reinforced, we say, by what it has done in para.9.52.

18 And then, in 9.53, Ofcom make a further point:

19 "If we were in a position to conclude that there were clear and unequivocal
20 benefits to consumers from NCCNs 985 and 986, we might place less weight on
21 the practicability concerns outlined above. However, given our conclusion that
22 Principle 2 is not met, we consider that these concerns are relevant".

23 Now, the problem, we say, with that is that essentially Ofcom has allowed uncertainties in
24 Principle 2 to bleed over into Principle 3, and the real vice with that is that you end up
25 double counting the same uncertainties in two sides of the equation. This, we say, is not the
26 only time that Ofcom has done it; it has done it in respect of Principle 2 as well, where it
27 has effectively double counted a number of uncertainties more than once. But here, we say,
28 is a clear instance of Ofcom overtly doing it, Ofcom overtly accepting in terms that
29 uncertainties on one of its separate principles should lead over into the second.

30 I would make further points about this. The first is that if BT is now right on Principle 2 it
31 means that we must be right on Principle 3 as well because of what Ofcom say in para.9.53,
32 if there are not the uncertainties that Ofcom says in Principle 2 then Principle 3 does not
33 have the strength of effect that it did in the final determination. Even on Ofcom's own

1 analysis, if we succeed in convincing the Tribunal that we are right on Principle 2, it
2 necessarily means that Principle 3 flows in our direction as well.

3 The second point we make is that we say that this is inconsistent in reality with the way that
4 it would actually play out in the markets. Ofcom sensibly, in our respectful submission,
5 concluded in 0800 that a number of the points that were being put up were matters that
6 would really be resolved through negotiation. We say the position has not really changed
7 between the 080 final determination and the 0845 final determination. Instead, we say it is
8 another one of these instances where the burden seems to have increased against BT the
9 closer it got to the winning goalpost.

10 I will give some examples of this, if I may. Firstly, Mr. Kilburn makes it absolutely clear in
11 his first statement in the 0845 appeal at para.68 that BT was not looking to have definitive
12 answers to all the questions on billing or on pricing, etc, etc. It was prepared, for example,
13 to accept whatever the chief financial officer said about the position on ARPs. He says in
14 terms in para.68 of that statement that BT is prepared to work with the MNOs to establish a
15 fair and reasonable approach to settling a notional actual end user charge on the MNOs'
16 network. It is very easy, in our respectful submission, for a party to come along and say,
17 "Well, there is this problem, there is that problem", etc, etc, and you may have to in the
18 course of this hearing weigh some of the evidence you hear about how difficult or otherwise
19 this actually is, particularly given that BT is, itself, not trying to impose some draconian line
20 about how all these materials are put forward.

21 We say that it is particularly important in the context of issues about billing. I have already
22 illustrated to you that there are really quite detailed provisions within the Standard
23 Interconnect Agreement for dealing with these sorts of problems. This is not something
24 new, this is not rocket science, if you like. That is why there is an annex B in the Standard
25 Interconnect Agreement, specifically to deal with issues and concerns about billing. Given
26 that BT is not, and has made it absolutely clear that it is not, seeking the nth degree of
27 certainty from MNOs about their pricing, we say that this is really a case that should
28 probably properly have been dealt with in the context of negotiation and not effectively BT
29 being shut out at this stage on Principle 3.

30 To support that further, we do point to the interventions from both Cable & Wireless and
31 Opal and the evidence of Mr. Harding and Mr. Aspinall, and in particular to show that BT is
32 prepared to engage in proper negotiations about how to deal with this. Cable & Wireless, as
33 you will appreciate, is a major competitor of BT, and they have, as you know from other
34 cases, sir, had their difficulties and spats between them. This is not a sort of lapdog of BT

1 rolling over. It is a hard nosed commercial competitor giving clear evidence that these
2 things are capable of being negotiated, and that is a matter, we say, that at the end of the day
3 is obviously correct and that Ofcom have effectively come up and leapt upon the
4 uncertainties far too early, rather than doing as they did in the 080 final determination, and
5 allow the parties to see what they could do about it.

6 Can I just try and illustrate a couple of the points about this by taking you back a couple of
7 pages in the final determination to competitive distortion, which is on p.169. I make it
8 absolutely clear, sir, that here we are dealing with Principle 2. This forms part of Ofcom's
9 conclusions on its assessment of Principle 2, and one sees that at p.166. The heading there
10 at p.166 above para.9.16 is "Assessment of Principle 2", and within that context one of the
11 issues that Ofcom deals with is at 9.33, competitive distortion. One can see that there are
12 four areas that Ofcom deals with in competitive distortion. The first is the TCPs, which is
13 dealing with in paras.9.33 and 9.34, and Ofcom effectively holds that the risk of distortion
14 of competition among the TCPs is interests hosting services is relatively low. In other
15 words, that box is ticked in BT's favour.

16 On transit it talks about the issue of foreclosure in the transit market, and at 9.36 it says:

17 "However, we have concerns on transit providers' ability to identify the OCP of
18 some calls to bill of course's accurately (for example, when calls arrive via
19 another transit provider who does not identify the OCP)."

20 So the issue about whether or not call traffic can be identified by reference to the OCP when
21 it has gone through transit is a concern:

22 "... we noted that BT (as the TCP) may be unable to determine the identity of
23 the OCP if the call is from a ported number and the TCP is unable to identify
24 the OCP based on the ingress route ..."

25 Then at 9.37:

26 "We are concerned that this may lead to competitive distortion in the transit
27 market by encouraging OCPs to choose inefficient routing choices to avoid the
28 payment of higher termination charges. Although the scale of our concern is
29 uncertain, we maintain our concern about the risk of a distortion in the transit
30 market in the absence of a mechanism to solve this problem ..."

31 There is Ofcom latching on to an uncertainty as a reason for being concerned about the
32 effect on competitive distortion. So tick on the TCPs, cross on the transit.

33 Then we turn to OCP's retail services, and at para.9.38 one can see the conclusion there:

34 "Therefore, we do not currently place great weight on this potential concern."

1 Then it deals at 9.39 with another possible concern and at the end of that it concludes:

2 “In addition, the significance of this issue is likely to depend on the way in
3 which the average retail price is derived and updated over time, and the
4 frequency with which BT might change its termination charges.”

5 In other words, there is a question mark being put over OCP’s retail services because of the
6 way that the average retail price is being derived.

7 Then finally we say the MNO hosting of MVNOs, if one looks at the end of para.9.41:

8 “Therefore, we consider that any potential distorting effect may avoid material
9 distortion to the incentives of MVNOs to switch between MNOs.”

10 In other words, the conclusion that Ofcom is reaching on that is that that is not a
11 problematic issue.

12 Then it 9.42 it deals with the conclusions on the competition effects, and as you can see (b)
13 says that there are concerns about the potential distortion; and (c) concludes; and (c)
14 concludes:

15 “But the nature of these effects depends on the method derive MNOs’ average
16 retail price (which is considered below under Principle 3).”

17 Then at (d) they maybe avoid a significant distortion. So it is (b) and (c) that are the ones of
18 concern.

19 Perhaps I can conclude that by saying that Ofcom use those two problems as saying that it
20 concludes on Principle 2, including the competitive distortion in the round, “we conclude
21 that Principle 2 is not met”. In other words, the competitive distortion effects are being fed
22 into the conclusion on Principle 2. We say that there has been uncertainty put forward by
23 Ofcom over certain of the arrangements, which is simply not correct in respect of
24 competitive distortion.

25 What it then does is bleed those factors into Principle 3, because if one looks at 9.47, we
26 see:

27 “A number of practical difficulties of implementation remain unresolved. For
28 example, porting at the OCP end may affect billing accuracy (where CLI
29 information would not identify the OCP of the call).”

30 So that directly mirrors the point being put forward in para.9.36, and we say that it is a
31 classic instance of the way that Ofcom says a problem is uncertain and then uses it in the
32 equation not simply in Principle 2 but over into Principle 3 as well – in effect, double
33 counting. You keep saying there are uncertainties, uncertainties and uncertainties. It is
34 either going to be an uncertainty in Principle 2 or, we say, it is going to be an uncertainty in

1 Principle 3, but you cannot, in our respectful submission, weigh up the uncertainty from one
2 principle into another and then give it double the weight as a result.

3 THE CHAIRMAN: Well does that necessarily follow, Mr. Read? Can the same factor not be
4 relevant to two distinct principles?

5 MR. READ: We are not saying it could not be relevant to two distinct principles, but we say it
6 goes to the vice that we say is within the 0845 determination. If you count the uncertainties
7 too many times of course you end up with the conclusion that it is all too uncertain and
8 therefore you have to put the position back to the existing *status quo* even though that
9 existing *status quo* may have been one of market failure. We say this is the problem with a
10 lot of the determination that the uncertainties end up getting counted several times within
11 the whole of the equation and, as a result, they develop a significance that they are not
12 merited.

13 If this matter was being dealt with solely in Principle 3, our case would simply be that this
14 is a matter that the parties are perfectly capable of negotiating and resolving a means
15 compromise of sorting this particular problem out, but if one then says there is an
16 uncertainty here and there is an uncertainty there one ends up with the problem that
17 effectively there is a bias built in against BT, and when I use the word "bias" I do not mean
18 it in the pejorative normal legal sense, i.e. I mean it is a burden as such, I do not want there
19 to be any mistake between Ofcom and BT.

20 THE CHAIRMAN: No, you made that very clear in your pleadings.

21 MR. READ: Likewise, we say the same thing happens with the position on the OCP retail
22 services, which is reflected in para. 9.48. 9.49 they go on and deal with the complexity of
23 real-world pricing which we will come back to when we look at the direct effect and the
24 modelling.

25 The point we do make is that (1) we say there has been too much counting of the
26 uncertainties, and I will come back to that point when dealing with Principle 2. (2) Principle
27 3 could and should have been dealt with by dealing with it through negotiations between the
28 parties. (3) there is a clear preference expressed in para. 9.52 to defer to the non-geographic
29 numbers review. Finally, we say in para. 9.53 there is a very clear indication given that in
30 fact there is, if you like, a double counting process going on which is reflected against BT,
31 but in any event if BT wins on Principle 2 therefore it gets over Principle 3. At the end of
32 the day we say that Ofcom was wrong to have rejected this on Principle 3 as well as
33 Principle 2. The core point, we say, and the real battle lines between the parties is really
34 Principle 2 and that is what at the end of the day the decision should actually come down to.

1 Can I now then turn to Principle 2, and can I start with the two elements that I want to deal
2 with? The first is what is termed the direct effect within the final determinations, and I want
3 to explore that in some detail because obviously it relates to the modelling and what one can
4 conclude from the modelling and again we say what is important in the context of all of this
5 is to actually look at it in a dispute resolution context, and I will come to that in a moment.
6 The second element I want to turn on to is the welfare analysis and how that is all dealt
7 with. I should make the point however from the outset that some of the points obviously
8 overlap on one another, so I will in the course of dealing with the direct effect have to set
9 out at least some of the principles that one will have to come on and consider when one is
10 considering the overall welfare analysis.

11 The direct effect is obviously the effect that the NCCNs has on the prices for 08 calls –
12 0845, 0870 or 080 (“08 calls”). That is clearly set out in the glossary at p.2 of the final
13 determination, I will not take you to it. Ofcom’s point is that in considering whether or not
14 the wholesale tariff structure prices were fair and reasonable it is necessary to consider
15 whether the benefits that BT claimed for them were likely to materialise, i.e. whether or not
16 the WTS was likely to lead to reductions in the 080 prices. As I have indicated, the direct
17 effect is only one element of the welfare analysis, but it is an element where, if BT is right
18 about it, BT wins, because Ofcom themselves have accepted in terms that if the incentive
19 properties of the WTS is to drive it to the lowest tier of the WTS ladder, 8.49p in the case of
20 the 080 and 12.49p – I think for the sake of clarity although strictly speaking it should be
21 the miniscule beneath 12.5 and 8.5, I am going to refer to 8.5 and 12.5 respectively.

22 THE CHAIRMAN: Yes.

23 MR. READ: But it obviously is just beneath that. What we say is that Ofcom themselves accept
24 that if it is likely to go to that level then the benefit on their weighting of the whole matter is
25 positive and BT succeeds on Principle 2.

26 The starting point obviously is that Ofcom’s view about the direct effect was different
27 between the 080 final determination and the 0845 final determination, because whereas
28 Ofcom in the 080 final determination held that prices were going to be incentivised to
29 increase, by the time of the final determination in 0845 they held they were going to be
30 incentivised to decrease although the magnitude of that effect was uncertain. Obviously in
31 light of that BT’s grounds of appeal vary somewhat between the 080 notice of appeal and
32 the 0845 notice of appeal, but underlying both notices of appeal there are some common
33 themes, in particular first, BT contends that Ofcom put an overly exacting burden on BT
34 and this goes back to the whole question I have been talking about earlier on about what

1 exactly the burden should have been upon BT to demonstrate how uncertain or otherwise
2 the effects were going to be. For example in the 080 final determination, ground CB sets
3 out BT's complaints, about this burden, and likewise in Ground 3B(b) of the 0845 appeal
4 the same complaint is made.

5 The second point that I wanted to deal with is that we say that Ofcom in both
6 determinations ended up reaching the wrong conclusions as to the likely pricing effect. We
7 say, firstly the 080 conclusion was obviously wrong, and we say that that is demonstrated
8 by Ofcom's conclusions in the 0845 final determination.

9 Far from the WTS incentivising prices to increase the incentive is for them to decrease
10 albeit that there is a dispute over how certain or uncertain the magnitude of that decrease is
11 going to be.

12 What we say what Ofcom should have considered about the magnitude of the effect is what
13 is the most likely pricing scenario that would result? It is not satisfactory simply to say in
14 the context of dispute resolution: "We believe the prices will be incentivised to fall, but we
15 do not know precisely to where". Dispute resolution we accept can never be an exact
16 science pinpointing exactly what is going to happen in the future, but refusing to reach some
17 form of conclusion because precise future effects are uncertain fails properly to resolve the
18 dispute certainly where ultimately Ofcom is being asked to constrain a contractual right.
19 Ofcom itself accepts that it was not having to decide this on anything other than the balance
20 of probabilities, that is admitted in para. 31 of Ofcom's defence to the BT notice of appeal
21 at B1, tab 5, p.14.

22 BT says that when one actually analyses what these uncertainties are and considers what
23 BT's modelling was designed to achieve then on balance the most likely of all the possible
24 scenarios is that the MNOs, will be incentivised to fall to the lower steps of the WTS; that is
25 BT's primary position. Ofcom should have pinpointed in the context of this case which was
26 the most likely scenario, it failed to do that and BT says that when one analyses the material
27 it does fall to the lowest step, on the balance of probabilities. But even if BT is wrong about
28 that Ofcom ought to have actually also considered the most likely other scenario, it is no
29 good, we say, simply saying: "We are not sure what it is going to do". On the material that
30 they had at the time of the 0845 decision there should have been a sufficient material for
31 them to have an idea as to where exactly on the pricing ladder it will go, and this is very
32 important because obviously if the prices are initially set at 40p per minute and they fall to
33 35p per minute, then one accepts that there may be uncertainty about what the overall effect
34 could be. But if the reality of the situation is that they are likely to fall either to 12.5p per

1 minute, or 17.5p per minute – or a combination of both as we say the material in, for
2 example, Mr. Pratt’s statement tends to indicate, then on that basis there plainly is an
3 important incentive for the prices to have fallen, and that incentive in itself ought to have
4 been considered as being beneficial to consumers no matter what test one actually uses for
5 the consumers. So in other words, what we say Ofcom failed to do in this whole process is
6 really weigh up what is the most likely scenario that was going to come about and BT says
7 that should have been 12.5, but even if it was not 12.5 they should have looked at the other
8 scenarios. We say that that is particularly true when you are putting us all in the context of
9 a market failure in any event. It is not good enough simply to say: “It is all too uncertain we
10 cannot decide it”, because the obverse of the position is that you leave in place an admitted
11 and serious market failure. Therefore, it was incumbent, we say, on Ofcom to actually do a
12 proper analysis, rather than simply hedging its bets with saying: “It is all too uncertain,
13 there are too many uncertainties in this” and actually come up with what it felt was the more
14 likely scenario.

15 I want now, having made those introductory points, to structure the rest of the submissions
16 in this sub-section on Principle 2 by looking first at an initial consideration of what exactly
17 BT’s modelling was designed to achieve. Secondly, I want to go through in a little detail of
18 some explanations of the various terms that are involved in all of this. I appreciate that I
19 may be trespassing on grounds of economic confidence in doing this, but it is quite
20 important, in our respectful submission, because one of the problems in this case is we
21 believe that there may have been a misunderstanding about what BT’s modelling was
22 actually doing, and that unless one actually clearly understands what was going on, the real
23 danger is that it gets disregarded for a series of reasons.

24 Then I want to have a very brief overview of the chronological consideration of how the
25 modelling developed. I was going to spend a little bit more time on that but I think it is one
26 of the sections I am going to try and cut down on.

27 Then, finally, I want to identify where the issues that actually are still alive as to the direct
28 effect actually are in the case and where the evidence has got to. Again, it comes back to
29 the point that I have been making before, that one of the problems with the way that Ofcom
30 has approached it is that there have been references to uncertainty here, uncertainty there,
31 and one has to strip those away in order to see what it is that is actually really still there as
32 alleged uncertainties. If I can give just one example – it is perhaps unfair to pick upon him
33 because I am sure he has not done it in any way intentionally – Mr. Pratt repeats in various
34 places within his witness statement the uncertainties that he considers are still there. The

1 problem with it is that a lot of them are repetitions of the same point. I do not criticise
2 Mr. Pratt for doing that because of the way he has structured his statement. He is going
3 through it and he is basically repeating things in slightly different contexts. I do want to
4 make the point very forcefully that there is a great danger in reading a long statement from a
5 witness seeing him refer to uncertainty, uncertainty, uncertainty, and then assume that there
6 are an inordinate number of uncertainties, whereas in fact he is discussing a number of the
7 same uncertainties but several times over. As I say, I do not make any criticism of Mr. Pratt
8 for doing it that way, but it is important to realise that that is, in fact, what is involved.
9 Can I start then with BT's modelling and what it was intended for. BT introduced its
10 modelling – I say “introduced” loosely, because in fact there was modelling earlier on, but I
11 am going to start with Reid 1 and Professor Dobbs number 3. That was in response to what
12 we say was Ofcom's rather simplistic original conclusion in the 080 draft determination that
13 the WTS scheme would incentivise an increase in 080 prices, and I will come back to that in
14 a moment.

15 Its introduction was actually in response to Ofcom saying prices would go up rather than
16 specifying a precise level at which prices would go down. In that respect, it is worth
17 making the point again that BT's modelling has been emphatically proven to be correct
18 because Ofcom now fully accepts in the 0845 determination that prices will not increase,
19 they will positively decrease, although Ofcom says that it is not certain by how much.

20 Indeed, Ofcom itself accepts that the analysis that is being done by Mr. Reid and
21 Professor Dobbs has, to quote the words of the final determination in the 0845 that Ofcom's
22 view has been greatly informed by the presentation of explicit economic models. That is
23 para.8.47 of the 0845 final determination at B1, tab 1, p.130. As it was put in para.2.132 of
24 the supplementary consultation, BT's models provide a coherent economic theory result
25 suggesting that MNOs will have an incentive to reduce their 0845/0870 prices.

26 So in the context that the Reid 1 and Dobbs 3 models were introduced, they have been
27 actually totally effective and Ofcom recognises that effect. So, therefore, there is a slight
28 issue we take with the criticisms that are being heaped on Reid 1 and Dobbs 3 modelling
29 given that they actually have achieved what they originally set out to do, which is to show
30 that the incentive for prices to go up was wrong.

31 The next point I want to make is that no modelling can ever be more than an abstraction of
32 what is actually happening, and therefore it is necessarily going to involve some
33 simplifications. One has to stand back, we say, and consider what exactly the modelling is
34 designed to do. It is not designed to satisfy a 95 per cent confidence interval, for example,

1 which is a common requirement in so many academic studies. It is not required to
2 demonstrate beyond all reasonable doubt that the prices will unequivocally fall to the
3 bottom of the tier.

4 One also has to consider the consequences of this, that this is not the type of situation where
5 one looks at studies and modelling, and so on and so forth, and is concerned because the
6 consequences that might flow from that decision about the acceptance of the models has
7 very serious impacts – for example, if one was doing some modelling on radiation exposure,
8 or whatever. The serious consequences of that would obviously reflect in the fact that you
9 would expect the modelling to be so much more rigorous and so much more concerned with
10 getting the right answer. The blunt fact is that this modelling was introduced in the context
11 of a dispute resolution, and it was there to give a steer on what the likely impact on the
12 consumers was going to be.

13 It is modelling at the end of the day and it has to be appreciated that it is modelling that is
14 done in the context of the swift and basic process entailed in dispute resolutions. It cannot,
15 therefore, in our respectful submission, be expected to close off every conceivable avenue
16 of concern, otherwise the dispute resolution process would become hopelessly impossible
17 and you could never use any modelling like this to inform the decision.

18 Ofcom accepts though that this modelling has helped to inform them. We say that in the
19 context of dispute resolution one cannot at the end of the day just raise every avenue of
20 uncertainty as being a potential problem and why you cannot rely upon the particular results
21 of the model.

22 PROFESSOR STONEMAN: Mr. Read, can I ask you: do you not here want to have your cake
23 and eat it? Can you not argue on the basis of the Court of Appeal decision that that was all
24 right in the dispute resolution procedure, but you are now here at the appeal stage where lots
25 of new information can be fed in and therefore it does have to be proved to the point of
26 irrefutability because we do have more time, we are not pushed by these time margins?

27 MR. READ: Tempted as I am to say that I always like to have my cake and eat it, I do not
28 necessarily think that that is what I am trying to achieve in this case.

29 PROFESSOR STONEMAN: I know it is not what you are trying to achieve.

30 MR. READ: I put it like this: obviously what I fully accept and do not try and hide away from is
31 that in the context of deciding this particular appeal, obviously one has to have regard to all
32 the material that is actually out there in the public domain, whether it is Dobbs 4, Dobbs 5,
33 Dobbs 6, Walker 1, Walker 2, Walker 3, etc, etc. One has to have obviously regard to all of
34 that and obviously as time has gone on it has become more informed, but whilst that may

1 actually, if you like, impact upon the assessment of the evidence, on the totality of the
2 evidence that the Tribunal has to consider, it still has to be recognised that this is being done
3 in the context of the dispute resolution process.

4 One of the key problems BT contends that has happened in this is that there is uncertainty
5 after uncertainty after uncertainty being raised against BT's model, but when BT answers
6 this and does further analysis, as has been done in Dobbs 4, in Dobbs 6 and in Dobbs 7, the
7 answer keeps coming out the same, that the model appears to be relatively robust, that the
8 original model was relatively robust, and the further you push it, if you like, the more it
9 demonstrates that actually it was robust in the first place. That is the way we put it.

10 Obviously if the model fell down because somebody had come out with some point or
11 another that destroys it, then that would be a different matter. We do not say that has
12 actually happened in this case, but we do say that you cannot, if you like, expect to higher
13 the standard to be imposed upon the modelling that originally started the dispute resolution
14 – in other words, you cannot expect BT to have shut off and closed down every single
15 potential, possible, minor avenue of uncertainty, and if at the end of it all emphasis is still
16 placed on the uncertainties then we say that that is the wrong approach to dispute resolution
17 process; and it goes back to what we say is a constant theme underpinning all of this, that
18 Ofcom effectively placed too high a burden on BT in what it had to produce in order to
19 satisfy Ofcom that they should not intervene.

20 I hope that deals with the point as far I can without trying to have my cake and eat it.

21 The further point that I do want to make about this modelling is that one has to look at what
22 it was actually setting out to do. It was seeking to do something in a very specific context
23 which, as Professor Dobbs explains in his sixth report, is not the norm. He says that most
24 academic analysis of price discrimination looks at trying to determine an optimal tariff
25 schedule or tariff package. The Dobbs/Reid approach is different because the problem
26 being addressed is different. What they are trying to achieve is not to derive an optimal
27 solution for the tariff package, they are seeking to explore properties of tariff packages that
28 the MNOs have actually set. That is an important point, we say, when one comes to gauge
29 it. If one looks, for example, at O2's intervention, they say there is no single peer reviewed
30 economics paper dealing with this point. This is the point they make at para.8.2 of their
31 statement of intervention, B1, tab 9, p.6. What we say is that that completely misses the
32 point. Of course there is not going to be a peer reviewed paper. Leaving aside the fact that,
33 given the number of people who have actually looked at this economic paper already,
34 Mr. Myers, Mr. Pratt, Professor Valletti, Dr. Walker, etc, etc, one might say that it has

1 almost been peer reviewed in any event. Leaving that aside, of course you are never going
2 to have a peer review study of this type of situation because that is not what the modelling
3 was ever intended to do. That is not what is normal for this type of modelling.

4 Therefore, we say that you cannot expect to achieve 100 per cent certainty when you are
5 actually looking at the modelling that was being conducted. Dr. Maldoom makes the point,
6 quite validly, we say, in his seventh report that if you assume that the modelling has to
7 produce too much and criticise it because it has points that you say need further work on or
8 it does not show that it actually conforms, you effectively adopt a precautionary approach,
9 which is a term that environmental lawyers well know about, that effectively it is saying
10 you do not want to intervene because, or you do need to intervene because you cannot be
11 sure of what the outcome is.

12 We say that that is the wrong approach for what this modelling was designed to do. It was
13 designed to give a steer on what was going to happen on price disputes. It could not and
14 should not be taken as having to be the nth definitive item in deciding exactly what is going
15 to happen in this particular stage.

16 There are two further points that I would like to make and then perhaps, if the Tribunal
17 wants a short break at that point, it would be convenient. I will just finish those two point.
18 The first is that BT has managed to achieve all the modelling in the context of not, itself,
19 having access to all the relevant data. Ofcom accepts that a little begrudgingly, but up to a
20 point, that BT does not have such material. It is the point made in para.60 of Ofcom's
21 skeleton argument. Although Ofcom says that there is one area that BT could have
22 investigated, which I will come back to in a little while, the reality ...

23 3.30

24 ... and all Ofcom say is there is one area that BT could have investigated, which I will
25 come back to in a little while. The reality is that BT did not have the material to actually
26 provide the sort of intensity of modelling that everyone suggests they should do in this case.
27 For example, Dr. Walker in his report says in terms that BT has not provided any empirical
28 evidence on the shape of the demand curves used in the analysis of the incentive effects of
29 the proposed WTS even though it is potentially crucial to their results. Part of the problem
30 with that is that BT does not have the type of empirical evidence that would allow it to
31 actually support the material that is being put forward. BT is almost having to do this with
32 one hand tied behind its back, it certainly does not have access to volumes and profitability
33 considerations that underpin the MNOs pricing decisions and the driving parameters, and it
34 really is, in our respectful submission, unfair for both Ofcom and the MNOs to criticise BT

1 f or failing to close off every avenue of potential uncertainty when essentially it has had to
2 do the modelling with one hand tied behind its back.

3 The second point I want to make is that BT's modelling has been picked all over by
4 numerous individuals, including an original report by Frontier Economics on behalf of O2,
5 Vodafone and Three, which are not being called as a witness, and when one looks at all the
6 picking over that has gone on with Dr. Walker, Mr. Pratt, Mr. Myers to a more limited
7 degree, and Professor Valletti, what is of particular note, we say, is that nobody has actually
8 sought to construct a counter economic model to contradict what is being put forward.
9 They pointed to alleged failings within the modelling but they have not constructed
10 anything themselves to suggest that actually this is all simply flawed because in fact the
11 effect is going to be this because our modelling has demonstrated that. Again, it is a factor,
12 we say, that needs to be taken into account when one considers and places weight upon the
13 modelling that has been introduced. Would that be a convenient moment, sir?

14 THE CHAIRMAN: Mr. Read, that would be, yes. 25 to 4.

15 (Short break)

16 MR. READ: Sir, I am sorry to take a little longer, but in fact I think the experts, as you probably
17 know, have had a without prejudice meeting and there seems to have been some useful
18 outcome as a result of it, which may help shorten some of the points that I was going to
19 make, certainly on the more fiendish QJ 08(X*). But if I can just go back to the final point
20 that I wanted to make about the nature of the economic modelling and go back to the point
21 that was raised – a question asked of me earlier on. I had made the point about modelling
22 in the context of saying: “You cannot put too high a burden upon BT to close off every
23 avenue” for all the reasons I set out earlier, but I would not want the impression being left
24 that we do not actually say that what Professor Dobbs has now achieved by the time of his
25 seventh report in fact goes a considerable way to demonstrating that a lot of these
26 uncertainties simply are not there, and that we say for all the reasons I said earlier, that you
27 do have to assess it obviously on the material that you have before you at the time of the
28 hearing and that obviously has to be firmly kept in mind and weighed at the time the
29 Tribunal reaches its decision, so I would not want to be misunderstood when I was trying to
30 suggest that maybe I am having my cake and eating it or not as the case may be.

31 Can I briefly try and go through some of the terms that are actually being used in the
32 modelling because one of the issues that has been floating around the back of this case is
33 what exactly, when Professor Dobbs looked at spill over effects in his fourth report, he was
34 actually doing. Paragraph 8.86 of the 0845 final determination – I do not think we need to

1 look it up, but effectively Ofcom were then going on to say what Professor Dobbs had been
2 doing in his “Dobbs 4” did not take account of the waterbed effect. I think it is quite
3 important that we are clear about what the various effects actually are if we have to get
4 down to a detailed level of cross-examination. Perhaps I can do this by taking a neutral
5 example of a car maker who makes various car products, let us say A, B, C and D. If the
6 price of model A is reduced then it is obviously going to have a direct impact on sales of car
7 A. If the price goes down and there is a proper elasticity then obviously the quantity of car
8 model A is likely to go up.

9 The effect of that is, however, on complements to car model A in that demand for them will
10 also go up as well, and perhaps if I can use my car example, if more model A cars are being
11 sold then obviously that is going to have an effect on the demand for the services and parts
12 for model A. On the other hand, products that are genuinely substitutes rather than
13 compliments, the demand is likely to go down, so that if, for example, car model A the
14 price goes down and more are sold, it is likely that people will not buy the car
15 manufacturer’s model B, and so demand for that will go down. In other words,
16 complements will tend to go up with the demand for the particular model, in this case model
17 A; substitutes, on the other hand, will tend to go down.

18 Obviously there are then secondary impacts which are going to take place, because if, for
19 example, with model car B, the substitute, demand for that goes down, then it is likely to
20 have an impact on the price for model car B as well in that it will adjust to the fact that
21 fewer cars are actually being sold of model car B. It is that re-optimisation of the prices as
22 it goes along that has been billed in reality by Ofcom as being the spill-over effects, or at
23 least that is what we think Ofcom actually means, although it is not entirely clear, but there
24 is also obviously going to be external interplays so that if the car manufacturer of models A,
25 B and C is dropping his price on car A other competitors are likely to adjust their prices in
26 response to it, and effectively what is going on is one is having a see-saw effect as prices
27 are changed in one particular parameter so they are going to re-optimize elsewhere, and it is
28 a process that is going on over a considerable period of time. We say that it is effectively a
29 see-saw process. It may actually be easier to describe this as a see-saw process as the prices
30 re-optimize.

31 The problem that we have with the way that Ofcom has introduced this, and certainly the
32 way it has dealt with Professor Dobbs’ material, in particular “Dobbs 4”, is that Professor
33 Dobbs was trying to capture a number of these optimisation changes between the different
34 prices within his spill-over model that he came up with in Dobbs 4. As a result we say that

1 a number of criticisms that are made of Professor Dobbs' report on this are wrong because
2 the effects of what he is actually talking about have not been fully understood. Can I
3 illustrate this by taking you to Professor Dobbs' sixth report, which is at C1 in the core
4 bundles at tab 6, and if I can ask you to go to pp. 16 and 17 and paras. 36 to 39. He spells
5 out the various impacts that get taken into account in the weighing process and at (ii) he
6 talks about the "MTPE Mobile tariff package effect and Waterbed effects". Then at para. 37
7 he splits out four effects relating to waterbed effects which deal with effectively the internal
8 impact on demand for the MNOs other services, and that is his (ii)(a) the impact from the
9 incentive to re-optimize the prices of services assuming no other reactions by MNOs, then
10 short run industry equilibrium, and then finally long run impacts. He makes clear in para.
11 39 that he analysed in his Dobbs 4 analysis that he was taking account of A, B and, to a
12 degree, C. As regards D I do not think anyone is actually suggesting that is material
13 because I think Professor Valletti himself accepts that he does not believe a long run
14 analysis is of material importance in the case.

15 The reason why I draw specific attention to this and the way that it has been done is because
16 we say that the criticisms being made of Dobbs 4 are really unfair, and there was a
17 misunderstanding by Ofcom, at the time that it conducted its 0845 final determination, in
18 saying that Professor Dobbs had not made certain assumptions about the spill-over effects
19 and we may have to investigate those. I am going, if you like, to park that issue for now
20 because I want to have a little more thought about the memorandum that is actually being
21 produced between the parties, but I do put that down as a marker as to where one of the
22 disputes may actually lie between the respective parties.

23 Can I at this stage mention one other thing that is quite important to distinguish, namely the
24 spill-overs and waterbed effects, and that is what I have been referring to throughout as the
25 "brand enhancement" effect, because over and above those interactive effects one aspect of
26 the reduction in 08X numbers is that it is going to help to restore consumer confidence in
27 the NTS brand, and consumers will therefore make more use of the freephone and non-
28 geographic numbers and that is a point that Dr. Maldoom identified very early on in this
29 case, for example in para. 10 of his third report.

30 This is important in our respectful submission because that is a completely different effect
31 to the spill-over effects and the waterbed effects that have been discussed rightly or wrongly
32 during the course of the final determination and during the course of the experts' reports.
33 This brand enhancement cuts not only in favour of the MNOs in that it may increase their
34 retail volumes of calls, but it affects other calls being made to services, service providers'

1 numbers from other areas, for example, if everyone feels more confident in NTS numbering
2 system, then the result may well be that there are more calls made on BT's networks to
3 those numbers, on Cable & Wireless' networks and, as a result, there are benefits that are
4 put back into the system both to people like BT and, of course, also the service provider,
5 and it is a point I am going to come back to and explain in more depth. The point I want to
6 make absolutely clear now so there is no mistake in this case at any stage is that that brand
7 enhancement, that demand-led effect that I am talking about here is not included in spill-
8 overs or waterbed, it is a separate feature and is one that we say was not clearly taken into
9 account by Ofcom in the course of their analysis, and I will come back to that point when I
10 am dealing with the welfare analysis but I do want to flag it up now as being a different
11 effect to the talk of spill-overs and waterbed.

12 Can I just return briefly to the waterbed effect and the suggestion that it is going to have an
13 equal weight as the direct effect. There is obviously some dispute about what the empirical
14 evidence is as to the waterbed effect and how strong it is. Obviously, if it is a pound for
15 pound effect, then there are going to be numerous inter-reactions going on in the pricing
16 between the various parties. However, we do not believe that Ofcom are actually
17 suggesting that there is going to be a 100 per cent waterbed effect. As we understand it
18 Ofcom set the 100 per cent waterbed effect as a reference point, but then fully accepted that
19 the waterbed effect was likely to be less than 100 per cent.

20 That means that if you decrease the prices in the 0800 number range it does not mean that
21 there is going to be a countervailing increase in prices in other services because it is not all
22 going to fall upon the consumers of those other services. Some of the cost is going to be
23 internalised by the MNOs themselves and there is not going to be a pound for pound effect.
24 We certainly understood that to be the case up until the service of Walker 3, but Walker 3
25 does seem to be suggesting – you understand what I mean by “Walker 3”, it is the report
26 that was served last week by Dr. Walker.

27 THE CHAIRMAN: Yes.

28 MR. READ: He is saying in terms, and seems to be implying in terms that the waterbed could be
29 100 per cent. We will have to investigate that during the course of the hearing and, in
30 particular, we will have to look at the empirical studies which we briefly touched upon
31 when I took you to simplifying non-geographic numbers earlier today – you will remember
32 there was a passage where it actually was dealing with the waterbed effect and there was
33 reference to the various reports. We say “yes, there are a few” to use Ofcom's own words
34 in simplifying non-geographic numbers, a few empirical studies on the waterbed effect in

1 mobile call termination, in other words what the studies that actually have taken place have
2 looked at, is what happens if you decrease mobile network operators' termination prices, the
3 effect that it has on retail call packages. Of course we are not actually looking at the effect
4 of depressing mobile termination rates. We are looking at the effects of depressing mobile
5 origination rates, and it may be that there are — at least in theory — some very good
6 reasons why the two might be comparable. But, they are just that. Nobody, as far as we are
7 aware, has done any specific study on mobile origination waterbed effects.

8 And the other point we make about this is that even though there are some studies that may
9 suggest that there is an effect, and there are also other studies that suggest there may not be
10 an effect, what is clear is that those studies have not concentrated simply on the UK market.
11 Professor Valetti himself says that it would be great to have a empirical structural model
12 that concentrates only on the specificities of the UK, but such empirical analysis is
13 unfortunately not yet available. That is what he says in terms in para.50 of his report.

14 Now, the whole point about this is that we say, of course there has got to be further testing
15 about empirical studies on the waterbed effect before anyone can form a concluded view,
16 but we say that even Ofcom themselves appear to accept that the waterbed is not going to be
17 100 per cent. And if it is not going to be 100 per cent, you do not have a direct correlation
18 between the mobile tariff package effect and the benefit to consumers by prices being
19 reduced. Of course, Ofcom, in the course of their final determination, do say that they put
20 greater weight on the reduction in the prices, the direct effect, than they do on the mobile
21 tariff package effect. The problem with that is that that assumption is trying to cram into it
22 a whole series of factors, one of which is that the mobile tariff package effect is very
23 unlikely to be the same simply because it is not 100 per cent. Another factor is that it is also
24 supposed to take into account externalities, ie that there is an existing market failure going
25 on. And this comes back to the weighting process that I am going to look at in the welfare
26 analysis, that the fundamental is that we say that, even though Ofcom says it tried to take all
27 these matters into account through giving this preference the direct effect over the mobile
28 tariff effect, the reality is that it has given the mobile tariff effect far too much weight in the
29 whole equation.

30 So, can I very very briefly then turn to the chronology of the evidence on the direct effect,
31 and as you have heard, it is quite important, in our respectful submission, to see what the
32 state of the evidence was at the various stages, because the problem with it is that it is diff to
33 make sense of the present arguments without seeing how the material has come about. So,
34 for example, as I have already indicated, the Reid 1 and the Dobbs 3 model was introduced

1 to deal with the suggestion that prices were going to increase, and it was not having,
2 therefore, having necessarily to deal with where exactly on the stepladder it would actually
3 go down to. Likewise, we say that the spill-overs that were introduced originally in the
4 course of the 0845 determination in Dobbs 4, that that in fact was introduced to deal with a
5 particular concern over spill-overs and whether it was a major factor that needs to be taken
6 into account.

7 It seems to me accepted now, within this case, that actually the spill-over effect is not going
8 to be large. There may be an issue as to what the respective parties mean by that because,
9 obviously, the Dobbs 4 modelling, we say, was taking more into account than Ofcom
10 appear to have understood when they were actually looking at the Dobbs 4 modelling.
11 However, one has to bear in mind that Dobbs 4 was being produced in response to the
12 suggestion that one did not know whether or not the spill-over effects were going to be large
13 or not, and at the end of the day it is now accepted between the parties, or it seems likely to
14 be accepted between the parties, that the effect is not going to be large, although there are
15 consequences that flow out of that from subsequent modelling that is being done.

16 We also say it is quite important to concentrate on the chronology of the effects, because it
17 illustrates a them that seems to have run through Ofcom's analysis from the outset, that it
18 has effectively adopted an overly-cautious approach to the modelling, so it dismisses Reid 1
19 and Dobbs 3 out of hand. It does not even actually look at Dobbs 1 and Dobbs 2, which
20 effectively says that is irrelevant. And we say it was hopelessly simplistic what Ofcom
21 were actually doing in the 080 determination. Then it raises concerns over the spill-overs in
22 Dobbs 4 which is dealt with in Dobbs 4, and that gives an answer to it. And so there have
23 been more and more, the reason why there has to have been more and more investigation
24 into the modelling we say is a direct result of the way that the uncertainties have
25 chronologically developed and gone forward, and that therefore you have to look at it in that
26 context.

27 Now, I do just want to draw the point that obviously when Ofcom originally looked at this
28 matter in the 080 determination they took, in our respectful submission, an incredibly
29 simplistic approach to this. They looked simply at the difference between prices and
30 revenue and concluded that that was going to be an assumption to drive prices up. Can
31 I just ask you to look briefly at that in vol.A, tab.1 p.109. This is the annexe to the final
32 determination that sets out the draft determination, but Ofcom in the final determination
33 conclude that there is effectively no evidence to the contrary. And it sets out in terms:

1 “A.369 As regards the first consideration, we note that the termination
2 charges in the NCCN 956 increase with higher retail call prices by the MNOs, but
3 they increase less quickly than the MNO’s retail call prices. Therefore, the
4 MNO’s retention increases as its retail call price rises. This is likely to provide the
5 MNO with an incentive to increase its 080 retail call price”.

6 And then, at A3.72 it looks at the potential demand effect by saying that obviously:
7 “a higher call price might deter some calls from being made”.

8 What, however, we say omitted, is to look at the other corresponding side of the equation.
9 And one can see this from the final determination in the 0845 dispute. So, perhaps if I can
10 ask you to very briefly get that out at the same time, it is in vol.B1. If I can ask you, sir, to
11 go to p.201 in divider 1, at para.5.41 it deals with the direct effect, and then over the page at
12 5.42 it says this:

13 “The Direct effect depends on whether it is more profitable for an MNO to
14 increase, decrease, or maintain the retail price of 0845 and 0870 calls following
15 the introduction of NCCNs 985 and 986. In essence, this will depend on the
16 balance between the following two opposing effects:

17 a The increase in the level of the termination charges in NCCNs 985
18 and 986 compared to the previous charges. On its own, this provides an
19 incentive on the MNOs to raise their 0845/0870 call prices.

20 b The structure of the termination charges in NCCNs 985 and 986, ie
21 the rate at which the termination charge increases with the MNO’s retail
22 price. On its own, this may provide an incentive on the MNOs to reduce
23 their 0845/0870 call prices in order to reduce the termination charge, and a
24 disincentive to raise call prices if this would result in an increased
25 termination charge”.

26 Now, we say that, effectively, they took account of para.5.42a in the 0800 determination,
27 but omitted the item at para.4.52b. So, that is one reason why we say that the original 080
28 determinations were in fact hopelessly flawed. So, I think we can put vol.A away.

29 Sir, I do not think I want to spend a lot of time taking you through the chronology. I think
30 I have made the point that you have to look at the context.

31 THE CHAIRMAN: Quite. It might be helpful, given the sheer volume of expert reports we have,
32 if — BT in particular — but perhaps all the parties could produce simply a list of their
33 experts’ reports with short bullet points setting out the propositions that they rely upon those

1 reports to establish, or indeed what they do not rely on the reports, so that one has on paper
2 a sense of the history. Because I quite understand that there is a conversation going on here.

3 MR. READ: Yes.

4 THE CHAIRMAN: Whereas the natural inclination is to read the experts' reports one after the
5 other. So, that one misses out part of the dialogue.

6 MR. READ: I am sure we will try and achieve that, but in fact I was going to try and capture
7 some of that in the next sub-section that I am about to move on to. Because the core point,
8 we say, and this is my final effective point on the direct effect, is that one needs to see what
9 is actually now in issue between the parties, because we absolutely agree with you, sir, that
10 there has been a conversation going on, and one of the problems with the conversation that
11 has been going on is that it is really important, in our respectful submission, to see what is
12 actually left at the end of that conversation as being live points in the dispute. And, if I can
13 say from the outset that there are certain phrases, grandiloquent phrases such as "BT's
14 modelling does not comprehensively capture the real world factors", and those sorts of
15 phrases one has to scrape away and look at in order to try and find out what they actually
16 mean, and I will come back to that in a moment. But in essence, we say that this case has
17 really come down to four, or possibly three depending on how you define them, core issues;
18 that when you strip everything out there are really only three or four, depending on how you
19 define them, battle lines between the actual parties. And, can I just summarise them to
20 begin with.

21 The first is the absence, the alleged absence, of empirical evidence concerning the nature of
22 the demand both as to whether the demand is elastic and the shape of the demand curve. In
23 particular, Mr. Pratt, for Ofcom, and Dr. Walker for the MNOs, suggest that with some
24 form of the demand curves, the incentive to reduce prices to the lowest tier is ambiguous,
25 and indeed in certain instances you may actually get an incentive to increase them. We say
26 that is wrong, but that is one of the battle lines that is actually between the parties — the
27 elasticity of demand and the shape of the demand curve which ultimately comes from the
28 suggestion "Well, there is a complete absence of empirical evidence as to elasticity or the
29 demand curve".

30 The second relates to the modelling done on the spill-over effect, and although it is not clear
31 how much this was actually relied upon by Ofcom in the final determination, and although
32 also this seems to be, in our respectful submission, more a theoretical than actual criticism,
33 it is quite clear that what is being said against Professor Dobbs, as he openly acknowledged
34 from Dobbs 4, it says it in terms, that he has when modelling the spill-over effects, made an

1 assumption of global linearity and I think it may just be useful to see what he actually said
2 about that in Dobbs 4. If I can ask you to take bundle C1, tab.4 and at p.33 he, himself, lists
3 out possible concerns with modelling the spill-over effect. Paragraph 44:

4 “The spill-over effect is derived via a first order Taylor expansion around the
5 MNO’s current average retail price. That is, the spill-over function used is
6 linear as retail price is varied around this point. This means that the spill-over
7 effect is ‘accurately modelled’ in a neighbourhood of the current price.

8 Whether the linear approximation spill-over function used is a reasonable proxy
9 as retail price diverges significantly from the current position is less obvious.

10 The issue is whether the true spill-over function might be convex or concave at
11 the MNO’s current prices. In Dobbs 3, spill-over effects were regarded as only
12 likely to be important at higher prices. This suggests the effect may be convex.

13 On the other hand, one might argue that, as MNO retail price becomes so large
14 that no one actually uses the services, the spill-over effect might eventually fall
15 and this might suggest concavity. Overall, it is difficult to conclude one way or
16 another on whether the spill-over effect might increase faster or slower than in
17 the linear specification.”

18 Paragraph 46:

19 “Perhaps the point to make here is that it would take quite strong concavity in
20 the spill-over function at higher prices to significantly affect the conclusions
21 drawn above.”

22 So it is a point that Professor Dobbs himself was flagging up in the Dobbs 4 report about the
23 assumption concerned with global linearity. That is a point that is still very much in issue
24 as is dealt with in Professor Valletti’s first section of his report. That is one of the second of
25 the battle lines that is drawn between the parties.

26 Linked to both of these points, and you can call it a 2A or a 3 in its own right, is Ofcom’s
27 suggestion that the absence of supporting empirical evidence might be important, because
28 the evidence of inelastic demand coupled with a profit maximisation assumption relies on
29 the existence of a significant spill-over effect. As I have already indicated to you when
30 discussing the question of definition of spill-over effects, Ofcom appear to accept that a
31 strong spill-over effect is unlikely. That is at para.8.45 of the 0845 final determination.
32 So what is said is if there is not a strong spill-over effect and there is inelastic demand and
33 you assume profit maximisation, these factors do not necessarily, if you like, stack up in
34 terms of the correctness of the modelling. If you have got inelastic demand with profit

1 maximisation you would expect the existence of a significant spill-over effect. The absence
2 of a significant spill-over effect suggests that there might be a problem with the assumption,
3 or one of the assumptions involved with the modelling. Again, BT does not accept that is a
4 correct criticism because it comes back to the fact that it is all made on the assumption of
5 inelastic demand. BT, of course, itself does not have the relevant material to actually deal
6 with that, because that is one of the empirical evidence matters that we say we are fighting
7 with one hand tied behind our back. Such as there is rather suggests that it might actually
8 be not an inelastic demand but an elastic demand.

9 PROFESSOR STONEMAN: Mr. Read, I know you are not working in your area of expertise, but
10 I am having some problems with what you are saying. It seems to me that the argument is
11 that the elasticity of demand is less than 1, between 0 and minus 1, because there are spill-
12 over effects. If there were no spill-over effects we would not expect an inelasticity of
13 demand between 0 and minus 1. In my view, you are turning it upside down. I think it
14 might be better if you left some of these things to your experts to say in the witness box.
15 May I also say, while I am at it, we had a piece of paper given to us in the break this
16 afternoon, and I think that is wrong. I have a feeling that note A about the definition of
17 spill-over effect is an incorrect definition. I would appreciate it if the two Professors could
18 get together and have a look again at what spill-over effect means. They say here it means
19 the impact of other prices on the setting of the optimal 0800 price, and I am not sure that is
20 correct. I think what it should mean is the impact of the 0800 price on the number of
21 owners or the number of subscribers to the network.

22 I have a feeling there is something wrong with that, which is associated with the definition
23 of the spill-over effect, and it is the spill-over effect that you are talking now. It might be
24 better if some of these things were clarified and actually given to us in evidence.

25 MR. READ: I wholeheartedly apologise if I have got my elasticity and inelasticity of demand the
26 wrong round, and I will certainly ----

27 PROFESSOR STONEMAN: You have got them the right way round, it is just the combination
28 of the inelasticity with the spill-over effect is a crucial issue and you cannot separate one
29 from the other.

30 MR. READ: Yes. In any event, I think I can safely say that it is an issue that is still live and
31 constant in this case. The point I was trying to make was whether one defines that as an
32 interplay between the first point about the empirical evidence on demand and the second
33 point about the modelling of the spill-over and says that it is something that lies in between

1 the two, or whether you say it is something it is own right, it is linked to the first and second
2 points that I have been listing.

3 Sir, the final point, and whether you call it the third or the fourth is obviously an open
4 question, remains the question about multi-price points, price discrimination. Again,
5 Professor Valletti deals with that in his expert report at sections 2 and 3, and it was in that
6 context that the issue of whether QJ 08(X*) was positive or negative was going to arise.
7 Whether that will arise now or not, I am not absolutely sure myself from the note that has
8 been produced. There is the battle line that is actually drawn over it.

9 It seems to us that those are the key issues that have really been drawn between the parties
10 and the interplay between the experts' reports over the time. That is where the battle lies.
11 Can I now go back to the 0845 determination process and highlight a couple of issues that
12 were seen to be important at one stage within that process but now appear to have fallen
13 away. Can I take you back to volume B1, tab 1, which is the 0845 final determination and
14 ask you to look at annex 3, which starts at p.192. The bit I want to look at is para.5.131 at
15 p.220. At para.5.130 Ofcom sets out its two principal concerns with respect to BT's
16 analysis as a direct effect. It relies on the theoretical model of pricing:

17 "… based on a number of specific assumptions relating to issues such as the
18 pricing policies of the MNOs, the nature of demand for services supplied by
19 MNOs, and the nature of competition between MNOs …"

20 It is making the empirical evidence point.

21 In 5.131 it goes on:

22 "Second, and relatedly, we consider that there are a number of potentially
23 important considerations that are not adequately reflected in BT's analysis. In
24 particular, we note …"

25 Then it lists out various factors. I would just ask you to look at 5.131(e):

26 "BT's analysis assumes that MNOs do not adjust the prices of their other
27 services (i.e. assumes that there is no Mobile tariff package effect)."

28 Certainly at this stage it appeared as though the mobile tariff package effect was being
29 brought into the equation as part of the direct effect. Of course, as we know subsequently
30 from the way that the final determination was eventually produced, it is not brought into
31 effect in the direct effect, it is a countervailing factor that is taken against the potential
32 direct effect. I see some nods, I will not actually take you to the ----

33 THE CHAIRMAN: I recall that in Mr. Myers' statement.

34 MR. READ: Can I also ask you to look at 5.131(c) where it says:

1 “BT’s analysis does not allow for the possibility of substitution between
2 0845/0870 calls and other services supplied by MNOs.”

3 The question of substitution now appears also to have disappeared as a relevant concern for
4 the direct effect. If one goes back in the bundle to p.139, one sees in terms at para.8.98 that:

5 “The available evidence does not suggest that this is likely to be large, a view
6 set out in para.289 of the supplementary consultation. We remain of this view.”

7 In other words, although it was a concern that was raised and although Ofcom still has some
8 concerns about it, what the available evidence does not, in fact, suggest is that it is likely to
9 be large. So, as a problem, it seems to have disappeared.

10 The reason why I am trying to take you through this and show you this is really to show
11 how certain of the issues disappear, and how certain of the issues, when you boil them down
12 to what they really are, come back to the concerns, the battle lines, that I have already
13 indicated as drawn between the parties. It goes back to the point that I was making right at
14 the start of this, that there is a real risk of double counting a number of the features, a
15 number of the uncertainties, and not properly seeing where the true battle lines are actually
16 drawn, and considering them in that context but only in that context.

17 Can I take you at this stage then to the suggestion that the BT’s models do not
18 comprehensively real world factors. Can I ask you to look at how this has come about, and
19 perhaps the easiest place is to go slightly back in the bundle to p.126 in the final
20 determination. One sees here that Ofcom is dealing with Principle 2, that is at the top of
21 para.8.31 and it is dealing with empirical evidence in relation to BT’s model, and so this is
22 how it has actually come up. Then at para. 8.36:

23 “Vodafone argues that BT’s economic framework should be treated with caution
24 principally because it does not capture the ‘real world’ factors that influence the
25 way commercial entities operate in the market. It argues that it is necessary for
26 Ofcom to: (i) investigate the extent to which BT’s economic theory and the
27 outcomes that it generates are robust to real world settings; and (ii) consider
28 whether there is any factual evidence that is consistent with the economic theory
29 BT has advanced.”

30 In reality, we say that when you pull those points down what it is actually dealing with is
31 the lack of empirical evidence, that is what the question, we say, is really being put here and
32 it is under the heading, obviously empirical evidence in relation to BT’s models. It goes on
33 in para. 8.38:

1 “In Vodafone’s view, those ‘real world factors’ explain why price elasticity and
2 spillover effects can simultaneously be low. Vodafone attaches a graph showing
3 how, if spillovers are zero and the profit maximisation assumption is relaxed
4 MNOs will have a strong incentive to raise the 08 price.”

5 We say they are coming back to the points that I have already outlined, they are coming
6 back to the effect of the interplay of the spillover and the elasticity of demand, they are
7 coming back to the issues about whether there is empirical evidence as to the nature of the
8 demand and the demand curve that is actually involved. So when one strips out this phrase
9 “real world factors” one is actually back to the real core battle lines. One perhaps sees this
10 in particular when Ofcom deal with the matter at para. 8.44 and 8.45 over the page at p.129.

11 “8.44 We acknowledge the empirical evidence available from all the parties and
12 interested parties on the Direct effect is limited. We disagree with BT’s arguments
13 that its models are empirically based.

14 8.45 Neither BT nor Professor Dobbs have provided supporting empirical
15 evidence in relation to demand elasticity or the structure of MNOs’ demands, other
16 than some ‘stylised facts’.”

17 And then it goes on to complain that BT’s framework is not completely consistent with the
18 stylised facts.

19 Again, what we say is that this contention that it has not taken account of real world factors
20 in fact boils down to this lack of empirical evidence point which again I have drawn the
21 battle lines on.

22 Picking up again at para. 8.49:

23 “We note the arguments of Vodafone, T-Mobile/Orange, O2 and H3G on Bt’s
24 analysis and agree that there are limits to BT’s analysis because it does not
25 comprehensively capture the ‘real world’ factors that influence the Albion Yard
26 commercial entities operate in the market. This is reflected at paragraphs 2.137 –
27 2.141 of the Supplementary Consultation.”

28 If I can just take you on to that, it is in the same document and it is at p.272. One sees again
29 just how many of these supposed real world factors are actually linked in to these points
30 about empirical evidence and the price discrimination, the multi-price points item. If one
31 looks at 2.37 at the first bullet point:

32 “BT has provided no empirical evidence to support its assumption except to argue
33 that inelastic demand would not be consistent with profit maximisation.

34 Additionally, operators are setting their prices in a competitive market and there is

1 no reason to expect firms maximising prices in a competitive market to be on the
2 elastic part of the market demand curve.”

3 So again it is back to elasticity and the demand curve. The next bullet point: “MNOs
4 currently offer a range of tariff plans ...” well that is right, but that is something that is
5 obviously being considered in the context of multi-price points. The reason why I am
6 taking the Tribunal at a little bit of length through this we do say that ultimately a lot of the
7 uncertainties all come back to the same basic points, and those are the basic points that the
8 Tribunal will have to consider when it is reaching its views about Ofcom’s approach to the
9 direct effect.

10 Can I very briefly just make a few points about the outstanding four items that I have
11 actually dealt with. I do not want to spend too long on this because I apprehend that it is
12 probably better for the matter to be dealt with in the witness box between the various
13 experts when, no doubt, they can explain in greater detail where I am going wrong with my
14 elasticity and high spill-over.

15 As regards the empirical evidence I want to make five points. The first, which we say is
16 really important in this case, is that we are concerned only with a limited range on the
17 demand curve. We are only looking at prices from 12.5p upwards to 40p, because there
18 would be no incentive for the prices to fall below the 12.5 or the 12.49p per minute
19 element, and we know that the absolute highest that has been put forward for retail prices as
20 the highest headline rate is 40p per minute, so one is only look at that part in the demand
21 curve, and of course what we say is that in reality even that 40p per minute is too high
22 because at the end of the day it is a headline rate, it is not the average rate which is what the
23 modelling is actually dealing with, it is not dealing with the highest price, it is dealing with
24 the average retail price, the ARP, so therefore the range is actually going to be even less
25 than simply saying between 12.5 and 40 pence per minute. Indeed, we say that in reality – I
26 think I made the point earlier on when we were going through it when I took you to table
27 A5.1 of Simplifying non-geographic numbers, you will remember it was the table that set
28 out the average revenue retention by the MNOs and by the fixed line operators in respect of
29 the respective 08 and 0845 and 0870 numbers, and it showed that the MNOs had substantial
30 revenue retention on those numbers, whereas the fixed network operators had less, but it
31 was showing prices that were significantly lower than the 40p per minute headline rate. I
32 understand that obviously from that table you have to make some allowance for the fact that
33 there are originating costs also being taken into account, but even so in our respectful
34 submission it does not push it anywhere near the 40p per minute headline rate that is the

1 highest headline rate one has actually seen. So that is the first point, the range that one is
2 looking at is not the theoretical ends of the curve, it is actually within that pricing structure,
3 and that is what one needs to concentrate on.

4 The second point, which I think I have already made previously, but I want to list it again
5 here, is that obviously BT does not have access to the empirical evidence that will allow BT
6 to do the analysis in the absolutely ideal world that its modelling would do, as I have
7 already indicated at least at para. 60 of Ofcom's skeleton argument there is some acceptance
8 of that point.

9 It is said in Ofcom's skeleton argument at that stage that BT could have obtained some
10 information from its own business, and there is a reference to footnote 689 in the final
11 determination. If you still have that bundle open I will just briefly refer you to it, it is at p.
12 295, footnote 684 you see there:

13 "It is not clear that BT has exhausted all of the possible analysis. For example,
14 empirical analysis of the calls that BT originates could provide evidence to
15 support the relevance to real-world pricing decisions of BT's theoretical economic
16 models ..."

17 With respect that is completely off the scale of the prices that one is actually looking at for
18 the purposes of considering BT's WTS. BT's fixed line origination of calls prices are
19 much, much lower as we have seen from that table, for example, A5.1, and so therefore one
20 simply is not comparing like with like, and the suggestion that BT is being criticised
21 because it did not do some analysis that no doubt if it had done that analysis people would
22 say if it is not part of the relevant range and so therefore it does not give any benefit, really
23 demonstrates again this burden that is being put upon BT.

24 In fact, evidence was obtained about price elasticity from what we say would be a far better
25 source, namely IVR, and that is the evidence of Mr. Andrew Martin, who has given
26 evidence, his statement is at C1, tab 24. I have not actually caught up with whether he is
27 one of the witnesses who is being called or not – I suspect he is not.

28 If one looks at the final determination at p.132 at para. 8.63 one sees there the reference to
29 "IVR having provided some data on call volumes to 0845 and 0870 numbers dating from
30 specific dates such as when 02 increased prices to 08 numbers in October 2007 by taking
31 these calls out of bundles. "IVR has broken down call volumes to reflect calls originated
32 from BT, other landline operators, all mobile operators ..." and so on.

33 Over at 8.65:

1 “Based on this data IVR considers that this demonstrates pricing being elastic.
2 IVR considers that MNOs can price below the 12.5ppm threshold to avoid BT’s
3 charges and this reduction will be sufficiently large to offer benefit to consumers
4 resulting in increased call volumes. On the other hand if they increase prices, call
5 volumes will reduce and they will be in a worse position.

6 8.66 For these reasons IVR concludes the elasticity theory proposed by BT is
7 significantly more conclusive than the inelasticity theory proposed by the MNOs.”

8 So there was evidence and there was evidence that was being put forward of price elasticity.
9 Can I now turn to the modelling and the spill-overs, and we say that part of the problem
10 with all of this – and I suspect that Professor Stoneman may actually have picked that up
11 from the note he has just commented - part of the problem with this is what exactly is spill-
12 overs and what exactly is being modelled for? It comes back to the definition point that I
13 was talking about earlier.

14 What we do say is that you have to look at this again in the context that Ofcom were plainly
15 being advised by Professor Valletti at the time that this was all going on and we see
16 references to him within the final determination, e.g. annex 5 sets out his comments on
17 various of the Dobbs’ models and the problems with it, and it is in that context that one has
18 to recognise that in our respectful submission Ofcom itself acknowledges that the modelling
19 done by Professor Dobbs does demonstrate the direction of the price incentive is down, so
20 the modelling of the spill-overs did result in a direct change in the way that Ofcom were
21 actually looking at it. So again it is an issue of, in effect, the emphasis that you put on this
22 rather than the underlying issue of whether it is right or wrong, because we now know from
23 the final determination that Ofcom itself accepts that spill-overs are unlikely to be great and
24 that the spill-over modelling done in Dobbs 4 was sufficient to convince them that, in fact,
25 the prices were likely to be incentivised to fall.

26 This point again, we say, has to be put in the context that we are only concerned with a
27 relatively narrow range of prices, and whether global linearity is, in fact, important at some
28 abstract point far outside the investigation made by Professor Dobbs is probably not really
29 relevant in any event. In any event, Professor Dobbs has actually now done the modelling
30 which is annex 3 to his seventh report. I should indicate that there is actually a typo entered
31 into Professor Dobbs’ report because he refers to it being in annex 2. The material on the
32 modelling on the spill-over global delinearity issue is in annex 3, just so that there is no
33 confusion over that.

1 Again, that is an area where we say the point has been closed off by what Professor Dobbs
2 has done in his latest report.

3 There is then the issue of the question of multi-price points or price discrimination. It is at
4 that point that the magic QJ 08(X*) enters into the proceedings. Professor Valletti has
5 suggested in his original annex 3, I think it was, that Professor Dobbs had made a fatal
6 mistake in that he had modelled, on the assumption that the formula was actually going to
7 be positive throughout, whereas in fact what Professor Dobbs says is that it does not
8 actually matter.

9 I have to go away and digest what the experts have actually agreed between themselves
10 over this point, but it has always been considered that one of the problems may have been
11 that Professor Valletti did not entirely understand what Professor Dobbs had been trying to
12 do in his original annex, and it may have been a misunderstanding. As I say, I will have to
13 take some instructions on where we have actually got to on that point, but it does look as
14 though at least the issue has moved further forward so therefore I am not going to even
15 attempt at this stage to explain to the Tribunal how the QJ 08(X*) actually operates,
16 although I was looking forward to it!

17 Can I just conclude the opening remarks on the direct effect by saying this: BT accepts that
18 there are always going to be some uncertainties over the modelling that is actually done
19 because any model seeks to extract from the real world. However, as Professor Dobbs
20 indicates at paras.13 and 14 of his seventh report, he is convinced they do give a reasonable
21 approximation of what incentives the NCCNs were likely to give rise to.

22 We also say that as each set of criticisms have been levelled, the further research has shown
23 that the model's predictions are indeed robust. We say that that of itself is a real indicator
24 as to the value of this modelling.

25 Secondly, Ofcom itself has accepted the modelling has been valuable and it is clear that
26 Ofcom itself accepts that the modelling has actually proven what it actually set out to do,
27 namely that prices were not going to be incentivised to rise, they were, in fact, going to be
28 incentivised to decrease, and it has done that.

29 We say that one of the underlying problems is that Ofcom has latched on to alleged
30 uncertainties as a justification for leaving the status quo of a market failure in place. In fact,
31 when one strips the uncertainties away they are not as great as they appear from the listing
32 within the final determination or indeed some of the evidence, and as a result it comes down
33 to effectively four real battle lines between the parties. Attempts by people to, if you like,
34 obfuscate the whole thing by saying that there are more elements involved, real world

1 pricing issues, really simply demonstrates the fact that actually, if one strips it down, this
2 modelling was rather good. The fact that it has just come down to four real issues at the end
3 of the day in our respectful submission demonstrates that for modelling of this type this is a
4 confident conclusion.

5 We say that Ofcom has simply attached far too much weight to the uncertainties and the
6 problem with it is that it has almost approached this as though one was having to prove
7 beyond all reasonable doubt or a 95 per cent confidence, whereas in fact, put at its highest,
8 all that Ofcom itself was saying that was needed to be done was proof on the balance of
9 probabilities, and we say that that is what Ofcom did not properly do, make an assessment
10 of whether, on the balance of probabilities, the prices were likely to fall to the lowest level.
11 We say it gives a pretty clear answer that prices are more likely to fall to the 12.5p per
12 minute than actually either increase or do something only partially up the scale, i.e. drop
13 back from the 40p per minute to 35p per minute.

14 Even if Ofcom is right and it would not have gone down to the bottom tier of the ladder, we
15 say that Ofcom has not actually done what it ought to have done, which is to say, what,
16 therefore, is the most likely scenario? Is it going to fall to 12.5p per minute with some
17 falling to 17.5p per minute, is it going to fall completely to 17.5p per minute, is it going to
18 be somewhere higher up the chain? We say that that is the exercise that ought to have been
19 undertaken during the final determination.

20 Then finally, we say that Ofcom failed to weight this in the overall balance properly. That
21 really leads on to the welfare effects which I am now going to come on to. Can I introduce
22 this. I do not want to take too long, but there was a diagram that should be handed up to the
23 Tribunal, which is one that I perhaps misguidedly as Professor Stoneman will tell me in due
24 course, decided to try and put together to illustrate the various effects. (Same handed) If
25 there is an error then it is a direct result of a lawyer trying to usurp economists, I am afraid.
26 It certainly was helpful to me to try and formulate this in my own mind. Can I explain what
27 the diagram actually entails. If one looks to the right hand side of the page one sees a
28 heading "08X prices". What I have tried to do by the three boxes that are underneath is
29 highlight out the various components of the price as it stands at the moment and what might
30 happen to it. For example, if one takes a current price level of 25p per minute one can see
31 that it will not fall below a certain level. I have listed the boxes A, B, C, D, and given them
32 all various letters, but even if the prices fall there is a certain level below which they will
33 not fall, and in this particular case is 12.49p, and therefore the MNOs will get a certain

1 amount of call revenue. That is box C at the bottom. That is the revenue that the MNOs are
2 going to retain in any event.

3 There are two possibilities. The first possibility is that the MNOs do not reduce their
4 current prices. For example, if one takes the current price level of, say, 25p per minute,
5 which I have put as a level at the top, a certain amount of that money is going to flow across
6 in the termination charge under the wholesale tariff schedule. We say that is reflected by
7 box B that I have drawn on that diagram. That is the money that will go across to BT.

8 There is another possibility, which is that the call prices will not fall all the way to 12.5p per
9 minute, but will fall half way down at 17.5p per minute; in which case there are two effects
10 going on. The first is, which is represented by box A, that the MNOs are going to lose a
11 certain amount of call revenue because the price has dropped. For example, if one thinks of
12 the top of box B that I have listed there as being 17.5p per minute, if prices fall there, then
13 obviously the MNOs are going to lose the difference in revenue between 25p per minute
14 and 17.5p per minute. That is reflected by box A on that diagram.

15 In addition to that, there is obviously going to be money going across to BT because if the
16 price falls to 17.5p per minute it will end up with a termination charge which will go across
17 to BT and be reflected in that box 1 that I have drawn to the left of box B. In other words,
18 money will pass from the MNOs to BT.

19 THE CHAIRMAN: You are assuming constant demand here, are you?

20 MR. READ: Yes, I am just predicating what actually happens to the money – it is the flow of
21 funds – if prices fall and prices are not increased. I fully agree with you that it is lacking the
22 demand effect, although the reason I have done this box in this way is to try and illustrate a
23 component that we say has got missed out of the equation, and that is box K down at the
24 bottom.

25 THE CHAIRMAN: I understand, but just for my own satisfaction, it is possible that if you reduce
26 prices as you are hypothesising here that there are actually more calls being made?

27 MR. READ: Yes, and the revenue goes up.

28 THE CHAIRMAN: So the revenue in fact increases?

29 MR. READ: Yes, I fully agree that it is a scenario that I have not, with my word processing
30 skills, managed to capture within this simplistic legal diagram. I did want to split those
31 boxes like that because it is important then when one comes to consider the mobile tariff
32 package effect. To the right of it I have put prices of other services within the MNOs' call
33 packages, and box D represents the revenues that are already raised by the MNOs on other
34 call types.

1 If there is a waterbed effect then there are going to be two components to that waterbed
2 effect. The first is to match the call volumes that are actually lost to the MNO because it
3 has reduced its prices. In other words, what I have called box W on the right goes to
4 replace box A on the left under the 08X prices.

5 The only MTPE that directly relates to the termination payments is the box X, which relates
6 to the money that goes out to BT across into box 1. Conceptually, this is quite an important
7 point, in our respectful submission, because when one is analysing the waterbed effect one
8 cannot simply equate the whole of the waterbed effect to the whole of the monies that are
9 passed across to BT, because there are other potential interplays. For example, if there is a
10 mobile tariff package effect some of that money is going to replace the money that was lost
11 to the MNOs as a result of them reducing their prices down to, for example, to 17.5p per
12 minute.

13 The reason why I want to draw that distinction is because one of the errors that Ofcom, we
14 say, has made in its welfare analysis is to look at the mobile tariff package effect in total
15 without splitting the effect up between the mobile tariff package effect that might be used to
16 compensate the MNOs for the reduction in revenues caused by the price drop, and the other
17 part of the mobile tariff package effect that effectively goes in part to replacing the call
18 revenues that go across to BT as a result of the termination payment.

19 The real significance of that is because Ofcom itself accepts that the MTPE has less
20 emphasis than the direct effect. Therefore, if prices fall to 17.5p per minute what one
21 cannot take into account as being a relevant counterbalancing factor is any part of the
22 waterbed effect that replaces that revenue, because Ofcom have accepted that in those
23 circumstances the direct effect outweighs the mobile tariff package effect.

24 I also wanted to demonstrate this because, of course, one of the points about the mobile
25 tariff package effect is that if it is not 100 per cent the revenues lost to the MNOs under the
26 080 current pricing system are not entirely replaced by boxes W and X on my diagram,
27 there is also a cost that the MNOs themselves bear which are boxes Z and Y at the top. I
28 wanted to illustrate that on the diagram as well. That is quite important when one comes to
29 consider the whole of the effect.

30 Can I very briefly trespass on the Tribunal's time just to finish off showing the nature of
31 this diagram, if one looks on the other side of the equation one sees that the money is
32 transferred over to BT, if of course prices do not fall to 12.5p per minute. If they have
33 fallen to 12.5p per minute Principle 2 has been satisfied in any event because Ofcom, itself,
34 on its own analysis, accepts that that is beneficial to consumers.

1 Of that money, obviously some of the money is going to go to BT and some of the money is
2 going to go to the SPs, we say, and the evidence we say is pretty clear on that from the
3 various respective parties saying that they are going to force BT through competitive
4 pressures to pass it on. Each of the moneys you can split it up thereafter into money that
5 directly benefits BT's consumers, and that will be through the fixed tariff package effect,
6 for example, and other investment innovation, money that BT itself retains in terms of
7 profits, and from the SP's point of view benefits to consumers in improved quality and
8 services and then the money retained by the SP.

9 The key point, we say, is that when you are looking at the whole equation you have to
10 remember that if one is actually looking at an overall effect on the benefits one cannot
11 simply disregard the money that is effectively retained by BT and the money retained by
12 the SP in preference and over other effects on the other side of the equation. I have tried to
13 map all this out by showing where the various component effects fit in.

14 Can I finally deal with the box K at the bottom because this is quite important. This is the
15 increase in demand caused by improvement in brand quality, it is the point that I have been
16 going on about and we will have a look at it in some more detail tomorrow morning.

17 That has an effect, obviously across the board. If there is an increased demand on NTS
18 numbers that will help the SPs, that will help BT and it may even help the MNOs, but it is a
19 factor that is not directly linked into the waterbed or the spill-over effects certainly as
20 regards BT or the SPs. In other words, there is a benefit to the service providers and to BT
21 which directly flows from the brand enhancement that is actually caused by customers
22 feeling happier that they can ring 08X numbers and know the prices they are actually going
23 to be charged, and that is the brand enhancement effect that Dr. Maldoom has indicated
24 from his third report onwards. That is again an important factor that we say Ofcom has not
25 properly weighed in the welfare analysis.

26 I hope that sets out our thinking before I turn tomorrow to hopefully deal with the welfare
27 effects quite quickly.

28 PROFESSOR STONEMAN: I know we want to finish, but there seems to be a missing box here
29 which is the payment by SPs to BT for hosting services. Is there any waterbed effect on
30 that arising from 5? If the SPs are doing much better in this new world with the WTS will
31 BT benefit from greater payments from the original service providers that it hosts, because
32 at the moment I fail to see what benefit BT is going to get out of a price of 12.5p per
33 minute?

1 MR. READ: I think that BT in particular is interested in the Box K in this matter, because I think
2 what BT sees is that there are business opportunities for it if confidence can be restored in
3 NTS numbers, and BT can therefore increase the opportunity to attract new SPs to host on
4 their service. Now that is not quite the point that I think you were asking about.

5 PROFESSOR STONEMAN: It is the area, it is the waterbed effect for BT, if you like.

6 MR. READ: One is back to definition again I think on this because I do not think, certainly on
7 Ofcom's definition of the waterbed effect, it would not be included in it because it is a
8 separate factor, and that comes out ----

9 PROFESOR STONEMAN: It might be a ...

10 MR. READ: Yes, I think the problem with all of this, and this is one reason why I wanted to list
11 the box out because it is quite important to see what the factors are and therefore where they
12 fitted into Ofcom's welfare analysis – it certainly helped me to do it in this fashion,
13 obviously the jury may still be out whether it helps others.

14 MR. CLAYTON: (No microphone): ... your box K as well, Mr. Read, that will ...out the MNOs,
15 would it not? They would lose on the reduction of their price with the volume, the volume
16 could then go up and that would also help them, because it gets them some offsetting, or
17 partially offsetting benefit ... volume to them.

18 MR. READ: I absolutely agree with that and that is why I put the arrow from box K up to the
19 MNOs, but one would have to be careful, I think, in dealing with that not to trespass into
20 the elasticity of demand with the 080 existing numbers. In other words, it would not be
21 simply that because prices were lower therefore MNOs got more calls, because of course
22 that relates back to the elasticity of demand and the demand curve, but it would be a factor
23 if generally there was a brand enhancement across the whole of the network leading to more
24 people who currently do not use the 080 numbers from the MNO actually using them going
25 to the MNOs and boosting demand in that way. So, yes, I agree there is a factor, that is why
26 I put the arrow down there but it would be important to tease that out from the effect that is
27 already within the direct effect I think.

28 Sir, would that be a convenient point.

29 THE CHAIRMAN: Yes, we thought that perhaps a 10 o'clock start tomorrow might assist with a
30 view to enabling the other openings to start perhaps at 10.30 ----

31 MR. READ: Yes.

32 THE CHAIRMAN: -- and hopefully finishing them in the course of tomorrow rather than spilling
33 over.

1 MR. READ: As I say, I think those who are actually opening are fairly confident that even if we
2 go over to Wednesday it is not going to create a significant problem because although I still
3 have to take stock of which witnesses are actually left now for Wednesday we, in fact, think
4 we will be appreciably ahead of the evidence certainly come Friday and, as a result, this
5 case will move faster than it appears on paper to do at the moment.

6 THE CHAIRMAN: That is helpful. The only other indication we would give regarding timing,
7 we can be flexible on other dates but we will definitely have to finish at 4.30 on Friday. 10
8 o'clock tomorrow morning.

9 (Adjourned until 10.00 a.m. on Tuesday, 5th April 2011)

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