

This Transcript has not been proof read or corrected. It is a working tool for the Tribunal for use in preparing its judgment. It will be placed on the Tribunal Website for readers to see how matters were conducted at the public hearing of these proceedings and is not to be relied on or cited in the context of any other proceedings. The Tribunal's judgment in this matter will be the final and definitive record.

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

5 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 TWO

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 THE CHAIRMAN: Yes, Mr. Read.

2 MR. READ: Good morning, sir. Firstly, can I say, as a matter of housekeeping, that I understand
3 there is going to be an updated experts' agreed note in due course as a result of the
4 intervention of Professor Stoneman yesterday.

5 Secondly, can I just briefly remind you where I had got to, which is that I had been dealing
6 with Principle 2. I had taken you through yesterday at some length the direct effect, and I
7 had moved on to the welfare effect and I introduced my diagram yesterday, which I will
8 occasionally refer to in the course of these submissions.

9 We say that the issues surrounding Ofcom's welfare analysis really break down into three
10 parts. First, what were the factors that Ofcom decided it was appropriate to take into
11 account when conducting its welfare analysis, and which factors did it feel it ought to leave
12 out? Second, what weight did Ofcom give to the factors it did include? Third, did Ofcom
13 explain properly what it was doing, or has it shifted its ground from the final determination?
14 You will recall yesterday that I mentioned quite early on about the passage in our reply
15 where we make specific reference to the Competition Commission's decision and the clear
16 emphasis there has to be on the transparency of the decision making process. It really goes
17 back to the point that I was repeating several times in different contexts, which is that unless
18 you can actually understand the reasoning process clearly from it. It means that the decision
19 at the end of the day is obfuscated and does not give clear justification for the way it is
20 actually being taken. We say it is quite an important point because of all the points I was
21 making yesterday about it is no good simply saying something is uncertain and therefore we
22 take this decision on the basis of uncertainties. You have to actually analyse the
23 uncertainties at some length, and you have to make sure that you are being consistent in the
24 way you are actually dealing with them. If that is not explained properly that, in itself, is a
25 ground that vitiates the final determination.

26 If I can put BT's case in respect of that, it is simply this: firstly, Ofcom ignored a number
27 of matters that it should have taken into account; secondly, it failed to give sufficient
28 weight to some of the matters that it said it was taking into account and gave too much
29 weight to others, and in particular we say the mobile tariff package effect; thirdly, we say
30 they failed really to give proper and clear explanation, and indeed it is almost as if one has
31 been on a journey which we finally glean the end result of from Mr. Myers' statement at the
32 end of the day.

33 Can I, before I deal with each of those three points, just outline four introductory points.

34 The first is that we say that the assessment that Ofcom carried out in the final determination,

1 the 0845 final determination really is completely at variance with the assessment that
2 effectively it has made in the simplifying non-geographic numbers review. We say it did
3 not take proper account of the external and horizontal externalities. We also say that they
4 completely missed the fact that when you look at the mobile tariff package effect it has to
5 be balanced against the fact that there is, to use the phrase I read to you yesterday, an
6 “inefficient relative consumption of the services compared to a situation where the market
7 failure was not present”. In other words, there is an assumption, if you are looking at the
8 mobile tariff package effect, you have to first look at the fact that there is already a
9 distortion going on, and that there is already therefore an over-consumption in one area of
10 the market. Therefore, to concentrate upon the MTPE as a bare factor without first
11 analysing the corollary that, in fact, it starts from the position that there is an imbalance in
12 the first place, in our respectful submission, is completely inconsistent with the simplifying
13 non-geographic numbers.

14 Of course, the point I made yesterday, again from simplifying non-geographic numbers,
15 Ofcom itself estimates that there is a massive consumer detriment in excess of £500 million.
16 Although, obviously, that applies to all non-geographic numbers and not just 080, 0845 and
17 0870, we still say that when you analyse what the figures that Ofcom itself used in the final
18 determination are, there is a massive imbalance between what Ofcom relied upon and what,
19 in fact, it has subsequently found in simplifying non-geographic numbers.

20 The second introductory point I want to make is a point I have made earlier, but I want to
21 emphasise it again. Obviously none of this welfare analysis actually matters if the Tribunal
22 accepts that it is more likely that the prices will fall to the bottom tier. If it falls to the
23 bottom tier, Ofcom, on its own analysis, accepts that that is consumer beneficial and
24 therefore it should be allowed in any event. Of course, as I emphasised yesterday, because
25 of the way that Ofcom has effectively bled certain uncertainties from Principle 2 into
26 Principle 3 it also means that the Principle 3 goes as well. It is slightly like a pack of cards,
27 that if that central issue is knocked away the whole edifice of the result in the 0845 final
28 determination falls away.

29 The other side of that point is that we say that Ofcom did not properly analyse the situation
30 where, if it did not actually fall to the bottom tier, what was the situation if it fell to an
31 interim level – for example, if it fell to 17.5p per minute for some, 12.5p per minute for
32 others, or if it fell somewhere else on the ladder system? Again, we say that Ofcom did not
33 actually carry out that analysis. The problem that we say has happened is that because
34 Ofcom did not really fully and properly consider that, it has ended up weighing the effects

1 in the wrong manner. I will come back and illustrate that in a moment when we look very
2 briefly at table 9. Can I just revert to the point I made yesterday on my own diagram,
3 obviously what we say is that if prices fall so that one is looking at a consequence to the
4 mobile network operator that is reflected by my boxes A and B on that diagram, one has to
5 consider the effects differently on the MTPE according to whether or not the MTPE is
6 reflecting the termination payments to BT. Is it compensating the MNOs for effectively
7 losing revenue on that element because they paid monies over?

8 The other element is considering the loss of revenue that the MNOs have sustained as a
9 result of them reducing their prices, and we say that is a point that Ofcom never clearly
10 considered at any stage.

11 Can I just briefly ask you to go to C1, tab 14, which is Dr. Maldoom's seventh report, and
12 can I ask you to just very briefly look at figure 1 which is just above para.26 on p.11. There
13 is an arterial diagram there. I just wanted to draw your attention to this diagram, because
14 we say it is quite an important and useful tool in considering the analysis regarding the
15 termination payments as to how the flow of funds actually operates in this situation. I want
16 to make the point clearly, so that there is not any misunderstanding about this, that that
17 diagram is concentrating on the flow of funds across into the termination system. In other
18 words, what it is looking at is, on my diagram, effectively the box B and the box 1 elements,
19 it is not taking into account obviously the box A element, it is not showing that. We say
20 that that is the right question to be asking when you come to do an analysis of the flows of
21 revenue and the benefits that actually accrue to them.

22 In dealing with that and where he looks at the consumer surplus of mobile customers at 1
23 minus X down at the bottom on the right hand side of that diagram, he obviously is taking
24 into account what is in effect my box X on my diagram, not box W on my diagram. I hope
25 that makes sense, because it took me some time to work out what was going on, although I
26 am sure the tribunal are far more adept at these things than I am. At the end of the day it is
27 helpful to see that that diagram is confined to that element of the equation.

28 PROF STONEMAN: Mr. Read, while we are in this area, I do not expect you to answer it
29 straight away. Is there, in any of the documentation, any estimates of the size of B of 1,
30 which you say are the same for the elasticity scenarios that have been modelled? I know
31 we have the original BT estimate. I do not know if the original number is confidential, but
32 the original quote of a number between 50 and 80, which eventually came down a number
33 between - I do not know - 35 and 55 per annum. Have we got any evidence from the
34 modelling as to what 1 or B will be if the price does not go to 12.5?

1 MR. READ: I know that within the Final Determination there is an analysis by Ofcom of what
2 happens if it falls to a tier lower than the top tier. So in other words if prices do not stay,
3 they may come down. I was going to take you to that in a minute. I cannot for the
4 moment lay my hands on anything that deals directly with all the points that you are
5 making.

6 PROF STONEMAN: It is implicit in the Dobbs modelling, that is all, and I am just wondering
7 whether we have it, or whether we can have it.

8 MR. READ: Certainly, as regards the direct effect, we have information as to what happens.

9 PROF STONEMAN: It is 1 or B, the one we are going to compare with the 800. We have got
10 500 we were quoted yesterday as to the benefit from the direct effect.

11 MR. READ: As I say, the only point that I can think of is at para.8.150 in the Final
12 Determination (B1 tab 1 p151). It is the overall effect on consumers of increasing
13 termination charges. Basically, what Ofcom do from 8.150, as you can see from that, is
14 they are looking at: "We also noted the important contrast between MNOs rebalancing
15 their prices to have lower 0845/0870 prices" and higher prices for other mobile services.
16 So it is looking at the MTPE effect. Then if one goes over the page to 154 there is a table
17 8.1. I am not absolutely clear from my version what is confidential within that and what is
18 not. Certainly, unless anyone is going to shout very loudly at me straight away, it looks as
19 though the box that deals ARPs one tier lower than the best estimate, which is the column
20 fourth in from the left. It has a non confidential total figure of 21.1 m as opposed to the
21 best estimate, as we understand it, of 43.4 m again, neither of which appear to be
22 confidential. That is what I can immediately lay my hands on.

23 PROF STONEMAN: That was the sort of thing I was looking for. If there is any more detail, it
24 might be useful to us.

25 MR. READ: I was making the point, sir, that in respect of the situation that Dr. Maldoom was
26 describing in that figure 1 that I took you to (we do not need to go back to it) essentially
27 what BT's case is is that when you do a proper analysis, even on the worst case scenario of
28 no reduction, which is in fact a more extreme assumption than Ofcom itself actually
29 makes, because Ofcom itself assumes that the prices will fall but is unclear what it is, but
30 even on that assumption we say (and this is the point that Dr. Maldoom describes in his
31 report at para.66 p.20) there it at worst a small net disbenefit in this unlikely case.
32 We say that is the outcome of a proper welfare analysis. If prices stay as they are, then
33 maybe (but not definitely clear) there is more net disbenefit to consumers. But once it
34 starts falling, if you concentrate on a medium fall then in fact the benefits are, we say, very

1 clearly tilted in favour of a positive. For that reason, Ofcom just misted their welfare
2 analysis.

3 The final point that I make as an introduction is that what we say is clear that Ofcom really
4 looked at one particular scenario and did not consider the scenarios in between. I will
5 come back to that in a moment when I look in table 9.1.

6 Can I now briefly turn to the factors that Ofcom considered were appropriate to include in
7 its consumer welfare analysis and those that it thought should have been left out. We
8 know, from the Final Determination, that Ofcom took into account the effects on callers to
9 080 numbers, which they call the direct effect (para.9.19); it took into account the effects
10 of the MTPE (para.9.23); then Ofcom also says that it included benefits to 080 callers that
11 were fed back into them as a result of the benefits from the service providers' services and
12 that is what they call the indirect effect (para.9.28).

13 What we say that Ofcom does not appear to have taken into account at all are the benefits
14 to the service providers or their customers, i.e. the service providers themselves, the
15 benefits that they may derive from it, as opposed to the benefits that might feed back to
16 callers from improvements in their service, etc.

17 This is not absolutely clear, and it is one of the points that we make in respect of
18 transparency. If you take the Final Determination bundle B1 tab 1 p.167 para.9.28 table
19 9.1 that we have been talking about. Just so that one is clear about this table, it is actually
20 showing the summary of direction of effects on consumers. That is how it is headed. As
21 you can see, we make a number of points about this table. It is basically dealing with an
22 0845/0870 prices fall but without saying how far they fall, an 0845/0870 prices unchanged,
23 and an 0845/0870 prices rise. But the two columns at the right i.e. the "prices unchanged"
24 and the "prices rise" are the ones that Ofcom itself discount. What Ofcom does not do is
25 actually divide the possible scenarios according to how much the prices of 0845 and 0870
26 actually fall.

27 Can I then ask you to look down at the bottom at the indirect effect where it has 0845,0870
28 prices fall. It says: "Positive for SPs but uncertain for callers". From that one might deduce
29 that in fact Ofcom was taking into account the benefits to the service providers themselves
30 within that indirect effect, because that is what it appears to indicate. However, it is fairly
31 clear now that Ofcom says that it is not in the indirect effect, taking into account any
32 positive benefit to the SPs it is actually leaving that in a different part of the equation and
33 that part of the equation is effectively the weighting it gives between the MTPE and the
34 direct effect.

1 I should make clear that what I am talking about here is I am talking about the termination
2 payments, so if you look on my diagram it is the flow from box B to box 1 and I am not
3 talking about box K or indeed box A. Mr. Myers, in his statement indicates quite clearly at
4 para. 397 that if Ofcom had placed equal weight on the benefits of the service providers as
5 to the callers when considering the indirect effect then Ofcom would not have concluded
6 that there was a negative effect, and it clearly follows from that that the benefits to the SPs
7 themselves were not being included within the indirect effect.

8 Likewise, no account is taken of any benefits that may flow through to BT in the
9 terminating providers position other than in a rather weak context my box 4 in my diagram
10 in terms of the fixed tariff package effect, but we say in reality they did not actually give
11 much weight to the fixed tariff package effect at all, because if one looks at the conclusions
12 in this s.9 of the final determination, they do not actually mention at all the fixed tariff
13 package effect, that has been dismissed earlier on and so therefore even the fixed tariff
14 package effect is not treated with any great weight, but in any event the other boxes, box 3
15 for example, in my diagram is completely disregarded in this process.

16 The justification as you know is that they say they are required to have a consumer focus
17 under the Communications Act 2003 and for all the reasons that I have outlined earlier on
18 and do not intend to repeat we say that is a misguided analysis of the Communications Act
19 and the Framework Directive.

20 What therefore Ofcom appears to be considering is that the interests of other users and
21 customers, like those of the TCPs and the service providers are too remote and will not
22 therefore definitely benefit from the payment of termination charges. It seems implicit
23 within that that what Ofcom is actually saying is essentially the force of the waterbed
24 assumptions that hold for the MPTE do not flow through on the other side of the equation to
25 the position with BT and the service providers and the like, and I think Professor Stoneman
26 picked that point up yesterday in the course of my submissions.

27 What we say is that that is wrong, the interests of the mobile customers should not be
28 winning out over the interests of the other entities, the companies such as the service
29 providers and BT, it should not be an all on one and nothing on the other side, then maybe –
30 we accept this – a balancing exercise to be done as to how much weight you do put on the
31 respective elements, and as I made the point yesterday what you cannot do which Ofcom
32 has done is say we should exclusively put our focus on this side of the equation to
33 effectively leave out taking any account of the other parts within the equation resulting from
34 termination payments.

1 THE CHAIRMAN: I can see the force in what you say about the inclusion of service providers
2 because, as I understand it, the only reason one is focusing on the callers is because of the
3 caller pays principle. If one had, for instance, a different principle where the recipient of
4 the call pays it would be very different to resist the conclusion I would think that they were
5 not consumers, but is there not something of a difference between an SP and BT in this
6 scenario?

7 MR. READ: Of course one can draw distinctions between them and one can say that because of
8 the payment chain and the way it is set up that the SPs are actually paying for services in
9 any event, but if one is actually looking at 'users' because that is the phrase that the
10 Framework Directive uses in Article 8. What we say is that it necessarily means that you
11 cannot simply discount a user of an electronic communications service out of the equation.
12 There are good reasons for that we say, because if money flows into BT then BT has the
13 opportunity to innovate and improve services generally just as, indeed, the service providers
14 themselves can innovate and, indeed, the benefits can be passed on as illustrated in my
15 diagram on to box 4. So we do not accept that BT are not users for the purposes of Article
16 8, we say they are users for the purposes of Article 8 but we do accept that obviously there
17 may be different weightings you give to the situation. Certainly when you come to the SPs
18 we absolutely agree with you, sir, that there can be no doubt in this scenario that the SPs are
19 consumers and users for the purposes of the Act and Article 8 and therefore account has to
20 be taken of the benefits, you cannot simply push them to one side. The problem with all of
21 this, and it is a point that is explored in Professor Dobb's sixth and seventh reports, is that if
22 you are doing a welfare analysis you have to look at the whole picture and it is all very well
23 saying that in fact these are human consumers getting the benefit, etc of money and how can
24 you equate them with banks and so on and so forth or, in this case, BT, but at the end of the
25 day even if the money goes to BT it is going somewhere else; this is not a focus simply on
26 one piece of money that stays in one particular place and gets lost further up the chain so
27 that you can ignore it, that money is circulating in terms of going to employees or pension
28 providers or whatever, it is still money that is in circulation and we say has to be taken into
29 the equation, not completely excluded – what weight you give it within the equation may be
30 a different matter, but Ofcom has actually excluded that from the equation.

31 THE CHAIRMAN: Yes, I was just having some difficulty with your labelling of BT as a user
32 whereas it seems a rather more natural designation to call BT a provider.

33 MR. READ: Again one comes back to the unfortunate complexities of the chain, but if I can give
34 you an example, with 080 calls if the MNOs priced at zero BT would be paying for that

1 service and so therefore would be, certainly on that view, a user of the origination services.
2 The normal way one looks at it is a single chain where at one end of the chain you have a
3 customer and normally that customer is the calling party who pays. This, of course, is a
4 completely different chain because there are inter-reactions going both ways up the chain
5 which is why we say it makes much harder to simply dismiss BT as being a user in this
6 sense of electronic services. In any event, the point still holds for the SPs, even if I were to
7 be wrong about that. I think probably I do not want to spend too much longer on that.

8 THE CHAIRMAN: Thank you.

9 MR. READ: Again, I think I should give you a few references. I do not want to take you to the
10 documents, but Professor Dobbs in his sixth report at paras.45 to 47, (C1, tab 6, p.18) makes
11 this point that the profits obviously go somewhere, and from an economic perspective one
12 cannot simply ignore them when one comes to do some form of welfare assessment.
13 Likewise, in his seventh report, para.24 (C1, tab 7, p.34), he makes the case for taking a
14 total welfare perspective. In reality we say that actually there probably is not a great deal of
15 dispute between the parties that if you were looking at it from solely from an economic
16 point of view you would want to have a look at the totality of the welfare effect. The only
17 question that comes is whether Ofcom is right that, as a result of the legal duties that have
18 been imposed upon it, it, in fact, therefore has to take a different, more blinkered, we say,
19 approach to it. I hope that explains how BT sees the problem, that the economic perspective
20 is clear, but it is Ofcom who depart from that by relying on this consumer based focus, as
21 they say.

22 Again, we make the point that there is nothing intrinsically wrong with revenue sharing.
23 Indeed in our respectful submission, it is really quite important when one goes back to the
24 basics of this. You will recall that Ofcom say they introduced their three Principles from
25 six Principles that have been laid down about costs, one of which of course is very clearly
26 about the distribution of benefits. That is precisely what we say BT's wholesale tariff
27 structure is all about, it is about a fairer distribution of benefits within the NTS chain.
28 Therefore, one should not be artificially restricting the focus of what happens with these
29 termination payments by concentrating on one side of the equation.

30 Over and above that, we say that there is a further point, which is that even Ofcom are right
31 that the focus should be on human consumers, they have actually got that balance, on their
32 own analysis, wrong. It was a point I was explaining yesterday, which is that some of the
33 MNO callers are going to be business callers. They are not exclusively going to be human
34 callers. To weigh those business callers, who may well be banks and may well be big

1 businesses who have bought handsets for their employees, or whatever, to equate those, or
2 to give those a stronger preference than the SPs is, in our respectful submission, clearly
3 wrong. Even if Ofcom is right on its own analysis, we say it has not actually done the job
4 properly because it has ignored the fact that a certain element of those callers are going to
5 be business customers.

6 The last point that I wanted to make on this is to deal with the point that the reason why
7 Ofcom actually focus on the consumer harm is because they say that, in fact, the problem is
8 that if you reduce the 080 call prices it will have a harm to consumers as a result particularly
9 of the MTPE. We say that that is really inconsistent with the way that Ofcom have actually
10 dealt with the matter in simplifying non-geographic numbers, and for the reason I was
11 making earlier, that there is a significant consumer harm already in the existing situation.
12 That is before one comes on to deal with the issues, for example, of how much the MTPE is
13 actually going to be because, as I said yesterday, Ofcom itself accepts that it is not going to
14 be 100 per cent. It uses 100 per cent as its reference point but then accepts that 100 per cent
15 is not going to be the actual amount.

16 Can I move on and deal with how Ofcom actually weighted the matters. So far I have been
17 concentrating on boxes B and 1 in my diagram. One of the key points, we say, is that
18 Ofcom effectively missed out box K on my diagram from the equation, which is the brand
19 enhancement issue. There are very significant benefits, we say, to service providers and to
20 consumers as a whole resulting from volume driven improvements. That is the first point
21 we rely upon.

22 The second point we rely upon is that when one looks at the way that Ofcom has actually
23 combined the equation, and particularly leaving out the benefits to the TCPs and the SPs
24 from termination payments, we say that effectively all Ofcom has actually done, therefore,
25 and been left with in its balancing equation is the MTPE. That, therefore, gives the MTPE a
26 disproportionate weight. It is because Ofcom effectively leaves key points out of its
27 equation or gives insufficient weight to them that we say it has effectively constructed a
28 cost benefit analysis that almost pre-determines that unless you go to the bottom tier you are
29 going to end up failing the welfare analysis. We say that that has given the MTPE a much
30 more significant weight than it actually deserves.

31 Can I briefly deal with the increase in volumes. It is quite clear, we say, in Mr. Myers'
32 statement that he now says that this is a feature that is taken into account in the indirect
33 effect. Can I show this by a document that has been a matter of some debate in this case,
34 but I want to take you to it. It is Mr. Myers' statement, which is in volume C2, tab 28, p.82,

1 just above para.265. There has been a lot of comment about this particular diagram. It
2 features in Dr. Maldoom's seventh report, and has been the subject of argument from
3 Dr. Walker in his report. This is the one time that one sees at any point how exactly Ofcom
4 might have weighed up the various matters. It is said this is only illustrative and it therefore
5 should not have too much read into it. With respect, one point comes through absolutely
6 clearly from this diagram, that if you look at 12.5p per minute, which is towards the left on
7 the zero line, one sees that zero benefit is given to the indirect effect at 12.5p per minute.
8 What that means is that Ofcom was not, and could not, taking into account in the indirect
9 effect any element relating to my box K, the demand increase to brand enhancement. Of
10 course, brand enhancement will be greatest when the price is at its lowest. So, therefore, at
11 12.5p per minute, if one was including the brand enhancement effect within the indirect
12 effect, you would expect the indirect effect to be considerably higher than zero. So it is not
13 simply illustrative, this diagram, you do get material out of it. Indeed, that is consistent
14 with what Mr. Myers says in other parts of his statement about the fact that they did not
15 include the demand benefit within the 0845 indirect effect.

16 I should, perhaps, while discussing this take you slightly on in his statement.

17 PROFESSOR STONEMAN: Just before you leave that, para 267 p.82 at the bottom:

18 "In effect, the greater weight of the Direct effect in the Final Determination is
19 labelled differently in Maldoom 5 as Indirect Effects. But there is little difference
20 in substance between the Final Determination and Maldoom 5".

21 Is that not the same point that you are making? Is this just a matter of labelling, or is it
22 really a matter of measurement?

23 MR. READ: We accept that where Mr. Myers says this issue is taken into account is in the
24 preference that is actually given to the direct effect over the mobile tariff rate. I fully agree
25 with that. If I can take you on to the bit that I was actually going to take you to, p.107, this
26 is where he deals with the description of the indirect effect and he sets out at para.363:

27 "The Indirect effect is described as follows in the analytical framework in the
28 Final Determination: (a) the impact on service providers ... (b) the factors that
29 influence the attractiveness to an SP of offering 0845/0870 services are referred to
30 in the following discussions as "Indirect effects". This is because they may affect
31 volumes of 0845/0870 calls made on the quality of services provided the SPs,
32 ultimately increasing or reducing the benefits that callers obtain from 0845."

33 Then it says the indirect effect operates at the terminating end.

34 If one goes on into 364 he explains that:

1 "Ofcom's analysis of the Indirect effect in practice relates to the effects on each of
2 SPs and callers that are triggered by a change in the hosting class or revenue share
3 as a consequence of NCCNs 985 and 986. This is consistent with the descriptions
4 of the Indirect effect set out above to the extent that they include the effects both
5 on SPs and callers.

6 (365) But I accept that the latter description shown at para.363b above does not
7 entirely match my interpretation. In particular, it appears to suggest a broader
8 definition of the Indirect effect, also including the effects on the SPs of changes in
9 the volumes of calls, i.e. the volume-driven service quality effects in Maldoom 5."

10 So he is making the point very clear, and it is clear from that, we say, that it is not clear
11 from the Determination itself how exactly it was being done. That is quite an important
12 point, in our respectful submission, not only for the purposes of deciding how exactly the
13 weighting was done and what weight was given to it, but also from the fact that we say
14 there is an element of transparency. I see Mr. Herberg wants to say something.

15 MR. HERBERG: I think it might help for the Tribunal to read para.366 while it is there, the first
16 part, sir, up to (a) (b) (c). I will have to come back to this, of course, but to complete the
17 point.

18 MR. READ: Sir, I am grateful to my learned friend. I want to make it clear that we ourselves do
19 not understand how the Final Determination works at certain places, because it does seem to
20 be contradictory. But that, in our respectful submission, makes the very point that there has
21 not been transparency about the way that matter has been dealt with in the Final
22 Determination.

23 Sir, what we do say is that once it is accepted, as it was in the 0845 Final Determination,
24 that prices would fall, this volume driven effect is actually extremely important, because it
25 is quite clear that it is going to have an effect (my box K) and it is going to operate to the
26 benefit of SPs. So therefore where exactly the weighting was given in this respect is
27 absolutely important, in our view. The fact that it basically could be here/could be there in
28 Ofcom's analysis within the Final Determination makes the point, we say, that the
29 weighting process has not been done in a proper manner. That is particularly true, we say,
30 because of course Ofcom did not go through any form of process of saying: what do we
31 think is the likely drop going to be; if it is not going to be 12.5 per cent do we think it is
32 more likely to be 17.5 per cent, do we think it is more likely to be 22.5 per cent or
33 whatever? We say that is an effect that was simply not taken into account.

1 To make that point, we do say it is quite remarkable that something so fundamental as that
2 really ends up effectively being dealt with in the way it has in the course of the Final
3 Determination.

4 We are not simply asking the Tribunal to draw inferences from the lack of prominence these
5 benefits were given in the Final Determination. We do know from the comments in its
6 defence that Ofcom did not even try to conduct any qualitative weighing at all of the policy
7 preference benefits. They say in effect that it was too difficult an exercise to do.

8 But the trouble with that line of apparently simply saying: it is very difficult to do a
9 weighing process is that one does not know how Ofcom took the benefits into account at all.
10 It is all very well throwing everything up in the air and saying this is all terribly uncertain
11 and we cannot actually at the end of the day decide what is likely to happen, but in a
12 scenario like this where the regulator is intervening as regulator to restrain a contractual
13 position, we say it is crucial that if they are doing some form of welfare analysis they have
14 to have some assessment as to the relative weighting that there has to be between the
15 respective elements. We say that in any event, Ofcom's Final Determination does suggest
16 that it was taking some form of, or trying to make some form of, qualitative effect. For
17 example, if you say you give more weight to the direct effect than you give to the mobile
18 tariff package effect you are already giving some form of qualitative analysis of how you
19 weigh those particular benefits up.

20 We say therefore one cannot simply turn round and say it is all too uncertain and therefore
21 we cannot actually do something with qualitative assessment if you are already embarking on
22 part of that process. That is particularly important when, for example, one looks at table 9.1
23 where you see that Ofcom never at any stage split up what might be the events if prices fell
24 but did not fall to the lowest tier. Again, by putting an overly cautious approach on the
25 weighing process by simply saying it is uncertain and therefore we cannot actually come out
26 with a particular answer to this, we say what effectively has happened is that they have put a
27 qualitative basis on it of effectively giving too little weight to the direct effect and allowed it
28 to be outweighed by the mobile tariff package effect.

29 Can I turn, then, at that point to the mobile tariff package effect. This has, we say, acquired
30 an importance because effectively it comes down to being the second most important factor
31 within this equation, direct benefits first, the mobile tariff package effect next supplants all
32 the other points that I have been making about the benefit to SPs from termination payments
33 and the demand led effect in my box K. If one actually looks at the MTPE we simply say
34 that it does not bear the weight that has been placed upon it and BT's experts deal with that

1 at some length. I will just give you some references for that because I am conscious of the
2 time, paras 144 to 150 in Dr. Maldoom's seventh report at C1 tab 14, p.43, paras. 104 to
3 108 in his fifth report at C1 tab 12, p.34 and in Professor Dobb's report at C1, tab 6 p.24
4 paras. 63 to 74 and again at Dobb's 7, C1, tab 7, they deal in some length with waterbeds.
5 Can I shortly summarise what the points are? The first is that we say: (1) the MTPE is in
6 fact relatively small in size for the weight that is being put on it. First, we say the waterbed
7 effect is clearly not 100 per cent and, indeed, when one actually looks at the figures one is
8 talking about, and that was the section I took you to in the final determination earlier on to
9 show you the respective 21 million figure. If one looks at that one sees that it is actually a
10 relatively small sum involved. If you then take that and say: "It is not 100 per cent in any
11 event, so for example if we are looking at 75 per cent it is about 15.6 million, if at 50 per
12 cent it is 10.8 million.

13 In addition to that, of course, Ofcom acknowledges that the benefit of that price reduction
14 ought to be given greater weight because of the externalities and because of its policy
15 preference, so again it has to be discounted further because of Ofcom's analysis as a result
16 of the concerns about the policy preference. That has to be contrasted with the 500 million
17 that we have seen in the simplifying non-geographic numbers for existing consumer harm
18 and, although as I said earlier that is not all simply focused on certain numbers, it is such a
19 big figure compared to the type of figures that Ofcom are talking about that it really
20 demonstrates how much weight the MTPE was given when in fact it is relatively small in its
21 effect.

22 The next point that I would make on this is that Ofcom itself considers the actual MTPE
23 effect on the prices of other services will be small and in aid of that we refer to the final
24 determination at para. 8.124 where it actually starts the sentence: "Whilst NTS calls
25 represent a relatively small proportion of the MNO revenues ..." it then goes on to give the
26 reasons for distinguishing that, but Ofcom itself therefore accepts that as a proportion of
27 MNO core revenues it is a relatively small amount. Can I just make this point that when
28 one is considering this issue one should not be beguiled into accepting the figures that the
29 MNOs have put forward in various places within their material, and I obviously will not go
30 into it because most of it is confidential, because of course it is not all relating to the
31 termination payments and therefore the mobile tariff package effect we are looking at is, if
32 you like, boxes A and B in my diagram, not box B, which is the one that we say is pertinent
33 to the equation in this case.

1 Further, regarding the MTPE, of course the point you made earlier, it is simply a corollary
2 of the fact that there has been inefficiencies and over consumption there already, as the
3 simplifying non-geographic numbers point which I took you to yesterday, I think it was A2
4 189 to A2 192. It makes the point very clearly that there is already an inefficient over
5 consumption of services there already, so again that is a factor we say that should not allow
6 the MTPE to have the weighting that Ofcom has given it.

7 I am sorry, sir, I am conscious of the time, and I am trying to see what I can cut out from
8 my submissions. (After a pause) Can I finally then in this section turn to transparency? I
9 make the point, and I have taken you through a number of these points already so I will not
10 spend a great deal of time on it, that what we say has happened is that the position has
11 shifted as it has gone along. We say that there are certain features that are still unclear, for
12 example, the whole question of real world pricing and exactly what categories we are
13 talking about, and it was the point I was making yesterday in respect of the direct effect, and
14 we say very forcefully that this is a flaw for the reasons that I have indicated in the
15 Competition Commission decision that one needs transparency in the way one has actually
16 calculated these things.

17 What Ofcom cannot do is subsequently seek to add to the reasons, and that is, we say clear
18 from the *Napp* decision, I will not take you to that – it is in our skeleton argument at para.
19 23 which I think is now at B1 tab 6, and we set out the position on that there. If I can just
20 concentrate on the three elements? The first is the externalities, and the first point about
21 that is the issue of whether weight was given to the benefits to the service providers from
22 price reductions – it is a point I have already dealt with. We do say that it is not clear how
23 Ofcom were actually using this question of the benefits to service providers from the price
24 reductions because it is now said that this is taken into account in giving a greater
25 preference to the direct effect over the mobile tariff package effect, but we say that it was
26 not clear whether this was being used as a tie break or whether or not it was something more
27 than that. In the defence at para. 18 they say that it was more than a mere tie breaker in the
28 case of the points for recall. This is based upon one footnote in the final determination as
29 we understand it, and can I just ask you to look at it, it is at B1, tab 1, para.5.28, p.69 – I
30 think it also occurred somewhere else within the draft determination in annex 3. What we
31 say about this is that sticking it away in a footnote here, if this is what the footnote really
32 means, we say it is not clear from the other parts of the determination, and that is material
33 set out in the original notice of appeal and so I will not rehearse it again.

1 We say that if what you are really saying is that you are giving a major preponderance to the
2 direct effect because of the externalities and because of the policy preference, then in reality
3 that ought to be far clearer in the course of a final determination like this, and it ought to be
4 made plainly transparent how exactly you are approaching the matter. It is dealt with at
5 some length in para.26 of BT's reply at B1, tab 15, so I will not spend a great deal more
6 time on that.

7 Likewise, we say that there is the question of the indirect effect in Ofcom's final
8 determination and what they have taken into it. I have already dealt with that taking you to
9 figure 8 and Mr. Myers' statement and showing that it was not clear, and Mr. Myers,
10 himself, accepts it was not put clearly at a certain point.

11 Finally, we rely upon, as an instance – and I make the point that these are instances rather
12 than anything else – the definition “the consumer”. As you have already seen from table
13 9.1, in fact, it is not clear that Ofcom were taking the approach it now says it takes to
14 consumers in respect of SPs at the time. It seems within the table 9.1 to be including them
15 as part of consumer welfare, and not excluding them in the way that has become from
16 Mr. Myers' statement. Again, the point is made at 9.32, and I do not think we need to turn
17 it up. It is there as well.

18 We say that this is part of the problem, that Ofcom's approach to weighting its definitions
19 of indirect effect on consumers are all unclear in the final determination and that is what
20 creates a considerable part of the problem.

21 What we do want to make absolutely clear about this whole welfare analysis is that we say
22 that Ofcom has conducted a heavily circumscribed analysis. It has effectively disregarded
23 certain elements of the welfare weighting, it has not done it transparently, and it seems to
24 have given much greater emphasis to things that subsequently it accepts are not as relevant
25 as they might be, and in particular the mobile tariff package effect.

26 As a result, we say that if you stand back from it, you effectively say it is counter-intuitive
27 what Ofcom have actually done. Effectively what Ofcom has done, and they say this in
28 para.5 of the defence, they say that the cure is more likely to be worse than the disease. The
29 problem with that, we say, is that if you stand back from it, the disease is obviously pretty
30 bad, and that is what the simplifying non-geographic numbers review makes absolutely
31 clear. There is nothing in the final determination to suggest that BT's NCCNs were actually
32 going to cause harm of anything near that magnitude. As a result, we say it is virtually
33 counter-intuitive if you actually stand back from this. To say that prices are going to fall,

1 that monies may well be passed across to SPs, but actually that is worse than what we have
2 got at present – the cure is worse than the disease.

3 Can I make two final points about the whole of Principle 2. Firstly, we make the point that
4 it is very easy to be beguiled in a case like this into thinking that because there is a very
5 lengthy and long final determination, there is lots of discussion about various points, and so
6 on and so forth, to take the view that the Regulator must have got it right because it
7 considered everything and it was effectively a weighing process which it was entitled to
8 weigh. We say that is not the job of the Tribunal for all the points that I have made earlier
9 on, which is at the end of the day the Tribunal has to ask whether or not they got it correct.
10 They have to ask whether, if you scrape away at it, it really does actually justify the
11 conclusion that Ofcom reached, and we say that when one looks at it in a fair amount of
12 detail, one sees that there are flaws and creaking problems within the final determination.
13 So we urge upon the Tribunal in respect of Principle 2 not to be beguiled by the siren, the
14 voice of Ofcom saying it is all a matter of regulatory judgment.

15 The final point that I want to make is to take you to the final determination at para.9.31,
16 which is B1, tab 1, p.169. It makes quite clear that:

17 “Our judgment in respect of Principle 2 is therefore finely balanced.”

18 We say that, if that is right, anything that BT is correct about in its criticisms of the
19 assessment Ofcom has actually done is going to lead at the end of the day to the conclusion
20 that the whole edifice swings in BT’s favour, and with that edifice swinging in BT’s favour
21 we say Principle 3 goes as well. We say that BT does not have to go far to change the effect
22 of this final determination.

23 Sir, lastly, I was gong to deal with the 080 final determination. Can I just make three very
24 short points because I am concerned about the time I have taken so far. We have dealt with
25 most of the matters in our notice of appeal in that case and the reply. The first point we say
26 is that it is pretty pointless, in our respectful submission, to do what Ofcom asks if the
27 Tribunal, as we say it must in the circumstances of the 080 case, accept that the decision
28 was wrong. It is pointless, in our respectful submission, for that matter to be remitted to
29 Ofcom for Ofcom to reconsider it again in the whole. Clearly, the Tribunal will have all the
30 material now before it to reach a clear on what is or is not the right course. We say that, in
31 effect, Ofcom asking for the whole matter to be remitted to it to re-deal with it is effectively
32 Ofcom seeking to avoid the inevitable consequence that there is an error in the 080 decision.
33 Just to give one example of an error, it is quite plain, in our respectful submission, that
34 prices were not going to increase as they say under Principle 2, but, in fact, were going to

1 do something different. Again, I do not want to get involved in a detailed about that. We
2 say that it is pointless in those circumstances for the matter to be remitted back to Ofcom
3 for Ofcom to completely re-weigh the matter.

4 The Tribunal can deal with the matter. It has got power under s.194 to give clear directions
5 to Ofcom as to how it should reconsider the matter in the light of a remission, and that is
6 what the Tribunal has done previously, for example, in the TRD appeal. There was a very
7 clear direction given subsequent to the decision that I took you to yesterday about what the
8 price levels actually should be. So we say it is pointless sending it back.

9 The second point is that that is probably even more important in this case, the 080 case,
10 because over and above the evidence in the 0845 case, there is an additional factor which is
11 that Ofcom, itself, on its own analysis, accepted that more weight ought to be given to the
12 080 preference because of the effects of vulnerable people. We do not entirely accept that
13 because we say that vulnerable people are affected just as much with 0845 as they are with
14 080, but on Ofcom's own analysis, they say that greater weight ought to be given to its
15 policy preference with 080 than with 0845. Whatever you decide in the 0845 will apply
16 even more strongly in the 080.

17 Finally, can I just deal with the point about ground four of our ----

18 PROFESSOR STONEMAN: Before you change away from relief that is sought, will you be
19 addressing us again on that issue? The issue is the date from which you wish the NCCNs to
20 operate. Your notice of appeal, 136B, basically said that MNOs are liable to pay all
21 incomes due and owing under NCCN from 1st July 2009, that is what you want us to do.

22 MR. READ: That is certainly our primary position.

23 PROFESSOR STONEMAN: So you would be asking for a situation whereby the MNOs would
24 not have had a chance to change their prices or react to the NCCN 956 to be reinstated?

25 MR. READ: That, we say, is the inevitable consequence if you use the dispute resolution process,
26 that if you object to prices and you do not take your decisions on the basis that those prices
27 might work their way through, then that is a consequence. That actually is one of the key
28 points in the *TRD* appeal, because of course what Ofcom was saying was: no-one has been
29 affected because in fact the pricing has not actually been put through. The Tribunal in that
30 case specifically rejected the suggestion that that was a good reason for not allowing the
31 prices that should have been in place from the outset.

32 PROFESSOR STONEMAN: I would appreciate if you could address us in your closing with
33 respect to that matter. It would be useful.

1 MR. READ: Yes, I see the point. The point is noted. Sir, unless there is anything else can I
2 suggest that perhaps we adjourn for five minutes at this stage and then let my learned
3 friends commence their openings.

4 PROFESSOR STONEMAN: You were not going to say something just before that?

5 MR. READ: Yes, I am sorry. I was simply going to mention Ground 4, which of course is the
6 point about the scope of the dispute. We say that is still relevant in this case because we say
7 it all goes to the fact that Ofcom basically did not get its decision right because it did not
8 have the relevant information provided to it before it considered the matter.

9 We set it out in some detail in our Notice of Appeal. In a case of this nature it probably is
10 not going to weigh as the most important point. I simply would not want the point to go.
11 Sir, that is my final point.

12 THE CHAIRMAN: Thank you very much, Mr. Read. We will take five minutes. Quarter past.

13 (Adjourned for a short time)

14 MISS SMITH: Sir, before I start my opening, there are two very small matters of housekeeping.

15 First, you will be aware, I hope, that Dr. Mike Walker has produced a third expert report
16 dated 23rd March and strictly we need permission to put that further report into the Tribunal.
17 There has been no objection to the production of that further report so I hope that is
18 uncontroversial.

19 THE CHAIRMAN: Yes.

20 MISS SMITH: It should, I hope, have made its way into the bundle, if not could I ask that it be
21 put in core bundle C2 at tab 46A, between tabs 46 and 47 – I am not sure if it has already
22 found its way into the bundle. I will not be referring to it in my opening, but if it has
23 not ----

24 THE CHAIRMAN: We will make sure we slot it in.

25 MISS SMITH: I am sorry, I have just been told that the bundle has been renumbered so it is
26 actually tab 47 and everything that follows is 48 and onwards, so I hope you have it at tab
27 47.

28 THE CHAIRMAN: Yes.

29 MISS SMITH: The second point is an application that our expert, that is EE's expert, Paul
30 Muysert be admitted to the confidentiality ring for the purposes of the hearing just in case
31 any confidential figures need to be put to him in the witness box. Again, that possibility has
32 been put to all the parties and there have been no objections, so I would ask that the
33 Tribunal make an order if necessary that he be admitted to the confidentiality ring for the
34 purposes of the hearing.

1 THE CHAIRMAN: We are happy to make that order.

2 MISS SMITH: Thank you, sir. Then turning to my opening, as you will be aware Everything
3 Everywhere (“EE”) appears in this case as the appellant in case 1168 appealing Ofcom’s
4 08450/0870 determination and as an intervener in BT’s two appeals against Ofcom’s 080
5 determination and its 0845 determination, respectively cases 1151 and 1169.

6 In its appeal EE does not challenge the outcome of the determinations, Ofcom rejected BT’s
7 NCCNs as we say it should have done so, but our case is that the way in which Ofcom
8 reached that outcome is wrong, that Ofcom’s reasoning in the determinations is flawed. In
9 particular we challenge Ofcom’s conclusion that if, on the evidence it can be shown to
10 comply with Ofcom’s three principles a tiered structure of wholesale charges, set by
11 reference to MNOs retail prices, such as that proposed by BT in these cases could be held to
12 be fair and reasonable. That is our primary case and I will spend the vast majority of my
13 opening today dealing with that case.

14 However, if the Tribunal is not persuaded by our primary case then our secondary case is
15 that Ofcom was correct to reject BT’s NCCNs; it was correct to find that the proposed
16 termination charges were not fair or reasonable, and therefore BT’s challenge to Ofcom’s
17 determination we say should be rejected in any event. If time permits I propose to outline
18 briefly our secondary case at the end of my opening, but it is important I think to note up
19 front the position that the interveners find themselves in this regard following the Court of
20 Appeal’s judgment of 10th March on issues relating to the admissibility of BT’s expert
21 evidence in this case.

22 Following that judgment Ofcom has indicated that it will leave it up to the mobile operators
23 to take the lead on certain matters, in particular the magnitude of the direct effect in this
24 case. So, until 10th March the mobile operators had prepared their evidence and their cases
25 on the basis that Ofcom would play a full role in defending its decision, and Mr. Walker’s
26 evidence in particular was prepared on that basis. However, given the stance which is now
27 adopted by Ofcom we have had to prepare, EE in particular has had to prepare to take a
28 more active role in challenging BT’s case on these points and including through cross-
29 examination of BT’s expert witnesses. We will, of course, seek to avoid any duplication
30 with Ofcom’s case and insofar as Ofcom deals with a point then we will not do so, and
31 between ourselves the mobile operators have also had discussions in order to ensure that we
32 do not duplicate any cross-examination of witnesses.

33 It is also important that given – I think I can fairly say – the vast amount of expert evidence
34 that has been served by BT in this case, we have taken the view that the only proportionate

1 and practicable approach is to focus on the most recent expert reports and to cross-examine
2 on main areas of disagreement, so we will take that approach in this case, and it is proper to
3 put the Tribunal and BT on notice as to that. We in fact have already put them on notice as
4 to our approach in our letter of 25th March.

5 Returning to our primary case and EE's grounds of appeal in case 1168, these have over the
6 course of pleading and argument boiled down to four main arguments and what I propose to
7 do is to summarise them and then to develop in more detail two of those arguments, namely
8 the arguments on the policy preference and on cost orientation.

9 First, we say that even if Ofcom could make out a case that BT's pricing structure was
10 capable of fulfilling its three principles, such a case would depend on Ofcom imposing what
11 is, in effect, an indirect retail price control on the mobile operators. We say without having
12 made a finding that the mobile operators have SMP in the relevant retail market –
13 significant market power – Ofcom is not entitled to take that course. Ofcom is not entitled
14 to do indirectly that which it has no legal power to do directly.

15 Our second argument is that BT's costs of termination should have been at the very least the
16 starting point for Ofcom's analysis of the termination charges set out in the NCCNs. We
17 say that Ofcom erred in not taking those costs into account in determining whether those
18 charges were fair and reasonable.

19 We do not make a positive case for the purposes of this appeal that BT termination charges
20 should necessarily have been limited to its costs, we do not need to make such a case. Our
21 argument is that Ofcom's approach was flawed as a matter of principle in that Ofcom failed
22 to take any, or any proper account of a relevant consideration, i.e. BT's costs of termination.
23 We also say that as BT was unable to put forward any justification for its NCCN's based on
24 its costs and it continues not to put forward such a justification Ofcom was entitled to, and
25 we say Ofcom should have, rejected BT's NCCNs as having failed at the first hurdle.

26 Moreover, we say that BT's proposed charging ladder, which bears no relation to BT's costs
27 of providing the termination for which the charges are levied, imposes different termination
28 charges on mobile operators depending on their different retail prices, and we say that that
29 is discriminatory.

30 Ofcom has failed, we say, properly to address that point on discrimination, in particular
31 Ofcom has failed to address the point that Article 8(3)(c) of the Framework Directive
32 requires it to ensure that there is no discrimination in the treatment of communications
33 providers even where there has been no finding of dominance or SMP on the part of the

1 undertaking which is alleged to have engaged in the discriminatory treatment, so it does not
2 depend on a finding of SMP or dominance.

3 Our third argument is that Ofcom failed to take proper account of the serious practical
4 difficulties that EE, in common with all mobile operators but EE in particular, would face in
5 calculating an average retail price. The calculation of an average retail price being required
6 for BT's proposed wholesale charging structure.

7 In support of that ground of appeal we rely in particular on the evidence of Mr. Ornel,
8 who was at the relevant time head of carrier services at T-Mobile, and he gives evidence,
9 and will give evidence, on the complexity and impracticability of attempting to calculate an
10 average retail price of calls to 08 numbers across the network.

11 His evidence is countered by the evidence of Mr. Kilburn for BT and I will explore the
12 evidence Mr. Kilburn gives in cross-examination, and having done so I think it is better that
13 I develop my arguments on that point in closing, and I propose to do that.

14 Our fourth argument is that Ofcom acted in breach of the requirements of procedural
15 fairness by failing to provide EE with a copy of BT's submissions on the dispute reference.
16 For the purposes of this opening I think it is sufficient to note that in its 17th December 2010
17 draft revisions to its dispute resolution guidelines Ofcom has indicated that it intends in
18 future cases to provide such submissions to the parties to a dispute. So in those
19 circumstances we simply ask the Tribunal to note the procedural unfairness that occurred in
20 the present case and also to note that Ofcom should take such an approach in future cases.
21 As I said, I want to develop my arguments on the first two points, i.e. the policy preference
22 and cost orientation, but before doing so I would like to make brief introductory
23 submissions, if I may, on (a) the purpose of EE's appeal; and (b) the general approach that
24 we say, supported by recent Tribunal case law, Ofcom should take to determination of
25 disputes such as the present.

26 Dealing first with the purpose of the appeal, as I have already indicated, we do not
27 challenge the outcome of the determinations. We say the line of reasoning underpinning the
28 determinations was flawed, but this is important, and our appeal, we say, is important,
29 particularly because Ofcom has clearly stated in its determinations that it would take the
30 same approach to similar cases in future. Just for your note, I would refer you to para.8.11
31 of the 0845 determination, which is in tab 1 of core bundle B1, where Ofcom explicitly
32 stated that its determination should be treated as:

33 "… providing additional guidance to industry as to Ofcom's view of such
34 charging structures."

1 So, in effect, Ofcom has given the green light to ladder pricing structures where the
2 wholesale charge is set by reference to the retail price. We say that that is wrong.
3 Moreover, BT has, in effect, ignored Ofcom's determinations in the 080 dispute and the
4 0845 dispute by introducing new wholesale charges also based on similar ladder structures,
5 relying upon Ofcom's reasoning the determinations, as have other fixed network operators.
6 In particular, despite Ofcom's declaration and order in the 080 determination that BT should
7 revert to its previous trading conditions, shortly after Ofcom issued that determination BT
8 issued NCCN 1007, which contained revised wholesale charges based on the same ladder
9 structure as that contained in NCCN 956. BT claimed, and continues to claim, that that
10 NCCN fulfils Ofcom's three principles as a matter of fact.

11 Mr. Read referred to NCCN 1007 yesterday and he submitted that it simply altered the
12 ladder steps. With respect, that is not the complete picture. It put a ladder charging system
13 back in place for 080 calls, despite the fact that in the 080 determination Ofcom had ordered
14 that BT should revert to its previous non-ladder charging system for 080 calls. We,
15 therefore, say it is vital that the Tribunal address whether Ofcom's approach in these two
16 determinations was correct.

17 The second preliminary point I want to deal with is the approach that Ofcom should take to
18 the determination of disputes such as the present. Yesterday the Tribunal asked how does
19 one derive the criteria by which Ofcom should determine disputes and how does that fit
20 with the contractual position under the SIA. I would like, if I may, to seek to address both
21 of those points.

22 In summary, we say Ofcom has a power to determine disputes referred to it under ss.185 to
23 188 of the 2003 Act. It is clear from the statutory framework that it must exercise that
24 power, subject to the duties imposed on it by ss.3 and 4 of the Act. We say that Ofcom
25 must resolve disputes by reference to its existing regulatory policy and it cannot use the
26 dispute resolution procedure to introduce new regulatory policy.

27 As to the contractual position under the SIA, we say that is subject to and can be overridden
28 by regulation, including the exercise of Ofcom's dispute resolution powers.

29 Sir, if I can develop those introductory points. The essence of the approach that we say
30 Ofcom should have taken to dispute resolution in this case and in other cases is set out in
31 the Tribunal's judgment in the TRD appeal. Can I ask you to pull out that case. It is in the
32 second authorities bundle at tab 29. It is the case of *T-Mobile, BT & Ors. v. Ofcom*, and it
33 has become known as the TRD Core Issues judgment. Can I take you first to para.101 of

1 that judgment. There the Tribunal considers the test that Ofcom should have applied in
2 these disputes. The second sentence:

3 “That test can be expressed as requiring Ofcom to determine what are
4 reasonable terms and conditions as between the parties. The word ‘reasonable’
5 in this context means two things. First, it requires a fair balance to be struck
6 between the interests of the parties to the connectivity agreement. It therefore
7 requires the same kind of adjudication that any arbitrator appointed by the
8 parties to determine a dispute about the reasonable rate would carry out. But
9 secondly, because Ofcom is regulator bound by its statutory duties and the
10 Community requirements it also means reasonable for the purposes of ensuring
11 that those objectives and requirements are achieved.”

12 So Ofcom plays two roles in determining a dispute such as the present one.

13 The touchstone is what is fair and reasonable between the parties against the background of
14 the relevant domestic and European legislative requirements.

15 Can I then take you to the more detailed guidance which the Tribunal gives starting at
16 para.177 of this judgment.

17 THE CHAIRMAN: What was the dispute that Ofcom was being asked to resolve in this case?

18 MISS SMITH: It was essentially whether or not the termination rate charging by the mobile
19 operators to BT and other termination providers was reasonable or not, and there was a
20 question as to the approach that Ofcom took to determining that charge. It did not take a
21 strictly costs orientation approach in that case, it took into account (and I am trying to
22 remember what it was called) a number of other factors that should be taken into account
23 and the Tribunal said it should not have taken those factors into account. It said, on my
24 reading, that it should have started with a costs oriented approach to the setting of the
25 termination charges, and that is what I want to take you to at para.177 onwards.

26 THE CHAIRMAN: I understand, but is there a paragraph in the judgment which just articulates
27 exactly what Ofcom was deciding, simply the scope of the dispute that Ofcom considered to
28 have before it?

29 MISS SMITH: Off the top of my head, I am not sure I can give you that, but I will see if we can
30 find a paragraph that gives you that, sir. As is often the case with a number of these
31 disputes, there are a lot of difficult issues by the time it got to ----

32 THE CHAIRMAN: It is never as easy to identify as one would like to think.

33 MISS SMITH: Why I want to focus on this judgment at paras.177 onwards is here, if you see in
34 para.176, about the middle of that paragraph, the Tribunal is considering:

1 “... what general guidance can be given to Ofcom as to how it should resolve
2 disputes referred to it under section 185 of the 2003 Act and also how the
3 current disputes should be disposed of.”

4 I just want to look, for our purposes, at the general guidance, which is set out in 177 to 189
5 of this judgment. There is a four step road map, “route map”, as the Tribunal described it in
6 para.195. First of all, as the Tribunal sets out in paras.177 to 181, Ofcom should, first of all,
7 consider why the dispute has arisen. At the end of para.177, the top of p.75, the Tribunal
8 makes it clear that the onus lies on the party proposing the variation to justify it:

9 “The onus lies on the party proposing the variation to provide to the other party
10 and to Ofcom the justification for the change in the terms upon which the
11 parties have hitherto been prepared to do business.”

12 I think a submission was made yesterday by Mr. Read to the effect that the onus was on the
13 mobile operators to establish why the NCCNs were not fair and reasonable. We say that
14 that is wrong. I will develop this point, but it is clear from the Tribunal’s judgment, we say,
15 that what one has to look at is the terms upon which the parties have hitherto been prepared
16 to do business, and it is for the party that is proposing the change to those terms to justify
17 the change.

18 THE CHAIRMAN: Miss Smith, that is why I am interested in exactly what the dispute was. I
19 see in para.177 that it says there, “We have got a dispute arising in the context of an existing
20 commercial agreement where one of the parties is trying to vary the terms”. In one sense,
21 one can say that an NCCN is a variation, on the other hand, it is simply the exercising by
22 BT of a contractual right that it has under clause 10 and on that basis it is not really a
23 variation in the sense of something that requires any kind of consent.

24 MISS SMITH: If I may, I would like to address you explicitly on that point, explicitly on the
25 point made by Mr. Read about the difference between Clause 12 of the agreement and
26 Clause 13, but I was proposing to do that after I had been through what is in the *TRD*
27 judgment, if that is suits.

28 THE CHAIRMAN: Certainly, you take it in your own order.

29 MISS SMITH: Sir, in para.177 we have where the onus lies in this case. Then in para.178 the
30 second sentence:

31 ”Ofcom’s first task is to examine the reasons put forward for the proposed change
32 in terms and decide whether they are justified. ... Ofcom must have regard to what
33 is fair as between the parties and what is reasonable from the point of view of the
34 regulatory objectives ...”

1 That reflects what is set out in para.101. Then in para.179:

2 "If it is clear that the reasons put forward do not support the change proposed, then
3 the dispute may be resolved simply by upholding the rejection of the proposal by
4 the recipient of the OCCN and ordering the parties to continue doing business on
5 the terms and conditions that so far applied."

6 We say that it was open to Ofcom to take that approach in the present case.

7 The second step along the route map of guidance given by the Tribunal is starting at
8 para.182 p.77. I would like to draw your attention in particular to para.184. This is about
9 information about costs which is of central importance to the second argument that we are
10 going to make in our appeal. In 184:

11 "Even if the submissions made by the parties do not focus on costs issues, the
12 Tribunal would expect Ofcom at least to consider whether an analysis, however
13 broad brush, of the relationship of prices to costs is necessary. Ofcom should also
14 have regard to the consistency of price and cost trends in all cases, regardless of
15 the stance adopted by the parties."

16 So even if the submissions do not focus on costs issues, the Tribunal would expect Ofcom
17 at least to consider the relationship of prices to costs. As I have said, those comments are
18 important in the context of our appeal in the present case and also have to be read in light of
19 the Tribunal's comments on the relevance of costs earlier in its judgment. Could I ask you
20 to leave a marker in para.184 and flick back in the judgment to para.104 p.46:

21 "Ofcom was wrong to disregard entirely the relationship between prices and costs
22 in this case. There is an underlying assumption in the Disputes Determinations
23 that there is no middle ground between eschewing analysis of the relationship or
24 price to cost completely on the one hand and a full investigation of costs of the
25 kind carried out as part of the SMP market review on the other. The Tribunal does
26 not accept that there is such a strict dichotomy. It should be possible to carry out
27 some investigation of costs to form a broad idea of what that relationship is. Such
28 an assessment may or may not give rise to a cost based price. It may simply result
29 in Ofcom concluding that the price proposed is a reasonable one even though that
30 price was not arrived at on a cost basis. [Then the very important last sentence]
31 The costs are not only relevant when setting a 'strictly cost based price' but are
32 likely to be a factor to a greater or lesser extent in most cases where the dispute
33 between the parties concerns price."

1 We will develop, in our arguments on our second ground of appeal, there are good
2 regulatory and economic reasons why that should be the case: why the costs should be the
3 starting point in any case where the dispute relates to price.

4 In para.105 (I think I can summarise that) the Tribunal made the point simply that it is not
5 excuse that the dispute resolution process is meant to be a speedy process and a
6 determination issued within four months. It should be possible, nevertheless, for Ofcom to
7 carry out some assessment of costs.

8 Then, can I ask you to turn back to p.78 for the third and fourth steps along the route map.

9 Paragraph 186 p.78:

10 “Benchmarking is a useful tool and Ofcom should consider the value of
11 comparisons put forward by the parties and what they show about the
12 reasonableness of the charges or other terms and conditions being proposed.”

13 Then finally at paras.187-189 Ofcom should consider other regulatory objectives. So we
14 have that pretty clear four step route map. It is notable that since this judgment was handed
15 down in 2008 Ofcom has followed that route map in other determinations.

16 Could I ask you to look at Ofcom’s 0870 determination in June 2009 in CAT bundle 22,
17 which is bundle B attached to our Notice of Appeal, at tab 3. We have a determination
18 (although it does not appear on the front) of June 2009. That determination set the
19 termination charges to be paid by BT when BT was acting as an originating
20 communications provider for BT originated 0870 calls, so the same call range as one of the
21 ranges in issue here, but BT in its role as originating communications provider.

22 Before we look at the detail of this, Ofcom set the termination charges to be paid by BT by
23 reference explicitly to the cost of the termination services. More specifically, it set a charge
24 based on the costs of the termination of geographic calls plus a relevant additional mark up
25 for the costs of termination of the 0870 calls on a fully allocated costs basis. That can be
26 seen from the Executive Summary para.1.21 p.3.

27 PROFESSOR STONEMAN: Was BT found to have got SMP in this situation?

28 MISS SMITH: No, no SMP finding in this particular determination. Also the summary of 121
29 and 125 are relevant to the decision. The importance of this decision is that they were set
30 by reference to costs of termination. It is also important to see the approach that BT took in
31 this case, so if I could ask you to turn to p.34 of the determination, para. 6.6 Ofcom sets out
32 the factors that it has had regard to in assessing what the charges might be. We see there in
33 effect the TRD core issues judgment route map and explicitly in footnote 37 reference is

1 made to the TRD judgment, so we have the relationship of price to cost, benchmarking,
2 relevant regulatory objectives and consistency of approach.

3 We submit that was the correct approach for Ofcom to take in that case, that is the correct
4 approach for Ofcom to take in the present case. We will argue that none of the points put
5 forward by Ofcom provide a justification for it taking a different approach in the present
6 case.

7 If I could now deal with a slightly different but related point made by BT, BT has sought to
8 distinguish the approach taken in the TRD judgment to that which should be taken in the
9 present case - for your note this appears in paras. 45 and following of its skeleton, core
10 bundle B2, tab 16. Essentially BT appears to argue that because the TRD appeal concerned
11 the setting of prices under clause 13 of its standard interconnection agreement the position
12 is totally different, I quote: "... from the position here where BT has the agreed contractual
13 right to change the prices."

14 It is true that in the present case BT issued the NCCNs in issue under clause 12 rather than
15 clause 13 of the SIA, but we say that provides no reason for taking a different approach.
16 Mr. Read placed great emphasis on BT's contractual right yesterday. I have dealt with the
17 point about where the onus of proof lies in the present case but also it is important to note
18 that we say BT's contractual right to vary the terms is explicitly subject to regulation by
19 Ofcom in the event that the variation is not accepted by the parties. That is the clear
20 position under the contract, BT knows that and always expected that to be the position in
21 the present case. So in order to make that submission good, if I could ask you first to
22 actually turn up the Standard Interconnection Agreement, which we did not look at
23 yesterday, it is in CAT bundle 22, tab 17.

24 We have the SIA and the relevant clause is clause 12, which appears on p.9 of 23. By way
25 of introduction we say that this clause gives BT the power to vary its charges, but that
26 power is clearly qualified and clearly subject to regulation by Ofcom. We see in clause
27 12.2:

28 "BT may from time to time vary the charge for a BT service or facility by publication in the
29 Carrier Price List ..." and it takes effect on the effective date. But if you then go on to look
30 at clause 12.3.2 it is provided that BT may vary a charge which has retrospective effect if
31 the variation is as a result of "an order, direction, determination or requirement of OFCOM
32 or any other regulatory authority ..."

33 THE CHAIRMAN: That is only charges as you have read out which have retrospective effect.

34 MISS SMITH: Yes.

1 THE CHAIRMAN: Whereas the NCCNs here were all clearly

2 MISS SMITH: Yes, that is dealt with in the subsequent sub-clauses. If you look at clause 12.5
3 we see that:

4 "As soon as reasonably practicable following an order, direction, determination or
5 consent [for a BT service or facility] ... BT shall make any necessary alterations
6 to the Carrier Price List so that it accords with such determination."

7 So it clearly envisages that the variation may be subject to a determination by Ofcom and
8 therefore should be varied following that determination.

9 Similarly, over the page at 12.6:

10 "If a determination ... is subject to a legal challenge, the parties shall ... treat the
11 determination as valid until the conclusion of the legal proceedings, unless the
12 court otherwise directs. If the court finds the determination to be unlawful the
13 parties agree to revert to the charges payable immediately prior to such
14 determination being made."

15 So it envisages amendment, variation by BT subject to the dispute as to termination. It
16 envisages legal challenge, and most importantly, perhaps, at 12.9:

17 "If there is a difference between a charge for a BT service or facility specified in
18 the Carrier Price List and a charge determined by OFCOM, the charge determined
19 by OFCOM shall prevail."

20 So it is quite clear there that although there is this power to make a variation it is clearly
21 subject to regulation by Ofcom through the dispute determination process.

22 THE CHAIRMAN: Yes, are you going to take me to clause 26 in the SIA?

23 MISS SMITH: I was not proposing to do so now but ----

24 THE CHAIRMAN: Well do not do it on the hoof.

25 MISS SMITH: I will perhaps have a look ----

26 THE CHAIRMAN: Over the adjournment.

27 PROFESSOR STONEMAN: While we are around clause 12 those points are relevant to the issue
28 I raised this morning with respect to relief for BT?

29 MISS SMITH: Yes. And I will, if I may, deal with that point in due course.

30 PROFESSOR STONEMAN: Thank you.

31 MISS SMITH: I think it would be worthwhile perhaps taking you, if I may in this regard, to the
32 next CAT bundle, 23 and we say the documents contained in there make it clear that BT
33 always expected its charges to be disputed and that it always expected the dispute to be
34 referred to Ofcom in the normal way. So it is bundle 23, tab 8.1 - might I just explain what

1 this document is? During the course of the 0845 determination Ofcom put various
2 questions to BT under its s.191 powers. BT was required to answer those questions, and if
3 you look at request of the information request, Ofcom requests that BT provide copies of
4 internal documents that consider the impact of NCCN 985 and 986 on BT's business. I am
5 afraid that this tab is rather unhelpfully unnumbered, but towards the back of the tab, in fact,
6 I think the final document in this tab, is BT's internal management document proposing the
7 pricing variations. It is important to note that this document contains confidential material.
8 The document as a whole is not confidential; I will try not to refer to any of the confidential
9 material for the purposes of this point, but what I would like to take you to, just for the
10 purposes of the point I am making at the moment, if you have that document?

11 THE CHAIRMAN: I do not think I have it yet.

12 MISS SMITH: It is nine pages, it is entitled at the top of the page: "In confidence. BT Wholesale
13 Community only devolved authority. BT terminated 0845/0870". It is quite an important
14 document, and I anticipate we will be coming back to it on a number of occasions over the
15 next few days.

16 PROFESSOR STONEMAN: (no microphone): Is this the one that contains the responses of BT
17 to each of the questions that was put?

18 MISS SMITH: No, it is an internal contemporaneous document. I am instructed it was not in the
19 bundles when they were originally filed for some reason.

20 THE CHAIRMAN: I will stop looking then.

21 MISS SMITH: It is quite an important document – if it has not been inserted ----

22 MR. READ: I am just trying to find where it has got into the bundle.

23 MISS SMITH: (After a pause): Sir, that is the document. It has just been inserted in a difference
24 place in that tab. That is the problem with unnumbered documents. Do we have it?

25 THE CHAIRMAN: We are getting there.

26 MISS SMITH: This point may not be the biggest point to be made on this document, but it is
27 important that everyone has it.

28 THE CHAIRMAN: Miss Smith, we are all there.

29 MISS SMITH: As I said, this is the document that was provided, as I understand it, by BT in
30 response to a request from Ofcom for contemporaneous documents assessing the impact of
31 the pricing proposal of the NCCNs on BT's business. You will see that this is a proposal
32 for pricing produced, it appears, for internal consideration by BT. The executive summary
33 at section 1:

1 “This paper outlines a proposal to increase the charges for BT termination of
2 0845 and 0870 services to CPs who charge their end users at a retail rate above
3 12.5 pence per minute. The charging mechanism proposed will improve the
4 margin of revenue for 0845 and 0870 by up to [...] per annum, and based on a
5 1st November implementation up to [...] this financial year.”

6 For the purposes of this point, I would just like you to turn to p.5 of 9, and while we are
7 here we may as well look at section 5 on rationale. I will be making a point on this section
8 later in my opening:

9 “This proposal is based on the regulatory principle that the Originating CP is
10 making a margin on a call where the purpose of the numbering convention is to
11 ensure that value is passed on to the terminating carrier [and not the service
12 provider hosting the number] and providing a service to the calling party. For
13 carriers choosing to price above the 12.5ppm threshold BT Wholesale believe
14 that some form of profit share ...”

15 that is profit share between the mobile operator and BT –

16 “... is a reasonable approach to pricing and that the structure outlined above
17 offers a manageable and fair approach.”

18 I will be coming back to this document in more detail, but it is sufficient to note at the
19 moment that the figures contained in this document assume that, one, mobile operators will
20 maintain their prices at previous levels. There is no provision made in the figures in this
21 document for any reduction in prices by the mobile operators. Two, the second assumption
22 on this document is that there will be no pass-through of revenue from BT to service
23 providers. The rationale quite clearly stated is that there should be a share of profits
24 between the mobile operators and BT.

25 THE CHAIRMAN: For carriers choosing to price above 12.5.

26 MISS SMITH: For carriers choosing to price at those high levels. I will come to the question of
27 the high levels in prices later, if I may.

28 PROFESSOR STONEMAN: (no microphone) ... possibly some drop-off in activity.

29 MISS SMITH: That appears to be the only impact that is actually highlighted in this document.

30 PROFESSOR STONEMAN: So the risk is that ----

31 MISS SMITH: The volumes may go down but the prices do not go down.

32 PROFESSOR STONEMAN: The volumes may go down and therefore there is a risk attached to
33 these figures that are being presented?

1 MISS SMITH: Yes, that is highlighted there. That point is there, the indirect point. For the
2 purposes of the point I am making at the moment about challenge, I wanted to draw the
3 Tribunal's attention to section 6 on risks. This is a departure from the way in which the
4 termination notice had been charged in the past and it will hit the affected communication
5 providers' bottom line. It is expected that CPs will challenge both the rate and any
6 associated methodology, so it clearly expected a challenge.

7 "Comments on the legal basis for a challenge are contained in the legal annex."

8 That is not produced, understandably.

9 "Other options open to the originating CPs ..."

10 that is the mobile operators and others who are here today –

11 "... a direct challenge to the charge and underlying principles, billing dispute
12 referral to Ofcom."

13 So clearly BT did not think, "We can just vary and impose a charge we want", they
14 anticipated, correctly, that there would be a challenge and the rate may be going to be
15 determined by Ofcom.

16 We say, just by way of conclusion on this point – and I will come back, if I may, on the
17 contractual point on clause 26 that you brought up, sir – that two points can be taken from
18 this. Clearly BT's variation of the termination charge in the present case was not a simple
19 exercise of its contractual rights. Those contractual rights are clearly subject to regulation
20 by Ofcom if the variation is disputed, and the approach we say that Ofcom should take to
21 the determination of such a dispute when prices are disputed is that set out in the TRD Core
22 Issues judgment that I took you to.

23 Can I then turn to the substantive points that I want to develop in support of our appeal.

24 The first aspect of our case that I propose to develop in opening is the argument that
25 Ofcom's approach in the determinations was retail price control by the back door
26 effectively, and that Ofcom was not entitled to take such an approach in the present case.

27 First, by way of background it is necessary briefly for me to outline the current regulatory
28 position as regards non-geographic number calls. I think that is regulatory position,
29 regulatory obligations rather than preferences. I think that is probably most easily done by
30 reference to my skeleton in the core bundle B2, tab 17, starting at para.27, p.14. There are
31 two aspects of Ofcom's regulation of NTS calls. Those two elements set out in para.27 are
32 the NTS call origination condition, which applies to BT only, and the National Telephone
33 Numbering Plan which applies to all communications providers.

1 So addressing first the NTS call origination condition, as I have said there, it is important
2 this applies only to BT. This applies as a result of a finding most recently confirmed and
3 most recently made in 2009 by Ofcom that BT has significant market power in the market
4 for call origination. So it is an SMP condition that imposed on BT.

5 In summary, what it does is it allows BT to retain from its retail charge for 08 calls an
6 amount equivalent only to its costs of origination. So it has got to pass on everything that it
7 obtains from its retail price for 08 calls apart from the costs of origination which are to be
8 passed on to the terminating communications provider.

9 This does not impose any direct regulation of BT's retail prices, but the operation of the
10 condition does mean that it is less likely that there is any incentive on BT to raise its retail
11 prices or increase its retail prices for NTS calls because if it does it simply has to pass on
12 any surplus, any increased revenue that is obtained. So it could be said to be an indirect
13 control on the retail prices that BT charge.

14 It is also of relevance because it provides that there is some pass on of revenue from the
15 originating call provider to the terminating call provider by control on what the originating
16 call provider can maintain. It can only maintain its costs of origination; it has to pass on
17 any remaining part of the retail price to the terminating communications provider.

18 But the important point is that this applies only to BT. It is an SMP condition applied only
19 to BT. It is important to note, and I think Professor Stoneman had already picked this up
20 yesterday, since 2009 this NTS call origination condition has not applied to 0870 calls. It
21 applies only, for the purposes of this appeal, to 080 and 0845 calls. That is the first aspect
22 of regulation.

23 The second aspect of regulation is the National Telephone Numbering Plan, the NTNP. It
24 can be most easily appreciated, I think, if you look at para.30 of my skeleton argument
25 where the relevant provisions of the NTNP are set out: the relevant conditions, the relevant
26 controls on 080, 0845 and 0870 numbers. This applies to any communications provider that
27 uses these number ranges: the 080, 0845 and 0870 number ranges. 080 is designated as a
28 special service, no charge to customer except where the charges shall be notified to callers
29 at the start of the call. So the effect of that is if you notify charges to callers at the start of
30 the call, you can in effect impose any charge to the customer.

31 THE CHAIRMAN: This is under Section 56 of the Act?

32 MISS SMITH: That is right, yes, Section 56 of the 2003 Act.

33 THE CHAIRMAN: So what happens if the words in brackets were not there and said no charge
34 to customer, is it your position that one could charge?

1 MISS SMITH: I think so. It is quite complicated as to exactly on whom this NTNP imposes
2 legal obligations. Strictly under s.56 it appears to impose legal obligations on the person
3 who uses the number ranges, which would be the terminating communications provider, but
4 I think because of the interconnection agreement there is a contractual agreement between
5 the parties that everyone will comply with the NTNP.

6 Maybe that is not quite the point you are making, sir. If the words in brackets were crossed
7 out, then this would be a free phone number. If there is a notification of charges, then a
8 charge may be imposed on customers. I am going to come back as well to 080 and how that
9 has been dealt with by Ofcom. For my purposes at the moment, it is important to note that
10 no retail price control is imposed on mobile operators or in fact any OCP including BT as to
11 charges for 080 numbers if the charges are notified. It is simply a transparency
12 requirement.

13 THE CHAIRMAN: The actual amount of the charge is not disclosed, is it?

14 MISS SMITH: This is a point that is in issue between the parties and will have to be addressed in
15 cross-examination. BT has said that the mobile operators do not comply with the NTNP
16 because they do not say: this charge will cost you 7.3p; this charge will cost you 25.7p per
17 minute. We say that that is not the obligation that is imposed on the operators by this plan
18 and that it could never have been so intended. It is not possible or practicable to say: this
19 particular call will cost you X pence. The call might be part of a tariff package, it might
20 depend on whether you have made it at a stage where you still have some credit left in your
21 package or not. So what we say (and I will be exploring this with the witnesses) is the
22 obligation that is imposed by the numbering plan is simply to notify that there will be a
23 charge for this call. That is combined with general condition 20.2 which imposes an
24 obligation to publish call charges. You will see from documentation that I will take you to
25 that the headline rate for call charges to 0845/0870/080 numbers is clearly published by the
26 mobile operators. So that is our position on this, but we will be exploring that further with
27 the witnesses.

28 THE CHAIRMAN: I am sorry to labour the brackets on the 080 point, but your first headline
29 point was that Ofcom is imposing an indirect price control which it has no direct right to do.
30 But if you are right, and you can impose a no charge to customer rule on all communication
31 providers by virtue of s.56 --

32 MISS SMITH: We say you cannot, we say you certainly cannot and I will be coming on to this.
33 We say at the moment (and I will be coming to the law) this is the extent to which Ofcom
34 could control prices. This NTNP reflects the fact that it can only impose at the most

1 transparency requirements on the mobile operators. There is a complication on 0845
2 numbers (it may be that Ofcom will have to clarify this, because it is something that I have
3 had difficulty with as well) that the 0845 provision in the NTNP says that the special
4 services rate is charged at BT's standard local call retail price for BT customers inclusive of
5 VAT, the price charged for other OCPs may vary. So our first point is it is quite clear that
6 the price charged for other OCPs may vary, so from the point of view of mobile operators
7 there is no control on prices. It does appear to impose a control on the retail price of BT
8 calls. That may be a hangover from the fact that until 2009 BT was held to have SMP in the
9 retail market for these calls. But this is something that will have to be explored with
10 Ofcom, I am afraid.

11 THE CHAIRMAN: I see that, but just to understand the point you made before, the 0845 point, is
12 it your position that if the NTNP changed, in other words one moved from a further
13 iteration and changed in the way I am hypothesising, namely the deletion of the brackets,
14 then in that context you would have a form of price control on all operators in the market
15 subscribing to these national numbers?

16 MISS SMITH: Yes, and we see that at the moment, at the time of the determination most
17 importantly, there was no legal power for Ofcom to do that. I will come on to the point that
18 there may be a legal power for it to do that, to impose retail price control, in the future.
19 That is what it envisages doing in its Simplifying Non Geographic Numbers consultation.
20 But explicitly, and I will come back to this, Ofcom makes it clear in its consultation paper
21 that it can only do that, it can only impose the direct retail price control, after change in law
22 that is coming about in May 2011, 25th May. The Better Regulation Directive [2009] is to
23 be implemented into UK law, and Ofcom has interpreted that Directive to give it an
24 additional power of imposing direct retail price control.

25 I will take you to that, but the important point, we say, is at the time of the determinations
26 there was no legal power for Ofcom to impose a direct retail price control without having
27 made a finding of significant market power. I will take you to the directives to make that
28 point good, if I may. What we are saying is that this is reflected in the regulatory controls
29 that are currently in place for NTS members. Put simply, there is the NTS call origination
30 condition imposed on BT because of an SMP finding in the market for origination of calls.
31 There is the national telephone numbering plan, which imposes no restriction on the retail
32 prices that mobile operators may charge.

33 THE CHAIRMAN: Yes, I do understand that point. I just need to be clear that had (which I
34 accept, of course, has not happened) this particular 8th March 2010 NTNP been drafted

1 differently without the brackets, then that would have been a legal course for Ofcom to
2 take?

3 MISS SMITH: No, we say it did not have the legal power to do that. We say it only had the legal
4 power to do what it has done, which is impose transparency requirements.

5 THE CHAIRMAN: I see, and the position is changing.

6 MISS SMITH: The position is changing and I will take you to that.

7 THE CHAIRMAN: I understand.

8 MISS SMITH: We say effectively, in a nutshell, Ofcom has jumped the gun; it knows the
9 position is going to change and it makes proposals to impose direct retail price control
10 under the Simplifying Non Geographic Numbers Review. It is trying to do that which it
11 cannot now do indirectly and trying to pursue the same objectives, and we say it has jumped
12 the gun before it has the legal power to do so.

13 PROFESSOR STONEMAN: Just before we go away from this section, does the implicit
14 definition of customer as call originator have any relevance to our discussions?

15 MISS SMITH: In what ----

16 PROFESSOR STONEMAN: Mr. Read was making the point that “customer” can be very widely
17 defined to include SPs. This really is set up to say what price the call originator should
18 pay, and that call originator is labelled “customer” and I am asking you whether there is any
19 relevance in that definition of what customer ----

20 MISS SMITH: I am not sure if I have misunderstood your point, with respect, Professor
21 Stoneman, but my reading of customer in the NTNP is that ‘customer’ is caller.

22 PROFESSOR STONEMAN: So it is originating caller, it is not consumer?

23 MISS SMITH: Yes, absolutely. For the purposes of my appeal I am not sure whether I need or
24 want to take any point on that. We are effectively riding on the coat tails of Ofcom, I
25 hope ----

26 PROFESSOR STONEMAN: Fine.

27 MISS SMITH: -- on the point about what consumer means for the purposes of the 2003 Act, and
28 the obligations and duties that Ofcom have in that regard, so I am happy to leave all those
29 points to Mr. Herberg. I think I have made the point to death now, simply there is no
30 regulatory control on the prices that mobile operators may charge, the retail prices they may
31 charge.

32 That, by way of background is, we say, important background, it bears emphasis. Back to
33 our case on Ofcom’s policy preference. BT’s starting point, set out, for example, in paras. 4
34 to 10 of its notice of appeal in case 1169 – I do not need to take you to it, but it is repeated

1 in a number of other places. It describes the mobile operator's charges for the 08 calls as
2 'excessive' – a loaded term – and complains, and I quote, that:

3 "Ofcom has singularly failed to introduce any regulation to prevent the MNOs from
4 imposing these excessive charges on their customers."

5 We say, with respect, that is potentially misleading and also wrong insofar as it suggests
6 that these prices are excessive. The starting point – important starting point – is that mobile
7 operators' retail prices are set in a competitive market. No mobile operator has been found
8 to have significant market power in the retail market or in the origination of calls. On the
9 contrary, in a number of places there have been explicit findings both at the European level
10 by the European Commission and by Ofcom that the mobile retail market is highly
11 competitive. I think it is worthwhile if I could take you to the third authorities bundle, tab
12 49. This is the European Commission's decision on the merger of T-Mobile and Orange,
13 obviously something close to the hearts of those instructing me. It is a decision made by the
14 European Commission in March 2010. It considered the merger, but it also made various
15 findings about the state of the mobile retail market in the UK. If I could ask you to turn first
16 of all to para. 47 which is on p.10:

17 "Available data shows that prices have been falling on a year-on-year basis for a
18 basket of mobile services."

19 There is a table there setting out the real cost of a basket of mobile services which have
20 been falling in the UK since 2003 up to 2008. If I could ask you to turn over the page, to
21 p.11, para. 53:

22 "In the course of the market investigation the Commission verified that the UK retail mobile
23 market is characterised by the strong presence of MVNOs ..."

24 - Mobile Virtual Network Operators – those who do not have a physical network but by
25 origination from the mobile network such as Tesco Mobile, those sort of MVNOs -
26 "... and by a large number of efficient distributions channels. Compared to other European
27 mobile markets, in the UK there is a significant level of switching between different mobile
28 service providers, and there is pricing and service innovation. These factors point to the
29 fact that the UK retail mobile market is very competitive."

30 Finally, if you could turn over the page to p.13, para.64 – I am not going to read it all out,
31 you can read it to yourselves, but it says simply:

32 "The Commission has verified that the U K market for retail mobile services is
33 competitive and is likely to remain competitive following the proposed transaction
34 [the merger] taking into consideration the market structure and characteristics."

1 If I could ask you then to put that away and take up bundle CAT bundle 11. This is
2 Vodafone's statement of intervention and I am shamelessly going to use the information
3 that they have put in, tab 6, this is their statement of intervention in the 080 case. Tab 6 is
4 Ofcom's mobile sector assessment of 17th December 2009: "Mobile Evolution". I am going
5 to ask you to look first at the executive summary, p.2, para.1.1:

6 "Mobile communication has transformed the way almost all of us keep in touch.
7 Ofcom's view is that currently mobile markets are serving UK citizens and
8 consumers well and competition between mobile operators is driving this
9 success."

10 So that is Ofcom's view at 1.1. On p.15, if I could just ask you to turn to p.15, para. 3.2:

11 "Our analysis of the mobile sector indicates that the continued promotion of
12 competition should remain the primary means for achieving good outcomes for
13 citizens and consumers. Our bias against regulation leads to a preference for the
14 maintenance of healthy infrastructure-based competition at the deepest level
15 possible to produce differentiation in mobile services and pricing."

16 So I would simply stress, and I will come back to the relevance of this statement, that
17 competition should be the primary means of achieving good outcome for citizens and
18 consumers, and that there is a bias against regulation.

19 Page 17, if I could ask you to look at paras.3.10 and 3.11.

20 "3.10 The UK has five national MNOs, enabling what many see as one of the most
21 competitive and active mobile markets in Europe.
22 3.11 The competition between national mobile radio access networks constitutes a
23 marked difference between the mobile sector and the fixed-line sector, in which,
24 for the majority of UK residents, there is only one physical fixed
25 telecommunications access network (and for all residents, there is only one
26 ubiquitous fixed access network). More than any other feature of the market, the
27 multiplicity of competing networks determines our approach to regulation of the
28 mobile sector."

29 Then if I could ask you to turn to p.19, para. 3.23.

30 "We also found that on some measures (such as operating profit) the mobile sector
31 in the UK has exhibited lower profitability than elsewhere in the EU across the
32 period surveyed in Figure 10. This, coupled with the evidence that retail pricing is
33 low compared to other EU countries, provides indirect evidence that the market is
34 working in consumers' interests. It implies considerable competitive pressure on

1 operators to find new ways to win customers, and improve margins by bringing
2 new services and devices to market.”

3 Then finally p.22, paras. 3.36 and 3.37 again statements about effective competition but if I
4 could just emphasise the last sentence of 3.37:

5 “In light of the degree of competition in the market and the significant costs that a
6 market review would impose, directly on operators and indirectly on consumers,
7 we do not intend to conduct a market review at this time.”

8 So not only has there been no finding of SMP, Ofcom have indicated that in light of the
9 degree of competition on the market it is not even going to carry out a market review.

10 I would like to take a number of points on the back of that document, if I may.

11 First, and a very important point for the purposes of this appeal, although in isolation the
12 prices for 08 calls may appear high, one has to look at those prices in context. Competition
13 between mobile operators has to be assessed and is properly assessed in terms of bundles of
14 services rather than specific elements. Mobile operators compete for customers by offering
15 a bundle of services. In our submission, that bundle of services include various tariff
16 packages, which may or may not include 08 calls. Yesterday Mr. Read emphasised that 08
17 calls are often not included in tariff packages offered by mobile operators. The evidence
18 before the Tribunal, and I do not think I need to take you to it for these purposes, is that T-
19 Mobile has in the past offered a tariff package that includes 08 calls, and other MNOs, I
20 think such Vodafone, have offered a bolt-on product that includes 08 calls. Whether or not
21 08 calls are included in the specific tariff packages does not detract from our submission
22 and from the fact that mobile operators compete on a bundle of services. That bundle
23 includes services both within the tariff packages and those that fall outside the tariff
24 packages. It is multi-product competition. I understand that is the economic term for it, on
25 instructions.

26 Those bundles of services include higher prices and may include higher prices on services
27 that customers are unconcerned about and lower prices for those that they are more
28 concerned about. The competitive market ensures that the charges which matter most to
29 consumers are kept as low as possible within the overall basket.

30 To put it more technically, although each of the services should and may cover its
31 incremental costs, certain services may make a higher contribution to fixed and common
32 costs than others. That does not mean that those services are overpriced or priced
33 excessively. What is important is that over the bundle of services the prices are set at a
34 level which is in the interests of consumers and competition.

1 It is not just me that is saying this. I would like to, if I may, take you to an article produced
2 by Dr. Maldoom, and expert for BT in this case, which is in CAT bundle 20. This is an
3 accepted economic position and is the position taken, I think, by various experts, most
4 people engaged and involved in the mobile sector. Would you turn to tab 6 where you have
5 a paper produced in 2001 by Koboldt and Maldoom, and on p.7, before we get on to the
6 equations – I am not even going to go there – perhaps for completeness start on p.6, under
7 the heading 2.3 “The mobile service basket”. Perhaps I could ask you, rather than me
8 reading it out, to read to yourselves the first paragraph there. (After a pause) Then p.7, the
9 paragraph just above 2.4, “The relevant benchmark”, the sentence half way through that
10 paragraph:

11 “The fact that charges for some services are – perhaps significantly – above
12 LRIC ...”

13 - which is long run incremental cost –

14 “... may not indicate a lack of competition, but rather the fact that customers are
15 less price sensitive with regard to those services. Effective competition should,
16 nevertheless, lead to overall cost recovery across a basket of services, as other
17 more price sensitive services will bear a lower share of common cost.”

18 That is reflected, if I could ask you just to turn back to p.3, in the second paragraph on p.3,
19 and perhaps I could ask you to read that to yourselves. This was about call termination
20 charges, but we say the general points apply equally in the current dispute to retail prices for
21 08 numbers.

22 PROFESSOR STONEMAN: Will we be getting some more expert evidence on this? This is
23 basically the principle that Ramsey prices have some optimality properties. It is not
24 obviously clear, if you take account of some of the distributional impact of those prices,
25 such that the poor will have to pay more for the services that they use more often and the
26 rich pay less for the services they use most often, or in a market where there are
27 externalities or where it is a two-sided market, that Ramsey pricing has the benefits that I
28 think you are trying to say that one would get in a properly competitive market. Are we
29 going to have expert evidence on that?

30 MISS SMITH: I think we are. My purpose in drawing attention to this document at this stage is
31 simply to counter the rather colourful statements that have been made about the excessive
32 prices charged by MNOs for 08 calls, and my point is that one cannot simply focus in on the
33 price of one particular element within the bundle. One has to look across the bundle.
34 Obviously there are points, and I will be coming to them in submission, and I am sure they

1 will be dealt with in expert evidence, about the externalities in this case, the two sided
2 market and those justifications that are given by Ofcom for moving away from, for
3 example, cost based pricing. I am not proposing to make any submissions on them at this
4 stage, but obviously there is always the question as to whether, in a market which is two
5 sided and where there are externalities that this is possibly the best approach. I am simply
6 referring to this at the moment to try to counter the slightly extravagant statements that are
7 made about the 08 call prices.

8 We also say that the MNOs' evidence to Ofcom in the current dispute was that demand for
9 non-geographic calls was inelastic – that is that consumers did not really care about the
10 price of those calls. They were much more concerned about the price of calls of geographic
11 numbers. We said that the volume of the calls made would not be substantially affected by
12 an increase in price. That, we say, is supported by evidence gathered by Ofcom in its recent
13 simplifying non-geographic numbers consultation, which appears in an annex to that
14 consultation paper. The annexes do not appear in the paper, but the annexes were attached
15 to Vodafone's skeleton argument. I am not sure whether those have appeared in your core
16 bundle, B2. There were a number of appendices served with Vodafone's skeleton.

17 Unfortunately, my copy of Vodafone's skeleton in bundle B2 does not have its appendices.
18 It is at the very back, tab 23, and if you do not have them we have copies.

19 THE CHAIRMAN: We have them.

20 MISS SMITH: This is a research document, October 2008, that was attached to Ofcom's
21 simplifying non-geographic numbers consultation paper and it is the results of various
22 consumer surveys. I would like to draw your attention to pp.22 to 24. At p.22 consumers
23 were asked:

24 "If all calls to 0800 numbers were free from mobiles there would be a cost to
25 the operator. If your total bill stayed the same would you like to have 0800
26 numbers free from your mobile even if other calls became more expensive?"

27 You will see that the overwhelming response is "no", 49 and 59 per cent.

28 Over the page on 23, question 40:

29 "If all calls to 0845 and 0870 numbers cost the same as a call to a standard
30 geographic number there would be a cost to the operator. If your total bill stayed
31 the same would you like 0845 and 087 numbers to be priced in this way, even if
32 other calls or line rental became more expensive?"

33 Again, the answer overwhelmingly is no.

1 Then finally on p.24: “Which would you prefer: to keep the costs for these 08 and 09 calls
2 the same as they are now, or reduce the costs of these calls and increase the cost of local and
3 national calls?” and 70 per cent said the costs the same.

4 THE CHAIRMAN: There are comments elsewhere in this paper about customers being put off
5 making 0800 and 0845 and 0870 numbers from numbers because of the costs, and
6 switching to fixed line, or being deterred from making the calls.

7 MISS SMITH: I am sure there is. I am sorry, I did not catch your final point, sir.

8 THE CHAIRMAN: I am sorry, it almost seems to be a contradiction where they are saying that
9 customers are happy with what they are getting, but then earlier in this report there is
10 comment that there are put off by the size of the charges and they are using alternative
11 means of communication to avoid that.

12 MISS SMITH: Yes, they may be. At p.12 there are some figures to the effect that people tend to
13 use their land lines when they are making these types of calls.

14 THE CHAIRMAN: Yes, also p.16.

15 MISS SMITH: But we say there is this alternative available to the majority of callers. We will
16 have to address the point about vulnerable callers, whatever, but it is relevant to the point
17 about the externality that is identified in this case and the extent of that externality. It is a
18 simple point that I am making at this stage. What we say is that consumers care more about
19 the price of geographic calls than they care about the price of 08 calls. In that situation,
20 where there is competition across a bundle of services, it may be that calls to those numbers,
21 the 08 numbers which people care less about, are higher than the calls to numbers which
22 they care more about, the geographic numbers. That, we say, may be a perfectly valid
23 response and a perfectly sensible response to competition across the bundle of those
24 services. The point is, consumers may not like the higher calls and they will switch to fixed
25 lines, but they are not willing to pay in order to get lower call prices. They are not willing
26 to take the hit on the prices for geographic numbers in order to get lower prices on the 08
27 numbers. They are of less importance.

28 The point I want to make is really also this. As we have seen from the document to which I
29 took you, the Mobile Evolution document, Ofcom’s mobile sector assessment, it is
30 competition, we say, rather than regulation, which should be the primary means to achieve
31 good outcomes for citizens and consumers. We say that a similar approach is taken in the
32 European regulatory framework. The Common Regulatory Framework was intended to
33 reduce the level of regulation which member States may impose, and most specifically, it

1 provides quite clearly that price controls should only be imposed where a market is not
2 effectively competitive.

3 As I have already indicated, at the time of the determinations, the relevant European
4 Directives had been amended by the Better Regulation Directive 2009 140EC, but the
5 deadline for implementing those changes is not until 25th May 2011 into UK law. So it is
6 relevant to consider the directives and the UK implementing legislation before those
7 amendments were made. May I start with the Framework Directive in Authorities Bundle 1
8 tab 8.

9 PROFESSOR STONEMAN: Just to clarify what you are saying, you are saying that competition
10 is the best way to correct externalities, are you?

11 MISS SMITH: We are saying it may be, and what I will go on to say and put to Ofcom is that it
12 has not established that – and there are a number of points that I will be putting to them –
13 effectively, they have not established that the externalities that they have identified and
14 provided for in the determinations, because it is notable that they have not taken into
15 account or sought to quantify any of the externalities; they have not even taken into account
16 a number of externalities that may arise. What they have not sought to do is to get an
17 optimal price across the platform. They have taken into account certain externalities and
18 said: this justifies us departing from the standard approach of setting a cost oriented price
19 for determination charges; this externality is very important. Actually, it is their policy
20 preference that is important, that is what has been driving them, not an attempt to set an
21 optimal price across the platform. If they had been intended to do that, they would have had
22 to have taken into account more externalities than the vertical externality they have
23 identified, and they would have also had to very carefully quantify those externalities in the
24 costs and benefits that arise from it. They have not done that. We say it is dangerous in that
25 situation to try to do a sort of semi job of optimising prices. In fact, what they have done is
26 taken into account certain externalities but that is their policy preference. We say you
27 should not, in that situation, depart from the orthodox approach of starting with costs,
28 because you cannot do a proper price optimisation across the platform in these
29 circumstances in dispute resolution.

30 Back to the Framework Directive at Authorities Bundle 1 tab 8. Can I take you to Recital
31 27 which, if you have got the same document, is p.4 of 20.

32

1 “It is essential that ex ante regulatory obligations should only be imposed where
2 there is not effective competition, i.e. in markets where there are one or more
3 undertakings with significant market power ...”

4 Just to summarise, in that situation the Commission draws up Community Guidelines for
5 national regulatory authorities to follow in assessing whether competition is effective, and
6 national regulatory authorities should also analyse whether a given product or service
7 market is effectively competitive. So the Commission is to draw up guidance, the NRAs
8 (National Regulatory Authorities) are to carry out market analysis. But the important thing
9 is the regulatory obligation should only be imposed where there is not effective competition.
10 If you turn to 14.2, just in passing, on p.13 of 20, it defines significant market power as
11 being effectively the same as dominance for the purposes of the competition law.

12 Article 15 of the Framework Directive sets out the Market definition procedure, that is the
13 Commission is to adopt a recommendation on relevant product and service markets, and the
14 recommendation shall identify those product and service markets within the electronic
15 communications sector, the characteristics of which may be such as to justify the imposition
16 of regulatory obligations. I think a point was made in O2’s skeleton argument that the
17 mobile retail market does not appear in the Commission’s recommendation as “the
18 characteristics of which may be such as to justify the imposition of regulatory obligations”.
19 But for my purposes the structure is important.

20 The first stage is that the Commission carries out a market definition procedure; the second
21 stage in Article 16 is that after the adoption of the Commission regulation an NRA is to
22 carry out an analysis of the relevant market (a market review). Then Article 16.2 on p.14 of
23 20 is important:

24 “Where a national regulatory authority is required under [various provisions of the
25 Universal Service Directive and the Access Directive] to determine whether to
26 impose, maintain, amend or withdraw obligations on undertakings, it shall
27 determine on the basis of its market analysis referred to in paragraph 1 of this
28 Article whether a relevant market is effectively competitive.”

29 Then 16.3:

30 “Where a national regulatory authority concludes that the market is effectively
31 competitive, it shall not impose or maintain any of the specific regulatory
32 obligations referred to in paragraph 2 of this Article.”

33 I will take you shortly to those Articles of the Universal Service Directive and the Access
34 Directive, but it is important the specific provision in Article 16.3:

1 “Where a national regulatory authority concludes that the market is effectively
2 competitive it shall not impose or maintain any [of those regulatory objectives].”

3 It is only in effect where the national regulatory authority finds that the market is not
4 effectively competitive that it can impose the obligations set out in the USD and the Access
5 Directive.

6 If I could ask you to turn to the Universal Service Directive, which is at the following tab,
7 tab 9, Article 1.2, which is at p.9 of 24 sets out the scope of the Universal Services
8 Directive. It establishes the rights of end-users, clearly callers, it is concerned with retail
9 markets. Article 16, which is on p.13 of 24, sets out review of obligations. Member States
10 have to review the existing obligations that are imposed on retail tariffs etc, and for our
11 purposes it is important to focus on Article 16.3:

12 “Member States shall ensure that, as soon as possible after the entry into force of
13 this Directive, and periodically thereafter, national regulatory authorities
14 undertake a market analysis, in accordance with the procedure set out in Article
15 16 ...”

16 of the Framework Directive which you have just seen - “... to determine whether to
17 maintain, amend or withdraw the obligations relating to retail markets.” So that the market
18 analysis is to be carried out, and then at Article 17(1):

19 “Member States shall ensure that, where:

20 (a) as a result of a market analysis carried out in accordance with Article
21 16(3) a national regulatory authority determines that a given retail market
22 identified in accordance with Article 15 of (Framework Directive) is not
23 effectively competitive, and

24 (b) the national regulatory authority concludes that obligations imposed
25 under (other Directives) or Access Directive would not be sufficient.

26 National regulatory authorities shall impose appropriate regulatory obligations on
27 undertakings identified as having significant market power on a given retail market.

28 And Article 17.2 states:

29 “Obligations imposed under paragraph 1 shall be based on the nature of the
30 problem identified and be proportionate and justified The obligations imposed
31 my include requirements that the identified undertakings do not charge excessive
32 prices ...”

1 So those are the sorts of regulatory requirements that can be imposed but the Directive
2 makes it clear that they are only to be imposed after a finding that the market is not
3 effectively competitive.

4 For your note I think it is enough to note, and it is set out in our skeleton, that similar
5 provisions appear in the Access Directive relating to the wholesale market and those are
6 found at Article 8 and Article 13 of the Access Directive which is at tab 6. The relevant
7 domestic implementing legislation, I can take you to it, sir, or it may be simple enough for
8 me to make reference to the sections unless you would prefer me to take you to it.

9 THE CHAIRMAN: No, that is fine.

10 MISS SMITH: Section 46(7) states that SMP conditions may only be imposed on undertakings
11 that have been found to have SMP. Sections 87(1) and 87(9) relate to conditions that may
12 be imposed as regards network access, so wholesale conditions and include price controls.
13 Section 91(1) (5) and (6) relate to the retail market, and also make it clear in our submission
14 that price controls in the retail market may only be imposed following an SMP finding.
15 We say the relevant regulatory framework at European level and domestic level obviously
16 make it clear that price control is only to be imposed following a finding of SMP.
17 Obviously Ofcom has not made a finding of SMP in the retail mobile market and, in fact, as
18 we have seen in its mobile sector assessment, mobile evolution Ofcom made it clear that the
19 degree of competition in the retail mobile market meant that it did not consider it necessary
20 even to carry out a market review, so even to take that first step in the regulatory process.
21 Turning then to Ofcom's policy preference. First, for 080 numbers Ofcom says that prices
22 should be set at zero, or as close to zero as possible. Secondly, for 0845/0870 numbers
23 Ofcom says its preference is that they should be aligned with the relevant geographic call
24 rate. I would like to make three short preliminary points on Ofcom's policy preference.
25 First, the Tribunal asked yesterday: "Where do these policy preferences come from?" Good
26 question. From our perspective they appear in various different forms, in documents
27 produced by Ofcom on non-geographic calls from the late 1990s onwards. However, from
28 our point of view they are unclear and they do appear to have mutated over time. For
29 example, on 080 calls, Ofcom has indicated in the past that it would prefer them to be free,
30 this was meant to be a freephone number, but the formulation of its policy preference as
31 being that they should be zero, or as close to zero as possible, appeared as far as we are
32 aware only for the first time in the 080 draft determination in this case.
33 Secondly, Professor Stoneman asked how far should one go in pursuing this policy
34 preference. In this regard it is relevant I think to consider Oftel's approach to an

1 interconnection dispute between Orange and BT in 2001, which is referred to in evidence in
2 this case as the “2001 Orange Direction”. In our submission it sets the scene for everything
3 that has followed subsequently. It is in CAT bundle 3, this is the 080 appeal bundle, tab 32.
4 This is an ancient determination by Oftel as it then was back in 2001, and the context is
5 there was a dispute between Orange and BT on freephone numbers - there were two
6 disputes but we are only concerned with the freephone origination dispute.

7 By way of background Orange, a mobile operator at that time, was not charging customers
8 for dialling freephone numbers, 080 numbers, and that is found at 3.11 of the determination,
9 but in that situation therefore it was not charging its customers for 080 calls, the revenue to
10 cover the cost of those calls had to come from somewhere, and it was from the service
11 providers who offered the freephone services were paying for the freephone services. They
12 were paying the terminating communications provider, which was BT, and BT was in turn
13 paying Orange an origination charge.

14 That origination charge that BT, as terminating communications provider was paying to
15 Orange was calculated by reference to the NTS formula – I am not going to get into the
16 NTS formula today, but it will be coming up again. Effectively, the important point for the
17 purposes of this determination is that the origination charge that BT was paying to Orange
18 was based on the costs of origination of fixed line operators. Orange’s point argued to Oftel
19 was that because it was running a mobile network, and the costs of running that mobile
20 network were higher than those of a fixed line operator, it should be paid a higher
21 origination charge by BT in order to enable it to carry on offering those calls for free.
22 Oftel’s response is very interesting. If I could ask you to look at para.3.7 of Oftel’s
23 response and para. 3.8. Oftel says there is an alternative – fixed lines, and it does not appear
24 at the moment that there is any evidence that service providers want to encourage free
25 mobile telephone calls so that they would be prepared to pay the higher cost of getting these
26 calls from mobiles, of ensuring that their callers got these calls from mobiles for free and if
27 you look then at para. 3.18 ----

28 PROFESSOR STONEMAN: Can you contrast 3.7 and 3.8? 3.7 is just one possibility, 3.8 is the
29 other possibility, and Oftel is not coming down on either side?

30 MISS SMITH: Where it does come down is at para.3.18, that is who should cover the cost, the
31 caller. 3.18:

32 “The costs should be recovered from those who cause them to be incurred. This
33 gives the right price signals to encourage economically efficient behaviour. The
34 increased cost of originating a call to a freephone number from a mobile as

1 opposed to a fixed line is caused by the calling party who initiates the call by
2 mobile, rather than choosing to call via a fixed line substitute. The principle of
3 cost causation therefore holds that costs should be borne by mobile customers [i.e.
4 the callers] who choose to call freephone numbers on mobile phones.”

5 So Oftel is saying that it is the callers who should cover the extra cost of making calls to 08
6 numbers. This is simply a starting point but the starting point is that despite this policy
7 preference that is the decision that Oftel made in 2001 which led to the fact that Orange had
8 led directly to the introduction of retail charges for 080 calls in this context.

9 If I may, in perhaps one minute, make the third initial point on the policy preference which
10 it is important to note that Ofcom’s approach in the determinations does not necessarily give
11 effect to its policy preference in any event. It has never been, as I understand it, either BT’s
12 or Ofcom’s case that NCCN 956 would incentivise a reduction in price of 08 numbers to
13 zero. At the best their evidence is that we dispute this evidence but BT’s evidence is that the
14 call prices would drop to the lowest tier which is just below 8.5 ppm. Nor has it ever been
15 the case, perhaps more importantly, that NCCNs 985 and 986 would incentivise a reduction
16 in those prices for those calls to the level of their geographic equivalents. There is no
17 evidence in the determination as to what the prices for the geographic equivalents might be,
18 let alone any evidence that the NCCNs would incentivise a drop to those levels. Again, it is
19 simply a general reduction, at the very best a reduction down to the lowest tier of 12.5 ppm.
20 The major argument, and I will deal with that shortly after lunch is that it was illegitimate in
21 any event for Ofcom to have treated its policy preference as a potentially determinative
22 factor in the dispute between the MNOs and BT.

23 **THE CHAIRMAN:** You are already covering this point as part of that point, but just to check:
24 you will be addressing then the relevance or irrelevance of Mr. Read’s brand quality in the
25 interests of the service providers at the other end of the chain, those who are, as it were, also
26 consumers of 080 and 0845 numbers?

27 **MISS SMITH:** I will be addressing it in the context of my appeal to the extent that it may be one
28 of the explanations – it is difficult because that really is a point that goes to BT’s appeal
29 against Ofcom, and I think it is better dealt with by Ofcom in defence to BT’s appeal. My
30 points on appeal are the retail pricing by the back door and the fact that costs origination
31 should have been a starting point. Ofcom’s response to my costs origination point is to say
32 that this is a different type of market, it is a two-sided market with externalities, which
33 means we were entitled to depart from cost orientation and I will be responding to that point
34 but that is slightly different from Mr. Read’s point about another externality, as I understand

1 it, I think I understand his box K to be an increase in the volume of calls resulting from a
2 decrease in the price of 08 calls, which he says Ofcom did not either take into account at all
3 or take into account properly. That does not really plug into my grounds of appeal.

4 THE CHAIRMAN: Well save to this extent, if Ofcom were to say: “This is relevant factor that
5 we need to take into account in terms of deciding what form of NCCN BT may or may not
6 impose”, do you agree it is a relevant factor, or do you disagree and say it is a factor that
7 Ofcom should not take into account at all?

8 MISS SMITH: What I say is effectively what I developed to Professor Stoneman earlier, that
9 there are a number of externalities in this case that could be identified in common with all
10 telecommunications markets, there are a number of different externalities, and more and
11 more of them are being raised by Mr. Read, by us, by Ofcom. What I say is that if they
12 were not taken into account adequately by Ofcom that actually supports our argument that
13 within the context of dispute determination it is not a good regulation and it is not
14 appropriate to try to do a full market review and a full assessment of all possible
15 externalities across the whole platform. What Ofcom should have done and what it has
16 done in other contexts – and I will take you to this – is that when it is looking at wholesale
17 termination charges it has concentrated simply on the termination charges in that part of the
18 market, the wholesale part of the market, and has looked at whether those charges are
19 justified by reference to the costs of wholesale termination.

20 If it is concerned, as it appears to be from the simplifying non-geographic numbers review
21 with externalities that effectively appear in the retail side of the market, the prices that
22 callers are charged, the impact this may have on the volumes of the services that they buy,
23 those are problems that appear on the retail side of the market and that the better approach,
24 Ofcom recognises is to address them on the retail side of the market. By trying to address
25 them through fiddling about with wholesale termination charges and trying to assess what
26 the impact of those wholesale termination charges may be on the retail prices, and we see
27 the vast amount of evidence that has been produced, and we still, with respect, do not know
28 what the impact of those wholesale termination charges will be on the retail prices – we
29 have arguments about the demand curve, about the spill-over effect, and everything else. It
30 is not good regulation to try to set the wholesale termination charges so that we hope they
31 will result in these retail prices if there are concerns about failures in the retail side of the
32 market a better regulatory response is to concentrate on imposing those regulatory
33 provisions that you have, those regulatory tools that you have on the retail side of the
34 market, and that is what Ofcom has done in the past and I will take you to where it has

1 done. That is where we say it fell into error in this case by taking its eye off from a cost
2 oriented approach to termination charges it tried to do too much and failed.

3 THE CHAIRMAN: The difficulty, as I see it, is this though you took us very helpfully to those
4 passages showing that the mobile network operator market is a competitive one and so
5 clearly you do have a pressure on prices, which redounds to the advantage of the consumer,
6 that being the person who buys services from his mobile network operator provider. But
7 does that not mean that the other end of the chain falls out of account in that the interests of
8 the service providers are simply not reflected in any assessment because you have what is in
9 the round a competitive market when you are looking at the caller paying.

10 MISS SMITH: Yes.

11 THE CHAIRMAN: But one therefore ignores these exceptions to the caller paying principle
12 where there is an interest and a consumer at the other end of the chain.

13 MISS SMITH: Perhaps the first point to be made on that, the revenue sharing point in effect – I
14 will make a number of points on that. The first important point is that Ofcom’s desire to
15 ensure that there is a revenue share must be a second order preference, because if Ofcom
16 gets the result that it wants at the retail prices that redound to the level it wants there will be
17 no revenue to share. If the policy preference is fulfilled there will not be this excess
18 revenue being passed along to the terminating communication provider, so they do pull
19 against each other, the policy preference and the desire for a revenue share. The revenue
20 share only comes about when you have the higher prices, the higher termination charge, the
21 possibility of passing some of that termination charge from the TCP on to the service
22 provider. If the retail prices go down to the lowest tier there is no increase in termination
23 charge, there is no possibility for revenue sharing, so they do pull against each other.
24 The second point I think is that if revenue sharing is considered appropriate and you will
25 note that throughout Mr. Myers’ statement he caveats his comments on revenue sharing
26 whenever he makes them by saying “If it is considered appropriate”, and we say that in this
27 market there is not actually a demand for revenue sharing on those number ranges, and I
28 will come to the evidence on that. If it is appropriate then it may be provided for, he says,
29 by comparing net termination charges for termination costs. What that effectively is doing
30 is saying that it may be appropriate for whatever policy reason – we say it is not appropriate
31 – to make some sort of adjustment to a cost oriented price to provide for revenue sharing if
32 you consider that that is a policy objective that you should pursue in this case. What that
33 does not mean is that you should ignore the cost of termination and start, in effect, from the
34 other end, start by looking at the retail prices and setting termination charges by reference to

1 those retail prices and saying: “Okay, we get a good chunk of that retail price but that means
2 there is a possibility of revenue sharing,” = well actually BT have never proved - and we
3 say the contemporaneous evidence shows that they never had any intention of passing any
4 of that chunk of the increased revenue on to service providers in any event, but it is taking it
5 from the wrong end.

6 THE CHAIRMAN: That is helpful.

7 MR. READ: Can I just mention one matter, Miss Smith very helpfully indicated at the start that
8 in fact the MNOs were going to allot various cross-examination points, it would actually
9 help, I think, BT’s concerns if it knew in advance precisely who was going to be doing what
10 on what because, as I say, we are concerned and have been concerned from the outset that
11 we are not taken by surprise in some form or other, so it would be useful in fact if we knew
12 from the MNOs how it is they propose to divide this cross-examination that they say they
13 have to take over from Ofcom. I put that marker down so that we are all clear that BT
14 knows what it is actually facing.

15 THE CHAIRMAN: The marker is put down, I am not going to say anything in response to it
16 though. Shall we say five past two?

17 (Adjourned for a short time)

18 MISS SMITH: Sir, before I continue with my submissions perhaps I could just address three
19 points that were raised this morning. First of all, your question on the National Telephone
20 Numbering Plan and what can and cannot be imposed as a matter of law through the
21 National Telephone Numbering Plan. Sir, as you indicated, the legal basis for the NTNP is
22 s.56 of the Act which is general conditions, the general condition specifically is the NTNP.
23 It is also relevant to look at s.51(4) of the Act (I am not going to take you to it) which
24 simply provides that you cannot impose a price regulation through one of the general
25 conditions which includes the NTNP. So we say that if the words in the brackets were not
26 there, they should be there, they have to be there.

27 THE CHAIRMAN: That would be an impermissible course. I understand, thank you.

28 MISS SMITH: On the TRD judgment, the best I can offer you is a summary of the case at
29 paras.42 to 48. In effect, there were a number of disputes between BT and the mobile
30 operators on one hand and the mobile operators and H3G on the other hand about various
31 termination rates that had been introduced, blended termination rates. Also, a point that I
32 did not make earlier that I should have made is that the majority of the disputes arose from
33 what are called OCCNs (Operator Control Charge Notices) which were issued under Clause
34 13. But it is notable and I think it appears in para.42 of the judgment that the first OCCN

1 that was issued by Orange to BT was accepted by BT. So that OCCN has not been
2 challenged under Clause 13; it had already been accepted and BT were attempting to
3 reverse it in effect by raising a dispute.

4 MR. READ: There was a separate OCCN that had actually been issued subsequent to the one that
5 was accepted, and that was what formed the basis of the Orange allegations over
6 jurisdiction, that effectively BT was trying to jump in and have another go by putting
7 another OCCN in. I do not think Miss Smith is quite right on that point.

8 MISS SMITH: The third point is your reference, sir, this morning to the agreement Clause 26.
9 This sets out a procedure under which disputes can be ultimately referred to Ofcom under
10 the agreement. Clause 26.9 perhaps we should go to. Bundle 22 tab 17 p.19 to 23 which
11 sets out a dispute procedure. It makes provisions for written notice and then a procedure by
12 which disputes are to be raised under the agreement. A slightly puzzling aspect of this
13 clause is Clause 26.9 which states:

14 “The dispute procedure specified in this paragraph shall not apply to disputes
15 arising out of the service of a Charge Change Notice.”

16 THE CHAIRMAN: I am not sure that is puzzling though, because Charge Change Notice is
17 defined in Clause 13 not Clause 12, and Clause 13 contains its own dispute resolution
18 process, which is why I think Clause 13 is exempted from Clause 26. 26 seems to apply to
19 Clause 12.

20 MISS SMITH: I think from our point of view, not just a vain excuse on my part, from the mobile
21 operators’ point of view what is most important, it has never been disputed that we have a
22 right to refer a dispute to Ofcom and that we have always relied in the past on our direct
23 right to refer disputes which arise as a matter of European law, quite apart from this
24 agreement. That is the right to refer disputes to Ofcom that arises under Article 20 of the
25 Framework Directive and Article 5.4 of the Access Directive which then feeds through into
26 Sections 185 through to 188 Communications Act 2003. So there is a freestanding right
27 under European law to refer disputes to Ofcom that stands alongside this in effect.

28 THE CHAIRMAN: I see that, but Ofcom does require there to be, as it were, a genuine dispute.

29 MISS SMITH: That is found within the provisions of European Law which also require that there
30 has to be a dispute which has been implemented into Ss.185/186. So I do not think that
31 comes from that agreement.

32 THE CHAIRMAN: No, I understand that. My point was simply this. It may be more a question
33 for Mr Herberg. In determining whether there is or is not a dispute triggering the s.185

1 procedure is it not relevant to see whether the contractual remedies as provided for have
2 been exhausted?

3 MISS SMITH: I think that must be a question for Mr Herberg. As far as we are concerned
4 obviously in these disputes Ofcom did consider whether there was a valid dispute and the
5 parties had gone through the process required under s.185/186 and Ofcom's guidance to
6 establish there was a genuine dispute. That was the first stage that Ofcom then came to its
7 initial determination that there was a genuine dispute and then went on to determine the
8 substantive dispute.

9 In so far as there are any further points, it may be better if they relate direct to Ofcom rather
10 than to the MNOs.

11 THE CHAIRMAN: Just returning to the TRD judgment, and I will obviously look again at
12 paras.42 to 48, but on a quick look through it did seem to me that there was a 2004 Charge
13 Control statement that was the origin of the various disputes on blended rates.

14 MISS SMITH: As I understand it, the position in that case is that the mobile operators'
15 termination rates for 2G calls were subject to a price control because the mobile operators
16 had been found to have SMP for 2G. 3G at that stage, although the position has now
17 changed, was not subject to an SMP condition because H3G were not found to have had
18 SMP. I think that 2004 Charge Control Notice was issued as a result of the SMP.

19 THE CHAIRMAN: I see. It would be helpful if I could have a copy of the Charge Control
20 provision that was being considered in the TRD decision. I do not think it is actually quoted
21 in the decision itself; I may be wrong. It would be helpful to have that.

22 MISS SMITH: I will see what I can do. May I return to the argument on the policy preference.

23 As I indicated before lunch, it is the argument that it was illegitimate for Ofcom to have
24 treated its policy preference as a potentially determinative factor in a dispute between a
25 mobile operators and BT. In this regard I would like first to focus on the stated purpose and
26 the actual effect of Ofcom's policy preference.

27 As to the stated purpose of policy preference can I take you to the evidence of Ofcom, Mr.
28 Myers, core bundle C2 starting with Mr. Myers' first statement in tab 27 in the 080 dispute
29 para.131. He explains there how the policy preference affected matters in this case. Second
30 sentence:

31 "Ofcom explained , whilst generally the balance of prices set by MNOs as
32 between the prices of different mobile services is a matter to be determined
33 through mobile competition, special considerations apply to 080 calls such that a
34 departure from this general approach was warranted. In particular, Ofcom

1 specified that it had a clear preference for a balance involving lower 080 call
2 prices (and correspondingly higher prices for other mobile services).”

3 That was the position in the 080 case. Would you turn to tab 28, his second statement in
4 0845, para.36 p.12.

5 “In other circumstances, i.e. in the absence of such a policy preference, Ofcom
6 does not have a stated preference on the balance of MNOs retail prices between
7 the different services that they offer, which is a matter to be determined in
8 competition in the retail mobile market. The policy preference, however, led to a
9 departure from this general view.”

10 So the stated purposes, therefore, of Ofcom’s policy preference is to prevent the MNOs
11 retail prices being set by competition, is to depart from the general view that the prices
12 should be determined by competition in the retail mobile market.

13 The actual effect of the policy preference I will explore in a little more detail with the
14 witnesses, but it can be best illustrated if you turn to para.61 in Mr. Myers’ second
15 statement p.19. He refers to Ofcom presenting a simplified case, this is a reference with the
16 simplifying assumptions:

17 “(a) 100% waterbed effect; (b) no change in the volume of services when prices
18 change; and (c) equal weight on the Direct and Mobile tariff package effects.”

19 He then says what the results would be under each of these three scenarios. In para.62 he
20 says what the results would be under three scenarios on this reference case. 62a refers to
21 the no reduction scenario. That is where there is no reduction in 08 prices:

22 “The Direct effect is zero, i.e. the no reduction scenario, consumers are worse off
23 because the Mobile tariff package effect is negative (since the MNOs face a loss
24 of profit as a consequence of BT’s higher termination charges).”

25 So we have no reduction on prices, however we have higher termination charges and that is
26 a cost to the mobile operators that they have to find somewhere else, revenue they have to
27 find somewhere, and the mobile tariff package means higher prices on other services and a
28 detriment to consumers.

29 The full reduction scenario is what is in (b): if the Direct effect leads MNOs to reduce
30 0845/0870 prices to the bottom tier, i.e. the full reduction scenario, the direct effect is X, the
31 benefit to a 100% waterbed effect, the Mobile tariff package effect is the same, is X, there is
32 no question of any moving revenue, but the lost revenue through the reduction of prices is
33 recouped by the mobile operators from other mobile services. So the consumer benefit
34 arising from the reduction in 08 prices is fully offset on this reference case by the consumer

1 detriment arising from increases on other mobile service. This is the 100% waterbed
2 mobile use.

3 Then we have the partial reduction scenario in (c): “mobile consumers lose more from the
4 higher price for other mobile services than they gain from the lower prices for 08 calls (the
5 positive Direct effect).” What happens here is there is a partial decrease in 08 prices, say
6 half X, which is offset by a half X increase in other services. There is also a half X increase
7 in termination charges which feeds through to SPs, but Ofcom’s position on the Indirect
8 effect is that some of it may, in time, feed through to SPs, but Ofcom’s position on the
9 indirect effect is that some of it may in time feed through to SPs, some of that revenue, but
10 it definitely does not go through to callers, and so the detriment resulting from the mobile
11 tariff package effect outweighs any positive direct effect.

12 For my purposes, on the policy preference, what is important is para.63(c) which tells you
13 what the impact of the policy preference is on this reference case. More weight is placed on
14 the direct effect than the mobile tariff package effect, so there could be positive net benefits
15 to consumers even if the prices do not fall to the bottom tier. For the same reason there
16 could be positive net benefits to consumers if the direct effect was sufficiently large that
17 MNOs reduced their prices to the bottom tier. So there could be net positive benefit effects
18 even if they do not go down to the bottom tier. There will be positive net benefits if they go
19 to the bottom tier because although, as a matter of quantum, the direct effect resulting from
20 the drop in 08 numbers may be X, and the mobile tariff package effect resulting from the
21 increase in other services for prices may also be X, so although they may both be equal and
22 cancel each other out under, for example, the no reduction scenario, the greater weight that
23 Ofcom gives to the direct effect as a result of its policy preference means that they
24 nevertheless would allow the termination charges.

25 In a nutshell again, the result of the application of a policy preference is that even though, as
26 a matter of economic assessment, quantitative assessment, Ofcom came to the conclusion
27 that the consumer benefits resulting from reduced prices for 08 calls, the direct effect is
28 equal to, or even, it appears, slightly less than the consumer detriment resulting in increased
29 prices for other mobile services, the mobile tariff package effect, nevertheless it will allow
30 the termination charges, on the basis, essentially, we say, that the effect of the termination
31 charges would be to reduce the mobile operators’ retail prices for 08 calls to a particular
32 level in line with its policy preference.

33 We say, therefore, that both the stated purpose and the actual effect of Ofcom’s policy
34 preference is to impose an indirect control on mobile operators’ retail prices for 08 calls.

1 Ofcom has, as I hope I have shown, no power to impose a direct retail price control in the
2 absence of a finding of SMP. It does not have that power in the context of a dispute
3 determination.

4 Ofcom may have the power to impose such retail price controls in the future and this is
5 where the simplifying non-geographic numbers consultation comes into place. In summary,
6 in that consultation Ofcom proposes putting in place regulatory remedies for the problems
7 that it identifies, the externalities that it identifies, in the non-geographic numbers market. I
8 will take you to those, but in summary those include tariff unbundling and maximum retail
9 prices. Ofcom accepts on the face of the consultation document that such remedies will
10 only be available to it once the Better Regulation Directive changes have been implemented
11 into domestic law.

12 If I could take you to ----

13 PROFESSOR STONEMAN: Before you go there, could I just go back a little bit. I am having
14 some difficulty with accepting your definition of price control. Basically the argument is
15 that EE and the other mobile operators refer a dispute over price to Ofcom for resolution.
16 Ofcom come up with a resolution that says basically what the price should be. You call that
17 price control, direct or indirect. I just find that pattern of argumentation rather difficult to
18 accept. You ask for the resolution of the price dispute and then when you are given a
19 resolution you call it "control".

20 MISS SMITH: The important point is that you are asked to resolve whether the wholesale price is
21 fair and reasonable. I am not saying in that situation that that dispute cannot be determined,
22 what the wholesale price should be. When you are in effect saying, "We are going to set the
23 wholesale price, the disputed wholesale price, in order to achieve a control on another price,
24 the retail price", we say in that case it is retail price regulation by the back door, an indirect
25 price control on retail prices because you are not simply determining what the correct
26 wholesale price is, you are seeking to control the retail price through your setting of the
27 wholesale price.

28 THE CHAIRMAN: Is what you are advocating Ofcom do, which is to determine that primarily
29 by reference to BT's costs, not a direct price control over a wholesale market?

30 MISS SMITH: No, it is a price that is in dispute. If you look, for example, at the *Hutchison 3G*
31 (*No. 1*) case in that situation Ofcom is required to determine what would be a fair price
32 between the parties. In that situation, in determining what is a fair price, you have got to
33 have some reference by which you can determine what the fair price should be. BT say,
34 "We want to introduce this price set in this way". The mobile operators say, "No, we do not

1 think that is a fair price, Ofcom have got to determine what a fair price would say”. We say
2 one good way of determining what a fair price would be, or the best way of determining
3 what a fair wholesale price is to start with, or at least have some regard to, the costs of
4 providing that service.

5 THE CHAIRMAN: I suppose we are going back to the question that I asked yesterday, where
6 does this gloss “fair” come from? Are we going back to TRD?

7 MISS SMITH: I think we are going back to TRD.

8 THE CHAIRMAN: Because “fair” of course is nowhere in the SIA.

9 MISS SMITH: No. I think it is a combination of in the TRD judgment – and I am speaking off
10 the top of my head now – we have para.101 where it says that there is a dual role for Ofcom
11 as arbitrator, and also as a regulator. So as arbitrator they have got to set a price somewhere
12 between the competing positions of the two parties to the contract. They have got to set that
13 price against the background of their regulatory objectives, and that price has got to be set
14 so that it does not contradict their duties to encourage competition, to protect citizens and
15 consumers. Where the word “fair” comes from I am entirely sure. It may be something that
16 Ofcom can assist us.

17 THE CHAIRMAN: What troubles me is this: I completely understand that if the dispute between
18 A and B can accurately be described as what is a fair price I can quite see how the s.3
19 general regulatory obligations on Ofcom flow in there. I can understand that, but if one has
20 a different obligation which applies to a different sort of dispute where there is simply a
21 bare right to change prices, one articulates the dispute thus: one says, “Can BT issue an
22 NCCN in these terms?” Answer, “Look at clause 12”. On the face of clause 12 the answer
23 seems to be rather straightforward, one simply says, “Yes, BT can”. What is troubling me
24 is where one derives the qualifications to clause 12. What seems to be to happening is that
25 one is being presented with the abstract notion that these qualifications exist, but in terms of
26 precisely articulating what they are, one has, of course, got a whole range of different
27 views, three of which are represented in front of us now. The problem with that is that there
28 seems to be in what is intended to be a dispute resolution process a legislative process
29 almost, whereby points of policy are articulated and perhaps glossed for the first time in the
30 course of resolving the dispute, when in fact those principles by which the dispute is to be
31 resolved ought to be clear beforehand.

32 MISS SMITH: Yes, and we say that the principles have been clearly set out in the TRD
33 judgment. The principles by which Ofcom should determine disputes are set out in the
34 TRD judgment. We would disagree with your characterisation of clause 12 as giving BT an

1 unfettered right to vary prices. It is clear, we say, from clause 12 that that is subject to
2 regulation by Ofcom in the event of a dispute, that the prices set by clause 12 – clause 12,
3 itself, considers that the prices – can be replaced by prices determined by Ofcom.

4 THE CHAIRMAN: True, but that rather begs the question of what criteria Ofcom applies when
5 decide whether an NCCN issued under clause 12 is legitimate or not. One could say that
6 the regulatory control exercise by Ofcom only arises when, for instance, there is an SMP
7 condition in place.

8 MISS SMITH: Standing back, if I may, from the SIA, I identified in the points I raised before I
9 got back to the policy preference point, that, with respect, focusing on the terms of the SIA,
10 which is an agreement which was agreed between parties before 2003 when the new
11 European Common Regulatory Framework was put into place may be a little misleading
12 because the primary right of the parties to refer disputes to Ofcom comes under Article 5 of
13 the Access Directive and Article 20 of the Framework Directive.

14 I think it might be helpful to go back to the Access Directive and to the dispute resolution
15 process in the Access Directive, which is in authorities bundle 1 at tab 6. Can we go to p.6
16 of 14, Article 5, which sets out:

17 “Powers and responsibility of the national regulatory authorities with regard to
18 access and interconnection.”

19 That is what we are dealing with here, interconnection between two communications
20 providers and, NRAs have to encourage and where appropriate ensure adequate access
21 interconnection, exercising their responsibility in a way that promotes efficiency,
22 sustainable competition, and gives the maximum benefit to end-users. In particular, without
23 prejudice to measures that may be taken regarding undertakings with SMP, NRAs shall be
24 able to impose obligations of end to end connectivity”. Technical and operation conditions,
25 5.2, they have to be non-discriminatory, 5.3, but importantly, 5.4, and this is where the
26 dispute resolution comes from:

27 “With regard to access and interconnection, Member States shall ensure that the
28 national regulatory authority is empowered to intervene at its own initiative
29 where justified or, in the absence of agreement between undertakings, at the
30 request of either of the parties involved, in order to secure the policy objectives
31 of Article 8 ... in accordance with the provisions of this Directive and the
32 procedures referred to in the [Framework Directive].”

33 So the national regulatory authority, and I am sure Mr. Herberg will develop these
34 arguments if necessary, my understanding is that the whole dispute determination process is

1 against the background of regulation, and against the background that the Member State has
2 to ensure that the NRA can intervene either at its own initiative or at the request of the
3 parties involved in order to secure these policy objectives.

4 I understand, and I am acting here on instructions, I was not involved in the TRD case, that
5 in the TRD case that Ofcom asked the Tribunal for guidance on what principles it should
6 apply when intervening pursuant to this Directive provision, pursuant to Article 5.4 and
7 Article 20 of Framework Directive – what principles should it apply in determining a
8 dispute under those Articles. It was in the light of that request that the Tribunal in the TRD
9 judgment set out the general guidance that I have taken you to at paras.177 through to 194.

10 I do not know – again, others may be able to assist you more, I was not involved in this case
11 – but I would anticipate that the principles that were developed by the Tribunal in that case
12 were developed by reference to general regulatory objectives and policy objectives set out
13 in the Directives, the encouragement of competition and ensuring, for example, that prices
14 are set by reference to costs on the basis, one assumes, that that is a good proxy for effective
15 competition. Prices that end up being close to cost are prices that are likely to result in an
16 effectively competitive market. Now I really am trespassing on to something that perhaps I
17 should not make submissions on, but that is how I understand things have developed.

18 I also should refer you to s.185 of the Communications Act, which is at tab 3 of that bundle.
19 I am afraid the numbering is a bit of a mess in here. There is a small chunk of print-out
20 which starts 1 of 12. That is s.185, and that sets out reference of disputes to Ofcom. I have
21 been asked to refer you to s.185(8)(a):

22 “For the purposes of this section –

23 (a) the disputes that relate to the provision of network access include disputes
24 as to the terms or conditions on which it is or may be provided in a particular
25 case ...”

26 So that is the specific sub-section under which a reference for the determination of the
27 present dispute might be made.

28 THE CHAIRMAN: Are you saying then that s.185(8)(a) is the legislative basis for saying that
29 even if the contract says X, Ofcom can, through the dispute resolution process, say, “We do
30 not care whether it means X, we are imposing solution Y”?

31 MISS SMITH: The primary source of the legislative obligation is the Directives.

32 THE CHAIRMAN: Sure.

33 MISS SMITH: Those, as I understand it, have been implemented into the UK law by s.185, and
34 s.185 provides as to when disputes can be referred to Ofcom, and those include disputes as

1 to the provision of network access. Section 186 sets out the action that Ofcom can take on a
2 dispute reference, and then s.190, perhaps most importantly at p.5 of 12, gives Ofcom the
3 power to resolve those referred disputes and it provides that:

4 “... Ofcom can make a determination for resolving a dispute referred to them
5 under this Chapter, their only powers are those conferred by this section.”

6 But it sets out the powers, to make a declaration, to give a direction, sub-section (2), and
7 (2)(b) in particular is important here:

8 “... to give a direction fixing the terms of conditions of transactions between the
9 parties to the dispute ...”

10 So there is a legislative power on Ofcom to fix the terms and conditions between the parties
11 and there is no suggestion there that that power cannot be subordinate to the contractual
12 position between the parties. It is a legislative power on Ofcom to fix the terms and
13 conditions of the transactions between the parties. I say that is reflected by the recognition
14 in clause 12 that, okay, BT may vary the price under clause 12, but if it is disputed it can be
15 replaced by a direction from Ofcom and s.190(2)(b) gives Ofcom to fix the terms and
16 conditions between the parties.

17 THE CHAIRMAN: That is very clear and helpful, thank you. What that means is that dispute
18 resolution has within it a very broad legislative streak, if Ofcom chooses to exercise that.
19 You do not shy from that, that is your case.

20 MISS SMITH: I am sorry?

21 THE CHAIRMAN: Dispute resolution normally means that you have two competing views as to
22 the rights and obligations of the parties to the dispute.

23 MISS SMITH: Yes.

24 THE CHAIRMAN: And it is resolved by a third party who articulates what those rights are.

25 What you are submitting is that the process that we have here may involve that, because we
26 can see that in s.190(2)(a) where you have a declaration setting out the rights and
27 obligations of the parties. Your point, and I do see the force of it, in s.190(2)(b), is that
28 Ofcom wants to go down this route as part of its resolution of the dispute it can say, “I am
29 actually going to impose a solution. That has nothing to do with the existing rights and
30 obligations of the parties.

31 MISS SMITH: We do not say, I do not think we can say in light of the TRD core issues
32 judgment, that the role of Ofcom in a case such as the present where there is a dispute over
33 the price to be charged is limited to an arbitral role. That is definitely not the case and we
34 accept that. The role that Ofcom have to play in determining disputes is not simply to

1 determine disputes between two parties, but they need to have regard to the fact that they
2 are operating in a highly regulated industry and an industry where the history is that there
3 was an incumbent, then monopoly, provider, and so the regulations that the regulatory
4 authority Ofcom have in determining a dispute have to be put into the context of the general
5 obligations that they have, the powers and responsibilities that they have, for example,
6 under Article 5 of the Access Directive, to encourage and ensure adequate access and
7 interconnection. Those general powers feed into the role that Ofcom has in determining
8 dispute, as I understand it.

9 It is also very important - and I know BT may disagree with this - that one cannot interpret
10 and apply the standard interconnection agreement as if it is a standard commercial contract.
11 It is not; it is a contract that is entered into with a party that historically has been an
12 incumbent provider. But even now, if mobile operators want their callers to be able to call
13 certain 0845 numbers they have to enter into an agreement with BT in order to get access to
14 those numbers. They have to be able to enter into an agreement on price with BT in order
15 to terminate those calls. BT is an essential trading partner for the mobile operators in this
16 situation and in a number of different situations. So it is not, we say, appropriate; you
17 cannot simply look at the SIA as a normal agreement between commercial operators.

18 THE CHAIRMAN: The question that inevitably follows, though, is why does one need SMP
19 conditions at all if dispute resolution can do all this? You submitted this morning that the
20 higher prices for, say, 080 numbers was simply a reflection of a very rational and
21 competitive pricing decision on the part of mobile communications providers. But equally,
22 why cannot one say that BT's decision to impose a ladder tariff is a commercial decision
23 being taken as a part of a broader and rational pricing policy which BT is perfectly entitled
24 to undertake?

25 You may come back and say BT is in a special position because it is a very powerful,
26 monopolistic entity in this market. But is not the answer to that to say yes, that is why there
27 have been various SMP findings against BT in various areas but not here? So why wait
28 until there is an SMP finding, why cannot BT simply do what it would appear that Ofcom
29 are doing?

30 MR. BEARD: Sorry, just one point, it may be useful, given the line of questioning that the
31 Tribunal is exploring, just to bear in mind that of course Cable & Wireless is in a different
32 position, as is set out in the evidence. It has put in place laddered pricing but of course
33 there is no SMP condition in relation to C&W in this regard. So in considering this

1 discussion it might be relevant to have that in mind, because it will be something that has to
2 be picked up in closing, and I do not want that to come as a surprise to anybody.

3 THE CHAIRMAN: No, that is helpful, Mr. Beard. I did have that in mind. It is very helpful to
4 have a reminder. Sorry, Miss Smith.

5 MISS SMITH: With respect, I think this line of questioning might be more fruitfully put to
6 Ofcom as the regulator who is operating this system and this process. All I can say is that
7 from the mobile operators' point of view, our submissions in these disputes and our
8 submissions to Ofcom in these disputes, were that BT does have SMP in this market, that it
9 is an essential trading partner and that we cannot terminate our calls anywhere else.
10 Ofcom's response to that is: we are not going to make a finding that they have SMP; we are
11 not going to make a finding that they do not have SMP.

12 THE CHAIRMAN: Quite.

13 MISS SMITH: But in any event, perhaps also the distinction between the situation that I am
14 talking about, the retail prices charged to consumers and the access prices charged to enable
15 access and interconnection between, say, the mobile operators and BT, is just that. We are
16 talking about retail at one level; we are talking about access at another. From the regulation
17 generally the European Framework regulation, Ofcom has an obligation to ensure access
18 and interconnection, presumably on the basis that overall it is to the benefit of consumers
19 that there is this access and interconnection. So a mobile customer can pick up the phone
20 and make a call and it is terminated on any other network. So it is a very different situation
21 regulating the relationship between undertakings that are interconnecting and regulating the
22 relationship between a consumer who is using a mobile service and who can go off and
23 switch mobile providers; they can make their calls from a fixed line if they do not like the
24 prices. It is a very different situation.

25 THE CHAIRMAN: Miss Smith, that has been extremely helpful. I am very sorry to have pulled
26 that particular rabbit out of the hat.

27 MISS SMITH: Now Mr. Herberg has had to give notice of it, no doubt he will deal with it.

28 THE CHAIRMAN: That was, in part, my intention, not necessarily for opening but it is a matter
29 which is troubling, and for closing it may be that the parties can think whether they want to
30 say anything further on that matter. I do not want to pressure on Mr. Herberg in his opening
31 submissions today. But I have taken you out of your way and I am very sorry. Do go on.

32 PROFESSOR STONEMAN: I am sorry, could I take it just a little bit further, back to the price
33 control. Under 192b, where we were, Ofcom has the power to give a directive fixing the
34 terms and conditions of transactions between the parties to the dispute. It does not say it

1 cannot control prices, and there is no requirement here for an SMP condition. If one argues
2 that it was price control (and I am not sure whether I accept that or not at the moment) there
3 is nothing stopping them controlling prices.

4 MISS SMITH: No, in our submission there is nothing stopping them determining the dispute
5 between the parties and setting the terms and conditions of transactions between the parties
6 to the dispute. So there is of course nothing stopping Ofcom fixing the price to be paid for
7 the wholesale termination when there is a dispute between the parties as to what that price
8 should be. We say that when they set that wholesale price in order to achieve a certain
9 result, in order to achieve a control of the retail price, which is not the price that is in
10 dispute, which is not the terms and conditions of the transaction between the parties, the
11 European Common Regulatory Framework has obviously said that in that situation you
12 cannot do indirectly what you cannot do directly.

13 So it is obvious Ofcom will determine a dispute as to the wholesale price; it is not what the
14 purpose and effect of fixing that price is. If the purpose and effect of fixing that price is to
15 control another price that is not in dispute, we say that is illegitimate.

16 PROFESSOR STONEMAN: Thank you.

17 THE CHAIRMAN: I have nothing further at the moment, Miss Smith. Thank you very much.

18 MISS SMITH: Sir, if I could, I think I was about to take you to the Simplifying Non Geographic
19 Numbers consultation paper which is in bundle 13 tab 3.1. This was simply to make good
20 the point that Ofcom may have the power to directly control the retail prices and therefore
21 deal with the problems that it identified in the non geographic numbers market in future, but
22 it was seeking to do indirectly what it did not yet have the power to do directly.

23 May I take you to para.1.20 p.7. That makes it clear that the proposals which are set out
24 previously in 1.19 (and I will take you back to those) - the proposals in 1.20 which
25 effectively are a maximum price set, for example, for free phone calls, they anticipate
26 changes to the UK legislation linked to the revision of the EC Telecommunications
27 Framework “which will clarify our right to set regulations in this area.” Then on p.10
28 para.1.43:

29 “Recognising that further work will need to be done, and subject to transposition
30 of the revised EU Framework into UK legislation, in this consultation our
31 proposal in summary, are as follows:

32 Freephone)808/050/116) should be free to callers from all phone companies [so
33 that is explicit price control]

1 We should maintain a non geographic range charged at the same rate as
2 geographic numbers. [Although it is interesting to note that that will not be 0845
3 and 0870; that will be an 03 range, but there is still a price control there.]

4 The other number ranges aligned with geographic pricing should be rationalised.

5 We recommend that 0845 and 0870 should be delinked from geographic rates.”

6 The policy preference appears to have changed for the purpose of this consultation paper.
7 But what is important is what they are proposing is subject to transposition. The price
8 controls they are proposing are subject to transposition of the revised EU framework into
9 UK legislation.

10 Just for completeness, on pp.25 to 26 of this document the revised EU framework is set out,
11 starting at para.2.66, and 2.68 is the relevant amendment: Part C to the Annex to the revised
12 Authorisation Directive which provides:

13 “Designation of service for which the number shall be used [These are general
14 conditions which can be put in place] including any requirements linked to the
15 provision of that service and, for the avoidance of doubt, tariff principles and
16 maximum prices that can apply in the specific number range for the purposes of
17 ensuring consumer protection.”

18 At the moment, all that Part C says, I think, is designation of the service for which the
19 number will be used. So it is the additional words on which they rely which will allow
20 Ofcom, they say, to impose maximum prices through general conditions.

21 We do not necessarily agree that Ofcom’s reading of the change in the law is without
22 problems, or that it clearly gives them the power to impose the power which they propose in
23 the consultation. But the point is that Ofcom were undoubtedly of the view that it was only
24 when this change in the law was implemented into national law that it could impose
25 remedies which directly pursue its policy preference and directly address the problems that
26 it identifies in the market.

27 I make the submission that it would appear that in determining these disputes, which Ofcom
28 did do at about the same time as it was preparing its NGN review and the paper for
29 consultation, Ofcom effectively jumped the gun and sought to achieve the same objectives
30 without having the legal tools to do so. It sought to direct indirectly that which it could not
31 yet regulate directly.

32 I appreciate this is opening, not closing, but it would be useful perhaps just to deal very
33 briefly with the points made against us by Ofcom in their skeleton and, to a certain extent,
34 by BT. First, Ofcom say that under s.3 of the Act they have an obligation to further the

1 interests of systems and consumers, so they would have failed in their duty had they not
2 considered the impact of the dispute on the prices paid by consumers.

3 We say, first of all, that Ofcom's general duties which find their source in Article 8 of the
4 Framework Directive cannot be applied so as to be inconsistent with the specific
5 requirements of the common regulatory framework, that is the specific requirement that
6 there must be a market review and a finding of SMP before price controls are imposed.
7 Second, Ofcom say they cannot be required to ignore the impact of the NCCNs on the
8 prices to be paid by consumers and whether or not that impact is desirable. We are not
9 saying that Ofcom should ignore the impact of the NCCNs on prices paid by consumers.
10 What they cannot do, however, in our submission is to place a greater weight on certain
11 prices, that is those paid by consumers for 08 calls than on other prices, that is those paid by
12 consumers for other mobile services, in order to control the level of prices paid for 08 calls.
13 That is what they are effectively doing by placing a greater weight on the direct effect as
14 opposed to the MTPE.

15 Ofcom refers to and relies upon the case of *H3G* [2005] CAT 39 which is summarised at
16 para.32 of their skeleton argument. It might be helpful to go there rather than to the full
17 case. It is at core bundle B2 tab 18 para.32. Ofcom refers there to the *H3G* case and says:

18 "Ofcom argued that it did not have the power to determine the price of connection
19 if there was a disagreement about it, unless it had first made an SMP decision in
20 relation to the party seeking to change the price, and indeed that '*in the sense of an
21 SMP designation, Ofcom would have to decide the pricing dispute in favour of
22 H3G, because to do otherwise would be to impose forbidden price control*'
23 contrary to Article 8(3) of the Access Directive. The judgment of the Tribunal at
24 [131] made clear that this was wrong. A power to determine an interconnection
25 dispute, even if that dispute related to price, was not price control and could be
26 exercised without a finding of SMP."

27 I think this is effectively the same point that Professor Stoneman was making. What we say
28 is very different and important here is that Ofcom in *H3G* were saying: we cannot
29 determine this price because we have not made an SMP finding on this price in this market.
30 That is not what we are saying. We are making a different point (which I think I have
31 already made, but at the risk of repetition) we are not saying that Ofcom cannot determine
32 whether or not BT's wholesale charge was fair and reasonable, but we do say it cannot and
33 should not use its dispute resolution powers to control MNOs retail charges where it would
34 otherwise have no power to do so.

1 Then in para.33 of Ofcom's skeleton it says:

2 "If the resolution of an interconnection dispute which determines that a wholesale
3 price demanded by one party is not fair and reasonable is not price control, it
4 plainly cannot amount to price control merely to have regard to the desirability of
5 particular retail prices which a proposed wholesale price might incentivise (but not
6 compel) another party to adopt."

7 Again, we say that is a non sequitur. That is not what Ofcom is doing in the present case. It
8 is approving a wholesale charge on the basis that it will have a particular effect on retail
9 prices. That is that it will reduce them to a certain level, and it is that which we say was the
10 error in this case.

11 May I then turn to the second ground of appeal which is cost orientation. We say that BT's
12 costs of the termination should have been at the very least a starting point for Ofcom's
13 analysis of the termination charges. We do not say they are the end point, but they should at
14 least have been a starting point, or at least have figured in Ofcom's determination and they
15 did not. Ofcom erred in not taking those costs into account in determining whether the
16 charges were fair and reasonable.

17 There are good economic reasons for regulators to set cost oriented charges, generally and
18 in the present case. Those are set out in the first witness statement of Mr. Muysert at
19 paras.1 to 10, core bundle C2 tab 36. That will no doubt be explored in cross-examination.
20 I am not going to take you to that evidence now. In summary, we say that setting charges in
21 line with efficient costs can be shown to best promote competition and provide benefits to
22 end users. Cost orientation is a good proxy for what the long run competitive outcome
23 would be in a competitive market.

24 Also, it is important that this is the approach, cost orientation, that Ofcom as regulator has
25 generally taken in cases where it is dealing with disputes over charges. I refer in that regard
26 to those cases cited at para.89.3 of our Notice of Application, core bundle B1 tab 2.

27 Moreover, as we have already seen in the TRD core issues judgment, the Tribunal held that
28 in determining a dispute such as that in the present case which concerns prices, costs are a
29 factor which, to a greater or lesser extent, should at the very least be considered by Ofcom.
30 It is also the case that when regulating charges which can be levied by undertakings found
31 to have SMP Ofcom will almost invariably set cost oriented charges. For example, as we
32 will see, and this will come out in the evidence, this is the approach that Ofcom took to
33 setting the termination charge the mobile operators can charge for terminating calls on their

1 networks, each mobile operator having been held to have SMP on the market for
2 terminating calls to mobiles on its own network.

3 Even in a full scale market review such as that carried out for mobile call termination rates.
4 Ofcom does not seek to set prices by reference to some sort of global assessment of the
5 effects of higher prices on different consumer groups or customer groups, taking account of
6 the pass through that may or may not happen from higher termination rates into potentially
7 lower retail prices. Instead it focuses on the costs of provision of the service in the narrow
8 market in which that supply arises, and I refer in this regard to paras 24 to 27 of the first
9 expert report of Mr. Muysert.

10 It also is relevant in the present case that in 2004 Ofcom proposed to find in its NTS call
11 termination review that BT had SMP in the market for NTS call termination in the UK. For
12 your note that is found at bundle 22, tab 5. In its NCCN 500 determination, a Competition
13 Act investigation in August 2008 Ofcom found that BT was dominant in the market for the
14 termination and hosting of NTS calls in the UK for the relevant period of the investigation
15 (bundle 22, tab 6).

16 In the current disputes, as I have already said, Ofcom did not make a finding either way as
17 to whether or not BT had SMP (para. 7.93 of the 0845 determination) where Ofcom makes
18 it clear that they made neither a finding that BT has SMP nor a finding that BT does not
19 have SMP. What we say is that at the very least there was a risk that BT had SMP, and this
20 is supported by the fact that BT felt able to impose the NCCNs in the present case on the
21 mobile operators, and that the mobile operators only recourse was to raise a dispute with
22 Ofcom. They could not obtain the termination services in the present case from anyone
23 else, BT is an essential trading partner for the mobile operators in this regard. But all we
24 take from that is that we do not need to establish SMP, we do not need to put the case any
25 higher than this: there was a risk that BT had SMP in this market, Ofcom did not find
26 whether or not they had SMP, it explicitly said "We are not going to find they do; we are
27 not going to find they do not." In those circumstances Ofcom should have been very
28 careful to justify a departure from cost base pricing. But, on the contrary, in this case Ofcom
29 did not even consider BT's costs of termination. They did not feature in any of the three
30 principles that Ofcom applied in the present case.

31 Ofcom's starting point in response to this criticism is to say that it departed from cost base
32 pricing in the present case because it was dealing with a two-sided market, and this term is
33 going to be bandied around, no doubt, a lot in this case so I think it might be sensible, and
34 helpful to turn to the second witness statement of Mr. Myers for Ofcom, where he gives a

1 helpful explanation of what a two-sided market is (core bundle C2, tab 28, para. 25 on p.9)
2 of Mr. Myers' second statement - I am not going to read that out, perhaps it might be more
3 efficient for you, sir, to read that to yourselves.

4 So we have a customer at each end of the call, and one looks at the value of the platform
5 overall, the balance of prices between the two sets of customers. It is arguable in our
6 submission that all telecoms' markets are two-sided and that there is a caller on one side and
7 a core recipient on the other side, and that the only reason why the flow of funds goes in one
8 direction rather than the other is because UK has decided to put in place a 'calling party'
9 pays structure.

10 In any event more importantly the point we make is that the fact that we are here dealing
11 with a two-sided market is not enough in itself, we say, to justify Ofcom's approach. Even
12 where Ofcom has been dealing with two-sided markets which are on all fours with the
13 present case it has applied cost based termination charges. I have already referred you to
14 Ofcom's 0870 determination in June 2009 and I do not need to take you back to it, but you
15 will recall that that determination set the termination charges to be paid by BT for BT
16 originating 0870 calls to various TCPs, and those termination charges were explicitly based
17 on the cost of termination. That is exactly the same two-sided market that we are dealing
18 with here. The fact it is a two-sided market is not enough alone to justify a departure from
19 cost orientation. Ofcom took the same approach as it took in the 0870 determination in
20 June 2009 in its determination of termination charges that EE should pay to BT for 030
21 calls. These are another non-geographic number range, and in January of this year Ofcom
22 issued a determination setting the termination charges that EE should pay to BT for
23 termination of those non-geographic calls, and that for your note is in CAT bundle 19, tab 7.
24 Again, I am not going to take you to that determination at this stage, it is sufficient to note
25 though in that determination Ofcom took exactly the same approach and in fact set exactly
26 the same charges as it had taken in the 0870 determination. It set termination charges based
27 on the cost of termination. So again, I hope that makes the point that the fact this is a two-
28 sided market there is no magic in that term alone, it is not enough in itself to justify a
29 departure from cost based pricing.

30 What Ofcom relies upon as I understand it is the existence of what it describes as a market
31 failure or an externality, that is the first point. The second point, the existence of revenue
32 sharing that not just is this a two-sided market, but there is this market failure or externality,
33 or there is a desire to pursue revenue sharing, and it must be those aspects that justify, or do
34 not justify in our submission, the departure from cost oriented pricing.

1 So dealing first with the market failure or the externality. First, as we understand it there is
2 what Ofcom describes in its simplifying non-geographic numbers consultation as a ‘vertical
3 externality’. Essentially as I understand it this is as follows: originating call providers such
4 as the mobile call operators have no direct relationship with service providers, and so they
5 have no incentive in setting their retail prices to take the service provider’s interests into
6 account when setting those prices, so they may set prices that are “too high” and which
7 might reduce the volumes of non-geographic calls to the detriment of the service providers.
8 Ofcom also refers to a “horizontal externality” as it calls it in the simplifying non-
9 geographic numbers review, and that as I understand it is as follows: originating call
10 providers do not have any incentive, because of their lack of relationship with the service
11 providers, to take account of the impact of their prices on consumers’ perceptions of the
12 NTS brand. This is also to the potential detriment of service providers because the
13 devaluing of the brand could result in reduced volumes of such callers. As I understand it,
14 this appears to play a lesser role in Ofcom’s reasoning but there are those two and it is
15 important that they are distinct externalities.

16 We say that externalities are normal features in telecoms’ markets, and neither of these
17 supposed externalities we say have been shown by Ofcom to be substantial enough to
18 justify a departure from cost based pricing in the present case. On the contrary, we will
19 show that the evidence points the other way. Yesterday Mr. Read placed great emphasis,
20 and again this morning, on the simplifying non-geographic numbers consultation paper and
21 the tables and assessment in the second annex, table 220 and para.A2.239 of the
22 consultation where Ofcom stated it had derived a figure for detriment to consumers of £563
23 million. That figure, I anticipate, will be cited a number of times over the next few days.
24 Our response to that is that, first, this is clearly a consultation paper. It is open to
25 consultation, it is not a final view, it post-dates the determination.

26 Perhaps most importantly though, that figure of £536 million is highly contentious. In
27 response to Ofcom’s consultation, my clients at least will explain why, in their view, that
28 figure is wrong by a factor of at least ten. I do not think I am jumping the gun if I just
29 quickly, because figures that are bandied around like £500 million, will have an impact, and
30 I think it is important to make clear that one cannot and should not rely on that figure. Can
31 I just take you to the Simplifying Non-Geographic Numbers consultation paper, bundle 13.
32 It is tab 3.1. There are two points I would like to take, and again I am piggy-backing on
33 Vodafone, but the first point is not a piggy-back on Vodafone. Could I ask you to turn to
34 p.42, para.4.4 of the consultation paper. Ofcom sets out its three main concerns, three

1 related market failures, one, lack of price awareness; two, coordination between different
2 elements in the value chain, the vertical externality, which I have just explained; and three,
3 the horizontal externality. As I understand it, and this is obviously still up for consultation,
4 but most of the £500 million consumer detriment figure is accounted for in Ofcom's
5 calculations by reference to the lack of price awareness. That provides the majority of the
6 £500 million figure.

7 One of the criticisms that can and will be made of Ofcom's analysis in this case is that
8 Ofcom's assessment and quantification of the detriment resulting from lack of consumer
9 awareness compared the lack of consumer awareness on 08 numbers with perfect
10 awareness, which is, say (I do not know the figures), but 45 per cent of non-geographic
11 callers did not know the price of the call, and they have compared that in quantifying the
12 detriment with a position where everyone knows the price of the call, but that is not the
13 correct counterfactual. The correct counterfactual is that you should compare the lack of
14 price awareness on non-geographic calls with what the situation might be on geographic
15 calls. So there are real problems with that figure.

16 It is also important to look at p.192 of the SNGN consultation and the table that I think you
17 were taken to by Mr. Read, table A2.22. It is a simple point. Mr. Read made two points:
18 first of all, the detriment related to all non-geographic number ranges, not just the number
19 ranges that we are concerned with in this case, not just the 08/0845/0870 number ranges, it
20 also relates to the detriment arising from all callers, those calling on fixed networks and
21 those calling on mobile networks. You see the consumer welfare gain, all OCPs figure of
22 £563 million under the column on the far left, the bottom of that column. When you look at
23 the figure for mobile OCPs, we see it is only £66 million (at the bottom). So a dangerous
24 figure and we say you should not seek to balance it against any other figures that are
25 provided in this case.

26 We say that in this appeal we will show that it is far from clear that one of the essential
27 conditions for any divergence from cost based pricing, that there is an externality that the
28 parties on each side of the market are unable to internalise is satisfied in the present case.
29 It is also very important to note the evidence that we will be putting in front of the Tribunal
30 that shows that where the level of retail prices is sufficiently important to service providers
31 they can and they have made arrangements directly with the originating call providers, the
32 mobile operators, for those calls to be set at a certain level to be zero rated.

33 So, in the jargon, this externality can and has been internalised.

1 Can I take you to the witness statement of Miss Durie for Everything Everywhere, core
2 bundle C2, tab 32, paras.21 through to 22 on pp.6 to 7 of the statement. She gives evidence
3 on the arrangements that have been made between T-Mobile and Orange with charities and
4 with the DWP, direct contracts that have been entered into that ensure that the prices for
5 calls from T-Mobile or Orange handsets to those numbers for the charities, the Helpline
6 Association Group of Charities and some individual charities and DWP, are zero rated. So
7 where there are service providers who are offering charitable voluntary services where they
8 want the prices to be zero rated then they can and they have entered into direct
9 arrangements with those OCPs.

10 PROFESSOR STONEMAN: Do we know how extensive that is? For example, do we know
11 what proportion of MNOs' 0800 calls are, in fact, zero rated?

12 MISS SMITH: I do not off the top of my head, I might be able to find that sort of figure. In my
13 respectful submission, it is not just the proportion to zero rated, it is the type of calls. 0845
14 and 0870 calls ----

15 PROFESSOR STONEMAN: This is 0800?

16 MISS SMITH: These are 0800.

17 PROFESSOR STONEMAN: It was 0800 I was asking about.

18 MISS SMITH: I think the point holds good that I was make, it is not just a proportion of those
19 numbers that are covered by these arrangements overall, it is also the type of services. It is
20 not just charity helplines and DWP numbers that are provided over the 08 number ranges,
21 there are also a number of commercial service providers giving access to commercial call
22 centres, such as banks, catalogue retailers follow-up, who use these numbers for the
23 provision of those services. They could, if they wished, similarly enter into such
24 agreements with OCPs, but they have not.

25 That is our point about internalising the externality. We also say – and this is a point I made
26 in response to questions from Professor Stoneman earlier today – that Ofcom has focused
27 on the externalities allegedly arising from the high retail prices charged by MNOs for 08
28 calls. There may be other externalities in the market that Ofcom has not taken into account.
29 For example, we say that BT's termination charges will result in a loss of revenue to MNOs
30 which will have to be recovered through higher prices for other mobile services – Ofcom
31 agrees with this, it is the MTPE. This may result in a reduction in the volumes of other
32 mobile services. BT has no obvious incentive to take that into account when it sets the
33 termination charge, but that is an externality which does not figure in Ofcom's assessment,

1 let alone is it quantified in Ofcom's assessment of the NCCNs. In fact, none of the
2 externalities are explicitly quantified.

3 Arguably, those are the sorts of matters that Ofcom should have taken into account if it had
4 wanted to carry out a full analysis of the optimal prices to be charged across the NTS
5 platform, but it did not do this. As Mr. Muysert says in his first expert report at paras.34 to
6 35, if Ofcom had really wanted to set prices so as to optimise the platform in a two sided
7 market, it would have had to have carried out a far more detailed analysis than it actually
8 did. But Ofcom did not do this, and we say, feasibly, reasonably, could not have done so in
9 the time available for determining the dispute. Within the confines of the dispute resolution
10 process, that is a decision that has to be made within four months. We say Ofcom could and
11 should have taken its usual and orthodox approach to set oriented termination charges.

12 Finally, and perhaps most importantly, the externalities with which Ofcom is concerned, the
13 vertical and the horizontal externalities are both found on the retail side of the market. They
14 are problems that callers on the retail side of the market encounter. We say that they should
15 therefore more properly have been addressed by regulatory intervention on the retail market
16 in so far as any intervention was necessary, which we question, and not by an analysis of
17 the potential indirect effect of BT's termination charges. As I have said, we see that from
18 the vast amount of evidence in this case which we say still results in uncertainty of the
19 potential indirect effect of BT's termination charges.

20 Could I ask you to go back to Mr. Myers' witness statement in core bundle C2, his first
21 witness statement at tab 27, para.60 in that witness statement, p.21. About half way down
22 that paragraph he says:

23 "One example of an option not available in the Disputes, but which might be
24 available in a policy project, is the possibility of direct regulation of OCPs,
25 requiring them all to offer 0800 calls ..."

26 because at this stage it was just the 0800 dispute –

27 "... at zero prices to callers. Such a policy option has some clear potential
28 advantages over the use of tiered termination charges, as in NCCN 956, to seek
29 to induce MNOs to set lower prices for 080 calls."

30 He goes on to explain that:

31 "... if the objective is for MNOs to set zero prices for 080 calls, this outcome
32 could be ensured through direct regulation, whereas it may be highly uncertain
33 whether tiered termination charges would achieve it for any or all MNOs."

34 Then it goes on to the point of the risk of higher prices.

1 In para.60 he accepts in essence that the better way to deal with the externality of high call
2 prices is through using the regulatory tools that are available to Ofcom in the retail market.

3 THE CHAIRMAN: You say there are not any.

4 MISS SMITH: We say that it has to use the regulatory tools that are available to it, and if the
5 European framework is that prices in the retail market can only be regulated by way of an
6 SMP provision and Ofcom has found, as we have seen this morning, that the retail market
7 for mobiles is competitive, that there is no problem from competition, then the result must
8 be that the regulatory tools are not available for control. We say that if you are looking at,
9 “Should we control the problems we have identified in the retail market through trying to
10 induce indirect effects by playing around with the charges that are to be imposed in the
11 wholesale market?” we say that, from a regulatory point of view, yes, there may be these
12 externalities but that is not the way you deal with them.

13 In para.61 Mr. Myers said:

14 “... the Disputes were a process that was less well-suited to the change in
15 regulatory policy contemplated in the Maldoom report. However, that is and
16 should be an important issue in Ofcom’s current policy project on the regulation
17 of non-geographic calls, concerning the future regulatory regime for 080 calls.”

18 It would be better to do it through the Simplifying Non-Geographic Numbers review.

19 He makes the same point in his second witness statement. That is at tab 28, para.159, p.50.

20 He is responding here to the evidence of Mr. Muysert who suggests, para.159:

21 “... that the first best approach is to deal directly with the market failure in the
22 relevant market rather than through adjustment to wholesale interconnection
23 rates.”

24 He says that is consistent with the European framework.

25 “160 The question of the best approach to deal with the market failures in
26 0845/0870 calls is currently being considered by Ofcom in its wide-ranging
27 review of the regulatory regime ... Ofcom’s favoured approach in its recent
28 NGCS consultation document is consistent with the views in Muysert 1, is not
29 to adjust wholesale interconnection rates but to use measures to deal more
30 directly with the market value.”

31 He then goes on to say in para.161:

32 “However, in the Disputes, Ofcom faced a different and much narrower
33 question of whether BT’s NCCNs ... are fair and reasonable. As already
34 explained, this means that the relevant analytical question for the Disputes is not

1 to identify the best approach to address the market failures ... as that is more
2 appropriately addressed in policy reviews and may involve options that are
3 simply not available in the context of dispute resolution. Instead, the relevant
4 question is whether BT's adjustment to wholesale interconnection rates in
5 NCCNs 985 and 986 would lead to benefits or detriments for consumers and
6 competition."

7 We say, with respect, that last sentence is not correct. The relevant question is whether the
8 proposed termination rates were fair and reasonable. Having concluded that the externality
9 was better addressed in the retail market, we say that in this case Ofcom should have
10 proceeded to take an orthodox approach to that question of whether the wholesale charges
11 were fair and reasonable, and should have assessed the fairness of those proposed wholesale
12 termination charges by reference to BT's costs, leaving the externalities, in so far as they do
13 exist, to be addressed in the policy review.

14 For completeness, can I ask you to turn to para.351 of Mr. Myers' second statement, which
15 is at p.104, and at para.351 he refers to the policy review and says in the last sentence:

16 "Ofcom's view for consultation is that deregulation is undesirable and that
17 termination charge schedules [the NCCNs] represent an inferior approach
18 compared to its favoured options (of tariff unbundling and maximum retail
19 prices)."

20 The second and final point I want to address you on on this point about cost orientation, the
21 second point upon which Ofcom relies to justify its departure from cost oriented approach,
22 is that Ofcom submits that the non-geographic numbers have been used as a micro-payment
23 mechanism for service providers. Providing that revenue is to be passed on to the
24 termination communications providers and that may be passed on to service providers as a
25 revenue share.

26 For your note, if you have got Mr. Myers' second statement still open, he refers to that in
27 para.98., which starts at the bottom of p.32. He says:

28 "In my view, there is a clear distinction between the circumstances of, on the
29 one hand, 0845/0970 and other non-geographic or NTS calls, and on the other
30 hand, 'normal voice calls', i.e. calls to geographic or mobile numbers.
31 Fundamentally, this distinction reflects the role that [the non-geographic calls]
32 do or can play as supporting a micro-payment mechanism as between callers
33 and SPs for the various services they offer. That is, the caller, can, in effect,
34 pay for the services provided by the SP on the non-geographic call through the

1 call price without needing to have any direct contractual relationship with the
2 SP. This micro-payment mechanism is achieved via revenue sharing, which has
3 often been supported by regulation imposed by Oftel and Ofcom of *cost-based*
4 *original charges* (with some exceptions discussed below). In contrast, the
5 regulation of geographic and fixed-to-mobile calls has not sought to support
6 micro-payment or revenue sharing and has generally involved *cost-based*
7 *termination charges* (with some exceptions discussed below). ...

8 In contrast the regulation of geographic and fixed to mobile calls has not sought to support
9 micro-payment or revenue sharing and has generally involved cost based terminating
10 charges, with some exceptions below.

11 And I said earlier that this is often caveated throughout this statement, provides a clear
12 justification for distinguishing 08450/0870 calls from normal voice calls. I would like t o
13 make a number of points on that. First, the point I made earlier that an objective to provide
14 for revenue sharing pulls directly counter to Ofcom's policy preference for 08 call prices to
15 reduce down to the lowest tier or to reduce down to geographic call price levels.

16 THE CHAIRMAN: Well I suppose it depends on how these particular calls work, does it not,
17 because if you have a particular number which is providing a service for which the caller is
18 prepared to pay a little bit more presumably you would have a special tariff for that
19 particular call to that particular number, or am I getting that completely wrong?

20 MISS SMITH: There are such calls, for example, if you want to phone up and vote on "American
21 Idol", which I am sure you often do, there are premium rate calls 09 calls, and those are set
22 at a premium rate, they provide a clear payment mechanism for the service provider who is
23 providing the voting service and callers pay a clear premium rate for those sort of calls. But
24 what Ofcom is saying is that they are attempting to distinguish geographic calls from the
25 NTS calls that the 0845/0870 and 080 number ranges in the present case on the basis that
26 the 08 calls provide a micro-payment mechanism achieved by revenue sharing by contrast
27 with the geographic calls which do not provide that revenue sharing. If their policy
28 preference is to reduce the 08 call prices down to the price of geographic calls the
29 justification for revenue sharing falls away, the contrast is no longer there.

30 MR. CLAYTON: But the payment on this, if they are reduced down to a level then the service
31 provider presumably pays a larger amount to get this favoured treatment on the 08 calls, if
32 you follow me? Someone has to pay.

33 MISS SMITH: Someone has to pay. If the service provider wants a zero rated call number then
34 they will pay for it and that is reflected in the commercial arrangements that have been

1 entered into by DWP for benefit helplines, for charity helplines; it is also reflected by the
2 approach that Oftel took back in 2001 to the Orange direction. If the service provider wants
3 a zero rated call then they will pay for it. Back in those days Oftel said there was not an
4 appetite by the service providers to pay effectively for the costs of getting a zero rated call
5 across mobiles, but that was 2001. For certain service providers it is obviously important
6 that there is a zero-rated number. For banks providing their customer service helpline, the
7 reasons why they choose an 0845 number, or some other number may be completely
8 different. The reason why a local firm of plumbers might choose an 0845 number is
9 because they do not want people to be able to identify they are based in Birmingham, they
10 want to get work from all around the country, so they put in place an 0845 number at
11 whatever rate and it does not identify where they are geographically. There are lots of
12 reasons why service providers choose to take those numbers and to use those numbers.
13 The first point is the revenue sharing pulls directly against the policy preference to reduce to
14 geographic price levels.

15 The second point, which is important and it is a slightly complicated but important point is
16 that revenue sharing has been achieved, as Mr. Myers explains, by the imposition of a cost
17 based origination charge, and that is the NTS call origination condition, that BT are only
18 allowed to retain the costs of origination and pass on the revenue to the terminating
19 communication providers who may then pass it on to the service providers. But that cost
20 based origination charge has only been imposed on BT and only as a result of the finding
21 that BT has SMP and call origination. Ofcom has not found that any other OCP has SMP
22 and call origination and nor has it even been suggested that MNOs might have SMP in such
23 a market. So Ofcom cannot impose a cost base origination charge on anyone other than BT.
24 So revenue sharing is simply a creature, it is a product of this regulation – a regulation of
25 cost base origination charges and a regulation of BT only. You cannot then turn around and
26 say that it is a distinguishing feature in and of itself for these types of calls.

27 PROFESSOR STONEMAN: Can I ask you, do the MNOs do any cost sharing, or revenue
28 sharing of this kind? Do the MNOs say to, say, a bank: “We might be charging 50p a
29 minute for a call to your 0845 number, but we will give you 44p of it?”

30 MISS SMITH: I would have to take instructions on that. That is the mobile operators as an
31 originating call provider, or as a terminating call provider?

32 PROFESSOR STONEMAN: As an originating call provider.

33 MISS SMITH: I think I will have to take instructions on that.

1 PROFESSOR STONEMAN: Is it right that currently BT do not charge for 0845 and 0870 calls at
2 the moment? They do not charge for origination? There is a zero origination price?

3 MISS SMITH: I am sorry, I am not sure. They certainly charge a retail price for those calls.

4 PROFESSOR STONEMAN: Are you sure, because I was looking on Google at prices for an
5 0845 and an 0870 call and I am sure BT announced that it was now zero. Am I wrong?

6 MISS SMITH: I really do not think so, I will have to check that but I do not think that is the case.

7 PROFESSOR: All right.

8 MISS SMITH: It is certainly not something that I have become aware of or that is in evidence in
9 this case.

10 THE CHAIRMAN: Looking at the time, maybe now is an appropriate time for a five minute
11 break and we will resume at ----

12 MISS SMITH: I am sorry for the time this has taken, I hope I should only take another 15
13 minutes.

14 THE CHAIRMAN: Miss Smith, if it is anyone's fault it is ours, not yours.

15 (Short break)

16 MISS SMITH: (No microphone) ... questions in opening. I just wanted to deal with one or two
17 of Professor Stoneman's questions this morning about the extent of the agreements directly
18 between OCPs and service providers. We may or may not be able to get you figures on
19 volumes, and I will try to do that, but in the meantime it might be useful to have a look at
20 the 080 Determination in volume A core bundle tab 1 p.94 Annex 2. It at least gives you a
21 flavour of the extent of these arrangements. I think the list here is confidential but the fact
22 that there is a list of charities using the Helpline Association zero rate is not confidential.
23 That gives you an idea of the extent of the impact of the agreement between the Helpline
24 Association and the mobile operators. Of course, as Miss Durie said in para.20 and 21 of
25 her second witness statement, there is an agreement between the Helpline Association and
26 the MNOs as a result of which these charities benefit from zero rating. There are also
27 individual agreements between various charities and the MNOs and individual agreements
28 between DWP and MNOs and the other agreements that are highlighted: the Swine Flu
29 Emergency Helpline - an agreement was reached with the government on that one. We will
30 try to get you some more information on the other points that were raised.

31 THE CHAIRMAN: Thank you.

32 MISS SMITH: We were making the point that there was no fundamental difference between non
33 geographic calls and geographic calls that would justify a departure from cost based pricing
34 in the present case. The fourth point I wanted to rely on is that as a matter of fact we will

1 show through the evidence in this case that revenue sharing plays no role in relation to 080
2 and 0870 calls, as Professor Stoneman noted yesterday, and a very minimal role in 0845
3 roles. The only real revenue share left on that number range is for dial up internet. Most
4 strikingly, BT's contemporaneous business plan, which we have already seen, showed
5 absolutely no intention on the part of BT to pass on to service providers any higher
6 termination charges that it imposed on mobile operators under the NCC. It had no intention
7 to engage in revenue sharing.

8 Finally, we will also show, as appears to have been recognised by Ofcom in its
9 determination and in Mr. Myers' evidence, that a desire to allow revenue sharing in
10 appropriate cases is not necessarily inconsistent with taking a cost oriented approach to the
11 setting of termination charges. It may be that an adjustment instead, a better way of
12 allowing for revenue sharing, if it is held to be appropriate, is to make an adjustment to a
13 cost based termination charge and we will develop that in the evidence. However, our point
14 is that in its determinations Ofcom failed to consider BT's costs at all. It is clear BT never
15 provided Ofcom with any details of its costs in this determination, and it is clear from the
16 contemporaneous documents which we will see that BT did not seek to justify, nor could it
17 have justified, the substantial increase in termination charges under the NCCNs by
18 reference to an increase in its costs.

19 Yesterday, Mr. Read stated at the very beginning of his opening that "BT have been
20 concerned for some time that the MNOs were charging for 080 calls and that BT had
21 increased its termination charges in response to the major market failure resulting from
22 MNOs charging high prices for 08 calls in disregard of Ofcom's policy preference." With
23 respect, that was clearly not the case. We will, of course, explore the evidence with BT's
24 witnesses, but in opening it is sufficient perhaps to just look at the justification BT gave to
25 the mobile operators in its letters introducing the new termination charges.

26 I am afraid these are rather hidden away, but perhaps the easiest place to find them is in
27 exhibit LPW1 to the statement of Lawrence Wardle for O2. I hope that is in bundle 17.
28 There should be O2's statement of intervention and a witness statement of Mr. Lawrence
29 Wardle. Apparently the exhibits are in the core bundle, but if you have got that open, we
30 can look at it there. It is the second witness statement. LPW1 pages 1 to 2 of that exhibit.
31 It is the letter to O2, but it was a standard form letter that was sent to all mobile operators.
32 It is the standard form letter that was sent by BT to all mobile operators.

33 "BT is changing its charges for the termination calls to its 0870 and 0845 number
34 ranges."

1 Then in the fourth paragraph:

2 “The purpose of this letter is to make you aware that BTW is amending its charges
3 for 0845 and 0870 call termination and how those changes will affect O2. This
4 new pricing structure is an attempt to address the imbalance which currently exists
5 and to ensure that BT as a Terminating Network Operator receives an appropriate
6 return for the provision of these services.”

7 BT wanted a share of the revenue that the MNOs were getting on their retail prices.

8 Yesterday, Professor Stoneman asked, in response to the diagram produced by Mr. Read,
9 what was in it for BT if the result of these termination charges would be what he suggested?
10 I think it is also in this regard important to note the situation as it currently is. Again, this is
11 a point made on relief that Professor Stoneman made to Mr. Read this morning. By this
12 appeal, BT seeks to be able to impose the termination charges retrospectively back to the
13 date of the NCCNs in 2009. If, as Ofcom intends, regulation of the NTS calls comes into
14 force in May 2011, the impact of that is that there will be lower prices and no revenue share.
15 There is no time, effectively, for there to be any passing of benefits to SPs or consumers. It
16 is simply a retrospective windfall payment for BT.

17 So in conclusion we say that on this second point there is no justification for Ofcom’s
18 failure to consider BT’s costs of termination at all. Costs are an appropriate starting point,
19 even for a full scale market investigation. It was disproportionate and wrong for Ofcom to
20 wholly depart from a cost oriented approach in the context of a procedure which is
21 supposed to provide for a swift resolution of disputes. That is, in outline opening, EE’s
22 primary case.

23 I have said at the beginning of this opening that we had a secondary case and that if you are
24 not persuaded of our first case, if Ofcom was correct to reject the NCCNs and BT’s appeals
25 should be rejected, in that regard we rely upon the economic evidence submitted by Ofcom
26 and by Dr. Walker jointly instructed by the MNOs who are represented here today. I think,
27 if I could have a couple more minutes just to outline what our case is in that regard, it
28 reflects the other mobile operators’ case.

29 I make the following points. First, the extent to which the NCCNs might incentivise a
30 reduction in the retail prices of 08 calls is uncertain, it remains uncertain. The extent,
31 therefore, of any consumer benefit arising directly from the NCCNs (what Ofcom called the
32 magnitude of the direct effect) is uncertain. We say Ofcom was correct to reach that
33 conclusion in the determinations, and nothing in the huge volume of economic expert
34 evidence served by BT subsequently changes that. The 16, or maybe it is 10, expert reports

1 that have been served since the determinations were issued are simply an ex post facto
2 attempt to justify the NCCNs on a basis that was clearly never the reason why BT sought to
3 introduce them in the first place, and they fail to provide that justification.

4 In any event, we say the effect of any reduction in the retail price of 08 calls would clearly
5 be to decrease MNOs revenues and they would have to seek to recover that revenue through
6 higher prices for other mobile services. This is the waterbed effect, or the mobile tariff
7 package effect as described by Ofcom.

8 We say that Ofcom was correct to hold, as it did, that this waterbed effect would be
9 substantial. We say in effect it will be close to 100 per cent. The reference to that is the
10 second witness statement of Myers para.56. We say that the waterbed effect would be
11 substantial so that any decrease in the retail price of 08 calls would be matched by a near
12 equivalent increase in the prices for other mobile services to the detriment of consumers.
13 Unless there is a reduction in the retail price of the 08 calls right down to the very lowest
14 tier of BT's wholesale charging ladder, that is below 12.45 p per minute, 8.49 p per minute,
15 the mobile operators will also be paying increased termination charges to BT. Those
16 increased costs will also give rise to a mobile tariff package effect to the detriment of
17 consumers. Those increases in costs will also have to be recovered by the mobile operators
18 through higher prices for the other mobile services.

19 Ofcom did identify a further potential benefit to consumers arising from this increased
20 wholesale revenue passing from the MNOs to BT which it called the Indirect effect. That is
21 BT could, I stress could, pass on some of that revenue to service providers. The service
22 providers could pass it on to callers in the form of better services or lower prices. Whether
23 BT would in fact pass that increased revenue on to its hosting customers, the SPs, depends
24 on the extent to which BT faces competition in that hosting market, faces competition from
25 other hosting providers. If it does not face competition it is more likely just to hang on to
26 that increased revenue.

27 We do not accept that BT will pass on any of that revenue to the service providers. That
28 was certainly not its intention. Its intention was not to pass on any of that revenue, as the
29 contemporaneous evidence shows. However, Ofcom found there might be some pass on of
30 the revenue by BT to the service providers but it found that the extent and timing of that
31 pass on was unclear. Ofcom found that there would not be any pass on of the revenues
32 from service providers to the ultimate callers to those numbers in the form of better services
33 or lower prices.

1 We agree with Ofcom's conclusion that the Indirect effect was also unquantified and
2 unclear. In those circumstances, therefore, we support Ofcom's case that it was clearly
3 entitled to reject BT's NCCNs on the grounds that the risks of consumer detriment arising
4 from the MTPE outweighed the potential consumer benefits.

5 Like Ofcom, we also reject the economic evidence contained in the reports of Dr. Maldoom
6 and Professor Dobbs on the total welfare analysis. In a nutshell, what we understand that to
7 be (although it was not, with respect, clearly put in this way by Mr. Read) is a total welfare
8 analysis which is certainly put forward very strongly by Dr. Maldoom and by Professor
9 Dobbs that any detriment resulting from higher prices on other mobile services, the MTPE,
10 will be balanced out by a benefit. A pound is a pound and it matters not where that pound
11 comes from or where it goes to. The detriment, the cost, will be balanced out by a benefit
12 and it matters not whether that benefit accrues to the service providers, to the customers (the
13 callers of the service providers), or to BT's shareholders as increased profit for BT.

14 That may or may not be a correct economic approach as a matter of economic analysis, but
15 we agree with Ofcom that it is clearly inconsistent with Ofcom's statutory duties under the
16 2003 Act to protect the interests of consumers. Regulation of the telecoms industry is
17 concerned with consumer surplus rather than producer surplus, to put it in the jargon.

18 That, in a very short, two minute nutshell, is our secondary case. Unless there are any
19 further questions, sir, those are my submissions.

20 THE CHAIRMAN: No. Thank you very much, Miss Smith. Mr. Herberg, you have half an hour
21 to make a start.

22 MR. HERBERG: I may not finish! Sir, the Tribunal having heard at length from the two
23 appellants, it may be one of the easier submissions which I make when I say that Ofcom
24 was faced, in entertaining and determining these appeals, with issues of very considerable
25 complexity, novelty and difficulty. Sir, that complexity, novelty and difficulty now faces
26 the Tribunal and indeed faces it in aggravated form because since Ofcom entertained and
27 determined these matters, there has been what has been variously referred to as an
28 avalanche, staggering amount, forest of further evidence and indeed argumentation. The
29 Tribunal is faced with that position, and subject to certain argument as to jurisdiction
30 (which I will come to at some point but probably not this afternoon) has to make a
31 determination.

32 Sir, I do start off by looking back, perhaps slightly wistfully, to the exhortation of the
33 Tribunal in the TRD core issues appeal at para.105. I need not ask you to turn it. May I just
34 note it. The Tribunal recognised the potential for problem, recognised the risk that although

1 all the appellants accepted that the dispute resolution procedure is meant to provide a quick
2 answer to the dispute, the parties may be tempted to swamp Ofcom with the same level of
3 economic and accountancy information that they generally provide in market reviews. So
4 that was not a paragraph that Mr. Read took you to.

5 After canvassing various things that could potentially be done about this, the Tribunal
6 commented, really by way of exhortation, on the need to avoid Ofcom getting bogged down
7 in arguments about how to measure cost. This was raised by the Tribunal with the parties
8 during the hearing. The Tribunal expects parties to future disputes to behave responsibly
9 and be realistic in their expectations. Similarly, they expect Ofcom to adopt a firm stance
10 with the parties as regards the information it seeks and receives during the course of the
11 investigation.

12 Sir, clearly we are where we are. I do suggest that the Tribunal's hopes and expectations,
13 there set out, have not been fulfilled in a case such as the present. We have not seen a
14 responsible or realistic limitation on the evidence and argumentation. That is not
15 necessarily to blame any particular party. The parties all have perhaps very strong
16 economic incentives to do all that they can to leave no stone unturned in a matter such as
17 this.

18 Sir, this is not just a vain comment because we do say that it is relevant, particularly when
19 one comes to consider the issue of uncertainty and the very strong criticisms that have been
20 made, particularly by BT, against Ofcom that it has effectively done worse than simply
21 given up where it hits uncertainties; it has seized on uncertainties as a pretext, they say, for
22 not deciding in its favour.

23 We say that is not an allegation which should have been made in any event. Ofcom did
24 properly and responsibly consider the case and did seek to reach a determination. But it is
25 also an allegation which is patently ill suited to the situation in which Ofcom was, and in
26 which the Tribunal now finds itself. These are extremely complex and difficult matters.
27 If it is right, and if EE is wrong and O2 are wrong and the Tribunal does now have to
28 determine the matters and Ofcom did have to determine the matters, it has to do the best it
29 can. There are radical uncertainties, not at one stage but at multiple stages in the process.
30 We do say that the suggestion that there is an easy way through that: there should have been
31 quantitative analysis, that it is wrong at certain stages to say we just cannot be persuaded of
32 this; the evidence is not strong enough; this is too theoretical, that is not something which
33 should, a priori, be a subject of criticism. Of course it will be looked at very closely and
34 will be looked at with profound and rigorous scrutiny, but it is not a conclusion which

1 should look at first sight unusual or strange. When one is faced with this type of
2 justification for a proposed radical pricing change, then it may very well be the position that
3 that is the position in which the decision maker finds itself, be the decision maker Ofcom or
4 the Tribunal.

5 That was where Ofcom came out. There are multiple uncertainties recorded in both the
6 Final Determinations. We do not shrink from any of those. We say they were rightly
7 found, and subject to questions of burden of proof, we say that those were good reasons for
8 finding as they did in relation to the two determinations.

9 So the approach which I will follow in seeking to open this is, of course, to give an
10 overview of Ofcom's response to the main issues on the appeal, without getting bogged
11 down in technical details. I originally, rather optimistically, estimated this at half a day but
12 I think I should say now that it is going to take rather longer than that. I am responding
13 effectively to two days' worth of submissions. I am certainly not going to try to deal with
14 every point or go down every byway, but even dealing with the main important points, I
15 suspect it is going to take me a considerable part of tomorrow to address the issues which I
16 think the Tribunal will be helped by me addressing at this stage.

17 Sir, I will focus however on the significant policy issues and also on the issues which are
18 important to clarify Ofcom's thinking as it was at the time of the Final Determinations in
19 the light of the criticisms made by the parties to it.

20 Sir, you will of course have read the Court of Appeal judgment on the admissibility issue,
21 fully and triumphantly upholding the Tribunal's approach against our arguments. You will
22 also have seen the postscript to that judgment and probably the correspondence which
23 followed that between the parties. Sir, there is no need, in view of the fact that the parties
24 have reached in the main a sensible accommodation on the way forward, to take up a lot of
25 time addressing that. We have liaised with the parties, we have tried to set out an indication
26 in the skeleton of what we intend to cover and not to cover, we have liaised with the MNOs
27 in relation to particular issues. The line we have tried to draw is to take the line that we will
28 not be in the forefront of litigating issues, not so much for reasons of saving costs or
29 anything like that, but particularly because of the concern that where the arguments have
30 considerably developed or taken new turns since the determinations of Ofcom it is simply
31 not appropriate for Ofcom to be, as it were, becoming a commercial litigant on these
32 matters and taking a line on what are fresh matters, particularly in circumstances where
33 there are commercial parties here who can do that and particularly in circumstances where
34 the matters are so new.

1 We have, of course, in taking our line, borne very carefully in mind the stage at which these
2 proceedings have reached. All our witnesses will attend and give evidence, even where
3 they may be seen to go beyond Ofcom's decision in their evidence, and they will be
4 available for all parties to examine and cross-examine. I will still be playing, I suspect, a
5 relatively major role just because there are so matters which do raise policy questions and
6 do involve an elucidation of the decision. But particularly in matters relating to the
7 quantification of the direct effect and the other particular welfare calculus, once one moves
8 beyond issues of principle and issues which Ofcom did and did not take into account, we do
9 propose to take a backseat role, and we hope that the Tribunal will not be prejudiced
10 thereby. The other parties are effectively able to pursue that role.

11 Sir, of course in doing so we are not in any way making any concessions on the arguments
12 that we are not taking as primary litigants. The Court of Appeal clearly envisaged in the
13 postscript that Ofcom could choose not to play a full role in appropriate cases without
14 thereby conceding the case in any way. The Tribunal will not rely on Ofcom acting in that
15 way, or should not do, we say.

16 THE CHAIRMAN: No.

17 MR. HERBERG: Can I divide my submissions into three parts. They are fairly obvious parts,
18 although within that there are a huge number of sub issues. Firstly, sir, I will make some
19 general introductory submissions about the nature of the proposed charges and hence the
20 shape of these issues with which Ofcom had to grapple and also deal with some of the
21 general issues of law relating to the burden of proof and the proper approach of the Tribunal
22 on this appeal. Then I will address the core issues relating to EE's appeal. I think it is
23 appropriate to take EE's first because in many ways its challenge to Ofcom's determination
24 is more fundamental than BT's, BT, simplifying wildly, is content with Ofcom's approach
25 but is content that Ofcom can now be shown to have gone wrong on its application, where
26 as EE, supported by O2 contends that the whole approach adopted by Ofcom is erroneous,
27 as you have heard.

28 Finally, therefore I will address some of the issues raised on the BT appeal, again focusing
29 on points of policy or substance and of necessity, given the timing, I am going to be very
30 limited as to how much I can get into the detail.

31 Can I perhaps start with the nature of the proposed charges? Some of this may be old hat;
32 you have heard from both the appellants on this but I think it may be helpful to go over
33 some of the semi-basics again, certainly basics as far as lawyers are concerned, and to make
34 submissions as to Ofcom's position. A helpful starting point is perhaps BT's flow of funds

1 diagram, which we find a useful reference point; it is helpful in showing the different effects
2 and anticipates some indeed of what I was planning to do in its scheme. As you have seen,
3 it shows in particular the different effects arising out of two different things: first, the
4 potential increase in termination rates payable by the MNOs to BT as a result of the
5 schedule of ladder pricing and it shows what happens to those increased termination
6 payments and what the MNOs do to prices for other mobile services in consequence.
7 Secondly, it shows the mechanism potentially leading to a reduction in MNO/OCP retail
8 prices which BT alleges would flow and Ofcom accepted was likely to some extent in
9 consequence of the charging schedule. So each of those perspectives is, of course, relative
10 to Ofcom's assessment of the welfare benefits or dis-benefits flowing from the proposed
11 charges, so I will leave aside for now the question of which welfare basis is appropriate.
12 You have already seen, of course, that Ofcom identified and considered the three effects in
13 making its assessment: the direct effect, the mobile tariff package effect and, in relation to
14 that, BT's flow of funds diagram helpfully demonstrates the mobile tariff package effect is
15 not just the flip side of the direct effect, W, it also arises out of any increased termination
16 charge paid by the MNO, X. So it is, we say an important part – and certainly important for
17 Ofcom's analysis – that the waterbed, the mobile tariff package effect is split into those two
18 halves reacting to the two potential different effects. The third effect is the indirect effect,
19 being the consequences for the quality of services provided by the service providers, hosted
20 on the TCPs networks. So, sir, if the TCPs, such as BT, obtain larger termination payments
21 because of an increase in termination rates or as a consequence of the NCCNs and if such
22 charges, or part of such charges, are passed on to the service providers, for example through
23 reduced charges for hosting or some other revenue share arrangement, then the service
24 providers may utilise that bounty not by pocketing the money but by improving the quality
25 of service that they offer to the callers, so those are the indirect effects. As I shall come
26 back to, Ofcom did not weight the indirect effects equally on all people, it weighted them
27 differently on service providers and callers.

28 There is one technical addendum which I should make to the indirect effect and it has
29 already been referred to by Mr. Read, in introducing the indirect effect the 0845 final
30 determination suggested that one potential ingredient of the indirect effect is an increase in
31 the volume of 08X calls. That is something that is actually missing, of course, from Mr.
32 Read's chart but you, sir, suggested very quickly after seeing it, that there was the missing
33 effect, the volume effect which effectively comes out of A, prices reduce and there is a
34 potential volume effect, increased use of the services.

1 That volume effect was originally suggested by Mr. Read to be treated as part of the indirect
2 effect, but as Mr. Myers (for Ofcom) has explained (C2, tab 28, p.107, annex 1 to 2nd
3 statement, paras. 361 to 3608) that effect was in reality categorised by Ofcom and
4 considered by them in their assessment, not as an indirect effect, but rather as reflected in
5 the additional weight given by Ofcom to the direct effect. That is because volume related
6 impact tends to flow directly from the reduced price of 08X calls, it is not a revenue driven
7 effect, which is what the indirect effect was concerned with.

8 Sir, Myers 2, para. 379 addresses that, it is clear evidence and it can also be seen from table
9 6 on p.74 of Mr. Myers second statement. At this stage I just put that down as a marker in
10 terms of the classification. The point is technical but it has some relevance because of the
11 different weights given by Ofcom to the different effects and I thought it right to draw
12 attention to it at the outset.

13 Can I come back against that background of the three effects to the two perspectives which
14 identified the increase in termination rates, and the reduction in retail call rates? It is
15 helpful to look at how those two effects operate in the various scenarios. They are set out in
16 Mr. Myers' second statement, and it might be worth just having this to hand, it is bundle
17 C2, tab 28, p.21. The first scenario can be ignored for present purposes, the price increase
18 scenario, and that was found to be effectively not to be likely in any circumstance. The
19 first realistic scenario is the no reduction scenario, column C which posits MNOs leaving
20 their retail 08X prices unchanged. In that case, which Ofcom found to be possible but
21 unlikely there is plainly a substantial increase in termination rates paid by the MNOs to BT.
22 There will be no direct effect but there will be a BT Box X type of mobile tariff package
23 effect only as the MNOs react to decreased profitability of 08 calls by increasing other call
24 prices. Of course, there will in that scenario scope for an indirect effect to the extent that
25 there is revenue share between BT and the SPs, and that is BT boxes 5 and 6 in the BT flow
26 diagram.

27 As set out in box C3, going back to Mr. Myers' diagram, one can see the assessment of the
28 indirect effect. Mr. Myers indicated that Ofcom concluded that the indirect effect was
29 positive for SPs but uncertain for callers, and the overall effect on consumers was negative.
30 The distinction between the indirect effect for SPs and for callers arises if the SPs
31 effectively pass on the benefit, for example by improved offerings to callers, that distinction
32 is significant because Ofcom did not treat the two categories the same. I will need to deal
33 with this in more detail in responding to Mr. Read's argument, but to anticipate Ofcom did,
34 contrary to what Mr. Read suggested, treat the SPs as consumers. We say that the entire

1 argument based on the failure to treat the SPs as consumers was entirely misconceived.
2 What it did do was to accord them less weight than it accorded to the indirect effect on
3 callers when it had been passed through. I will take you to the evidence that makes it
4 absolutely clear we say. Mr. Read latched on to a paragraph in my skeleton argument at
5 16.3, which does not say what he thought it said. I will go that in due course. The crucial
6 point is that Ofcom did recognise SPs as a category of consumers. There was no error of
7 law involved here at all, but it did accord them less weight and that is why there is this
8 important distinction between the indirect effect on SPs and then the question of the extent
9 to which SPs passed it through to callers, and then the effect on callers as a result.
10 What Ofcom then did was accord less weight in welfare terms to indirect effect held by SPs,
11 and for that reason a finding that there would be an indirect effect for SPs but either none or
12 very uncertain indirect effect on callers was significant because it would not, therefore,
13 necessarily give rise to a strong indirect effect. Even if there was a large amount of money
14 going out of BT and going to the SPs that might not give rise to a strong indirect effect if
15 the SPs were putting it in their pocket, or simply giving it to their shareholders. That is the
16 significance.

17 Sir, then one has the full reduction scenario, which is Mr. Myers' column A, if I can jump
18 across from partial reduction to full reduction for the moment. This, of course, is the
19 reduction in the 08 retail prices by the MNOs all the way down to a level where they do not
20 have to pay any increased determination rates to BT under the NCCNs, the lowest step on
21 the ladder.

22 Ofcom found on balance that this scenario had not been established to its satisfaction in the
23 0845 case, although of course BT contends that it is the most likely scenario. On that
24 hypothesis there is of course a large positive direct effect. There is once again a mobile
25 tariff package effect in the opposite direction as MNOs react the decreased profitability of
26 the 08 calls, either at 100 per cent or less than 100 per cent of the waterbed. Sir, the
27 significant fact is that at this time it is, on BT's diagram, a type W waterbed, not a type X
28 waterbed.

29 Sir, there is, in this scenario, no indirect effect at all, because there is no increased
30 termination rates capable of being revenue shares with the SPs – or technically, I should
31 say, no more than at present.

32 Sir, as shown in the bottom box of table A in the Myers' table, one sees that Ofcom's
33 assessment was that this involved a net beneficial effect to consumers in the 0845 case.
34 This as because of a greater weight given to the direct effect.

1 Sir, can I draw to the Tribunal's attention some features of the two types of mobile tariff
2 package effect before I go on to the partial reduction scenario. Again, this may be lawyers
3 moving at a very slow pace, but I thought it right in view of the submissions from Mr. Read
4 to identify the differences between the two types. Sir, it is common ground between Ofcom
5 and BT that the combination of call revenues lost to MNOs and the mobile tariff package
6 effect at W in BT's diagram, which is effectively tariff rebalancing, is beneficial for
7 consumers. That is, of course, a battle line with the MNOs or, strictly, with EE and O2, but
8 as far as Ofcom is concerned, and we made absolutely no bones about that, tariff
9 rebalancing was an attractive feature because of the perceived market failure. Sir, that
10 recognition of market failure can be seen in the final determination in a number of places,
11 but for your note para.4.32 explicitly discusses the balance of prices between 0845/0870
12 and the other mobile services and explained that Ofcom preferred the combination of lower
13 045/0870 prices, higher prices of other services because of its policy preference. Paragraph
14 4.33 then sets out that Ofcom took this into account through the greater weight it gave to the
15 direct effect over the mobile tariff package effect.

16 Then para.7.62 records Ofcom's agreement with BT that there are overall benefits to
17 consumers to tariff rebalancing – in other words, if the direct effect and the mobile tariff
18 package effect were equal in size, or even if the tariff effect was slightly larger, that would
19 effectively give rise to greater weight being placed on the direct effect and the balance
20 being preferred in welfare terms.

21 Sir, the important point, however, is that none of this applies in scenario B where the
22 corresponding waterbed – in other words, where call revenues are being paid to BT under
23 the wholesale tariff schedule and the indirect effect is in play. None of this applies where
24 the waterbed effect in issue is the waterbed at X, where the increasing call price to MNOs is
25 not matched by a corresponding decrease in 08 prices. In that situation there is no volume
26 effect or brand improvement effect because we are not seeing prices come down. What we
27 are seeing is prices rising, and we are seeing revenues going to the SPs, but we are seeing
28 the waterbed resulting from box B rather than box A.

29 Sir, in that situation the corresponding welfare benefit can only come from the indirect
30 effect, and that is, of course, subject to the uncertainties and discounts which Ofcom
31 considered were attached to that route, as it were.

32 So where one is in scenario BX rather than in scenario AW, the balance between the direct
33 effect and the mobile tariff package effect looks very different, that different element.

1 PROFESSOR STONEMAN: Can I just ask for a point of clarification. The policy preference
2 you say is based on AW?

3 MR. HERBERG: Yes.

4 PROFESSOR STONEMAN: And you believe that AW will yield a social benefit. Is it only
5 based upon AW, or is it also based upon some interpretation of K?

6 MR. HERBERG: Sir, yes, I think it is right that K is, as it were, an independent effect what
7 follows. What it is clearly not based on is anything to do with revenue share and anything
8 going to the SPs. That is absolutely clear. One of the reasons why Ofcom has a policy
9 preference is, as you will have seen and as I will take you to, because there will be
10 improvement in brand quality, improvement in clarity, its signal as to what an 080 number
11 is, what an 0845 number is.

12 PROFESSOR STONEMAN: That is what I was looking for. So the policy preference is based
13 on AW plus the removal of the externalities?

14 MR. HERBERG: Sir, yes.

15 PROFESSOR STONEMAN: Thank you.

16 MR. HERBERG: Sir, what one then does, of course, is put it all together in the scenario B in
17 Mr. Myers' diagram, which is the partial reduction scenario. Ofcom had to consider this
18 because it found that the magnitude of the likely fall in retail prices was uncertain. Of
19 course, in reality, sir, there is not one partial reduction scenario, but a number of them, a
20 number of different possible magnitudes of price reduction realistically corresponding with
21 the top of each step below the MNOs' current retail price. The evidence does suggest that it
22 would be very difficult to see how it could be economically rational to price at a different
23 point along the step other than at the top of the step. That still leaves a number of different
24 possible pricing points between whatever the MNOs' current pricing level is and the lowest
25 step.

26 What is significant here, we say, is that all the effects in BT's flow of fund diagrams are in
27 play simultaneously. On the positive side there may be both a direct and an indirect effect;
28 on the negative side there are both kinds of mobile tariff package effect involved, and we do
29 say that one only has to look at the flow of funds diagram to see how fiendishly complicated
30 it is in that scenario to assess the overall effect on consumers in this circumstance,
31 particularly obviously in any sort of quantitative way. Although, of course, the Tribunal
32 will have to consider all the detailed evidence as to this, we submit that as a starting point
33 BT's own diagram is a graphic illustration of the good reasons for the conclusion in the
34 bottom box of Myers at column B, which is the bottom of the partial reduction scenario, the

1 effect is uncertain – positive if the direct effect is sufficiently large relative to the mobile
2 tariff package effect give the indirect effect, but negative if this is not the case.

3 There comes a point, sir, when the overall effect does become positive at some point, but it
4 is not possible to identify where that is, Ofcom found, apart from in the full reduction
5 scenario. That was Ofcom's conclusion based on its attempt to make a judgment of the
6 various competing effects.

7 Of course, I should say that it is not simply a question of quantifying the different arrows.
8 Behind that there lies a whole number of further disputes as to the methodology to do so, of
9 which you have had, as it were, a taster already in terms of demand curves, and everything
10 else. The diagram itself shows simply the number effects that need to be quantified in order
11 to do the calculation.

12 Sir, I notice it is half past four. That is a very basic introduction, but I thought it might be
13 helpful to start there.

14 THE CHAIRMAN: Thank you very much, Mr. Herberg.

15 MR. HERBERG: I will seek overnight to really work out what it is that I need to cover in
16 opening and what I do not need to cover. I certainly will be until lunchtime tomorrow, I
17 think, doing my best, but I feel I may need to go some little way beyond that.

18 THE CHAIRMAN: That is fine by us. We will see how the timing goes this week, and, if
19 necessary, next week sit longer hours.

20 MR. HERBERG: Sir, I think it is certainly the case that there are a number of witnesses who all
21 the parties have indicated they do not wish to cross-examine at all, factual witnesses, so
22 there is actually a lot of slack in this week. At one time we were thinking about even
23 possibly having Friday off, although that may be over-optimistic on the progress that we are
24 making, but certainly we do not see any problems in going back from the timetable that we
25 have set ourselves at this stage. Next week it may be a different matter.

26 THE CHAIRMAN: That is good news, we will see how it goes. In that case we will say 10.30
27 tomorrow.

28 (Adjourned until 10.30 a.m. on Wednesday, 6th April 2011)

1
2
3

