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IN THE COMPETITION APPEAL TRIBUNAL

Case No: 1284/5/7/18
1290/5/7/18

Salisbury Square House
8 Salisbury Square
London EC4Y 8AP

Thursday 9 June 2022

Before:
The Honourable Mr Justice Michael Green
Derek Ridyard
Sir Iain McMillan CBE FRSE DL
(Sitting as a Tribunal in England and Wales)

BETWEEN:

Royal Mail Group Limited
BT Group PLC and Others v DAF Trucks Limited and Others **Claimants**

v

DAF Trucks Limited and Others **Defendants**

A P P E A R A N C E S

Tim Ward QC, Ben Lask and Cliodhna Kelleher (On behalf of RM/BT)
Daniel Beard QC, Daisy Mackersie and James Bourke (On behalf of DAF)

1 Thursday, 9 June 2022
2 (The hearing commenced in private - see separate transcript)
3 (11.46 am)
4 (In public)
5 THE CHAIRMAN: Good morning again.
6 Right, Mr Delamer needs to be sworn in. We are in
7 open session now?
8 MR BEARD: We are in open session. I had a quick word with
9 Mr Lask. He thinks until at least lunchtime we can stay
10 in open, but it is with the usual caveat that if
11 Mr Delamer wants to say anything confidential, then to
12 indicate and then we can pause or deal with it later.
13 MR JULIAN DELAMER (affirmed)
14 THE CHAIRMAN: Thank you. Please sit down, Mr Delamer.
15 Examination-in-chief by MR BEARD
16 MR BEARD: Again, Mr Delamer, you have provided three
17 reports and signed a joint expert statement in relation
18 to these matters?
19 A. In relation to financing, correct.
20 Q. Thank you. Subject to a couple of corrections I will
21 come to, are those true to the best of your knowledge
22 and belief?
23 A. They are.
24 Q. Thank you. Now, you made two corrections which were
25 actually communicated to Royal Mail and BT by way of

1 a letter which can be found -- and we will not call it
2 up because it has some confidential material in. It is
3 at {J4/OC428}. Now, I am not going to go through those
4 corrections. Mr Lask has them. They are available.
5 I doubt that they are going to be in any way material
6 for cross-examination so it is really just for the
7 record. You have seen that letter?
8 A. Correct, yes. Two minor corrections in preparing for
9 today.
10 MR BEARD: Sir, I will leave it, if that is okay --
11 THE CHAIRMAN: That is fine.
12 MR BEARD: -- so we can stay in public and do not need to
13 pull anything up.
14 Thank you. I do not have any questions for you
15 Mr Delamer but I imagine Mr Lask may have one or two.
16 MR LASK: Thank you.
17 Cross-examination by MR LASK
18 MR LASK: Good morning, Mr Delamer.
19 A. Good morning.
20 Q. I am going to start by asking some questions about the
21 relevance of the WACC as a measure of Royal Mail's
22 financing costs.
23 You agree, I think, with Mr Earwaker that the WACC
24 is a blend of the cost of debt and the cost of equity;
25 yes?

1 A. Correct.
2 Q. You would accept, I think, that the use of debt
3 financing, for example to fund expenditure on trucks,
4 entails a cost to the company; yes?
5 A. Yes, an interest cost.
6 Q. But overall you disagree with Mr Earwaker that the WACC
7 is an appropriate measure of Royal Mail's financing
8 costs in this case; yes?
9 A. Correct.
10 Q. Essentially you disagree because you disagree that the
11 use of equity financing, so a core component of the
12 WACC -- you disagree that that entails a cost to the
13 company; yes?
14 A. It does not entail a monetary cost to the company.
15 Q. A monetary cost?
16 A. A monetary cost.
17 Q. I see. I want to ask you, if I may, about the basis for
18 your disagreement, please. I want to start by asking
19 you to confirm a few basic and, I anticipate,
20 uncontroversial propositions that are based on your
21 reports. I do not anticipate it is going to be
22 necessary to turn up your reports, but if at any time
23 you want me to show you where the proposition comes
24 from, then do ask for it and I will give the relevant
25 reference.

1 Firstly, firms are financed through equity either by
2 issuing new shares or by re-investing their earnings;
3 yes?
4 A. Correct.
5 Q. It is fair to say, is it not, that re-investment of
6 earnings is a common form of equity financing; yes?
7 A. It is.
8 Q. In return for their investment, investors expect to
9 receive dividends from the company's residual profits;
10 yes?
11 A. Not necessarily dividends. They invest in the hopes of
12 receiving a return. Dividends is a common way of
13 receiving that kind of return but it could be in other
14 forms as well.
15 Q. One other form would be an increase in the value of the
16 shares, capital appreciation?
17 A. Correct.
18 Q. But there is no contractual guarantee of either, is
19 there?
20 A. No.
21 Q. The expectation that equity stakeholders have is
22 measured by the cost of equity; yes?
23 A. That is, yes, one way to measure it.
24 Q. Thank you. If we could turn up, please, paragraph 40 of
25 your first statement. Are you using hard copy bundles

1 or the screen?
2 A. Yes -- I mean, depending on the nature of the question,
3 I do prefer hard copies.
4 Q. It is absolutely your preference. So I think your first
5 report is at tab 4 of the hard copy and the Opus
6 reference is {E/16/22}. It is paragraph 40, {E/16/23},
7 I would like to ask you about. Do you have that?
8 A. Yes.
9 Q. You say:
10 "To sum up, equity holders get whatever is left
11 after all the firm's costs (including debt financing
12 costs) are paid. Contrary to debt repayments, the
13 returns earned by equity stakeholders do not represent
14 per se a cost to the firm, nor does their expected
15 returns (as measured by the cost of equity) affect the
16 company's costs."
17 What do you mean by "per se" in this context?
18 A. Well, it is not a monetary cost, as I mentioned earlier,
19 so it is not a cost as the other costs, all of which are
20 monetary costs. So you need to pay for salaries, that
21 is a monetary cost; you need to pay for trucks, that is
22 a monetary cost; you need to pay interest on your debt,
23 that is a monetary cost. This is not a monetary cost.
24 Q. Are you distinguishing here between monetary costs and
25 other sorts of costs?

1 A. Indeed I am.
2 Q. So there are non-monetary costs that may be relevant?
3 A. So, as Mr Earwaker explained earlier today and
4 yesterday, the notion of economic cost, which is
5 a theoretical cost, so it is a theoretical
6 representation of, in this case, the opportunity cost
7 for the shareholders. So this is what we are describing
8 here and here is the main disconnect between, I believe,
9 our opinions.
10 Q. You describe it as an economic cost but a non-monetary
11 economic cost. Do you say that is only a cost to the
12 shareholders or might it also be a cost to the company?
13 A. It is an opportunity cost to the shareholders because
14 shareholders invest in a company expecting to get
15 a return -- right? -- and they could have invested
16 elsewhere. So this is the basic premise and that is an
17 opportunity cost for the shareholder. The company in
18 which they invest, they are aware of that expectation of
19 the shareholders and these economic models are a way to
20 internalise those expectations of the shareholders in
21 a practical tangible way within a business, but it is
22 still an economic model to try to capture, measure and
23 do something about those expectations of the
24 shareholders.
25 Q. So they are a way of measuring the cost to shareholders

1 and sort of capturing how it might be relevant to the
2 company; is that fair?
3 A. It is a way of estimating, yes, with financial models
4 the expected returns of shareholders, the opportunity
5 cost and internalising that into the business.
6 Q. I see. Thank you.
7 SIR IAIN MCMILLAN: May I ask a question?
8 MR LASK: Of course, please.
9 SIR IAIN MCMILLAN: Is your position here that the dividend
10 to the shareholders is not a cost because it is
11 a distribution, a non-contractual distribution, that is
12 paid to the shareholders after the profit and loss
13 account has been finalised?
14 A. Yes, in part, yes. The better the company does, the
15 more profits it generates. If it is distributing all of
16 that profit in dividends, the dividends go up. So one
17 would not say that the cost is going up because the
18 company is doing very well and paying more dividends
19 because it is not a cost. It is the ultimate profit
20 generated and if it is distributed to the shareholder
21 through a dividend, so be it. But it is a profit, it is
22 not a cost.
23 SIR IAIN MCMILLAN: Okay. So just a follow-up, if I may, it
24 is not part -- the cost of the dividend is not part of
25 the profit and loss account because it is a distribution

1 after that figure is struck but it still has an impact
2 on the company's cashflow?
3 A. Yes. If a dividend is paid, it is a cash outflow that
4 leaves the company, but a very specific kind of cash
5 outflow, which is the distribution of those profits and
6 how it is extracted from the balance sheet because it
7 impacts both assets and liabilities. Both are impacted
8 and that cash goes to the ultimate owners of the
9 company, who are the shareholders. So it is
10 a distribution of the profits.
11 SIR IAIN MCMILLAN: Thank you.
12 MR LASK: Thank you, sir.
13 Could we turn, please, to paragraph 61 of this
14 statement, which is at page 31, {E/16/31}. You are in
15 the same bundle, Mr Delamer. At paragraph 61 you say:
16 "A company's shareholders receive the residual cash
17 flows left after all costs (including debt) have been
18 paid. In that sense, equity investors participate in
19 the upsides and downsides of the company. If the
20 company's profitability is impacted by a certain event
21 (such as the alleged overcharge), the ultimate value
22 received by the shareholders, (through either dividends
23 or capital appreciation) may change, but the company
24 will not face any higher or lower financing cost
25 associated with its equity investors."

1 Then you will see there is a footnote there, 75.
2 Could we scroll down so we can see that, please? This
3 is a qualification to what you say in the main body.
4 You say:
5 "If a company relies on raising fresh equity capital
6 as a source of funding, an event that negatively affects
7 its profitability (such as an overcharge) could
8 potentially make it more expensive for the company to
9 raise capital (ie, it would be able to raise less
10 capital for the same number of shares issued)."
11 Then you go on to say that the claimant has not
12 raised any fresh equity capital.
13 So based on that qualification, if a company were to
14 fund an overcharge by raising fresh equity, your
15 position, as I understand it, is that this would
16 represent a cost to the business because it would be
17 receiving a smaller injection of capital than it would
18 have otherwise; is that fair?
19 A. No, I do not think it is. For this to have an impact it
20 has to be really a very significant event, something
21 that affects -- that fundamentally changes the prospects
22 of the company's profitability into the future because
23 that is really what determines the cost of raising
24 capital, is the expectations into the future.
25 So you would have to have something that has a very

1 big impact that would affect one of two things, to be
2 honest: the expected profitability in terms of cash
3 flows and the expected risk or discount rate applied to
4 those cash flows. Mr Earwaker has already explained
5 that it is not his position that the discount rates or
6 the cost of equity has been affected by the overcharge,
7 so I think that is not in the question. Then in terms
8 of the impact on, you know, the expected profitability
9 of cash flows, it would have to have a significant
10 impact for that to have an effect on raising new equity
11 capital and for it to be more expensive.
12 Q. So I think what you are saying is it is a matter of
13 degree and depending on the magnitude of the
14 expenditure, so, for example, depending on the magnitude
15 of the overcharge, it could become more expensive to
16 raise fresh equity and that would represent a cost to
17 the business; no?
18 A. Ultimately not to the business but to the shareholders.
19 As many of the books cited by Mr Earwaker explains, when
20 you issue more equity, what you are really doing is
21 diluting existing shareholders. You are diluting the
22 participation of existing shareholders. So in order to
23 break even with your shareholders, that additional
24 capital needs to be invested in a business and generate
25 the profit that can provide the new shareholders and the

1 old shareholders to get this high rate of return. So at
2 the end of the day it looks back to the shareholders'
3 profitability.
4 Q. I am just looking at your footnote 75 where you talk
5 about an event that negatively affects a company's
6 profitability, making it more expensive for the company
7 to raise capital; not for shareholders, for the company.
8 That is why I am asking or I am putting the point to you
9 that it appears to be your position that, where
10 a company relies on raising fresh equity to fund an
11 overcharge, depending on the magnitude of the
12 overcharge, the overcharge could result in a cost to the
13 company.
14 A. A cost in the sense of issuing more shares to raise the
15 same amount of capital, but you see that has really an
16 impact on the shareholders, not on the firm's P&L, on
17 the net income of the firm. It really has no impact on
18 that.
19 Q. So in what way is it more expensive for the company,
20 which is what you say in footnote 75?
21 A. In the sense that it has to issue more shares for the
22 same amount of capital.
23 Q. I see. From an economic perspective there is no
24 difference, is there, between issuing new shares and
25 retaining earnings within the business?

1 A. Well, from -- if we take a Modigliani-Miller economic
2 approach of efficient markets, no taxes, no costs, yes.
3 That is not real life. There are some differences in
4 one way or the other.
5 Q. Thankfully neither you nor Mr Earwaker have relied on
6 the Modigliani-Miller theory so far in this case so I am
7 not going to ask you any more questions about that.
8 A. No, it is the only way in which to answer your question.
9 It is exactly the same. It is only in efficient no cost
10 environment, as these economic models sometimes operate
11 in, but they are models, which then in practice things
12 work slightly different.
13 Q. They are stylised models; yes?
14 A. Sorry?
15 Q. They are stylised models; yes?
16 A. I am not sure what "stylised" means, but it is the
17 theoretical framework under a certain -- and the
18 assumptions under which some economic models operate and
19 those determine the outcomes, and these models, these
20 initial models, go back to the 1970s and they have
21 evolved and have become more complex. They are
22 internalised now in, for example, the decision to buy
23 back shares or pay dividends. When the tax rates apply
24 to share buy-backs and dividends, it is different. It
25 is more efficient to do one or the other from the

1 shareholder perspective. So it has practical
2 implications in which approach a company takes to
3 benefit its shareholders.
4 Q. Can I ask you to engage in a thought experiment with me?
5 This is a very simplified stylised example. Suppose you
6 invest £10 in my company and I run the business well and
7 I make a 50% return on your investment, one option is to
8 pay you a dividend of £15, but I consider that and
9 I decide that I would rather have that £15 to further
10 invest, to buy some supplies for running the business,
11 for example, so I can pay you the dividend of £15 and
12 then ask for it back as fresh equity or I can simply
13 keep the £15 and use it to buy further supplies.
14 Are you with me so far?
15 A. Almost. If you had a 50% return --
16 Q. Sorry, may I just finish the point? I am asking the
17 question. As long as you are with me, it is all right.
18 A. I am not with you.
19 THE CHAIRMAN: I am not sure he is with you at the moment.
20 A. If you made a 50% return, you would pay me a dividend of
21 £5, not £15.
22 MR LASK: Yes, I am sorry. So my maths is off, is it?
23 Apart from that, are you with me? Are you following the
24 example I am trying to engage in?
25 A. Yes.

1 Q. From an economic perspective there is no difference, is
2 there, between me paying you the dividend and then
3 asking for it back in the form of fresh equity, on the
4 one hand, and, on the other hand, just keeping it and
5 re-investing it?
6 A. Just in the Modigliani-Miller world because, if you pay
7 me a dividend, I would probably have to pay taxes on
8 that and then re-invest it so there is an implication.
9 It is not exactly the same.
10 Q. All right. Thank you. Could we go, please, to
11 Mr Earwaker's first statement at {E/9/15}? This is
12 tab 3 of your bundle, Mr Delamer. If we scroll down,
13 please, to paragraph 2.17. Do you have that?
14 A. Yes.
15 Q. You see there Mr Earwaker says:
16 "The expectation is that a well-run company will
17 then make good this opportunity cost of capital [which
18 has been referred to in the previous paragraph] through
19 the payouts that it makes to providers of both debt and
20 equity finance and, more generally, in the way that it
21 acts as a steward of company monies. Among other
22 things, the managers of such a company can be expected
23 to do one or more of the following [things]:
24 "be cognizant of investors' required rates of return
25 when setting annual profit targets;

1 "use the cost of capital as a 'hurdle rate' when
2 evaluating ... investments ...
3 "retain earnings within the company only when they
4 can identify ways of generating returns ... that exceed
5 the opportunity cost of capital ..."
6 If we scroll down, please, {E/9/16}:
7 "pay out as dividends or distributions to
8 shareholders any excess cash that cannot be used for
9 these purposes."
10 Then he says:
11 "Through these kinds of actions, the company
12 internalises the investor opportunity cost of capital as
13 an ongoing cost to the business."
14 Do you agree with Mr Earwaker's description of how
15 a company or a well-run company at least will
16 internalise the investors' opportunity costs?
17 A. Well, he mentions several things here but in general
18 I agree with this and we exchanged reports
19 simultaneously and I think I have a very similar list in
20 my first report.
21 Q. Okay. Thank you. Do you agree that using the WACC as
22 an investment appraisal tool is one of the ways in which
23 a company internalises the investors' opportunity costs?
24 A. Absolutely.
25 Q. Thank you. You would accept, I take it, that a company

1 will strive to deliver the returns required by its
2 investor equities; yes?
3 A. In theory management will try to invest in projects that
4 will allow it to cover all of its costs, its financing
5 costs and provide its shareholders with a return
6 commensurate with expectations. Yes, that is what in
7 theory should happen.
8 Q. We have established that it does not have any
9 contractual obligations to the investors in that regard
10 so it is not doing it because it is contractually
11 obliged, but it is not doing it out of a sense of
12 altruism either, is it?
13 A. No, it is doing it because the shareholders, when
14 investing, when buying shares, get what is known in the
15 literature as "control". So debt investors get a right
16 to cash flows. It is contractually based and the
17 company needs to repay the monies and pay interest, you
18 know, in a very well determined way, and if they do not,
19 they have a right to sue the company -- you know, to
20 take the company to court, to make it bankrupt if
21 necessary.
22 Shareholders do not get that. They invest and they
23 are, you know -- all things equal, they just have to see
24 what happens with their investment and how the company,
25 you know, operates. But what they do get is control.

1 What do I mean by "control"? Control either directly or
2 through the board is that they do have a say in big
3 decisions, investment decisions, restructuring
4 decisions, and they also have a say in sacking senior
5 management and appointing new management. That is
6 control; right?
7 So, yes, the managers of a firm do not try to
8 achieve, you know, the returns for their shareholders
9 out of altruism; they do it because they will get sacked
10 if they do not. That is a possibility. Also how the
11 corporate governance of the company -- I am simplifying
12 things, but that is the concept. Shareholders get
13 control and get a way to sway how the company operates,
14 to maximise the chances of them getting the returns they
15 expected, which are not guaranteed.
16 Q. I think you would agree with me, therefore, that the
17 reason or at least a reason that a company internalises
18 its investors' opportunity costs when taking its
19 commercial decisions is because it matters to the
20 company whether it is able to deliver returns in line
21 with those expectations?
22 A. It matters to the management, of course.
23 Q. Yes, because failing to meet those expectations, whether
24 by making dividend payments or delivering capital
25 appreciation, may, as I think you have described, have

1 adverse consequences for management?
2 A. Yes, which is not monetary cost adverse consequences.
3 They are other kind of consequences. I think here is
4 the main disconnect, I believe, in this whole point
5 because, if I may, I think we agree with Mr Earwaker on
6 the literature, on the economic models, because, as
7 I have just explained, shareholders invest in companies
8 expecting a return but then what they can do about it is
9 limited; right? Shareholders -- sorry, management
10 receive shareholder money to invest in the business and
11 try to get this return -- right? -- so they face this
12 question of: how do I do this? How do I decide which
13 investments achieve this?
14 So what they do is -- and here is where the economic
15 theory comes in to help management because all of these
16 books talk to managers on how to deal with these
17 questions, so you need to invest in projects that will
18 cover all of their costs, fixed costs, variable costs,
19 and then have enough profits to be able to repay or
20 service your debt -- that is where the cost of debt
21 component of the WACC comes in -- and then in theory you
22 need to generate a return that will keep your
23 shareholders happy, you know, give the shareholders
24 their required rate of return, and that is the cost of
25 equity, which is synonymous to opportunity cost of the

1 shareholder, cost of equity.
2 So economists have devised these models and the WACC
3 comes out of this cost of debt, cost of equity, to help
4 management with this capital turn around and say, "Okay,
5 what investments am I going to select? I am going to
6 select investments that yield the WACC or some that are
7 expected to yield the WACC so I can turn around, pay all
8 of my cost, pay my debt and give my shareholders the
9 return they expect".
10 So this is how this economic theory, that we agree
11 with Mr Earwaker what it means, actually works in
12 practice. It is a tool for management to try to select
13 investments that will allow them to do all of this and
14 give the shareholders a return.
15 Now, this cost of equity, which represents the
16 opportunity cost, when I say it is not a monetary cost,
17 it is because it is not. It is just a theoretical tool
18 which helps in real life managers decide on investment
19 opportunities to hopefully give their shareholders the
20 return they want. But that return is not a cost to the
21 firm. Returns then can be a bit higher, a bit lower.
22 It does not change the cost with the shareholders. It
23 just provides slightly higher or lower returns. So
24 I think this is important because we agree on the theory
25 but disagree on how this works in practice.

1 Q. Yes, thank you. The question I asked was whether you
2 agreed that failing to meet its investors' expectations
3 could have adverse consequences for the company or for
4 the management and I think you agree with that.
5 A. Absolutely.
6 Q. I think you said that one way in which it could have
7 adverse consequences is because the management could get
8 sacked; yes?
9 A. Absolutely.
10 Q. Are there other ways? So, for example, might it also
11 lead to the value of the company falling if it cannot
12 meet its investors' expectations?
13 A. But that is not a concern of the company. That is
14 a concern of the shareholders.
15 Q. So the company does not care or the management do not
16 care if the value of the company falls?
17 A. If the equity value -- right? -- the market
18 capitalisation or the equity value of the company
19 falls -- I think we are discussing that.
20 Q. Yes.
21 A. If that falls, shareholders will not be happy and
22 shareholders will use whatever tools of control they
23 have to try to, you know, get back on track, being
24 revising management, being assessing big investment
25 projects, whatever the board is concerned with or the

1 shareholders.
2 Q. So ultimately it could have an adverse impact on the
3 company because the shareholders will, as you say, take
4 action to express or reflect their disappointment?
5 A. Absolutely. My clarification is that the equity value
6 going down is not a direct concern of the firm. The
7 shareholders will be concerned and then they will
8 have -- they will use whatever tools they have on the
9 firm.
10 Q. Yes. Could we go, please, to your third statement which
11 is in tab 8? For Opus, it is {E/72/17}. So it should
12 be page 17 of your bundle.
13 Could we just scroll up, please, so we can see a bit
14 more of this paragraph 27? Do you have that,
15 Mr Delamer?
16 A. Yes, I am here.
17 Q. This is where you are agreeing with statements that
18 Mr Earwaker set out from the corporate finance textbooks
19 which I will come back to. I want to focus on what you
20 say at 27(d). So you are listing a number of things you
21 agree with Mr Earwaker on. If we look at (d), please,
22 you say you agree that:
23 "The return expected by capital providers
24 intrinsically depends on the risk of the business."
25 That means, does it not, that the riskier the

1 business or the riskier the business is perceived to be
2 by investors, the higher the expected returns; yes?
3 A. Correct.
4 Q. Would you accept that, all else being equal, a company
5 that fails to deliver returns in line with its
6 investors' expectations will be seen as a riskier
7 investment?
8 A. I think there it depends on the magnitude of that
9 change.
10 Q. But potentially?
11 A. Potentially, yes.
12 Q. So if a company -- and this may be the point you were
13 making at footnote 75 in your first report, which we can
14 go back to if you need to -- but if a company fails to
15 meet its investors' expectations, so if it pays out
16 fewer or lower dividends than its investors hope for,
17 this may make it harder for it to raise fresh capital in
18 the future or may mean that the returns required by the
19 investors are higher; yes?
20 A. It is a possibility.
21 Q. Is that not another reason why it matters to the company
22 that it can meet its investors' expectations?
23 A. Well, two things. First, as I clarified, in the end it
24 matters to the existing shareholders really, not to the
25 company itself, but, second, I think this is a bit

1 academic because Mr Earwaker said very clearly that he
2 does not consider that an overcharge would have an
3 impact on the cost of equity. So what I am discussing
4 here in 27(d) we agree with Mr Earwaker is not something
5 that has happened in this case.
6 Q. Sorry, are you referring to what Mr Earwaker says about
7 the raising of fresh equity?
8 A. No, no, I am referring to in the joint statement he at
9 one point clarifies that -- I do not want to --
10 I paraphrase, but by now means -- does not mean that the
11 impact of the overcharge has had a change in the
12 percentage cost of equity of the firm; right? So he is
13 saying that, because there was an overcharge that, you
14 know, reduced your profits, that does not change the
15 cost of equity in percentage terms. We can look up the
16 joint statement.
17 Q. It may be helpful to look at that at some point, but
18 perhaps the reference can be found at a convenient
19 moment.
20 MR BEARD: If it is convenient, {E/IC85/8}. I think this is
21 the reference. So it is in C4. Perhaps Mr Lask --
22 A. Yes.
23 MR LASK: Do you have that in front of you?
24 A. On the screen, yes. If I can read it out, Mr Earwaker
25 says:

1 "... I have not at any point stated, and do not
2 consider, that the percentage cost of equity was
3 impacted as a result of the overcharge."
4 So bringing that back to point 27(d) of my third
5 report, my point is that, yes, if a company is seen to
6 be significantly riskier than others, then the cost of
7 equity would increase, but that is just not something
8 that either Mr Earwaker or I believe happened in this
9 particular case.
10 Q. What do you understand a percentage cost of equity to
11 mean? I ask because obviously Mr Earwaker has finished
12 giving evidence, but we are dealing with a dispute
13 between you and Mr Earwaker as to whether the WACC is an
14 appropriate measure of financing costs. Obviously
15 Mr Earwaker has expressed the view that it is an
16 appropriate measure of Royal Mail's financing costs in
17 this case, so how do you understand this point he makes
18 here to fit with that overall view?
19 A. I think the only way I can interpret this is -- so he
20 has computed a stream of percentage values, yearly
21 percentage values, for the cost of equity, for the
22 claimant's cost of equity, 10%, 12%, 9%, whatever it is.
23 He is saying there is no difference to that number in
24 the actual and counterfactual worlds; in other words,
25 with or without the overcharge, that percentage, equity,

1 cost of equity value, is the same.
2 THE CHAIRMAN: This is just about calculation of the WACC,
3 is it not?
4 A. Yes, exactly.
5 THE CHAIRMAN: Calculation of the WACC.
6 A. Yes.
7 THE CHAIRMAN: It is not whether WACC is the appropriate --
8 A. Absolutely. Absolutely, and just I brought this to the
9 attention of -- when I was taken to 27(d) where I am
10 listing -- I mean the title of the section says,
11 {E/72/16}, "Points of Agreement in Relation to the
12 'Orthodox Economics/Corporate Finance' Theories". It
13 was just setting the affirmation that essentially
14 Mr Earwaker and myself, we agree on the theory, that
15 there is no point of disagreement. This point is one of
16 many high-level theoretical points, but I am just, maybe
17 for efficiency, saying I do not think this applies in
18 this case because we agree with Mr Earwaker that there
19 has been no change in the risk profile of the claimant
20 because of the overcharge. There is no change to the
21 cost of equity.
22 MR LASK: I think I understand the position. Thank you.
23 The question I was asking you was at a level of
24 principle, which was whether, if a company fails to meet
25 its investors' expectations, it may make it harder for

1 it to raise capital -- sorry, raise fresh equity in the
2 future or may mean that the expected returns are higher
3 and that that matters to the company. So I am asking
4 you at a hypothetical level and I think you agree with
5 that, but please say if you do not.
6 A. Absolutely, hypothetically, yes.
7 Q. Thank you. Can we go, please, to Mr Earwaker's second
8 statement at paragraph 3.7? It is tab 5 of your bundle,
9 Mr Delamer, and for the Opus reference it is {E/32/15}.
10 This is where Mr Earwaker sets out a series of
11 extracts -- do you have that? -- from corporate finance
12 textbooks.
13 A. Yes.
14 Q. He says:
15 "Speaking as an economist, I can be clear that
16 Mr Delamer's 'cash outflows or liabilities' only
17 formulation is unnatural and unduly constraining. The
18 notion that shareholder equity capital comes with a cost
19 provides a foundation to modern corporate finance as
20 taught and applied around the world."
21 Then he sets out the extracts. I think you
22 generally agree with those textbook statements; is that
23 right? I am thinking of paragraph 27 of your third
24 report which we can go to if you need reminding.
25 A. Yes, that is a fair statement. I generally agree with

1 all the academic textbook quotes.

2 Q. Thank you. If we look at the extract from Schlosser's

3 Business Finance at 3.8, it says:

4 "Capital is no different from all the other

5 resources needed for running a business: it has a cost

6 that is equal to the price asked for by its suppliers."

7 Do you see that?

8 A. Yes.

9 Q. I am going to show you three extracts and then I am

10 going to ask you a question.

11 Then if we look at 3.11, {E/32/16}, Mr Earwaker

12 quotes from a book with many authors, called

13 Corporate Finance: Theory and Practice. The extract

14 says:

15 "... the cost of the company's financial

16 resources -- its cost of capital -- is none other than

17 the rate of return required by investors, which is

18 a function of the risk on capital employed."

19 Yes?

20 A. Yes, it says that.

21 Q. Then if we could just scroll down a little, please, so

22 we can see 3.12:

23 "The returns received by investors in securities

24 must be provided by the issuers of those securities and,

25 from the issuer's viewpoint [so that is the company's

1 viewpoint], the return demanded by investors is
2 effectively a cost -- typically referred to as the cost
3 of capital. Therefore, the terms 'cost of capital' and
4 'required return' could be used interchangeably and, in
5 assessing the cost of capital for any project, we focus
6 on the return required by investors to compensate them
7 for providing capital."
8 So these textbook extracts are telling us, are they
9 not, that using equity capital carries a cost to the
10 company that is equivalent to the rate of return
11 required by investors even if it does not necessarily
12 involve a cash outflow? That is what these statements
13 are saying, is it not?
14 A. So a few things. First, it is important to see the
15 context of these phrases; right? These are just
16 extracts from books that are thousands of pages long and
17 say many, many things; right? So perhaps we will
18 eventually go to these extracts to see the chapters
19 where they are in. I am pretty sure that most, if not
20 all, of these extracts are from portions where they are
21 discussing tools used by management to appraise
22 projects, decide investments. In fact, in the last
23 quote we get a glimpse of this because it says at some
24 point:
25 "... in assessing the cost of capital for any

1 project, we focus on the return ..."
2 Right? So assuming that is the context out of which
3 all of these quotes are extracted, absolutely, as I have
4 explained a moment ago. So this is a tool,
5 a theoretical economic tool, used by management to
6 materialise this intangible thing, which is the
7 opportunity cost of the shareholders, and make a tool
8 with which they can make tangible decisions in the real
9 world when appraising investments. I absolutely agree
10 with that.
11 Q. In the real world. So it is using this tool because it
12 wants to cover these costs when it is making investment
13 decisions; yes?
14 A. No. No, it is trying to cover all the cost of the
15 projects, it is trying to cover the financing cost of
16 cost of debt and it is trying to achieve returns
17 commensurate with the opportunity cost of the
18 shareholders. That -- and some of these quotes say that
19 you can use two or three terms interchangeably and it is
20 in some of these quotes. You can use the term
21 "opportunity cost of the shareholders", you can use
22 "discount rate", you can use "cost of capital". I think
23 perhaps we are trying to read too much into one of those
24 three formulations, which is "cost of capital" and the
25 word "cost" in there, but I want to bring us back to

1 what it means. It means theoretically -- you know,
2 a tool used by management to ultimately try to achieve
3 returns commensurate to the shareholders' expectations,
4 call it "opportunity cost", call it "discount rate", you
5 know, whatever you want to call the tool.
6 Q. Thank you. I asked you whether the company was using
7 this tool because it wants to cover these costs when it
8 is making investment decisions and you said, "No. No,
9 it is trying to cover all the cost of the projects", but
10 does that not include the costs of the shareholders'
11 expectations?
12 A. So your question was very broad and I am just saying the
13 cost, what is called the "cost of equity", is also
14 called the "opportunity cost" of the shareholders, it is
15 also called the "discount rate". It is called many
16 things. So it can be considered theoretically as a cost
17 by the company, again, to be able to decide properly on
18 investment decisions, but that is not because it is an
19 actual cost to it. It is --
20 Q. Not a monetary cost, is that what you mean?
21 A. It is not a monetary cost. It is not a cost in the
22 P&L -- in the profit and loss accounts. I mean, I think
23 it is agreed with Mr Earwaker and with Mr Jeavons that
24 it is not a cost that you will find anywhere in the
25 company's account because it is not a cost. It is the

1 ultimate profit generated by the company for the
2 shareholders.
3 Q. The reason the company is using this tool to inform its
4 investment decisions is because it matters, does it not,
5 to the company that it can cover these costs, as I am
6 putting it?
7 A. It matters that they provide the shareholders with
8 returns commensurate with their expectations.
9 Q. Yes. All right. Can we go, please, to Helen Bradshaw's
10 witness statement? I think you have it at tab 1,
11 Mr Delamer. It is at {D/2/11}. Do you have that?
12 A. Yes.
13 Q. So Ms Bradshaw is one of the witnesses who has given
14 evidence on behalf of Royal Mail. You may be aware she
15 has held various senior finance roles within Royal Mail,
16 including in relation to investment appraisal. You will
17 not have heard her give evidence because she was not
18 cross-examined but I would like you just to look,
19 please, at these paragraphs you have in front of you,
20 5.1, 5.2 and 5.3. We see that Ms Bradshaw says:
21 "The WACC is a calculation of the company's cost of
22 capital, meaning the cost of its sources of capital
23 (debt and equity), by their relevant weightings. The
24 WACC therefore reflects both the cost of equity, the
25 cost of debt finance, and the proportions ...

1 Essentially, it is a financial measure that describes
2 the company's overall cost of funding business assets
3 and activities, and therefore ... the minimum return
4 that the company must earn in order to meet those
5 financing costs."
6 Then she explains that:
7 "Royal Mail's WACC was used in investment appraisal
8 and capital planning ..."
9 She says that at 5.2. At the end of 5.2:
10 "In other words, an investment would need to achieve
11 a return sufficient to meet the Hurdle Rate in order to
12 'break even'."
13 If we can just scroll down, please, to 5.3:
14 "As the investments made by a company are ultimately
15 financed by capital, whether that is debt, equity, or a
16 combination ... the cost of capital and a WACC can be
17 calculated ... In practice, Royal Mail has not always
18 calculated its own WACC. The identification of the WACC
19 as a relevant metric for the business occurred around
20 the year 2000 and was part of a wider transition towards
21 a more sophisticated investment appraisal function ..."
22 So you would accept, would you not, that from
23 Ms Bradshaw's perspective at least the WACC describes
24 the company's overall cost of funding business assets
25 and activities?

1 A. Yes, this is in line with the literature we have just
2 discussed.
3 Q. You would accept, as we see here, that from around 2000
4 Royal Mail was using the WACC for investment appraisal
5 purposes; yes?
6 A. Exactly, to measure the expected profitability of
7 projects, so looking at profits, not at costs.
8 Q. But it played an important role, we see, in commercial
9 decision-making --
10 A. In deciding which investments to pursue and which ones
11 not to pursue.
12 Q. Yes. Could we go, please, to Mr Jeavons' witness
13 evidence, which is at tab 2 of your bundle, Mr Delamer,
14 and it is at {D/7/47} of the bundle. Mr Jeavons is
15 group CFO for the Royal Mail Group of companies. He has
16 had a series of other finance roles. Did you hear him
17 give evidence?
18 A. I caught part of it. I must say I missed a bit.
19 Q. All right. If we look at paragraph 20.2, please. We
20 will need to scroll down the page. He says:
21 "From my perspective as Group [CFO], I would add to
22 Helen Bradshaw's comments that the Group WACC is
23 a fundamental aspect of how the Group has operated (and
24 how it continues to operate). It is extremely important
25 that the Group WACC is estimated to a high degree of

1 accuracy by Group Treasury. The financial consequences
2 for the business of adopting an inappropriate estimate
3 of the Group WACC for investment appraisal purposes
4 could be severe."
5 Yes? Then he explains the problem with calculating
6 it too low and calculating it too high. Again that
7 tells us, does it not, that Royal Mail takes the WACC
8 very seriously in its commercial decision-making; yes?
9 A. In a part of their business, which is in appraising
10 investments, not in assessing its costs.
11 SIR IAIN MCMILLAN: Can I ask a question here, if I may come
12 in here --
13 MR LASK: Yes, please.
14 SIR IAIN MCMILLAN: -- because you appear to return to this
15 term "cost" and the cash that is used to pay dividends
16 to shareholders does not form part of the profit and
17 loss account, it is a distribution after the profit and
18 loss account has been finalised, but it is still money
19 that leaves the company. It leaves the company's bank
20 account to pay the shareholders a return on their
21 investment. Is it not the case that that money that
22 leaves the company's bank account to the shareholders
23 could have, if it was retained, be used to generate more
24 income for the company and therefore there is an
25 interest in the company at stake here? Am I correct or

1 am I wrong?
2 A. Absolutely. So if profits -- I try to explain this in
3 a lot of detail in my second report where I do several
4 examples of, you know, a hypothetical company that has
5 £1 million in profit and the different things it can do.
6 So if it retains it, what it can do with it within the
7 business and the different returns it can generate or
8 the different financing costs, debt financing costs, it
9 can avoid.
10 So absolutely it can have an impact, but avoiding
11 a cost of equity is not one of them. That is my
12 position because that is not something that happens
13 tangibly in a company. It is not a cost faced by the
14 company, the cost of equity. So that extra profit,
15 there is no tangible decision that can be made by the
16 company, were it to allocate that £1 million, that would
17 allow it to avoid a cost -- a financing cost of the cost
18 of equity.
19 SIR IAIN MCMILLAN: Are we getting the interest of the
20 company and the interest of the shareholders confused
21 here? I know that they are separate legal entities but
22 the amount of money used to pay the shareholders'
23 dividend is leaving the company, is it not, and
24 therefore that is money that cannot be used within the
25 company to generate more income over time because it has

1 gone to the shareholders at that point in time?
2 A. Yes.
3 SIR IAIN MCMILLAN: That is correct, is it not?
4 A. From the company's perspective, absolutely, yes.
5 SIR IAIN MCMILLAN: Thank you.
6 A. What I am trying to do is, in general, I am trying to
7 bring down all of the economic theory down to practice,
8 down to the real world, let us call it. That is why we
9 see examples of what happens within the firm with monies
10 that flow. The reason why I am doing that in part is,
11 the way I understand it, our job here is to help you
12 decide this case and the starting point to me is what is
13 being asked for by the claimant, what is being pleaded.
14 What I read there is, but for the overcharge -- you
15 know, if there is an overcharge, in the counterfactual
16 scenario I would have had additional monies and with
17 those additional monies I could have borrowed less and
18 saved on cost, on financing cost.
19 So I am following that through -- okay? -- so you
20 have additional monies. I think it is quite clear and
21 we all agree on, if you use that to repay debt, what
22 happens? You save on interest; right? But it is not
23 clear at all to me what happens if that is allocated to
24 equity. I certainly do not see a connection in avoiding
25 the theoretical cost of equity. What I do see, if that

1 overcharge is assigned to equity and is, for example,
2 retained within the company as retained earnings, then
3 we say, "Okay, so we have these additional funds. What
4 is the impact?"
5 That is where we see that, well, when you are
6 retaining earnings, different things happen in different
7 moments in time. We heard Mr Earwaker today that he
8 believes that in the initial years it would have gone to
9 the mails reserve, we know the mails reserve invested in
10 gilts, so we know what is happening and we know the
11 interest rate earned or avoided by those decisions
12 within the firm. My point is that there is no cost of
13 equity that can be avoided with extra funds.
14 SIR IAIN MCMILLAN: Thank you.
15 MR LASK: Thank you, sir. As Mr Delamer quite rightly says,
16 we are concerned here with the situation in which -- or
17 the argument on our side of the room is that, as
18 a result of the overcharge, there was a diminished
19 ability, if I can put it that way, to pay out dividends
20 or to meet shareholders' expectations in the way that
21 Royal Mail did, but your question is timely because
22 I wanted to go next to what Mr Earwaker says about this
23 point, please, which is in his third statement at
24 {E/60/12}.
25 A. Which tab? Sorry.

1 Q. For you this is the third statement of Mr Earwaker,
2 which I think is in your bundle at 7. Do you have that?
3 A. Yes, thank you.
4 Q. In fairness, it may be helpful just to look at
5 paragraph 2.6(b) to see what Mr Earwaker is responding
6 to here. He is responding to some of your concerns. So
7 if you look at 2.6(b)(ii), {E/60/11} -- can you see
8 that?
9 A. Yes.
10 Q. He is responding to your concern that:
11 "The way in which the cost of equity reflects an
12 opportunity cost to shareholders."
13 He says that is what you are troubled by.
14 Then if you go back to 2.9, {E/60/12}, you will see
15 that is what he is dealing with. At 2.9 he says:
16 "... the corporate finance literature is clear that
17 the opportunity cost to shareholders ..."
18 Just pausing there, you will accept, I think, that
19 if, as a result of an overcharge, less money flows to
20 shareholders than it would otherwise have done -- you
21 would accept, I think, that that is at least a cost to
22 shareholders, a monetary cost to shareholders; yes?
23 A. So the shareholders -- if the overcharge would follow
24 all the way through to the shareholders, if the
25 shareholders receive less value from the claimant, they

1 would incur an opportunity cost.
2 Q. When you say "opportunity cost", do you distinguish
3 between an opportunity cost and a monetary cost?
4 Are you saying that is not a monetary cost?
5 A. Well, it is an opportunity cost because it is
6 a theoretical cost of what they could have potentially
7 done with that money. How you measure that -- you
8 cannot measure it because it is a hypothetical; right?
9 There is where, again, financial models come in to try
10 to assess expected returns at certain risk levels such
11 as the capital asset price in the market. So it is not
12 a monetary cost, it is a theoretical cost.
13 Q. So even from the shareholders' perspective, receiving
14 less by way of dividends or something akin to dividends
15 as a result of an unlawful overcharge -- even that does
16 not involve what you would regard as an actual cost; is
17 that correct?
18 A. So they would receive a lower -- just to simplify
19 things, let us assume no retained earnings, no reverse
20 splits, just whatever profit there is, it is paid on
21 dividends to the shareholders -- right? -- so if there
22 is a positive overcharge, then the shareholder
23 ultimately receives less dividends. That is a monetary
24 impact. I have less money in the bank because the
25 dividends were lower.

1 Now, the cost of that, the opportunity cost of
2 having less monetary amount in my bank account, that is
3 a theoretical opportunity cost because nobody knows
4 exactly what are the alternative investments that
5 putative shareholder would have invested in.
6 Q. I see. So you have accepted, I think, that there is at
7 least a monetary impact on the shareholders?
8 A. Yes, but not on the cost, the financing cost. That is
9 the opportunity cost, so they receive a lower amount but
10 then the financing cost from that amount, that
11 opportunity cost, is a theoretical one.
12 Q. So it is something different. All right. We may have
13 to agree to disagree on that and we can obviously make
14 submissions. Can I then take you back to Mr Earwaker's
15 statement at 2.9? He says:
16 "On point (ii), the corporate finance literature is
17 clear that the opportunity cost to shareholders and the
18 cost to the firm are two sides of the same coin."
19 Do you see that?
20 A. Yes.
21 Q. Then at 2.10:
22 "If cost to investors did not have a mirror image as
23 a cost to the firm, one would logically have to take the
24 view that equity financing is a form of free money for
25 companies, even if the amounts involved are substantial

1 and even if the payback periods involved are lengthy.
2 Indeed, this is precisely where Mr Delamer appears to
3 repeatedly end up ... As I explained in Earwaker 1 and
4 Earwaker 2, I do not think that it is tenable to regard
5 equity capital as 'a "free" way of funding' ... or to
6 think that Royal Mail could have financed sizeable
7 overcharge amounts -- ie the amounts not financed by
8 debt -- free of consequences and at zero expense."
9 Then at paragraph 2.12, {E/60/13}, he says about
10 halfway down:
11 "For the avoidance of doubt, it is the possibility
12 that retained earnings could otherwise have been paid
13 out as distributions had Royal Mail not had to pay the
14 Defendants' overcharges ... that gives rise to an
15 additional equity financing requirement and an
16 additional cost of equity that I have sought to quantify
17 in my reports."
18 Do you see that?
19 A. Yes.
20 Q. I am not expecting you to agree. I have read these
21 reports. I understand that your position is different
22 to that.
23 A. I have answered to this, I believe.
24 Q. Yes, but you see that that is Mr Earwaker's opinion,
25 that there is a cost to the company.

1 A. Yes. I mean, perhaps this should be broken down a bit.
2 Just starting from the beginning of 2.9, you skipped the
3 quotes there which sustain his affirmation -- right? --
4 of this mirror image --
5 Q. Only because I had already taken you to some points that
6 I did not want to go over again.
7 A. So we are always talking about in the context of the
8 firm, more specifically the management, making
9 investment decisions and using an economic model to
10 internalise the opportunity cost of the shareholders
11 into this process to make good decisions in the
12 investment appraisal process, as we have heard or read
13 from Ms Bradshaw and is consistent with the literature.
14 That is absolutely right. But we are talking about
15 calibrating returns, choosing investments, so we are
16 talking about profit targets.
17 Q. Yes. As I say, I understand that you differ from
18 Mr Earwaker on this but I was merely asking you to
19 acknowledge that his view is that using retained
20 earnings or retaining earnings within the business to
21 finance expenditure involves a cost to the company.
22 I appreciate you disagree with that, but that is his
23 view, is it not?
24 A. I do not disagree. That is the point. We agree on
25 this, on the literature. We agree.

1 Q. But it is not just the literature, though. It is
2 Mr Earwaker's view as well, is it not? That is my
3 point.
4 A. Yes, but in the sense that this opportunity cost to the
5 shareholder is internalised by the business through
6 economic theoretical models to choose investments,
7 I agree with that, and we know that the claimant has
8 used that approach to decide investments. I think what
9 we disagree with is the relevance of that in this
10 context because here we are not assessing the foregone
11 returns the claimant could have achieved by investing
12 those funds and following the processes that we see they
13 have taken in the past that involved the WACC because
14 there is where the WACC is relevant in assessing
15 investment or re-investment projects.
16 But I do not think that is what we are here to
17 assess. We are here to look towards the other side, the
18 costs that could have been avoided. Looking at that
19 side of the business, the costs side, there we disagree
20 about the relevance of these theoretical models that are
21 used to assess investments, not assess costs.
22 THE CHAIRMAN: Sorry, I think the problem with this debate
23 is really over the definition of "costs", is it not?
24 You are using "costs" in slightly different ways, it
25 seems to me --

1 A. Absolutely.
2 THE CHAIRMAN: -- that -- where there is an actual cost,
3 whether it is reflected in the balance sheet or the
4 profit and loss account of the company or whether it is
5 a more theoretical cost --
6 A. Absolutely. So we agree on this definition of "economic
7 cost" that can be used as a tool to then go after
8 appropriate investments. But here, I mean, what
9 I believe we are trying to assess is this differential
10 between the actual and the counterfactual -- right? --
11 where you would have had additional monies if an
12 overcharge would have been avoided. In that sense, if
13 a firm has additional funds, there is no cost of equity
14 can avoid because there is no such thing as a tangible
15 cost. I think the clearest example is, if a company
16 performs better or worse, for whatever reason,
17 overcharge, head winds, for whatever reason, its
18 profitability will change and how much it therefore
19 eventually distributes to shareholders changes.
20 You would not call that a change in the company's
21 costs because they are paying more or less dividends
22 because it did better or worse. That is just the
23 profits being handed over to the owner of the company;
24 right?
25 THE CHAIRMAN: But do you see the profits or retained

1 earnings as essentially shareholder funds?
2 A. They are. I mean, part of it is shareholder funds that
3 are invested in the company.
4 THE CHAIRMAN: Yes, they could otherwise be distributed as
5 dividends --
6 A. The shareholder --
7 THE CHAIRMAN: -- to the shareholder --
8 A. Yes.
9 THE CHAIRMAN: -- or they are being retained by the company
10 to invest elsewhere, but for the benefit of the
11 shareholders?
12 A. Absolutely. Absolutely. But my understanding is that
13 we are not here to evaluate how the company could have
14 re-invested the overcharge because that is not the basis
15 of the financing losses claim being pleaded. Here what
16 I am trying to answer is what are the costs that could
17 have been avoided. It used to be -- the way it used to
18 be pleaded, as I understand it from the red lines, is
19 that initially the claimant was asking for the foregone
20 profits on the investments it could have pursued with
21 these funds it was deprived of by the overcharge. There
22 I can understand the theoretical foundation to turning
23 first to the WACC because you should invest in projects
24 that yield at least the WACC, but that is with several
25 caveats. The first one is: well, did the company

1 actually have the ability to deliver those returns?
2 That is why I have analysed the historical returns
3 because I have not seen that the company has delivered
4 those returns.
5 You should also assess if the company was actually
6 capital constrained, if there were other good projects
7 to pursue if they had more money, which has not been
8 explored thoroughly because, again, I do not think that
9 is what is being claimed. What is being claimed is
10 simply, "I have more money. What costs can the company
11 save?", and the cost of equity is not one of them
12 because it is a theoretical tool to evaluate
13 investments, not a cost that is actually faced by the
14 company.
15 MR LASK: Thank you, sir. You actually had anticipated my
16 next question, which is an attempt to draw some of these
17 threads together, if I may.
18 Could we go, please, to Mr Delamer's first statement
19 at paragraph 78? This is tab 4 of your bundle and it is
20 {E/16/41}. Do you have that, paragraph 78?
21 A. Yes.
22 Q. You are dealing here with a statement from Mr Jeavons'
23 evidence that retained earnings form part of the
24 shareholders' equity and do still incur a cost of
25 equity. You say it is not entirely clear what he means.

1 "Based on my understanding set out [above] of what
2 actual financing costs are (ie outflows faced by the
3 company, or liabilities generated that will imply
4 a future cash outflow for the company at some point),
5 I would disagree with Mr Jeavons. The decision (or
6 need) to retain earnings to finance expenditures does
7 not create or alter any of the company's costs -- there
8 is no additional cash outflow related to such
9 a decision. From the perspective of the Claimant, the
10 use of its retained earnings is a 'free' way of
11 funding."
12 Just to be clear, where you say it is a "'free' way
13 of funding", based on the earlier part of that paragraph
14 and what you have told us this morning -- when you say
15 that, you mean, I think, that it does not involve any
16 additional cash outflow; yes? You have referred to
17 monetary cost a number of times.
18 A. I have expanded on this in my subsequent reports because
19 it raised some concerns and I have clarified and
20 expanded the explanation and I am happy to repeat those
21 explanations.
22 Q. Please.
23 A. What I say here is from the perspective of the company
24 towards the shareholders, there is no monetary cost that
25 is incurred. I think there is agreement that the way

1 equity works is very different to debt where you do
2 have, you know, an obligation to pay interest. Here,
3 when you invest equity, you are entitled to a portion of
4 the profits and that is it, so there is no monetary cost
5 obligation with the shareholders. You just eventually
6 will pay out to the shareholders all the profits you
7 manage to achieve.
8 So in that sense it is a free way of funding, in the
9 sense that you take in equity money, you do not commit
10 to a payment of monetary, you know, interest payments or
11 whatever, you do have a responsibility of trying to
12 achieve a return for your shareholders and you have
13 a pressure, and we have discussed about corporate
14 governance, how the shareholders can try to get the
15 company to achieve those returns, but it does not create
16 a monetary cost.
17 Q. Yes. So I think you are agreeing with me or agreeing
18 with my interpretation of your position, which is that
19 retaining earnings or the decision or need to retain
20 earnings to finance expenditure, when you say that is
21 free to the company, you mean free in the sense that it
22 does not entail cash outflows; yes?
23 A. It does not entail an obligation to certain cash
24 outflows.
25 Q. Yes.

1 A. It entails consequences, as we have discussed in the
2 past.
3 Q. But given what we have been discussing about the way in
4 which companies internalise the investors' opportunity
5 costs and how they strive to meet the expectations and
6 how they use the WACC as a tool for investment appraisal
7 purposes, what we have seen from the textbooks, what we
8 have seen from Mr Earwaker, you must accept, surely,
9 that in those circumstances there is a cost to the
10 company in a broader sense. By "broader sense" what
11 I mean is that it diminishes the company's ability to do
12 the very thing it is striving to do, which is it is
13 satisfying its investors' expectations either through
14 dividend payments or capital appreciation.
15 A. I will have to ask you to repeat that. I lost the first
16 part there.
17 Q. Of course. So just bearing in mind everything else we
18 have been discussing --
19 A. Yes.
20 Q. -- what I am inviting you to accept is that, where
21 a company has to retain earnings to fund expenditure on,
22 for example, an overcharge, where it does that, that
23 involves a cost to the company in a broader sense. Then
24 what I went on to do was explain what I mean by "broader
25 sense". What I mean by "broader sense" is it diminishes

1 the company's ability to do the very thing it is
2 striving to do, which is meet its investors'
3 expectations, pay out dividends, achieve capital
4 appreciation, those sorts of things. So I am inviting
5 you to accept that there is a broader cost in that
6 sense.
7 A. And that is because the funds that were not available
8 because of the overcharge could not be re-invested in
9 the business to generate those profits for the
10 shareholders?
11 Q. Correct -- well, no, it is because the funds that are
12 not available because of the overcharge cannot be used
13 to meet the investors' expectations in a whole range of
14 ways, whether that be by investing in further profitable
15 projects, whether it be by paying dividends, whether it
16 be by achieving capital appreciation.
17 A. Well, I think those are two very different things. So
18 re-investing in the company and trying to achieve
19 returns to eventually meet the shareholders' expectation
20 is one. Again, that is not what we are trying to answer
21 here, I believe, because that is not what is the basis
22 for the compound interest claim. Then paying out those
23 to the shareholders will definitely make the
24 shareholders marginally more happy but it does not avoid
25 a cost to the firm.

1 Q. Yes, we are looking, I think, at two sides of the same
2 coin. You are asking, "Well, is there a cost if there
3 is a payout to the shareholders?"; I am asking about the
4 costs that arise when there is a diminished ability to
5 pay out to shareholders. So a diminished ability as
6 a result of the overcharge, what I am putting to you is
7 that that involves a broader cost to the company because
8 it is impacting adversely on its ability to do the very
9 thing it strives to do.
10 A. I cannot agree with that. It is a bit too general, you
11 know, a broader hypothetical cost. You need to break it
12 down to be able for me to accept or not your
13 proposition. It is a bit too broad.
14 Q. Shall we take an example of a situation in which, as
15 a result of the overcharge, the company retains earnings
16 that might otherwise have been used to make
17 distributions to shareholders? Would you accept that
18 that involves a cost to the company in the broader sense
19 that I am describing?
20 A. It depends on what the company does or would have done
21 with those retained earnings. As I explained --
22 Q. So it is possible, is it? You say it depends. It is
23 possible, is it?
24 A. Absolutely, and I have explained this at length,
25 particularly in my second report, where I showed

1 different examples of how a £1 million profit can flow
2 through the company and what impact it can have. Just
3 to draw very briefly one or two of those examples. You
4 retain the earnings, you use that additional funds to
5 repay your debt, then the impact, the actual monetary
6 impact on the company, is the cost of debt you avoid.
7 If instead you allocate those funds to short-term
8 financial investments, then the impact is the additional
9 returns you would have earned on those short-term
10 financial investments. If you keep the cash in cash,
11 then it does not have any impact in terms of costs
12 avoided or profits generated and so forth and so on.
13 I see no tangible way in which those funds can be
14 allocated in a way that a cost of equity can be avoided.
15 Q. I see. I think you accept there is a cost but you say
16 that the way in which one ought to measure that cost is
17 by looking at the cost of debt and the foregone returns
18 on short-term investments; is that fair?
19 A. No. I am saying there could be a cost, there could be
20 no cost. I just explained one example in which those
21 funds are allocated to cash, it generates no cost.
22 Q. But if there is a cost, do you say that the way to
23 measure it is by looking at the cost of debt and
24 short-term investments? Is that your position?
25 A. Those are possibilities. I am not saying that is the

1 way to measure it. I am saying that possible tangible
2 monetary impacts are, for example, repaying debt,
3 investing short-term investments, holding cash; all
4 possibilities.
5 Q. All right. I think I have taken that as far as I can.
6 Sir, I was going to move on to a different part of
7 the WACC debate. I am conscious of the time. That
8 might be a convenient moment.
9 THE CHAIRMAN: All right. Well, as long as we are not in
10 any danger of --
11 MR LASK: No. We are well on track.
12 THE CHAIRMAN: Well on track. All right. We will break now
13 then.
14 You are not allowed to talk about the case with
15 anyone whilst we have the break so please ensure you do
16 not do that.
17 A. I will have lunch by myself somewhere.
18 THE CHAIRMAN: I am sorry about that. Okay.
19 (12.56 pm)
20 (The short adjournment)
21 (2.00 pm)
22 THE CHAIRMAN: Yes, Mr Lask.
23 MR LASK: Good afternoon, Mr Delamer.
24 A. Good afternoon.
25 Q. I want to turn now to another of your objections to

1 using the WACC in this case. You say in your second
2 report that Royal Mail did not pay any dividends during
3 the infringement period so any profits or losses that it
4 generated ultimately impacted on its assets and
5 liabilities. Do you recall that?
6 A. Yes, I believe I do.
7 Q. So this is obviously a factual issue but I would like to
8 show you some of the evidence on it because you have
9 commented on it in your reports.
10 A. Sorry, could we start by -- if you could take me to that
11 specific part of my --
12 Q. Of course. Your second statement, which is tab 6 in
13 your bundle, {E/47/35}. It may actually be the
14 following page. I am looking for paragraph 54,
15 please -- no, sorry, that was the right page,
16 paragraph 51. Do you see paragraph 51? You say:
17 "Since, during the infringement period, the Claimant
18 did not pay out dividends or receive fresh equity
19 injections ..."
20 A. Yes, I see that.
21 Q. If we turn, please, to Mr Jeavons' evidence, which is
22 your tab 2, Mr Delamer, and on Opus it is {D/7/43}, if
23 we could scroll down, please, to 19.5, you will see he
24 says -- sorry, do you have that?
25 A. I am there.

1 Q. He says:

2 "In the period prior to the 2013 IPO,

3 The Post Office Corporation and Royal Mail Group Limited

4 made payments/allocations equivalent to shareholder

5 distributions in the form of payments under the EFL and

6 allocations to the 'Mails Reserve' ..."

7 He goes on to elaborate. At 19.6 he says in the

8 second sentence:

9 "The function of the EFL was effectively to act as

10 a mechanism for the UK Government to extract what was

11 akin to an annual dividend payment from the nationalised

12 industries ..."

13 Do you see that?

14 A. I see that, yes.

15 Q. Then at 19.8 and 19.9, {D/7/45}, he talks about the

16 mails reserve and he says at the end of 19.8 it was

17 created in February 2003 and:

18 "... RMGL allocated funds to the Mails Reserve

19 during the period up to the ... IPO."

20 Then at the end of 19.9 --

21 A. Just one comment there. Is that still true? I thought

22 it was clarified that the mails reserve disappeared in

23 2007.

24 Q. I am going to take you to some of the documents but

25 I wanted to show you first what Mr Jeavons says about

1 that.
2 A. Okay.
3 Q. At the end of 19.9, {D/7/46}, he quotes from the
4 accounts and says that "the amounts allocated ... were
5 applied 'as if they were profits available for
6 distribution ...' such that they were equivalent to
7 dividend payments". That is the end of 19.9.
8 So you see from Mr Jeavons' perspective that the
9 payments it was required to make under the EFL and the
10 mails reserve were akin to dividends; yes?
11 A. That is his view.
12 Q. Yes. Could we go, please, to -- I am afraid I do not
13 think this is in your hard copy bundle so you will have
14 to view it on the screen. Could we go, please, to
15 {I3/62/3}? These are the Post Office accounts from
16 1998/1999. If we could zoom in on the bottom of the
17 left-hand page, please, do you see it says "Financial
18 Target"? Under "Targets and Reorganisation"?
19 A. Yes.
20 Q. Then "Financial Target":
21 "... (EFL) for the Group as a whole. This specifies
22 the amount of surplus cash which we are required to
23 generate for Government."
24 Do you see that?
25 A. Yes.

1 Q. So that is consistent, is it not, with Mr Jeavons'
2 impression of the EFL as a mechanism for the Government
3 to extract funds?
4 A. No.
5 Q. You do not think that is consistent?
6 A. No.
7 Q. Why not?
8 A. So this I would find more consistent with, again,
9 appraisal of projects, where you aim at investing to
10 generate a certain level of return eventually for your
11 shareholders and I believe that is what the EFL
12 mechanism did. It set -- it is a bit of a convoluted
13 way -- a negative funding limit, which is essentially
14 saying the amount of surplus cash or profits that needs
15 to be generated. Now, that has nothing to do with
16 dividends, with paying dividends.
17 Q. I was not asking whether it was a dividend. I was
18 asking whether it was consistent with Mr Jeavons' view
19 that the EFL was a mechanism for the Government to
20 extract funds.
21 A. It is not extracting funds so it is not akin to
22 a dividend because a dividend, by definition, when it is
23 paid, it leaves the company -- it leaves the company's
24 balance sheet so there is no recourse. I mean, you pay
25 a dividend and that is it. Here in the EFL you are

1 lending money to the Government.
2 Q. So your concern is that it does not leave the balance
3 sheet?
4 A. Amongst other things, yes.
5 Q. That is fine. I do not want to interrupt you but I am
6 conscious of the time so there are moments when I am
7 going to have to move on fairly rapidly.
8 If we could go, please, to {I3/64/11}. These are
9 the Consignia accounts, so the parent company accounts
10 from 2000/2001. This is dealing with the post -- I am
11 going to zoom in, do not worry -- this is dealing with
12 the post-EFL period. It is a transitional period
13 between The Post Office Corporation and RMGL.
14 If you see note 7 on the left-hand side, "Future
15 dividends" -- do you see that in the middle of the page?
16 A. I do, yes.
17 Q. "In anticipation of the changes to the status of
18 The Post Office under the ... [2000 Act], [the]
19 Government has indicated an expectation of dividends on
20 the trading results for the last two years of operation
21 as a Government Corporation. Under the terms of the
22 British Telecommunications Act 1981, The Post Office is
23 unable to declare and pay dividends, but the Board
24 Members have instead designated an amount of reserves to
25 reflect this expectation.

1 "This amount is expected to be paid by
2 Consignia Holdings plc to [the] Government as a dividend
3 when the formalities ... have been discharged."
4 You see there the Government is expecting dividends
5 to be paid out once they can be and that the company is
6 setting aside funds in the expectation of doing so; no?
7 A. So just one practicality. I am not trying to be
8 difficult but I am having problems seeing the screen.
9 I literally see the crane behind me reflected, so if you
10 could either --
11 Q. That is entirely fair.
12 A. -- go closer or give me hard copies.
13 Q. I am sorry.
14 A. No, no. It is small font as well so I am struggling.
15 THE CHAIRMAN: Maybe it can be zoomed in a bit.
16 A. That is much better. Thank you.
17 Yes, I remember reviewing this at the time --
18 Q. Yes, you refer to it.
19 A. Sorry?
20 Q. You refer to it, this document, do you not?
21 A. I believe so, yes.
22 So for two years I believe dividends -- future
23 dividends were declared which I believe were never paid.
24 Q. All right. Well, let us move on to the next document,
25 {I5/472/45}.

1 A. This one is not in the bundle either?
2 Q. Not in the hard copy, I am afraid. Royal Mail Holdings
3 plc, so this is the parent company but by now the name
4 has changed. If we scroll down, please, so we can see
5 note 18, you see the table there and the "Transfer of
6 dividend reserve ..." in the third row of the table
7 referring to 244 million. Then the note beneath:
8 "... Government confirmed in July 2002 that the
9 funds set aside for the possible payment of prior year
10 dividends are now considered to be part of past
11 surpluses. Accordingly, the amounts in the dividend
12 reserve have been transferred to the profit and loss
13 reserve within Royal Mail Holdings plc. The past
14 surpluses of the Group are dealt with in accordance with
15 the restrictions applied to the Mails Reserve ..."
16 So we are seeing there, are we not, that the
17 244 million that had previously been set aside in
18 expectation of having to pay a dividend has now been
19 transferred to the parent company's profit and loss
20 reserve; yes?
21 A. I believe the funds were transferred to the mails
22 reserve within the claimant entity.
23 Q. Well, it says in the note:
24 "... the amounts in the dividend reserve have been
25 transferred to the profit and loss reserve within

1 Royal Mail Holdings ..."
2 You see in the table that the 244 million has moved
3 from the third column to the first column.
4 A. That is an accounting conversion. I mean, the profit
5 and loss is not part of the balance sheet. It is how
6 you process movement in cash --
7 Q. I see.
8 A. -- so it could have gone through the parent to the
9 Holdings' profit and loss account. My understanding is
10 that those funds that have been ringfenced initially
11 eventually ended up in the mails reserve, which is
12 a reserve within the claimant entity.
13 Q. Yes, so you say it all goes to the mails reserve.
14 Could we see, please, {I3/70/33}?
15 A. Excuse me, could we keep going. It is halfway through.
16 Thank you. That is it. Thank you.
17 Q. You may have seen this -- you may have seen it before
18 but you may have seen it earlier because Mr Earwaker
19 commented on it. This is Royal Mail Group Limited's
20 accounts for 2006/2007. Note 24 describes what happened
21 with the mails reserve. By all means take a moment to
22 read it, but the only point I want to point out is that
23 eventually what happens is the funds remaining in the
24 mails reserve are paid out as a distribution to the
25 parent company.

1 A. Well, first, funds are accumulated, I think almost
2 £2 billion, then here it says 1.1 billion were spent or
3 used or invested, I think to support the Post Office
4 network, then additional funds, 75 million, I believe,
5 were also deployed in some way and then, in 2007, at the
6 end, when the mails reserve was wound down, what was
7 remaining, the 795 million, were transferred to the
8 parent company, to the holding company, and put in
9 escrow for the pensions.
10 Q. But being paid out as a distribution to the parent
11 company by the claimant company; yes?
12 A. Being transferred to the holding company, yes.
13 Q. So the short point I want to put to you based on these
14 documents and on Mr Jeavons' evidence is that it is
15 oversimplistic, if I can put it that way, to say that
16 Royal Mail was not paying dividends during the
17 infringement period because what it was doing was paying
18 something that was considered to be akin to dividends.
19 A. I disagree. I think the fact is very simple and no
20 dividends were paid. Again, I do not consider funds
21 being either lent to the Government in the initial
22 period, so the negative EFL, or funds that are
23 ringfenced within the company and invested in short-term
24 investments -- I do not consider that akin to a dividend
25 when the main feature of a dividend is something that is

1 paid to the shareholder.
2 Q. But that is what we are seeing here. Eventually those
3 funds are paid to the shareholder in 2007.
4 A. In 2007 there are funds transferred to the shareholder,
5 yes, and put in escrow.
6 Q. So in the first instance the funds are being ringfenced
7 for future payment and then eventually they leave the
8 company; yes?
9 A. Some of those funds.
10 Q. Some, yes.
11 We saw from Ms Bradshaw's witness statement earlier
12 that, from around 2000, Royal Mail started using the
13 WACC for investment appraisal purposes; yes? Do you
14 remember that?
15 A. Correct.
16 Q. That is the behaviour -- using the WACC as a tool for
17 investment appraisal purposes, that is the behaviour, is
18 it not, of a company that is striving to meet
19 shareholder expectations?
20 A. Absolutely.
21 Q. So it is the behaviour of a company that is expecting to
22 pay dividends or at least something akin to dividends;
23 yes?
24 A. If all projects are evaluated at the WACC and are
25 expected to ex ante yield returns equal or above the

1 WACC, yes. I am not entirely sure that is what was
2 happening at the claimant entity during this period.
3 Q. I am going to come on to what you say about that.
4 Turning, though, to the post-IPO period, you have seen,
5 I think --
6 THE CHAIRMAN: Sorry, can I just ask, while we are just on
7 these accounts, we have been talking up to now, as
8 I thought, of the shareholders being effectively the
9 Government --
10 MR LASK: Yes.
11 THE CHAIRMAN: -- but then you said that this was
12 effectively a distribution by way of dividend to the
13 holding company, that that was --
14 MR LASK: Which is owned by Government, the sole
15 shareholder, yes.
16 THE CHAIRMAN: Right, but it was not a payment to the
17 ultimate shareholder, was it? It was within the group
18 to its immediate parent?
19 MR LASK: I think that is right, sir, yes.
20 THE CHAIRMAN: Yes, okay.
21 MR LASK: We can make submissions in due course, but we say
22 that that is akin to a dividend payment to
23 a shareholder. That is our position.
24 THE CHAIRMAN: Right. Okay.
25 MR LASK: May I deal with the post-IPO period, please?

1 Are you aware, Mr Delamer, that after 2013 Royal Mail
2 has paid dividends?
3 A. Yes.
4 Q. In your report you refer only to the paying or
5 non-paying of dividends during the infringement period
6 and you make no mention of the fact that dividends were
7 paid after 2013. But the financing of historical
8 overcharges is an ongoing process, is it not, that
9 continues to the present day?
10 A. Yes, correct, but just to clarify -- I might need to
11 refresh my memory or we can go there, but in my report
12 I think I am commenting on what Mr Jeavons says or
13 Mr Earwaker said about dividends being paid.
14 Q. I see. So that is why you are only focusing on the
15 pre-2013 period; is that right?
16 A. It is just what the facts show, that there was not any
17 dividends being paid during that period.
18 Q. Sure, but the point I am putting to you is that, if it
19 is relevant to consider the payment or non-payment of
20 dividends by Royal Mail, then it is relevant to consider
21 that issue after the infringement period as well as
22 during it because the financing losses, however you
23 measure them, are continuing to accumulate.
24 A. Could you ask that again?
25 Q. If it is relevant to consider the payment or non-payment

1 of dividends by Royal Mail, then it is relevant to
2 consider that issue after the infringement period, so
3 post-2013, as well as during it?
4 A. I mean, I think the payment or non-payment of dividends
5 is one piece in the puzzle. Here I am commenting about,
6 you know, what has been said by Mr Jeavons, by
7 Mr Earwaker, and I believe -- yes, as I always try to
8 bring things down to earth and to real monetary amounts,
9 and it makes a difference, I believe, in a period where
10 you are paying dividends or not paying dividends, how
11 you can track those flows from investment to company to
12 shareholders.
13 Q. Yes, I am not seeking to fixate on the point that this
14 post-2013 period has not been mentioned in your reports.
15 A. Okay.
16 Q. I am really just seeking to establish that I think we
17 agree that, if the tribunal comes to consider the
18 payment or non-payment of dividends as relevant, it
19 really needs to look at the post-2013 period as well as
20 the pre-2013 period?
21 A. Absolutely, and yes, they did pay calibrated dividends,
22 very fixed dividends, since 2014 until Covid.
23 Q. Moving on to an additional reason that you oppose the
24 WACC as a measure of Royal Mail's financing costs, in
25 your first statement -- and we can turn it up if you

1 wish. It is at tab 4, paragraph 69, {E/60/34} on
2 Opus -- you see there at 69 you say -- do you have that?
3 A. Yes.
4 Q. You refer to an additional reason. Then you go on to
5 present this comparison between the actual percentage
6 returns achieved by Royal Mail from its activities,
7 represented by its return on assets, and the WACC. So
8 you are comparing those two things; yes?
9 A. Correct.
10 Q. If we scroll down to figure 3, you see the results.
11 A. Yes.
12 Q. You went on to update your analysis in your second and
13 third reports. You did so by adding the return on
14 capital employed as an alternative measure of returns
15 and you compared it against Mr Earwaker's WACC rather
16 than Royal Mail's WACC; yes?
17 A. So it is in my third report.
18 Q. Yes.
19 A. I added four additional measures of the historical
20 returns because Mr Earwaker, in his second report,
21 replying to mine, expressed some concerns, although he
22 did not tell me how he would do it differently. So just
23 to be on the safe side I computed four additional
24 metrics of computing, you know, the history of the
25 returns in slightly different ways.

1 Q. But it did not alter your central conclusion that the
2 returns generated by Royal Mail were sometimes below the
3 WACC; correct?
4 A. Yes, on average significantly below and, as we have
5 heard from Mr Earwaker yesterday, no matter how you
6 compute it, it is below.
7 Q. Can we go, please, to Mr Earwaker's second statement?
8 You have it at tab 5. I would like to look at
9 paragraph 3.35. On Opus it is {E/32/21}. I think in
10 fairness this is before you have recalculated so there
11 is a reference to some of the criticisms that you have
12 just been referring to. But he says that even if you
13 had reported figures on a comparable basis -- that is
14 really I think the bit that you say has fallen away
15 because you have re-done the exercise. He says:
16 "... even if ... this would simply indicate that
17 risks generally crystallised in an unfavourable way for
18 Royal Mail between 1997 and 2020 -- ie that the revenue
19 that Royal Mail was able to generate from its day-to-day
20 operations fell short of its costs, inclusive of the
21 ex ante cost of capital, meaning that shareholders lost
22 money.... "
23 So the point is -- and it is a short point -- when
24 you are carrying out this exercise, you are comparing
25 the WACC not with what you think is an appropriate

1 measure of the costs incurred by Royal Mail but with the
2 returns that it achieved. You are looking at
3 profitability; yes?
4 A. As explained by Ms Bradshaw, that is what the WACC is
5 used for by the company.
6 Q. Yes, but assume for the moment that Mr Earwaker is right
7 that the WACC rates are an appropriate measure of
8 financing costs in this case, your comparison does not
9 suggest that awarding Royal Mail compound interest based
10 on those rates would enable it to recover more than its
11 costs, does it?
12 A. So two things. One is I agree this speaks more directly
13 to foregone return on investments, what we are no longer
14 discussing in the new pleaded way of compound interest,
15 but, still, assuming Mr Earwaker is right, his equation
16 holds because he equates expected returns by
17 shareholders are equal to the actual cost of equity
18 faced by the company. So that is his premise; right?
19 So if you accept that, there is a link, there is
20 reasons to examine it and interrogate the actual returns
21 generated because we need to make sure that the
22 shareholders were actually expecting or demanding their
23 returns and we know that was not always the case, as for
24 example in the price review period number 2, where the
25 shareholder was not requiring a return.

1 So in his equation, for that price review just to
2 take a few years, because the demanded rate of return of
3 the shareholder is zero, the cost of equity is zero, so
4 you would not have any cost of equity even for the firm.
5 That can perhaps explain why the returns were in fact
6 low, the actual returns were low, because the
7 shareholder, at least in that period of time, was not
8 requiring any return.
9 Q. You seem to be seeking to cast doubt on the way in which
10 the WACC has been calculated, but you have agreed the
11 rates with Mr Earwaker, have you not?
12 A. Yes, but those are theoretical rates.
13 Q. I know and I am asking you to just accept for a moment
14 the hypothesis that the WACC is an appropriate way of
15 measuring costs, the costs that Royal Mail incurred. On
16 that basis the point I am putting to you is that your
17 analysis does not suggest that those WACC rates would
18 actually be enabling it to recover more than its costs.
19 You are simply comparing the WACC to the returns it
20 eventually achieved.
21 A. But when you are asking me to assume that the WACC is
22 the appropriate way to look at the costs, then all of
23 this theoretical discussion falls away. I am trying to
24 connect the reasons why it could be reasonable, you
25 know, the relevant rate to measure costs, and that

1 reason is predicated on the cost of equity being equal
2 to the rate of return or the opportunity cost of capital
3 of shareholders.
4 Q. We have been discussing and I have certainly put to you
5 that financing an unlawful overcharge with retained
6 earnings involves a cost to the company even if it does
7 not involve cash outflows. I know you do not accept
8 that but I have put it to you. You agree with
9 Mr Earwaker that this cost cannot be observed directly
10 and so it has to be estimated by analysis and I think
11 you agree with him that the WACC is a standard textbook
12 measure of doing this; yes?
13 A. Correct.
14 Q. So if one is seeking to estimate the cost to a company
15 of using debt and equity finance -- sorry, debt and
16 equity to finance an unlawful overcharge, you would
17 accept the WACC is a suitable measure for doing so; yes?
18 A. But your premise defines the answer.
19 Q. In what way?
20 A. Because you are saying if the cost of capital or the
21 WACC is the right measure to measure those costs, is the
22 WACC -- should the WACC be used, and --
23 Q. Yes, I see.
24 A. -- your premise is the answer.
25 Q. All right. Perhaps I can break it down a bit. If one

1 is seeking to -- and I do not think this is
2 controversial -- if one is seeking to estimate the cost
3 of debt and the cost of equity combined, the WACC is
4 a standard way of doing it? It is a well-established
5 method of doing it?
6 A. Yes, as a tool to evaluate investments projects, yes.
7 Q. I am going to move on now to a different topic and it
8 may be prudent at this stage to go into private session
9 for the same reasons as yesterday.
10 THE CHAIRMAN: All right. Can we do that? Turn off the
11 livestream. Everyone is okay here?
12 MR BEARD: Everyone's within the ring on this side. I can't
13 speak for the others.
14 THE CHAIRMAN: Okay, great. What about the transcriber?
15 Are we okay just to go straight in? Thank you.
16 (2.26 pm)
17 (The hearing continued in private - see separate transcript)
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1 INDEX

2

3 MR JULIAN DELAMER (affirmed) 1

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5 Examination-in-chief by MR BEARD..................1

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7 Cross-examination by MR LASK 2

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