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IN THE COMPETITION
APPEAL TRIBUNAL

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

Victoria House,
Bloomsbury Place,
London WC1A 2EB

12 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 SIX

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

Mr. Tim Ward QC (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.

The Intervener Cable & Wireless UK was represented by internal counsel.

The Intervener Hutchison 3G UK Limited was represented by internal counsel.

The Opal Telecom Ltd did not attend and was not represented.

1 THE CHAIRMAN: Mr. Read?

2 Mr. GEOFFREY RICHARD PLATT MYERS, Recalled

3 Cross-examined by Mr. READ, Continue

4 Q Good morning, Mr. Myers. As you know, we were part of the way through your cross-
5 examination, and I think, in the light of what was said yesterday, I may be able to cut
6 matters a little shorter. We were discussing the mobile tariff package effect. Just before I
7 leave that, I would quite like to go now to the size of the waterbed effect, if I can call it that,
8 i.e. how large or otherwise it might be. We have obviously seen in the course of the final
9 determination the fact that a reference point of 100 per cent waterbed effect was used by
10 Ofcom as a starting point for its analysis.

11 A I'm not quite sure that's right. It was a reference point. That was one of the simplifying
12 assumptions in the reference case, that Ofcom throughout said that waterbed effect was
13 likely to be less than 100 per cent.

14 Q Exactly, I was saying you start with the 100 per cent reference point but then you fully
15 accept in the course of the final determination that it is not going to be 100 per cent.

16 A Yes.

17 Q So the question then becomes what is the likely scenario for it, because obviously a lot turns
18 on your respective weighting between the direct effect and the waterbed effect, if the
19 waterbed effect, for example, was 35 per cent or it was 45 per cent or it was 75 per cent or
20 80 per cent – do you see what I mean?

21 A Yes, indeed, so what Ofcom did was, for the likely size of the waterbed effect, took as the
22 reference point the analysis that had been done in the previous market review for mobile
23 termination and indeed taking account what the Competition Commission had said about
24 the waterbed effect. In fact, subsequent to that – before I move on to the subsequent effect,
25 Ofcom, in its 2007 statement, had said that the waterbed effect was significant. It had not
26 quantified the waterbed effect. It was an important issue in the context of that market
27 review but it did not come up with a significant quantification. Its judgment was, in that
28 market review, that the waterbed effect was significant. The Competition Commission in
29 its determination seemed to accept that the waterbed effect was strong. I think there is a
30 quotation in the final determination from that Competition Commission determination.
31 Then subsequent to the final determination Ofcom has recently, last month, published a
32 further statement on mobile termination. In that document again Ofcom didn't quantify,
33 didn't put a specific number to the waterbed effect, but again expressed its view that the
34 waterbed effect was likely to be strong.

1 Q Let us unpick that a little bit. First of all, I think it is fair to say that the Competition
2 Commission – you are talking about the Competition Commission’s views on the 2007
3 market review. That is what you are talking about?

4 A Yes, I think that determination of the Competition Commission was 2009.

5 Q It is 2009, the determination.

6 A Yes.

7 Q Would you accept that, in fact, that nobody in that particular case was arguing that the
8 waterbed effect was insignificant, or anything like that. It was just an accepted feature
9 within arguments before the Competition Commission?

10 A I think that’s right. As I recall, the quotation in the final determination was along the lines
11 of, “As there has been no dispute the waterbed effect is strong”.

12 Q One of the reasons obviously that there is a problem about this is that there are few
13 empirical studies about it. There are some studies but there are, to use Ofcom’s own phrase,
14 only a few empirical studies that have actually been performed?

15 A I think that’s fair, yes.

16 Q It is the word, in fact, that is used in the Simplifying Non-Geographic Numbers. I am glad
17 to see that you are *ad idem* with that. The other point about it is, of course, that those
18 studies and indeed all the discussion before the Competition Commission was looking at a
19 waterbed effect at the termination end of the market, was it not? Effectively the question
20 was, “If we reduce termination rates will that have a waterbed effect elsewhere in the
21 market?” So it was concentrating very much on the termination end and what was actually
22 happening to termination prices and the effect?

23 A Well, that’s what triggers the waterbed effect in both Ofcom’s statements on mobile
24 termination and in the Competition Commission determination. It’s triggered by a
25 reduction in mobile termination rates or possibly an increase, and then what is analysed is
26 the effect that has on retail prices charged by mobile operators to their customers. That is
27 the waterbed effect.

28 Q Whereas here, obviously, we are looking at a slightly different end, because we are looking
29 at the origination end and the effect on origination prices; or, if you reduce the origination
30 prices, what actually happens elsewhere in the pricing scenarios?

31 A There is that difference, but the analogy, I think, stands. There is an analogy here. The
32 waterbed effect in mobile termination is triggered by a reduction in profits on mobile
33 termination, which is caused by the reduction in the mobile termination prices in that case.
34 The issue we are talking about here is a reduction in profit on 08 calls for mobile operators,

1 as we have discussed yesterday, caused either by an increase in termination rates or by a
2 reduction in 08 prices. That reduction profit then may flow through, through a similar
3 mechanism as in the waterbed effect in mobile termination to lead to an increase in prices
4 for other mobile services.

5 Q I certainly would not quibble with your word “analogy”, certainly if you say “possible
6 analogy”, but my question is really focused on this: no one has actually done an empirical
7 study on it, have they, on the effect if you reduce origination prices in terms of what
8 happens elsewhere as a result of mobile tariff package effect?

9 A I’m certainly not aware of any study.

10 Q Can I also see if you agree with this: that there has been no study that concentrates on the
11 specificities of the UK market, they have been looking in some studies at a Europe wide
12 analysis and in other studies actually wider than that, Europe and the USA?

13 A That may well be right. I’m not 100 per cent sure because I don’t know the full details of
14 all of those studies. That may be right.

15 Q Can I ask you very quickly to take CAT bundle 13, which is the Simplifying Non-
16 Geographic Numbers, and also in case we need it, bundle B1 of the core bundle, which
17 should be to your immediate left which of course has got the final determination in. I hope
18 that those are the only three bundles that we will need to refer to. Can I ask you to take the
19 CAT bundle 13, and could you look at p.176, behind tab 3.1. It starts, I think, at
20 para.A2.182. You set out there a series of comments about the few empirical studies on the
21 waterbed effect, the first of which is the Genakos and Valletti study. You say in terms that
22 they concluded that the waterbed existed though it was not complete, i.e. it was not profit
23 neutral. Did you have to consider the Genakos and Valletti study in any depth in producing
24 this Simplifying Non-Geographic numbers?

25 A Well, these studies were looked at. What is said here, I mean these studies did not play an
26 important role in this review. What is reported in these paragraphs is intended to be merely
27 a factual reporting of what the studies said, it does not include any Ofcom interpretation of
28 these studies. For Ofcom interpretation of these studies, or the conclusions that it would
29 draw in the light of this and any other relevant evidence we would need to look at the
30 mobile termination market review published last month where, as I said, Ofcom’s
31 conclusion was that the empirical evidence supported, or it’s view, taking account of the
32 empirical evidence was that the waterbed effect is strong.

1 Q Can I just ask you very briefly about the study we see at para. A2.186, because that is one
2 that Ofcom itself commissioned, is it not, it is the one by Dr. Veronese and Professor
3 Pesendorfer?

4 A Yes.

5 Q Professor Pesendorfer I think is quite a well known economist, is he not, quite highly
6 respected in the world of economics?

7 A Yes, I think he is quite well known.

8 Q Ofcom, in going to him, obviously were looking for some information about what exactly
9 was happening with the mobile tariff package effect?

10 A I don't think that was what, as I recall – I mean I don't have a very strong recollection of
11 certainly the details of this study. My recollection is it was focused on – well it wasn't
12 focused on the size of the waterbed effect, it was focused on a much broader brush, higher
13 level understanding of fundamentally different termination rate regimes, so for example in
14 North America and in some parts of the Far East they have what tends to be called a “bill
15 and keep regime” essentially a zero or close to zero termination charges for calls to mobile,
16 whereas in Europe their regime that is based on calling party pays and cost base mobile
17 termination rates which have been substantially higher than that. As I recall this study was
18 simply trying to contribute to that debate that Ofcom was engaged in at that time, which
19 was about the high level question of whether there should be a fundamental shift in regime.
20 The waterbed effect comes into that obviously because you are comparing countries with
21 fundamentally different regimes, which have very different termination rates; one of the
22 questions of interest is how does that affect the retail prices having those different regimes?
23 As I say, I don't think it was focused *per se* on the size of the waterbed effect.

24 Q Perhaps we ought to just look at it very briefly, because I do not want to have to spend time
25 later in the hearing actually going back to it. Funnily enough this is in the authorities'
26 bundle 3, tab 54. I think you will be given a copy of it. As it says on the first page it is a
27 report prepared for Ofcom and the study undertaken for Ofcom. If we go to p.3, which is
28 the executive study, we see from the second paragraph the study is intended to contribute to
29 the ongoing debate about the relative performance of calling party pay networks (CPNP)
30 and bill and keep charging regimes, and developing better outcomes to consumers
31 particularly with regard to retail prices and usage and the take up of mobile services. So in
32 other words, as you quite rightly said earlier on, its primary focus was on a comparison
33 between the two sets, the two types of calling charging. But if we go on we can see that the
34 critics of the CPNP system argue that higher MTRs raise the cost and hence the price of

1 calls between networks and this acts to hold down usage. However, there is also a need to
2 consider a potential effect in the opposite direction as higher MTRs can lead operators to
3 compete more strongly for customers and their association. Existing empirical studies have
4 found conflicting evidence of the relationship between overall retail price and level of the
5 MTRs. It then goes on to talk about the data and one can see it talks about the Merrill
6 Lynch data there, and then:

7 “To overcome problems of earlier studies, in this paper we focus as much on the
8 level of MTRs as on the choice of regime and we rely on a new data set prepared
9 by Ofcom that is specifically designed to address some of the data issues that have
10 affected many of the earlier studies.”

11 So Ofcom had actually given them more information than generally was within the study
12 regimes?

13 A Again, I am going on my recollection, but my recollection is that what Ofcom attempted to
14 do was to adjust the Merrill Lynch data for the perceived deficiencies, or deficiencies for
15 this purpose in doing this kind of analysis. That is my recollection rather than having, as it
16 were, a brand new data set.

17 Q I see, well I am simply going by obviously what they say in the executive summary. Page 4
18 they set out their key findings and obviously the first two are dealing with the bill and keep
19 regime, and the CPNP regime. Then on the third point that they raise on p.4:

20 “Third, we did not find strong evidence in relation to the effects on **prices**. We
21 found some evidence that higher levels MTRs lead to somewhat higher revenues
22 per minute (RPM) using the original Merrill Lynch data. However, the original
23 data on RPM include revenues from termination fees charged in CPNP countries.
24 And hence, when used as a proxy for retail prices, will tend to make retail prices
25 appear relatively high ...”

26 And then they indicate that they take on the analysis of the prices and then in the course of
27 this they actually deal with a number of analyses and in particular if one goes on to p.30,
28 after having debiased certain of the material, the data, they then go on to consider the effects
29 on price changes. Do you agree with that at all?

30 A I think I would need longer to precisely establish ----

31 Q Well perhaps it is unfair to test this witness at this stage on a report he has not seen for
32 probably a year or so. Well let us put that away then, Mr. Myers. Let me ask one final
33 question on this. Are you saying that your views on the waterbed have significantly
34 changed since simplifying non-geographic numbers came out?

1 A Well, I would say Ofcom has strengthened its view. I think the view in the 2007 mobile
2 termination statement was that the waterbed effect was significant. In the 2011 statement,
3 last month, it said that — I can't remember the exact wording, we can turn it up if you need
4 the exact wording — but essentially it said that the waterbed effect was likely to be strong,
5 which seems to me to be a slight strengthening, if anything, of Ofcom's position on the size
6 of the waterbed effect.

7 Q But, in neither study, in neither instance, has there actually been any percentage.

8 A No, indeed. I think that kind of illustrates, because in both of those market reviews, the
9 waterbed effect was of great significance to the overall analysis, and I think it is quite
10 striking that in neither of those statements was there any quantification, which I think
11 illustrates the difficulty with coming up with a reliable quantification of, you know, in
12 percentage terms, of the waterbed effect.

13 Q And that is really because of the lack of empirical data which is — rather more information
14 in order to happen.

15 A Indeed. I think to have a reliable percentage, I think one would need, not just one empirical
16 study or whatever, but would need a body of evidence which provided some kind of
17 reasonable consensus view. That would be, I think, the kind of thing one would need for a
18 reliable inference about the percentage waterbed effect.

19 Q Can I now turn to a slightly different subject, and just go through with you Ofcom's views
20 on competitive effects. Can I ask you to go to bundle B1 which is the final determination.
21 It is at tab.1, bundle B1. Can I ask you to look at para.9.34, p.169.

22 A Yes.

23 Q We see there, it says that:

24 "Based on all available evidence, we conclude that the ability of other TCPs
25 broadly to replicate BT's termination rate schedules implies that the risk of a
26 distortion of competition among TCPs in NTS hosting services is relatively low".

27 And we see a similar conclusion, if I can ask you then to look at bundle 13, which is
28 simplifying NGNS, tab.3.1. I am sorry, I think my reference has gone wrong. I may have
29 to leave that and pick it up later. But let us just concentrate on the 9.34. Now, the effect of
30 that, Mr. Myers, is that, even if not in the absolutely immediate short term, at least after
31 that, there is going to be potential for competition amongst TCPs in the design of the
32 wholesale tariff schedules, and the consequence of that is, effectively, monies will end up
33 being passed through to the SPs.

1 A Well, some monies will. I think the extent of, just as with the waterbed effect in mobile
2 termination of the waterbed effects in this dispute, the strength of competition between
3 mobile operators affects precisely how much. Similarly here, the strength of competition
4 between TCPs will affect how much of higher termination rates would be passed through to
5 service providers.

6 Q Well, put the other way round, it is not going to, it is not, certainly not going to get stuck
7 with BT as it is going to be passed through because the competition effect, which Ofcom
8 has actually found, in para.9.34, is actually going to force at least some of that money to be
9 pushed through to the SPs.

10 A Yes, I agree.

11 Q Yes, quite how much, whether it is significant, very strong or less than very strong, I fully
12 accept you cannot actually necessarily gauge at this stage.

13 A I agree.

14 PROFESSOR STONEMAN: While we are in this area, can I explore this issue of competition a
15 little further? The waterbed effects and all the other effects do not actually come into play
16 until the price of these 08 calls starts to fall; and the Ofcom conclusion is that you are not
17 convinced that the prices will fall, the 12.5p. So, with principle 2, there may be some
18 reduction in price, but Ofcom is not convinced it will fall to 12.5p. Now, in coming to that
19 conclusion, what assumptions were made about the pricing behaviour of other TCPs or
20 TCPs other than BT or the market — because all you were actually considering was an
21 NCCN from BT. BT does not have 100 per cent of the market, and each of the mobile
22 network operators will be dealing with a number of TCPs. What assumptions were being
23 made about the pricing behaviour of the other TCPs?

24 A In assessing the size of the price reduction?

25 Q Yes.

26 A Yes. So, because Ofcom took the view that other TCPs were likely to replicate, and indeed
27 there was some evidence that other TCPs were already doing so, I think that was taken into
28 account to some extent, but perhaps I might defer to my colleague, Mr. Pratt, on that
29 question because he was overseeing the analysis of the direct effect, not myself.

30 Q I will ask him the same question, then. But, this does then, if we go through to Mr. Read's
31 diagram here.

32 A Yes.

33 Q His boxes, for example, box 1 "Revenues received by BT", if all the other TCPs are setting
34 in the same ladder pricing as BT, that will not be revenues received by BT, that will be

1 revenues received by all TCPs, which will be then split out according to their market shares,
2 yes?

3 A Yes, that must be right, yes.

4 Q Also, even if the others do go for ladder pricing, there is no reason why they should choose
5 exactly the same ladder prices as BT, is there?

6 A No, indeed. As I recall, there was at least one TCP that had chosen a slightly different way,
7 perhaps a somewhat different structure, although I think some other TCPs have chosen very
8 similar structures to BT. There is a potential for difference.

9 Q Especially when there are steps in the different ladders. You could end up with a very non
10 ladder-like structure on the total prices placed by MNOs.

11 A My recollection is that one of the TCPs, for example, didn't have ladders. It was just a
12 constant proportion of, I think, above a threshold level. The determination rate was then a
13 proportion.

14 Q But, it is that average mix —

15 A Yes, indeed.

16 Q — that will determine the prices MNOs, that they charge callers that will — yes.

17 A So, that is right, and that I think was one of the complicating factors, if I recall correctly,
18 that Ofcom discussed under principle 3; and the discussion of principle 3 recognised that
19 one of the features of complexity here was that other termination, terminating operators
20 were likely to replicate, were likely to introduce their own termination rate schedules, but
21 they might not be quite the same as BT's and so the MNO response would have to take
22 account of, given their practice, of the difficulties for them in setting different call prices for
23 calls to different TCPs. If they are setting the same price for calls to all of the TCPs, they
24 need to take some view of the mix or the range of termination rate schedules offered by the
25 range of terminating providers in order to come to a view on their pricing response.

26 Q But, the determination makes it sound very much as if we are only talking about BT.

27 A Well, of course the issue that was faced, the issue in the dispute, was to rule on the BT
28 NCCNs. There is discussion of other TCPs in some contexts where it is particularly
29 relevant.

30 Q Which is where we are at the moment.

31 A Which is, for example, the one Mr. Read took me to, which is, you know, if affects
32 competitive pressure on BT to pass it on. It affects the potential for competitive distortion,
33 it affects complexity, and I can't recall precisely how we took account of that in the analysis
34 of the direct effects, but that is my —

1 Q I will explore it further with Mr. Pratt.

2 THE CHAIRMAN: Mr. Myers, it is a hypothetical question, but I would be grateful if you could
3 try and answer it. As you said a moment ago, this, of course, is a dispute between BT and
4 various MNOs. Supposing the dispute had been between MNOs and a different TCP,
5 would your approach and your answer, or Ofcom's answer, to these determinations have
6 been the same? And, if not the same, how would it have been different?

7 A Perhaps I can just merely give a provisional answer to that, because it's not a point I have
8 completely focused on. I can't immediately identify any feature of Ofcom's analysis which
9 would be particularly different, I think. I think the analysis would be largely the same.

10 Q Which is what I expected you to say, but I am grateful.

11 MR. READ: Can I move on, then to a different point. You very frankly conceded yesterday that
12 Ofcom's thinking on the externalities had moved on subsequently. That is what you said in
13 the transcript:

14 "The kind of analysis and the greater granularity of the effects underlying under
15 the policy preference that has occurred subsequently was exactly that, it was
16 subsequent."

17 Can I ask you then to look at para.231 in your statement which is on p.71, C2, tab 28. You
18 make it quite that:

19 "... Ofcom placed greater weight on the Direct effect because of its policy
20 preference that 0845/0870 calls should be priced by the OCPs in the same as
21 geographic calls. This greater weight already reflects the different types
22 externality, because these form part of the rationale for that policy preference.

23 To go beyond this would, in my view, amount to double-counting."

24 Then you criticise Dr. Maldoom for looking at the different externalities and not taking
25 them as part of the consistent picture.

26 A Well, it certainly wasn't intended to be a criticism, it was merely an observation.

27 Q Perhaps I can not take that further. My point to you is this: how can you possibly start
28 considering the question of double-counting or weight if you have not actually analysed the
29 nature of the externalities?

30 A You will see that para.231 cross-refers to, perhaps particularly in this context, paras.211 to
31 215, and that is where I set out – what I did was I looked back at the policy documents that
32 establish or set out Ofcom's analysis of the situation that the policy preference relates to. In
33 particular in para.213, I explain how the features from those documents which I set out in
34 para.212 and 213 relate to the externalities as they have been articulated in Maldoom 5.

1 That is the basis for my comment that the greater granularity provided in Maldoom 5 maps
2 on to, or is consistent with, or can be closely related to, Ofcom's analysis in the preceding
3 policy documents in 2005 and 2006.

4 Q We do not see the analysis that you have done at 211 to 213 anywhere discussed in the final
5 determination, do we?

6 A No, I think we covered this point yesterday. Ofcom took the policy preference as given and
7 then looked at the implications of that policy preference. The exploration of precisely what
8 underpinned that, the economic underpinnings of that policy preference and how it related
9 to the different types of externalities, the different types of effects, I think, as I said
10 yesterday, has been done subsequent to the final determination itself.

11 Q Let us see what is actually packed into this preference. The first is the policy preference
12 itself, in the sense that you obviously say it is about externalities. Surely it was not just
13 confined to externalities. There must be some weight to be given to the fact that Ofcom is
14 trying to set out some preferences in the market and explain what the preferences should be
15 over the distribution of benefits between the respective players within that particular
16 market.

17 A I'm not sure I follow your question.

18 Q The sole point I am putting to you, Mr. Myers, is really that over and above the question of
19 externalities there must be some weight given to the fact that this was a preference that
20 Ofcom had actually set out for effectively how the market in NTS call traffic should
21 actually operate. In other words, it cannot just be confined to the fact that there might be
22 externalities in the market. There must be some weight given to the fact that it is actually a
23 policy preference that Ofcom has actually said dealing with the distribution of benefits in
24 the chain?

25 A The policy preference reflects, I think it is fair to say, a range of considerations. One of the
26 important considerations was Ofcom's analysis of market failure in OCPs' pricing of non-
27 geographic calls and 0845/0870 in particular. That market failure reflects the externalities.
28 What is included beyond that, I agree there are some other considerations, such as potential
29 for scams and consumer anxiety, and I would have to, I think, refer back to the documents
30 themselves to articulate exactly what further considerations were included. That's right, it
31 wasn't solely about the externalities, but the externalities and the market failure was a key
32 part of the analysis.

33 Q We know, because we touched on it yesterday when we were looking at the Simplifying
34 Non-Geographic Numbers and the consumer detriment, there is the element of vulnerability

1 to callers. If particular groups of callers are vulnerable to high prices – for example, those
2 on lower social classes who use only basically pre-pay mobile phones – that is another
3 factor that was weighted in to this preference that you gave to the direct effect?

4 A I certainly agree that that is in Ofcom’s 2010 Simplifying Non-Geographic Numbers
5 document. That point and that type of detriment is made. It may be in the earlier
6 documents, I am not sure.

7 Q It certainly comes up in the 0800 determination, does it not, because that is one of the
8 reasons ----

9 A Yes, it came up – absolutely, it came up there.

10 Q You are also packing into this preference my box K on my diagram, the demand effect, are
11 you not, because that is how you say that that gets weighted into the equation. Because of
12 the preference you give to the direct effect over the mobile tariff package effect, that takes
13 into account the demand effect, the benefit to service providers and others in the chain,
14 caused by the brand enhancement, if I can call it that?

15 A That is one aspect of the market failure, and the consequence of the externalities, so it is
16 included, as the alleviation of the externalities would be included.

17 Q My point is really this: you are packing quite a lot, are you not, into this preference of the
18 direct effect over the mobile tariff package effect?

19 A I think we need to distinguish between “a lot” in terms of number of granular effects, or
20 effects that one can set out distinctly, even if they are kind of related effects – in that sense,
21 yes, one can disaggregate a number of these effects as has been done, and one can do that in
22 different ways, in different categorisations. But I think the significant question for the
23 disputes was, as it were, “a lot” in terms of the value, and that goes to the question that we
24 were discussing yesterday about the extent to which these NCCNs would, in fact, alleviate
25 effectively the market failures, whether it really would improve consumer confidence, and
26 whether it really would lead to brand enhancement that would yield this magnification of
27 volume increases.

28 Q The point I am putting to you, Mr. Myers, is that there is no discussion about how exactly
29 you analyse the weight to be given to all these factors that get weighed into the balance on
30 the preference given to the direct effect. There is no discussion about that set out in an
31 analytical framework within the final determinations themselves, is there?

32 A No, I think there was an area of uncertainty. Like many of the other effects here, it was
33 very difficult to quantify or even really provide much understanding of exactly how large
34 this effect would be, and that is essentially why Ofcom felt unable to reach a clear

1 conclusion in the partial reduction case, and said that the conclusion as to whether it is
2 overall beneficial or detrimental depends on the relative sizes of all of the effects, of which
3 precisely how much greater weight should be given to the direct effect is one, and said that
4 those effects were uncertain.

5 Q Can I move on to a different point now, because I think I have explored what you say about
6 that sufficiently. Can I ask you to go p.83 of your statement and footnote 194? I think
7 yesterday you agreed that what you have actually said there is not correct?

8 A That's right. The footnote, as I said yesterday, only discusses the indirect effect on callers,
9 whereas the diagram in figure 8 the line of indirect effect includes both indirect effect on
10 service providers and callers.

11 Q So if I can go to my flow of funds diagram what you are saying is effectively packed into
12 that are not just box 6, but also boxes 6 and 7?

13 A Yes, suitably weighted, yes.

14 Q And we know that it is quite likely that because of the competitive effects that in fact the
15 SPs are going to end up receiving quite a chunk of the money that is received by BT
16 through the termination payments. In other words, the box 1 figure, a fair amount of that is
17 going to be passed down the line to box 5 and the SPs, and then the SPs are going to one
18 way or another either divide it up between boxes 6 and 7?

19 A That's right, and Ofcom I think have a view on the split between boxes 6 and 7.

20 Q I understand what you say about that, but the reality is, is it not, that boxes 6 and 7 actually
21 have between them quite significant sums within them?

22 A I am not sure what you mean by "quite significant"? I agree that the expectation was that
23 because of competition between TCPs, the ability of other TCPs to replicate in broad terms
24 even if not precisely, in broad terms the BT termination rate schedule that some pass-on was
25 expected from higher termination rates through to service providers. If that is what you
26 mean I agree with that.

27 Q But perhaps if we can just look at your figure 8 diagram, which I think is the previous page,
28 82. The key problem really comes as to how you weight them, is it not, because you have
29 obviously drawn an indirect effect on your figure 8 that is quite a low gradient, it does not
30 give it much weight when you get to the current price?

31 A I think, as I explained yesterday, in relation to the indirect effect line there were two points I
32 was trying to establish with this diagram, one was that at 12.5ppm on Ofcom's analysis of
33 indirect effect it is essentially zero, and draw the contrast in that with the corresponding
34 figure diagram in Maldoom 5 where he was including other types of effect and the indirect

1 effect, so it relates to that difference in labelling. That is one point that this diagram was
2 trying to illustrate. The second point was at the current price the indirect effect in Ofcom's
3 view was smaller than the mobile tariff package. So that is right but beyond that there was
4 no particular significance of the precise gradient of the indirect effect line.

5 Q I understand that and obviously it is a point that has been fastened on to by the subsequent
6 experts' report, but is not one of the problems about this that it is all very well to say the
7 indirect effect has less weight than the mobile tariff package effect but to do a proper
8 analysis you have to actually have some idea about how much less the indirect effect has
9 compared to the mobile tariff package effect, otherwise you effectively do not end up with
10 any proper weighted analysis?

11 A Ofcom considered the split between 6 and 7 in your diagram in the determination and it's
12 using the available evidence which was I think from a 2005 survey or analysis of service
13 providers and what that evidence suggested was that many of the service providers did
14 choose these 045 and 0870 number ranges for the purpose of revenue share, and in fact the
15 revenue share would have been larger in 2005 than it would be today on these number
16 ranges. Secondly, that when they were asked questions about how they regarded the
17 revenue share most of those businesses said that they did not treat it as income and would
18 not miss it if it was not there. So Ofcom's inference from that in the context of the disputes
19 using that evidence was that that made it quite uncertain that they would, in fact, respond to
20 increased revenue share by changing their behaviour and increasing the quality of their
21 services, there was significant doubt they would do that, they might just simply take the
22 money and not change behaviour.

23 Q Would you agree with this: Ofcom accepts that if the prices fall to 12.5ppm or it is likely
24 that the prices fall to 12.5ppm then in that circumstance it is welfare beneficial?

25 A Yes, the full reduction scenario is likely to be welfare beneficial.

26 Q At some point between that and prices staying the same, in other words, we are looking at a
27 partial reduction scenario, at some point there has to be a tipping point where you can say it
28 is now welfare beneficial at this partial reduction price, there has to be some tipping point
29 even in a partial reduction?

30 A Yes, I agree.

31 Q If we take for example a scale of prices so that zero is the bottom tier and 100 is prices stay
32 at current prices – do you understand, I am just predicating the scale of effective price drop
33 so that zero is at the bottom and 100 is at the top, i.e. current prices. At some point in that

1 scale there has to be a point where it becomes clear that the reductions are actually going to
2 be beneficial to consumers?

3 A Yes, in principle that is right.

4 Q And the problem with the analysis Ofcom has carried out, I put to you, is actually t here has
5 been no attempt to say what likely range that situation may actually arise where the tipping
6 point actually occurs?

7 A I agree that Ofcom did not do that. I am not sure I would accept that that is a deficiency in
8 the analysis because I think it is extremely difficult, what that would require in order to
9 identify what this tipping point, or I think it has been called the “break even” point in some
10 of the expert reports, what that point is would require quantification of all of these effects –
11 and reliable quantification of all of these effects. Bear in mind that figure 8 shows nice
12 straight, flat lines for the direct, indirect and mobile tariff package effects, the reality might
13 be substantially more complicated and unclear exactly what these lines would look like if
14 they were measured, so the shape of these lines could be quite different from those shown in
15 this very simplified figure 8 diagram. So if there had been a basis for reliable quantification
16 of all of these effects, including the greater weights on things and the magnification of the
17 direct effect, and the size of the waterbed effects and the mobile tariff package effects, then
18 I agree that I think one in theory would have been able to narrow down the range and
19 identify either what the tipping point was or an indication of where between the bottom tier
20 and the current price it might be. But I do not believe there was sufficiently reliable
21 evidence in order to attempt, sensibly attempt that kind of quantification. We have already
22 discussed for example this morning that even in market reviews of mobile termination
23 where the waterbed effect is of considerable significance Ofcom has not there done more
24 than a qualitative indication of the size of the waterbed effect. It hasn’t thought to quantify
25 or put a tight range in percentage terms on that. And that’s in a context of probably the
26 largest market view that Ofcom conducts every four years. So, I think, to expect that kind
27 of analysis to be done within a short dispute is very difficult. In terms of the direct effect,
28 how large the magnification, how effective the NCCNs might be in alleviating the market
29 failure, again, that’s a very complicated question to put a quantification to that. And, again,
30 that’s something that I would observe has not been attempted within the simplifying non-
31 geographic numbers. There was an assessment of the potential option for alleviating the
32 market failures; the analysis was qualitative. There was no attempt to put a quantification
33 on precisely how much of the market failure would be alleviated. So, I think it would be an
34 extremely difficult task, and I am unconvinced that there is even sufficiently reliable

1 evidence available, never mind the time and effort and complexity needed to assess both
2 these effects and the shapes of all of these lines. Therefore, in my view Ofcom took a
3 sensible approach, which was to say, “We have four scenarios, obviously some more
4 relevant than others, price can go up, prices stay the same, prices go down to the bottom
5 tier, and prices fall but not to the bottom tier”. In three of those scenarios, Ofcom did reach
6 a clear view on the overall effect on consumers. It was only in this partial reduction case
7 where it did not. But, as we have discussed, that is the most complicated scenario, because
8 all of the effects are present of both higher termination rates and tariff rebalancing, and that
9 is really why it is a particularly complicated case to analyse.

10 Q That was a very long answer. So, let us try and unpick it a little bit.

11 THE CHAIRMAN: Well, I actually had a question arising out of that, if I may, Mr. Read

12 MR. READ: I am sorry, sir.

13 THE CHAIRMAN (To the witness): All we have got here, Mr. Myers, is a very sophisticated
14 economic analysis, if I may say so, based upon a near total lack of empirical data. That
15 leads, inevitably, to uncertainties which you simply cannot deal with, and that, as
16 I understand, is what you have articulated in your answer. Given that the data simply is not
17 there, your position is that there are certain conclusions that you simply cannot draw
18 because of the uncertainty. Would you say that that results, in terms of the economic
19 analysis that you achieve, in a bias, and I do not mean that in the pejorative sense, I mean in
20 a tendency in favour of the status quo when one is considering changes to, say, tariffs, as we
21 are at the moment?

22 A On the grounds of economic analysis, I am not sure, I mean, the position reached was
23 Ofcom was uncertain whether or not it would lead to benefit to consumers or detriment to
24 consumers. I think the view was then taken to put greater weight on the risk of detriments,
25 so I think it is that point which I do not think directly arises out of the economic analysis.
26 The economic analysis takes you to, “Do we know which way it might go?” “Do we have a
27 reason to believe it is more likely to be beneficial or detrimental”, and Ofcom took the
28 position in the partial reduction case in particular, and overall it was kind of unclear which
29 way it would go. It’s the fact that Ofcom then placed greater weight on the risk of
30 detriment that I think leads to the favouring of the status quo.

31 Q I understand what you are saying is, it is not so much a question of economic analysis. The
32 more one does with the identified deficiencies in the economic analysis which arises out of
33 the lack of empirical data.

34 A That’s exactly right, yes.

1 Q That is very helpful. Thank you.

2 MR. READ: Can I go back, and let us start with what we do know. We know that Ofcom was
3 persuaded that prices were going to fall, that the wholesale tariff schedule was more likely
4 to incentivise the MNOs to reduce their prices.

5 A Yes.

6 Q So, the scenarios where prices might go up or stay the same were really, on Ofcom's
7 analysis, very unlikely scenarios.

8 A Well, they were less likely.

9 Q Less likely scenarios. But effectively, on Ofcom's analysis, there were two remaining
10 scenarios as a result that were certainly more likely; and the first of those is the price point
11 at 12.5ppm or somewhere in between. Now, we know from the final determination that
12 Ofcom had conducted its own investigation into the economic modelling that BT had done,
13 because we see, for example, discussion at certain points about partial price reductions.

14 A Yes.

15 Q So, having actually conducted that sort of analysis — and it is presumably the sort of
16 analysis that Mr. Pratt has actually set out in his witness statement, in particular the annexes
17 at the end. Is that right? You do not know.

18 A I am not sure if that is precisely right.

19 Q But, having done that, Ofcom then fails to do any sort of scenario-based approach by
20 saying, "Well, let's say they fall to 17.5ppm, how is this all going to weigh up in that type
21 of scenario?" Now, I am not suggesting that you necessarily have to come up with precise
22 figures. What I am suggesting, Mr. Myers, is that unless you do some form of analysis like
23 that, the danger is that you overlook factors when you are actually conducting your analysis,
24 and you certainly do not carry out any form of sensitivity analysis to allow you to reach
25 firmer conclusions as to whether or not you have got the right answer. It is a long question.
26 Do you want me to put it again?

27 A I mean, on one part of that question, what did Ofcom look at, I think there was a distinction
28 between the full reduction case and the partial reduction case. Ofcom then specifically in
29 s.8 looked at the situation if MNOs reduced prices to take them down by one tier. And in
30 that case that is one particular case within the partial reduction scenario. That is in s.8, it is
31 para.8.51 I think on p.152, and the table on the following page on p.153.

32 Q Thank you, yes.

1 A So, that's what Ofcom did look at. Beyond that, I'm somewhat unclear what it is you are
2 suggesting Ofcom could have done to have narrowed down or to come to a clearer overall
3 conclusion.

4 Q Well, for example, it has not done, if one just looks at 8.152, they have done it with what
5 happens if it falls to the next tier down, have they not? They certainly have not looked at
6 what happens if it falls to the tier immediately above 12.5ppm.

7 A I agree. There are a set of possible cases within the partial reduction scenario. However,
8 I am unclear how referring to those, or articulating the range of possible scenarios would
9 actually have assisted in allowing an overall conclusion to be reached, because in the partial
10 reduction case one would still be left with uncertainty about the overall effect on
11 consumers. The closer prices were, the closer a partial reduction case is to prices all falling
12 to the bottom tier, the more likely it is that the overall benefits would be positive. But I'm
13 not sure one could necessarily say they would for sure. And, similarly, you know, being
14 symmetric in scenarios that are closer to the current price, one could say that makes it more
15 likely that they would be detrimental to consumers. But, again, I don't think, without a
16 more refined quantification of the effects, one could actually remove the uncertainty about
17 the overall effect.

18 Q But, it allows a sensitivity analysis, does it not? Because, what it is actually doing is, it is
19 saying, "Well, what are the likely scenarios in a partial reduction situation, and how are the
20 factors going to be weighted between them?" It is not saying "This is going to happen", it
21 is simply giving you a sensitivity analysis which will then allow you to work out how
22 exactly the factors play out against each other, and that is what Ofcom did not do.

23 A Well, I still can't see how that really would have assisted. One could, as I say, have
24 articulated different cases, set out in great detail the nature and effect in each case, which
25 would have been largely the same but with the potential for different quantifications of
26 them. Ofcom would then have been unable to put a quantification to any of those effects.
27 As I have just said in my previous answer, it would have had to conclude that, yes, one
28 could articulate a greater range of cases, but it wouldn't have resolved the uncertainty. I
29 think the term "sensitivity" is not – I don't think I would agree that that's the best way to
30 explain what I think you're suggesting. A sensitivity analysis would normally be
31 considered where one has a quantification, one has a set of base case assumptions, and then
32 there's always a lack of certainty about precise parameter values, or precisely how the
33 relationships might work. One explores different ways of quantifying these different
34 parameter assumptions in order to understand how much difference that makes to the final

1 result, what the result is most sensitive to. In the absence of quantification I can't see how a
2 greater articulation of these partial reduction cases would have assisted in resolving the
3 uncertainty.

4 Q You see, the point I am putting to you is that you had gone through that analysis it would
5 have actually allowed you to see how the respective uncertainties you have actually been
6 talking about, how they actually balance out in the various equation. It means that you do
7 not overlook something in carrying out that analysis?

8 A I don't agree. I don't agree that Ofcom overlooked material significant effects, and I am not
9 convinced that this greater articulation of partial reduction cases would have affected
10 Ofcom's analysis in a significant way.

11 Q You understand that BT's case is that there has been muddled thinking throughout as to
12 how these various effects inter-react with one another?

13 A Yes, and I disagree with those criticisms.

14 Q You disagree with it, but certainly it would have been clear how they were all going to
15 inter-react if Ofcom had carried out a scenario based analysis?

16 A Well, Ofcom did carry out a scenario based analysis. It looked at four scenarios, including
17 two scenarios involving price reductions, a full reduction scenario and a partial reduction
18 scenario.

19 Q If one looks at p.168, for example, your table 9.1 – I am in the final determination – in fact,
20 it is fairer to say, is it not, that really Ofcom was focusing on three scenarios: prices falling,
21 prices remaining unchanged and prices rising?

22 A Well, I agree that that table has one column for 08 prices falling, but, as I set out in, I
23 believe, table 2 ----

24 Q Table 6, I think it is.

25 A No, it is table 2 on p.21 of my witness statement. I have split out that column in my table 2
26 on p.21 into the full reduction case and the partial reduction case, and in order to do that I
27 have used points that are made within the final determination. I wasn't here elaborating the
28 final determination, merely drawing out what the final determination says. There are places
29 in the final determination where it makes it clear that Ofcom's conclusion was that in a full
30 reduction case there was a beneficial overall effect for consumers, and indeed commented
31 on the different aspects. So I think it is fairer to say that Ofcom did, in fact, consider four
32 scenarios.

33 Q We can leave it there because we will have to make submissions in due course about what
34 the final determination does. Can I just conclude this point by taking you over the page

1 from 168, 169, the final determination, para.9.31. There you accept that the issue is finely
2 balanced, do you not?

3 A Yes.

4 Q So actually it makes it even more important to go through a scenario based analysis in order
5 to see that you have not got the tipping point in the wrong place?

6 A Ofcom did not reach a view on where the tipping point, because, as I said, that would have
7 required a quantification of effects. I think one should only take the analysis as far as one
8 thinks is useful and can produce a reliable or defensible analysis or results. Ofcom took it
9 as far as it thought it sensibly could. To go beyond that, further quantification did not seem
10 to Ofcom to be justified and therefore it was unable to reach a clear conclusion on the
11 overall effect in the partial reduction and indeed to identify exactly where the tipping might
12 be, whether it was closer to the current price or closer to the bottom tier.

13 Q Does what you have done not essentially create a presumption in favour of harm? If it is all
14 too uncertain we must presume harm?

15 A I think I have covered that in my response to the question from the Chairman earlier. The
16 economic analysis said that Ofcom was unable to determine whether it was likely to
17 beneficial or detrimental for consumers, and then Ofcom, in interpreting that economic
18 analysis, placed greater weight on the risk of detriment.

19 Q Can I ask you to look at para.221 on p.67 of your statement. Perhaps we should start with
20 para.219 where you deal with the issue about whether regulatory policy is better addressed
21 in policy reviews and at 221 you set out a number of reasons why you say, in fact, it would
22 be better to address these issues in the context of a policy review?

23 A Yes, and that is, I think, dealt with in greater detail in my first witness statement.

24 Q You frankly set out the position and it is not really therefore surprising that Ofcom should
25 be attracted to solutions that preserve the position until a review?

26 A I think Ofcom stated in the final determination that, given a free choice, it would have
27 preferred to address the question of the complex and wider ranging changes that the NCCNs
28 would introduce to a policy review; but it also recognised that that wasn't appropriate, that
29 it had a dispute before it that it had to resolve.

30 Q A number of the comments you make there are obviously dealing with the issue of, it is a
31 better solution because it provides a more perfect answer to the problem?

32 A Sorry, where are you?

33 Q I should take you on to para.225.

34 A Yes.

1 Q You are talking there, for example, about the fact that the situation may not actually end up
2 in getting the solution that Ofcom wants, which in the case of 080 prices would be
3 freephone. This dispute, if it was accepted in BT's favour, would only reduce the prices to
4 8.5 ppm in the case of 080 calls?

5 A Yes.

6 Q The point I have put to you is that that may not be what Ofcom actually would want – it
7 does not want prices down to 8.5 ppm, it wants them to zero pence per minute. Of course,
8 that is a different task when you are actually considering whether or not a particular price
9 should or should not be allowed under the dispute resolution procedure?

10 A I agree, and that's the view I expressed in my response to Muysert 1, and I believe I
11 discussed extensively with Miss Smith yesterday, that a question in a policy review, in my
12 understanding, is different from the question in a dispute, and my characterisation of the
13 economic question in the dispute was that the relevant question was whether or not BT's
14 NCCNs would lead to an improvement or a detriment to consumers, not what was the best
15 policy response to the market failures.

16 Q The corollary of that is if actually the prices were to go down to 8.5 ppm, or 8.49 ppm in the
17 case of 080 and 12.49 ppm in the case of 0845/0870, the consequence of that was that part
18 of the problem that Ofcom is tackling in its review in Simplifying Non-Geographic
19 Numbers, part of that problem may have been ameliorated?

20 A Can I just clarify, are you asking me a question about the dispute or in the context of the
21 wider picture, because I think there is a slightly different ----

22 Q It is a fair point. I am now looking at the wider picture.

23 A The wider picture. In the context of the wider picture, I think that that does not follow at all
24 because I think the sensible approach, if one is thinking about how policy or regulation
25 might change in order to alleviate these market failures, is to, first of all, consider what the
26 best approach is, even that is some way in the future because of consultation and the need
27 for implementation at the time. Then the question arises, given where you are trying to aim
28 at, are BT's NCCNs a good staging post on the route to that best best solution and there it
29 seems to me that is not at all clear that it is desirable, perhaps particularly for 0845 and
30 0870, 080 might be a little different. But for 0845 and 0870 at least where Ofcom's current
31 thinking is and, of course, that is subject to consultation, but Ofcom is actually proposing to
32 remove the linkage of 0845 and 0870 to geographic pricing and instead to rely on 03 to
33 perform that function rather than having more than one number range to do it as is the case
34 at present. That is in the interest of creating a much simpler, more easily understandable

1 message for consumers, and also takes account of the entrenched difficulties and the
2 consumer distrust of 0845 and 0870. So given that that is the destination that we are trying
3 to reach, it does not seem to me that BT's NCCNs are necessarily a desirable staging post to
4 achieve that destination, particularly if there are costs which it has not been established how
5 significant, but if there are costs in order to implement BT's NCCNs through, for example,
6 any costs needed to establish what the average retail prices should be. In the case of 080
7 there might be more of a case that it is a sensible staging post because Ofcom's proposal in
8 the simplified non-geographic numbers is to require all OCPs to zero rate all 080 calls and
9 within that context, subject to the costs of implementation not being too large given the
10 limited life that the NCCNs termination charge review might have that might be a more
11 sensible staging post.

12 Q Just let us take 080 because the issue is fairly clear cut there. Ofcom would like prices to go
13 down to zero, BT's NCCN may, subject to all the other debate bring it down to 8.5ppm,
14 yes?

15 A Yes, that is a possibility.

16 Q And if that result is achieved it will actually have resulted in a partial but not total solution
17 to the issue of higher freephone prices?

18 A Well I think that is essentially what I have just said, but the further consideration would
19 need to be whether, given the length of time that that NCCN or the NCCN regime would
20 last before it was overtaken by implementation of , as it were, the final destination, the
21 policy solution if Ofcom retains the proposal that it is consulting on requiring all OCPs to
22 zero rate all of these calls, the question would be whether the cost of implementing would
23 be justified relative to the period of time for which those benefits would last, but subject to
24 that point I agree it could be a useful staging post towards the final destination of those
25 calls ----

26 Q But because it is a staging point the prices actually went down to that level, it would
27 actually make Ofcom's intervention less crucial because you would have effectively got
28 half way there, in other words, if you were doing an impact assessment you would actually
29 have to say "We have half reduced the problem, does that actually mean that we need to
30 now intervene into the situation?"

31 A I don't think I would accept the characterisation of "half way". I think the point about, and
32 one of the things I think Ofcom has learned over time, and particularly explored through its
33 Simplified Non-Geographic Numbers Review, is that previous reviews have taken a slightly
34 more piecemeal approach to understanding and trying to deal with the problems with the

1 non-geographic numbers regime, and the fact that it was not working too well. The
2 Simplified-Non-Geographic Numbers kind of recognised that piecemeal approach hadn't
3 really worked very well, but the problems were persisting, and actually a much more
4 strategic, if you like, approach was needed. One of the observations that might lead to, for
5 example, is that we need to recognise that there needs to be simple and clear messages for
6 consumers if we are really going to expect them to understand it, and zero prices for all 080
7 calls is simple and clear. The kind of situation that might arise through the NCCNs might be
8 better in one respect – and I will come back to the respect in which it might be worse – it
9 might be better in one respect than the current regime, which is that prices where they are
10 charged for by mobile operators, might be lower than they currently are. But that is still a
11 very complicated message for consumers to understand. Some 080 calls are zero-rated,
12 some are not zero-rated, there may still be a range of prices, that range of prices may be
13 lower than the current situation but that is quite a complicated message and therefore I think
14 there are significant doubts about the extent to which it really would materially alleviate the
15 market failure on 080, whereas the simple, clear message, easily understandable “080 calls
16 are free” that is likely to have a much greater effect. It is not clear how far it would get and
17 it might not get very far towards alleviating the market failure.

18 I said that that is the aspect that potentially is an improvement over the current situation, but
19 if prices do not fall to the bottom tier then termination rates go up, and if we recall Ofcom
20 concluded that termination rates going up was likely on its own to lead to detrimental
21 effects on consumers, because the increase in termination rates would find its way through
22 to higher prices through the mobile tariff package rate for higher prices for mobile
23 customers, and the potential offsetting benefit, which is the indirect effect, there were
24 doubts that that would flow through to callers, and that is why Ofcom concluded that the
25 consequence of termination rates going up was likely to be detrimental. So we have a case
26 here in the partial reduction case again where we have two sets of effects – tariff
27 rebalancing and price reduction on 080 which is likely to be beneficial, and termination
28 rates increasing which is likely to be detrimental.

29 THE CHAIRMAN: Mr. Myers, you mentioned several times ‘clarity of message’ and I can see
30 that as being an important aspect of non-geographic numbers. It not another aspect simply
31 the fact that you might designate a certain number as meaning a certain thing but actually, at
32 least as the regime stands at the moment there is no way of imposing that on the market?
33 The fact is you can say: “We would like this number to mean this” but there are large
34 portions of the market to whom you are addressing that message who can do as they please?

1 A Precisely, and that is precisely one of the key problems with the current regime, and aspects
2 of why some of these number ranges are not working at all well for consumers, and the
3 Simplifying Non-Geographic Numbers Review is looking to the future when the new EU
4 framework comes in and it will be possible, in Ofcom's view at least ----

5 Q Yes, I do not want to get into that debate ----

6 A On the basis that we assume that Ofcom can impose that, that is what Ofcom is proposing,
7 and indeed for 080 calls, Ofcom is proposing to impose a maximum price of zero on all
8 OCPs, that is its proposal in the Simplifying Non-Geographic Numbers, which certainly is
9 not the case at the moment.

10 MR. READ: Thank you, Mr. Myers, those are all my questions.

11 THE CHAIRMAN: Mr. Herberg.

12 Re-examined by Mr. HERBERG

13 Q I have just two small topics of re-examination, both of which I hope are short. The first,
14 Mr. Myers, it was suggested to you by Mr. Read, that there was nothing in the final
15 determination that indicated that the brand quality effect – if you can call it that – had been
16 included in the weight given to the direct effect?

17 A I am not sure I quite put it like that.

18 Q Can I ask you to take the final determination in bundle B1, and go to para. 7.97? (After a
19 pause) Now, this is reporting a BT argument. This is the part of the final determination
20 dealing with submissions made to Ofcom in response to the draft determination. That notes,
21 as you will see, that BT states, reporting a BT argument:

22 "In the context of the six principles, as argued by Dr. Maldoon, the externalities
23 arising from non-compliance with Ofcom's 08X policies were not taken into
24 account in the 080 determination and that this view is also applicable here".

25 This is the 0845/0870. Now, the reference to, as argued by Dr. Maldoon, appears to be a
26 reference to Maldoon 3. If I can just briefly take you to that. Maldoon 3 is in vol.C1 at
27 tab.10, para.41. If you would just read para.41.

28 A Yes.

29 Q And, could you also just read para.48.

30 A Yes.

31 Q Can I ask you, what effect is Dr. Maldoon talking about in these paragraphs?

32 A Well, I understand that this includes, certainly, the brand enhancement effect.

33 Q Can I ask you to look at the place where Ofcom responded to this criticism, so it is back in
34 the final determination, a few paragraphs further forward at para.7.103:

1 “In relation to BT’s comments from Dr. Maldoon, we comment on the presence of
2 an externality and the resulting need to balance the benefits to both sets of
3 consumers, taking into account the needs of the SPs and why they have chosen the
4 number range in paras.4.5-4.9 above. We have taken it into account in our
5 analysis, indeed we put greater weight on the direct effect in part for this reason,
6 as discussed above”.

7 What is the effect on SPs that is being referred to here, and how does it say it is being dealt
8 with?

9 A Well, I think there are two potential effects on SPs from lower 08 call prices, which I think
10 is the context here. One is simply that there is a lower price that is more in line with, less
11 likely to be discrepancies from choosing that number range; and, second, that lower price
12 may stimulate greater volume. So they would receive a greater volume of calls. And, sorry,
13 the second part of your question?

14 Q How does it Ofcom say it is dealing with that?

15 A Ofcom says, “Let’s take it into account by putting greater weight on the direct effect”.

16 Q And, is that your understanding of what Ofcom in fact did?

17 A Yes.

18 Q Finally, can I just ask you about something else Mr. Read suggested? I think he suggested
19 that it was either a possible analysis or indeed the proper analysis of the final determination
20 that greater weight on the direct effect was merely operating as a tie break, ie only operating
21 in situations where the two effects were exactly equal. And he showed you, I think, I will
22 not take you back to them, paras.4.33 and 7.62 of the final determination. And you said that
23 those paragraphs were consistent with either interpretation. In other words, either a tie-
24 break or counteracting greater mobile tariff package effect, although you did not accept that
25 the final determination overall suggested that Ofcom had taken a tie-break approach. (And
26 just, perhaps for the transcript note, that is p.78 of yesterday’s transcript, lines 17-20). Can
27 I ask you to look at one other passage in the final determination, at para.5.28.

28 A Is that in Annex —

29 Q It is in the final determination, it is in the main, it is p.70 in my version. I did have page
30 numbers that were neither Mr. Read’s nor the witness ones, but it is round about p.70.

31 A The paragraph number —

32 Q It is 5.28.

33 A Thank you.

1 Q If I could ask you to read 5.28 and also footnote 125 which goes with that paragraph. In
2 particular, the footnote.

3 A (After a pause) Yes.

4 Q Do you consider that para.5.28 and in particular footnote 125 is consistent with the tie-break
5 analysis of the weight placed on the direct effect?

6 A No, I don't think so, because it's — in the footnote it says, "The greater weight reduces the
7 size of the positive direct effect required for the overall effect on consumers to be positive".
8 So, in a sense, linking this to an earlier discussion with Mr. Read, effectively what it's
9 saying is the greater weight changes the tipping point. It changes the tipping point, and
10 means that prices don't necessarily need to come down to the bottom tier. But one might
11 have a positive effect if prices fall by less than that, and that doesn't seem to be consistent
12 with a tie-breaking role.

13 Q Thank you, Mr. Myers. Sir, I have no further questions.

14 PROFESSOR STONEMAN: Just a question to help me and the other members of the Tribunal to
15 find what we want in the papers. In the final determination para.9.34 which is the
16 paragraph we were at before on competitive distortion.

17 A Yes.

18 Q It is the last line:
19 "The risk of a distortion of competition amongst TCPs and NTS hosting services
20 is relatively low".

21 In any of the papers, do we have any detail of the market for NTS hosting services? In
22 other words, who were the players? What are the market shares?

23 A Sir, that's not covered in the final determination. I'm just wondering to what extent that's
24 covered in the simplifying NGNS document. I'm not sure on that point.

25 Q It is just it would be useful, because there is argument about the BT revenues and the
26 revenues of other TCP providers shifting it through to the SPs, and therefore that market
27 somehow being competitive. And I would just like to see some information on the nature of
28 that market. I have not come across it, but I thought you might know the papers better
29 than I.

30 MR. HERBERG: Sir, maybe, certainly Ofcom can collectively see whether we can come up with
31 anything.

32 PROFESSOR STONEMAN: Thank you.

33 THE CHAIRMAN: Mr. Myers, thank you very much.

34 A Thank you.

1 THE CHAIRMAN: We will rise for five minutes before we have Mr. Pratt.

2 (Short break)

3 THE CHAIRMAN: Mr. Herberg, before you call Mr. Pratt, Mr. Read will know that this
4 Tribunal has a habit of circulating questions that it would be helpful to have addressed
5 before closing.

6 MR. HERBERG: Sir, yes.

7 THE CHAIRMAN: We have a piece of homework which we anticipate might be a little more
8 substantial, so I thought I would raise it now. I hope you have had circulated what is a very
9 crude diagram. It would be of some assistance to us if we could have an agreed statement
10 of how the calling system work for geographic numbers, 080 numbers, 0845 numbers and
11 0870 numbers, so set out separately, and illustrating in each case, first of all, how the
12 contractual relations operate; secondly, how the money flows operate; and thirdly, which
13 parts of the overall system are regulated and which parts are not. By “regulated”, I mean
14 actually regulated, I do not mean where there is a potential for regulation but where there is,
15 in fact, regulation at the moment.

16 MR. HERBERG: And not where the parties have agreed contractually to follow the regulated
17 approach but actually by direct regulation.

18 THE CHAIRMAN: Where something is imposed, exactly so. I am sorry to throw that at you
19 now.

20 MR. HERBERG: No, there are two steps in that: internally working out the answers, and then
21 seeking to agree it with the other sides, and we will seek to do that.

22 THE CHAIRMAN: Thank you very much.

23 MR. HERBERG: If I can call Mr. Pratt to give evidence.

24 Mr. NEIL MICHAEL PRATT, Sworn

25 Examined by Mr. HERBERG

26 Q Mr. Pratt, can I ask you to find volume C2, and turn to tab 29. That should, on the first
27 page, be a witness statement with your name?

28 A Yes.

29 Q Then if you could turn to p.47 in that document. It is the signature page. I do not know
30 whether the copy in front of you bears a signature?

31 A It is not signed.

32 Q I think one can be provided to you. (Same handed) Is that your signature?

33 A Yes, it is.

34 Q Does that statement contain the evidence which you wish to give to the Tribunal?

1 A Subject to one correction, please.

2 Q Would you like to tell the Tribunal about that correction?

3 A Page 22, I'd like to correct footnote 46, if I may.

4 Q Page 22, footnote 46.

5 A It should say:

6 "In the context of a firm that sells multiple products, the Lerner condition

7 applies to a particular product if the price for that product does not affect the

8 demand of any other products sold by the firm."

9 Q So as I understand the nature of your correction, at the moment it says "if the demand for

10 the product" ----

11 A That's right.

12 Q -- and you want to change it to "price". Can you explain the significance of that?

13 A This footnote is just a clarification of when the Lerner condition, which I report at para.63,

14 how that applies to a firm that sells multiple products.

15 Q Does that correction have any impact as far as you are concerned on other parts of your

16 statement?

17 A No, it does not.

18 Q Now your statement responded to, I think in the procession of statements, Dobbs 6 and

19 Maldoom 5 and since then obviously there have been various further reports. Can I ask you

20 to take up bundle C1 and just go to the index page would be most convenient first?

21 A I have it.

22 Q Within that in relation to Professor Dobbs' evidence the most recent report is Dobbs 7

23 which is at tab 7, if you could just turn to that and the contents page, the second page?

24 A Yes.

25 Q I think it is right to say, is it not, that II.I and II.II and annexes 2 and 3 that effectively

26 respond to your evidence or deal with the matters your evidence gives, I should say?

27 A That is correct.

28 Q What, if anything, have you done by way of reading or reviewing this statement?

29 A I have read those sections, II.I, II.II. Annex 2 and annex 3 I have not had the opportunity to

30 work through the details of the algebra or carryout any analysis myself to confirm the

31 results, but I have read and understood what has been said.

32 Q Subject to that qualification is there anything in those parts of Professor Dobbs' 7th report

33 that would cause you to change the views expressed in your witness statement?

34 A No, there is not.

1 Q I understand you have also reviewed Professor Dobbs' note C, is that right?
2 A Remind me what note C is?
3 Q I am sorry, yes. I am not sure where it is put in your volume, whether that could be
4 indicated to me? I have got it at the end of vol. C2 at the very end, but I do not know
5 whether a place has been agreed for this statement. You will recall Professor Dobbs' notes
6 A, B and C just before the start of trial?
7 A No, sorry, that is the agreed note between Professor Valletti.
8 Q Can I ask to be handed to the witness the three Dobbs' notes, please? I am handing you a
9 copy of three notes actually which Professor Dobbs produced just prior to the start of the
10 hearing. The first is "Further equations in relation to the spill over notes", it is called "A".
11 A Yes.
12 Q The second is "B" – "Further equations relating to Dobbs 7, Annex 4 and to the Q
13 function." The third note, "C", "Note on figures in Simplifying non-geographic numbers
14 regarding the demand for 08X numbers". (Same handed) Am I right in saying that the third
15 note is the one that effectively engages with issues dealt with in your evidence?
16 A That is correct.
17 Q And have you read that note?
18 A Yes, I have.
19 Q And does anything in that note cause you to change any of the views expressed in your
20 witness statement?
21 A No, it does not.
22 Q Just catching up with other evidence that has come in. There have been, I think, two reports
23 of Dr. Walker since the date of your statement, and the first one of those is bundle C2 at tab
24 46?
25 A Yes.
26 Q And have you reviewed this statement?
27 A Sir, again I have restricted myself to section 2 here which deals with the incentive effect of
28 the NCCNs on the 080 prices.
29 Q That is the part that affects your statement, is it?
30 A That is section 2 of the report. I have not checked the results that are reported in table 1 or
31 in figures 1 and figures 2, but I understand what they are saying and they are broadly
32 consistent with what my statement says.
33 Q And then can I ask you the same, in Walker 3, which again I am not sure, sir, has a tab
34 number yet.

1 THE CHAIRMAN: 47.

2 MR. HERBERG: 47. That report, looking at the contents page, which is the part of that which is
3 relevant to your report?

4 A Section 2.

5 Q Professor Dobbs' demand curve evidence?

6 A That's right.

7 Q This responds to the demand curve evidence in Dobbs 7, and you have considered that
8 section, you say?

9 A Yes, I have.

10 Q And do you have any comment to make on that part of the statement? Does it cause you to
11 change anything in your evidence?

12 A I am in agreement with this.

13 Q I think you can go back to your own statement and just ask you a very few questions about
14 what you say.

15 MR. READ: I wonder if the witness might keep his voice up because we are having some
16 difficulty listening over this side of the court.

17 MR. HERBERG: Mr. Pratt, can I ask you to go back to your own statement which is in C2, and
18 to go to para. 51b of your statement?

19 A Yes.

20 Q In 51b, as I understand it, you say that assuming the Dobbs' model is correct, the predicted
21 outcome is sensitive to the functional form of demand?

22 A That is correct.

23 Q You say essentially there that certain shapes of demand curve will not produce the outcome
24 of a fall to the bottom stair?

25 A That is correct.

26 Q Professor Dobbs responds to this particularly in his seventh report, so I am afraid I am
27 taking you back to the other bundle again, tab 7, p.16, and in particular para 52 and
28 following.

29 A Sorry, what paragraph?

30 Q 52. The whole of section II.I effectively he is responding to this point I think, starting
31 higher up that page. Effectively, Professor Dobbs responds to what you say. He says it is
32 not a material criticism because he has performed a sensitivity analysis and, in particular,
33 you see he says at para. 52 at the beginning that linear demand and constant elasticity
34 demand can reasonably be viewed as boundary cases, and he deals with this in more detail

1 in annex 2, and if I can just take you to one statement he makes there, p.51, para. A2.11
2 where he is dealing with the same issue. This section is headed: “Criticisms of demand
3 assumptions and why they are not material”. He says at A2.52:

4 “We know, as a matter of commonsense, that there would be significant demand at
5 a price of 40ppm, and indeed at much higher prices, and hence we know that
6 demand *must* feature some convexity somewhere on the price interval above
7 20ppm. That means we know that assuming linear demand or concave demand is
8 not a good assumption for higher prices”.

9 Now, assuming for a moment that Professor Dobbs is right about the significant demand at
10 a price of 40ppm, do you think that that has any implications for, first of all, for whether
11 there is convexity somewhere on the price interval above 20ppm?

12 A Sir, if I could just comment on this argument in Annex 2 of Professor Dobbs’ note, it might
13 be useful to turn the page to p.53 and look at fig.2.1. As I understand it, the argument
14 Professor Dobbs is making is that, if one considers an initial price of 20ppm as a pre-NCCN
15 price, and you draw a linear demand curve through that price, which we can see in the
16 schedule there, in the figure there, and then one looks at the point at which that demand cuts
17 the vertical axis, you can read off the check price, and this is P2 in the diagram. This is
18 effectively saying — sorry, just to go back, I think it is important to be clear what this
19 demand curve relates to here. So, this is the demand for 08 calls for an individual MNO
20 operator. This is not the market demand for 08 calls, it is for an individual operator. So,
21 what this checkpoint represents is, let’s take Vodafone as an example. If Vodafone raised
22 its price to P2, everyone else holds their price constant, Vodafone would not have any 08
23 demand at that price. So, it checks off demand. Now, what I understand Professor Dobbs
24 to be saying is that, as a matter of commonsense, there are mobile subscribers who would
25 have a willingness to pay for these calls in excess of P2. P2 is around about 40ppm in the
26 examples that we have been looking at. The comment I would make about that is it’s quite
27 possible that there are people, subscribers, who have a willingness to pay in excess of
28 40ppm. They may not choose to stay with Vodafone if Vodafone sets a price at 40ppm they
29 may switch to other mobile operators. And so, I don’t think you can conclude from the fact
30 that as a matter of commonsense there are callers who would be prepared to pay more than
31 40ppm; that the demand for Vodafone must be higher at the checkpoint.

32 Q So, just to clarify and ask a specific question on that, what is the relevance, then, of
33 Professor Dobbs’s argument for the shape of the demand curve at lower levels than 20ppm?

1 A In this particular Annex I don't think it discusses the shape of the demand curve below
2 20ppm as far as I'm aware.

3 Q But, no, my question was, does his argument have any relevance in the shape of the demand
4 curve?

5 A No, it does not, no.

6 Q Can I ask you very briefly a question about Professor Dobbs' note C, then. You may have it
7 loose, still.

8 A I do.

9 Q If I can just highlight to you, note C, you can see, relates from what he quotes in para.1 deals
10 in particular with an agreement between the DWP and mobile companies in January 2010,
11 that calls to its 0800 help lines would now be zero rated. And you can see in para.2 he notes
12 that:

13 "The data shows that 100 per cent reduction in 0800 prices has led so far to an
14 increase from 15%-52% in the share taken by mobiles".

15 I think he is talking about the share of the calls to 0800 numbers. And he discusses the
16 implications of that for arc elasticity, and he considers that it is an underestimate of the
17 demand elasticity. And then, para.3, he states that:

18 "This empirical estimate of demand elasticity can be compared with the implied
19 point elasticities for the 08 pre-NCCN prices",

20 And he does so. And at the end of para.5 he concluded, I am not going to take you to the
21 details at this stage:

22 "In my view, this provides empirical evidence that demand is convex, not only for
23 price increase, but also for price decreases".

24 Now, can I ask, do you accept Professor Dobbs' conclusion that this evidence that he has
25 addressed here provides good empirical evidence for the convexity of the demand curve at
26 prices below the pre-NCCN price?

27 A I do not. I think there are good reasons to be cautious about reading across from this
28 example.

29 Q Could you explain to the Tribunal why you are cautious in that way?

30 A Yes. So, this example relates to an agreement between the Department for Work and
31 Pensions and all of the major mobile operators, so, six, I believe, was the case, to zero rate
32 calls to DWP 0800 benefit claims lines. He said by zero rating this is an agreement that any
33 mobile originated calls to these numbers will be free to the caller, it is guaranteed. And
34 that's, it crosses, so at that point you have zero rated across the market. So, irrespective of

1 the network you called from whether it's fixed or a mobile network, then irrespective of
2 your tariff, you will not pay anything for these calls. So, it's quite a particular example,
3 I think, in that respect. And I think what this annex invites us to do is to draw an inference
4 that, because this particular market wide zero rating led to a large change in call volume,
5 this then would be true of a change by an individual MNO of its 0845 price. Now, I think
6 the reason to be cautious about reading across here are twofold: first of all, if one thinks
7 about the typical caller to the DWP benefit claim line, they are going to be, these claim lines
8 are for Job Seeker Allowance and things like access to credit. So, typically, these are going
9 to be callers who are probably of slightly lower income than the average caller, I would
10 argue. And as a consequence I think it is possible they may be more price sensitive than the
11 typical caller to 0845 or 0870 numbers, bearing in mind that many of the SPs for 00845 and
12 0870 services are things like bank help line and commercial help line services, it is a rather
13 distinct base of callers to the numbers, arguably. So, there's one reason to be cautious.
14 I think the other is what I alluded to a moment ago, and this is a very clear price signal to
15 consumers that you are guaranteed when you call to these numbers, that you will not be
16 charged, irrespective of your tariff and the network, and that's a very very simple message
17 for consumers to understand. Mr. Myers yesterday spoke about the entrenched problems of
18 price transparency and lack of consumer confidence in the number ranges 0845/0870 and
19 other 08 numbers, and I think, again, going back to the demand curve, there is interest here,
20 it relates to the impact of a change in price by an individual MNO on its 08 call volume.
21 It's quite different from an across the board reduction to zero. I think, for those reasons,
22 I think this intercept, the consequence of that is its intercept could well significantly over-
23 estimate the true intercept demand curve we are interested in.

24 THE CHAIRMAN: Thank you, Mr. Pratt. If you would just wait there for questions from
25 Mr. Read.

26 Cross-examined by Mr. READ

27 Q Mr. Pratt, can we start by looking at your involvement. You accept that you were involved
28 in analysing Professor Dobbs' third and fourth reports. Did you also conduct an analysis of
29 Mr. Reid's modelling as well?

30 A We looked at, we did look at that yes.

31 Q And when you conducted your investigation of Professor Dobbs' model, you carried out the
32 analysis during the course of the determination process.

33 A Yes.

1 Q We know from your witness statement that we have various scenarios, and they are
2 probably best seen at the end of your witness statement, tab.29, right at the end of it after
3 p.47. You have two annexes. Do you have that?

4 A Yes, I do.

5 Q You have two annexes set out there. Is it right that this work was actually done during the
6 course of the determinations?

7 A I would describe this as a re-presentation of the work that was done in the course of the
8 determinations. In the course of the determinations we had spreadsheet models that allowed
9 this kind of analysis to be done.

10 Q So it may not have been in this presentational form, but the underlying calculation ----

11 A The underlying calculations and the idea that there are pricing thresholds in the models that
12 determine what the outcome will be were certainly very much in our minds.

13 Q So Ofcom was effectively conducting some form of sensitivity analysis as it went along on,
14 in this particular case, the shape of the demand curve and also on various prices?

15 A I think you will see that right back in the draft determinations, that we carried out this
16 analysis with the original Dobbs 3 model and highlighted on the basis of that the sensitivity
17 of the outcome to the shape of the demand curve, the partial costs of origination and the
18 average price.

19 Q That is not, is it, true completely because annex 2, if you look at it, actually expressly is
20 referring to Dobbs 4 model.

21 A Sorry, I did mention it. I said the draft determination was specifically on Dobbs 3. We did
22 not have Dobbs 4 at that point.

23 Q I just wanted to get the general feel of this, that you actually had conducted, by the time you
24 came to the final determination, even if you had not presented it in this format, most of the
25 testing that is actually illustrated here in annexes 1 and 2?

26 A In respect of Dobbs 3, I had already responded; in respect of Dobbs 4, we did not carry out
27 any additional sensitivity analyses of this kind during the course of the determination. We
28 received reports from Professor Dobbs, as set out, and results of the models across a range
29 of scenarios.

30 Q Mr. Pratt, can I ask again if you can try and keep your voice up. Because of rustling papers
31 and everything else going on around me I cannot always catch what you are saying. If I
32 have understood you rightly, you are saying that effectively the calculations you carried out
33 in annex 2 were not done during the course of the final determination?

34 A That's correct.

1 Q Effectively, you have done what we see in annex 1, but not what you did in annex 2?

2 A No, and specifically for the Dobbs 4 model we relied on the results reported by

3 Professor Dobbs in his Dobbs 4 report.

4 Q It was, was it not, as a result of the material, be it the analysis that you had done during the

5 draft determination and the Dobbs 4 material, that led Ofcom to the view that actually the

6 direction of the direct effect was not uncertain, it actually was going to incentivise the

7 MNOs to reduce their prices?

8 A These were two important pieces of evidence that contributed to that conclusion, yes.

9 Q In that respect there is actually no dispute between you, Professor Dobbs and Mr. Reid over

10 the direction of the direct effect. All of you are in agreement that it is going to head in a

11 downwards direction?

12 A Ofcom concluded that it was more likely than not that prices would be reduced. We did not

13 rule out the possibility that prices may be increased, but on balance, taking the evidence as a

14 whole, we concluded that it was more likely to go down than not.

15 PROFESSOR STONEMAN: On that, can I just interrupt. You are referring here to these annex

16 1 results. You have built into that the marginal cost is zero?

17 A Yes.

18 Q If you go back to para.63 in your statement, which states the Lerner condition, does that

19 mean that the gross margin is 1, price minus marginal cost over price; price minus zero

20 over price, which is 1. Therefore, the assumption is that the elasticity at p_0 is 1, and

21 therefore all of these results are based upon a unit elasticity assumption at p_0 ?

22 A I think I can clarify there, it does not because there is a pre-existing termination charge that

23 already had a marginal cost in there. So the marginal cost is relevant. It is the marginal

24 cost of origination plus the pre-existing termination rate.

25 Q Thank you.

26 A Otherwise I would agree.

27 MR. READ: Just following up, so there is no doubt about what annex 1 is actually doing, it is not

28 just testing in the case where marginal cost is zero, it is also testing in the case where

29 marginal cost is, I think, 1.9 ppm?

30 A It includes that sensitivity, yes, it does.

31 Q So it is a fairly full sensitivity analysis that is actually going on?

32 A It covers the parameters, including the Dobbs 3 model, yes.

33 Q I think the Dobbs 3 model, to be fair to the Dobbs 3 model, actually did it far wider, did it

34 not, because it was doing it up to 5 ppm. In fact, I think it went beyond it. It certainly was

1 looking at 5 ppm for marginal costs. Would you have actually, within the course of your
2 analysis, been looking at not just zero or 1.9 ppm as the marginal cost, but other marginal
3 costs as well?

4 A And in the draft determination we report the result up to marginal costs of around about 5
5 ppm, from memory. I think in the back of our mind was that the relevant marginal cost of
6 origination here is more likely to be a short run one rather than a long run one. You get to
7 the higher marginal costs of origination once you start to load in things like the fixed and
8 common costs of origination on top of the marginal cost for origination.

9 Q But of course they are not marginal costs then, are they, they have become a form of a
10 distributed fixed costs element as well?

11 A That's correct. So the reason in my statement that I have kind of restricted myself to the
12 lower end of the marginal costs estimate. It exactly reflects that.

13 Q It, in fact, is entirely consistent with the marginal cost basis that Ofcom itself considers,
14 because in Simplifying Non-Geographic Numbers, for example, we know it is estimated to
15 be around 0.5 ppm.

16 A Yes.

17 Q So, in fact, 1.9 ppm is, in fact, quite a conservative estimate for the marginal costs?

18 A Yes, I think I agree with that.

19 Q Can I see what issues are still extant between Professor Dobbs' modelling and Ofcom, and I
20 think the best place to start is to ask you to go to para.52 in your statement. If I have
21 understood correctly, Mr. Pratt, what you were telling Mr. Herberg earlier on, essentially
22 your view has not changed at all. It still remains in this format in para.52? Paragraph 52 is
23 where you set out your concerns about the reliability and robustness of Dobbs 3 and Dobbs
24 4?

25 A Yes.

26 Q What I am asking you is, you have obviously seen subsequent material. Your views on this
27 have not changed?

28 A No, they have not.

29 Q Can I just list what the issues appear to be between you and the Dobbs 3/Dobbs 4 model.
30 The first is the issues about the elasticity of demand, both the pointy elasticity at existing
31 prices and also the shape of the demand curve?

32 A Correct.

33 Q That is the first element and I think we see that in your sub-para.(a) – yes?

34 A Yes.

1 Q You also are concerned about issues about the spill-over effect and in particular whether
2 spill-over function can be assumed to be globally linear, and that is set out in (c), I think?

3 A That is one of the concerns.

4 Q I will come back to it in a moment. I am just trying to clarify where we have actually got
5 to, the default lines, if I can put it like that. It is fair to say, is it not, that that is what
6 Professor Valletti deals with in his report at section 1, I think it is, and you do not really
7 have any view over and above that?

8 A That is correct.

9 Q Then, sitting somewhere between elasticity of demand and spill-over is the issue about
10 whether, if demand is not highly inelastic, a weak spill-over effect can be reconciled with
11 profit maximisation?

12 A Yes.

13 Q And that is essentially your (b) there?

14 A That's right.

15 Q Then (d) is a series of other concerns which you say are set out in paras.131 to 133, which I
16 will come back to in a moment. Just so that we can be clear about this, one of the major
17 concerns, or the major concern, within them is this issue about multi-price points and price
18 discrimination between the MNOs?

19 A Sorry, I'm not sure what you're referring to there.

20 Q Let us take you on then to para.131, which I think is at p.44 of your statement (bundle C2,
21 tab 29).

22 A Yes.

23 Q These are the paragraphs that you have just referred to in your earlier paragraphs. I took
24 you to para.52, and 52(d) said "I refer to paras. 131 to 133". I am sorry, I took you to the
25 wrong paragraph it is 53.

26 A I was with you.

27 Q Right, okay, thank you very much. If I can just refer you to para. 133a, you say:
28 "As is commonly the case with economic models, the Dobbs 3 and Dobbs 4
29 models abstract from the details of MNOs' pricing decisions (including, for
30 example, the fact that MNOs typically offer a variety of tariffs ...) and the
31 reliability of the predictions of these models depends on the extent to which they
32 take into account all material relevant factors."

1 Essentially, that is to say they are differentiating between price, so they are offering a
2 number of prices, price discrimination if you like, between various services and between the
3 MNOs?

4 A That is not really the purpose of this paragraph. What I was trying to explain here is that
5 these models, I think the point of agreement between the economic experts, these models
6 are abstractions from a number of real world details of the MNOs' pricing, and I think the
7 issue that was troubling Ofcom is these models, theoretical in nature, they have not been
8 tested in anger, and there is a gap between the theoretical predictions and the reality on the
9 ground, and that is the issue that was troubling Ofcom. When I mentioned multiple price
10 points there it is really just an example of the level of complexity the MNOs actually face.

11 Q Let us try and take this a stage at a time. You agree that there is an issue about multiple
12 price points?

13 A An issue in what sense?

14 Q An issue between Ofcom's view of the modelling and Professor Dobbs' view of the
15 modelling, and that is the issue that Professor Valletti touches on in the second section of
16 his report?

17 A I believe this was the issue that Professor Dobbs and Professor Valletti discussed in the pre-
18 meeting, and agreed that there is not really much of an issue there in respect of that
19 particular point.

20 Q Yes. In para. 133a, the one we have just looked at, that is the example that you are using
21 about problems with real world pricing, is it not?

22 A No, the example that Professor Valletti highlighted in his report was a concern which I think
23 may have turned out to be a misunderstanding. The mathematical analysis carried out by
24 Professor Dobbs did not guarantee that all individual 08 price points would go down. My
25 understanding is that that is not what Professor Dobbs was claiming. He was claiming that
26 the average 08 price goes down. Individual prices – some may go up, some may go down –
27 on average the price is coming down. It is quite a specific technical point I think that is in
28 dispute there. The point I am making here is more one to do with the complexity of the
29 problem facing the MNOs and the relevancy of this is that this is a non-trivial problem they
30 are trying to solve, it might look relatively simple but when you write it down on paper and
31 do it as a mathematical model, there is a risk of a gap between the theory and the reality.

32 Q But that is going to be true of virtually any economic model is it not? There is always the
33 risk ----

34 A Of course it is.

1 Q -- of the theory not corresponding to what is going on, that is inherent within any economic
2 modelling?

3 A I agree. The issue is what inference do you draw from that. In my view it really depends on
4 what you are trying to do with the economic model. There is a very significant difference
5 between using a model to draw inferences about direction of effect, so is it more likely that
6 prices go up or down? That is a relatively broad brush question. That is quite different
7 from asking a model to predict the pricing responses of MNOs on individual prices to a
8 complicated new tariff. You are putting the model to different uses there, I think, and
9 different levels of precision are required.

10 Q Well we will come back to that in a moment, but can I just be clear about one other thing
11 while we are talking about all these uncertainties, because if one goes back in your
12 statement to p.7 and para. 21 we see there setting out in terms some of your concerns about
13 the reliability and the robustness of the Dobbs 3 and Dobbs 4 models, and we see you
14 talking there about the problems of the available evidence about the elasticity of demand.
15 Then in “b” the point about if demand is not highly inelastic whether a weak spill-over
16 effect can be reconciled with profit maximisation. In “c” the point about the global
17 linearity in the spill-over effect, and then in para. 22 a number of other concerns, do you
18 see? I have taken you to paras. 52 and 53 earlier on, and just so we are absolutely clear, I
19 am not trying to criticise you over the way you have constructed the witness statement, or
20 anything like that, but so we are clear these are the same uncertainties that you are referring
21 to in paras. 52 and 53 by reference ----

22 A Yes, this is a summary of overall conclusions.

23 Q I think we can draw other instances throughout, but the key point I am making is that paras.
24 52 and 53, with the reference onwards to paras. 131 and 133, are the issues as far as you are
25 concerned. Simply because you have made reference to others earlier on, it is limited in
26 fact----

27 A The repetition does not multiply the issues.

28 Q Thank you. Well as a lawyer one sometimes knows that repetition can actually confuse the
29 issue, so I wanted to make absolutely clear that that is not happening in this case. Can I turn
30 then to your first point, which is about the assumptions of elasticity? Can I see if we can
31 reach agreement on this to begin with? In essence the key for the modelling is not what
32 might be happening at the extremes, it is actually what is going on at the points where the
33 likely prices are going to be. So in other words, the starting price, the pre-NCCN prices, as

1 | opposed to where they might end up, that is really what you want the modelling to actually
2 | be doing?

3 | A | Sorry, for these models you need a demand curve that covers the full range of prices from
4 | the highest pre-NCCN price, the information we had there was around about 40ppm ----

5 | Q | Yes.

6 | A | -- down to 12.5ppm.

7 | Q | Yes.

8 | A | You need to cover that range.

9 | Q | That is the point?

10 | A | Yes.

11 | Q | Thank you. And so what may or may not happen to the demand curve at the ends may have
12 | some relevance to what you say the shape is in that area between 40 and 12.5ppm. But the
13 | core thing that you need to concentrate on is what is going on in that key area between 40
14 | and 12.5ppm. You agree with that?

15 | A | I agree.

16 | Q | At para. 52a, if we can just look on that on p.18, you assert that Ofcom found that the
17 | available evidence suggested that the demand is inelastic, yes?

18 | A | Yes.

19 | Q | Now, I briefly want to look at what material we are actually talking about here. Can I start
20 | by asking you to take out, if you have not got it lying there already, bundle B1.

21 | A | May I put C1 away?

22 | Q | No, leave C1 out. What would be sensible, I suspect they are probably there already
23 | because these were the bundles I had out for Mr. Myers. You should have CAT bundle 13,
24 | it should have a "13" somewhere on the spine. If you have got three bundles on your table
25 | at the moment.

26 | A | I have B1, C1 and C2.

27 | Q | Okay. Well you can put, I suspect C2 away. Sorry, C1 away.

28 | A | Okay.

29 | Q | And you have got B1 to hand on the desk, have you?

30 | A | Yes.

31 | Q | Can you take B1, then, and go to the first tab there, to p.217, it is the 0845 final
32 | determination. It may not be 217 in your bundle, but it is Annex 3 which is the draft
33 | determination, and I am looking at para.5.113. It may be on the page before, it may be on
34 | p.216 in the version you have got. Have you found the paragraph?

1 A Yes, I have it.

2 Q Perhaps we should start at the paragraph above, 5.112. You set out some of the views about
3 elasticity, and then you refer to an entity that has been excised for confidentiality reasons,
4 talking about the price for 0845 and 0870 calls. So, I should indicate at this stage that,
5 although this is the confidential version of the final determination, what actually seems to
6 have happened in case there is any query about this later on, is that the annexes to it which
7 refer back to the draft determination and the supplementary consultation have actually been,
8 the non confidential versions that have been appended, if, for any reason there is a necessity
9 to refer to the confidential versions of the draft determination there should be a separate
10 bundle which I hope the Tribunal has, called “Supplementary bundle 1”, which contains the
11 confidential versions of the draft determination and the supplementary consultation. I hope
12 that that bundle has reached the Tribunal, but I make that clear that you are not going to find
13 it in the confidential version by reference to the annex, you will have to look elsewhere into
14 another bundle.

15 A Thank you.

16 Q I do not think we need, actually, to go to the confidential version, but what we know is that
17 there was one entity from para.5.113, that was providing some form, and of course it is very
18 difficult to actually work out what that form was from the non confidential version, some
19 form of information about price elasticity.

20 A Yes.

21 Q So, at the time you had the draft determination, you really only had this concrete example of
22 the issue of price elasticity, actual figures that have been provided by the relevant MNOs.

23 A I think it’s fair to say that this was a number of areas where there was real dearth of
24 empirical evidence. So, what Ofcom relied on was statements of the MNOs to the effect
25 that their experience when they changed these 08 prices, they did not have a big effect on
26 call volumes. There was very limited empirical evidence attached to that apart from this
27 particular example. This example did seem quite germane to us, because it related to a price
28 change by a particular MNO for a particular service, and without going into the details of
29 who and what, it did indicate that the call demand was quite inelastic.

30 Q So, that was one set of, if I can call it that, “hard evidence”. That one instance which you
31 set out in para.5.113.

32 A Yes.

1 Q If it becomes necessary to refer to actually what was involved, sir, then I hope I have given
2 you the reference point for it. Can I then ask you to look at p.131, I think in your bundle,
3 132 in my bundle, para.8.63. I think it is 131 in your bundle.

4 A Yes.

5 Q This is the IVR data which I think turned up between the draft determination and the final
6 determination. And we can see that they provided call data when 02 increased its prices to
7 08 numbers in October 2007, set the material out and so on and so forth, and effectively
8 what was being said, and we see this from para.8.65, that IVR considered they had
9 demonstrated the pricing being elastic.

10 A Sorry, that's what IVR said.

11 Q Yes.

12 A Yes.

13 Q But, again, it is —

14 A Sorry, I think — to be quite precise, my recollection is that IVR said their analysis
15 supported BT's elasticity theory. So, there was no quantitative estimation of an elasticity in
16 here.

17 Q I see. But anyway, it provided a set of data from which something could be taken,
18 depending upon what actually was meant by, what exactly it inferred.

19 A Yes.

20 Q You agree with that. Because, if we just look back to para.52A in your report, you say that
21 Ofcom found that the available evidence suggested that the demand is inelastic. And that is
22 not actually right, is it, because if we go on to para.8.68, we see Ofcom setting out its view,
23 and it goes on at 8.69 to discuss the IVR data. You then, at the end of it, conclude, and I am
24 reading from p.133 in your version, 134 in my version:

25 "Therefore although the data provided by IVR suggests that demand is not
26 completely inelastic, it does not provide a reliable basis for us to form a definitive
27 view on the size of the price elasticity for 0845/0870".

28 Do you see that?

29 A I do.

30 Q So, Ofcom in the final determination are in effect saying, "Well, we can't form a definitive
31 view about price elasticity" rather than saying that the price was inelastic, as you suggested
32 in para.52A. It is agnostic rather than definitive that it is inelastic.

33 A This particular paragraph, para.8.69, is commending on the IVR data.

34 Q Yes.

1 A And the view we reached on the IVR data was, it did tell you something, but it told you
2 something that was not very surprising. It said that if prices go down for these calls,
3 demand will go up a bit. It didn't tell you much more than that, and it certainly didn't allow
4 you to make a reliable quantification of the magnitude of that effect. And what this last
5 sentence says is that the IVR data suggests that demand is not completely inelastic. What's
6 intended there is that, by completely inelastic, that would mean if the price goes down there
7 is no demand response at all. I think just to clarify Ofcom's position on elasticity overall,
8 I accept, you know, the data here is very sparse. I think it's very difficult to reach a firm
9 view. The view that Ofcom reached was, on balance, they thought the demand was more
10 likely to be inelastic than elastic, but I don't think there was a definitive view that elastic
11 demand was, you know, totally out of the question.

12 Q You say that it is a view that Ofcom has actually formed, this is what you say in para.52A,
13 and you do not actually provide a quote for Ofcom found that the available evidence
14 suggested that demand is inelastic, you do not actually put a reference in at that point. But,
15 if we go on to para.108 at p.38 in your statement, we see the point again, that:

16 "Ofcom found that the balance of the available evidence suggested that the MNO
17 0845/0870 demand is inelastic",
18 and you give a reference there which is footnote 94, and footnote 94 refers us back to
19 para.8.68 which is the one that immediately precedes it. You see that?

20 A I do.

21 Q And, the point I am putting to you is that 8.68 and 8.69 do not actually suggest that Ofcom
22 has found that prices are relative, that demand is relatively inelastic.

23 A If I may just read from 8.68 in the middle we say:
24 "Whilst Professor Dobbs supplies one interpretation for this, ie that demand is elastic, this
25 does not appear to match with the balance of the evidence available to us".

26 Q Well, okay. That is what you are relying upon in any event, that Ofcom found it was
27 inelastic.

28 A Yes.

29 PROFESSOR STONEMAN: On that particular point, is there any evidence with respect to the
30 elasticity of demand for mobile call origination more generally, quite apart from 0800
31 numbers?

32 A At a market level or a firm level?

33 Q A firm level

34 A Not that I'm aware of.

1 MR. READ: Can I, just before the adjournment, take you to one other point, which is one other
2 piece of information that I think has arrived since the date of the final determination. Can I
3 ask you to go to tab 49 in bundle C2. It is a statement of Mr. Aspinall. Do you have that?

4 A I do.

5 Q If one goes to p.5, para.16, he discusses the paragraphs we have just been looking at in the
6 final determination, and he sets out his view that retail demand for calls to these numbers is
7 reasonably elastic and that retail customers will therefore be making many more calls. He
8 gives some figures and his conclusions on what those actually show. Have you seen that
9 before?

10 A I have not looked at it in detail, no.

11 Q If you want to have an opportunity to read it over the short adjournment by all means feel
12 free to do so. Would you agree with this, that it is another instance of somebody actually
13 providing some hard material about the possibility of elasticity or otherwise?

14 MR. HERBERG: Can I suggest it might sensible for the witness to answer that question after he
15 has read the material over the short adjournment?

16 THE CHAIRMAN: Yes.

17 MR. READ: That would appear sensible.

18 A Can I just clarify, when did this first become available?

19 Q I think it became available after you had served your statement. It is part of the statement of
20 intervention and the evidence adduced in support of the statement of intervention, and
21 therefore I think it would have followed on after the defence.

22 A I understand.

23 Q And your statement. Obviously you have not seen it before so I will give you an
24 opportunity to have a look at it over the short adjournment and we can come back to it after
25 that.

26 A Thank you.

27 THE CHAIRMAN: Two o'clock.

28 (Adjourned for a short time)

29 THE CHAIRMAN: Yes, Mr. Read.

30 MR. READ: Mr. Pratt, just before the short adjournment I was asking you about Mr. Aspinall's
31 statement, particularly at para.16, which is at bundle C2, tab 49, p.4, and you wanted to
32 have a quick look at it. I think you have now had a look at it.

33 A Ample time, thank you.

1 Q Would it be fair to say this: that it is providing some further information about the likely
2 elasticity in this case?

3 A I don't think it provides anything much more than we already know. The evidence here
4 relates to the decision by Talk Talk to move 0845 and 0870 calls into their call bundles, and
5 what it says in para.16 is that – this was in June 2009 – following date Talk Talk subscribers
6 could make an unlimited number of calls to these numbers free. It is rather like the DWP
7 example but here it's specific to Talk Talk customers. What I can't see in this statement is
8 any reference to the price that existed prior to June 2009. So it is unclear what the price
9 reduction is and therefore what the significance of the volume increase is in that regard.
10 The other point I would make is that I think there is a distinction to be drawn between a
11 reduction in the average pence per minute retail price, which is what NCCNs would
12 achieve, and a move from out of bundle pricing to in bundle pricing where there is no pence
13 per minute price at all guaranteed for all Talk Talk subscribers. So they're distinct in that
14 respect.

15 Q But it is still providing some information, is it not? You cannot completely dismiss this as
16 being irrelevant to the equation of whether there is elasticity. I fully accept ---- Sorry, do
17 you want to answer that?

18 A I think what it tells you, rather like the IBR data, is that if there is a significant price
19 decrease down to zero in this case guaranteed, you will get some demand increase. I think
20 that's what it tells you. It's telling you that demand is downward sloping. I'm not sure it's
21 telling you much more than that.

22 Q Yes, but it is certainly saying something about elasticity, is it not? It is varying with price.
23 On any view, it is saying that there is variation in call volumes as a result of a reduction in
24 price?

25 A Yes, it's telling you the demand curve is sloping downwards. That's not the same as telling
26 you what the elasticity of demand is. I can clarify that if that would be helpful.

27 Q In any event, you accept that this information was not something that you had available at
28 the time that you came to the final determination?

29 A No.

30 Q We also know about, because you have already alluded to it in evidence in chief, the
31 material with the Simplifying Non-Geographic Numbers which is set out at para.A2.91 in
32 that table. Let me take you to it. Could you go to CAT bundle 13, and at tab 3.1 there is an
33 exhibit to Mr. Myers' witness statement which is Simplifying Non-Geographic Numbers –
34 do you see that?

1 A Yes.

2 Q If you go to p.149, para.A2.91, one sees set out there the change in respective demands in
3 respect of the DWP reductions to zero, which you were discussing earlier with Mr. Herberg,
4 and we can see that that table is the same table that is referred to in note C in
5 Professor Dobbs' material that he discussed with Professor Valletti. This was material that
6 would have been available, would it not, to Ofcom around about the time it was deciding
7 the 0845 determination?

8 A It was after. This was information that was collected after the final determination. So the
9 provenance of this example was a submission from DWP.

10 Q I am sorry, I am not catching that, can you keep your voice up.

11 A My understanding is that the provenance of this particular example was a submission to the
12 non-geographic call consultation team that arrived after we made the final determination,
13 confirmed by other colleagues on the team.

14 Q It is just that we see that it includes data up to the week ending 4th June 2010. We know
15 that the final determination was finalised at the beginning of August. You are saying that
16 this information was not available at that date in August when ----

17 A This example was provided after that.

18 Q This example was provided after that.

19 A The example was provided after the final determination.

20 Q Thank you. In any event, as I understand it, you are saying that this is not helpful for two
21 reasons. The first is that it was something that bound all MNOs; and the second is, as I
22 understand it, that it is a particular category of callers, namely, if I can call it this, the
23 socially more vulnerable?

24 A Yes. Could I just go back and clarify the first point: it bound all MNOs in a very particular
25 way. It bound all MNOs to a guaranteed price of zero. As I said at the beginning of my
26 testimony, as a consequence of this, callers to these DWP help lines were guaranteed to pay
27 nothing irrespective of the network they were on, fixed or mobile, and irrespective of the
28 tariff they were on.

29 Q I understand the point that you are making on that, but let us just assume that two or three of
30 the mobile operators, or even one of them, had reached this agreement with a DWP, it is
31 very unlikely in those circumstances that there would not have been a song and dance made
32 about it, and, as a result of this transparency, it would have induced the other MNOs to
33 reduce their price as well?

34 A That's possible, I don't know.

1 Q The point I am making is that simply because it was an agreement that may or may not have
2 been reached by all five at exactly the same time, the reality is that it does not necessarily
3 mean that if one of the MNOs is forced to reduce its prices, or does reduce its prices, it will
4 automatically mean that it is a completely different scenario to the scenario we have got
5 here?

6 A I think the issue is the comparability of this situation where we have a market wide zero
7 rating of these calls, and the issue is, can you read across from the demand response to that
8 kind of very clear market wide signal? Can you read across from that to what the response
9 would be to the reduction of price to zero, for example, by an individual MNO?
10 Remember, that is the relevant demand curve we're considering here. It's the individual
11 MNO.

12 Q Do you suggest that we get absolutely nothing at all from this information?

13 A I'm not suggesting that, no. I'm suggesting that there are good reasons to be cautious about
14 reading across from this.

15 Q What effectively we have got are four hard pieces of information. Of those four each of
16 them has got potential problem with them, but that is all the material that we actually have
17 on the elasticity of demand at present?

18 A Could you just enumerate the four that you are referring to?

19 Q I was referring to the specific example that one saw in the draft determination at 5.113, I
20 think it was.

21 A Yes.

22 Q We have got the IVR material, we have got the material e have just seen in Mr. Aspinall's
23 statement, and we have got this material here.

24 A Yes.

25 Q All of them have limitations in how you can actually use them?

26 A I'm sorry, it depends what you were trying to use them for, so I think the beginning of this
27 line of questioning was: what can you tell about whether the demand is elastic or inelastic?
28 It may be worth just clarifying this point that for an economist inelastic demand has a very
29 specific meaning, so demand elasticity is defined as the percentage change in quantity that
30 would occur from a 1 per cent change in price. If demand is inelastic in the technical
31 economist sense that value is less than one in absolute terms, if it is elastic it is bigger than
32 one. So in order to deduce that you need some quantitative information that tells you how
33 much is price change and how much is volume change. My point on Mr. Aspinall's
34 example is the information needed is not there, it simply tells you there is a move of these

1 services into free call bundles from some higher price and that led to an increase in the core
2 bundles.

3 Q Can I just ask one more question about the IBR data, and can I ask you to take another
4 bundle, which is bundle 27, and that may not be one that is immediately to hand, or perhaps
5 you can see it there. I am told that that may be the confidential version that you have there.
6 That obviously is not going to affect you because you can look at it, Mr. Pratt, but what I do
7 say is do not refer to anything that is marked confidential in it.

8 A Yes.

9 THE CHAIRMAN: Well, let us clarify – if you want to refer to it then let us know and we will
10 make sure the people who should not hear it are outside the courtroom.

11 MR. READ: Absolutely, sir, my fault. I was trying to limit the initial blurring out of information
12 and overlooked the fact that he should have the opportunity if he wants to. If you go to tab
13 24, this is the letter of 21st July 2010 which actually was the material Ofcom had?

14 A Yes.

15 Q We can see the amount of detail that was actually included within that, and again a lot of it
16 is confidential so I am not going specifically to advert to it. It is fair to say that this is quite
17 a lot of detailed information, is it not? We have given you everything you need there to
18 actually have a go at considering what it is in terms of the shape of the demand curve that is
19 likely to flow through?

20 A We actually set out our reasons in the final determination for not accepting the IVR
21 evidence as reliable for the purposes of calculating elasticity. It might be useful if we go to
22 the specific paragraph in the final determination.

23 Q I see, anyway you have had a chance to look at it, so let us go back if you want to, to the
24 final determination, which is in bundle B1 and I think it was para. 8.68 and 8.69, which on
25 your bundle is p.132.

26 A Paragraph 8.69 explains that Ofcom reached the view the IVR data was deduce that there
27 was a downward slope in demand so a price reduction would increase volume to some
28 extent, and then we set out a number of reasons why we did not think it possible to
29 determine a reliable elasticity figure from this data. As we say here, one of the examples
30 IVR gave us was a decision by O2 to move 0845 and 0870 calls out of bundles, they used to
31 be in free bundles, they moved them out. When we put this to O2 they explained to us that
32 one of the reasons they did that was because they were getting a very large volume of cars
33 to 0845, 087 numbers, designed to exploit what was called an “international arbitrage”
34 issue. So my understanding is that this is where calls are made using 0845/0870 numbers in

1 the free bundle, and then they were used to do international call forwarding and the revenue
2 share of the 0845 numbers was used to fund that is my understanding. So as a consequence
3 of that the kind of starting volume was exaggerated if you like by this international arbitrage
4 problem. We conclude on the back of that, that that was going to distort any elasticity
5 calculation potentially quite seriously.

6 Q I do not want to take up unnecessary time actually taking you in further depths to that, we
7 know where the material is, we have seen what the conclusions are in the final
8 determination and Mr. Martin, I think it is, has given some evidence of that in a witness
9 statement, and I do not think I need to take up any more time taking you through it. I have
10 put the point to you. The long and the short of it is that when you come to actually look at
11 all this material you, I think, would agree that there is a dearth rather than an over
12 abundance of material in terms of the issues about elasticity. You are nodding, so that is
13 “yes” for the tape?

14 A I think I said earlier that absolutely there was a dearth of good evidence on demand
15 elasticity. We had the example from one of the MNOs in the final determination we
16 discussed earlier. My view is that Ofcom found that on balance elastic demand was more
17 likely than not given what the MNOs had told us, but did not rule out the possibility that
18 demand could be elastic, hence when we look at the range of scenarios is relevant to
19 consider the possibility of elastic demand and inelastic demand.

20 Q Can I just turn to the shape of the demand curve itself now, and both linear and concave
21 assumptions suggest at certain points the prices become highly inelastic, you would agree
22 that that is the sort of outcome of a concave and a linear curve?

23 A Mine becomes increasingly elastic as the price increases, yes.

24 Q You refer to the fact that the demand curve might be concave, but in reality you are not
25 putting forward that as a likely scenario, are you?

26 A Sorry, would you mind if I just looked at my witness statement?

27 Q Yes, go to para. 70 on p.24, I think this is where you deal with it?

28 A Yes, para. 70:

29
30 “For the avoidance of doubt, I am not asserting that this concave demand is an
31 appropriate representation However, this figure illustrates the possibility that
32 both the linear and constant elasticity demand forms could overstate the increase
33 in the volume of 0845/0870 calls from a reduction in the ... call prices”.

34 That was the point I was trying to make.

1 Q Yes. But what I am putting to you, Mr. Pratt, is that concave is not actually that likely in
2 this scenario, is it? A concave demand curve is not that likely in this situation.

3 A I think in the situation as we have, again, there is a dearth of empirical evidence here to
4 inform the shape for the demand curve. The point I was trying to make here is, Professor
5 Dobbs carries out scenario analysis. He looks at the linear and constant elasticity demand
6 curve cases, I think the issue is whether they exhaust all the possibilities. And I think, on
7 the basis of the information that is available, I do not think they do. I think it is quite
8 possible that demand could be to the left of the linear demand curve.

9 Q At certain points.

10 A Sorry, yes. At certain points. Yes. I think the relevant areas are prices below the pre
11 NCCN price.

12 Q Because, I mean, when we are talking about these curves, again, I am sure it is absolutely
13 second nature to all economists, but just so that we are absolutely clear for the lawyers in
14 this court, I mean, a convex curve can be a variety of shapes, can it not? It can be constant
15 elasticity. I think another example is a semi log. There are a number of shapes that a
16 convex curve could actually be.

17 A Yes indeed, yes.

18 Q And, would you accept that virtually all convex curves, if they are used, the price falls on
19 the Dodds 3 and 4 modelling to around about 12.5ppm.

20 A Sorry, if any convex curve is used?

21 Q Well, most convex curves will achieve that result. I mean, obviously there may be convex
22 curves that are very close to the linear, in which case, obviously, your points about —

23 A I understand, I'm sorry. I think within the Dobbs models there is a minimum degree of
24 convexity one needs, if you like, to tip the balance. I think, yes, okay I will stop there.
25 There is a minimum degree of convexity.

26 Q Yes. Did you carry out any testing, other than linear and concave or whatever, for the
27 purposes of doing your analysis?

28 A To determine that minimum level of convexity?

29 Q What happened to the prices depending upon the precise shape of the demand curve.
30 Because we know that you obviously looked at it from the linear position. Did you do any
31 testing for concave positions?

32 A No.

1 Q Did you — and you obviously must have tested it on constant elasticity — because you
2 were obviously trying to see what the position was with the Dodds 3 and 4 model. Did you
3 do any other testing the convex curves, other shapes, semi logs, for example?

4 A The testing that Ofcom and I did was to examine the demand forms put forward by
5 Professor Dobbs, which were the linear and the constant elasticity cases. We did not, and
6 I did not, investigate the concave example. The reason for that is because when you look at
7 the linear demand it is exactly in that case that you start to get the ambiguity over whether
8 prices go down to 12.5ppm. So, without doing any further analysis, you can be sure that
9 more concave demand curve than linear is got make it less likely that you go down to
10 12.5ppm.

11 Q I think it is fair to say, although they may not have been reported, that Professor Dobbs
12 actually did a variety of tests on concave curves and the like, as well as linearity as well.
13 You saw that from subsequent passages in the subsequent reports.

14 A Yes.

15 Q Yes. Let me ask you this question — do you accept that the normal assumption is the
16 demand curve will have some form of convex, that is the most likely demand curve, in these
17 types of situations, that it is more likely to be convex than concave.

18 A No, I don't accept that.

19 Q Can you look at CAT bundle 13, this is the simplifying non-geographic numbers at tab.3.1.
20 Can I ask you to look at p.189. This is the process that Ofcom was going through to try and
21 get a handle on consumer detriments. If you want to go back in the bundle and just look at
22 that you see, at p.186, the heading there, “The potential magnitude of current consumer
23 detriment”. Do you see that on p.186?

24 A I do.

25 Q So, that is the context in which this is being done, but if one goes to p.189 at fig.A210, we
26 see that Ofcom itself is using a convex demand curve, is it not?

27 A That is a convex curve, yes.

28 Q It is in fact a semi log, because if one looks at footnote 305, we see it has assumed a non
29 linear demand curve of $Q=Ae^{-p}$ do you see that?

30 A Yes.

31 Q And that is effectively a semi log formula, is it not?

32 A Yes.

33 Q Yes. So, Ofcom itself has assumed there that in fact the demand curve is likely to be some
34 form of convex shape.

1 A So, this demand curve here, I believe, relates to a market demand for all 08 calls, from what
2 I can tell. I think that is point number one. And this is not the firm level demand, it is
3 market demand. I think the second point is that this kind — this is a calculation designed to
4 give an order of magnitude idea of what the consumer detriment is, from moving the
5 perceived price closer to actual price. It is only an order of magnitude estimation. I think
6 you could use different kinds of demand forms in there and carry out this in recalculation.
7 I'm not sure anything in particular, any significance should be the choice of a semi log
8 formula, it is quite often used in this kind of analysis because it's a very simple one to
9 handle. When we come to the NCCNs, it is not enough just to take a downward slope in
10 demand curve, and the reason it's not enough is because what the Dobbs analysis tells us is
11 the results are potentially very sensitive to the shape of the demand curve.

12 Q You understand, do you not, that Professor Dobbs says it is more normal to start from the
13 assumption of a convex demand, not necessarily constant elasticity, but some form of
14 convex demand shape, and that's what Ofcom are doing here, is it not? They are doing just
15 that. They are using a convex demand curve.

16 A They're using that for the purpose of getting a rough estimate of consumer detriment in this
17 market.

18 THE CHAIRMAN: Mr. Pratt, you say this is a demand curve for market. Does not what the
19 demand curve for market says provide at least some kind of indicator as to what is going to
20 happen at the firm level up from the firms that comprise the market? Or is that simply a
21 false conclusion?

22 A I think that is a false conclusion in this type of market, where the firms are offering
23 differentiated products one typically thinks of in economic analysis firm level demands.

24 Q It would be standard to argue that the market elasticity is the bottom line of the firm
25 elasticity. So, the firm elasticity is not likely to be below the market elasticity. So, if you
26 can work out what the market elasticity is, if that is greater than one, then you know the
27 firm elasticity is going to be greater than one. Would that be right?

28 A Sir, I think I would agree with that in a market where there is good price transparency and
29 consumers are selecting on the basis of price efficiently. I think one of the issues in this
30 market, as Mr. Myers mentioned, is that consumers do not perceive these prices very
31 accurately. I think that is germane to thinking about how consumers will respond to a price
32 cut. So, I mean, put crudely, if you think the price is 50ppm at the moment, your mobile
33 operator cuts the price but you don't actually realise that, or don't have confidence in it,
34 why would you change your volume, why would you change your consumption pattern?

1 Q: That is making a slightly different point, is it not, Mr. Pratt? What I was trying to get a feel
2 for was whether a market curve provides, just in general terms, some kind of indication as
3 to what is happening at the firm level. It may well be that for other reasons, imperfect
4 knowledge in the market or an obscurity about pricing, that does not hold true, which is
5 what I understand you are saying now. As a broad proposition, do you agree with
6 Professor Stoneman's point that there is at least some kind of bottom line that is indicated
7 by a market demand curve which enables one to draw perhaps not a strong inference, but
8 some kind of inference, as to what is happening at the firm level?

9 A If the market is working efficiently, I would agree with Professor Stoneman, yes.

10 MR. READ: Just going back to the question of the shape of the demand curve again, do you
11 know of any empirical studies that actually estimate demand (other than*) on either a linear
12 basis or a convex basis?

13 A Not to my knowledge, no.

14 Q There is one point that I wanted to pick up from something you said earlier. I think you
15 were asked in particular – let me just find the correct reference – about Professor Dobbs'
16 seventh report, bundle C1, tab 7. Can I ask you to go to p.53, and you were asked about
17 that in your evidence in chief, and you said that P2 was about 40 ppm.

18 A I think I was referring to – just bear with me for a moment – I did say that, yes. Are you
19 referring to para.A2.11?

20 Q A2.11. I think your point was that it is quite possible that somebody might pay more than
21 40 ppm ----

22 A Would be willing to pay more than 40 ppm.

23 Q Willing to pay more than 40 ppm, but it may have an influence upon their decision whether
24 or not to stay with that mobile provider or go elsewhere?

25 A Yes.

26 Q The point is this: if you are looking at the type of individual who is going to stay with its
27 mobile network provider it is very unlikely that if they are prepared to pay that price that
28 they are actually going to be bothered about switching to another mobile network in any
29 event, is it not?

30 A Sorry, I'm not sure what you are putting to me.

31 Q I think what you were saying earlier on in your evidence in chief, and maybe we need to
32 look at the transcript tomorrow, but not with you, I hasten to add. You said it was quite
33 possible that someone may pay more than 40 ppm, but it did not take into account the fact
34 that they may switch between mobile networks?

1 A Yes.

2 Q I thought that was the point you were making.

3 A Yes.

4 Q The point that I am putting back to you is: how realistic a scenario is that, given that
5 somebody who is prepared to pay more than 40 ppm is probably not focused on the charge
6 of the call in any event, and therefore why should they switch service provider as a result?

7 A I'm not sure it follows that because you are able to pay for the call, you won't look for the
8 cheapest deal to make that call.

9 Q Can I now turn to the tension between inelastic demand and limited spill-over? Can we
10 start with this proposition: you accept, do you not, that if the evidence is that demand was
11 more elastic then this whole point about there being a tension between inelastic demand,
12 limited spill-over and profit maximisation, that falls away, does it not, because it always
13 depends upon the idea of inelastic demand as a starting point?

14 A Yes, the Dobbs 3 model, which does not have any spill-over effect, is consistent with
15 demand being elastic.

16 Q Would it also be fair to say this: that elasticity, of course, can be very short term, or it can
17 be over a more intermediate period or it can be over a longer period?

18 A You can measure it over different time periods, yes.

19 Q If one takes the example perhaps of the price of petrol going up, people cannot adjust
20 necessarily their consumption habits for the petrol immediately, so they cannot physically
21 cut out the school run, if you like, immediately, the day after, but they may in time either fix
22 up a share-in for the school run or indeed they may actually change cars in order to have
23 one that is more economic on petrol. There is a width of changes over a period of time – do
24 you agree with that, as a general proposition?

25 A It depends on whether the range of responses one can make over time increases or not.

26 Q Is there any suggestion in this case that the range of responses will not increase over time?

27 A Sorry, the range of responses to what?

28 Q If there was a reduction in 080 calls or 0845/0870 calls, there is nothing to suggest that the
29 range of responses would rule out a longer period for elasticity changing?

30 A I think your responses basically are you don't make the call or you switch MNO. You can
31 do that the day the price changes, subject to contractual restrictions. I'm not sure there's a
32 huge distinction between the long run and the short run here.

33 Q What people are not going to do is stop using their mobiles, either buying mobile phones, or
34 stop making geographic calls?

1 A I would agree with that.

2 Q Of course, there is a limit to how quickly people can actually change their mobile phone if
3 they are tied into some of contract?

4 A Yes.

5 Q Even with pre-pay customers they will have credit on their phone and they will want to use
6 that up. In reality, if you put the price of 080 calls up, people are not going to stop buying
7 their mobile phones and they are not going to stop making geographic calls? It is not going
8 to have that sort of effect?

9 A No.

10 Q So in that instance you are not going to have much of a spill-over effect, are you?

11 A Sorry, are we talking about – the spill-over effect has been defined as the impact ---- This
12 was the point that was clarified last week. If an individual MNO changes its price for 08
13 services, what is the effect on that MNO's demand for other services – subscription, for
14 example? It is that cross-price effect. There is then the question of changes in other prices,
15 either the change in MNO subscription prices or changes in the rivals' prices that then may
16 feed into the spill-over effect. Can you just remind me of your question again?

17 Q Let me take it a stage back, Mr. Pratt. We agree that Dobbs 3 predicates elastic demand and
18 is not looking at spill-over?

19 A Yes.

20 Q So Dobbs 4 introduced the question of spill-over and the way the model is constructed is it
21 links the elasticity to the spill-over, does it not?

22 A Yes. The model implies a relationship between the spill-over and elasticity. So, to be
23 precise, as elasticity gets lower, so demand becomes more inelastic, the spill-over effect
24 must perforce be stronger. So you end up with a conjunction of low elasticity, high spill-
25 over.

26 Q It was there effectively to add to the Dobbs 3 model because of the criticism that it had not
27 taken account of this spill-over effect?

28 A No, I don't think that's correct. It was there in response to a criticism in the draft
29 determination that the Dobbs 3 model is only consistent with elastic demand, it is not
30 consistent with inelastic demand, so Dobbs 4 was put forward to try and reconcile a
31 possibility of inelastic demand, with profit maximising conduct by the MNOs and the
32 additional ingredient that tied those together, if you like, was the introduction of this spill-
33 over effect.

1 Q Just to conclude that point can I ask you to go to the final determination which is at bundle
2 B1 and can I ask you to go to tab 1, annex 4 at p.270. Can you look at para. 2.24 and 2.25 –
3 it is probably p.269 in your version, do you have it?

4 A Yes.

5 Q There it is set out by Ofcom as to what the position is?

6 A Yes.

7 Q We see at the end there it says that despite all of this:
8 “... although we raised the issue explicitly in para. 5.137 of the Draft
9 Determination in our view neither has any of the MNOs provided a satisfactory
10 alternative explanation ...”?

11 A Yes.

12 Q So in fact what you were doing was saying: “Here is the problem, but actually the MNOs
13 have not given an explanation for this either”, or “Here is a potential problem, and the
14 MNOs have not given us an explanation for it either”?

15 A Yes, I think we were left in the situation, in this scenario where you have low demand
16 elasticity, which we were unable to rule out on the basis of elasticity evidence, there was no
17 satisfactory explanation of how firms were pricing in that scenario, so that is left as an
18 unresolved issue, yes.

19 Q Can I now just ask you to look at your statement and I would ask you to look at para. 90.
20 That indicates that if the demand has constant elasticity we know that the price is
21 incentivised to 12.5ppm?

22 A Yes.

23 Q Scenario one. You did not test any other convex curves in between, that is what you just
24 told us earlier on. You tested global linearity and if we go to para.101, p.36. You set out a
25 series there of scenarios A and B where you say that in scenario A prices are likely to be
26 incentivised to 12.5ppm. In scenario B there may not be the predicted outcome, and I just
27 wanted to explore that a little. You have two conditions in 101a as to when exactly prices
28 will fall to 12.5ppm, and we see them in the middle of the sentence:
29 “...if a reduction in an MNO’s 0845/0870 retail price to this level results in a
30 relatively large increase in the volume of these calls originated by the MNO (as
31 illustrated by the results with constant elasticity MNO 0845/0870)”

32 So in other words, if prices are relatively elastic the effect will be to fall to 12.5ppm, and
33 also if the spill-over effects are large, which is the second, the and/or spill-over effects are
34 large?

1 A Yes.

2 Q So in other words, we have a series of scenarios tucked up within your 101a where you
3 accept that the incentive is unambiguous to 12.5ppm?

4 A Yes, what 101a is saying is that in the Dobbs 4 model there are two basic considerations of
5 MNO when they are thinking about “shall I reduce my price or not, and by how much”.
6 Number one is: “how will that affect the profits I earn on the 08 call?” and that is going to
7 depend on the demand elasticity, so how much does volume increase. The second effect is
8 this spill-over effect that we have talked about, so that is the idea that as you reduce your 08
9 price in the Dobbs 4 model what happens is you attract additional subscribers, and you earn
10 additional profits and other services, and so there is an inducement over and above that
11 captured in the profit, in fact, on the 08 calls to cut prices, that is what this paragraph is
12 saying.

13 Q So, for example, you could have prices that are inelastic but if there is a large spill-over it
14 would still predicate that the falls to 12.5 ppm ----

15 A You run into the evidential problem that spill-over effects are not large.

16 Q But certainly on a scenario basis ----

17 A On a scenario basis absolutely.

18 Q In 101b we really come to the one scenario in play where they may not, as you say, fall to
19 12.5ppm, which is where you assume an inelastic demand, and the spill-over effects are not
20 significant?

21 A I am sorry, I don't assume an inelastic demand, I assume that demand response is limited, it
22 may be inelastic at the current price.

23 Q Yes.

24 A But the demand has gone through ----

25 Q Yes, effectively it is because you have assumed a linear demand curve?

26 A Linear for the example, yes.

27 Q That is the one instance where you have a linear demand curve and spill-over effects that
28 are not significant, but then one actually ends up with this problem of not falling to 12.5 ----

29 A If you restrict yourself to constant and linear demand, yes.

30 Q But I thought you had not actually tested other than constant elasticity and linear demand?

31 A I explained a moment ago there is no need to test that particular scenario because if demand
32 is less response than linear you know that the profits you get from a reduction in price are
33 going to be less than in the linear case, so you can just conclude directionally that ----

1 Q Well let us then go to annex 2 and just look at the end of your report, because this is where
2 you do assume linear demand, is it not?

3 A Yes.

4 Q And we can see from the diagrams the first one at the top on the left hand side of that page,
5 that you are assuming marginal cost between nought and 1.9ppm, so you would accept that
6 that is actually a very realistic assumption given that what has been said in Simplifying
7 Non-Geographic Numbers, about the marginal cost?

8 A Yes.

9 Q And we see that if the existing pre-NCCN price is 19.1p or less ----

10 A I am sorry, where are you looking?

11 Q I was looking at the top left hand side, it is annex 2 I am looking at.

12 THE CHAIRMAN: It is with the Dobbs 4 model.

13 MR. READ: The Dobbs 4 model and linear demand, and as I have already indicated it has the
14 marginal costs within the range that is, we would say, obvious. The point I am putting to
15 you is that if prices are at 19.1ppm, at their pre-NCCN prices, we know from that table that
16 they will in fact be incentivised from 4 to 12.5ppm?

17 A That is the prediction that Dobbs 4 makes.

18 Q That is the prediction, yes. Likewise it obviously varies from what precisely you are
19 looking at but I think if we stick with 19.1ppm, because it is the lowest I think of the figures
20 that is within this annex, that in fact anything, any price on this basis below 19.1ppm falls to
21 12.5ppm with the NCCN.

22 A Sorry, just to be clear, this annex is predicated on the idea that the demand elasticity to one,
23 and so Annex 1 has a slightly different figure.

24 Q Yes, it is either 0.8 or 1, as it actually says at the top there, does it not?

25 A Yes, the elasticity figure, yes.

26 Q Yes. If, on the other hand, it falls in the range between 26.7 to 19.1ppm, pre NCCN prices,
27 it is predicated to fall to the next tier, 17.5ppm.

28 A Yes.

29 Q And it is only in the position where one gets above 26.7ppm that in fact other steps in the
30 price ladder have come into play, and we see that from your material there, do we not?

31 A In this scenario, yes.

32 Q Yes. And we are talking here, are we not, about average retail prices.

33 A Yes.

34 Q We are not talking about, “Oh, there’s one here that’s actually forty pence” —

1 A Average retail prices.

2 Q Yes. And if I can ask you just to look at simplifying non-geographic numbers again, which
3 is CAT bundle 13, tab.3.1, p.275. Do you have it?

4 A Yes, I do.

5 Q Table A5.1 sets out the average retention of pence per minute for the mobile and fixed
6 OCPs, and we see that on the right hand column of the table A5.1. Do you have that? It is
7 p.276.

8 A Yes.

9 Q And you see the table, and we see that the average retention of pence per minute for 080
10 numbers is 14.7ppm, 0845 is 13.4ppm and 0870 is 10.6ppm. Now, I accept that is the
11 average retention rather than the average price. But the reality is that the average price is
12 not going to be massively higher than those figures that are actually there, is it, because
13 effectively the termination costs are not going to be a large sum.

14 A Just to be clear, this average retention is for, it is an average across all of the MNOs. So,
15 this is not the average retention for each MNO. I think that's point number one. So, the
16 retention for individual MNOs would differ from that individually — some higher, some
17 lower. And the second point is that the source of this data was the flow of funds study that
18 was discussed last week, and we heard some of the concerns about the limitations of that
19 data last week. So, I think there is a question about the reliability of this data.

20 Q The trouble is, of course, that we do not have an ARP actually worked out for each separate
21 MNO, do we? So, in terms of what the average ARP is, this is probably about as close as
22 we can get to having some form of guesstimate about what it is likely —

23 A The final determination did contain some figures that were provided by the MNOs.

24 Q Yes. Figures provided by the MNOs.

25 A Yes.

26 Q But, obviously, there are all the issues that we say about whether they are right or not. But,
27 anyway, I do not want to get into that debate with you, Mr. Pratt. All I am simply pointing
28 out to you is that of the scenarios that could be predicated in this case, I think you accept the
29 only scenario where it is likely to end up as not being, falling to 12.5ppm is the scenario
30 where you say that prices are relatively inelastic and spillovers are not significant, and that
31 within those ranges, within that range in fact, it is not by any means clear that all the prices,
32 or it is not clear that in fact prices will not fall to 12.5ppm because it all depends upon the
33 average retail price to begin with.

34 A Certainly, yes, the level of the ARP matters very much in these models, yes.

1 Q Thank you, Mr. Pratt. If you would just like to wait there.

2 (Re-examined by Mr. HERBERG)

3 MR. HERBERG: Mr. Pratt, just one single question to you arising out of Mr. Read's questions.
4 Mr. Read put a number of questions to you about para.101 of your witness statement, you
5 remember, with A, B and C. Does that paragraph set out your views, or your interpretation
6 of what the Dobbs model, if it is correct, does?

7 A Paragraph 101?

8 Q Yes. Does that paragraph set out your own views, or does it set out your interpretation of
9 what the Dobbs model, if it is correct, does?

10 A So, this paragraph is reporting on if you implement the Dobbs models, as they are set out in
11 Dobbs 3 and Dobbs 4, this is largely to the predictions of the models.

12 Q Thank you.

13 PROFESSOR STONEMAN: This morning I asked your colleague, Mr. David Myers, a question.
14 He very kindly volunteered you to answer it.

15 A I thought that.

16 Q What I am interested in is that we are considering these NCCNs which were proposed by
17 BT, but there are a number of other terminating call providers on the market. And
18 obviously how the MNOs react in their pricing depends upon how those other termination
19 call providers change their prices in reaction to the BT NCCNs. What I wanted to find out
20 are what assumptions you made in your predictive behaviour in your models as to how
21 those other TCP providers would change their pricing practice, if at all.

22 A Sir, at the time we were carrying out this analysis, we were aware that other providers were
23 putting in place their own step tariffs. In terms of the approach that we followed in the
24 determination, in the analysis of practical purposes, largely, we treated the BT NCCNs as a
25 market wide phenomenon if you like. So, we did not engage with the details of multiple
26 distinct types of tariff introduced by different TCPs.

27 PROFESSOR STONEMAN: And that was with the 080 as well as with the 0845 and the 0870.

28 A Sir, in 080 we didn't carry out any — all of this simulation analysis has taken place in the
29 context of the 0870 and 0845, all of Ofcom's simulation analysis.

30 Q But you still had Dobbs 1 to consider in 080.

31 A Yes.

32 Q Which has an implicit assumption, I think, that BT is the only provider?

33 A Yes, I believe that's correct.

1 Q I think, effectively, in the 080 you have assumed that everybody would be doing what BT is
2 doing without actually realising perhaps?

3 A Yes.

4 Q You may not be able to answer this: is that a fair way to consider the NCCN? It is a
5 proposal from BT that you have implicitly extended to every other player on the market. It
6 does not mention it at all as far as I can see in the determination, that that is how it has been
7 treated.

8 A I think that's correct, we don't say that's how it's been treated. It's implicit in the final
9 determination. Is it fair? It's difficult to see which way you would send it, if you like. I
10 think you probably need to look at what are the individual NCCNs offered by all other
11 operators. You probably need to know something about the termination traffic share and
12 then come up with a significant additional dimension to the complexity ... and build a
13 model that encompasses that.

14 Q Even to consider that, because it is not necessarily – I can see that the other operators might,
15 for their own profitability, like to put in place a nice ladder pricing scheme, but there may
16 be advantages in having different steps in the ladder, having bigger gaps, smaller gaps,
17 instead of taking it down to 12½, they might take it down to 11½, I do not know. To take a
18 view on all that without mentioning it does perhaps cause me problems.

19 A It would be a very significant complication to the analysis, I think, and, to be clear, as a
20 practical approach, we didn't engage with it.

21 THE CHAIRMAN: Are there any questions arising out of that?

22 MR. HERBERG: Just for Professor Stoneman's note, we think there is some consideration of this
23 in annex 3 to the 0845 final determination at para.5.156.

24 THE CHAIRMAN: What page is that?

25 MR. HERBERG: 5.156 is the paragraph, and the page is around 225, approximately, under the
26 heading "Other issues".

27 PROFESSOR STONEMAN: I have got p.225, and paragraph?

28 MR. HERBERG: Paragraph 5.156, sir, just under the heading "Other issues". It may be a couple
29 of pages either way, because for some reason mine was printed out differently. It is
30 para.5.156 through to 5.161.

31 PROFESSOR STONEMAN: Yes, I think it very much clarifies 158, those are the issues raised
32 that I was concerned about. Thank you very much.

33 THE CHAIRMAN: Thank you very much.

34 (The witness withdrew)

1 MR. READ: Sir, I will call Dr. Maldoom next, unless this is a convenient point to have a break.

2 THE CHAIRMAN: We will carry on a little longer.

3 MR. READ: I will call Dr. Maldoom.

4 Dr. DANIEL JAMES HARRY MALDOOM, Sworn

5 Examined by Mr. READ

6 Q You are Daniel James Harry Maldoom, and your business address is 17 Welbeck Street,
7 London W1G 9XJ – is that right?

8 A Yes, that's correct.

9 Q You have probably got a whole swathe of bundles up there at the moment, Dr. Maldoom.
10 Can I ask you to clear everything away and could you take bundle C1 and turn, first of all,
11 to tab 8 in that bundle. This is not a witness statement for the purposes of an actual appeal,
12 it is a report that you included some time in late January, and you do not have a signature at
13 the end of it. Are you happy that that still reflects your position and, in so far as it impacts
14 on the evidence, your evidence in the case?

15 A I am, yes.

16 Q At tab 9, I think it is, likewise there is another report that is not, in fact, again signed
17 because of course it was done for the purposes of the determination. Again, in so far as it
18 becomes relevant, do you adopt that material as evidence in the case?

19 A Yes, I do, yes.

20 Q Then at tab 10 we come to a report and at the end of that report at p.37 we see your
21 signature. Does it actually have a signature in that bundle?

22 A This one does, yes.

23 Q Is that your signature?

24 A It is my signature, yes.

25 Q Do you adopt that report as your evidence in the case?

26 A I do, yes.

27 Q At tab 11, we are back again to a report that is not signed because it was not actually
28 prepared for the purposes of a hearing. Again, in so far as any of that material is relevant,
29 do you adopt it as your evidence in the case?

30 A I do, yes.

31 Q If we can go to tab 12, we see your report which was prepared for this appeal, and if we go
32 to the end at p.66, I have a suspicion there may not be your signature on the version in your
33 bundle?

34 A No, my signature is here.

1 Q Your significant is there?
2 A It is here, yes.
3 Q You are one up on me! In that case, is that your signature?
4 A It is, yes.
5 Q And do you adopt that as your evidence?
6 A I do, yes.
7 Q Finally, at tab 13, we have the expert report that was served with the statement of
8 intervention on behalf of BT, and at the end of that, at p.28, is that your significant there?
9 A I don't have a signature on that one, I'm afraid.
10 Q Assuming that there is a signature somewhere, can I just ask you if you adopt it as your
11 report?
12 A It does look like my report, yes, and I adopt it.
13 Q I am sorry about this, sir. Then at tab 14, we have an expert report which was served with
14 the reply, and at p.63 there is a signature page.
15 A That's true, yes, unfortunately no signature, but again this does look like my report, yes.
16 THE CHAIRMAN: Perhaps you can make good these omissions.
17 MR. READ: Yes, we will, we will ensure that they are in the bundles. Does your copy, sir, have
18 signatures or not?
19 THE CHAIRMAN: Like Dr. Maldoom's, it is variable.
20 MR. READ: Those seven reports constitute your evidence in this case – is that right?
21 A They do, yes.
22 MR. READ: Thank you, Dr. Maldoom, just wait there.
23 THE CHAIRMAN: Mr. Herberg?
24 Cross-examined by Mr. HERBERG
25 Q Good afternoon, Dr. Maldoom. Can we start off with something on which we perhaps
26 agree. We will start with the size of the indirect effect, and in particularly focusing on pass
27 through from service providers to customers. You accept that there is uncertainty about the
28 degree of pass through from SPs to customers, do you not?
29 A Indeed, yes.
30 Q I think it is para.144 of your seventh statement, tab 14, you ask the question:
31 "What then do SPs do with these funds? This is less clear."
32 A Yes, I accept that it is uncertain as to what the situation is with pass through, yes.

1 Q You say in para.145 that a proportion might conceivably be taken as profit by some SPs, but
2 you also consider the other possibility that some might be expended by SPs in a way that
3 would benefit callers. You consider both possibilities?

4 A We have both possibilities. I think I make the additional point that here we are primarily
5 talking about 080 calls, 0845 calls where I think one would not expect, say, a service
6 provider with some unique and non-replicable services to be using that to actually charge
7 essentially a high price to users of that service, this is probably not a number range where
8 that is terribly relevant. That might obviously happen with premium rate calls so therefore I
9 think my presumption was it was probably more likely that we were in the pass-through
10 case than the alternative case where there was perhaps not much competition with other
11 service providers providing similar services.

12 Q You say it is reasonable to assume that the main beneficiary of increased termination
13 charges will be the SP customers?

14 A In the majority.

15 Q In the main but not exclusively, you say in para. 33?

16 A Yes, indeed.

17 Q The reason you give for expecting at least reasonable amounts of pass-through or possibly
18 more is what is described as inter-service provider competition I think, para. 144. You say
19 that in many cases SPs will be competing with each other to deliver services to customers.
20 In these cases one would expect inter-SP competition to deliver benefits to consumers to
21 enhance services. Then you concede in other cases SPs might not face much competition in
22 the service it is delivering and so be able to make additional profits?

23 A Yes, that's correct. I think that is the point I just put to you.

24 Q The aspect of the touchstone is therefore – you are relying therefore in making the
25 distinction between the two categories on, as it were, the degree of competition, you are
26 relying on the SPs changing their behaviour where there is competition by improving the
27 quality of the services?

28 A Well there is the question of what I am relying on that for. Certainly in terms of the extent
29 to which there is pass-through ----

30 Q Yes, that is the question we are dealing with, from that perspective?

31 A Then that is obviously the relevant factor for pass-through. There are some complications
32 around that, I mean clearly there is also the possibility even without competition, There
33 could be innovation issues as well that actually even a service provider who is a monopolist
34 might be driven to innovate, which is an additional issue to that.

1 Q But sticking with this for now, the prices are fixed so we are talking about competing on
2 quality of services, assuming there is a sufficient degree of competition?

3 A Yes, if you take the services largely as a given, and you are looking at aspects of quality of
4 those services then clearly inter-SP competition is relevant. If you take a slightly longer run
5 view of this then one would also probably want to think about this innovation point.

6 Q I want to suggest to you that looking at it insofar as one is looking at it from the standpoint
7 of competition there are good reasons for thinking that competition is quite limited in this
8 particular area. Can I ask you to look in that connection back at the NGCS report, bundle
9 13. In that bundle at tab 3.1 if you go to para. A2.160, which is p.172. This is Ofcom's
10 view of course, and in the consultation documents looking at the heading two paragraphs
11 above that is "Preliminary views on competition"?

12 A Yes.

13 Q And Ofcom comments:

14 "In relation to SPs there may be some competition among services, but many calls
15 are either 'locked-in' or competition is limited due to unawareness of substitutes,
16 the inability for SPs to influence retail price (and the vertical externality), or the
17 limited ability of SPs to extract a greater share of any additional revenue generated
18 from the higher retail prices (in order to invest to improve the quality or range of
19 available services)."

20 Do you accept that those are all at least proper factors to take into account in assessing the
21 degree of competition?

22 A Well I am not sure they are, because actually what seems to be being discussed here is at
23 least the potential for problems with inefficiencies created by the vertical structure here to
24 have an effect on competition. We talk here about the vertical externality and the potential
25 for control of retail price, the potential for revenue pass-through as being in some sense
26 affecting the degree of competition from the service provider, so I think the causality here
27 seems to be the opposite way around to what you are suggesting.

28 Q Let me give you an example, let us deal with locked in customers. We have already had the
29 example of the water bottle in front of me, my Nestlé has turned into Buxton today, so I am
30 not sure the point applies, but if you could think we are still dealing with Nestlé. I buy my
31 water and if I have a complaint I dial the 0845 number, or whatever it is on the bottle, in a
32 sense I am a locked in caller, there is no suggestion that I will buy my water according to
33 the price or quality of the helpline I ring if I want to complain, clearly. There is no effective
34 degree of competition there, is there, operating on the service provider?

1 A I think one needs to distinguish a number of cases, that is really an 080 case.

2 Q Deal with that case first?

3 A Well let us deal with this case first, okay. The Nestlé case, clearly what is happening here is
4 that Nestlé would like it to be possible for people to ring it with whatever inquiries they
5 might have about mineral water. In that case Nestlé has the incentive to ensure that they are
6 contactable, and presumably when they were procuring that service they would actually like
7 to have, or they would prefer a service in which that objective is achieved by the retail price
8 being low or indeed even free, as we have heard from Mr. Myers, being Ofcom's objective.
9 I think one wants to distinguish that case from other issues which you are suggesting which
10 are more about revenue pass-through than actually being able to actively charge for, say, an
11 information service, something like that; I think that is a slightly different situation.

12 Q But in my locked in customer case, accepting that there may be differences between that
13 and other situations, in that example, you might accept that there would be low degrees of
14 competition, there might be plausibly some reasons why there were some being placed on
15 quality, for example, on a complaint line, something like that, some other locked in call,
16 there may be very low reasons to infer competition?

17 A Well hang on, I think you need to be very careful about what you are talking about here.
18 When you are talking about locked in, you are talking about essentially callers, okay, yes, I
19 have no option but to ring the number that is on the water bottle if I want to make an inquiry
20 to that producer. So in that sense the customer has no choice. But that is exactly, if we turn
21 this around, the consideration for the mineral water manufacturer in procuring the freefone
22 service which it wants to be able to access its customers, which is I think a point between
23 which I and Ofcom quite strongly agree, in fact.

24 Q You suggested, as I understands it, that for that reason locked in callers would be typically
25 found on freefone numbers, 08 numbers, is that right, 080 numbers?

26 A Let us just be clear, I mean locked in customers can be potentially found probably on any
27 number range depending on what the exact circumstances are. All I am suggesting, I think,
28 here is that I do not see that it is a well-defined question really in this case to look at
29 competition on the caller side. If we have this scenario of a mineral water bottle with a
30 number the competition that is occurring is essentially you need to look at the procurement
31 of that service by the mineral water company itself and what options it has.

32 Q Can I just put to you that the locked in phenomenon is certainly not something which is
33 going to reduce to the freefone or even be found in greater numbers there. If you turn
34 forward to para.A7.235 in the same report, p.387?

1 A Yes.

2 Q This is discussing the higher price range, and you will see there at the bottom of that
3 paragraph: “In 2005 we found that 45-55% of 0870 numbers were ‘locked in’ i.e. the caller
4 could not realistically switch to another SP”. So to the extent that the locked in
5 phenomenon is something which impacts on competition, this is something which is going
6 to apply throughout the number ranges we are dealing with here, the three number ranges
7 we are dealing with, is it not?

8 A I think the problem with quoting locked in as a proportion is it just fails to distinguish
9 between two cases. The mineral water bottle is as good an example as any, which is a cause
10 of locking is going to be that NTS numbers are used as a way of providing support lines, or
11 in association with selling other products, now in that sense you are absolutely right because
12 I have no option but to ring the person with whom I have a relationship. I think the other
13 issue is around the use of the NTS system to actually – let us take another example, a
14 weather line, or an information line, to actually make something available to customers;
15 and I think under those situations, that we don’t really have available any particular premise
16 that there should be a lock in, because it’s not associated with a prior customer relationship.
17 They’re simply using the NTS system as a sales channel, hopefully to be able to post a retail
18 price to customers that they can ring and then access that service. So, I think, without
19 making that distinction, I don’t see that it’s particularly meaningful to talk about
20 proportions.

21 Q Now, you have not cited, and you have not got any empirical evidence, have you?
22 Effectively you are reasoning from the situation to reach an intuitive conclusion.

23 A Yes, I mean, you will see, you know, a large part of the reports actually include what you
24 might call “thought experiments” and just going through —

25 Q I am just identifying the basis on which you are giving that view.

26 A That’s right, yes. I mean, the reason that I have discussed that is very much what you might
27 call “reverse engineering”, the eventual conclusion that Ofcom comes to, just to try to
28 understand what Ofcom must have assumed about some of these factors to reach its
29 conclusion, you know. I won’t digress further, because I’m sure other people will ask me
30 questions on exactly that point.

31 Q Let me just put to you what Ofcom did decide on the point, going back to the final
32 determination itself. That is in B1, that is a bundle I have not taken you to yet. And if I can
33 take you in that to one of the annexes, annex 3 at para.5.225.

34 A Okay. Where do I go?

1 Q It is round about p.238, but not exactly. It is annex 3 so, this is dealing with the draft
2 determination.

3 A This is under the heading “Our view on indirect effects”.

4 A Can you just give me the page number again? Sorry.

5 Q It is around about p.238, but look for the paragraph number for help when you are around
6 there. It is 5.225.

7 A Yes. Right.

8 Q This is Ofcom’s conclusion based on the evidence which it cites. They say:
9 “Additionally, given that revenue share is available on other NTS number ranges,
10 it is more likely that SPs have chosen the 0845/0870 number ranges for reasons
11 other than revenue share. For example, research among SPs as part of the “NTS:
12 A Way Forward” consultation in September 2005 found that ‘many of these
13 businesses had chosen the 0845/0870 numbers because of the simple local rate
14 and national rate pricing message. Additionally, the business qualitative
15 research found that the main reason NTS numbers were used was for convenience
16 (eg, ease of routing calls, number portability, and to help customers remember the
17 numbers) — most businesses did not claim to associate the small revenue gained
18 from 0845 or 0870 numbers as actual income and most claimed they would not
19 miss it if it was not there”.

20 This suggests, does it not, that there is little or no competition between service providers to
21 provide services to secure micro payments?

22 A I think that’s a very large lap, to go from that to say that there’s evidence of lack of
23 competition. I mean, what that paragraph says to me is, I mean, this is almost a statement of
24 how the NTS system is sort of understood to operate, which is — I mean, these companies
25 are saying that they essentially want the retail price to be something that is controllable, so,
26 I mean, let me paraphrase this. They are saying, “Well, I don’t actually want a little bit
27 more revenue. What I want is controllability on the retail price”, seems to be the message
28 here. That doesn’t really tell us anything about the conditions of competition between
29 service providers. I could have two competing service providers who would provide
30 exactly the response which is given here.

31 Q But it is still right, there is a first step, that this does suggest there will be little or no
32 competition between service providers to provide services to secure micro payments, taking
33 that stage of the argument. You may say it is a leap from there to the ultimate conclusion,
34 but that stage must follow, must it not?

1 A I don't see —

2 Q If the evidence is right, of course.

3 A Well, the evidence is saying, all this is saying is that revenue share does not appear to be
4 particularly important for these SPs. I don't see what then follows from that.

5 Q What follows from that may be that there will not be much incentive on service providers to
6 change the quality of their services to secure micro payments, to compete for micro
7 payments. That is what follows.

8 A Well, there are a number of aspects to the service which is being provided to an SP. So, you
9 may have some SPs who are interested in micro payments. Clearly that is an issue, you
10 may have some —

11 Q Of course you may have some. But what we are looking at is the overall picture.

12 A Well, hang on —

13 Q Ofcom's overall judgment here. You may disagree with it, but the point Ofcom is making
14 is that most of the reporting in the survey would not miss it if it was not there. If that is
15 right, and we have not got any evidence to go behind the survey, but if that is right, and we
16 are looking at most, not what some might do, because we are talking at a fairly high level of
17 abstraction, we are looking at the market as a whole — it must be right, must it not, that
18 there will be a lack of competitive impulse on service providers to improve quality in order
19 to chase micro payments?

20 A Okay. I mean, you started by asking me a question about TCP competition, I think, didn't
21 you, before you switched over here? Sorry. I just want to be absolutely clear as to whether
22 we are talking about SPs competing for customers.

23 Q No, we are talking about SPs competing for customers just as this paragraph addresses.

24 A Right. Okay. But there are other issues here, aren't there? I mean, let's go back to the
25 mineral water bottle again. Or, indeed, a bank, or anybody who might be using the NTS
26 system to support a product. Clearly there is an issue for them about the retail pricing of the
27 calls to them, so, I mean, this information here seems to say that, okay, some people don't
28 care about micro payments, but those service providers may well still care an awful lot
29 about the retail price of that service, and that may actually be important in competing with
30 other, what you might call service providers, I mean, mineral water bottles presumably are
31 not sold on the basis how easy it is to ring their 0800 number. But I would have thought
32 that there probably are services which are being provided where that is important.

1 Q Now, let us just take that stage by stage. We are here talking about competition between
2 SPs, because the question that we are addressing in this section is whether SPs are going to
3 pass on payment to callers.

4 A Sure.

5 Q Or benefits to callers, I should say.

6 A Okay, that's understood.

7 Q That is the framework of what Ofcom here is looking at and what I have been asking you
8 about. This evidence, relied on by Ofcom, suggests that SPs are not particularly interested
9 in exploiting the micro payment as income, would not miss it if it was not there. That is,
10 better or worse, right or wrong, that is the evidence which is being provided to Ofcom. It
11 has to follow, does it not, from that, that SPs are not incentivised to improve or change the
12 quality of the services that they offer to customers in order to change micro payments. That
13 is not to say there might not be other reasons in some cases why particular SPs want to
14 improve the quality of their services, but if we are looking at the competitive effect, it has to
15 follow, if the survey is right, does it not?

16 A I think I am repeating the point that I don't think that does necessarily follow. I mean, let us
17 try and take a simple example. Let us suppose that we had two banks, say, who were both
18 offering NTS numbers to be contactable. If one of those is somehow able to secure a
19 controllable retail price on ringing its number, that clearly is a competitive advantage. Take
20 a phone banking service, that is potentially quite a large competitive advantage.

21 Q Can I just pause and clarify what you ----

22 A This is a competition amongst those two organisations, which is occurring as a result of
23 their arrangements for NTS.

24 Q There is no controllable retail price here, is there? We are dealing with fixed prices for
25 these numbers?

26 A I think that is part of the question around the whole structure of the NCCNs, isn't it, what
27 the effect is on retail prices.

28 Q We are dealing with a situation here. We are looking at competition among SPs at whatever
29 retail prices are offered on these number ranges. There is no question here of controlling
30 the retail price. What we are looking at is the indirect effect, which is about what happens if
31 you increase the revenue share – is that not right – not what happens if you control the retail
32 price. Aren't you looking at this from the wrong end?

33 A No, I think you've got an implicit assumption in your question. The implicit assumption is
34 clearly that there is uniform pricing by the originators. I think at least part of the question

1 here and part of the question I have raised in my report is that about the efficiency of
2 vertical arrangements within the industry. It is not necessarily the case that there need be
3 uniform pricing. I think you're actually taking that as a premise. I think my points about
4 the controllability of prices are really linked to that point, to be clear.

5 Q MNOs may have the ability of course to change their retail price, but SP end of the
6 equation, the end we are looking at here, the competitive effect we are examining in relation
7 to the indirect effect, there is no question of retail price changes there.

8 A Okay, it is a question of assumptions. I am just trying to clarify what we are each assuming.
9 I think part of this discussion is because we are assuming slightly different things. I think
10 my point is that competition needs to be looked at in a fairly broad context. Perhaps you
11 want to put the question to me again, given that clarification on my position.

12 THE CHAIRMAN: Dr. Maldoom, counsel I think is assuming that the price that is paid by the
13 caller is set by the MNO and the service provider has, for better or worse, no input into that.

14 A Yes.

15 Q He is putting his questions to you on that basis. What assumption different to that are you
16 making?

17 A I'm not assuming those prices necessarily need to be uniform, I think was my point. The
18 point that I was trying to make was that controllability of retail prices may be an attractive
19 proposition for a service provider, and that one might actually think more broadly around
20 what possibilities there are for a service provider to go to a particular hosting and TCP
21 arrangement that might produce a better outcome for it. That was purely the point that I'm
22 trying to make.

23 Q No doubt it is my fault, but let me try and unpack that answer. I quite understand that the
24 prices that a customer to an MNO may pay for dialling an 08 number may vary according to
25 which MNO one is contracted with. It obviously depends on the package and the MNO in
26 question. Again, what I do not understand is the connection between the service provider at
27 the other end and the price that is paid by the customer of the MNO. Implicit in your
28 answer seems to be that there is some form of connection which I am afraid I do not
29 understand and which I would like to be clear on.

30 A Okay. I think I've probably taken this on a step too far to be absolutely honest, just to be
31 absolutely clear. The point that I am making is purely that the ladder pricing arrangements
32 potentially provide an incentive for TCPs to compete for service providers in a way where
33 they can offer some controllability on retail price. That is only point that I am trying to
34 make here.

1 MR. HERBERG: Are you not moving back now? Are you not slipping back to considering
2 TCPs competing for a service provider? We are trying to focus on service providers
3 competing for customers. You are not answering the question which I am asking you about,
4 which is what happens if you increase the service providers' revenue share? What happens
5 if they get a stream of money coming through as termination payments from the TCP? We
6 will assume for now that there is competition at that stage, and that a TCP like BT passed
7 the money on to the service providers. The question is what happens to the pot of money
8 that the service providers get – do they pocket it, does it go into their general business, or
9 does it get competed through to customers? On that question, we are not looking at
10 questions of changing the retail price, or anything like that. I would like you to consider
11 this on the basis that we stick with the system we have got, the MNO decides the retail
12 price, and the question is what happens to the money in the service provider's hand? What I
13 was putting to you was, whether it is lock-in or whether it is the reasons that Ofcom have
14 given in the paragraph I took you to, that there is considerable evidence to suggest that there
15 is not a strong impulse on the service providers to compete that through to the customers to
16 improve services in many case, not as a uniform absolute proposition, but in many cases.
17 Do you think that is a fair conclusion to reach based on Ofcom's reasoning?

18 Q Well, the survey data says what the survey data says. It may be that there are quite a lot of
19 SPs that respond I this manner. I still do think that there is quite a significant step to go
20 from that to assume that there isn't any inter-SP competition. I just don't see that that
21 necessarily follows.

22 Q Saying there is not any would clearly be a further step, but you have not got any survey
23 evidence to set against this, have you?

24 A No, absolutely not.

25 THE CHAIRMAN: Mr. Herberg, would that be convenient moment?

26 MR. HERBERG: That might be a convenient moment, yes.

27 PROFESSOR STONEMAN: I was going to chip in there. Are you saying that if the service
28 provider has got a greater flow-through of funds from the NCCN, through BT to the service
29 providers, they might use that money, for example, to do more DWP type side deals
30 whereby they avoid ----

31 A Absolutely, and that was exactly the point – I was probably putting this extremely badly
32 because I think we were at cross-purposes here, but that was exactly the point that I was
33 making. It is very easy to be too presumptive about which arrangements are fixed and what
34 is potentially variable and can change. I think, if we are talking here about competition

1 amongst service providers, we have to look at what the service provider is potentially
2 interested in. Mr. Herberg tells me, “Look at this survey evidence, they are not particularly
3 interested in revenue shares”. I absolutely accept that, if that is what the data says that is the
4 data says, I don’t have any other data. On the other hand, I think there is an issue which is
5 this question about controllability of pricing, which is why I brought up this example of,
6 say, a bank, or somebody who is actually using to contact customers. One question is, are
7 we actually talking about competition too narrowly? I can imagine competition between
8 service providers that would have that aspect. I say, my bank gives you a better deal if you
9 ring us than your bank, and the reason could be that I have negotiated individually with the
10 OCPs or it could have been that I went to another TCP that has used a wholesale pricing
11 arrangement that provides good incentives to control the retail price for that service
12 provider. That is just a broader notion of competition than I think Mr. Herberg was
13 intending me to address, and hence I think the cross-purposes to some degree.

14 MR. HERBERG: Sir, that might be a convenient moment.

15 THE CHAIRMAN: Thank you, we will rise for five minutes.

16 (Short break)

17 THE CHAIRMAN: Mr. Herberg?

18 MR. HERBERG: Professor Maldoom, can I ask you to turn to para.36 of your second statement,
19 so that is tab 14, bundle C1, paragraph 36?

20 A Yes.

21 Q It is under the heading: “The extreme nature of Ofcom’s assumptions”, and you note at the
22 end of para. 36 that in the determination itself, 08450, 0870, we have only got a highly
23 summarised qualitative assessment, no quantitative information about the relative
24 magnitude of the different effects?

25 A Yes, I do.

26 Q You then go on to note that it is possible to draw some inferences from what was figure 8 of
27 Mr. Myers’ second statement, which you reproduce at the top of the next page of your
28 statement, with some additions, and about the implicit views as to the relative sizes of the
29 different effects and just identifying first what you take from that. First, we can see at
30 para.37 you suggest that in the no reduction scenario based on his graph, the indirect effect
31 is about one-seventh of the mobile tariff package effect, that is what it seemed to be?

32 A That is right. What I have taken is essentially the four arrows which were indicated on
33 figure 8.

34 Q Yes, I can see that.

1 A And I have taken ratios.

2 Q I am just analysing what comes out of it first. That is the first, the figure for the indirect
3 effect compared to the mobile tariff package effect?

4 A Yes, these are obviously rough estimates.

5 Q Then secondly at para. 41 I think, another factor you infer from the table is Ofcom's view of
6 the strength of the waterbed effect and you get that by looking at the ratio of the direct
7 effect, and the mobile tariff package effect at 12.5ppm. You measure that to be about 80
8 per cent again, approximately?

9 A Yes, I take that.

10 Q Let us make sure of A and B this time?

11 A I would not necessarily call it "Ofcom's assumption" what I have taken is what is in Mr.
12 Myers' figure.

13 Q You call it "Ofcom's Implicit assumption' yourself, in the first line in 41?

14 A Yes, I use the word "implicit", yes.

15 Q Then you describe these assumptions as extreme and implausible, I think, at para. 85, let me
16 just take you to that shortly. Again, you are saying: "Ofcom's assumptions are implicit in
17 this figure. There is a strong waterbed ... and relatively weak external benefits ..." etc.
18 You say: "This is a highly implausible waterbed effect. At the same time ... only about
19 one-seventh of any additional revenue ..." etc.

20 A Yes, I think it is the combination of the assumptions, and I think I make this somewhat
21 clearer with a figure later. There is one more ----

22 Q Well, maybe 70, 72 possibly. There is another fact I think you take from it – that is not the
23 right reference, it is 71 I think. This is still taking the information from the same table, is it
24 not?

25 A Yes. All the information is in the ratios of A, B and C, so essentially any inferences only
26 involve those particular numbers.

27 Q Yes, and in those paragraphs you set out why you do not see how the percentages can work,
28 and I think the bit I was looking for actually was 73, you are quite right:

29 "Nor is it in the direct effect, as it appears that at most 20% of the direct effect
30 must accommodate all externalities including this volume effect for SPs."

31 A Yes.

32 Q Can I first understand how you did this? If one goes back to your figure 2 on p.15, am I
33 right in thinking what you did was you took out a ruler and you measured the height, which
34 you labelled "c", obviously on your own particular graph you would have been that to

1 Mr. Myers' equivalent table. May I ask you to just get that one out. Can I ask you to leave
2 that out, but also pull out bundle C2, please, tab.28, which is Mr. Myers' second statement,
3 and go to p.82. Have you got that?

4 A Yes.

5 Q So, am I right in thinking what you did was, you took out a ruler and you measured the
6 height that you have indicated at C and at B to find the proportion of the indirect effect to
7 the mobile tariff package effect?

8 A Roughly, yes. Yes.

9 Q Only roughly, not exactly?

10 A Well, I mean, these are rough proportions.

11 Q Yes, I see, the proportions are rough.

12 A Yes. The proportions are rough.

13 Q With a ruler it is going to be not exact, is it? And again, your ruler did service to measure A
14 and B and then to work out the waterbed effect around that.

15 A Yes, all I have measured is A, B and C.

16 Q And you — obviously I will not take too much time on this, you have been in court and you
17 have heard Mr. Myers' explanation, have you not, that this was effectively not a two-scale
18 diagram. His diagram, he says, was an adaption of your diagram fig.4 in Maldoon 5, and it
19 was, and indeed as it says at the top, "For illustrative purposes only".

20 A Yes, I mean, this has arisen as a result of dialogue. I mean, it really goes back to my
21 original point about the difficulties of deducing any kind of quantitative information from
22 the determination itself, and I think it was Maldoon 5 I introduced this diagram. I think at
23 that point there was a degree of cross-purposes between Mr. Myers and myself about
24 exactly where various effects were, and I think we put them in different places, which
25 I think has now been identified and in a sense resolved.

26 Q Indeed.

27 A I mean, I don't think there is any debate about that. So, the figure came into life as a result
28 of that. But, I mean, I would emphasise that this is essentially all I have to go on in terms of
29 judging the relative magnitudes of the different effects.

30 Q You do not have that to go on, do you?

31 A Well, okay.

32 Q Do you now accept you do not have that to go on?

33 A Okay, in terms of quantitative assessment, let me be clear, in terms of quantitative
34 assessment, this is all that I have to go on, really, in terms of assessing the relative weight

1 that has been given to the various effects. So, in particular, I mean, I think this is not an
2 unreasonable approach, because Mr. Myers yesterday said to take this diagram and to
3 compare, he invited us to compare the direct effect on the MTPE in the case of full
4 reduction, and also to compare the indirect effect on the MTPE in the case of no reduction,
5 and I think I am effectively just taking up his offer to make those comparisons. I mean, the
6 reason I wanted to look at this was in particular because of the very small value of the
7 indirect effect at the current price, and also the relatively modest mark up of the direct
8 effect, because we can from here deduce how much magnification has been given to the
9 direct effect for the issue of externalities.

10 Now, I entirely accept that this is, indeed, illustrative in the sense that these are straight
11 lines and nobody would expect this to necessarily be straight lines.

12 Q But, do you accept the truthfulness and indeed accuracy of Mr. Myers' evidence when he
13 said that this table, his table, was not intended to be meaningful in the sense of depicting
14 commensurate effects, but was meant to be schematic in the sense of illustrating the
15 different treatment of the indirect effects in your table and his table, and indeed the different
16 interception of the direct effect. I mean, he was illustrating different, he says he was
17 illustrating schematically different treatment of the effect, was he not, and nothing more
18 than that? Do you accept that evidence, or are you saying that he conveyed more than that
19 in his diagram?

20 A Okay. What I have taken from this, I mean, I don't want to in any way impugn Mr. Myers'
21 actions in putting this in here. But I think it is useful in illustrating implicit assumptions.
22 Now, it is very clearly illustrative in the sense that I don't think there's any particular reason
23 to assume that that there are necessarily linear relations here, and indeed the fact that the
24 MTPE has been shown at constant as, you know, that may not be the case even on the basis
25 of Ofcom's assumptions. However, you know, what this diagram does do is, it shows a
26 single vertical scale. Now, if I show anything on a single vertical scale, I consider those to
27 be commensurate, okay? If these are not commensurate, they really should either be, they
28 should be on separate scales, they should not be shown on the same diagram. So, I think,
29 I take from this that these are measured in the same units.

30 Q Did it not strike you that what you were doing was a bit odd? I mean, it would be pretty
31 surprising, would it not, if Ofcom, having resolutely declined in its final determinations, to
32 quantify the sizes or relative sizes of the various effects, having said despite BT's criticisms
33 that there was too much radical uncertainty to do more than come to a view on directional

1 and weighted factors — in spite of all that, if Mr. Myers had, without saying he was doing
2 this, smuggled into his graph a hidden quantitative analysis waiting to be decoded by you.

3 A Well, okay. I wouldn't suggest that he would do that. However, if I were drawing this
4 diagram, as indeed Mr. Myers must have been doing, I would not be able to draw this
5 diagram without making some implicit assumptions. So, I have to take a view, for example,
6 about how much larger the direct effect is going to be than the MTPE when I draw this
7 diagram.

8 Q You mean where you actually put your pen to start the line.

9 A No, no, no. I mean, this is not a piece of art work, this is meant to be representing to the
10 reader the balance of these effects, okay. So, I have to think to myself, "Right, let's take the
11 full reduction case. Right, the direct effect should be shown on this as larger than the
12 MTPE and what is the logic for that?" Well, the MTPE represents essentially, that
13 essentially reflects, on the full reduction case revenues which come from mobile customers.
14 Well, that's also there in the direct effect, but the direct effect also includes externalities.
15 So, I think to myself that I actually have to add something here to the direct effect. The
16 similar logic would also apply to the case here where we look at the current price in that,
17 you know, Ofcom has weighted the indirect effect, apparently, in some sense, so therefore
18 I have to represent the fact that the indirect effect is smaller than the MTPE. I mean, if we
19 think about this as financial flows, in the case that there is no price reduction, the MTPE is
20 basically — the revenue that comes from that is essentially the entire indirect effect. So, if
21 I want to show that I have weighted this in some way, I have to show the indirect effect as
22 being smaller at that point than the MTPE.

23 Q But, you have relied on it for much more than that, have you not? You have relied on it for
24 getting specific ratios, 80 per cent ratio and such like, one-seventh of the MTPE should be
25 claimed. What I am asking you now is not whether you think Mr. Myers' approach was the
26 best —

27 A Yes.

28 Q — or whether your interpretation of this was right or wrong, but as it were, just trying to
29 establish where we are now. You have heard what Mr. Myers has explained about what he
30 intended by this diagram, and the fact that he was not putting the lines on intending to show
31 any particular quantitative relationship. If, as I think you do, you accept that that is his true
32 and accurate evidence as to what he did, then the very simple question is you presumably
33 accept, do you not, that the figures which you have derived, no matter whether reasonably
34 or not, the figures you have derived, are valueless?

1 A Okay, let us just be clear about this. I mean, if that were the case, then we should have
2 separate scales shown on this chart. Now, if that is an error on Mr. Myers' part, and he
3 thinks that that should have been shown either as three separate diagrams or with multiple
4 scales, I am entirely happy to accept that.

5 Q But we do not need to go that far. You may say it is an error on Mr. Myers' part. He may
6 say it is an error on your part in the interpretation you place, but the simple fact is that,
7 having heard the evidence he gave, without any "if"s or "but"s, the inferences you drew are,
8 whether reasonable or not, are valueless, are they not?

9 A No. I mean, I don't accept that, because I think he also pointed out yesterday the fact that
10 there are relativities within this diagram in terms of two particular scenarios, the full
11 reduction scenario and the case at which prices stay constant; and he did mention this, and
12 the diagram is a representation of that. It has a vertical scale, and I think we can draw
13 inferences from that.

14 Q Let me be clear, you are drawing inferences from the fact that the diagram has a vertical
15 scale, and from the fact that, in some sense there were relativities, you are saying that you
16 can draw assumptions about the precise ratio of A-B and C-B on this diagram. Is that the
17 evidence you are giving the Tribunal after having heard Mr. Myers' evidence?

18 A Well, I consider that Mr. Myers invited these comparisons to be made.

19 Q I have just made plain to you, that is not, we are not interpreting whether his was reasonable
20 or not. I am asking you to judge it now on the basis of the evidence which he has given
21 which you accept was truthful as to what he did, as to whether you can still draw the
22 conclusions that you were drawing or whether they are valueless?

23 A Okay, I consider I can still draw those conclusions. From what Mr. Myers said yesterday, it
24 was not my understanding from that evidence that these effects were incommensurate, as
25 shown on this diagram. I fully accept that this is illustrative, as I have discussed before, but
26 I can't see where he said that this was incommensurate on this diagram.

27 Q I think the Tribunal will be able to see Mr. Myers' evidence in due course. I do not think I
28 can take this matter any further at this stage. Can I turn to the topic of market failure and of
29 course Ofcom and BT agree that there is a situation of market failure that we are dealing
30 with here. Can I ask you to go to para.18 of your seventh statement, where you refer to
31 Ofcom's simplifying geographic numbers recent consultation document. I should say that
32 you are discussing here the cost benefit analysis and the size of the market failure, and you
33 say that that statement:

1 “... argues that the detriment associated with current pricing of 08X calls is
2 likely to be large (in the order of £500m per annum or more for NTS calls
3 which is roughly one-quarter of total NTS market revenue).”

4 You say at para.20:

5 “Ofcom’s ultimate conclusions about the impact of the NCCNs on economic
6 welfare are counterintuitive. Given the large magnitude of the market failure
7 due to excess 08X pricing by MNOs, one would expect that if the NCCNs lead
8 to lower retail prices, even if only a little lower, then it is reasonable to expect a
9 net improvement in economic welfare.”

10 Can I ask you to NGCS consultation back in bundle 13, please. It is tab 3.1, and would you
11 turn to p.192.

12 A Yes, I have it.

13 Q You will be familiar with this table showing the estimate of the annual consumer detriment
14 for over-estimation and it is broken down into all OCPs, fixed OCPs and mobile OCPs.
15 One sees that the aggregate of £563 million is broken down into £497 million attributable to
16 fixed OCPs and £66 million attributable to mobile OCPs – yes? It is right, is it not, as
17 indeed is stated immediately below the table in para.237 that high mobile charges may well
18 be one of the explanations for the perceptions of fixed customers. In other words, high 08
19 charges may not only affect the £66 million figure, but they may also affect it, in the sense
20 of being one of the causes of the £497 million figure for fixed OCPs?

21 A Absolutely, Ofcom says that, yes.

22 Q You would agree with that?

23 A That seems quite logical, given what we have here, yes.

24 Q It is right, is it not, that as well as the potential effect from high mobile call prices there are
25 other potential effects as well, are there not, causes for those numbers?

26 A Yes. My understanding of this is that this is related to customers over-estimating prices and
27 that can be shown against fixed and mobile volumes, but that isn’t the only issue here.
28 There are other externalities and sources of market failure as well.

29 Q So, for example, perhaps most obviously another cause of these figures would be confusion
30 between the different 08 number ranges, free on 0800, different charges for other ranges
31 leading to consumer confusion and distrust of the ranges?

32 A Well, that would depend on how Ofcom’s survey was constructed. I don’t really feel able
33 to comment about that.

1 Q I am just identifying one of the likely causes of the bottom line figure. I am not trying to
2 quantify it, or anything like that. It seems highly likely, in fact inevitable, that that is going
3 to be a contributing factor?

4 A Indeed, Ofcom, themselves, are sort of worried about 0845 and 0870 confusion. That seems
5 perfectly possible.

6 Q Indeed. You are not in a position to go further than Ofcom does in this document, are you,
7 on the relative weight of the causes of over-estimation by fixed line customers, for example,
8 are you?

9 A I'm not. What I took from this was essentially that Ofcom was offering a lower bound, and
10 I took from this probably the first significant digit of that number and not much more.
11 These estimates are obviously extremely difficult. As an order of magnitude assessment, I
12 thought that was potentially quite useful.

13 Q I am not asking you about the order of magnitude of the bottom line figure, I am asking you
14 about the different causes of the figures. Again, you are not in a position to offer evidence
15 as to how these figures have been made up from different causes, such as, for example, the
16 relative attribution from mobile charges being high, for example, on the one hand, and
17 general confusion between the different number ranges on the other hand?

18 A Obviously, they are Ofcom numbers and Ofcom may know about that. I certainly can't
19 offer any evidence. The only thing I would say is that we do know something about the
20 pricing behaviour of different operators within the market. So it seemed to me not
21 unreasonable to suppose that these numbers, as split between fixed and mobile were really
22 representing where an impact occurred. It wasn't representing a source, which I think is the
23 point that you're making.

24 Q Ofcom comment, I think it is para.A7.35, that it is plausible that high mobile 08 charges
25 may affect the reputation of 080 calls, for example, from fixed OCPs?

26 A Yes, that seems perfectly possible.

27 Q You then say in para.20 of your witness statement, that I just took you to, that, given the
28 large magnitude of the market failure, if the NCCNs lead to lower retail prices, even a little,
29 it is reasonable to expect a net improvement in economic welfare. That proposition
30 contains a big assumption, does it not, which is that the market failure will be substantially
31 ameliorated even in the situation of a small reduction in retail prices so as to lead to the
32 welfare improvement that you are anticipating?

33 A I think "substantial" is quite a strong word. Obviously the paragraph you have referred to is
34 in my kind of overview section at the beginning of my paper, and obviously I go into a lot

1 of detail later about the benefits versus the costs. Here we are primarily talking about the
2 benefits, and maybe if I just stick to this question of the direct effect, I certainly wouldn't
3 claim that that whole £500 million necessarily is something that is solvable purely by BT's
4 NCCNs, but I don't think I've said that. I think the point here is that even actually a
5 fraction of that is still – one easily gets to a number of which is in the hundreds of millions
6 or the large tens of millions, which is a significant number. This is fraught with uncertainty
7 in terms of quantification, but in terms of order of magnitude that seems to me a useful
8 point to take.

9 Q So there are two stages, are there not? The first stage, which we have already discussed, is
10 what percentage of that £500 million is actually attributable to high mobile prices, so it
11 comes within, as it were, scope of our analysis in the first place; and now we are moving on
12 to the second question of, of that percentage of the £500 million, what percentage of that
13 might sensibly be expected to be ameliorated by, for example, the change of these NCCNs?
14 That is the analytical framework, is it not?

15 A Indeed. On the second point, I think we can start to think about that because if the NCCNs
16 – clearly they don't reduce price to zero, that is in the case of 080 or indeed, necessary due
17 to a comparable level with geographical prices on 0845, 0870. But, on the other hand, if
18 they did reduce MNO prices to those levels generally, then that is clearly in my mind a
19 significant reduction and actually was a considerable reduction in uncertainty for customers.
20 I think simplifying, NGN lists lots of examples of customers who seem very uncertain about
21 prices, you know, experience bill shocks, cost of ringing and so on. It seems to me that over
22 a reasonable course of time at least some of those problems would actually be resolved to
23 quite a significant degree. It is obviously exceedingly different to put a number on that
24 which I think order of magnitude assessments are quite useful.

25 Q So you noted one potential complicating factor, even if prices fall to the lowest tier, which
26 is, as it were, BT's best case scenario, there will still be relatively substantial amounts
27 charged for these calls compared to the situation on BT fixed lines, 12.5ppm?

28 A Yes, there is still a differential, but I mean okay ----

29 Q You talk about a reduction of differential and what impact that has?

30 A Yes, but I think we also need to recognise the impact of uncertainty and imperfect
31 information for consumers here as well, and obviously in a best case scenario that is
32 actually quite significantly reduced, and indeed one would imagine actually largely
33 eliminating – still the differential would remain in terms of prices between ----

34 Q We would also have the possibility of different charges for different operators still?

1 A Yes, that is possible. In the best case scenario those differences would be quite small. I
2 think the existing situation has been that there have been quite significant differences in
3 headline rates. I suspect those will probably unsustainable in this scenario. I think there is a
4 significant improvement, but one would not necessarily expect that to be entirely resolved.

5 Q And in the partial reduction scenario which you were contemplating in these paragraphs,
6 where you said even a small reduction would make a difference. In that case there would be
7 a greater disparity of prices, would there not, or expected to be?

8 A Well not necessarily disparity ----

9 Q Sorry, disparity between mobile prices and BT's fixed line prices ----

10 A Indeed, yes.

11 Q -- there would be a greater disparity there?

12 A I think one wants to distinguish between disparity amongst mobile prices and disparity
13 between mobile and fixed prices.

14 Q I am asking about the latter??

15 A Indeed, yes, that is absolutely right, I mean this is a matter of degree in terms of how much
16 of that benefit is achieved.

17 Q In addition, the general confusion between the different number ranges will, of course, still
18 be there?

19 A Yes, that is right.

20 Q And that is the confusion which has led Ofcom to make the proposals it has in the NGCS
21 review, effectively it has decided that confusion is so bad it is better to scrap some of these
22 number ranges and start again?

23 A That is not the only reason, is it? There are other issues, that does not address the issue of
24 08 calls for example.

25 Q Can I just move on then from that to imagine the partial reduction scenario and just follow it
26 through, moving away from the particular estimates of the market failure, in the partial
27 reduction scenario where we are positing a smallish reduction in price only we are then
28 dealing with a fairly substantial termination price increase, therefore, are we not?

29 A Yes.

30 Q I am talking in very rough terms.

31 A Well, what were you thinking?

32 Q If we are in the partial reduction scenario and we only see a small reduction in prices by the
33 MNOs from their present level, we are then left with the MNOs being above the lowest,

1 | depending on their current average retail prices, they may be above the lowest level of the
2 | step still?

3 | A | Oh absolutely, yes, I mean ----

4 | Q | Some way up the line?

5 | A | -- the nature of ladder pricing is that they do not reduce the price much they will face a
6 | higher termination rate.

7 | Q | Of course, I understand that BT's case is that they will be incentivised to move their prices
8 | all the way down to the lowest step, but let us just assume for a moment, to analyse the
9 | situation where we are dealing with a partial reduction – a small reduction – in prices, and
10 | let us assume also for the purpose of looking at the scenario that there is a waterbed in
11 | operation so that at least a good chunk of the increased termination charges gets fed through
12 | to the mobile tariff package effect, we do not need to discuss how large a waterbed at this
13 | stage.

14 | A | Okay.

15 | Q | Now in this scenario it is right, is it not, that we have a welfare benefit flowing from the
16 | small amount of rebalancing that there is?

17 | A | We would, yes.

18 | Q | That arises because we are going some way to addressing the externality concerns and,
19 | indeed, as recognised by Ofcom's policy preference?

20 | A | And indeed, there is also a direct gain in consumer surplus from cheaper prices from these
21 | calls on the volume of calls made, apart from any externality issues?

22 | Q | Indeed, and the externality effects which are capable of improvement in that situation can
23 | perhaps be labelled as the brand quality improvement, and the volume effect from higher
24 | prices, if you want to break them down?

25 | A | Yes, there would be a volume effect. I think it is also worth just emphasising that there
26 | could actually be quite a significant reduction in price uncertainty for consumers even with
27 | this small reduction and that may actually have an appreciable effect on service providers –
28 | it is the previous discussion, I won't go back to that point.

29 | Q | On the basis of the previous discussion I might suggest to you that both those effects might
30 | plausibly be argued to be quite small in the situation of a small reduction in prices because,
31 | first of all you will not be achieving anything like uniform pricing where there has only
32 | been a small reduction in prices. There will not be any greater clarity or visibility of 08
33 | prices generally, that is fair, is it not?

1 A I think it is very difficult to tell in the case of a small reduction. I do not think you can
2 necessarily assume that. It would potentially stop particularly high prices for consumers, so
3 in that sense it may be that some of the worst examples of consumer complaint in
4 simplifying NGNs that Ofcom's lists may be avoided and there may be a greater degree of
5 predictability on retail prices, at least mobile retail prices.

6 Q It is also right, is it not, that if it is true that 08 services are not very price sensitive in the
7 sense that people are not generally aware how much 08 services cost and do not
8 discriminate on that basis, then a reduction in price may do little for the volume effect
9 either?

10 A Under your assumptions that's correct. I don't think we have any evidence for that. I think
11 the evidence, if anything, contradicts that.

12 Q The evidence suggests, does it not that headline mobile rates – if we are looking at different
13 mobile originated calls – the headline mobile rates, geographic calls, people are more price
14 sensitive about those than they are over 08 service calls?

15 A Yes.

16 Q Relative?

17 A Relatively I think that is true, yes.

18 Q So if we then look at what is on, as it were, the other side of the line in the scenario I am
19 positing, on the other side of the line the waterbed effect will operate?

20 A Under your assumptions, yes.

21 Q Under my assumptions they would have been an uncertain size, and that waterbed will flow
22 from two things will it not? It will flow first from the small price decrease that we have
23 posited, and it would also flow from the bigger increase in termination rates?

24 A It will, yes.

25 Q And that will affect the MNOs geographic prices to the extent it is passed through the
26 waterbed and, as you accept, there is good reason to believe that those are more price
27 sensitive than the 08 calls?

28 A They may be.

29 Q And so potentially at least the mobile tariff package effect could have a greater
30 proportionate impact in efficiency terms on the size of the mobile calls pie could they not?

31 A That does not follow automatically from what you have said so far.

32 Q But would you accept that it is likely to follow because the service is more price sensitive,
33 and to the extent that it is passed through – we are not making a judgment as to the likely

1 extent of pass through – but to the extent it is passed through it will have a price effect on
2 that service?

3 A Ah yes, but we also have to think about the sort of diluting effect of the fact that these NTS
4 calls are actually a very small proportion of the total revenue of the MNO which you have
5 not listed so far, so I think your conclusion does not follow without also making some
6 assumptions about that.

7 Q Because it is a much larger pie to begin with, as it were, because there are many more
8 mobile minutes. I want to pursue a little the potential different understandings of the nature
9 of the mobile tariff package effect, but can I do that by taking a step back and looking at a
10 suggestion you make at para. 52 of your statement ----

11 A Yes.

12 Q It is under the heading “The welfare standard” and it is on p.21 of your seventh statement.
13 You say there:

14 “... there is a sharp contrast between the welfare standard in Ofcom’s consultation
15 ‘Simplifying NGNs’ and the approach adopted in the Determinations and by Mr.
16 Myers. In ‘Simplifying NGNs’, Ofcom concludes that excessive margins earned
17 on 08X calls could lead MNOs to price other mobile services inefficiently low,
18 leading to under consumption of 08X calls and over-consumption of other mobile
19 services. Therefore, cheaper is not always better and there is an acknowledgement
20 that fixing the market failure in NTS pricing is desirable even if some prices rise
21 (and indeed specifically because inefficiently low prices rise.)”

22 A Yes.

23 Q I am struggling to see why you regard that as a contrast, let alone a sharp contrast with the
24 final determination or Ofcom’s position. Can I put a number of questions to you in that
25 regard?

26 A Yes.

27 Q In the final determination in the first place, Ofcom accepted that the full reduction scenario
28 was welfare beneficial did it not?

29 A It did, yes.

30 Q And that therefore tariff rebalancing was a good thing, 08 prices going down and other
31 prices going up?

32 A Yes.

33 Q In that scenario?

34 A Yes, it did.

1 Q And even in the partial reduction scenario it also maintained the same view that tariff
2 rebalancing was a good thing, and gave expression to that by giving the direct effect more
3 weight than the mobile tariff package effect, that is right, is it not?

4 A Well this is where it gets more complex, I think. Under that partial reduction scenario I
5 think Mr. Reid's diagram is quite helpful at this point – can I go back to that just because
6 everybody is using this to simplify matters.

7 Q Yes.

8 A I think the problem is under the partial reduction scenario you have really got two issues
9 within the waterbed, which is that there is that bit of the waterbed associated with the
10 greater unit termination costs, and that bit associated with the lower retail prices.

11 Q W and ----

12 A Exactly, so I think the issue is obviously that if rebalancing is beneficial then that allows us
13 to – I think this discussion has already been had to some degree – we can actually take
14 essentially A and W out because we know what the situation is in terms of that balance,
15 okay? Put that to one side as a positive ----

16 Q Yes.

17 A – which then allows us to concentrate really on analysing this BX issue, and also the
18 consequences of where B flows through. The slightly whimsical kind of pipe diagrams in
19 my report were essentially looking at this question of the BX analysis ----

20 Q Well I was just interested in the pipes ----

21 A They were only illustrative of course. I did have some algebraic symbols on them on the
22 other hand. I think the issue here is really that once we break this up into these two parts I
23 think we can then clearly see the tariff rebalancing issue separately from the issue of the
24 higher unit termination cost. My problem is that, you know, that is quite a helpful way of
25 doing it, that is not really in the final determination and one sees the whole MTP as being
26 effectively cost, whereas some of that MTP is associated with rebalancing as I think we
27 agree is actually beneficial once you look at the retail price side.

28 Q So would it be fair to say that your criticism of the final determination of Mr. Myers is
29 perhaps represented by what you say at para. 112 of your statement, and I think this is
30 picking up the same point. You say that:

31 “For example, in his explanation of Ofcom's analysis, Mr. Myers does not think in
32 terms of the prices of other mobile being cross-subsidised from excess margins on
33 O8X calls as a problem, but rather a benefit to mobile customers:

1 *‘In this no reduction scenario, termination charges increase due to*
2 *NCCNs 985 and 986, and the average prices paid by mobile consumers*
3 *across their whole bundle of services go up ... This is because the TCP is*
4 *taking money from the pocket of MNOs, which triggers the negative*
5 *Mobile tariff package effect (whilst in this scenario there is no positive,*
6 *offsetting Direct effect for mobile consumers of lower 0845/0870 prices)’ ”*

7 A Yes.

8 Q And then the bit you have underlined:

9 “Overall in the no reduction scenario, there is a net detriment to
10 consumers and economic efficiency because the negative Mobile tariff
11 package effect is likely to exceed the positive but uncertain Indirect
12 effect.”

13 And I think you are effectively commenting – the third line of the next paragraph:

14 “*In the Determinations Ofcom did not see lower prices for mobile services arising*
15 *from a waterbed effect as the flip side of excessive prices for 08X calls (which of*
16 *course means that any significant change in the prices of mobile services can only*
17 *occur if 08X prices are particularly excessive), but rather as a currently enjoyed*
18 *benefit to mobile customers that could be lost.”*

19 A Yes, okay. I mean I think the issue here is really an issue about slicing up effects essentially,
20 because the problem with the determination is the way Ofcom has sliced things it makes it
21 very difficult to compare and actually it is not conducive to reaching overall conclusions,
22 the divisions that are made. The point here is really that we have the MTPE largely being
23 weighed up against the indirect effect, okay, that analysis being done, a result being
24 produced and then compared to the direct effect, the problem with that is that that is a very
25 difficult thing to do because the MTPE essentially has within it some things which are
26 really associated with the generation of benefits and are not really costs I think, in a way
27 what I was doing in the report was actually more detective work to work out where Ofcom’s
28 conclusions were coming from, but if I were to put this the other way around and say: “How
29 should one do it positively?” clearly there is a lot of benefit in splitting the MTPE up into
30 those bits which were associated with rebalancing and those bits which were associated
31 with high unit costs in the case of the partial reduction scenario.

32 Q I am going to suggest to you that there really is nothing between you and Ofcom on this
33 issue, and that the difference which you set up and the criticism you make is not right, if one
34 properly understands the approach of the determination and indeed, of Mr. Myers. In the

1 first place it is right, is it not, that Ofcom did distinguish effectively W and X, the two
2 different sorts of mobile tariff package effect? For example, if you look at para.8.150 of
3 the final determination, back in bundle B1?

4 A I have it.

5 Q If you could just read that paragraph to yourself rather than me reading it all out?

6 A (After a pause) Yes.

7 Q Is it effectively making that distinction?

8 A Yes, I think it is a helpful distinction to make.

9 Q Yes, indeed, absolutely, and I have to say I found Mr. Reid's diagram very helpful myself.

10 But in the paragraph we were just looking at, para. 112, is it not right that Mr. Myers and,
11 indeed, Ofcom's position as they are expressed is merely that whereas the negative mobile
12 tariff package effect can be beneficial as part of tariff rebalancing i.e. where it is
13 accompanied by positive direct effect, but on its own it remained a negative effect?

14 A On its own it clearly is, under that scenario it is a negative effect.

15 Q Just as if you took box X out of this diagram artificially and asked whether, in welfare
16 terms, it was a good or a bad thing, it is absolutely a bad thing?

17 A Under the no reduction scenario, just to be absolutely clear and to make sure we understand
18 each other, this para.112 is referring to the no reduction scenario. Under that case the
19 MTPE is entirely a negative effect which is then to be balanced against – to be balanced
20 against – the indirect effect. I think what I go on to say, the reason that I look at that case is
21 because my concern is, specifically with that case, that we have essentially a positive and a
22 negative that are of roughly equal size in that case, which is how I reached the conclusion
23 that I do not see that there is likely to be a particularly large net detriment in that case.

24 Q Can we leave aside for the moment the balancing with the SP because that is another whole
25 issue?

26 A Sure.

27 Q I am just looking at the understanding of the mobile tariff package effect first. What
28 Mr. Myers is referring to in the last sentence of 112 that you criticise is, he is, as it were,
29 taking box X out on its own and looking at it, is he not? In the no reduction scenario there
30 is a net detriment to consumers in economic efficiency because the negative mobile tariff
31 package effect – that is the bit on its own, and then he is comparing the two – is likely to
32 exceed the positive but uncertain indirect effect. That is a perfectly fair way of looking at it.
33 That does not imply he is against tariff balancing or he thinks there are not situations when

1 it is an advantage to have a negative mobile tariff package effect. He is purely doing the
2 weighing exercise there, is he not?

3 A He is, yes.

4 Q There is nothing wrong with doing it that way, is there, never mind the conclusions that you
5 reach in doing the weighing for the moment?

6 A No, under that scenario – okay, I see your point in that clearly under this scenario, the no
7 reduction scenario, it says nothing whatsoever about tariff rebalancing, absolutely, yes, and
8 it's simply ----

9 Q The same logical point applies even if you are in the partial scenario. As long as you are
10 talking about the B and X component of ----

11 A If you've made that split, but that's not a split which is made by Ofcom in the final
12 determination, they don't adopt that analytical framework.

13 Q I am not going to get involved in archaeology with you about the final determination and
14 what it says. Clearly, Mr. Myers makes that distinction, does he not?

15 A Well, he makes a distinction between those cases, but what he doesn't do is to split the
16 MTPE, I don't believe.

17 Q Would you agree that the only way that a price rise in box X on its own might be beneficial
18 would be perhaps if the prices being priced at under marginal cost – you actually got a sub-
19 marginal cost pricing scenario, there might be economic arguments that on its own the price
20 rise was beneficial. That is not a situation we are dealing with. Even that might open a can
21 of worms, but that is not a situation we are dealing with, is it?

22 A I think you don't need to press this. I entirely take the point that box X is entirely a cost
23 under the no reduction scenario. I think that is entirely clear.

24 THE CHAIRMAN: Mr. Herberg, would that be a convenient moment?

25 MR. HERBERG: That would, sir.

26 THE CHAIRMAN: In that case we will say 10.30 tomorrow morning.

27 (Adjourned until 10.30 am on Wednesday, 13th April 2011)

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