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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

Monday 13 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**

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**A P P E A R A N C E S**

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

Monday, 13 June 2022

1  
2 (10.00 am)

3 Housekeeping

4 THE CHAIRMAN: Good morning.

5 MR WARD: Morning, sir. We have one process point about  
6 this morning's hot tub.

7 THE CHAIRMAN: Okay.

8 MR WARD: I can explain now. Mr Harvey has asked to have  
9 with him a hard copy of some documents which are derived  
10 from the disclosure which relate to the regulatory  
11 process and we have explained it to DAF. We provided  
12 them with an index over the weekend and I think the  
13 position is that they object. Of course, reference can  
14 be made through the electronic bundle. They are all in  
15 the bundle.

16 THE CHAIRMAN: Right.

17 MR WARD: But Mr Harvey thought it would be of assistance to  
18 have the hard copy and, of course ...

19 THE CHAIRMAN: So these are hard copies of what documents?

20 MR WARD: For example, Postcomm documents on volume  
21 forecasts and so forth.

22 THE CHAIRMAN: These are documents referred to by him in  
23 his --

24 MR WARD: I do not think necessarily, no, but I think he has  
25 reflected on that he thinks it would be useful for this

1 morning's discussion.

2 THE CHAIRMAN: Okay. What is the problem with that?

3 MR BEARD: Well, there is no formal problem with it save  
4 that we do not generally -- we have not generally been  
5 seeking to allow the experts to take into the box sort  
6 of curated sets of material. The two issues that will  
7 arise and will be matters for submission are these are  
8 documents that were not referred to by Mr Harvey in his  
9 report and, therefore, in relation to these matters, if  
10 there were matters that Mr Harvey wanted to rely upon  
11 and explain the significance, he really should have  
12 explained that previously. We will deal with that in  
13 due course.

14 The other matter, of course, is that these were not  
15 put to Mr Bezant who was dealing with these sorts of  
16 regulatory issues last week and therefore, again, there  
17 are concerns in relation to it. The fact that there are  
18 hard copies rather than just calling up the electronic  
19 is not of significance. Providing witnesses with  
20 essentially comfort blankets of curated documents just  
21 is not the way that we have been doing things so whether  
22 that constitutes an objection or not does not matter  
23 from our point of view. We are concerned about what is  
24 being done here when these materials have not been  
25 referred to in reports and no evidence has been

1 provided.

2 THE CHAIRMAN: Yes. Well, they might be valid points to  
3 make in closing, but I do not think they really affect  
4 the way that evidence should be given, and if it  
5 helps -- well, we will see if it helps, but ... so they  
6 are all in the electronic bundle, so we will be given  
7 electronic references.

8 MR BEARD: Yes. These are not documents that are outside  
9 Opus and that is why to put it as a sort of formal  
10 objection would be wrong because we recognise that it is  
11 not as though, like we had last week, with documents  
12 being introduced -- it is not the night before. I think  
13 two were added to Opus yesterday, it must be said, so a  
14 couple of them do fall into that category, but whether  
15 or not they are being added at the last minute --  
16 because I think most of these or all of them might be  
17 public documents, a bit like the ones previously. It is  
18 what is being done with them, but we will leave that.

19 MR WARD: Just a point of clarification. Mr Beard used the  
20 word, "Curated". I do not think he meant to suggest  
21 that the lawyers have curated them. They certainly have  
22 not. These are documents that Mr Harvey has asked to  
23 put in.

24 THE CHAIRMAN: All right. Well, I think we should just get  
25 on with it and -- with our proportionate hat on. Right.

1 Welcome back. You probably need to be sworn in again.

2 You can probably do it by heart by now.

3 PROFESSOR NEVEN: I think I could.

4 MR JAMES HARVEY (affirmed)

5 PROFESSOR DAMIEN NEVEN (affirmed)

6 MR BEARD: Sir, before we begin, the tribunal is probably  
7 well aware of all the document references but, actually,  
8 this is a topic on which Professor Neven has only  
9 produced one report -- I am sure the tribunal is well  
10 aware of that -- and then we have the joint statement.  
11 Mr Harvey has produced a couple. Thank you.

12 THE CHAIRMAN: Okay.

13 Questions by THE TRIBUNAL

14 MR RIDYARD: The first question is very general, Mr Harvey.  
15 Maybe you could go first for us on this. Could you just  
16 explain to us, what is the issue in relation to volume  
17 and can you summarise the methodological issues that  
18 arise in addressing that issue?

19 MR HARVEY: Yes. So the issue is when -- if Royal Mail's  
20 price is increased as a consequence of passing on the  
21 overcharge, the question arises what happens next and  
22 whether and how much their sales would have reduced as  
23 a consequence, and so the first thing we need to work  
24 out is by how much would their sales have reduced as  
25 a consequence, which requires information relating to

1           how responsive customers are to prices, elasticity of  
2           demand, and then the thing that happens next is if  
3           volumes do go down, the revenues fall, but it is also  
4           possible that Royal Mail would have made cost savings as  
5           a consequence of selling fewer volumes, and so we need  
6           to work out by how much costs would have gone down as  
7           a consequence of the volume loss.

8           MR RIDYARD: Just to get a handle on this, so let us say  
9           hypothetically we were talking about a 10% overcharge on  
10          trucks, that translates to an increase in the price of  
11          stamps of what kind of percentage?

12          MR HARVEY: So in my report I am having to take some  
13          hypothetical scenarios, but --

14          MR RIDYARD: Yes, of course.

15          MR HARVEY: -- but suppose that it was fully passed on, the  
16          increase in prices, I think, would be of the region of  
17          0.02/0.03%, something like that.

18          MR RIDYARD: So 0.02% increase in the selling price  
19          downstream, and then we want to know what impact that  
20          has on volume of stamps sold --

21          MR HARVEY: Yes.

22          MR RIDYARD: -- and then we need to know what the relevant  
23          cost measure was, what is the avoidable cost or whatever  
24          the relevant cost measure is so we can then understand  
25          what loss of profit arose there.

1 MR HARVEY: That is right, yes. So, they are the key  
2 economic issues.

3 THE CHAIRMAN: You are saying that there is also, possibly,  
4 a reduction in costs as a result of this loss of  
5 volume---

6 MR HARVEY: Yes.

7 THE CHAIRMAN: So margins could, sort of, stay the same if  
8 there is a balance, the increase in prices, loss of  
9 volume, reduction in costs.

10 MR HARVEY: It is not so much that, sir. When you, if you  
11 like, the sort of first round effect is revenues,  
12 revenues fall, but, obviously, what we are concerned  
13 about here is the extent to which that translates  
14 into...

15 (Realtime transcription pauses for technical issue)

16 THE CHAIRMAN: It is all being recorded so it is not ... so  
17 we might not have realtime; is that right? It is  
18 working now. It sort of stopped, I think, in the middle  
19 of Mr Ridyard's question. Why do we not go back to that  
20 and get your answer again?

21 MR RIDYARD: So then, let me ask again. So we have got  
22 a hypothetical 10% increase in truck price. If passed  
23 through into stamp price, it would be a 0.02% increase  
24 in stamps. That results in a loss of -- in a reduction  
25 of stamp revenue to the Royal Mail, which you get by

1 knowing the elasticity of demand for postal services,  
2 and that, in turn, then has an effect on costs because  
3 you do not have to print the stamps that you are no  
4 longer selling and some other things maybe, maybe some  
5 deliveries do not happen, so that saves some costs, so  
6 you end up with a net profit effect there?

7 MR HARVEY: That is correct.

8 SIR IAIN MCMILLAN: Just on that point, that subject, if I  
9 may. Reduction in costs to maintain or try to maintain  
10 profit levels, would that be variable costs, would it be  
11 fixed costs, would it be both, and how do you quantify  
12 which costs would be cut in order to do that and how do  
13 you quantify that?

14 MR HARVEY: So the costs that we are concerned with are the  
15 costs that vary with volume, so in terms of how we do  
16 it, we have evidence from Royal Mail at various points  
17 in time where they have sought to understand the extent  
18 to which their costs do vary in volumes, and I think one  
19 of the things that we are going on to discuss, but I can  
20 go there now, is which of those estimates are  
21 appropriate to use in the context of this calculation.  
22 But that is how it is done, so that the first part is  
23 the -- what is the reduction in volume, and there we  
24 have information from Royal Mail regarding how sensitive  
25 volumes are to price changes, and then the second part



1 is if that type of volume reduction takes place, what  
2 proportion, as it were, of costs are variable with  
3 volumes, and that comes from other documents.

4 MR RIDYARD: Thank you. Maybe, Professor Neven, do you want  
5 to step in now and pick up the story so far?

6 PROFESSOR NEVEN: Yes, indeed. Maybe the best thing would  
7 be for me to use a little graph and I would like to use,  
8 actually, the graph that Mr Harvey has produced, which  
9 is a simplified version of the graph that I initially  
10 produced. That is in the third report of Mr Harvey. It  
11 is on page 106 and the document is {E/IC52/106}.

12 Yes. That is it. Okay. So this graph actually  
13 explains, I think, very clearly what are the effects of  
14 an increase in price that the regulator would have  
15 allowed in order to compensate for the overcharge. So  
16 what you have on this graph is, first, the factual  
17 quantity, which is the quantity that Royal Mail has  
18 produced, and you have the price that has been charged  
19 by Royal Mail, which is denoted as "PF", so this is the  
20 price interaction. This is the price that has resulted  
21 from -- it has taken place during the infringement.

22 Now, what you also have in that graph is the  
23 quantity in the counterfactual and the price in the  
24 counterfactual, so you see that the quantity in the  
25 counterfactual is higher and the price in the

1 counterfactual is lower and, of course, the difference  
2 between the price in the counterfactual and the price in  
3 the factual is what is referred to as "Delta P", so it  
4 is the difference in price -- it is the increase in  
5 price that the regulator would have allowed in order to  
6 compensate for the existence of the overcharge. You  
7 also see that, because of this price increase, of course  
8 the quantity falls; that is to say the quantity in the  
9 counterfactual is higher than the quantity in the  
10 factual.

11 Now, in order to understand what happens when there  
12 is an overcharge -- and here I am making the assumption,  
13 like Mr Harvey, that the overcharge is a fixed cost. We  
14 can discuss whether it is a variable cost later, but let  
15 us assume it is a fixed cost, so all of a sudden Royal  
16 Mail has to incur a higher fixed cost. Royal Mail goes  
17 to the regulator and says, "Look, I have a higher fixed  
18 cost, I need to be compensated for that. The price  
19 needs to increase". What you see in this graph is that  
20 there is a price increase that is allowed by the  
21 regulator, which is delta P, which has two effects. The  
22 first effect -- and this is the one that we have been  
23 discussing so far -- is that the quantity is falling  
24 from QC to QF. This is the lost volume, and you see  
25 that on this lost volume there is a loss of profit,

1           there is a loss of margin, and this is depicted by the  
2           area D. So it is essentially the initial margin, which  
3           is the difference between the price in the  
4           counterfactual and the cost -- the variable cost of  
5           Royal Mail. You see that this is the loss of margin on  
6           the quantity that Royal Mail will have lost as  
7           a consequence of the increase in price which has been  
8           granted by the regulator.

9           What you also see -- and I think that there has been  
10          a discussion last week on this and I just want to  
11          clarify -- is that this is not the only effect, of  
12          course. What is also happening is that the price is  
13          increasing from PC to PF, which means that on the  
14          quantities that Royal Mail keeps on selling, this is the  
15          quantity QF, there is an increase in margin which is  
16          depicted by the area A, so whenever the regulator allows  
17          for an increase in price, two effects are taking place.  
18          On the one hand, there is a reduction in volume, which  
19          is the area D in the graph; on the other hand, there is  
20          an increase in revenues on what I referred to in my  
21          report on the intra-marginal sales. I mean, this sounds  
22          a bit technical, but, I mean, this is only referring to  
23          the sales that Royal Mail keeps making after the  
24          increase in price.

25          So if you now think about the process of the

1 regulator, the regulator is trying to find an increase  
2 in price so that the combination of the two effects, the  
3 increase in revenues on the intra-marginal sales less  
4 the loss of margin on the marginal sales, the sales that  
5 are lost, is equal to a certain percentage of the  
6 overcharge that has to be compensated. So Mr Harvey  
7 says, "Okay, the increase in price has to be such that  
8 50% of this overcharge is compensated". So what you see  
9 clearly in this graph is the regulatory process working.  
10 The regulator is calibrating delta P, so that A minus D,  
11 the sum of these two areas, so the increase in revenues  
12 on intra-marginal sales less the loss of profit on the  
13 marginal sales on those sales that are lost is equal to  
14 a certain percentage of the overcharge.

15 Now, what is the first thing to observe from this  
16 graph is that focusing on the loss of volume from the  
17 perspective of Royal Mail and seeking compensation for  
18 the loss of volume is a very one-sided perspective  
19 because whenever the regulator is increasing price,  
20 indeed there is a loss of profit on the lost sales, but  
21 there is an increase in revenue on the intra-marginal  
22 sales, so it is basically saying that the regulator is  
23 allowing for a price increase, there is a negative  
24 effect on the profit, there is a positive effect on the  
25 profit, and, of course, these two effects are meant to

1           be large enough in net terms in order to compensate the  
2           overcharge, but Royal Mail is seeking compensation for  
3           the negative effect, forgetting about the positive  
4           effect.

5           MR RIDYARD: I mean, your characterisation of the regulatory  
6           regime is sort of assuming the whole problem away here,  
7           is it not? You are saying if the regulator will make  
8           good whatever bad thing happens to Royal Mail, then,  
9           well, we can pack up and go home, can we not, because --

10          PROFESSOR NEVEN: Not necessarily because, I mean, Mr Harvey  
11          is making assumptions about the change in price that  
12          a regulator will set, which is only a proportion of the  
13          overcharge, and he is saying it is only a proportion of  
14          the overcharge, so there will be something left; okay?  
15          There will be a net reduction in the profit of  
16          Royal Mail. But focusing on the loss of profits on the  
17          lost sales is a very one-sided way of looking at it  
18          because, in any event, there is an increase in revenues  
19          on intra-marginal sales which has to be bigger --  
20          okay? -- and it has to be bigger because the regulator  
21          will make sure that is the difference between the  
22          increase in revenue, the area A, less the loss of  
23          profit, the area D -- that the difference between them  
24          is large enough in order to compensate a proportion of  
25          the overcharge. I am not saying it is 100%. Mr Harvey

1 is saying it is 50%; okay?

2 In a sense this is not Mr Harvey's problem.  
3 Mr Harvey had instructions to look at the loss of  
4 profits associated from the reduction in sales, but what  
5 I want to emphasise -- and this is one of the points  
6 that I made in my own report -- is that it is a very  
7 one-sided way of looking at the consequence of the price  
8 increase that is allowed by the regulator.

9 MR RIDYARD: Mr Harvey?

10 MR HARVEY: So I think in the context of the first report  
11 I was approaching it from the perspective of there is  
12 a pass-on that takes place, and call it 50%. What would  
13 be the volume loss associated with that pass-on? So  
14 I did not really make any particular assumption about  
15 the way the regulator was going about its work at that  
16 point. It was simply to calculate that number.  
17 Professor Neven, in his reply, made the argument that,  
18 well, this would have been wrapped up in the way the  
19 price control worked, so that, in a sense, any increase  
20 in prices that gave rise to a volume reduction would be  
21 compensated for in a sense by the regulator allowing  
22 Royal Mail to charge a bit more, and then in my reply  
23 report to that, in my -- I have forgotten --  
24 supplementary report, I commented on what I thought  
25 about in terms of that argument and the applicability on

1           it, which I think is the second agenda matter.

2           PROFESSOR NEVEN: Sorry, I disagree with the description  
3           that Mr Harvey gave. I mean, in the first report that  
4           he has submitted, Mr Harvey has computed the price  
5           increase that would be required in order to absorb,  
6           indeed, the increase in the fixed cost associated with  
7           the overcharge. He has not referred in particular to  
8           the regulator. But the only way in which you can have  
9           a price increase in a regulated firm is if the regulator  
10          allows it, so Mr Harvey has actually computed that in  
11          his report. He has computed the price increase that is  
12          required in order to compensate for the overcharge.

13          Now, there is one difference between what Mr Harvey  
14          does and what I have done, which relates to the question  
15          of Sir Iain, is that what Mr Harvey has done in his  
16          first report is to consider that whenever there is an  
17          increase in the price and the reduction in the quantity  
18          sold by Royal Mail, Royal Mail will lose not only D but  
19          also F, so basically he is assuming that the regulator  
20          is going to calibrate the price increase in such a way  
21          that the increase in intra-marginal revenue less D and F  
22          is such that it is equal to a proportion of the  
23          overcharge. So essentially what Mr Harvey is assuming  
24          is that the regulator will not take into account the  
25          fact that whenever the volume of sales of Royal Mail

1 goes down, the cost -- the variable cost of Royal Mail  
2 also goes down. He is looking at a loss of revenue on  
3 those marginal sales. He is not looking at the loss of  
4 margins.

5 I have assumed in my own calculation, in light of  
6 what Mr Bezant says, that the regulator would take into  
7 account the fact that if you were selling less as  
8 a consequence of the price increase, you are also going  
9 to save on variable cost because you are going to sell  
10 less and this is going to be taken into account in  
11 finding this price increase which will guarantee that  
12 additional revenues or additional profit, actually  
13 compensate for this additional fixed cost. So that is  
14 another difference between Mr Harvey and myself, at  
15 least in the context of the first report, because  
16 Mr Harvey does something different, as I am going to  
17 explain in a second, when he actually computes the loss  
18 of profit.

19 SIR IAIN MCMILLAN: Could I ask a question in relation to  
20 that, please? So if one assumes that the regulator  
21 allows an increase in the price to make up for the loss  
22 of profit or cost, whatever, is it possible, then, that  
23 that increase in price causes an additional drop in  
24 sales and it gets into a never-ending spiral?

25 PROFESSOR NEVEN: Yes, of course, what the regulator does --



1 I mean, you see that the regulator has to find the  
2 delta P such that the area A minus D is equal to a fixed  
3 amount. Of course, I mean as you are increasing the  
4 price you are converging to that number -- okay? -- so  
5 there is one number that you can easily see -- there is  
6 one number which will ensure that the increase in  
7 revenues on intra-marginal sales less the loss of  
8 margins on the marginal sales is equal to that fixed  
9 number, so it is not never-ending. I mean, what happens  
10 is that you have to take both effects into account but  
11 it sort of converges to one number.

12 SIR IAIN MCMILLAN: So does that mean, therefore, that in  
13 your view, Professor, the increase in price for, say,  
14 stamps to make up for the losses elsewhere will not be  
15 elastic and that the sales will remain as they were in  
16 spite of the rise in cost to the consumer?

17 PROFESSOR NEVEN: No. What I am saying is that the price in  
18 stamps will increase by the amount delta P on this  
19 graph, and this is the amount which is calibrated by the  
20 regulator to ensure that Royal Mail has additional  
21 revenues that compensate for the overcharge or a certain  
22 proportion of the overcharge. So, indeed, the price  
23 goes up, the quantity goes down and there will be a loss  
24 of volume, there is no doubt about it, but the loss of  
25 volume and the loss of profit on that volume is only one

1 part of the story.

2 THE CHAIRMAN: You are saying it is all part of the  
3 regulatory process and the way the regulator arrives at  
4 the price cap?

5 PROFESSOR NEVEN: Exactly.

6 THE CHAIRMAN: So if we are not in a regulated world, then  
7 how does it work there?

8 PROFESSOR NEVEN: Ah, in a non-regulated world the problem  
9 would be much more complicated.

10 THE CHAIRMAN: Yes. You would not be able to see how the  
11 company arrived at its actual price, taking into account  
12 the volume effects and the knock-on ...

13 PROFESSOR NEVEN: Exactly. What happens is that a firm  
14 maximising profit will find the optimal price increase  
15 which adjusts -- I mean, it will find a price increase  
16 that -- I mean, it keeps on maximising this profit in  
17 order to absorb this increase in cost, so if you had to  
18 do the same exercise for a commercial firm, you would  
19 need to find what is the elasticity faced by that  
20 commercial firm and that will -- actually what matters  
21 is the firm level elasticity that will depend on  
22 competitors, that will depend on, you know, many  
23 different things, in order to find out what is the  
24 optimal level of pass-on, what is the optimal level of  
25 price increase.

1 THE CHAIRMAN: They are getting a long, long way from the  
2 original overcharge, are they not, because they are  
3 working out the effect of that or how it is passed  
4 through, then the effect on volume and then the effect  
5 on prices.

6 PROFESSOR NEVEN: They are finding the best way to  
7 accommodate the shock. I mean, the fact that they are  
8 hit by an increase in the price of trucks, so it is an  
9 increase in their cost, they need to figure out what is  
10 the best way of reacting to that in order to minimise  
11 the fall in profit. Of course, if you have an increase  
12 in cost, then there is no surprise. I mean, however you  
13 want to -- however well you will be able to adjust, you  
14 are going to have a reduction in your profit, but the  
15 commercial firm will do it in such a way as to  
16 optimise -- in such a way as to optimise its profit  
17 again, given the increase in cost that is incurring. In  
18 the context of a regulated firm, what leads to the price  
19 increase is not the optimisation of the commercial firm  
20 but it is the action of the regulator.

21 THE CHAIRMAN: So we need to -- we are examining what the  
22 regulator actually did?

23 PROFESSOR NEVEN: What the regulator actually did or what  
24 the regulator was supposed to do, yes, indeed.

25 THE CHAIRMAN: All right.

1 PROFESSOR NEVEN: What I have assumed, I mean, is that the  
2 regulator would take into account the fact -- I mean,  
3 with respect to what I was discussing in terms of one  
4 difference between me and Mr Harvey is that what I have  
5 assumed in light of what Mr Bezant has concluded is that  
6 the regulator would take into account the cost  
7 consequences of a reduction in volume. So you would  
8 lose your volume -- I mean, you are printing less  
9 stamps. If you are printing less stamps, I mean, you  
10 have sort of less cost in terms of printing stamps and  
11 Mr Bezant is suggesting that the regulator would have  
12 taken that into account.

13 THE CHAIRMAN: Do you want to comment on that, Mr Harvey?

14 MR HARVEY: I am just thinking what order to do it in. So  
15 starting with the difference between the regulatory  
16 period and the commercial period, I think what is  
17 essentially being advanced here is that in the  
18 regulatory period the regulator has a view as to what  
19 the allowed, in a sense, profit should be for  
20 Royal Mail, and when volumes changed that view does not  
21 change and therefore it feeds very precisely into the  
22 prices that they are allowed to recover.

23 In the case of the commercial firm, they cannot  
24 escape the response of demand to price changes, so to me  
25 there is a key and distinct difference between the price

1 control period and the non-price control period.

2 On the observations in relation to variable cost  
3 savings that Professor Neven made at the start, so in my  
4 calculations I do take account of the fact that costs  
5 would be saved. What I have not done is to assume that  
6 there would be an additional saving of truck costs in  
7 the event of a reduction in volume. In actual fact,  
8 because of the price, the smallness of the price changes  
9 that we are concerned with here and the smallness of the  
10 volume changes, I really do not think that makes any  
11 material difference at all to the sums that we are  
12 arriving at.

13 MR RIDYARD: On the smallness, let us leave smallness to one  
14 side because we should discuss that, I agree. Let us  
15 leave the smallness point in itself to one side just for  
16 now.

17 PROFESSOR NEVEN: Can I just comment in here because  
18 I disagree with what Mr Harvey just said.

19 Mr Harvey, in his first report, is calculating  
20 delta P. He is calculating the price increase that  
21 would be required in order to compensate for A the  
22 increase in intra-marginal revenues, less D, less F, so  
23 it is clear that in his first report he ignores the cost  
24 saving when he computes the price increase. However,  
25 that is not the end of the story because the next stage,

1 of course, in order to compute the loss of profit on  
2 lost volume, is to compute area D. I mean, that is to  
3 say that is what Royal Mail is seeking compensation for.  
4 It is the loss of profit.

5 Now -- and Mr Harvey actually could have done --  
6 could have used the price increase that he had computed,  
7 which will give the price in the counterfactual and the  
8 quantity in the counterfactual, in order to compute  
9 area D. He could have done it but he is not doing that.  
10 He is using a formula, and maybe it is worth to go into  
11 his first report where he explained where the formula is  
12 or just you want me to explain what the formula does?

13 MR RIDYARD: I am just -- I mean, this whole question over  
14 the formula is discussed at length, is it not, in your  
15 joint report? I mean, the to and fro of the arguments  
16 on the correct formula is explored in some detail in the  
17 joint experts' report.

18 PROFESSOR NEVEN: But I think -- would you just allow me to  
19 say one thing about the formula and explain why using  
20 the formula in order to estimate area D is incorrect?

21 MR RIDYARD: Okay.

22 PROFESSOR NEVEN: There are two reasons. This formula has  
23 a denominator, what Mr Harvey describes as the loss of  
24 profit associated with the reduction in volume which  
25 should be area D, but it is not. The denominator in

1 this formula has area B plus area D. So by doing that,  
2 naturally Mr Harvey is overestimating the loss of  
3 profits. He is going to tell you that it does not  
4 matter because the difference in price is small and we  
5 can discuss that indeed if the price difference is  
6 small.

7 There is a second issue with the formula of  
8 Mr Harvey, is that the denominator of that formula is  
9 a term that Mr Harvey is denoting as pass-on. If you  
10 look at the math, actually you can see very well what it  
11 is on the graph. It is QC, it is the counterfactual,  
12 multiplied by the difference in price, so it is A plus  
13 B. That is what you have in the denominator of the  
14 formula.

15 However, if you are using the formula, Mr Harvey  
16 could have used the price increase that he had computed  
17 in the first stage inputted into the formula but he does  
18 not do that. What Mr Harvey does is that he uses -- he  
19 replaces the area A plus B by, again, a proportion of  
20 the overcharge, and, you know, this is very odd because  
21 he has computed the price increase that would be allowed  
22 by the regulator in order to ensure a certain level of  
23 profitability. He does not use this price increase. He  
24 is introducing as estimate for A plus B a proportion of  
25 the overcharge.

1           Now, then you have to wonder what is the consequence  
2 of doing that? Basically, what he does, if you do that,  
3 is that he is now assuming, by doing that, that the  
4 price increase that would be allowed by the regulator is  
5 not the price increase that he has computed before but  
6 it is the price increase such that A plus B now would be  
7 equal to a certain proportion of the overcharge. So the  
8 effect of doing that is to introduce a change in price  
9 that is actually lower than the one he computed before;  
10 okay? But this is incorrect as a matter of using the  
11 formula and it is sort of logically very odd because, if  
12 you do that, if you use A plus -- if you use this -- the  
13 proportion of the overcharge as an estimate for A  
14 plus B, you are implicitly assuming that there is  
15 a change in price allowed by the regulator that ignores  
16 the elasticity. So, I mean, you are introducing in the  
17 formula a change in price set by the regulator that  
18 ignores the elasticity in order to compute what is the  
19 loss of profit that is only existing because of the  
20 elasticity, so this is an odd way of doing it. That is  
21 the second reason as to why there is a discrepancy  
22 between my calculation and those of Mr Harvey and this  
23 is why I think that the approach of Mr Harvey in  
24 computing the loss of profit is actually incorrect.

25       THE CHAIRMAN: I think you probably ought to give Mr Harvey



1 a chance to respond on that.

2 MR HARVEY: Well, I am conscious of what Mr Ridyard just  
3 said, so the first response to this is precisely what  
4 I said in the report, which is --

5 MR RIDYARD: I mean, this is gone over in some detail in the  
6 report.

7 MR HARVEY: Yes, and it makes very -- I think we are talking  
8 about £1,000 or something like that difference because,  
9 of course, the percentage point increase in prices is  
10 trivially small.

11 MR RIDYARD: Are you accepting that there is some logical  
12 validity to Professor Neven's point but it is --

13 MR HARVEY: No, there is another interpretation of these  
14 figures, which is that, in terms of the area B,  
15 Professor Neven said, well, I have sort of essentially  
16 over-included in the loss of volume reduction, albeit to  
17 a small number. The way that I was thinking about it  
18 was more from the perspective of what is included in the  
19 pass-on figure in the first place and whether that  
20 over-includes -- so put another way, the possibility  
21 that the regulator, in setting the price, the higher  
22 price in this scenario, would not have taken account of  
23 the reduction in volume and, therefore, assumed that  
24 they could have recovered the full increase in price as  
25 across the counterfactual volumes, not the factual

1 volumes, so it is more a question of what ought to be  
2 netted out of the 50% figure rather than the loss of  
3 volume figure itself. But, as I said, I do not think --  
4 this really does not add up to a lot of money at all.  
5 It is £1,000/£2,000.

6 PROFESSOR NEVEN: That is incorrect. I mean, what amounts  
7 to £1,000 or £2,000 is the fact that he has included the  
8 area B when he should not. What is a more significant  
9 mistake is the fact that he has replaced in the  
10 denominator what is the quantity in the counterfactual  
11 multiplied by the change in price by the percentage of  
12 the overcharge which ignores the elasticity. This is  
13 a more significant mistake.

14 MR RIDYARD: I suggest we leave it there because I think  
15 this is, as I say, pretty well rehearsed in the joint  
16 reports.

17 I just wanted to go back very briefly, Mr Harvey, on  
18 something you said. When you were responding to  
19 Professor Neven's distinction between a private company  
20 and a regulated company, he was talking in general  
21 terms, but then you talked in very specific terms about  
22 the Royal Mail case and you talked about the period when  
23 there was price regulation or -- I cannot remember the  
24 exact terms you used, but I just wanted to be clear from  
25 you which periods you were referring to there in terms

1 of the difference.

2 MR HARVEY: The difference -- so the periods that I had in  
3 mind were the second price control and the third price  
4 control --

5 MR RIDYARD: Right.

6 THE CHAIRMAN: Postcomm 2 and 3?

7 MR HARVEY: Postcomm 2 and 3 -- as opposed to the first  
8 price control, which you will recall was a price freeze  
9 for some product and a price increase at a rate of RPI  
10 for others, and then beyond that we had the period of --  
11 the Government period and after that the Ofcom period.

12 MR RIDYARD: So you are saying that the Postcomm 2 and 3  
13 periods are various -- it is perhaps right to  
14 characterise the things that are driving price as being  
15 the price regulation -- well, price regulation is  
16 relevant, of course, all the way through -- but it is  
17 more relevant to characterise Royal Mail's conduct as  
18 being conduct where it can go to the regulator for some  
19 compensation for the loss it suffers, whereas outside  
20 that it is better to characterise its behaviour as if it  
21 was a private firm operating in a -- well, not  
22 a competitive market exactly, but a normal market?

23 MR HARVEY: Outside of that period you do not have the --  
24 sort of the volume forecasting, price setting, get back  
25 to the same profit.

1 MR RIDYARD: Yes, I am just trying to understand -- that is  
2 what you are saying?

3 MR HARVEY: Yes. Sorry, the reason I slightly hesitated, on  
4 price control 1 there was, of course, a price control,  
5 but as far as I am aware, because they simply fixed  
6 the -- set a price at RPI or price-froze them, I do not  
7 think they were taking account of the feedback with  
8 volumes into those prices. So that is -- so, in fact,  
9 there is sort of these three periods -- price control 1,  
10 which is quite a crude, in a sense, price control  
11 process, price control 2 and 3, where volumes were  
12 considered, and then outside of that you are into what  
13 appears to be more like commercial price setting.

14 MR RIDYARD: One thing I would like to come back to now is  
15 what I mentioned a moment ago or a few moments ago now,  
16 is this point about the small size of the effect  
17 because -- a point I think, Mr Harvey, you make is that  
18 because these prices -- because the delta P is so  
19 incredibly small, you know, none of this would be sort  
20 of measurable and therefore none of it would change  
21 anything in reality, whereas if we are talking about  
22 a 5% price rise there might be a story to be explored,  
23 but if it is a 0.02% price rise there is nothing to see.  
24 Is that -- it may be crudely expressed -- is that your  
25 position on the smallness?

1 MR HARVEY: Broadly, yes. So it is obviously conditioned by  
2 my work on supply pass-on. What you learn through the  
3 loss of volume work is that the reaction of volumes to  
4 prices, it is inelastic, so if you have a 1% or 2%  
5 increase in -- a 1% increase in prices, then you have  
6 a proportionately smaller reduction in volume. So when  
7 I have already concluded that the price increases were  
8 of an order of magnitude that perhaps would not have  
9 influenced the price control, here the order of  
10 magnitude of the volume changes are proportionately  
11 smaller, and so in looking at some of the issues that  
12 arose in the process of volume forecasting, I looked at  
13 the difference in volumes that are implied by the price  
14 changes on an annual basis, which are in the region of  
15 1 to 2 million units out of sales of around 20 million.  
16 I also looked at the difference -- sorry -- 20,000, so  
17 20 billion. I also looked at the difference between the  
18 regulator and Royal Mail in terms of their volume  
19 forecasts and there was, obviously, a large difference  
20 between them. So sort of set against those sort of  
21 benchmarks, this is a small figure.

22 MR RIDYARD: Is this the same argument that was rehearsed  
23 when we talked about the pass-through effect in the  
24 first place?

25 MR HARVEY: Yes, it is similar. Not the same.

1 MR RIDYARD: If you won that argument then we would not be  
2 talking about volume changes and if you lost that  
3 argument then I suppose we would still want to be  
4 talking about them here, would we not?

5 MR HARVEY: Yes, we would, and then you are into how  
6 precisely do prices feed into the way the regulator --  
7 sorry -- the way volumes feed into the way the regulator  
8 sets prices through its modelling process.

9 MR RIDYARD: Yes.

10 MR HARVEY: That relates to the documents that I wanted to  
11 show you.

12 MR RIDYARD: Is that adding -- I mean, we sort of went  
13 through that with Mr Bezant's evidence at some levels.  
14 Is that adding any value to the discussion?

15 MR HARVEY: I think so, yes. I can take you to it now.

16 MR RIDYARD: Okay. Well, let us do it then, yes.

17 PROFESSOR NEVEN: Can I just make one observation?

18 MR RIDYARD: Yes, go ahead.

19 PROFESSOR NEVEN: Short. If you argue that the change in  
20 price is very small and if you argue that as  
21 a consequence the change in quantity is even smaller  
22 because elasticity is less than one, then the loss of  
23 profit has to be the product of the two which is even  
24 smaller, so, you know, if you argue that the changes in  
25 prices are small, there is no way you can argue that

1           there is a loss of profit that is measurable.

2       MR HARVEY: I disagree with that, obviously.

3       THE CHAIRMAN: Getting smaller and smaller as you ...

4       PROFESSOR NEVEN: Exactly. You multiply two small numbers,  
5           it gives you even smaller.

6       MR HARVEY: I am obviously not saying that the sum is  
7           irrelevant in the context of the overcharge. It is  
8           a different issue, is it not?

9           So these were the documents I wanted to show you.  
10          So if we could go to I3/390, page 47, {I3/390/47}. Does  
11          everyone have this? Okay. So just to locate this  
12          document, this is the document prepared by  
13          Frontier Economics. They are calculating volume  
14          forecasts for their price control.

15       THE CHAIRMAN: On behalf of who?

16       MR HARVEY: On behalf of Postcomm.

17       THE CHAIRMAN: Postcomm?

18       MR HARVEY: Yes.

19       THE CHAIRMAN: Okay.

20       MR HARVEY: So Frontier was Postcomm's adviser at this time.

21          So the final proposal is the consultation document that  
22          emerges just before Postcomm obviously makes its  
23          decision. So you will see in the third bullet they say:

24                "The overall ..."

25          Well, the starting point here says:

1           "The overall market volumes are iterated in that  
2 they are adjusted for the X factors proposed by Postcomm  
3 in its Final Proposals."

4           What Frontier is describing there is that they have  
5 done some sensitivity analyses to look at how the volume  
6 forecasts would be affected by adopting those X factors.  
7 Then this bullet point goes on to say that:

8           "The volume chosen by Postcomm for the Final  
9 Proposals (and reported in Table 18) ..."

10          Which is on the previous page:

11          "... is based on overall market growing at the same  
12 rate as if the current price control had continued.  
13 However, we understand that Postcomm took account of the  
14 financial impact of this iteration as part of its own  
15 financeability analysis."

16          So what they seem to be saying here is that they  
17 have done the sensitivity to take account of the  
18 interdependency between prices and volumes, but that the  
19 volume forecast that was, in fact, chosen by Postcomm is  
20 based on the overall mail market growing at the same  
21 rate as if the price control had continued, so the  
22 current price control, of course, at this time being the  
23 second price control.

24          So that is this document.

25          MR RIDYARD: Does the following sentence sort of negate



1           that, though?

2       MR HARVEY:  So the following sentence is saying that, when  
3           looking at, essentially, the cashflow implications,  
4           Postcomm also conducts some sensitivity analysis to see  
5           whether that would affect its view on where the price  
6           control should be set.  That is not the same as saying  
7           that Postcomm set the price control to reflect the Xs  
8           for the prices as in the final proposals.

9       MR RIDYARD:  This document is -- this is Postcomm's advisers  
10          describing what Postcomm did?

11      MR HARVEY:  Yes, in its final proposals, that is right.  So  
12          I think these were being produced in tandem.  So I think  
13          this was published at the same time as the  
14          final proposals came out.  Obviously they were talking  
15          to each other.

16      THE CHAIRMAN:  Are they saying that that is the appropriate  
17          course to take, Frontier Economics, or are they just  
18          recording --

19      MR HARVEY:  That is not my -- I think they are just  
20          recording what happened.

21          So that is that, and then Royal Mail.  So, if we can  
22          go to {I6/243.1/6}, so rather than me reading this all  
23          out, perhaps if you could read paragraphs 2.8 through to  
24          2.10?  (Pause)

25      MR BEARD:  Can I just check?  Is this now being put forward

1 as factual evidence as to Royal Mail's position?

2 THE CHAIRMAN: Well, we will wait to see, I think.

3 MR BEARD: Yes. No, well, it is something of a treat coming  
4 from the experts at this stage in the hot tub, but we  
5 will wait and see, as you say, sir. (Pause)

6 MR RIDYARD: So what is the bottom line?

7 THE CHAIRMAN: Probably the bottom line.

8 MR HARVEY: The bottom line is that when I spoke in my  
9 report about essentially a lack of fine-tuning of the  
10 prices to volumes in view of their size, this is what  
11 this document is suggesting, is that they are not  
12 actually fine-tuning the volume forecasts and the prices  
13 for the revised X factors.

14 MR RIDYARD: Professor Neven, are you inspired to comment on  
15 this or ...

16 PROFESSOR NEVEN: No. Not on this, no.

17 THE CHAIRMAN: Sorry, just so I understand, you are saying  
18 that this shows that Postcomm was not really taking into  
19 account any loss of volume as a result of any increase  
20 in prices?

21 MR HARVEY: What I am saying is that -- well, what this is  
22 showing is that new X factors emerged through the new  
23 prices, emerged through the price control process, and  
24 this is suggesting that Postcomm did not go back to  
25 recalibrate the prices in view of the volume reduction

1           that could arise from it, and that is what Royal Mail  
2           appears to be expressing concern about here. So this  
3           argument that the price control is set in a way that  
4           gets you, sort of, back to where you were when prices  
5           change because they sort of recalibrate and set a new  
6           set of prices, that does not appear to be precisely what  
7           is going on here. There is some difference.

8           SIR IAIN MCMILLAN: Mr Harvey, is your point here that the  
9           evidence that you gave in terms of the granularity, that  
10          this supports your evidence?

11          MR HARVEY: Yes.

12          SIR IAIN MCMILLAN: Thank you.

13          MR HARVEY: Then in the end Postcomm set the volume  
14          forecasts equal to what was in that table 18 in the  
15          Frontier report.

16          SIR IAIN MCMILLAN: Thank you.

17          MR RIDYARD: I think we have dealt with the question of the  
18          marginal sales in the earlier discussion. It seems to  
19          me the only topic we have not -- well, we have touched  
20          on it but I think it would be useful just to recap on  
21          it -- would be, insofar as volumes are lost -- you know,  
22          Royal Mail loses a certain volume of business, so how do  
23          we calculate -- how do we assess the impact of  
24          profitability on a lost -- you know, on these lost  
25          units? So which costs do we take into account when we

1           observe a loss of volume and to see what impact that has  
2           on the business?

3           Professor Neven, would you like to go first on that?

4       PROFESSOR NEVEN: Yes. I mean, I have taken an estimate  
5           that the variable accounts for 40% of the total cost,  
6           and this is a mid-point of the estimates that are put  
7           forward by Mr Harvey, and there is also an estimate that  
8           seems to be more appropriate for the later period. We  
9           understand from Mr Harvey's description that maybe the  
10          variable costs were higher during the initial period, so  
11          from that perspective it is conservative, and this is  
12          also a number that is supported by the regulator.

13          I mean, the regulator in the later period has  
14          a proportion which is 39% or 39.6% and I am not going to  
15          out-guess the regulator.

16       MR RIDYARD: Mr Harvey?

17       MR HARVEY: Yes, so the figures that I have used is a 30%  
18          variable cost estimate and 0% variable cost estimate, so  
19          perhaps if we go to -- I can show you the figures that  
20          Professor Neven was referring to, so --

21       MR RIDYARD: The 30 versus 39, is that worth us going to?

22          I mean ...

23       MR HARVEY: Well, so, within the documents there are a range  
24          of estimates.

25       MR RIDYARD: What would be the case for 0%?

1 MR HARVEY: The 0% is that the number of units that fall, so  
2 it is the 1-2 million a year, is incredibly small. The  
3 figures that we have, the 30/40% figures, appear to be  
4 related to a volume reduction of the order of 10-30%, so  
5 significantly larger, and what intuitively -- if you  
6 think about the way this business works, it needs to get  
7 letters and so forth all across the country to every  
8 home and it seems to me that the change in costs that  
9 could arise and the very small reduction in letter  
10 volumes might be a lot smaller than the change in cost  
11 that would arise for a 10-30% change because that might  
12 give you an opportunity to reconfigure the way that your  
13 network runs. It may give you an opportunity to change  
14 the number of vans you have on any given route and so  
15 forth, and so it is kind of a reflection of what our  
16 figures measure and the circumstance that we are in with  
17 this case.

18 MR RIDYARD: I mean, I have read what Professor Neven has  
19 said on this. I will give you a chance to comment on  
20 your own, Professor Neven, but essentially a big effect  
21 is, in a business like this, it is made up of lots and  
22 lots and lots of very small effects all added together,  
23 so when it is added together to a very big effect, you  
24 are happy to countenance the idea that it may involve  
25 some cost savings. So I just think, intellectually, why

1           would you then not countenance it if you happened to  
2           have broken it down into lots and lots of small effects?

3       MR HARVEY: I suppose what we are talking about here is  
4           1-2 million letters or items and 20 million households,  
5           so that is -- what? -- 0.1 letter a year, something like  
6           that. When you are thinking about the actual activities  
7           that are being undertaken, which is to get the letter  
8           from A to B involving going to customers' houses, it is  
9           not clear to me that you would actually save costs.

10       MR RIDYARD: Okay, but there has to be -- it is a bit like  
11           the discussion we had last week or whenever it was about  
12           the numerous price caps and which one might be close to  
13           the threshold and which one would not. I mean, at some  
14           point one has to decide whether to put another van on  
15           the schedule, and when that decision happens it is very  
16           lumpy, it is a big increment of cost, but there has to  
17           be something that triggers that decision, whether it is  
18           going up or down, the number of vans, and it is very  
19           unlikely that any one of these changes would trigger  
20           that, but if you think about enough theoretical  
21           possibilities across the whole network, then sooner or  
22           later you will find one that does trigger it.

23       MR HARVEY: That is possible, and that is why, in my  
24           analysis, I have a 70% assumption and the 100%  
25           assumption.

1 MR RIDYARD: Professor Neven, anything else to add?

2 PROFESSOR NEVEN: I agree with the observation that --

3 I mean, one cannot rely on effects being small because  
4 of the fallacy of small effects. I mean, when big  
5 effects are the combination of a large number of small  
6 effects, if you neglect all small effects then you do  
7 not have any big effects either, so it is just  
8 rephrasing, I think, what was discussed earlier.

9 The only additional comment I would like to make is  
10 about the inherent distinction between variable cost and  
11 fixed cost, and the distinction really has to do with  
12 the time horizon. I mean, in the long term all costs  
13 are variable. Here we are considering an infringement  
14 that has lasted -- what was it? 14 years? -- and so, you  
15 know, this is the long term. Of course, we are looking  
16 at these increments every year, but this is a bit  
17 artificial. This is something that is taking place over  
18 a long period of time, so from that perspective, I mean,  
19 you might say that, yeah, well, maybe ...

20 MR RIDYARD: You have been very generous, then, to allow for  
21 the 40%?

22 PROFESSOR NEVEN: Exactly.

23 MR RIDYARD: Mr Harvey, any comment on that point?

24 MR HARVEY: Well, even over that long time horizon, that  
25 figure is still significantly less than the 10-30%

1 volume reduction that is implied by these figures or on  
2 which these figures are based, so I do not -- you know,  
3 as I said, I accept that some costs could have been  
4 saved and I have used the 70% figure, but, in view of  
5 the large difference between the two, I think it is  
6 appropriate to consider alternative estimates as well.

7 MR RIDYARD: Okay. I think that pretty much covers the  
8 points that we wanted to raise. Any points of ...

9 MR BEARD: Just for clarification, I now need to raise a few  
10 points on cross-examination. You might be shocked and  
11 surprised, but very limited, I hope. I was intending to  
12 do nothing but now we have had some more documents --

13 THE CHAIRMAN: Yes. You want to go back to that?

14 MR BEARD: I would like to go back to it. Would it be  
15 possible now to have a break? We have now heard for the  
16 first time --

17 THE CHAIRMAN: I think that would be sensible, and we can  
18 resume -- so we will have Mr Harvey then being  
19 cross-examined first.

20 MR BEARD: Yes. I mean, I am thinking it is going to be  
21 15 minutes. I am not thinking any longer than that  
22 because the key issues have been covered in the hot tub.

23 THE CHAIRMAN: Yes, and so you are released from purdah for  
24 ten minutes or so.

25 MR BEARD: Then you have to go back in. Then you have to be



1 sworn back in. Exactly.

2 (11.12 am)

3 (A short break)

4 (11.31 am)

5 MR JAMES HARVEY (affirmed)

6 Cross-examination by MR BEARD

7 MR BEARD: This is not going to take long, Mr Harvey. You  
8 have been provided with this file of documents but you  
9 went to two of them this morning, a Frontier report  
10 dated January 2006, and then a Royal Mail document at  
11 tab 2. Could we just turn that up, please? So it is  
12 {I6/243.1/1}, I think. Now, I think you have accepted  
13 that you have not referred to this document previously  
14 in any of your reports, have you?

15 A That is correct.

16 Q It is a Royal Mail document and as far as we know none  
17 of the Royal Mail witnesses have referred to this  
18 document. We will obviously check, and that is not  
19 a question for you, but did you talk to Mr Jeavons about  
20 this?

21 A No, I did not.

22 Q Did you talk to -- there is someone called Mr~Soteri; is  
23 that right?

24 (Pause for issue with microphone)

25 MR BEARD: Thank you.

1 THE CHAIRMAN: Do you want to ask the question again?

2 MR BEARD: Yes. So the question I was asking -- you have  
3 answered in relation to Mr Jeavons. Mr Soteri, who is  
4 the Royal Mail's chief economist that Mr Jeavons  
5 referred to in his witness statement -- I can take you  
6 to it if you want -- but did you make any enquiries of  
7 Mr Soteri about this material at all?

8 A No.

9 Q No, or indeed in relation to anything concerning the  
10 regulatory scheme?

11 A No.

12 Q No.

13 The front page of this document says it is Annex A5,  
14 and it says, "Frontier Economics' Report on 'Market  
15 Share Analysis ...' A Response by Royal Mail". So you  
16 understand this to be a document that was put in in  
17 response to the preceding document that you referred to  
18 us from Frontier; is that correct?

19 A Yes, that is my understanding.

20 Q I see.

21 You took us to page 5, I think -- is that right? 5  
22 or 6? Page 6, {I6/243.1/6}. That is 2.8 to 2.10, under  
23 the heading, "Relationship of the [Frontier Economics]  
24 and Royal Mail Projections to Postcomm's Price Control".  
25 As I understand it, the point you are making is that

1 Royal Mail is making a complaint about the lack of full  
2 interaction between volume forecasts and price control  
3 proposals in the approach being adopted by Frontier. Is  
4 that the point you are trying to draw from this?

5 A Yes.

6 Q Yes. I see. If we go back a page, {I6/243.1/5},  
7 I think the 2.7 -- this is introducing those concerns,  
8 I think, under the header, "Royal Mail Addressed Inland  
9 Volumes", so far as I can see, reading this briefly.  
10 Does that look right to you?

11 A Yes.

12 Q Now, whilst you were speaking, I have been passed  
13 a document -- because we only got the index to this  
14 yesterday -- but someone very diligently has passed me  
15 a document from Frontier Economics. I do not know if we  
16 have enough copies. I hope we have. (Handed)

17 Have you seen this, Mr Harvey?

18 A No, I have not.

19 Q So you see what it says at the top:

20 "May 2006, Royal Mail's comments on Frontier's final  
21 report on modelling mail volumes proposed on final price  
22 control proposals [as read]."

23 Pretty self-explanatory, but then if we go down to  
24 the first paragraph, it seems to me, but I may be wrong  
25 on this, that what it is referring to is the response

1 that has been put in, and in particular it says:

2 "Market share analysis for Postcomm's Final  
3 Proposals [as read]."

4 Four papers which we labelled documents A to D.  
5 Document A, "Royal Mail's response to Postcomm's final  
6 proposals and draft licence modifications". Now, I have  
7 not seen that in this bundle of documents but that is  
8 not a document you have referred to, is it?

9 A No.

10 Q No, but document B says "Annex A5 to document A". That  
11 looks like what we are talking about at tab 2, does it?

12 A It does.

13 THE CHAIRMAN: Annex A5 to document A?

14 MR BEARD: Yes.

15 THE CHAIRMAN: Annex A5 was a Frontier Economics report, was  
16 it not?

17 MR BEARD: No, sorry. Let us go back to that. Sorry, sir,  
18 I should be really clear. {I6/243.1/1}. You can see  
19 the badge at the top there, sir. It is a Royal Mail  
20 document, Annex 5.

21 THE CHAIRMAN: Oh, I see.

22 MR BEARD: I think Mr Harvey was saying this was  
23 Royal Mail's response to the earlier Frontier report.  
24 I think that was his position. I think that is on the  
25 transcript. All I am doing is now linking that to this

1 document that I have been provided with, which is  
2 a Frontier document. Frontier has a particularly  
3 distinctive font and layout of its documents, so even if  
4 it was not labelled at the top, I think we know.

5 So what it is referring to are documents A to D  
6 because this document we have on the screen is an annex  
7 to the main submission which Mr Harvey has not referred  
8 to, but Frontier call out and refer to, slightly  
9 unhelpfully, Annex 5 of document A as document B, but  
10 there we are. They then make observations in relation  
11 to those Royal Mail responses. You have not seen this  
12 before, you say?

13 A No.

14 Q No. When we go through, you will see over the page, in  
15 the hard copy, "Input to model". I am not going to go  
16 through all of this and I am not going to pretend  
17 I understand what is going on here at all, Mr Harvey,  
18 but "Inputs to model, entrant costs", and then we have  
19 "Volume levels" on the next page, and you see in  
20 document B, so that is the one that you have taken us  
21 to:

22 "Royal Mail says it was right to submit its November  
23 projection. Royal Mail presented this November  
24 submission as a draft off the end of the consultation  
25 period ... [as read]", and so on.

1           It outlines the criticisms, but it appears, if you  
2           go over the page again, that actually there were further  
3           steps taken in relation to this because there is an  
4           output described on the next page. The concern,  
5           Mr Harvey, is that you have turned up at this stage  
6           referring to documents that have never been referred to  
7           in any of your reports. You have provided us with  
8           a Frontier document from 2006, you have provided us with  
9           this one Royal Mail document which has never been  
10          attested to or commented on by a Royal Mail witness and,  
11          actually, you have missed out entirely the fact that  
12          there are responses to this material from the authors of  
13          the report. You have, have you not?

14        A    Mr Beard, you said that this says that the further work  
15              was -- sorry, are you saying it says that further work  
16              was done in response?

17        Q    No, I am not saying that I know whether further work was  
18              done in response or not, Mr Harvey. What I am saying is  
19              that there is a further document that responds directly  
20              to the one you have relied on this morning for the first  
21              time.

22        A    There is, yes.

23        Q    You have not referred to that?

24        A    No.

25        Q    So this illustrates precisely the problem of curation of

1 documents at the last minute, does it not, Mr Harvey,  
2 because none of these materials have been put to  
3 Mr Bezant or are available to him, are they?

4 A This document seems to repeat the point that was made in  
5 the original Frontier report, so I accept that I have  
6 overlooked this document, but the two paragraphs say the  
7 same thing.

8 Q We do not know whether or not there is any other  
9 material, do we, Mr Harvey?

10 A No, we do not.

11 Q If we could just go back to the first document you took  
12 us to this morning, which was {I3/390/47}, I think.  
13 I think that was the page you took us to. If we just go  
14 back a page, {I3/390/46} -- I think this actually  
15 flashed up at one point when we were going through --  
16 you see this is all under the heading "Volume Forecast  
17 for Final Proposals", and here we have tables of numbers  
18 and those appear to be volumes of letters. Is that how  
19 you read it?

20 A Yes.

21 Q You will see the numbers there, and they are all rounded  
22 to the nearest million, are they not, Mr Harvey?

23 A They are, yes.

24 Q So we have volume forecasts being fed in here that are  
25 actually rounded to the nearest million, so there is

1 detailed consideration in relation to these forecasts.  
2 That is the relevant level of volumes to be considered,  
3 is it not?

4 A They are rounded to the nearest million. My point is  
5 a bit different, which is that these forecasts are not  
6 predicated on the final X figure and the price control.

7 Q I think we have been through the smallness issue that  
8 you have raised previously and I am not going to go back  
9 to the points that were discussed this morning or,  
10 indeed, with Mr Bezant in relation to what I think  
11 Professor Neven referred to as the fallacy of small  
12 effects. But leaving aside that smallness issue,  
13 I think, in fact, on the issue of principle, in relation  
14 to at least PC2 and PC3, I think there is actually --  
15 there is agreement, is there not, that in relation to  
16 the exercise that Postcomm was undertaking, it would  
17 have tried to triangulate volumes, costs and prices to  
18 come up with a settlement that resulted in the same  
19 profit outcome for Royal Mail, whether we are in the  
20 counterfactual or factual world, leaving aside the  
21 smallness issue; correct?

22 A Yes.

23 MR BEARD: I do not have any further questions for this  
24 witness. Thank you very much.

25 MR WARD: Can I ask more by way of re-examination?



1 THE CHAIRMAN: Of course.

2 Re-examination by MR WARD

3 MR WARD: It was put to you that you do not know if any  
4 further work was done, I think by Frontier, but are you  
5 able to comment on the nature of the final volume  
6 forecasts that were adopted by Postcomm?

7 A Yes. As I think I said earlier, they are the same  
8 volume forecasts that were presented in the Frontier  
9 document that I showed to you earlier.

10 Q Can we turn up on the screen, please, {I3/392/1}? This  
11 is the licence modification proposals.

12 MR BEARD: Is this really suitable for re-examination? It  
13 is a document that was not referred to at all during the  
14 course of the hot tub or indeed my cross-examination.  
15 I do not understand on what basis it is going to be  
16 referred to.

17 THE CHAIRMAN: Do you need to put it to this witness?

18 MR WARD: I do not actually. We will just put it in  
19 closing. That is fine. Thank you.

20 THE CHAIRMAN: Thank you very much, Mr Harvey.

21 Professor Neven, you have some questions?

22 MR WARD: I do have some questions for Professor Neven, yes,  
23 thank you.

24 THE CHAIRMAN: Just so the transcribers are aware, I think  
25 the counsel are the wrong way around in the transcript.

1 MR BEARD: Well, I sympathise with Mr Ward and I am  
2 delighted for my elevation!

3 MR WARD: The honour is all mine!

4 THE CHAIRMAN: Good. So Mr Ward?

5 PROFESSOR DAMIEN NEVEN (affirmed)

6 Cross-examination by MR WARD

7 MR WARD: Good morning, Professor Neven. I want to start  
8 with some questions aimed at defining the areas of  
9 difference between you and Mr Harvey and it would be  
10 useful, if we may, to pick up your first -- I think your  
11 only loss of volume report, which is at E4/37 -- I am  
12 not sure what bundles you have, I am afraid, [E/37/1].  
13 If we can go to page [E/37/6], please.

14 Do you have that, Professor?

15 A Yes.

16 Q Page 6, paragraph 2.6, you say:

17 "In this report, I have set out the correct  
18 framework and formulae for assessing the change of  
19 profits arising from pass-on. Using this framework and  
20 formula, but assuming the same Overcharge values and  
21 pass-on rate considered by Mr Harvey -- which I do not  
22 agree with, but which I adopt for like-for-like  
23 comparison of methodologies -- I find that the potential  
24 reduction in profits that RMGL experienced as a result  
25 of lost volumes would be £4.1 million."

1           Just pausing there, when you say, "the same  
2 Overcharge values and pass-on rate", the overcharge  
3 comes from Mr Harvey's report, and, of course, I know  
4 you do not accept that, and the pass-on rate we are  
5 talking about is 50%, and, of course, Mr Harvey says it  
6 is nil and Mr Bezant says it is 100%.

7           A   Exactly. That is right.

8           Q   Yes, so those are the assumptions. You say Mr Harvey's  
9 implied estimate is 5.8 million, and although we are  
10 grateful for you bumping it up, you appreciate that  
11 Mr Harvey thinks his upper figure is 5.3 million and  
12 that is just a calculation error of some kind. You do  
13 not?

14          A   No, I think that mine is correct.

15          Q   Okay. Well, all to the good, I suppose, for my client,  
16 but I want to talk now about what the differences are.  
17 The important point is that you say underneath, though,  
18 having given with one hand 4.1 million:

19               "Once the increase in profit on infra marginal sales  
20 is taken into account ... however, I find that  
21 [Royal Mail] would have experienced a significantly  
22 lower (possibly zero) reduction in its profits as  
23 a result of pass-on."

24               I wrote down this morning that you said the price  
25 has to be bigger, the regulator will make sure.

1 A I think that you are misquoting me.

2 Q I do not think so.

3 A What I have explained this morning is that there are two  
4 effects when you let the price increase -- when the  
5 regulator let the price increase. There was a reduction  
6 in profit from the lost sales and there was an increase  
7 in revenues from infra-marginal sales, and to the extent  
8 that the regulator calibrates the price increase so that  
9 the overcharge that has to be compensated with the 50%  
10 of the fixed amount that Mr Harvey is assuming --  
11 I mean, the price increase is supposed to compensate for  
12 that, then, necessarily, the increase of revenues on  
13 infra-marginal sales has to be bigger than the loss of  
14 revenues or the loss of profits on the lost sales  
15 because you get  $A$  minus  $D$  in what I showed this morning  
16 that has to be equal to a positive amount. So  
17 necessarily, since  $A$  minus  $D$  has got to be equal to  
18 a positive amount,  $A$  has to be greater than  $D$ .

19 Q So what I am trying to get clear, first, in evidence, as  
20 I read your report and as I heard your evidence, you are  
21 positively asserting that this increase in the price of  
22 infra-marginal sales took place -- not just the pass-on,  
23 which is the thing we are actually assuming, but that  
24 this additional increase to compensate for loss of  
25 volume?

1       A    I think you are being confused in the way you look at  
2            this, I am afraid. I mean, what we are looking at is  
3            whether, indeed, there has been a price increase allowed  
4            by the regulator that compensates for this fixed amount  
5            that we are considering, which is a proportion of the  
6            overcharge. That is what we are looking at.

7       Q    Yes.

8       A    How can the regulator do that? The regulator can only  
9            compensate for this additional cost by allowing for  
10           additional revenues.

11      Q    That is right, but I fear, as often has happened when we  
12            have met, we might be going round in circles slightly.  
13            Allow me to just try to -- in simple steps. We know  
14            that the way Mr Harvey has done this is to say, "I am  
15            doing an experiment to test the effect of 50% pass-on,  
16            even though I think the answer is zero. I then see what  
17            sales would have been lost as a result"?

18      A    No, but in order -- sorry, no, you are getting this  
19            wrong. In order to do that, Mr Harvey needs to have an  
20            assumption with respect to the price increase.

21      Q    Exactly.

22      A    What is the price increase that will be allowed?

23      Q    I think at the moment, Professor Neven, I am really just  
24            trying to discuss what Mr Harvey did do. I know you  
25            think it is wrong, I know --

1 A No, no.

2 Q You do not even agree that that is what he did?

3 A Okay. I think that I disagree with your description.

4 What I am saying is that, in order to identify the loss

5 of profit from lost volumes, Mr Harvey needs to have an

6 assumption with respect to the price increase, and the

7 price increase is the price increase that in all

8 circumstances is the price increase that would be

9 allowed by the regulator.

10 Q I will try again. What Mr Harvey thinks he has done is

11 he thinks if he takes an overcharge of 100, he thinks he

12 has added £50 on to that, on to his prices -- take 50 --

13 and then tried to determine what the effect would be on

14 loss of volumes. That is what his modelling is

15 actually -- what he has actually done, Professor Neven.

16 A Well, okay. What Mr Harvey has done in his formula is

17 close to what you describe, but this formula -- as

18 I tried to explain this morning, when you input this

19 fixed amount, which is the overcharge, when you input it

20 into the formula, it has a meaning in that formula and

21 in that formula it is the counterfactual sales

22 multiplied by the price increase, and if I sort of

23 back-engineer this price increase, indeed, I find that

24 Mr Harvey has assumed a price increase allowed by the

25 regulator which is actually -- is lower than one

1 initially computed in his first report, yes.

2 You know, it is all very confusing in Mr Harvey's  
3 report because the first part of his report computes  
4 a price increase, I mean, basically looking at the two  
5 effects, I mean, the reduction in the profit from the  
6 loss of volume and the increase in revenues from the  
7 infra-marginal sales, and then he forgets about that  
8 price increase. He does not use it. Then in his  
9 formula he inputs into the denominator this figure,  
10 which is the proportion of the overcharge which, in the  
11 context of that formula, must be equal to some price  
12 increase.

13 THE CHAIRMAN: It would help me, certainly, Professor Neven,  
14 if you just concentrated on the question that was being  
15 asked, which was to describe what -- it was describing  
16 what Mr Harvey was doing. I know you disagree  
17 fundamentally with the process of Mr Harvey, but I think  
18 we are just trying to establish what did he actually do.

19 MR WARD: I thought it was going to be simple, but I think  
20 what we can do is look at what Professor Neven did.

21 THE CHAIRMAN: Okay.

22 MR WARD: If you do not mind, Professor Neven, opening up  
23 now Mr Harvey's third report. It is at {E5/52/114}.

24 MR BEARD: So you intervened, saying that it is important  
25 that Professor Neven focused on the questions, of

1 course, but I think, just looking at the transcript,  
2 what Professor Neven was explaining was why Mr Ward's  
3 approach was not, in his view, an accurate account of  
4 what Mr Harvey had done, and he was answering,  
5 therefore, the question that was being posed. It may be  
6 a complex answer, but I think it is the answer.

7 A Sorry, which report?

8 MR WARD: It is Mr Harvey's third report, please, which is  
9 a supplemental report. Do you have that?

10 A Yes.

11 Q If we look at page {E/52/114}, please, we have  
12 a table 12. Do you have that?

13 A Yes.

14 Q Now, this is Mr Harvey's table, but it is based on the  
15 figures from your first report, and I just want to work  
16 through the line at the bottom with you, if you do not  
17 mind, which is the line of totals, where you start with  
18 29 million-odd of overcharge. Do you have that,  
19 Professor Neven?

20 A Yes.

21 Q Jolly good. Then you have "Impact of increase in  
22 prices", 18 million-odd, and Mr Harvey has interpolated  
23 these percentages, so he says the increase in prices  
24 is 64%.

25 A Of what?



1 Q Of the total overcharge.

2 A Okay.

3 Q Then he has your impact of reduction in volumes --

4 A Sorry, it is not an increase in price, it is an increase  
5 in revenue. It is the impact, so the revenues.

6 Q You are right. That is what it says at the top, "Impact  
7 of increase in prices" is 64%. Then we have your  
8 reduction of volumes minus 4.1 million, which is the  
9 figure we spoke about a few moments ago, and that is  
10 minus 14%. Then the overcharge less pass-on and loss of  
11 volume, minus 14.624 coming out at a total of minus 50.

12 A Yes.

13 Q So what we have in your calculation is essentially  
14 the -- a calculation based on the proposition that the  
15 impact of reduction of volumes of minus 14 is entirely  
16 compensated by the impact of increase in prices, which  
17 is plus 64, to get us to 50.

18 A So what this says is that overall there is 50% of the  
19 overcharged, which is 29 million, which is indeed  
20 absorbed, and 50% which is incurred.

21 Q Exactly. You assume, in effect, the loss of volume will  
22 be fully set off by the impact of increase in prices, do  
23 you not?

24 A No, I am not assuming anything like that.

25 Q To come out at 50, your minus 14 of loss of volume is

1 entirely offset by your plus 64 impact in prices, is it  
2 not?

3 A This is the mechanics of this calculation, is that --  
4 I mean, since you are looking at a price increase that  
5 will, indeed, lead to a compensation of 50% of the  
6 overcharge, you compensate for 50% of the overcharge,  
7 and there are two effects. I mean, there is the loss of  
8 volume effect and there is the -- as you quoted, the  
9 impact of the increase in price on the revenues --

10 Q Yes.

11 A -- so it has to be the case.

12 Q It has to be the case on your view of the world, but the  
13 question that we are asking is whether, in fact, it  
14 actually happened.

15 A Ah.

16 Q I mean, of course we are on the assumption that the  
17 overcharge is passed on. Would there, indeed, have been  
18 an adjustment to infra-marginal prices, not just to  
19 recover the overcharge but to compensate for the loss of  
20 volume?

21 A I rely on Mr Bezant's report with respect to this.

22 Q You rely on Mr Bezant's report, and we can see that --  
23 we can put Mr Harvey away for now. What we can see, if  
24 we go to your report, again, which is {E/37/14}, top of  
25 the page, please, you say -- do you have that?

1 A So, loss of volume, expert evidence 4, is it? No, it is  
2 not 4.

3 Q Tab 6, I am told, possibly, in your bundle.

4 A Tab 6?

5 THE CHAIRMAN: He has a few bundles there.

6 A Yes. Too many bundles.

7 MR WARD: This will be worth keeping out because we are  
8 going to come back to it.

9 A Yes. Okay, I have it. Which page is it?

10 Q Of your report, it is page 14. Do you have that?

11 A Yes.

12 Q This is where you say, at the top:

13 "I summarise below the key conclusions from the  
14 Bezant Report that are relevant to my assessment ..."

15 A 14?

16 Q Is the internal page number --

17 A It is 14.

18 Q So which would you prefer me to use, just for clarity?

19 A Whatever.

20 Q Whichever. I will just try and be clear which one I am  
21 using. So this is bundle 14, and you say at the top of  
22 the page:

23 "I summarise below the key conclusions from the  
24 Bezant Report that are relevant to my assessment of the  
25 loss of volume claim."

1           We can see that the footnotes at the bottom of the  
2 page are all from Mr Bezant's report and then on the  
3 next page we can see the same, although, in fact, there  
4 is one reference to Mr Harvey's report, {E/37/15}.

5           Now, is it fair to say that you have not engaged  
6 with the question of a supply pass-on itself, the  
7 question that has been debated between Mr Harvey and  
8 Mr Bezant?

9       A    I have not engaged with it. I have relied on  
10 Mr Bezant's report.

11       Q    You have relied on Mr Bezant's report. You appreciate  
12 that the issue here that Mr Harvey has raised is whether  
13 there would be an adjustment to volumes to reflect --  
14 sorry -- an adjustment to prices to reflect the very  
15 small volume increment we are talking about, which is  
16 1 or 2 million items a year out of 20 million? We  
17 discussed that this morning.

18       A    But sorry, again, I mean, Mr Harvey is assuming a change  
19 in price in order to get these calculations.

20       Q    Indeed he is.

21       A    He does, so he cannot deny the fact that he needs to  
22 have a price increase in order to be able to compute  
23 a volume effect.

24       Q    That is right, and the question is whether it is yet  
25 further fine-tuned, to use Mr Harvey's expression, to

1           compensate out the volume effect in the rise of prices  
2           in infra-marginal sales.

3           A    But, no, this formulation is incorrect and it is also  
4           a question that you put to Mr Bezant, which I think is  
5           the wrong way of looking at it. Whenever -- and this is  
6           what I tried to explain this morning. I am sorry. I am  
7           really trying to answer the question -- if you are  
8           increasing the price, there are two effects. There is  
9           an effect on the loss of volume, there is an effect on  
10          the additional revenues that you get from the stamps  
11          that you keep on selling. It is not additional. It is  
12          just part of the same. It is part of the same effect of  
13          the price increase that is allowed for, which Mr Harvey  
14          is also assuming.

15          Q    Well, the issue between us, I believe, is whether or not  
16          that increase in price is just the 50 in my stylised  
17          example, which is that it is half the overcharge, or  
18          whether it is the 50 plus 14, which is what you have in  
19          your report.

20          A    Again, you are misunderstanding this. I am sorry.  
21          I mean, the price increase is set so that it sort of  
22          just compensates for the 50% of this fixed cost, which  
23          is the 50% of the overcharge. That is what -- you know,  
24          what the price increase does in my calculation. That is  
25          also what the price increase does in Mr Harvey's initial

1           calculations.

2           Q    But the further step that is required for your  
3                infra-marginal sales point is that the volume changes  
4                that that causes feed back into the -- into a higher  
5                price.

6           A    No. I am sorry.

7           Q    You just think it is just automatic?

8           A    No, it is not -- no, I think you are misunderstanding  
9                this. I think that as you are moving along a demand  
10               curve -- I mean, as you are increasing the price, you  
11               are losing some quantities, but you keep on making sales  
12               on whatever you keep on selling, on the stamps that you  
13               keep on selling, and there is no further step. It is  
14               just part of the same step. That is why I think that,  
15               you know -- anyway, let me not comment on this.

16          Q    I will try again, and it is just this: on Mr Harvey's  
17                view of the world you pass on 50, you lose volumes. On  
18                your view of the world, the price increase is enough to  
19                compensate you for those lost volumes.

20          A    No, I think that is incorrect. I mean --

21          Q    Well, that is what the figures show we just looked at.

22          A    Both in Mr Harvey's world and my world, we are in the  
23                same world. I mean, whenever there was a price  
24                increase, there is an increase in the revenues from  
25                infra marginal sales and there was a loss of revenues

1 from what you do not sell. There is no additional step.  
2 It is part of the same step, and if you look at  
3 Mr Harvey's report, he does exactly the same. If you  
4 look at Mr Harvey's datapack, he does exactly the same.  
5 There is no additional step.

6 Q I am sorry Professor Neven, and forgive me if it really  
7 is my misunderstanding, but let me go back to the way  
8 Mr Harvey described your calculation. Back on page --  
9 if we go back to {E/52/114}, this was Mr Harvey's  
10 supplemental.

11 A Which page?

12 Q 114. We looked at this before. Bottom line. You get to  
13 50% overcharge by netting off the reduction volumes of  
14 minus 14 against the 64.

15 A But of course.

16 MR RIDYARD: Sorry to interrupt. I think this confusion  
17 might be caused by this 50% number. What, exactly, is  
18 it 50% of?

19 MR WARD: Well, the example that Mr Harvey tested was that  
20 50% of the overcharge would be passed on. That was the  
21 point.

22 MR RIDYARD: Right, but what exactly does that mean? So the  
23 overcharge is the £29 million --

24 MR WARD: It means 14 million-odd, 14,624.

25 MR RIDYARD: So 14 million is passed on?

1 MR WARD: Yes.

2 MR RIDYARD: But I think -- what exactly does that --

3 sorry -- what exactly does that mean? I think that is  
4 the source of the confusion between you.

5 MR WARD: It may be, and I am quite sincere in offering my  
6 apologies if I make it worse not better, but as I  
7 understood, what Mr Harvey was testing was if you round  
8 the number to 30 million to make our lives simpler, you  
9 add 15 million on to the price and then you test that  
10 through the elasticity of demand to see what the volume  
11 effect is.

12 A This is not how it works. I mean --

13 MR RIDYARD: You cannot -- when you say you add 15 million  
14 to the price, I mean, that -- you add 15 million to the  
15 total revenue, do you mean?

16 MR WARD: Yes.

17 MR RIDYARD: Taking account of what? Of what sales you will  
18 lose by doing so?

19 MR BEARD: I am very cautious to intervene, but given that  
20 Mr Ward is in this section and keeps going to this  
21 table, it is sensible to actually go back to 4.26 in  
22 Mr Harvey's own report, so that is a couple of pages  
23 back, where he explains what he says he understands  
24 Professor Neven is doing, and I leave Mr Ward to ask  
25 questions in relation to it, but I think there is



1 a fundamental problem with the line of questioning.

2 A I think that I now understand where you are coming from.

3 MR WARD: Okay.

4 A I think it is basically the idea that you get this  
5 14 million and you just put them on the top to the  
6 price. That is not the way it works. What happens is  
7 that you get this 14 million, which is an additional  
8 cost. You need to generate revenues to compensate for  
9 those. How do you achieve that? You achieve that by  
10 a price increase. This price increase has two effects:  
11 reduction in the profits on the lost sales; increasing  
12 revenues on the infra-marginal sales. That is what  
13 I do. This is what Mr Harvey is doing.

14 THE CHAIRMAN: What is important is what is the regulator  
15 doing.

16 A Then there is a question -- and there I rely on  
17 Mr Bezant.

18 THE CHAIRMAN: Right.

19 A You know, I am basically computing this price increase  
20 that would, indeed, make sure that the revenues  
21 compensate for these additional fixed costs and  
22 I rely --

23 THE CHAIRMAN: Do you say the regulator actually did that?

24 A I have no judgment on that. I rely on Mr Bezant.  
25 I have not looked at that evidence.

1 MR WARD: Thank you. So what you are telling us is you are  
2 not able to add anything to what Mr Bezant was able to  
3 say about this?

4 A Nothing.

5 Q If we just look at what you have said, if we could, in  
6 your report about this. If we go to {E/37/16}, and I am  
7 sorry, I do not know which tab it is for you,  
8 Professor Neven.

9 A 6. Which page?

10 Q This is where you talk about what the regulator actually  
11 did. If you go to the top of the page, you are talking  
12 about PC2. Page 16.

13 A Yes.

14 Q 3.27.

15 A Yes.

16 Q You say:

17 "The main implication of the above is that  
18 [Royal Mail's] costs during the period would have been  
19 broadly equal to its revenues on an ex ante basis ..."

20 You cite Mr Bezant for that, and that is, indeed,  
21 something quoted from Postcomm. Then in similar vein at  
22 3.29 you say:

23 "The implication of the above is that PC3 would  
24 have ... resulted in [Royal Mail's] costs over the  
25 period being broadly equivalent to its revenues on an

1 ex-ante basis, such that cost increases would be broadly  
2 met with price increases."

3 But you, yourself, have not done any detailed  
4 scrutiny of the regulatory material, have you, or any?

5 A None.

6 Q You have not looked at it at all?

7 A No. I just rely on Mr Bezant.

8 Q So you are not able to say whether that broad approach  
9 would have been sufficient to pick up this very small  
10 volume effect?

11 A I rely on Mr Bezant's conclusions.

12 Q So you have no independent view of whether that would  
13 have been the case?

14 A No.

15 Q You accept that that is a different question to the  
16 theoretical question of what should have happened or  
17 could have happened?

18 A I rely on what Mr Bezant is saying about what happened.

19 Q Again, when we look at what you say about unregulated  
20 prices, if we go back to the previous page, page  
21 {E/37/15}, you say in paragraph 3.25, the last four  
22 lines -- this is talking about unregulated prices:

23 "I ... assumed for the purpose of my analyses in  
24 this report that the approach to [Royal Mail's] price  
25 setting was consistent with the objective of the

1 regulatory approach adopted by Postcomm in PC2 and  
2 PC3 ... for non-regulated products ..."

3 You have not examined the facts about whether  
4 Royal Mail actually set its prices in that way, have  
5 you?

6 A But Mr Harvey has not either. I mean, Mr Harvey has not  
7 considered what happened to a commercial product, and we  
8 had the discussion this morning about what a commercial  
9 firm would have done, and in order to find out what  
10 a commercial firm would have done, you have to look at  
11 the elasticity and what would be the optimal pass-on.

12 Q Mr Harvey has actually considered quite a range of  
13 evidence, in fact, about Royal Mail's price setting, but  
14 you have not, have you?

15 A No, I have not, no.

16 Q So you are not able to say whether, in practice, it  
17 would have been done in such a way so as to capture  
18 these very small volume effects?

19 A It is an assumption that I am making in light of  
20 Mr~Bezant's reports, yes.

21 Q Would you just give me one moment, please?

22 THE CHAIRMAN: Yes. (Pause)

23 MR WARD: Thank you. I have no more questions,  
24 Professor Neven.

25 THE CHAIRMAN: Thank you. Any re-examination? Right.

1 Thank you very much, Professor Neven. Onto complements.

2 MR BEARD: So everyone gets released and resworn again.

3 I think we can probably start -- I mean, it is long  
4 enough to lunchtime to start now, is it not?

5 THE CHAIRMAN: Yes. I think we should. How are we doing on  
6 the overall timing? We are going to get through  
7 everything we need to in the two days?

8 MR BEARD: Oh I think absolutely. The only thing I would  
9 say is -- Professor Neven has obviously been in the  
10 hot tub and then cross-examined now --

11 THE CHAIRMAN: Shall we have a ten-minute break?

12 MR BEARD: I think that might be fair to him, just to have  
13 a breather and change gear, given that we are going on  
14 to another topic.

15 THE CHAIRMAN: Well, shall we say 15 minutes?

16 MR BEARD: That would be great, I think.

17 THE CHAIRMAN: That is not going to put us in any  
18 difficulty?

19 MR BEARD: None of this is going to impact on the chances of  
20 us finishing.

21 THE CHAIRMAN: All right. We will have a 15-minute break.

22 (12.14 pm)

23 (A short break)

24 (12.30 pm)

25

1 MR JAMES HARVEY (affirmed)

2 PROFESSOR DAMIEN NEVEN (affirmed)

3 Questions by THE TRIBUNAL

4 MR RIDYARD: Okay. So the subject is complements. Shall we  
5 start with the economic principles, if we may?  
6 Mr Harvey, do you believe that the prices of  
7 complementary products are likely to be negatively  
8 correlated to one another?

9 MR HARVEY: The economic theory says that when the price of  
10 one product rises and that gives rise to a reduction in  
11 demand for that product, it also will give rise to  
12 a reduction in demand for a complement and that could  
13 put downward pressure on its prices. Whether that  
14 happens in practice depends on how responsive demand is  
15 to price changes and conditions of competition in the  
16 complementary product market.

17 MR RIDYARD: So when would it not happen, then?

18 MR HARVEY: It would not happen when demand for the product  
19 is entirely inelastic, so there is no price response,  
20 and it would not happen when the product market for the  
21 complement is perfectly competitive, otherwise, in  
22 economic theory, there would be a relationship.

23 MR RIDYARD: So it almost always happens then?

24 MR HARVEY: Sorry, I do not know whether it almost always  
25 happens in practice, but in theory, yes, apart from

1           those two circumstances.

2       MR RIDYARD: The theory is there to try and predict. What  
3           happens in practice? Do you think the theory is wrong  
4           or ...

5       MR HARVEY: No, I am just saying that my economic theory  
6           predicts that there would be a downward pressure on the  
7           price of the complement, save for in those two  
8           circumstances. Whether that does happen is an empirical  
9           question.

10      MR RIDYARD: Fine. But apart from those two polar cases  
11           that you describe, the economically inelastic demand  
12           or -- what was the other one? Completely --

13      MR HARVEY: Perfectly competitive.

14      MR RIDYARD: -- perfectly competitive market, then theory  
15           would expect that, as the price of -- that you would get  
16           this negative price relationship between the two?

17      MR HARVEY: Yes.

18      MR RIDYARD: Professor Neven, anything to add on that?

19      PROFESSOR NEVEN: No, I think it is important to emphasise  
20           that strict complementarity is one of the provisions  
21           that is relevant for that discussion, but I think you  
22           are going there.

23      MR RIDYARD: But just to stick on this question, though,  
24           back to you, Mr Harvey, does that mean that we can go  
25           out and observe complements and see this happening in

1 practice by just looking at prices of complementary  
2 products to see whether their prices do behave  
3 negatively against one another?

4 MR HARVEY: No, you cannot just do that.

5 MR RIDYARD: Why not?

6 MR HARVEY: Because there might be other factors that  
7 influence the price changes of those products.

8 MR RIDYARD: For example, an upper demand shift for both  
9 products would lead both of their prices to go up  
10 because of an exogenous increase in demand, for example?

11 MR HARVEY: Yes, that is correct.

12 MR RIDYARD: Okay. Now let us look at what, in principle,  
13 the factors are that are likely to determine any  
14 complement effect. We have listed various factors in  
15 question B. The first one is strict complementarity,  
16 which means for every one of A, you automatically have  
17 to buy one unit of B as well. Is that the case in the  
18 trucks and bodies case, Professor Neven?

19 PROFESSOR NEVEN: What I would like to emphasise for the  
20 definition of strict complementarity is not that there  
21 was a strict ratio, that is to say for each naked truck  
22 you have a body or that for each tractor you need to  
23 have a trailer. What is key for the definition is that  
24 there is no other use of the complement but to be used  
25 in conjunction with the other item. That is to say that



1           there is no use for bodies if not to be put on a truck.  
2           There is no use for trailer if not to be pulled by  
3           a tractor. That is key because it means that the demand  
4           for the complement, the demand for the body, the demand  
5           for the trailer, derives solely from the demand for the  
6           system, so, indeed, in strict complementarity you have  
7           the use in fixed proportion. But what is even more  
8           important is the fact that there is no other use but to  
9           be used in conjunction with the other item, so that  
10          there is no other factor that will affect the demand for  
11          bodies.

12                 That is different for tyres. I mean, that is  
13          different for other products that may be complement to  
14          the truck because, you know, there is a big market for  
15          secondhand tyres, for replacement tyres, for instance,  
16          and that is the key thing, that when you have strict  
17          complementarity the demand is for the complement, for  
18          the bodies, for the trailers solely determined by the  
19          demand for the systems.

20          MR RIDYARD: We will come on to that maybe later on.

21                 Mr Harvey, any comments on that?

22          MR HARVEY: No, I agree with that.

23          MR RIDYARD: Are we agreed that that is the case with trucks  
24          and bodies?

25          MR HARVEY: To a large extent, yes. I think for bodies,

1 obviously, there are alternative uses for trailers, but  
2 in the context that we are talking about it is broadly  
3 correct.

4 MR RIDYARD: So, the second aspect is the -- we were  
5 wondering whether the price cost margins on the  
6 products, does that affect the kind of complementarity  
7 relationship you would expect to observe on prices?  
8 Mr Harvey, what do you think about that?

9 MR HARVEY: Yes, I think it would. I think this is  
10 a critical part. So the intuition is linked to,  
11 I think, the strength of competition in the two markets  
12 but one way of thinking about it is if the supply of the  
13 complement product is highly competitive, then the  
14 margins in the supply of that product would tend to be  
15 low, so in the event of a price increase for the truck,  
16 there may be little room for the complement supplier to  
17 cut its price because they are already at a price close  
18 to cost, so you can, I think, give the intuition in that  
19 way, but the relative -- essentially the relative, you  
20 might say, ability and incentive of one side of the  
21 market to sort of sap up the price increase by cutting  
22 its prices will depend on competition and, therefore,  
23 depend on the relative margins in the markets.

24 MR RIDYARD: Professor Neven?

25 PROFESSOR NEVEN: Yeah, I agree with the intuition that if

1 the market for complements is highly competitive, then  
2 it is unlikely that you will have a complement effect.  
3 If there is a shift in the demand for complement that  
4 results from a reduction in the demand for systems, it  
5 is unlikely that you would have a significant increase  
6 in the price of complement or assume there is a change  
7 in the price of complement.

8 Now, the issue with respect to the relative margins  
9 is much more complicated, and this is highlighted by the  
10 results of my calibration exercise and maybe when we  
11 come to that I will explain in a little more detail  
12 about how significant the differences in margins are.

13 MR RIDYARD: Okay. Can we deal, now, with what the basic  
14 facts are on that, though? I mean, are the margins on  
15 trucks different from the margins on bodies?

16 PROFESSOR NEVEN: Yes. I mean, the numbers that I am using  
17 for my calibration indicate that there are sort of  
18 different margins, at least for DAF, on different types  
19 of trucks, and just to give you a sense, the lowest  
20 margins are around 7%, and that is for the medium  
21 trucks, essentially the LF family, simple, medium  
22 trucks. The heavy trucks, rigids, I mean, have a higher  
23 margin of about 13%. If you are considering the  
24 tractors, I mean, again, the simple tractors have  
25 a margin of about 16 and the more expensive tractors

1 with more than two axles, so three axles, I mean, they  
2 have a margin of 17.

3 So you have a range of margins, and, actually, we  
4 will see, when we look at the results of my calibration,  
5 that it matters for the outcome, and with respect to the  
6 margins on complements, my central estimate is a margin  
7 of 11%. So you see that we have a margin for trucks  
8 that are, for some trucks, below; for other trucks,  
9 above.

10 MR RIDYARD: When we talk about "margins", here what is  
11 that?

12 PROFESSOR NEVEN: This is a difficulty for the -- not  
13 a difficulty for DAF, of course, because we are using  
14 the data that we have been discussing two weeks ago in  
15 the context of overcharge, so we have the actual  
16 transaction prices and we have MLO, so when I talk about  
17 the margin is on the basis of the MLO.

18 With respect to the suppliers of complements, I am  
19 using company accounts, and so this is not a measure of  
20 marginal cost, but this is a measure of a broad -- it is  
21 a measure of cost that is broader. I mean, it is  
22 probably closer to average cost.

23 THE CHAIRMAN: Sorry, that is an average, you say, for this  
24 of 11%?

25 PROFESSOR NEVEN: Yes.

1 THE CHAIRMAN: You say there were higher margins for the  
2 heavier trucks?

3 PROFESSOR NEVEN: Yes.

4 THE CHAIRMAN: Does that correspond, that the bodies that  
5 are supplied with those trucks -- are they higher  
6 margins or you do not know?

7 PROFESSOR NEVEN: I do not know. I do not know.

8 THE CHAIRMAN: You cannot get that from the company  
9 accounts?

10 PROFESSOR NEVEN: Exactly.

11 MR HARVEY: In terms of the data that we do have and the  
12 data that has to get fed into this analysis, we have,  
13 for the bodies and trailers manufacturers, their average  
14 margins, so we cannot look at any sort of mix effect.  
15 For the truck manufacturers, obviously we only have DAF,  
16 and so within Professor Neven's analysis it is necessary  
17 to back out of the implied margin for the other  
18 manufacturers.

19 In terms of the overall facts, I think the  
20 relativities do depend a bit on what time period you  
21 look at as well, so I think the margins for DAF trucks  
22 do change over time and so the relativity would be  
23 affected by that too. I do not have the figures off the  
24 top of my head.

25 MR RIDYARD: Is it a bit counter-intuitive to say that the

1 margins for a body manufacturer would be higher than the  
2 margins on truck manufacture? Professor Neven?

3 PROFESSOR NEVEN: I mean, the margins on trucks are higher  
4 for most trucks -- okay? -- than the margins for  
5 trailers and bodies, and it is only the LF type of  
6 trucks, so it is only the medium trucks for which the  
7 margin is below. I mean, it is 7% in the numbers that  
8 I am using relative to an average of 11.

9 Now, I mean, 11 is a weighted average of the margin  
10 of the suppliers, and, I mean, I identify the suppliers  
11 from various sources. When I focus on a subset of  
12 suppliers, I am allowing margins for some body suppliers  
13 and actually some lower margins for body suppliers and  
14 some higher margins for trailer suppliers, so it seems  
15 that there is -- to the extent that you can identify the  
16 trailer supplier and separate them from the body  
17 suppliers, there seems to -- it seems to do with the  
18 differentiation.

19 MR HARVEY: I mean, it is a little tricky because, of  
20 course, we do not have a lot of information about the  
21 way the supplier trends and bodies works and how  
22 competition takes place in that market, but what we do  
23 know is that there are a large, relatively speaking,  
24 number of suppliers. I think we each counted in the  
25 region of 20 --

1 MR RIDYARD: Of bodies?

2 MR HARVEY: Of body suppliers, yes. I think we also  
3 understand that -- I am cautious about saying this -- is  
4 that with some exceptions the product being supplied is  
5 fairly sort of vanilla, as it were, so the combination  
6 of those two things might led you to expect lower sort  
7 of margins measured in the correct way, as opposed to  
8 the trucks manufacturers where there are a few of them  
9 and perhaps greater product differentiation.

10 MR RIDYARD: I had in mind one of the factual witnesses,  
11 maybe it was Mr van Veen, I think, but he likened trucks  
12 to iPhones and he was saying they are very high-tech and  
13 therefore you would expect, obviously, very high sort of  
14 R&D costs and so forth, which seems intuitive, and  
15 therefore you need fairly high margins compared to other  
16 products, whereas -- obviously it is a very uninformed  
17 intuition of mine, but I might have wondered whether  
18 making bodies would be more of a sort of -- you know,  
19 a sort of simple engineering process which would have --  
20 not have loads of R&D associated with it and so forth.  
21 But that is just an uninformed speculation on my part,  
22 but having looked at these things, would that confirm  
23 with your views of what you think about the two  
24 industries?

25 MR HARVEY: I do not know the extent to which R&D costs are

1           incurred in the supply of bodies. There is variation  
2           between them. Obviously you have refrigerated bodies  
3           and those that are not and that type of thing, but my  
4           understanding is, in the main, all of the body suppliers  
5           are capable of providing those bodies. I think there  
6           are some exceptions. I think some of the trailers that  
7           BT purchased are modified in some way to help erect  
8           poles, but it is not something that I have investigated  
9           in detail.

10       MR RIDYARD: Professor Neven?

11       PROFESSOR NEVEN: I have tried to develop an intuition for  
12           that from a number of industry reports and I referred  
13           to, I think, three different industry reports. They  
14           tend to accord with the intuition that you have, namely  
15           that the supply of bodies and trailer is fairly  
16           commoditised, that this is a sector in which you do not  
17           have a lot of research and development. That is  
18           a sector whose cost is heavily influenced by the cost of  
19           metals, by the cost of steel, and, of course, as we both  
20           observed, you have a lot of entry. I mean, you have  
21           many competitors and you typically, I mean, would expect  
22           to have such a large number of competitors in an  
23           industry in which there are no large cost of entry,  
24           large fixed cost of entry or entry barriers, so all of  
25           that goes into the same direction. But, of course, as



1           you observed already, the data that we have on margins  
2           is unfortunately not of the same quality. I mean, the  
3           DAF data on margin is an MLO margin, the data that we  
4           have with respect to the supplier of complements is  
5           coming from published accounts, and it is difficult to  
6           control for -- I mean, what could potentially be issues.

7           I mean, for instance, one of the main suppliers of  
8           trailer is Cargobull. I mean, Cargobull is actually  
9           a German company. It has accounts in the UK, but, you  
10          know, what these accounts in the UK actually mean, I am  
11          not entirely sure. I mean, they could be heavily  
12          influenced by transfer pricing, for instance, because  
13          Cargobull is producing in Germany, it is producing in  
14          Poland, so we have to be aware of these differences in  
15          the quality of the data.

16         MR RIDYARD: Okay. The third item on our list was demand  
17          elasticity. I suppose if you are considering products  
18          in strict one-to-one ratios and there is no other  
19          production, then demand elasticity is the same for both  
20          products --

21         PROFESSOR NEVEN: Exactly.

22         MR RIDYARD: -- by definition.

23         PROFESSOR NEVEN: Is the demand for systems.

24         MR RIDYARD: Because the system demand, but what about --  
25          and is demand elasticity relevant at all, then, to the

1           considerations here?

2           PROFESSOR NEVEN: I mean, as we are going to see when we  
3           look at the results, I mean, the elasticity, what we  
4           calibrate is the elasticity of demand for systems, and,  
5           indeed, I mean, the parameter that is we calibrate, all  
6           the different parameters that we calibrate will  
7           correspond to different elasticity for systems and this  
8           has an impact on the overall effect, yes.

9           THE CHAIRMAN: When you say "systems", you are referring  
10          to ...?

11          PROFESSOR NEVEN: By "system", I mean the combination  
12          between a rigid and a body, so a system is a combination  
13          of the two relevant complements.

14          THE CHAIRMAN: So it is the whole?

15          PROFESSOR NEVEN: The whole thing, yes.

16          MR RIDYARD: Mr Harvey?

17          MR HARVEY: Yes, I think intuitively this matters in that is  
18          price -- sort of a stand-alone price increase in the  
19          price of the truck, then it will give rise to  
20          a reduction in the demand for it and complements, and,  
21          therefore, the scale of the price response from the  
22          complement supplier, I think, would depend on the  
23          potential reduction in demand, so I think that is  
24          probably why it feeds into Professor Neven's  
25          calculations and it is relevant.

1 MR RIDYARD: The other aspect of demand elasticity is the  
2 brand level elasticity of demand. So if I am a body  
3 manufacturer, something bad has happened to mean there  
4 are fewer trucks being demanded, so then I have to --  
5 then this whole debate is about what do I then do, to  
6 what extent do I then chase volume by cutting my price,  
7 or do I just say, "Well, I do not have very far to go to  
8 concede lower prices so I would rather lose sales than  
9 cut my margins". So from that point of view, would the  
10 demand level elasticity for the individual body  
11 manufacturers be relevant?

12 MR HARVEY: Yes, things are -- that would -- that probably  
13 goes back to the second bullet point. It is the  
14 strength competition that the brand manufacturer -- the  
15 body manufacturers -- face between one another, yes.

16 PROFESSOR NEVEN: But it depends, first and foremost, on the  
17 demand elasticity because, as you pointed out, the  
18 demand for trailers and bodies is the demand that is  
19 derived from the demand for the systems, for the  
20 combinations, and --

21 MR RIDYARD: Yes.

22 PROFESSOR NEVEN: -- the parameters that we calibrate, that  
23 I calibrate, are parameters that will reflect the  
24 significance of product differentiation in the suppliers  
25 of complement, and, of course, the optimal reaction to

1 a shift in the demand for system that may be induced,  
2 for instance, by the overcharge will be driven by the  
3 demand elasticity that they face.

4 MR RIDYARD: Which demand elasticity? The brand level or  
5 the --

6 PROFESSOR NEVEN: Brand level, exactly, because in the  
7 demand system you have parameters that will reflect the  
8 substitution between trucks that have -- or combinations  
9 that have, say, the same trucks, a DAF truck, a DAF  
10 body, and -- sorry -- a DAF truck, not a DAF body --  
11 a DAF truck and different types of bodies, and there  
12 will be a parameter that will reflect the degree of  
13 substitution between those, and --

14 THE CHAIRMAN: Sorry, please finish.

15 PROFESSOR NEVEN: -- of course, the extent to which  
16 a supplier of a body will have a demand such that buyers  
17 will easily switch to another combination involving  
18 a DAF truck and another body will determine the extent  
19 to which they will react, of course. So what I am  
20 trying to say is that the optimal reaction of the body  
21 suppliers or the trailer suppliers is going to be  
22 determined by some parameters of the demand system that  
23 we are trying to calibrate because this demand system  
24 will represent the degree of substitution between  
25 combinations, between systems, that have different body

1 suppliers which reflect this brand element that you are  
2 referring to.

3 THE CHAIRMAN: So my question was going to be, if there is  
4 perfect complementarity between the bodies and the  
5 trucks and the demand for trucks goes down because of  
6 price increase, how can there be any increase in the  
7 market for bodies because there is not the -- they have  
8 to go together with the trucks.

9 PROFESSOR NEVEN: Okay. So it is important to go through  
10 the reasoning. So what is happening is that we are  
11 considering an increase in the price of trucks that  
12 could be due to the infringement; okay?

13 THE CHAIRMAN: Yes.

14 PROFESSOR NEVEN: It means that for given price of  
15 complements, the price of systems is going up because  
16 the price of trucks is going up and the price of a  
17 complement is the price of a body or a trailer plus the  
18 price of the truck, so it means that the demand for  
19 systems is going down. As you pointed out, I mean, it  
20 also means that the demand for the bodies is going down.  
21 How could they react? If the body suppliers are  
22 reacting by reducing their own price, it will lead to an  
23 increase in the demand for system again that compensates  
24 the initial shift.

25 THE CHAIRMAN: So it will increase the demand of the whole

1           thing?

2           PROFESSOR NEVEN: Of the whole thing because, you know, what  
3           matters is the combination between the two price. So if  
4           the price of trucks is going up exogenously because of  
5           the infringement, I mean the sum of the two price is  
6           going up, that means that lower quantity of the  
7           complements is demanded. They might react by cutting  
8           their own price, which will go some way towards  
9           compensating the initial shift in demand.

10          MR RIDYARD: It will moderate the original price increase.

11          PROFESSOR NEVEN: Yes. Exactly.

12          MR RIDYARD: Yes. Okay. Now, are there any other  
13           characteristics of the industry that one should be  
14           looking at to try and get a handle on this complements  
15           effect, other than the ones we have just been through?

16          MR HARVEY: I think we have captured the main ones from our  
17           discussion. We did just touch on these of entry and exit  
18           and the supply of the complements, so I think anything  
19           that drives the relative strength of competition between  
20           the two parts of the system would be relevant.

21          MR RIDYARD: I was just wondering whether there will be  
22           anything on the supply side of the body manufacturers.  
23           If the body manufacturers could easily put other things  
24           together, other than bodies -- I do not know quite what  
25           that would be -- but if it is the same engineering

1 skills and -- that were required to make bodies plus  
2 other things, could that be relevant? Could that affect  
3 their -- the intensity with which they chased volume?

4 MR HARVEY: Yes, I think it could. It would -- if the body  
5 manufacturers are capable of doing other things, then  
6 changes in the -- obviously in the price they receive  
7 for the product might encourage them to either do more  
8 of that activity or, indeed -- and by doing less of  
9 something, something else, and, indeed, if the other  
10 markets they are operating in have a similar change,  
11 then it could go the other way.

12 PROFESSOR NEVEN: I mean, I agree with that. If they have  
13 an opportunity -- if they have alternative  
14 opportunities, using the equipment, the factories, the  
15 press and so forth, besides producing bodies or  
16 trailers, faced with a decrease in the demand for bodies  
17 and trailers they might switch to these other  
18 activities. However, I mean, going through these  
19 industry reports and, in particular, going through the  
20 company profiles, I mean, you tend to see that these  
21 companies tend to be quite focused, the product firms.

22 MR RIDYARD: Maybe it is not that interesting in practice.  
23 Okay.

24 So the next question is one which, Professor Neven,  
25 you have already sort of hinted at already, but just --

1 we were just wondering whether, you know, the truck and  
2 the body thing is the one aspect of complementarity that  
3 has been highlighted here, but you could think of the  
4 truck itself, which it is, really, a bundle of  
5 complements, is it not, because DAF, presumably, does  
6 not make tyres or -- I do not know whether it makes  
7 gearboxes or all sorts of other things and it certainly  
8 buys in engines for some of the trucks that we have been  
9 talking about, I believe, from another company, so why  
10 are we talking about this complements argument here in  
11 relation to bodies but we are not talking about it in  
12 relation to tyres and gearboxes and other engines that  
13 might be bought in?

14 PROFESSOR NEVEN: Yes. I think that there are two aspects  
15 to the answer to that question. The first one is  
16 actually a definition of what is a naked truck --  
17 okay? -- because we are making this distinction between  
18 a naked truck on the one hand and the bodies and the  
19 trailers, so, I mean, what sort of meaningful definition  
20 of a naked truck do we have? I think that the right way  
21 to look at it is to look at the naked truck as  
22 a combination of complements that cannot be unbundled.  
23 I mean, when you are buying a DAF LF, you are buying the  
24 chassis with the engine. You are not buying, sort of,  
25 separate bits and pieces; okay? You are basically,



1 I mean, buying a set of items that are put together that  
2 cannot be unbundled.

3 Of course, when we talk about bodies and trailers,  
4 they are unbundled and, typically, I mean, as we have  
5 discussed two weeks ago, I mean, the naked trucks are  
6 sold separately from the bodies and the tractors are  
7 sold separately from the trailers, so I think that is  
8 the first part of the definition. I mean conceptually  
9 a naked truck is a set of complementary items that  
10 cannot be unbundled, and, of course, bodies and trailers  
11 can be unbundled.

12 The second element that we already discussed is that  
13 bodies and trailers have no other use but to be used in  
14 conjunction with the naked truck or the tractor, which  
15 is not the case with tyres, which is not the case with  
16 sort of other items that may be complement to the truck  
17 or, for that matter, with the use of the truck.

18 MR RIDYARD: Well, truck tyres can only be used on trucks,  
19 can they not?

20 PROFESSOR NEVEN: Yes, but it was a replacement market.

21 MR RIDYARD: How is that relevant, then?

22 PROFESSOR NEVEN: It is relevant because it means that the  
23 demand for truck tyres, I mean, will be determined by  
24 the demand for new trucks but also by the replacement of  
25 tyres on existing trucks.

1 MR RIDYARD: Other than what we talked about -- let us leave  
2 that to one side -- the demand for replacement tyres  
3 would -- it is what it is, is it not, depending on the  
4 profile of the trucks out there?

5 PROFESSOR NEVEN: Yes.

6 MR RIDYARD: So the only thing changing at the margin when  
7 there is a -- you know, if there is a truck cartel which  
8 raised prices and reduces the demand for trucks, then  
9 that is bad news for tyre manufacturers.

10 PROFESSOR NEVEN: It is bad news but it is a small fraction  
11 of the overall demand for tyres. Indeed, it is bad news  
12 for Michelin that is selling tyres to DAF that we put on  
13 the truck, but, you know, the demand for tyres that are  
14 put on new trucks is a fraction of the overall demand  
15 for tyres, which includes the replacement market. So  
16 a shift in the demand that is resulting from an increase  
17 in the price of new trucks, I mean, will have less of an  
18 effect because it is part of a wider market.

19 MR RIDYARD: Proportionately, but it is still the same  
20 number of tyres that is going to be off the market  
21 because of the cartel.

22 PROFESSOR NEVEN: Correct, but there are other determinants  
23 in demand.

24 MR RIDYARD: Yes. Mr Harvey?

25 MR HARVEY: I do not think, at the level of principle, that

1           there is a major difference. I do understand that there  
2           might be a spectrum in terms of how closely knit the  
3           inputs are to the truck, but the general economic  
4           principles that we have been through, which are, you  
5           know, what happens when there is a price increase of the  
6           truck, does that put downward pressure on the demand for  
7           things that go into it, I think the considerations that  
8           we have spoken about apply there.

9           I mean, it strikes me that, you know, there may be  
10          a distinction here to be made between the supply of  
11          bodies to Royal Mail that were sold by DAF, so  
12          Royal Mail was buying -- literally buying the bundle,  
13          and so from DAF's perspective when these market forces  
14          mean that there is downward pressure on the price of  
15          bodies, it would be, in the first instance, DAF that  
16          experiences the price reduction as part of its input  
17          costs, and then, of course, it then needs to make  
18          a decision as to whether to -- and how much to pass that  
19          on to customers. The economic forces are the same, but  
20          obviously there is sort of another step, as it were, in  
21          that, whereas for the -- I think what is being labelled  
22          sort of the offsetting complements which basically  
23          relate to trailers, I think there the customers purchase  
24          them from the trailer manufacturers, and so I suppose in  
25          a sense that would be the direct beneficiary of any

1 reduction in price. So I think there might be  
2 a relevant distinction to make between those two  
3 circumstances, but the fundamental economics of these,  
4 I think, would apply to other things bundled with the  
5 truck, but it is a matter of degree, I suppose.

6 PROFESSOR NEVEN: I mean, there has to be a reality check  
7 here. I mean, you do not have a very active, open  
8 market for engines to be fitted in LF trucks; okay? It  
9 is not as if, you know, buyers --

10 MR RIDYARD: Yes. Understood.

11 PROFESSOR NEVEN: I mean, and so that is the -- and what we  
12 also have, however, is that there is a very active  
13 market for the supply of bodies to be fitted on rigid  
14 and there is a very active market for trailers to be  
15 pulled by tractors.

16 MR RIDYARD: This is probably -- yes. Maybe we will carry  
17 on -- there are one or two more questions this afternoon  
18 lunch.

19 THE CHAIRMAN: We will resume, then, at 2 o'clock, and you  
20 are still in purdah. I guess that means you can go out  
21 for lunch together, but maybe you have got alternative  
22 arrangements.

23 (1.04 pm)

24 (Luncheon adjournment)

25 (2.00 pm)

1 THE CHAIRMAN: Good afternoon.

2 MR RIDYARD: Okay. So just a couple of questions to finish  
3 off on this topic of the economic principles. I suppose  
4 I just wanted to get your perspective on why it is we  
5 are talking about the complement effects here, whereas  
6 we are not talking about it in relation to the other  
7 components, if you like, of trucks, some of which may be  
8 integral to trucks, some of them may be less integral.  
9 Do you think it might be something to do with the nature  
10 of the infringement, you know, the way in which the  
11 alleged cartel was formulated? Professor Neven?

12 PROFESSOR NEVEN: Yeah, I think that we are concerned about  
13 the complements with respect to bodies -- or concerned  
14 with bodies and trailers as complement, essentially  
15 because they are real complement, as discussed earlier,  
16 unlike many others, and secondly because they have  
17 a significant value relative to the value of the naked  
18 truck and because, indeed, the infringement, the way  
19 European Commission has described it, and the way  
20 I understand it, is an infringement that led to an  
21 increase, potentially, of the price of rigids without  
22 bodies and tractors, so, I mean, we have only one of the  
23 component in the system which is affected by the  
24 infringement and the other component is a strict  
25 complement and is significant in value. That is,

1 I think, what motivates the analysis.

2 MR RIDYARD: Mr Harvey?

3 MR HARVEY: I am not sure why it has been separated out, so  
4 I engage with the defence, as I saw it. As I said  
5 earlier, I do not really see a sort of a clear-cut  
6 distinction between the body, on the one hand, and other  
7 inputs that get bought into the manufacturer of a truck,  
8 so I am not sure I can assist you further with that.

9 MR RIDYARD: It may not be a question for you at all, but  
10 may be more of a legal question, but -- as to whether  
11 the infringement actually encompassed the bodies -- the  
12 prices of bodies as well as the prices of trucks.

13 MR HARVEY: Yes. I think we spoke about that in the context  
14 of the overcharge, and that is sort of, again, why, it  
15 seems to me, relevant to potentially make a distinction  
16 between the bundled complements and the offsetting  
17 complements because, on one view, the bundled  
18 complements effectively amounts to a reduction in the  
19 manufacturing cost of DAF and how that would affect end  
20 prices for customers if the infringement included  
21 bodies, then there would be sort of a lesser pass-on  
22 effect to customers compared to the counterfactual.

23 MR RIDYARD: Okay. Thanks.

24 Okay, so we will move now on to Professor Neven's  
25 approach to -- to put some numbers on the complements

1 effect.

2 So, Professor Neven, could you start, maybe, just by  
3 telling us what are the critical components -- you know,  
4 the set-up of your calibration model?

5 PROFESSOR NEVEN: Yes. Maybe just as an introduction to  
6 what the methodology does, so what the methodology does  
7 is to take a few observables, I mean -- and what  
8 I observed are the prices of DAF trucks. I observed the  
9 cost of DAF trucks. I observed the prices and, well,  
10 actually observed the margins of the complements.  
11 I observed different segments in the complements and  
12 I can deduce the price and the cost of the complements  
13 from the margins. So, basically, I have prices and cost  
14 for DAF trucks. I have sales of DAF trucks. I have  
15 sales in the market as a whole. I have market share of  
16 the other manufacturers. I have a segmentation of the  
17 different type of complements and I have prices and  
18 costs on average for those complements.

19 So these are things that I observe and I specify  
20 a model of competition between truck manufacturers and  
21 between body suppliers or complement suppliers, and in  
22 specifying that model, I derive what is the equilibrium  
23 of that model, and by "equilibrium", I mean the prices  
24 and the quantities that DAF and its competitors would  
25 have set, the prices and the quantities that the

1 suppliers of complement would have set, and then I  
2 basically impose the equality between what I observe and  
3 what is the equilibrium of this model of competition,  
4 and by imposing this identity between what I observe and  
5 what is the equilibrium of that model, I can deduce the  
6 parameters that are not observed, and the parameters  
7 that are not observed are essentially the parameters of  
8 demand, and the parameters of demand, they reflect  
9 essentially the degree of substitution between systems  
10 that have trucks from different manufacturers but the  
11 same complement, the same type of body, or the same type  
12 of trailers, the substitution between systems that have  
13 the same complement, say the same trailer or the same  
14 body with different truck manufacturers -- or the other  
15 way round, sorry. Maybe I said twice the same thing, so  
16 let us just rewind.

17 So the key parameters of demand is the degree of  
18 substitution between trucks of the same manufacturer and  
19 different bodies, suppliers, the degree of substitution  
20 between different systems that have the same bodies but  
21 trucks from a different manufacturer and then the degree  
22 of substitution between systems that have nothing in  
23 common; okay? These are the key parameters, and I also  
24 have specific parameters of demand for DAF and for the  
25 other manufacturers, but, I mean, not to be lost in the



1 details, essentially the calibration methodology is to  
2 rely on a few observables -- the prices, the quantities,  
3 the market size for both trucks and for the suppliers of  
4 complement, to derive a model of competition in which  
5 I can find what is the equilibrium. I impose the  
6 identity between the equilibrium and what I observe,  
7 which allows me to infer these key parameters of demand.

8 When I have inferred these key parameters of demand,  
9 then I have a fully computable model of the market,  
10 essentially I can then use that model in order to  
11 simulate what happens if there are some exogenous  
12 changes, and what I simulate is what happens if there is  
13 an infringement that leads to an increase in the price  
14 of trucks by all the manufacturers, so, essentially,  
15 I mean, the method is to use observable -- limited  
16 amount of observable, to develop a model from this to  
17 derive the parameters of demand that I do not observe to  
18 get a fully computable model, then simulate what happens  
19 to that equilibrium, to that model, if I have a change  
20 like the infringement that leads to an increase in the  
21 price of all manufacturers; okay?

22 So you realise that, in doing this, of course what  
23 is key is the structure of the model that you build in  
24 which you are deriving an equilibrium, and, you know,  
25 there you have to make assumptions. You have to make

1           assumptions about the market structure; you have to make  
2           assumptions about, in particular, the market structure  
3           with respect to the suppliers of complement; you have to  
4           make some solidifying assumption with respect to the  
5           market structure in the supply of trucks. That is  
6           essentially because we do not observe the prices of the  
7           competitors or the cost of competitors, so we have to  
8           make assumptions about the market structure and you also  
9           have to make assumptions about the various types of  
10          complements, and I have used information from the  
11          Department of Transport about, you know, different types  
12          of bodies and different types of trailers and I have  
13          done a separate calibration, a separate simulation, for  
14          each of those segments. We can discuss the specifics of  
15          these assumptions in a minute, but essentially the idea  
16          is to develop this model of competition to impose  
17          identity with some observables and then to simulate that  
18          model.

19         MR RIDYARD: Why do you need to make an assumption about the  
20                 structure of the components industry when we can observe  
21                 it?

22         PROFESSOR NEVEN: The problem is that I know that there are  
23                 a number of competitors.

24         MR RIDYARD: I think 20, you mentioned.

25         PROFESSOR NEVEN: Exactly, but I do not have the market

1 shares. I mean, I do not know how significant they are  
2 and, in order to meaningfully specify them, I would need  
3 to know their market shares, and I do not have that. So  
4 what I assume is that there is a competition between  
5 suppliers of bodies and trailers which is symmetric and  
6 I assume that there are only two suppliers, which may  
7 sound extreme -- okay? -- but it is precisely because  
8 there are 25 that I feel relaxed in assuming that there  
9 are two. This may sound counter-intuitive, but the idea  
10 is that if you have a large number of competitors in an  
11 industry which is one in which products are not highly  
12 differentiated, then one of the insights from models of  
13 competition is that we know that the number of  
14 competitors actually does not matter all that much in  
15 order to explain margins. I mean, what is going to  
16 explain the margins in an industry in which there is  
17 a low level of product differentiation is precisely the  
18 fact that there is a low level of product  
19 differentiation, so whether you have two competitors or  
20 four competitors or 10 or 15 may not matter all that  
21 much.

22 So, indeed, this is one of the assumptions that I am  
23 making in which I am imposing a structure which does not  
24 fit with reality. Clearly, I mean, I am assuming that  
25 there are two competitors that are symmetric. In

1 reality, there are many more, but I am relaxed in doing  
2 that because it is an industry in which margins are  
3 unlikely to be determined by the number of competitors,  
4 are much more likely to be determined by how close the  
5 products -- how close are the products that they are  
6 selling.

7 MR RIDYARD: So your two suppliers have very similar  
8 products and, therefore, there is very close competition  
9 between them under the assumptions that you have made?

10 PROFESSOR NEVEN: That is right. Exactly.

11 THE CHAIRMAN: I think you also said that you had to make  
12 assumptions about the market for trucks --

13 PROFESSOR NEVEN: For trucks, yes.

14 THE CHAIRMAN: -- as well.

15 PROFESSOR NEVEN: Let me explain what I do there. I only  
16 have prices for DAF and I only have cost for DAF, but  
17 I know that -- I mean, the position of DAF and the  
18 position of the other suppliers is very different.  
19 I mean, DAF has a market share which is much larger than  
20 the market share of the others. I mean, if you are  
21 referring to rigids, for instance, I mean, DAF has  
22 a market share of about -- it depends on whether it is  
23 medium or high, but it is around 30% to 35%, which is  
24 much in excess of the market share of the others. If  
25 you are looking at the market for tractors, I mean, the

1           asymmetry is less significant, but it is important that  
2           my model can allow for this asymmetry between DAF and  
3           the other suppliers.

4   THE CHAIRMAN: Is it relevant that it was not a competitive  
5           market?

6   PROFESSOR NEVEN: Okay. Let us get to this. I do my  
7           simulation, so I do my calibration at the time at which  
8           it is a competitive market, so what I do is that I do  
9           this exercise that I describe in matching the  
10          observables with the model for the period 2013, 2015.  
11          So I estimate the parameters in the period which is  
12          untainted, in which there is a competitive outcome, and  
13          then I assume, having derived this fully computable  
14          model -- I mean, having derived this, I then assume that  
15          with those parameters there would be an infringement,  
16          such that prices of all trucks would increase by 1%,  
17          say. But, so -- indeed you are right that I would have  
18          to be careful not to calibrate the model in a situation  
19          in which prices are not set competitively, but this is  
20          not what I do. I do this calibration for the period  
21          2013/2015.

22                 Now, to go back to your question about the market  
23                 structure for trucks, it is important that my model has  
24                 demand parameters that can explain the differences in  
25                 market shares between DAF and the others, but my model

1 imposes that competition from the others is symmetric,  
2 and, again, I wish I could do something better than  
3 that, but I cannot because I would need to have, you  
4 know, prices and sales of each of the competitors if  
5 I were to try to calibrate more precisely the sales and  
6 the prices of the -- use the sales and the prices of the  
7 competitors to undertake a calibration. So I basically  
8 have a model in which I have two demand parameters that  
9 are specific to DAF and then another two demand  
10 parameters that are specific to all others.

11 MR RIDYARD: Okay. So can you explain that -- just bring  
12 that out a bit more? So you have got a factual market  
13 structure which is one supplier has got more shares than  
14 the rest, the others are all considered to have small  
15 but similar shares --

16 PROFESSOR NEVEN: Actually what I do is that I -- because  
17 they all have similar shares except for the small  
18 ones -- I mean, you have Iveco and MAN that are about  
19 half the size of the others, so I assume that besides  
20 DAF there are four other competitors. It is Scania, it  
21 is Volvo, it is Daimler and then it is the combination  
22 between MAN and Iveco.

23 MR RIDYARD: Okay. So what does that mean in terms of how  
24 you characterise competition between those different  
25 groups in an industry?

1 PROFESSOR NEVEN: I mean that I characterise competition in  
2 the truck industry in such a way that the demand that is  
3 addressed to DAF has some specificity and I calibrate  
4 this demand specificity as we are going to see it is  
5 quite important for the result. So, I mean, I allow,  
6 I mean, to have specific demand features for DAF, but  
7 I impose that the demand features for the others are the  
8 same.

9 MR RIDYARD: To be more specific, when you say "specific  
10 demand features", what does that mean?

11 PROFESSOR NEVEN: Okay. What I mean is that I have a demand  
12 system -- I have a system of demand for combinations  
13 between trucks and complements, say trucks and bodies or  
14 tractors and trailers -- okay? -- and, I mean, those can  
15 be either a combination between a DAF truck and  
16 a trailer or a body for one of the two suppliers in the  
17 complement market or they can be a combination between  
18 any of the other manufacturers and, again, one of the  
19 two complement, either body or trailer. So my demand  
20 system allows the parameters, so the elasticities, if  
21 you want, to be different for DAF and for all the  
22 others. So the degree of substitution between  
23 a combination that has a DAF truck plus a body from one  
24 manufacturer is going to be allowed to be different in  
25 my model from the elasticity that I am going to be

1           calibrating for the demand for a system that involves,  
2           say, a Mercedes truck together with the body or  
3           a trailer from one of the two suppliers.

4       MR RIDYARD: Mr Harvey, any comments so far?

5       MR HARVEY: I think we have covered the critical inputs  
6           assumptions to competitors' competitiveness and then the  
7           truck prices for competitors. So I did, in my report --  
8           if I could just take you to some of the places where  
9           I have tried to address some of those points. So it is  
10          {E/28/110}.

11           So, the purpose of this table was to summarise the  
12          main input into the modelling. As Professor Neven  
13          indicated, we have the price and cost of DAF trucks, but  
14          we do not have that for non-DAF trucks, and so the start  
15          point for that is to assume that the cost of  
16          manufacturing for non-DAF trucks is the same and then  
17          the model outputs the price of non-DAF trucks. So, to  
18          the extent that the model is poorly calibrated, the  
19          model will mispredict the price of non-DAF trucks.

20           It is related to a concern I had, which is that in  
21          the run of this model the output suggested that the  
22          margins for non-DAF trucks and therefore the prices were  
23          significantly lower than for DAF trucks. I think that  
24          arises due to some of the points that Professor Neven  
25          has just made, but the effect of that is that on average



1 it means that the margins in the truck market are  
2 perhaps too low, depending on what the true margins are,  
3 and that would tend to tip that relativity in favour of  
4 the body manufacturers absorbing a means of price cut  
5 rather than the truck market. But, in any event, they  
6 are estimates. We do have DAF yearly sales.

7 The sales of bodies and trailers, and their prices,  
8 we do not know that. We do have some information on the  
9 market shares of the trailer and body manufacturers from  
10 their annual accounts, so that is the inputs.

11 On the assumptions out of table 26, which I now  
12 cannot find, which, again, the purpose of this is to  
13 summarise -- so that is on, sorry, {E/28/130}. I think,  
14 as Professor Neven has indicated, because we both have  
15 very little information regarding the prices and costs  
16 of everything but DAF trucks, the inputs into the model  
17 are relatively scant and so the outputs are driven by  
18 the modelling structure that Professor Neven has used.

19 So this summarises the various assumptions, which  
20 includes the number of body and trailer suppliers at 2,  
21 that they are symmetric, the decision in relation to the  
22 truck market, that they are symmetric, and so forth, so  
23 I will just take you to those briefly. It is intended  
24 to summarise the various choices that have been made and  
25 I have explained what I think about them in my report.

1           One of my concerns with the modelling in the first  
2           report was that there were some additional restrictions  
3           that were placed on the model in order to drive out  
4           a result. I relaxed those restrictions in my reply and  
5           found that they had a large effect on the implied  
6           complements effect and by removing them it reduced the  
7           effect. Professor Neven subsequently updated his  
8           report, which I suspect we might talk about later, but  
9           the results of my sensitivity analyses are in table 25,  
10          which is on page {E/28/122}.

11       MR RIDYARD: Maybe we will come on to those in a moment when  
12          we specifically talk about the various sensitivities.

13       MR HARVEY: Yes.

14       MR RIDYARD: Just to pick up one point in particular that  
15          you mentioned there -- and this is a question to  
16          Professor Neven -- I mean, the -- having assumed that  
17          DAF has similar costs to the competitors because it has  
18          a higher market share, you -- I can see why you have  
19          assumed it has got a higher margin, but, I mean, DAF's  
20          market share across -- sorry?

21       PROFESSOR NEVEN: I am not assuming that DAF has a higher  
22          margin. I think that, to be clear, what I am doing  
23          there is, of course, I observed the margin of DAF and  
24          I observed the market share of DAF. I do not observe  
25          the cost or the prices of the competitors. I assume

1           that the competitors for any given segment of trucks has  
2           the same cost as DAF, but I let the model calibrate the  
3           price of competitors, and this is an issue we will come  
4           back to because it is indeed something which is  
5           important for the results of the calibration.

6           MR RIDYARD: It leads to the competitors having a lower  
7           margin than --

8           PROFESSOR NEVEN: No. I mean, we are going to discuss that  
9           in a second. There are some parameter configuration in  
10          which they have lower margins and parameter  
11          configuration in which they have higher margins.

12          MR RIDYARD: But they have higher margins than DAF?

13          PROFESSOR NEVEN: Yes, and I will explain why. I think it  
14          is very intuitive, actually.

15          MR RIDYARD: Okay.

16          PROFESSOR NEVEN: So -- indeed, but you might still worry  
17          about the idea that I have the assumption that they have  
18          the same cost even if I allow the margins to be  
19          determined by the model, and I did some sensitivity  
20          around that. I mean, say, assume -- okay? -- cost of  
21          competitors are 5% below, cost of competitors are 5%  
22          above DAF, is it that the calibration and, in  
23          particular, the prices of the margin would be so  
24          different? That does not seem to be significant and it  
25          is very intuitive. I mean, you know, you have a margin,

1           this is what is key for this model.  If you fix one and  
2           if you allow the other parameters to vary, it is not  
3           going to have a big effect.  So, you know, what is --  
4           the real restriction in this calibration is coming from  
5           the fact that I do not have prices for competitors and I  
6           do not have specific market shares for the competitors.

7   MR RIDYARD:  Just a factual question.  I mean, DAF's  
8           position in the UK market as being the market leader, is  
9           that replicated across Europe in general?

10   PROFESSOR NEVEN:  No.

11   MR RIDYARD:  Does that provide any clues as to -- is the UK  
12           market -- is it right to look at the UK market  
13           separately for these purposes or is there any sort of  
14           cross-check that one can do by looking at the truck  
15           manufacturers' positions across other European markets?

16   PROFESSOR NEVEN:  Indeed.  I mean, this exercise could be  
17           replicated in other countries and the market structure  
18           in Germany is quite different.  I mean, in Germany, as  
19           you would expect, it is Daimler and MAN that have  
20           a higher market share than the rest and in France it is  
21           Volvo Renault that has a higher market share, so there  
22           are some remnants from these sort of national suppliers,  
23           and, indeed, sort of calibrating this model in these  
24           other countries would provide a cross-check, but I have  
25           not done that yet.

1 MR RIDYARD: Yes, indeed. Okay. Before we get to the more  
2 detailed points, I mean, perhaps, Mr Harvey, could you  
3 summarise for us why you do not like this approach?  
4 What would you say would be your main concerns with  
5 Professor Neven's approach?

6 MR HARVEY: So I think the start point for me was that we  
7 needed to find evidence about whether complements, the  
8 price of complements, in fact, fell. I do not really  
9 see -- this is not a criticism, actually, of this  
10 specific simulation model, but simulation models in  
11 general are intended to almost provide a refined  
12 hypothesis based on economic theory and models of  
13 competition, so I see this more as almost if everyone  
14 plays by the rules that are within the simulation  
15 modelling process, then we would expect to see these  
16 types of figures, assuming all of the inputs and so  
17 forth are correct, but that is not the sort of approach  
18 that we have adopted in the context of the -- say, the  
19 overcharge analysis, where we are seeking to measure, in  
20 fact, what happened. So that is my main concern in  
21 relation to, I think, the use of simulation models in  
22 this context.

23 In terms of the simulation model that  
24 Professor Neven has prepared, again, this is not really  
25 a criticism of Professor Neven. It had to rely on

1 a very large number of assumptions and estimates that  
2 are not capable of being verified, and so it is very  
3 hard to know how robust the answers really are. What  
4 I do know is that when I make changes to the input  
5 assumptions that intuitively matter, such as the  
6 margins, they have a very large effect on the results,  
7 so I think they are the three -- to summarise, they are  
8 the three main reasons that I have concerns with this  
9 type of approach.

10 MR RIDYARD: Perhaps that would be a good time to come on  
11 specifically to the sensitivities that have been looked  
12 at on this. Maybe, Professor Neven -- you have already  
13 mentioned these in passing, but are there some points  
14 that you would like to summarise here in terms of ...

15 PROFESSOR NEVEN: Yes. I think that it will be useful to go  
16 through the results because, you know, in the end,  
17 whether these models are useful or not depends a little  
18 bit on whether the results that they produce make  
19 sense -- I mean, whether there is an economic  
20 interpretation of the results that make sense, and so --

21 MR RIDYARD: Sorry, as you say that, I mean, maybe it would  
22 just be useful for us to summarise what you are saying.

23 So in all this you are forcing through the effect of  
24 a 1% increase in truck prices and your bottom line out  
25 of this is that about -- approximately a third of that

1 effect is --

2 PROFESSOR NEVEN: No, it is less. It is significantly less.

3 So that is why I think that we should go through the  
4 results.

5 MR RIDYARD: Okay. Just tell us what the bottom line is  
6 just so that we have got that in mind when we go through  
7 the --

8 PROFESSOR NEVEN: Okay. So the bottom line for Royal Mail  
9 is that about 6% of the overcharge would have been  
10 compensated by a reduction in the price of complement  
11 and in the case of BT it is about 25%. I mean, that is  
12 the ballpark estimate.

13 MR RIDYARD: That is driven by the fact that the BT bodies  
14 and trailers are more expensive?

15 PROFESSOR NEVEN: That is right. I mean, the BT -- it is  
16 only bodies in the case of BT, there was no trailer. In  
17 the case of BT -- I mean, the bodies are specialised  
18 bodies that are much more expensive than the trucks;  
19 okay? So BT is buying both medium and heavy trucks, but  
20 they tend to be fairly cheap in relation to the body  
21 that they are putting on them and so that is the reason  
22 why you get a stronger effect. But I think it is useful  
23 to go through the results because, I mean, in the end,  
24 I mean, the proof of the pudding is in the eating. I  
25 mean, is it that you get results that make economic

1           sense, that have an order of magnitude that make  
2           economic sense and also differences across segments that  
3           make economic sense?

4           So if we could go to my third report -- now let me  
5           see where this one is. It is EIC/63. I would like to  
6           go to table 1, {E/63/1}.

7   THE CHAIRMAN: Which page is that on?

8   PROFESSOR NEVEN: It is on page 18 in the pagination of the  
9           court, {E/63/18}. 16 in my report.

10           So what you have in this table are, first, the  
11           various segments in which I have performed  
12           a calibration, and let me explain what these segments  
13           are because it is important for the interpretation.

14           So, the first four segments, 0, 1, 2 and 3, are  
15           tractors, and segment 0 and segment 2 are cheap -- so to  
16           speak, cheap tractors. They are two-axle structures,  
17           okay? As I mentioned before, the margin on those  
18           tractors is about 16%. Segment 1 and 3 are more  
19           expensive tractors. They have three axles and DAF  
20           actually has a higher margin, about 17% to 18%, and  
21           a lower market share with respect to those tractors.

22           Now, for each of the tractors, say the cheap  
23           tractor, segment 0 and segment 2, I have two types of  
24           trailers, and that corresponds to what I observe in the  
25           data, in particular the data from Royal Mail, because BT



1 does not have trailers, and we see that Royal Mail is  
2 purchasing two types of trailers, a cheap trailer and an  
3 expensive trailer, and the cheap trailer is a standard  
4 trailer that costs about £25,000, so about the same as  
5 a -- well, a bit less than the tractor, and the  
6 second one, C2, is a very expensive trailer. It is  
7 a double-decker. It is essentially a trailer in which  
8 you have two levels inside the trailer and it is much  
9 more expensive. It costs about £55,000 per trailer.

10 So segment 0 is essentially the cheap tractor with  
11 the cheap trailer; segment 1 is the expensive tractor  
12 with the cheap trailer and so forth. So the first four  
13 segments, 0 to 3, are the tractor segments.

14 Now, from 4 to 14 you have the rigid segments and  
15 you have the distinction between the medium and the  
16 heavy trucks, and the segments involving medium are 4, 7  
17 and 13. You see 6 to 16, that corresponds to medium  
18 trucks and the segments that involve heavy trucks are 8,  
19 12 and 14. Again, for each, you have different types of  
20 bodies, and what I see in the data is essentially, for  
21 Royal Mail and BT, three types of bodies. I have -- and  
22 that is the bulk of the bodies for Royal Mail -- cheap  
23 bodies that cost less than £10,000. I mean, it is  
24 essentially a curtain side. It is a box. It is a very  
25 simple body.

1 I have more expensive bodies that typically cost  
2 about, sort of, £15,000 to £17,000. Those are referred  
3 as, "Bodies 10-20K", and then, in the case of BT, I have  
4 specialised bodies, those that were used by BT that can  
5 be very expensive. They can cost up to 50 again --  
6 £50,000 to £60,000. So basically I have a number of  
7 segments that correspond to different systems, I mean,  
8 trucks, that can be either cheap trucks or expensive  
9 trucks, medium or heavy and different types of bodies.

10 I undertake the simulation -- the calibration --  
11 sorry -- of the demand parameters for each of the  
12 segments separately, and then you see, in the last two  
13 columns, what is referred to as my minimum -- I should  
14 say Mr Harvey's minimum. Sorry, it is Harvey's  
15 minimum -- okay, it is Mr Harvey's minimum, and here let  
16 us explain what this is coming from.

17 As Mr Harvey has explained, I initially did  
18 a calibration of this model. Mr Harvey has identified  
19 the fact that I had not identified all of the possible  
20 parameters that would fit the observables and he did  
21 that by running my model, and he said, "Okay, you have  
22 investigated a range of parameters, but there are other  
23 parameters that you have not investigated that could  
24 also fit the observables". So I redid my calibration,  
25 and Mr Harvey was correct, that I had searched for valid

1 parameters in a space that was constrained. I have then  
2 expanded the search for valid parameter configurations  
3 and I have now new estimates of the complement effect.  
4 This is what is referred to -- what you have in this  
5 column, that is my minimum and Harvey's minimum is what  
6 Mr Harvey has found when he has looked at the first  
7 version of my calibration.

8 What is interesting is to look at the structure of  
9 those numbers. Now, it is interesting that if you look  
10 at the relationship between the number that you have in  
11 the "My minimum" column and the characteristics of the  
12 trucks and the complements, there is a meaningful  
13 economic relationship.

14 Let us start with the trucks for which we have the  
15 lowest margin. It is segment 4, 7 and 14. These are  
16 the medium trucks; okay? So these are trucks for which  
17 the margin of DAF is around 7% and for which the market  
18 share of DAF is about 30% to 35%, and you see that for  
19 those segment 4, 7 and 13 I have a complement effect  
20 which is 1.3. It means that in those segments where the  
21 market share of DAF is high, where the margin of DAF is  
22 high, the complement effect tends to be strong.

23 Let us now look at the segment with heavy trucks,  
24 which is 8, 12 --

25 MR RIDYARD: You said the margin of DAF is low?

1 PROFESSOR NEVEN: Low. Did I say "high"? Sorry.

2 MR RIDYARD: Yes. You meant "low", yes.

3 PROFESSOR NEVEN: I meant "low". The margin for the medium  
4 trucks is about 7% --

5 THE CHAIRMAN: So you said that the 4, 7 and 13 have  
6 a complement effect which is 1.3.

7 PROFESSOR NEVEN: 0.3, that is right. So 4, 7 and 13, you  
8 see that it is along 0.3, and these are the three  
9 segments for which we have medium trucks, for which the  
10 margin is low.

11 Let us now look at the heavy trucks. Heavy trucks  
12 is 8, 12 and 14. In those -- in this segment the margin  
13 of DAF is about 13%, it is more significant, and the  
14 market share of DAF is also high. What you see is that  
15 in this segment of heavy trucks we have a complement  
16 effect which, instead of being around 0.3, is now around  
17 0.2. You see that it is 0.19 for 8, it is 0.19 for 12,  
18 it is 0.19 for 14. So we see already that as a function  
19 of the characteristics of the market in which DAF is  
20 operating, we see there is a difference in the  
21 complement effect, and I explain, you know, why we get  
22 this in a second, but let us continue with the tractors.

23 Tractors you have 0, 1, 2 and 3, as I mentioned  
24 earlier, and what you see is that the two segments in  
25 which the margin of DAF is around 16%, which is the two

1 axles, has an effect which is now around 0.12/0.11, and  
2 we see that -- for the segment in which the margin of  
3 DAF is the highest, which is the tractor segment with  
4 more than two axles, the three, you see that the  
5 complement effect is, again -- is smaller, is 0.08 in  
6 segment 1 and segment 3.

7 So what we see -- and this is one of the reasons as  
8 to why I have some confidence in these results -- is  
9 that there is a relationship between the strength of the  
10 complement effect and the margin that DAF has in those  
11 respective segments. What I see is that the higher --  
12 or the lower is the margin that DAF has, the stronger is  
13 the complement effect, and I can explain why.

14 MR RIDYARD: Okay. Well, you will come to that in sort  
15 of -- that is how you would kind of expect the pattern  
16 to be, but I do not know that the fact that it is the  
17 right pattern gives us any assurance that it is the  
18 right level, that the numbers are right.

19 PROFESSOR NEVEN: Okay.

20 MR RIDYARD: I mean, they may be right relative to one  
21 another --

22 PROFESSOR NEVEN: Yes, exactly.

23 MR RIDYARD: -- but why are they right?

24 PROFESSOR NEVEN: But then, in order to understand why you  
25 might have some confidence in them, you have to

1 understand where these differences are coming from. Why  
2 is it? What is the effect? What are the parameters  
3 being calibrated that leads to these differences?

4 Essentially what is happening and what is explaining the  
5 difference in the strength of the complement effect are  
6 the characteristics of the parameters that are  
7 calibrated in terms of the relative significance of the  
8 substitution among different systems, on the one hand,  
9 and the substitution with outside goods, on the other.

10 So what is happening is that, as Mr Harvey has  
11 observed, there are many parameters that will fit the  
12 observable, so really there are many of them, and  
13 however you can characterise them economically, and  
14 there is a range of parameters which fit the model, such  
15 that there is a fair amount of price differentiation  
16 among the manufacturers, but such that there is  
17 a significant elasticity at the market level.

18 So to see the intuition, think about the price of  
19 a system going up. Two things can happen: either  
20 because the price of a system is going up the buyers are  
21 switching to alternative system, and that is going to be  
22 determined by the degree of product differentiation  
23 between the systems, or they would stop buying  
24 altogether -- okay? -- which is essentially aggregate  
25 elasticity, if you want.

1           Now, at the opposite, what you could have is  
2 a situation -- I mean, if you look at the weight between  
3 these two factors, you can have either a situation in  
4 which you have a significant effect associated with the  
5 substitution of one different system, so that in the  
6 event of an increase in the price of one system,  
7 customers are switching to the other system and the  
8 residual demand is unimportant, or you could have the  
9 opposite; okay?

10           Now, when is the complement effect going to be  
11 strong? The complement effect is going to be strong  
12 when, in response to a price increase by all  
13 manufacturers, there is a big shift in demand or the  
14 opposite, the complement effect is going to be weak  
15 when, in response to an increase in the price by all  
16 truck manufacturers, the shift in the overall demand is  
17 weak. You know, the shift in the overall demand is  
18 going to be weak when the elasticity in the market with  
19 respect to the outside good is limited.

20           So if I interpret the calibration of my model, if  
21 I interpret the parameters for which -- which explain  
22 these numbers, what I do see is that in those segments  
23 for which DAF has a low margin, essentially there is  
24 only one set of parameters that will achieve the  
25 calibration; those parameters for which the substitution

1 with the outside good is actually relatively significant  
2 in relation to the substitution among the systems. That  
3 is why, for instance, for the segments 4, 7 and 13  
4 I have a relatively strong complement effect, because  
5 for those segments in which the margins of DAF is  
6 relatively small, the dominant parameter configuration  
7 is one in which the substitution at the second level,  
8 the substitution with the outside good, is relatively  
9 strong.

10 What I have, however, for the other segments in  
11 which the margin of DAF is much higher is that there is  
12 an alternative parameter configuration which -- such  
13 that, you know, indeed, these parameters can match the  
14 equilibrium of the model, which has, I mean, a much  
15 lower level of product differentiation among the  
16 different systems, so a much closer substitution, but,  
17 at the opposite, almost no elasticity at the segment  
18 level. For those, of course, when you increase the  
19 price for all the manufacturers, the complement effect  
20 is going to be much weaker.

21 THE CHAIRMAN: I think we ought to give Mr Harvey a chance  
22 to comment on -- you have said quite a lot.

23 PROFESSOR NEVEN: I am sorry, but it is not simple to  
24 explain.

25 THE CHAIRMAN: No, I understand.



1 MR HARVEY: Can I just show you some of the sensitivities  
2 that I did that go to the level of the effect?

3 So that is on page {E/28/149}. As we spoke about at  
4 the start, we do not have good information about the  
5 prices and costs of the complements and so one of the  
6 sensitivities that I produced was to examine the extent  
7 to which the effects changed when we made alternative  
8 assumptions regarding the prices and costs of the  
9 complements.

10 So the first column, Professor Neven's model, that  
11 shows the median complement effect in his first report,  
12 so this is before he made the changes that he has just  
13 described, and at that point was using the median number  
14 that emerged from the model, not the minimum, and that  
15 was before the relaxation of the restriction that  
16 I identified. Then the subsequent column shows how that  
17 number, ie the median percentage change in the  
18 complement price, changes when I increase or reduce the  
19 complement cost or price, and this is to reflect that we  
20 do not know -- and neither do I in my analysis -- the  
21 margins at the segmental level.

22 If you just scan across this, what it shows is that  
23 the results of this simulation exercise are very  
24 sensitive to the -- to these figures. Of course, we do  
25 not know whether the true figures are higher or lower,

1 but it does indicate that modest changes in them give  
2 very different answers. I am afraid I do not have this  
3 table replicated for the use of the minimum that  
4 Professor Neven just presented or for the situation  
5 where we relaxed the restriction that he spoke about,  
6 but it does show quite how sensitive the levels are to  
7 changes in those key input assumptions. So I considered  
8 that was an important sensitivity in view of what we do  
9 and do not know about the products in question.

10 The other sensitivity that I did -- well, it is less  
11 of a sensitivity, really, it is just to sort of  
12 illustrate a point. So let me just find the table.  
13 Table 28. That is on page {E/28/143}. In this table  
14 I have not changed any of the input assumptions.  
15 Instead, what I have done here is to show the minimum  
16 complements effect emerging from the simulation, the  
17 median, which, at the time of this report, was the  
18 figure that Professor Neven relied on, and then  
19 a maximum, and the final column shows the ratio of one  
20 effect to the other, so the maximum to the minimum, and,  
21 as you can see, the range that emerges from this is very  
22 wide. It does not go to levels directly, but it does  
23 indicate that there is a lot of uncertainty within this  
24 modelling process that arises because of the lack of  
25 information that we have. So I am not sure this fits

1 under the standard bracket of "sensitivity", but I think  
2 it is relevant for the interpretation of the results.  
3 So they are the two sensitivities that I point to at  
4 this stage.

5 MR RIDYARD: Professor Neven, do you agree with the first  
6 one of those tables?

7 PROFESSOR NEVEN: No, I do not. I actually would like to  
8 draw attention to the sensitivity that I have replicated  
9 in my third report, so it is IC63, and that is on  
10 pages 21 and 22, {E/63/21}. The first table, which is  
11 on page 21, actually highlights the fact that the  
12 sensitivities that have been implemented by Mr Harvey  
13 are really unreasonable in the sense that you see, for  
14 instance, that -- and that makes a lot of sense -- if  
15 you have an 11% margin for bodies and trailers, if you  
16 have a 10% decrease in the price, that essentially means  
17 that the margin goes to zero, or if you have a 10%  
18 increase in the cost, it means, again, that the margin  
19 is zero.

20 This is what you have in the column, "Complements".  
21 These are the margins under the sensitivity of  
22 Mr Harvey. So there are two sensitivities of Mr Harvey  
23 with respect to complement which involve 10% decrease in  
24 the price or 10% increase in the cost that essentially  
25 annul the margins, and then, of course, if there was no

1 margin, then you would expect, indeed, the complement  
2 effect to become very small.

3 Similarly, the 10% increase in the price and the 10%  
4 increase in the cost -- sorry -- 10% decrease in the  
5 cost lead to margins which, for a sector like bodies and  
6 trailers, would appear to be very, very high. So I have  
7 replicated what I consider to be more reasonable  
8 sensitivities in the following page, {E/63/22}, and  
9 I have done that in the context of the new  
10 implementation of the model, that is to say the  
11 implementation of the model in which I have searched  
12 through the entire parameter space to identify the  
13 minimum.

14 You see there that the minimum undercharge in the  
15 case of Royal Mail in the benchmark is 6%; okay? There  
16 was 6% of the overcharge that is compensated by the  
17 undercharge across the different types of bodies and  
18 trailers. If I increase the body price by 5% and the  
19 trailer price by 2.5%, the effect goes to 8.5%. If I  
20 reduce the body price by 5% and the trailer prices by  
21 2.5%, I get that the effect goes down to 3.6%, and you  
22 have similar figures for BT bodies in the last line.

23 Clearly there is some sensitivity, I mean, clearly,  
24 depending on what you assume for the prices, you have  
25 changes in the results, and then I am not denying that.

1 I mean, these are changes. However, these are changes  
2 that also make economic sense. I mean, you expect that,  
3 as you are increasing the body price, that the effect is  
4 going to grow stronger; as you are decreasing the body  
5 price, that the effect is going to be weaker, for the  
6 reasons that we have discussed earlier.

7 So, indeed, I mean, there is some variation in the  
8 results, depending on the inputs of the model. You  
9 know, whether these changes are changes such that we  
10 should worry about, I mean, it is indeed a matter of  
11 judgment. I find comfort in the fact that they make  
12 economic sense and, similarly, you know, what motivates  
13 the relative comfort that I have in this methodology are  
14 the results that I described earlier. I mean, these  
15 results make sense in terms of the significance of the  
16 complement effect in relation to the margins of DAF and  
17 I can also understand where they are coming from. I can  
18 also understand that when DAF has a very low margin, it  
19 is impossible for the model to find a set of parameter  
20 configurations such that there is a very low elasticity  
21 at the segment level. There has to be something else.  
22 There has to be something in terms of the demand  
23 parameters that reflects some degree of differentiation  
24 among the systems in the market. So the fact that not  
25 only I get the systematic pattern, but I can also

1 explain why I get these differences, brings me some  
2 comfort.

3 Now, of course Mr Harvey is right in pointing out  
4 that, you know, there was a wide range of parameters  
5 that can actually fit the model, that is to say there is  
6 a wide range of parameters such that the equilibrium of  
7 the model replicates the observables that I have, but  
8 I think the -- it is an inherent property of that sort  
9 of model that you get many parameters. I mean, of  
10 course, if I had sort of better information, in  
11 particular, if I had information on the prices of  
12 competitors, I mean, the range of parameters for which  
13 I could get the calibration would be drastically cut,  
14 but I just do not have it. So it is an inherent  
15 property of that sort of exercise that you get many  
16 parameter configurations and I think that the test of  
17 whether you have confidence in the result is really  
18 whether they make economic sense and what I find is that  
19 I have parameters that make economic sense. I have an  
20 order of magnitude of the effect and a relative order of  
21 magnitude across segments that make some economic sense.

22 MR RIDYARD: So just to summarise your criticism of  
23 Mr Harvey's sensitivity analysis, you are saying that  
24 a 10% change in cost or price has a very extreme effect  
25 on margin and therefore it is too great. So you do not

1 disagree with the arithmetic, you just do not think it  
2 was the right sensitivity to look at?

3 PROFESSOR NEVEN: Yes. I think he also did it in the  
4 context of my first model, so my first calibration, and  
5 the results are different --

6 MR RIDYARD: Sure. That was just a function of the ordering  
7 of the processes.

8 PROFESSOR NEVEN: Yes.

9 MR RIDYARD: Is there anything that you would like to say on  
10 that, Mr Harvey?

11 MR HARVEY: Just two points. One is in relation to the  
12 sensitivities. It is obviously always a choice as to  
13 what one you run. I think the key issue is that what  
14 matters for the results is the margins at the segment --  
15 the segment level because different segments are being  
16 applied to Royal Mail and BT, and so I think the  
17 observation that it is too extreme or too heavy-handed  
18 a sensitivity here is motivated by almost an average  
19 view. I have got no idea and neither has  
20 Professor Neven what the margins would be for individual  
21 trucks. It is not obvious to me that it follows that it  
22 is too heavy-handed.

23 PROFESSOR NEVEN: Sorry, we are talking about complements  
24 here not trucks.

25 MR HARVEY: Sorry, complements. The second point around

1 sort of it making economic sense, I am sort of not  
2 really surprised that it kind of does follow  
3 Professor Neven's intuition because, of course, the  
4 model is built on a -- is built to follow economic  
5 rules, so I am not sure that that is a test of this  
6 model.

7 MR RIDYARD: The relative answers do not give you any  
8 comfort in the levels?

9 MR HARVEY: No.

10 PROFESSOR NEVEN: Well, can I just comment on that? I think  
11 that it is true, of course, that there was a lot of  
12 structure in these models. However, it is not as if any  
13 parameter configuration would work, okay? Let me do the  
14 infinity of potential parameter configuration. Many of  
15 them do not work. The model has some bite in  
16 restricting parameter configurations, so -- and, indeed,  
17 the model delivers parameter configurations that can be  
18 interpreted. That is why I have some comfort, but I am  
19 not denying the fact, of course, that this methodology  
20 here is a methodology that imposes a lot of structure.

21 MR RIDYARD: Earlier on we were talking about the relative  
22 margins of DAF versus the other truck manufacturers.  
23 This is all -- I am talking about DAF margins, so where  
24 do the other -- where do the competing truck  
25 manufacturers fit into the story?



1 PROFESSOR NEVEN: That brings me back to the two types of  
2 parameter configuration that I could distinguish as  
3 fitting the data. There is one of them, the one that  
4 involves an elasticity at the level of the segment and  
5 some differentiation among the systems, which typically  
6 yields fairly low prices for the competitors, so margins  
7 that are around the margins of DAF; typically slightly  
8 lower. It also makes sense -- I mean, given the  
9 observation that DAF has a higher market share, I mean,  
10 you know, you would ...

11 Now, the other parameter configuration that  
12 I referred to, the one in which you have almost no  
13 elasticity with respect to the -- at the segment level  
14 is one that typically involves much higher prices for  
15 the competitors. So I have these two -- I mean, the  
16 models can fit both. The model can fit both in some  
17 segments. The model can fit the world in which the  
18 prices of competitors are close to DAF as well as  
19 a world in which the prices of competitors are higher  
20 than DAF, except in those segments in which DAF has very  
21 low margins and in those segments the only parameter  
22 configuration that works is the parameter configuration  
23 in which the competitors' prices are close to DAF, and  
24 all of that makes a lot of sense. I mean, you know, you  
25 would not expect a situation in which DAF has low

1 margin, high market shares and the competitors could  
2 have much higher prices. It just would not make any  
3 sense. So it makes sense that this particular parameter  
4 configuration that you get for those segments in which  
5 DAF has a higher margin simply does not work when DAF  
6 has a lower margin.

7 The final thing I would observe, which I think gives  
8 me some confidence about the result, is that this sort  
9 of low margin for DAF and elasticity at the segment  
10 level, where do we observe it? We observe it for the  
11 medium trucks and that is also where we observe -- we  
12 expect to get some more elasticity at the segment level.  
13 Why? Because of substitution with vans. I mean, there  
14 is a substitution between LF trucks and vans. You  
15 expect more elasticity here, So that is where you get  
16 more segment elasticity and it does not -- it actually  
17 gives me some comfort that for that particular type of  
18 trucks I do not get the alternative possibility of very  
19 high prices for competitors and very low segment  
20 elasticity.

21 MR RIDYARD: Mr Harvey, any comments on that?

22 MR HARVEY: No, I have not.

23 MR RIDYARD: One thing -- I mean, it is -- one thing which

24 I would like to bring this discussion back to is  
25 a discussion we had earlier about the principles and the

1           sorts of features that would drive a big or a small  
2           complement effect, and when we were discussing the  
3           nature of trucks against the nature of trailers, I mean,  
4           I think there was some agreement with the idea that  
5           trucks would tend to have higher margins than trailers  
6           because trailers are commodities and trucks are  
7           high-tech products, you know, for want of a better  
8           characterisation.

9           I mean, I suppose I would like to know what you both  
10          think about that characterisation and how it fits with  
11          the numbers in this simulation because I suppose crudely  
12          you would expect to see the numbers going into this  
13          exercise, if we had the numbers, for much higher margins  
14          on trucks than on trailers and that does not seem to be  
15          the case here. Have I got that wrong or can you comment  
16          on why it is that we are seeing the numbers that we are  
17          seeing?

18       PROFESSOR NEVEN: What -- I mean, just first on the facts,  
19           I mean, the margin for bodies and trailers is around 11%  
20           in the main simulation. I do some sensitivity as well,  
21           but let us forget about this. I mean, you get sort of  
22           the -- well, I will look at the sensitivity still --

23       MR RIDYARD: It gets 7 to 16% on your trucks?

24       PROFESSOR NEVEN: Then you get higher margins on trucks --

25       MR RIDYARD: On some trucks, but not others?

1 PROFESSOR NEVEN: Exactly, not others. But it also makes  
2 sense that you get lower margins on the LF trucks.

3 MR RIDYARD: I can understand why the smaller trucks have  
4 lower margins than the big trucks but I do not  
5 necessarily understand why that range of margins  
6 straddles the margins for trailers.

7 PROFESSOR NEVEN: I mean, I have no direct answer to that.  
8 This is what I observe. I mean, I observe that the  
9 margins --

10 MR RIDYARD: We cannot observe a lot of these numbers, can  
11 we, because we are just using imperfect data?

12 PROFESSOR NEVEN: Exactly. It could be that the margins are  
13 lower -- it could be that the margin for bodies and  
14 trailers is lower than 11% and -- yes.

15 MR RIDYARD: Yes. Okay. Mr Harvey, do you have any  
16 observations on that?

17 MR HARVEY: The only -- we do -- so on the -- for the  
18 trailer and body manufacturers, of course, we have the  
19 accounting data so we do not know for certain exactly  
20 what costs are feeding in, the extent to which they are  
21 like-for-like. So in a world where they are including  
22 almost more fixed costs or something like that or too  
23 little fixed cost, rather, in this case, that could  
24 account for it.

25 One thing that we do know -- and I have not got the

1 date in front of me -- is that Cartwright, who was  
2 a supplier to Royal Mail of trailers, they exited the  
3 market and I cannot remember the date now.

4 PROFESSOR NEVEN: 2018.

5 MR HARVEY: 2018. Thank you. They exited with margins in  
6 their accounts around the level that we have foreseen  
7 for the others. We, of course, do not know why. I do  
8 not know why they exited and whether it was financial  
9 reasons or for other reasons, but that might indicate  
10 that the margins that we are observing in the accounts  
11 are not a true reflection of the margins that they were  
12 earning and making pricing decisions on, but that is all  
13 we know.

14 MR RIDYARD: It is a matter of perspective, is it not,  
15 really?

16 MR HARVEY: Yes.

17 PROFESSOR NEVEN: But, of course, if the actual margins were  
18 lower, the complement effect would also be lower. That  
19 is also true.

20 THE CHAIRMAN: When you say they "exited" the market, you  
21 mean they went into liquidation or they just decided  
22 they did not want to do any more of this sort of stuff?

23 MR HARVEY: I do not know the circumstances. For clarity,  
24 I am not attaching too much weight to this observation,  
25 but in terms of interpreting the figures and the

1           possibility they are not measuring the right thing --

2       PROFESSOR NEVEN: I think it was a family story, at least

3           this is what I got from the internet, that there was

4           a brother who was unhappy with the family business and

5           set up his own business which is also doing trailers and

6           bodies independently under a different name. That is

7           what I got from the internet.

8       MR RIDYARD: Okay. Are there any other points that -- or

9           areas that you think we -- Mr Harvey, I should address

10          this to you, I guess, in the first instance. Any other

11          points that we have not addressed in this discussion on

12          Professor Neven's calibration approach?

13       MR HARVEY: I think we have discussed the main issues from

14          my perspective.

15       MR RIDYARD: Professor Neven, any other points you wanted to

16          make?

17       PROFESSOR NEVEN: No.

18       THE CHAIRMAN: Do your conclusions, Professor Neven, have

19          the effect that the body suppliers, manufacturers, are

20          effectively bearing some of the cost of the

21          overcharge --

22       PROFESSOR NEVEN: Yes, that is correct.

23       THE CHAIRMAN: -- because it does not --

24       PROFESSOR NEVEN: You are right. I mean, as a consequence

25          of the increase in the price, they were left to reduce

1           their own price.

2       THE CHAIRMAN:  They are reducing their own prices --

3       PROFESSOR NEVEN:  That is right.

4       THE CHAIRMAN:  -- which then has an effect on the demand for  
5           the whole.

6       PROFESSOR NEVEN:  As you pointed out earlier, yes, exactly.

7       THE CHAIRMAN:  So DAF sort of gets the benefit of that --

8       PROFESSOR NEVEN:  So they certainly get hurt, yes, and DAF  
9           gets the benefit of it, yes, indeed.

10      THE CHAIRMAN:  -- because it is not reducing its prices?

11      PROFESSOR NEVEN:  Well, no.  That is right.

12      THE CHAIRMAN:  Okay.  I think we will take our ten-minute  
13           break.

14      (3.11 pm)

15   (A short break)

16      (3.22 pm)

17      MR RIDYARD:  Now we move on to Mr Harvey's approach, which  
18           is obviously a rather different way of looking at the  
19           problem.  Mr Harvey, can you summarise briefly what you  
20           have done?

21      MR HARVEY:  Yes.  I have gathered data on the trailer body  
22           manufacturer margins over time.  I have looked to see  
23           whether those margins, ie increases or decreases in  
24           them, appear to be related to changes in the prices of  
25           trucks to try and account for possible influences that

1           could put upward pressure on both truck prices and  
2           margins or vice versa. I have looked at -- tried to  
3           look at periods where conditions appear to be more  
4           stable. That is the essential basis of my approach.

5           MR RIDYARD: Just at the basic level, I mean, do we observe  
6           a sort of cyclical pattern in margins that you would  
7           expect if it was the case that trailer and body margins  
8           fall when demand falls and rise when demand increases?

9           MR HARVEY: Not especially, no. No. They seemed to just  
10          move up and down in a way that is -- appears relatively  
11          unrelated to the economic movements -- sorry -- the GDP  
12          growth and that type of thing. So, no, I did not detect  
13          a strong relationship between them.

14          MR RIDYARD: Obviously it is just a question of presenting  
15          a number of charts and you do not claim it is anything  
16          much more than that, but -- so what conclusions, if any,  
17          you know, can we draw from those pictures?

18          MR HARVEY: As you indicate, I have been reasonably careful  
19          about not seeking to present that analysis as if it is  
20          on sort of a par with the overcharge analysis, and so  
21          the conclusion that I draw is I cannot see within the  
22          data evidence of a complements effect. I acknowledge,  
23          though --

24          MR RIDYARD: Sorry to stop you there, but I mean there --  
25          I was talking much more generally, really, to see



1           whether there was even an impact of demand changes on  
2           margins, not specifically related to the infringement,  
3           but just in general. I think there would then be  
4           a whole other level of -- another level of, you know,  
5           analysis to try and focus on the effect of the  
6           infringement because then you would have to hold other  
7           things constant, which is what you tried to do with the  
8           econometric analysis, but I was talking at the -- just  
9           to be clear, I was talking about the whole general level  
10          of whether margins for trailers seemed to be influenced  
11          by swings in demand for trailers for whatever reason.

12       MR HARVEY: No, I cannot see that in the analysis.

13       MR RIDYARD: So if you cannot see that, then it seems fairly  
14          evident that you would never have a chance of seeing an  
15          effect of the infringement.

16       MR HARVEY: Well, it depends on -- there is a period that  
17          I investigate where I know that there was quite  
18          a significant change in truck prices. That coincides  
19          with the introduction of Euro 6 trucks at a time where  
20          other factors, such as demand, appear to be more stable  
21          and so I do not see an effect there either, but it is  
22          correct to say that I do not have a model that explains  
23          the formation of truck and trailer margins because I do  
24          not have the data to allow me to do that.

25       MR RIDYARD: Professor Neven, anything to add or comment?

1           PROFESSOR NEVEN:  No, I think that I have explained my  
2           concern about the two analyses that Mr Harvey is putting  
3           forward.  I mean, there is one analysis in which he is  
4           looking at margins during and after the infringement  
5           period for these particular manufacturers and, you know,  
6           it is impossible to identify the effect of the  
7           infringement if you do not control for what needs to be  
8           controlled for, and, you know, the overcharge exercise,  
9           you know, we spend a lot of time and effort controlling  
10          for the right thing and here we have sort of 17 data  
11          points per manufacturer.  I think, you know, it is very  
12          difficult to detect anything and, with respect to the  
13          second exercise in which Mr Harvey is looking at the  
14          margins of the suppliers of complements, on the one  
15          hand, and the changes in the prices of trucks, I mean,  
16          if you were to try to detect a complement effect, you  
17          really need to identify some exogenous changes in the  
18          price of trucks and it is extremely difficult to do  
19          that.  I mean, even considering the introduction of  
20          Euro 6 and the cost may be, you know, some more  
21          exogenous but the prices are not.  I mean, the prices of  
22          trucks will have been set, anticipating what is the  
23          demand for those trucks and also what is the demand for  
24          the systems, I mean, for the combination between the  
25          trucks and the complement, so I think that --

1 MR RIDYARD: Is that true, because I thought in 95% of cases  
2 the truck manufacturer does not provide the body.

3 PROFESSOR NEVEN: No, but --

4 MR RIDYARD: But you would still anticipate the --

5 PROFESSOR NEVEN: I would still anticipate the demand will  
6 be --

7 MR RIDYARD: I see the point.

8 THE CHAIRMAN: Mr Harvey, you, I think, accept the sort of  
9 economic theoretical basis for the complements effect --

10 MR HARVEY: Yes.

11 THE CHAIRMAN: -- but you did not -- in what you looked at,  
12 you did not see any such effect?

13 MR HARVEY: No, exactly. So I -- it is almost back to the  
14 differences between these analyses. So my analysis is  
15 attempting to look at what happened in terms of margins  
16 and the relationship with prices. It carries with it  
17 the limitations that we have spoken about, whereas the  
18 simulation analysis is not doing that; it is looking at  
19 what could happen if people follow the -- essentially  
20 follow the rules, as I said earlier. We have a --

21 THE CHAIRMAN: Are there such rules?

22 MR HARVEY: We have -- some of the criticisms that I made of  
23 Professor Neven's analysis in relation to the mix of  
24 trailers equally is made of mine, which is I do not know  
25 the changes in mix of trailers and that type of thing

1 over time either. So the difference is there are  
2 strengths and weaknesses of each analysis in their own  
3 right. Mine is attempting to look at market outcomes  
4 but it suffers from some limitations, as Mr Ridyard has  
5 alluded to.

6 THE CHAIRMAN: I understand your criticisms of  
7 Professor Neven's approach, but did it give you cause  
8 for concern that your analysis did not throw up what one  
9 might have expected to see from the pure economic  
10 theoretical point of view?

11 MR HARVEY: I think I am -- and I have indicated in the  
12 report -- I am conscious that if there are other factors  
13 moving and they are sort of dwarfing this complements  
14 effect, I may not be able to detect it in my analysis.  
15 That is not something that was triggered by  
16 Professor Neven's modelling or critique; that is  
17 something that I was conscious of when preparing the  
18 analysis.

19 THE CHAIRMAN: What are the sort of other factors that would  
20 be?

21 MR HARVEY: Other factors that could affect the relationship  
22 would be demand conditions, so if there is an increase  
23 in demand for the system, that could put upward pressure  
24 on the prices of both complements. Other factors could  
25 be changes in the mix of trailers sold. If some

1 trailers have -- attract higher margins than others,  
2 that could distort the measured relationship. Some of  
3 those things I tried to investigate if not take account  
4 of, so the reason for looking at margins rather than  
5 revenues or something like that was to take account of  
6 the different cost of manufacturing different trailers,  
7 so I use the word "control" loosely to incorporate that  
8 in the analysis.

9 The second thing that I tried to do was to look at  
10 periods in which some of those changes were more stable,  
11 so -- sorry -- some of those factors were more stable  
12 and seeing if I can detect an effect there, but, of  
13 course, that does come with the cost of removing data  
14 for me to investigate. So they are the things that  
15 I attempted to do.

16 On the introduction of the Euro 6 sort of case  
17 study, I thought that was an interesting case study to  
18 investigate because it is something that seems to affect  
19 the cost of supplying the truck but would not affect,  
20 necessarily, the cost of -- obviously the cost of  
21 supplying the bodies. It seemed something as close to  
22 a separate supply side event that I could investigate  
23 and I did not find an effect there either, but all of  
24 this was undertaken in the confines of the data that  
25 I had.

1 PROFESSOR NEVEN: Sorry, but you cannot expect to see  
2 anything if you are using 17 data points. I mean, there  
3 is such a serious problem of identification here.  
4 I mean, as Mr Harvey has explained himself, I mean, if  
5 you have a demand that is increasing, it is going to  
6 increase the demand for the truck, increase the demand  
7 for complements, both prices are going to go up, so,  
8 I mean, if you do not sort of control for the amount in  
9 a refined way, I mean, whatever you find in terms of the  
10 relationship between the price of trucks and the price  
11 of complements may be due to these common factors and,  
12 you know, in the overcharge you are using 155,000 data  
13 points in order to try to identify the overcharge and  
14 here we are using 17 data points on noisy data in order  
15 to try to see whether there is a difference between the  
16 period of the overcharge and the period outside the  
17 overcharge or we are looking at a correlation between  
18 the price of trucks and the margins which we know can be  
19 due to common factors without controlling for them.  
20 There are so many problems of identification here that  
21 I think that, you know, out of this you really cannot  
22 gather very much.

23 MR RIDYARD: That is sort of partly what led me to ask the  
24 question I asked. I will try and ask it again, but it  
25 seems to me that if -- one thing you might possibly get

1 out of 17 data points would be at least to understand  
2 whether, for an event such as, you know, the overheating  
3 of the economy in 2007 and then the GFC and the sort of  
4 falling off a cliff effect of demand in 2008 -- I mean,  
5 even there do you see an impact on the margins of the  
6 body of suppliers because, I mean, after all, in all of  
7 this we are talking about a scenario in which, other  
8 things being equal, demand for bodies falls. The one we  
9 are interested in, of course, is the effect of the  
10 infringement, but do we get an observable pattern from  
11 a very, very extreme experiment of overheating demand  
12 and then a huge drop off in demand in subsequent years?

13 MR HARVEY: So let me find a good chart just to look at.

14 MR RIDYARD: It depends on how you define a "good chart",  
15 I think.

16 MR HARVEY: You know what I mean.

17 So {E/1/135}. So this is the first of a series of  
18 charts that plot the gross margin of the various  
19 manufacturers over time. So this is what I was  
20 referring to earlier, Mr Ridyard. So in this chart  
21 there is a dip in the margin below the average level in  
22 the financial crisis period. Having said that, you can  
23 see, looking in the context of the entirety of the time  
24 period, it is rather up and down, so I would not --  
25 I did not reach a strong conclusion on that basis.

1           If we turn to the next page {E/1/136}, so --  
2           SCSC Realisations, that is the company for Cartwright  
3           I spoke about earlier. As you can see here, there is  
4           a sort of variation around the level. I am not  
5           detecting a strong demand change here.

6           MR RIDYARD: In fact we are getting -- in quite a lot of  
7           these charts you are getting quite big variations in the  
8           margins in years when nothing much is happening to  
9           demand, so it really is not showing up very much of --

10          MR HARVEY: That is right. There is a series of charts here  
11          which show variation in margin from year to year.

12          MR RIDYARD: Yes. Okay. I do not think there is much more  
13          to be said on it.

14          THE CHAIRMAN: Yes. Unless anyone wants to say anything  
15          more about it, that is the end of our hot tub session,  
16          then.

17          MR BEARD: I was going to have very, very limited  
18          cross-examination. I can actually ask a question for  
19          clarification now.

20          THE CHAIRMAN: All right.

21          MR BEARD: It may be just -- only because it flows on.

22                 Just going back to what you refer to as the "good  
23                 chart", Mr Harvey, so page 135, {E/1/135}, you said on  
24                 [draft] page 141 -- and it may be a date issue for me --  
25                 but you said, "in this chart there is a dip in the



1 margin below the average level in the financial crisis  
2 period". But, as I see it, the margins start falling  
3 from 2003 and continue on down towards 2008 and then  
4 start climbing up again. Are you saying that -- what  
5 are your dates for the financial crisis? I think that  
6 is the clarification.

7 MR HARVEY: 2008, 2009, 2010, and my eye here -- I was drawn  
8 to 2008, but you are quite right, it drops from the  
9 period before that, and I wanted -- sorry -- to clarify  
10 what I meant by "good chart". I did not mean "good  
11 chart" in terms of picking out something which showed  
12 a demand effect. What I was trying to say was charts  
13 that show how margins evolve over time.

14 MR RIDYARD: I fully understood that. Do not get me wrong.

15 MR BEARD: I will take "good chart" as a jury point for  
16 these purposes, but it was more the clarification on  
17 dates that I was interested in. As I say, I will review  
18 what I have but I do not think I am going to have  
19 cross-examination for Mr Harvey. But if we took a break  
20 now --

21 THE CHAIRMAN: Shall we take a break? Mr Ward, you have  
22 some cross-examination for Professor Neven?

23 MR WARD: I do actually, yes.

24 THE CHAIRMAN: Right. Okay. Have you any idea how long?

25 MR WARD: 45 minutes, maybe.

1 THE CHAIRMAN: Okay. So it would obviously be good to  
2 finish off this subject tonight, if we can.

3 MR WARD: Yes.

4 THE CHAIRMAN: So shall we just take a short break, maybe  
5 five minutes, because we had a break just before we --

6 MR BEARD: Yes. Sure. It is just to review what I have and  
7 I will confirm.

8 THE CHAIRMAN: Is that long enough?

9 MR BEARD: That will be fine. Thank you.

10 THE CHAIRMAN: All right. Five minutes.

11 (3.40 pm)

12 (A short break)

13 (3.46 pm)

14 MR BEARD: I have been back through the questions I have got  
15 a variance on, the questions Mr Ridyard was raising or  
16 go to matters where answers have been provided by the  
17 experts, and since we are not in the business of  
18 cross-examining on stuff that has already been dealt  
19 with in the hot tub, I am content to leave matters as  
20 they are and move on.

21 THE CHAIRMAN: Thank you very much. Excellent. Very good.  
22 So we will have Professor Neven, then.

23 MR BEARD: Yes.

24 MR WARD: That must mean that Mr Harvey is released from  
25 purdah because there are no questions for him.

1 THE CHAIRMAN: I think that must be right. He was anyway  
2 when he came out of the hot tub. He does not have to  
3 be -- yes. We need to do that.

4 PROFESSOR DAMIEN NEVEN (affirmed)

5 Cross-examination by MR WARD

6 MR WARD: You explained in your reports that you conducted  
7 the simulation analysis because you did not have the  
8 data to do a full empirical analysis of the complement  
9 studies; yes?

10 A That is right.

11 Q But, in principle, you would expect the existence of the  
12 effect is an empirical question.

13 A Yes.

14 Q Now, of course, your clients do sell a lot of trucks and  
15 quite a few bodies, do they not? Just to remind you,  
16 bodies are manufactured at Leyland and the pricing  
17 statement says from 2007 they sold about 1,000 a year.  
18 In addition, of course, they are selling bodies  
19 directly, manufactured by others, to Royal Mail and  
20 I think it is Morrisons, is it not? When they sell what  
21 you would call "naked trucks", the buyer is going to  
22 need a body or, if it is a tractor, a trailer from  
23 somewhere, are they not? Yes?

24 A Yes.

25 Q The consequence of your argument is, in effect, every

- 1           buyer will need a body or a trailer; yes?
- 2           A    Yes.
- 3           Q    So if you are right about this complements effect, it is  
4           quite a fundamental feature, is it not, of the market  
5           that DAF is selling into?
- 6           A    Yes.
- 7           Q    Indeed, the logic of your model is that even a 1% change  
8           in the price of the trucks will have a complement effect  
9           on the -- a price effect on the trailers or the bodies,  
10          will it not?
- 11          A    It will according to my simulation, yes.
- 12          Q    Would you accept that it is quite likely that DAF itself  
13          would have an understanding of whether any of this was  
14          happening in the marketplace, that it might notice that  
15          customers were putting pressure on them because trailer  
16          prices had gone up or they might find that if they put  
17          the price of trucks up, they cannot get such good prices  
18          for their own bodies?
- 19          A    I think that they might have a sense that the price of  
20          bodies will affect the willingness to pay of the buyers  
21          for the trucks and I think that Mr Ashworth actually  
22          said something to that effect.
- 23          Q    Well, he does not actually quite say that. We can look  
24          at what he says.
- 25          A    It is paragraph 73.

1 Q I think it is 72, but maybe you are right. Let us look  
2 at it together.

3 THE CHAIRMAN: Can we have the reference?

4 MR WARD: It is {D/22/21}. He says at 72 the things he took  
5 into account, (b):

6 "the price that DAF UK was able to negotiate with  
7 third parties for ... bodies and tail lifts ..."

8 A Where is it?

9 Q 72. He does not tell us much about what that would  
10 mean, but my question for you, really, is whether you  
11 asked DAF at all about whether it had any of that kind  
12 of market intelligence about what the relationship  
13 between these products might be, even qualitative  
14 information.

15 A Shall we look at 73 --

16 Q Yes.

17 A -- because 73, I think, is more informative with respect  
18 to the issue.

19 Q Well, let us look at it together, of course.

20 "As DAF UK had to deliver a fully built truck to  
21 Royal Mail, including the body and tail lift, Andy or  
22 Geoff ... with Bob ... negotiated with the bodybuilders  
23 ... DAF UK either charged these elements to Royal Mail  
24 at cost, or took a small margin ..."

25 A Then let us continue.

1 Q Yes.

2 "Any proposed price increase from a  
3 bodybuilder or tail lift ... was usually used to justify  
4 a corresponding increase to Royal Mail. Conversely, on  
5 [other] occasion, due to pressure ... we were forced to  
6 ask third-party suppliers either to hold or reduce their  
7 prices."

8 A That is very significant because it means that what  
9 matters to Royal Mail is the combination between the  
10 truck and the body, so there was pressure from  
11 Royal Mail, lower willingness to pay. They had to turn  
12 to the body suppliers to ask for a lower price. That is  
13 essentially an illustration of what my model is doing.

14 Q Well, does it really go that far, Professor Neven? Is  
15 it not really just saying that they passed these things  
16 on at cost or took a small margin? I think Mr Ashworth  
17 said £50 in the example we looked at.

18 A Well, I think that -- the first part of this quote  
19 I think is quite telling to show that there is really  
20 a competitive constraint exercised by the competitors in  
21 the complements market, but what I think is more  
22 interesting with respect to the perception that with the  
23 complements effect from Mr Ashworth is the last  
24 sentence, in which he says Royal Mail, on occasion, was  
25 not happy about the price, and so, you know, they had to

1           turn to the complement suppliers to obtain a better  
2           offer, which supports the view that Royal Mail was  
3           concerned about the price of the system.

4       Q    Yes, but it is not saying here that, as a result of  
5           that, the price that DAF offered on its part of the  
6           system was any different.

7       A    Well, no, it does not say that, you are right, it does  
8           not say that, but it sort of supports the idea in  
9           general that it was a complement effect.

10       THE CHAIRMAN: Well, is it not saying that it goes both  
11           ways?

12       A    Yes.

13       THE CHAIRMAN: I mean, sometimes it was used to negotiate an  
14           increase in the overall price.

15       A    Can I see the first part of the -- because the second  
16           part is clear -- right? -- so we have to go back to the  
17           first part.

18       THE CHAIRMAN: Yes.

19       A    Can we see the first part of the paragraph?

20       MR WARD: Yes. We have it now. (Pause)

21       A    Yes, the fact that they charged at cost, of course, is  
22           quite significant because there is a competitive  
23           constraint that is exercised by direct procurement.

24       Q    They just either passed it on or added a small margin  
25           which Mr Ashworth had said was £50 in the example, but

1           you have not asked them more generally about whether  
2           they have any experience of this complement's effect in  
3           practice?

4       A    I mean, that is a question that I have raised with them  
5           and I have asked and I never got a very clear answer,  
6           I mean -- and I think that is because I talked to the  
7           wrong people.

8       THE CHAIRMAN: You have asked them that specific question?

9       A    I have. I mean, of course I have sort of done this  
10          analysis and I have asked whether this analysis  
11          corresponded to their, you know, understanding of the  
12          market, and I never got a very clear answer about this.  
13          I think that maybe it is because I was talking to DAF NV  
14          and not people like Mr Ashworth. I do not know.

15       MR WARD: Is that in your report anywhere?

16       A    No.

17       Q    No. When you say you did not get a clear answer, you  
18          mean you did not get a supportive answer?

19       A    No, I did not get a clear answer.

20       Q    I see.

21                 Can I just get clear one very, very basic feature of  
22          this simulation model?

23       A    Yes.

24       Q    It is obviously not an empirical assessment of whether  
25          there actually was a complements effect, is it?



1       A    It depends what you mean by "empirical".  I mean, it is  
2            an empirical exercise because it relies on observable,  
3            market observable, and it imposes a lot of structure.  
4            It is not -- if you mean, by "empirical", an attempt,  
5            using econometric analysis, to try to see whether, in  
6            response to an exogenous increase in the price of  
7            trucks, the price of complements may have gone down, no,  
8            it is not an exercise of that sort.

9        Q    So it does not tell us whether, on the facts, in the  
10            past, during the infringement, the overcharge actually  
11            caused a complements effect?

12       A    If there was an overcharge --

13       Q    If there was an overcharge.

14       A    -- which -- I mean, because it is also -- you know, in  
15            doing this exercise, I mean, you have to be careful not  
16            to assume that there was an overcharge.

17       Q    I understand, but it is not a test of causation in the  
18            sense that what actually happened in the world --  
19            whether one thing caused another.

20       A    It is not a test which relies on trying to detect  
21            through an econometric exercise the existence of this  
22            complement effect, no, it is not.

23       Q    Now, I want to look at some of the inputs into the model  
24            in a bit more detail.

25            The first one is about the period of the data that

1           you used, and you touched on this earlier, that you used  
2           data from the period 2013 to 2015, although, of course,  
3           in fact, what we are interested in is whether there was  
4           a complements effect during the course of the cartel.  
5           It is right, is it not, that in your model you assume  
6           that manufacturers set their profit -- their prices --  
7           independently?

8           A    Of course.

9           Q    It is baked into your model, is it not?

10          A    Of course.

11          Q    One of the problems that we have here is that there is  
12               a cartel in the market as well?

13          A    Not in 2015, I believe.

14          Q    Indeed. That is, indeed, the problem with using that  
15               data?

16          A    No, sorry, I think there is a misunderstanding here.  
17               I am sort of using data for 2013 to 2015, which is  
18               a period where there is no infringement, and I am  
19               building a model which is a model of competitive  
20               interactions in which the truck manufacturers are  
21               setting their prices independently, and then, in the  
22               context of the simulation, I see what happens if they  
23               would all jointly increase the price by 1%.

24          Q    Yes. Of course, by doing that, what you are doing is  
25               assuming that there is the -- if you like, that the

1 infringement gave rise to a uniform increase in the  
2 price of --

3 A Yes, that is correct.

4 Q We have no data about that, do we, because we have only  
5 looked at DAF's infringement?

6 A That is correct.

7 Q So that, in itself, is a potentially significant  
8 departure from reality?

9 A I do not know whether it is. I mean, I have no -- any  
10 other assumption would be complete speculation from my  
11 part.

12 Q But the other thing it does not take into account is the  
13 fact that the price setting itself might be coordinated.  
14 Applying a single 1% increase across the board does not  
15 account for the fact that the price setting may not  
16 itself be independent, does it?

17 A But, I mean, if you have a 1% price increase from  
18 a competitive level, this can only arise if you have  
19 co-ordination, otherwise it will not stay on. I mean,  
20 this is just ... it is a matter of definition, really.

21 Q Is it not the reality that what you are doing here by  
22 using this later data is just airbrushing out the  
23 effects of the decision and imposing a uniform 1%  
24 increase that simply does not capture the reality of the  
25 cartel, does it?

1 A No, I think that it is a way of simulating what would be  
2 the effect of a 1% price increase which is exogenous,  
3 which is off from the competitive level, which is  
4 typically what an infringement would do.

5 Q But in an otherwise competitive market where people set  
6 prices independently?

7 A But, you know, you need to look at the effect of the  
8 infringement relative to something, I mean, and, you  
9 know, it is natural to look at the effect of the  
10 infringement relative to a competitive counterfactual,  
11 which is what I am doing.

12 Q Can I show you, please, {E/28/1}? This is Mr Harvey's  
13 second report. {E/28/139}. This is his reply report.  
14 Do you have that, Professor Neven?

15 A Yes, I do.

16 Q Thank you. If we look at table 27, Mr Harvey has drawn  
17 some comparisons with some key metrics used in your  
18 model between average invoice price, average MLO cost  
19 and average annual sales. For 2013 to 2015, which is  
20 the period you use, he compares the infringement period,  
21 which he then breaks down into two phases. Would you  
22 accept that what this shows is that this data is very,  
23 very different -- the infringement period data is very  
24 different from the data you used in your model?

25 A The numbers are different.

1 Q Indeed.

2 A The numbers in the table are different. The question  
3 is, you know, whether that would invalidate the  
4 methodology. I mean, is it what --

5 Q I am more interested in the results at this point than  
6 the methodology.

7 A No, no, I am interested in having a sound methodology  
8 and is it that, you know, observing that you have very  
9 different prices during the period of the infringement  
10 is something that would invalidate the methodology?  
11 Why?

12 Q This is just completely different. You have got very  
13 limited empirical inputs into your model. These are  
14 very different inputs. They may well alter the results.

15 A Well, the question is whether, with these different  
16 inputs, I would calibrate very different parameters and  
17 whether I would choose a parameter constellation  
18 corresponding to the minimum of the complement effect  
19 that would be different. I mean, I do not know,  
20 honestly, I do not know, and I do not want to speculate  
21 about that. I mean, I estimate the model -- I calibrate  
22 the model in a competitive environment and I think this  
23 is the only sensible way of doing it, that you need to  
24 have a benchmark and then I look at departure from that  
25 benchmark.

- 1 Q Well, let us look at another aspect.
- 2 A You know, I could not use this data because there was  
3 infringement during that period so there was no way  
4 I could use the data.
- 5 Q Well, that may be so, but it is precisely during the  
6 infringement period that we are trying to establish the  
7 extent of the complements effect.
- 8 A But that is precisely because there is an infringement  
9 that I need to have a counterfactual, and the  
10 counterfactual, I only have it in the data after the end  
11 of the infringement.
- 12 THE CHAIRMAN: You mean there needs to be a competitive  
13 market --
- 14 A Exactly. Exactly. There needs to be a competitive  
15 reference, otherwise I just --
- 16 MR WARD: But you then apply that, what you have learnt from  
17 the 2013-2015 period, to decide what the complements  
18 effect was during the infringement period.
- 19 A You know, I calibrate my model on the competitive  
20 counterfactual and then I simulate what would be the  
21 complement effect corresponding to a one-off, 1% jointly  
22 coordinated increase in prices by the manufacturers.
- 23 Q Assuming that that is the only effect that the cartel  
24 has on the competitive situation during infringement.
- 25 A You know, is there a better way of simulating the effect

1 of an infringement, which is a 1% increase -- it could  
2 be 1 or 10, by the way, it does not matter. I mean,  
3 that -- I mean, the idea of infringement, if there was  
4 a coordination, is indeed that you are off the  
5 competitive equilibrium. You have supporting prices  
6 above the competitive equilibrium I think is the natural  
7 way of doing it.

8 Q I want to talk about different aspects of independent  
9 pricing, which is the way that trucks and bodies and  
10 trailers were sold sometimes in bundles, as we have  
11 discussed, particularly for DAF, for Royal Mail in  
12 particular, but also, as we have said, more generally.  
13 You have said in your report that you ignore this  
14 feature, that you assume that all bodies or trailers are  
15 sold independently from trucks. Is that not right?

16 A I do assume that the bodies and trailers are set by  
17 independent suppliers, so I do not pay specific  
18 attention to the fact that a truck manufacturer may also  
19 be a supplier of complements. That is correct.

20 Q You know that is particularly important given the kind  
21 of purchases made by my client?

22 A I do not think it is important, honestly, because of the  
23 competitive constraint that is exercised by the  
24 suppliers of bodies and trailers. I mean, this is  
25 a fairly competitive market and you see it in the quote

1 from Mr Ashworth. Mr Ashworth, I mean, he is clearly  
2 saying that, you know, there is a competitive  
3 constraint. So I do not think that, you know, DAF would  
4 be in a position to deviate from the pricing of the  
5 suppliers.

6 Q In any event, it is not a feature that you picked up in  
7 your report?

8 A No, there is only so much you can do.

9 Q Well, let us talk now about the trailer and body  
10 manufacturers. As we discussed earlier, you have  
11 simplified -- in terms of trailer and body  
12 manufacturers, we go from a reality that there are 25 to  
13 you assuming that you have two and that they are  
14 symmetric.

15 A Yes.

16 Q So that completely disregards, for example, the point  
17 that Mr Ridyard made earlier about the possibility for  
18 brand level elasticity differences, does it not?

19 A It imposes that there is a symmetry in the model, yes;  
20 that the brand effect for the two manufacturers are the  
21 same.

22 Q It would disregard, for example, differences between the  
23 manufacturers such as Cargobull that you mentioned  
24 earlier, which you said was based in Germany, and that  
25 could make quite a big difference, could it not?



1 A In what sense?

2 Q Well, in terms of, for example, its costs, its currency  
3 impact?

4 A Yes. I mean, I guess that, you know, it is correct that  
5 there may be differences in the cost base and this will  
6 not be picked up in my simulation.

7 Q You made a point that, I think -- forgive me if I am  
8 misremembering. I did not take a note, I do not have  
9 a note here -- you made the point that you do not know  
10 what their market shares are, do you, the difference?

11 A No, I do not.

12 Q Can I show you a slightly different metric that  
13 Mr Harvey provided? This is in {E/28/135} in his reply  
14 report. This figure 26 is revenue of selected body  
15 trailer suppliers in 2013 and there are just 14 of them  
16 there. But what we can see is revenue in millions of  
17 pounds, GBP, is dramatic differences here, can we not,  
18 the scale?

19 A Yes.

20 Q So that again at least suggests that modelling on the  
21 basis of two symmetric suppliers, essentially competing  
22 in a materially identical way, is a very serious  
23 over-simplification, is it not?

24 A It is a simplification, but, as I explained earlier,  
25 I am not particularly worried about this. I mean, the

1 fact that there are many suppliers is actually a support  
2 for the assumption of assuming that there are only two  
3 because, if you have many suppliers, it means that entry  
4 barriers are very low, it means that they are producing  
5 products that are close substitutes. So this is not the  
6 assumption of this calibration that I would be sort of  
7 most concerned about.

8 Q It does rather suggest, assuming that there are two and  
9 they are symmetrical, it is a serious  
10 over-simplification?

11 A Oh, it is clearly -- I mean, any model is an  
12 over-simplification of reality. The question is to  
13 design a model in such a way that it is still reliable.

14 Q Well, let us talk about the truck manufacturers because  
15 here, again, you have simplified.

16 A Yes.

17 Q You have gone from six to five in particular.

18 A Yes.

19 Q What you have said about this is that MAN and Iveco have  
20 market shares that are roughly half those of the other  
21 three.

22 A That is right, yes.

23 Q Can we look, now, at your plausibility report, which is  
24 {E/10/25}. I hope you have that to hand. I am not  
25 absolutely certain you do. I am told that you might not

1 have it there, Professor Neven. Would you mind looking  
2 at the screen with me? It is your own bar chart.

3 A No problem.

4 Q What we have here is figure 1, which is market shares of  
5 truck manufacturers for trucks with a gross vehicle  
6 weight over 6 tonnes in 2005, so in the infringement  
7 period, in the UK. What we can see here, as you say  
8 yourself at 4.27 below, is there is a considerable  
9 degree of asymmetry in the market shares of truck  
10 manufacturers in the UK, and then you say:

11 "DAF [UK] has a significantly stronger position,  
12 followed by Daimler, Volvo-Renault ... Iveco, Scania and  
13 MAN have smaller market shares. This observation  
14 suggests that a common understanding would be difficult  
15 to reach and maintain ..."

16 But if we look at this data from within the  
17 infringement, if we do as you have proposed and add MAN  
18 and Iveco together, you are going to get another  
19 competitor -- I have not actually done the maths, but  
20 pretty much around the same share as DAF, are you not?

21 A Yes, but what matters for my calibration is the  
22 situation in 2013-2015 and, if you were to look at that  
23 data -- I do not remember the details of the data, but  
24 I think you will find that, indeed, Iveco and MAN  
25 together have shrunk and, in particular, Iveco has

1 shrunk.

2 Now -- so that the assumption that indeed you can  
3 put sort of Iveco and MAN together I think is probably  
4 more sensible for the period for which I am doing the  
5 calibration, 2013-2015.

6 Q Does that not rather make the point, though, that it is  
7 not representative of the period of the infringement?

8 A I mean, what it says is that, given that I need to build  
9 a competitive counterfactual, I make assumptions that  
10 are sensible in the context of building that competitive  
11 counterfactual and then I simulate the effect of the  
12 infringement by an increase in price.

13 Now, the fact that, you know, the competitive  
14 situation in terms of market share -- I mean, during the  
15 infringement and after the infringement, during the  
16 period for which I am doing the calibration -- are  
17 different is not something I can do anything about.

18 Q It just shows your model is departing from the reality  
19 of the --

20 A But again you have to explain in what way this will be  
21 important.

22 Q Well, it is important, is it not, if we have gone -- you  
23 have modelled one large competitor and four rather than  
24 five the same size. What we are really seeing is a lot  
25 of differentiation.

1 A But, you know, on what basis are you saying that adding  
2 one competitor -- I mean, having five instead of having  
3 four would make such a big difference? I mean ...

4 Q Well, Professor Neven, it just departs from reality.  
5 That is what I am saying.

6 A No, but the reference here is to look at whether  
7 economic models that would be calibrated with five  
8 instead of four would give different results. I mean,  
9 that would be the question to ask and I am not sure you  
10 are shedding any light on that.

11 Q Is not the answer you just do not know what difference  
12 it would make?

13 A It is something that you can test. I mean, it is  
14 something that can be tested, and typically in these  
15 models, when you go beyond four competitors, I mean,  
16 there was not much difference.

17 You know, the sort of assumptions I am making here  
18 with respect to market structure are really not uncommon  
19 among competition agencies when they do calibration.  
20 I mean, the European Commission is making similar  
21 assumptions when it is doing calibration for mergers and  
22 I have in mind exercises of calibration undertaken by  
23 the Commission that imposes much more structure than  
24 I have.

25 Q Those calibration models are done in order to predict

- 1 the future, are they not?
- 2 A Yes.
- 3 Q What we are doing here, in fact, is trying to predict  
4 the past, is it not?
- 5 A Indeed you are right. That is right. But it is  
6 a response to -- in both instances -- to the fact that  
7 we have no data.
- 8 Q Indeed, but the ultimate question for the tribunal will  
9 be not "Are we obliged to do this?" but "Is it robust  
10 enough to be relied upon?".
- 11 A I think this is a very -- this is a question for the  
12 tribunal, indeed.
- 13 Q You will appreciate our case is that it is not.  
14 Now, just moving on to the inputs into the model,  
15 the first one is a truck manufacturer prices and costs  
16 and, as we have already discussed, you only have prices  
17 and cost data for DAF --
- 18 A Yes.
- 19 Q -- and you assume that the costs of the other  
20 manufacturers are not the same.
- 21 A Yes.
- 22 Q What you explained this morning is that you allow the  
23 prices of the other manufacturers to be calibrated --
- 24 A Yes.
- 25 Q -- but, of course, those prices are an output of the

- 1 model, are they not, therefore?
- 2 A It is an output of the model in the same way that  
3 parameters that are estimated from the calibration, so  
4 it is in the same way.
- 5 Q So it does not actually help you overcome the problem  
6 that you do not have this input?
- 7 A It does, actually, because I think the fact that -- I am  
8 much more relaxed about the fact that I am assuming that  
9 manufacturers have the same cost as DAF, knowing that  
10 I allow the model to determine the prices.
- 11 Q Well, of course the costs incurred by the manufacturers  
12 are crucial, are they not, to the margin that they could  
13 earn?
- 14 A Yes, but the margins are determined by the model, so the  
15 thing is, I mean, because the prices are not put  
16 precisely, I mean, this will be equilibrium margins and  
17 the models will determine them.
- 18 Q The prices may well be determined by the model, but the  
19 crucial point here is you do not have the actual costs  
20 to put in in order to determine those margins. You just  
21 have to make an assumption.
- 22 A I think that I am not sort of getting my point across.  
23 I think that, you know, I am not too worried about  
24 assuming that they have the same cost because I have  
25 this flexibility with respect to the prices because the

1 prices will be determined by the model.

2 Q Let me turn, now, to what you say about the prices for  
3 bodies and trailers. I would like to go to your first  
4 report again, which is {E/12/39}. I want to just take  
5 you through the steps that you take in order to generate  
6 this price. It is B.7. Regarding bodies, you do not  
7 actually have prices for the bodies, do you, other than  
8 the DAF ones?

9 A No, I do have prices from the --

10 Q We are going to look at what you have and how you get to  
11 the price that you rely on.

12 So you start by obtaining data on volumes for  
13 different body types in the UK market from public  
14 sources.

15 A Yes.

16 Q At (a), over the page, {E/12/40}, you get data on the  
17 total number of registered trucks, so this is all trucks  
18 on the road.

19 A Yes, this is stock and I am assuming that the flow is  
20 equivalent to the stock.

21 Q Yes, exactly. So you make that assumption at (b)  
22 underneath. Although it is a stock, you assume that the  
23 flow, ie the distribution of sales in the period you are  
24 interested in, will be the same.

25 A Yes, that is right.



1 Q Then you say at B.8:

2 "The Department for Transport does not provide data  
3 on body values ..."

4 So then you say:

5 "I have obtained this data ... from third parties  
6 [which is the market intelligence report]. [It gives]  
7 aggregate volumes of sales and average values for  
8 popular body type ..."

9 So you say, three lines from the bottom, you derived  
10 average prices for body type and year. We see that in  
11 the graph. But then what happens is you do not actually  
12 apply those, do you?

13 A Correct them.

14 Q You make some more adjustments. Well, you say  
15 "correct", but you certainly adjust, and you say at B.9,  
16 on page 41, {E/12/41}:

17 "The estimates provided by the Absolute Report  
18 reflect the factory gate prices, hence they do not  
19 include amounts associated with the fitting of the body  
20 on the truck or amounts associated to tail lifts or  
21 other products normally sold with ... [it]."

22 Then you say:

23 "To reflect the actual prices ... I have used the  
24 prices collected in the Absolute Report to compute  
25 relative prices between bodies, taking box bodies as the

1 reference. I have then used the average body price  
2 obtained from DAF manufactured body price data (which  
3 relates to box bodies) as the reference value ... I have  
4 obtained adjusted values for other bodies by multiplying  
5 their price relative to box bodies in the Absolute  
6 Report by the reference value of box bodies obtained  
7 from DAF data."

8 So what you have done here is you have actually  
9 increased the prices of the bodies, have you not, above  
10 the level of the Absolute Report?

11 A I have increased the absolute value of both the  
12 Absolute Report using DAF data, which is, of course,  
13 much more precise.

14 Q The effect of that is to increase the scale of the  
15 complements effect in your model, is it not?

16 A Is that clear? It is not so clear, actually, because,  
17 I mean, in my -- the results of my simulation are not  
18 clearly -- actually, you see that in table 1 of my third  
19 report, is that the value of the complements does not  
20 have such a strong effect on the overall complement  
21 effect beyond -- I mean, what really is driving the  
22 result is the margin, so I do not think that you can say  
23 this and it is certainly not borne out by the result.

24 Q Would you accept that what we have here is a whole  
25 series of assumptions, so very different from simply

1           relying on actual invoice prices?

2       A    Oh yes.  I mean, indeed.  I mean, there is an  
3           approximation here.  Of course I am using DAF data  
4           because it is reliable and I know what are the  
5           weaknesses of the Absolute Report is that, you know --

6       Q    You are assuming, in effect, DAF's box body prices are  
7           sufficiently representative that they can be used as  
8           a scale across all types and across all manufacturers?

9       A    No.  I can use the difference between DAF's box body and  
10          the absolute price for box bodies.

11       Q    Indeed.

12       A    Yes.

13       Q    Then you are extrapolating that, essentially?

14       A    That is correct.

15       Q    So it is a very long way short of a robust price derived  
16          from actual data, is it not?

17       A    I wish I had better data.

18       Q    Of course.  Then for trailers, trailer prices, you base  
19          the entire analysis on Royal Mail's purchases of two  
20          types?

21       A    That is right.

22       Q    So, again, it is an assumption that the entire trailer  
23          market is equivalent to Royal Mail.

24       A    Yes.  That is -- I mean, I am only using these two  
25          trailers.  I tried to look for reliable sources of data

1 on trailers, but you do not get something -- I did not  
2 find anything comparable to what I found from the  
3 Absolute Report.

4 Q Then when we go to costs, we have heard already this  
5 morning that what you use is margin information, which  
6 is not a measure of marginal cost.

7 A That is correct.

8 Q You accepted this morning -- sorry, not this morning, it  
9 was this afternoon -- that within the average margins,  
10 body margins would be lower than trailer margins.

11 A Yes. I think it is likely to be the case.

12 Q So this is another significant over-simplification, is  
13 it not?

14 A I did a sensitivity on that.

15 Q What I want to ask you now about is the outputs of the  
16 model and we talked this morning about how you did  
17 a first specification and then, after Mr Harvey had made  
18 his point about the width of the parameters, you  
19 reconfigured the model and the result of that was  
20 a considerable reduction in the complements effect; do  
21 you recall?

22 A Yes.

23 Q Mr Harvey showed the tribunal this afternoon a table  
24 which contained variation in maximum, if you recall. We  
25 can look at it again, but I also want to show you an

1 updated one. Just to remind you and to remind the  
2 tribunal, we are talking about at {E/28/143}.

3 Sir, I am almost finished. I am on my last few  
4 questions.

5 THE CHAIRMAN: Fine.

6 A E/28?

7 MR WARD: 143. You will recall we looked at this about  
8 45 minutes ago or so.

9 A Yes.

10 Q This is a table that took your results, and he used the  
11 minimum and median that you had provided and then  
12 recalculated a maximum which was not in your results,  
13 and then what Mr Harvey pointed out in the hot tub is  
14 a great divergence of ratios of maximum to minimum. Do  
15 you recall?

16 A Yes. I recall that, but this is based on the output of  
17 my first model.

18 Q Exactly. Now we have the same table, which I am pleased  
19 to say is agreed between the parties, which deals with  
20 your updated results, and this -- I do not know if you  
21 have a hard copy, probably not. It is -- let me just  
22 get the reference. It is J4/445. Could we go to page  
23 {J4/445/3}, please? Do you see that, Professor Neven?  
24 It is the same table. What we see is -- if we read  
25 along the rows, we have got the segments, we have got

1 the "Previous minimum", which means I think your initial  
2 model, then the "Revised minimum", which is your second  
3 version, and then the "Maximum", which Mr Harvey  
4 calculated.

5 A But -- okay.

6 Q I just want to explain what it says before we start  
7 debating it -- then "Previous ratio (maximum to  
8 minimum)", which was in the table we just looked at,  
9 where we see it ranges from 1.0 to 4.0, and then in the  
10 last column we have "Revised ratio (maximum to  
11 minimum)", which -- reflecting your newly reduced  
12 minimum results. Here we can see a variation from 1.6  
13 to 13.6 in terms of ratio. Do you see that?

14 A Yes.

15 Q As I said, I am pleased to say that the arithmetic is  
16 agreed and I want to put two points, really, to you  
17 about this table. The first one is: would you accept  
18 that these extremely wide variations between the maximum  
19 and the minimum itself undermines the confidence we can  
20 have that the model is sufficiently specified?

21 A No. First observation is that this table is not  
22 actually representing the maximum of the second  
23 simulation. It is basically using the maximum of the  
24 first simulation to do minimum of the second simulation,  
25 so to have a like-for-like comparison you should have

1 looked at the maximum from the third simulation, but  
2 anyway.

3 Q I am so sorry, I thought it was agreed.

4 A Sorry, the numbers are correct but they are not the  
5 relevant numbers. But it is okay because if you were to  
6 do the correct exercise they would not be very different  
7 so that does not matter all that much. But as I  
8 explained earlier, I am not particularly worried about  
9 the fact that in a model like this one, in which the  
10 model is undetermined, that I have very different  
11 parameter configurations that are valid as long as I can  
12 understand them, and I understand that these maxima do  
13 not make any sense and so -- I mean, maybe there was  
14 a point that has not been sufficiently emphasised in the  
15 discussion today, is that, you know, I systematically  
16 take the most conservative approach possible. I always  
17 take the parameter configuration that yields the  
18 smallest possible complement effect, even in  
19 circumstances in which I think that the corresponding  
20 parameter configuration does not make so much economic  
21 sense.

22 I mean, for some of the segments that I discussed  
23 earlier, the minimum is actually achieved for prices of  
24 the competitors that are 30% above the prices of DAF.  
25 I do not think it makes a lot of sense, but that is

1           where the minimum is, so because I want to be  
2           conservative, because I know the limits of my  
3           methodology, I take this minimum.

4       Q    Saying it is conservative assumes that the model is  
5           reliable and one of the answers must be right, does it  
6           not?

7       A    I do not think this is the way in which you want to look  
8           at those models. I mean, you do not want to, I mean,  
9           look at the results of these models, of these  
10          simulations, and say there is just one parameter  
11          configuration that is correct. No. I mean, you have to  
12          take into account the characteristics of the  
13          methodology, you have to take into account the fact that  
14          inherently they will do a diversity of solution and you  
15          have to assess them overall without sort of focusing on  
16          one number.

17       Q    Does not that shear range of solutions that I am putting  
18           to you just show that the model does not have adequate  
19           data points in it to provide reliable answers?

20       A    I would not reach that conclusion. As I said earlier,  
21           I have confidence, some confidence -- I do not want to  
22           over-sell -- I mean, I have some confidence in the  
23           results of this calibration exercise because of the  
24           ranges of valid parameter configuration that I find and  
25           because of the interpretation that I can give.



1 Q Let us just look at that last point, which is my final  
2 topic. If we look at this table, I think the point you  
3 were making earlier in the hot tub is that, for example,  
4 segments 4, 7 and 13 are similar -- and we do not have  
5 the precise descriptions here -- and you pointed to the  
6 fact that under the revised minimum they were 0.31, 0.30  
7 and 0.29.

8 A That is right, yes.

9 Q But if we look at your first set of results --

10 A My first set of results? Yes.

11 Q -- 4 and 7 are respectively 0.36 and 0.77.

12 A Oh, but, I mean, there is no doubt that my second  
13 simulation is much better than the first one.

14 Q You were quite content to rely on the first one, were  
15 you not?

16 A All what I can do is that I -- can say, sorry -- is that  
17 I am very grateful for Mr~Harvey to have pointed out to  
18 the fact that I had looked at a subset of parameters  
19 that was not sufficiently wide and I have now looked at  
20 an even wider set of parameters than Mr Harvey had done  
21 and I am now sort of content that I have found the true  
22 minimum.

23 Q Well, part of what you are saying, Professor Neven, is  
24 that, because you find the results plausible, the model  
25 must be valid.

1 A What I am saying is that, you know, you do not want to  
2 assess the output of these models simply on the basis of  
3 the diversity of parameter configuration that you get.  
4 You want to look at what these parameter configurations  
5 mean, what the economic interpretation is, and this is  
6 what I have tried to do earlier today.

7 Q But justifying the model by reference to the fact that  
8 you think the results look plausible is just hopelessly  
9 circular, is it not?

10 A No, I do not think so, because when you start that sort  
11 of exercise, you know, you do not know what sort of  
12 results you are going to get, and if I had, you know --  
13 it is circular if you inevitably get to the conclusion,  
14 and here it is not circular because it is entirely --  
15 you know, it would have been possible for this  
16 simulation exercise to yield things that were completely  
17 random, I mean, uninterpretable, and it is not the case.

18 MR WARD: I have no more questions. Thank you.

19 THE CHAIRMAN: Re-examination?

20 Re-examination by MR BEARD

21 MR BEARD: Just a couple of quick re-examination questions.

22 Mr Ward put paragraph 73 of Mr Ashworth's statement  
23 to you, Professor Neven. We will deal with in  
24 submissions the fact that that was not put to  
25 Mr Ashworth and there was no questioning about these

1 issues of any DAF witnesses.

2 THE CHAIRMAN: Maybe they were content with what he actually  
3 said.

4 MR BEARD: Well, maybe. We will come back to that, but  
5 paragraph 47 of the pricing statement, {C/9/17}, could  
6 we go to that? Have you seen this pricing statement,  
7 Professor Neven?

8 A Where would that be?

9 Q It will pop up on the screen, but you are aware of what  
10 the pricing statement is?

11 A Yes, but I do not know which part --

12 Q No, no, sure. I just will not go to the first page. So  
13 this was a statement put in by way of evidence in  
14 relation to pricing matters by DAF at the order of the  
15 court. If we could just expand 46 and 47. Have you  
16 seen these paragraphs, Professor Neven?

17 A Some time ago, yes. Okay. So essentially 46 is  
18 referring to where, again, the fact that at least the  
19 dealer is going to take into account not only the truck  
20 but also the bodywork and, of course, the willingness to  
21 pay of the buyer will be a function of both, yes.

22 Q In relation to 47 that is customers, what is that  
23 talking about in the context of the debate we have been  
24 having today?

25 A Yes, it is very clearly what we were saying earlier,

1           that the customer would take into account the cost of  
2           the body.  Actually it is explicit, "when considering  
3           the sales price that would be paid for the Truck without  
4           the body", so that is quite direct.

5           MR BEARD:  Yes.  We will come back in submissions to the  
6           fact that this was not put to any DAF witnesses.

7                     If we could go to {E/12/60}, you referred to one  
8           sensitivity analysis at [draft] page 168 of the  
9           transcript.  You referred to a sensitivity analysis in  
10          relation to body and trailer margins.  Is that  
11          sensitivity analysis found -- I recognise this is  
12          leading -- in the section entitled "Sensitivity  
13          analysis" in your first report?

14          A    It was in the first report, this one, I think, but I did  
15          a sensitivity analysis also in the context of the third  
16          report.

17          Q    It is in the third report.  Okay.  Sorry.

18          A    I think I discussed it earlier this afternoon, so it is  
19          IC63.

20          Q    The sensitivity analysis section begins at page 17, so  
21          {E/63/19}, I think, two pages on.  Sorry.

22          A    It is page 22 in the --

23          Q    Right, {E/63/21}.  Page 22, did you say?

24          A    Page 22 of the tribunal's -- that is right.

25          Q    Could we just flip over again, {E/63/22}.  Thanks.  Is

1           it this one?

2           A    That is right.

3           Q    Do you want to explain very briefly what you have done  
4           there?

5           A    No, I think that we discussed it earlier. I think what  
6           I did is I changed the body prices as well as the  
7           trailer prices, which of course had the margin, so  
8           increased them or decreased them.

9           Q    So that was the sensitivity you were referring to?

10          A    Yes.

11          Q    That is helpful. I was just trying to clarify for the  
12          transcript. I do not have any further questions in  
13          relation to these matters.

14          THE CHAIRMAN: Thank you very much.

15          MR BEARD: Thank you.

16          THE CHAIRMAN: Thank you, Professor Neven. I think we have  
17          finally come to the end of your evidence. Thank you  
18          very much for all your help and to Mr Harvey as well.

19                    Tax.

20          MR BEARD: What a better way to spend a Tuesday, sir.

21          MR WARD: I am pleased to say I think it is the last one.

22          THE CHAIRMAN: Yes, I thought you might say that.

23          MR BEARD: Another negotiation has been had by the sound of  
24          it.

25          THE CHAIRMAN: Has there been any further narrowing?

1 MR WARD: Yes, I think there has been significant narrowing.  
2 THE CHAIRMAN: Good.  
3 MR BEARD: At the moment I am going to be an hour or so,  
4 maybe a bit longer, I will look overnight, but  
5 I certainly at the moment do not think I am going to be  
6 half a day, so ...  
7 THE CHAIRMAN: In terms of our preparation, is there  
8 something that we should concentrate on in terms of the  
9 re-reading?  
10 MR WARD: I gather there is a letter on its way which will  
11 explain the scope of the issues.  
12 MR BEARD: Yes. I think many have fallen away. If  
13 Mr Coulson says there is a letter coming, then I am  
14 going to wait and see what Mr Coulson has done in  
15 relation to these matters.  
16 THE CHAIRMAN: So we can start at 10.30 tomorrow?  
17 MR BEARD: That is absolutely fine as far as I am concerned.  
18 I do not want to speak for Mr Lask, but --  
19 MR WARD: I am confident he is not going to say he wants the  
20 whole day minus an hour.  
21 THE CHAIRMAN: All right. So 10.30 tomorrow. Thank you.  
22 (4.33 pm)  
23 (The hearing adjourned to 10.30 am on 14 June 2022)  
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