IN THE COMPETITION APPEAL TRIBUNAL

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

Salisbury Square House
8 Salisbury Square
London EC4Y 8AP

Tuesday 14 June 2022

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

BETWEEN:

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

v

DAF Trucks Limited and Others **Defendants**

A P P E A R A N C E S

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

Tuesday, 14 June 2022

(10.30 am)

THE CHAIRMAN: Good morning.

Good morning, Mr Lask.

MR LASK: Good morning, sir. Unless the tribunal has any introductory comments, we move on to the tax experts.

THE CHAIRMAN: No, straight on to tax.

MR LASK: So Mr Singer is up first and needs to be sworn in.

THE CHAIRMAN: Right. Yes, thank you.

MR GORDON SINGER (sworn)

THE CHAIRMAN: Thank you, Mr Singer. Please do sit down and make yourself comfortable. You have some water there, I think.

A. Yes, thank you.

MR LASK: Sir, may I take it that you are content for me to introduce Mr Singer in the abridged manner that we have been using for the other experts?

THE CHAIRMAN: Yes.

MR LASK: Thank you.

Examination-in-chief by MR LASK

MR LASK: Mr Singer, you have provided three reports and signed a joint expert statement. Are those true to the best of your knowledge and belief?

A. Yes.

MR LASK: Thank you. I do not have any questions, but if you wait there, Mr Beard will have some questions for you.

THE CHAIRMAN: Thank you. Mr Beard.

MR BEARD: Thank you.

Cross-examination by MR BEARD

MR BEARD: Good morning, Mr Singer.

A. Good morning.

Q. You are a tax partner so specialise in tax; correct?

A. Correct.

Q. Not an expert in finance --

A. No.

Q. -- so not here to opine on finance matters?

A. Indeed not.

Q. You say that with a smile. The sense of relief is palpable.

So I want to start summarising at a high level what the tax analysis both you and Mr Pritchard have been engaged in is meant to do in very general terms, and I think this is going to be non-controversial -- I am hoping that -- because it is just setting the scene because, as we have seen from correspondence and the interaction between you and Mr Pritchard, actually what I am going to ask questions on today is quite a limited part of what has been undertaken between you -- correct?

A. Correct.

Q. -- so apologies if I oversimplify. But very broadly speaking, the tax assessment has two steps which I think you and Mr Pritchard agree on. The first step aims to model Royal Mail Group Limited's tax position in the counterfactual world, assuming there had not been this putative overcharge; correct?
A. Correct.
Q. So in the actual world -- not the counterfactual world but in the actual world -- the amount of corporation tax payable by Royal Mail Group Limited, the theory goes, was reduced because of the impact of this putative overcharge; correct?
A. Correct.
Q. Yes. Just in very simple terms, that is because the overcharge would, for example, mean that Royal Mail Group was able to claim more tax losses on trucks, for example, and thereby reduce its taxable profits?
A. Yes.
Q. In the counterfactual, therefore, where there is no putative overcharge, Royal Mail Group Limited would have needed to pay more corporation tax. That is the theory we are going through?
A. Yes.
Q. Then what we are doing in this first step is trying to put Royal Mail Group Limited back in the position where

it would have been absent the infringement, so essentially you need to reduce its damages claim in your counterfactual model. That is broadly where we are headed here?

A. Yes.

Q. Yes. So we are looking in the first step at a potential reduction in the quantum of claim but in the second step in the tax analysis there is a recognition by both you and Mr Pritchard that Royal Mail Group Limited would need to pay corporation tax on any damages award; correct?

A. Yes.

Q. So the aim of the tax analysis, then, is to ensure that Royal Mail Group Limited is not out of pocket as a result of that corporation tax payment it would have to make; correct?

A. Correct.

Q. So this second step broadly involves increasing the overall quantum in loose terms?

A. Correct.

Q. Yes. So both you and Mr Pritchard have your own separate tax models which you use to model the impact of tax on any damages, but, although you do not agree on the tax models, as I say, you have managed to narrow the scope of practical disagreement; correct?

A. That is right.
Q. Yes. So for today the only material issue between you relates to the treatment of financing costs, I think -- the only material issue; correct?
A. Cost of equity.
Q. Well, I am going to just look at financing cost generally. I quite understand, you are quite right, it is about cost of equity, but I will come on to that in that context, if I may. But the important thing is that things like the overcharge, the putative overcharge we are talking about, how that is processed, we are not going to talk about today.
A. Yes.
Q. I am also going to be focused really on that first step that I was talking about because that is where these financing cost issues are important; correct?
A. Correct.
Q. As you say, the particular concern we are going to come on to is about equity financing losses and I think you agree with Mr Pritchard that these equity finance losses comprise a significant part of the financing losses claim; correct?
A. That is correct.
Q. I think that it is agreed, but it does not precisely matter, but I think it is around 97% of the financing

losses claim; is that right?
A. I do not remember the precise number. Something in that region.
Q. There is not actually a disagreement between you and Mr Pritchard on that, is there?
A. No.
THE CHAIRMAN: Sorry, when you say "the equity financing losses claimed", what do you mean? Claimed in these proceedings?
MR BEARD: Yes. For these purposes. so as part of the financing losses, it is 97% of the financing losses claim and in fact it is about three-quarters of the total claim. I can go to it if it is useful because I do not think there is a dispute between the experts. It is {E/IC86/23}. So this is the joint expert statement and you see the comment at the top. I think you do not demur?
A. No.
Q. Just to be clear, all of this, sir, is in the world where we are using WACC as the relevant interest rate.
THE CHAIRMAN: Right.
MR BEARD: So I place my very heavy caveat --
THE CHAIRMAN: Yes --
MR BEARD: -- that we are entering an Alice in Wonderland world here in dealing with WACC as a relevant --

THE CHAIRMAN: But if we are not using the WACC, are the figures -- then there is no cost of equity that comes into it?

MR BEARD: No, and Mr Pritchard has provided alternative figures using effectively a number of the measures that Mr Delamer used, so compound on short-term investments, compound on debt and simple on base rate plus 1. I think that is right.

A. Yes.

THE CHAIRMAN: Those figures are then agreed between the tax experts if we are not in the WACC world.

MR BEARD: I think that is right. If we are not WACC world and we are not discussing equity costs, they are agreed on it.

A. Then we both have models to model that.

THE CHAIRMAN: You are not very far apart?

A. In terms of modelling principles, there may be some points which, when the tribunal reaches its decision, will have to be reviewed in the context of the different models, but in principle.

THE CHAIRMAN: What, so we are going to pass it back to you, are we, once we make decisions on principles?

MR BEARD: I think that is something of an open question. Whatever expertise Mr Pritchard and Mr Singer have, it is not clear that they then deal with these matters

separately. Mr Pritchard has put forward these numbers. But, as I say, for today I am focusing on this particular issue and --
THE CHAIRMAN: Yes, of course.
MR BEARD: -- we rely on Mr Pritchard's figures in relation to those alternate calculations in his model.
THE CHAIRMAN: Yes, okay.
MR BEARD: So let us just work through financing losses generally. Of course you are right, Mr Singer, we are going to come to equity losses, but if you bear with me, let us just start with the cost of debt, if we may, just so we have got this in mind.

If you suffer an overcharge as Royal Mail -- and we are always talking about Royal Mail here, not BT. BT is making no compound interest claim, not reliant on the WACC and so it is completely irrelevant for this part of the questioning; agreed?
A. Agreed.
Q. So if you are Royal Mail and you do suffer this putative overcharge on the trucks you have bought, that means, in terms of the theory on cost of debt, you suffer a higher level of debt in the factual situation than in the counterfactual situation; correct? If we are just focusing on cost of debt and we are asking ourselves how does the overcharge impact on debt, an overcharge, which

is a greater cost to Royal Mail, would mean on this basis -- we are just focusing on debt for the moment -- we are hypothesising that Royal Mail incurs greater debt --
A. Yes, incurs greater debt.
Q. -- in the actual world because in the actual world we are thinking about this putative overcharge; yes?
A. Hmm-hmm.
Q. So --
A. Sorry, in the actual scenario, yes, of course.
Q. Yes, and in the counterfactual scenario, so without this putative overcharge, the point is you would have less debt and therefore pay less interest; correct?
A. Correct.
Q. Yes. So overall you would have made higher profits, all other things being equal?
A. Yes.
Q. We hold everything else equal for these purposes.
So in tax terms, when we are just focusing on the debt issue, you pay less in tax in the factual world than you would in the counterfactual world and we need to deal with that in the assessment of tax if there was an overcharge. That is what we are doing in relation to the cost of debt?
A. That is what we did.

Q. You have already mentioned there may be slight differences in the model, but both you and Mr Pritchard have agreed how that should broadly be done?
A. Yes.
Q. I think you also broadly agree about how one deals with foregone short-term investments because that is another category that we might be dealing with here. Let us just deal with those because I think there is broad agreement on those. Now, we know that Royal Mail had large amounts of short-term investment and I suppose short-term investment is a bit like the converse of the debt situation. If there was an overcharge, then Royal Mail would be able to acquire less by way of short-term investment than it would in the counterfactual world; correct?
A. Correct.
Q. So the idea is that in the counterfactual world Royal Mail would have had extra money coming in from those short-term investments that it could then have invested?
A. Yes.
Q. Yes, so when we are thinking about debt, we are thinking about what the tax treatment would have been in relation to debt in the actual world and the counterfactual world before tax and then after tax; correct?

A. Yes.
Q. In relation to short-term investments, we are talking about the lower level of income and then the higher level of income from those investments pre tax and then the tax treatment of that; correct?
A. Yes.
Q. Now, in both of those cases what one does is one looks at levels of debt and, as you have just agreed, considers the position in relation to the company's debt pre tax, applies tax principles and comes out with a post-tax number; correct?
A. Yes.
Q. In relation to short-term investments, you do that in relation to the returns on those investments; correct?
A. (Nods)
Q. But in relation to equity financing losses there is a different approach, you suggest, because in both the debt and short-term investments situation you put those measures -- I am going to use the term loosely -- through your model and Mr Pritchard's model to move from pre tax to post tax; correct?
A. You do.
Q. You say in relation to equity financing losses, "We do not need to do that", and that is what we are going to come and consider a bit further; correct?

A. Yes.
Q. Just before we move on, I think when we are talking about equity financing losses, you are not suggesting, are you, that there are any specific costs identified anywhere in the accounts which set out equity financing losses, are you?
A. I am not.
Q. So from a tax point of view I am guessing this is slightly unusual because normally you are taking figures that you can identify in accounts and thinking about how you process them in this sort of situation, but with equity financing you do not have that; correct?
A. It is post tax, therefore we do not have it.
Q. Well, I was just asking about the unusual nature of the fact that you do not have any identification of this as a cost. We are talking about equity financing cost and I think you accept that is a rather unusual situation for this exercise; correct?
A. Relatively.
Q. Now, perhaps we can go to your report at {E/IC8/20}. So this is your first report, Mr Singer. You will have it in the bundle and I do not have an index for that bundle so I am sorry I cannot help you with that. I will just bring things up on the screen --
A. Yes.

Q. -- but if you want to pause and find it in the hard copy, I will happily wait.
A. Thank you.
MR LASK: I think if that is the first report, it is tab 1.
MR BEARD: Thank you very much. I am grateful to Mr Lask.
So I am just picking it up at section 4 in your first report and this is the counterfactual analysis. That is the section we are in. I am not going to take you through all of it. I want to skip down to paragraph 4.39, if I may, which is {E/IC8/36} in the electronic bundle. You see at 4.39 you set out what you understand to be the components of the WACC, the weighted average cost of capital --
A. Yes.
Q. -- being equity financing losses, as they are put, and debt financing losses.
Then if we can just skip forward to 4.41, {E/IC8/37}, you deal with the debt financing component. You say:
"... for corporation tax purposes interest paid by Royal Mail to third parties on debt used to fund the acquisition or ownership of trading assets such as the Trucks would normally be allowed as a deduction in calculating Royal Mail's taxable trading profits."
Now, I know that I am not going to get all this

language right in terms of tax terminology, but what you are saying there, very clearly, is that in the normal situation, where you incur debt to acquire trading assets, you would normally be allowed to offset that debt against your profits for the purposes of tax calculation; correct?

A. The costs relating to the interest or the financing cost.

Q. Yes, I am so sorry. That was sloppy of me, but yes, exactly. I am only talking about the interest. You are quite right to correct me.

"I assume that the interest expense element of the Financing Losses Claim consists of such 'trading' interest. In view of this, I consider that where a reduction in interest expense in an accounting period in the counterfactual scenario forms part of the Financing Losses Claim, Royal Mail's taxable trading profits in the Counterfactual ... should be treated as increased by the same amount. This treatment of interest expense is in line with the agreement set out in E3 of the Tax Principles Table."

So that is you, I think, setting out rather more formally and clearly the position that I was just trying to put to you in relation to cost of debt.

Then if we go back to 4.40, {E/IC8/36}, this is where you deal with equity financing losses, so let us just have a look. You said:

"In relation to Equity Financing Losses, I note that it is agreed between the parties in E3 in the Tax Principle Table that the Financing Losses ... as a whole represents amounts that should be taken into account for corporation tax purposes as trading expenses incurred or trading income foregone, meaning that this amount will normally be included in the calculation of Royal Mail's corporation tax profits."

So you are referring to this E3 of the tax principles table that you had referred to in 4.41. I am going to come back to the remainder of 4.40 in a minute, but let us just go to that table, if we may. It is in {J3/IC401}. You may have it in the hard copy bundle, I am not sure. The page I want to go to is page 17, {J3/IC401/17}.

Let us just make clear -- I do not want to confuse you. Let us go back to page -- I think there is a bundle there next to you --

A. It is in tab 1.

Q. You do have it, yes. You are obviously familiar with it. So I was going to take you back on the electronics to show, but this is the agreed tax principles between you and Mr Pritchard; correct?

A. Yes.

Q. I just want to go to E3, which I think -- my reference is at page 17 but in your hard copy it is the internal page numbering 13, I think.

A. Yes, I have it.

Q. You have it. So "Principle" is what we see in the left-hand column:

"The marginal tax effects of the alleged overcharge with respect to Royal Mail's Financing Losses claim will depend (in part) on the nature of Royal Mail's claim; specifically, the extent to which Royal Mail's Financing Losses claim represents:

"(a) trading or non-trading expenses incurred in the Actual Scenario; and/or.

"(b) trading or non-trading income in the Counterfactual Scenario."

THE CHAIRMAN: I think you need to go down on the --

MR BEARD: I am so sorry, yes. Can we scroll down on the electronic? Thank you.

In brief, you agree with that; correct?

A. Yes.

Q. So let us just focus on the trading or non-trading expenses incurred in the actual scenario. What you are saying by reference to E3 is that the cost of equity is to be treated as a trading expense or a non-trading expense in the actual world. A non-trading expense would be something like a return on an investment. It would be some sort of financial gain; correct?

A. Something which does not relate to trading matters per se, yes.

Q. Sorry, I am not trying to define comprehensively.

In the counterfactual world what you are thinking of is that there is a reduced trading income or non-trading income, so that is the flip side; correct?

A. Correct.

Q. Let us just think about those terms for a moment. In the counterfactual world -- well, in any world but this includes the counterfactual world -- the term "trading income" is a term used to refer to pre-tax income, is it not?

A. Yes, it is.

Q. "Non-trading income" is a term that is used in relation to non-trading-related -- I am going to say "revenues" but that is probably the wrong term, but I want to use it broadly, in a pre-tax situation, is it not?

A. That is correct.

Q. Yes. If we then move back to expenses, the same is true of trading expenses. They are pre-tax expenses that are then considered in any tax assessment; correct?

A. Broadly correct.

Q. Obviously the same is true of non-trading expenses, correct?

A. (Nods)

Q. So what essentially the tax principles you have agreed to in E3 are saying is that, for these purposes, the cost of equity, which is what we are referring to amongst these losses, shall be treated as if it is either trading or non-trading expense or income. That is what E3 is saying, is it not?

A. I am not sure that it is because at this point the analysis of cost of equity, et cetera, had not been carried out, and when the analysis of cost of equity was carried out it was apparent -- and I am no financing expert, as I have said -- that it is presented on a post-tax basis.

Q. Let us just be clear here. In your report you refer to equity financing losses because we saw that. Let us go back to your report, so that is back in -- thank you very much. That is great, {E/IC8/36}. If we go up the page slightly so we can see 4.39, you are saying there, well, there are equity financing losses and debt financing losses that make up the WACC, so you have been told that, and you are specifically referring, both in 4.40 and in 4.41, to the tax principles table. What you are doing by referring to the tax principles table is accepting, are you not, that all of those losses, insofar as they are to be considered for the purposes of your model or Mr Pritchard's model, are to be treated as pre-tax losses or income, are you not?

A. No, I do not think we are. We are not because at the point the tax principles table was drawn up and agreed, the analysis by the financing expert of the components of the financing losses claim had not been drawn up. When it was drawn up, it was split into two parts. One part was pre tax, which was the cost of debt, the other part was the cost of equity, which we are told is post tax, and that would not be the correct treatment nor is it, I do not think, what is envisaged by the principle. The principle is envisaging something that is pre tax whereas the cost of debt is not pre tax. We are told it is post tax.

THE CHAIRMAN: So, sorry, the principles -- these are from a year ago, are they not? They are June 2021, so --

A. Yes, from before --

THE CHAIRMAN: So you had seen Mr Earwaker's report?

A. That is correct, yes.

MR BEARD: I understand what is now being said. There is no correction in any of the reports in relation to this matter so we are just testing how these things are laid out.

Let us just look at 4.39.1. Are you suggesting that you understood that equity financing losses might be calculated on a pre-tax basis at this point then?

A. At this point, no. In fact in 4.40 I say that I understand from paragraphs 6.62 to 6.63 of Mr Earwaker's report that the equity components of the WACC is presented on a post-tax basis.

Q. That is exactly where I was going next, Mr Singer. That is exactly where I was going next. So you did in fact know, when you provided this part of your report, that Mr Earwaker had said that the equity component was presented on a post-tax basis, but as we have seen by reference to E3, E3 proceeds on the basis that, under the tax principles, what you count for the purposes of assessing the marginal tax effects of the alleged overcharge with respect to financing losses is, as we have agreed, what is represented as trading or non-trading expenses, trading or non-trading income.

Now, you go on and consider the equity financing costs and, in accordance with E3, you would have to treat those as trading or non-trading expenses, would you not?

A. No, I do not think you would. I think that E3 here is predicated on an assumption that the financing costs are pre tax. I think it is quite difficult to be given a number that is then post tax and is clearly described as post tax and then to say it fits in E3, which was predicated on pre tax -- both. I can say at the time of the principles that I do not think either Mr Pritchard nor I considered the possibility of a post-tax cost of equity.

Q. I am struggling slightly, Mr Singer, because I did not write these bits of this report. You did and you said:

"In relation to the Equity Financing Losses, I note that it is agreed between the parties at E3 in the Tax Principles Table ..."

So it is you that takes us to E3 in the context of your consideration of the cost of equity and I put to you that E3 is all about pre-tax issues. You agreed with that and then, in those circumstances, you note that it is presented on a post-tax basis but you are saying there, are you not, that in order to comply with the tax principles table at E3, you should treat equity financing losses as falling within one of those categories of pre-tax trading or non-trading expenses, are you not?

A. No, I do not think I am. I do say in 4.40, in the first half which you have read out, that it is agreed, as you have read out, that the tax principles table does as you have described. I then go on to say:

"However, I understand ... that the equity component ... is presented on a post-tax basis. This means that the Equity Financing Losses are presented net of any corporation tax ..."

They are not pre tax at all, as you have described before. They are actually post tax. They are not pre-tax income or cost, they are post-tax income or cost and should be applied as such.

Q. Well, we will come on to this. The difficulty we have is, because of the Alice in Wonderland-ish situation, they are not really income or expenses at all for the company, but I am just concerned about what you are saying in relation to principle E3 because -- if we can just go to your third report, which is {E/IC59}, and I think it is at page 35, {E/IC59/35} -- could we just go down to this footnote at 38?

38 is actually a footnote to paragraph 2.68, which is to do with treatment of short-term investment, but it does not matter for these purposes. I just want to read the second sentence. You say:

"Principle E3 records Royal Mail's position that the Financing Losses Claim represents a combination of trading expenses and income."

Now, the financing losses claim, as we have agreed, is the cost of debt and the cost of equity on

Royal Mail's story, and here you are recording:

"... Royal Mail's position that the Financing Losses Claim represents a combination of trading expenses and income."

We have agreed that those are pre tax, have we not?

A. Yes, however this, as you said, is referring to something different to start with. It is referring to the treatment of a model which models short-term investment income.

Q. Well, look, Mr Singer, I understand that you attach this footnote to 2.68 because 2.68 is dealing with short-term investments but you are not qualifying principle E3 as being limited to short-term investments. It is absolutely clear what you are saying here, is it not?

A. What I am saying there is clear, but I am not sure if that is to the point you were making earlier.

Q. Well, it is clear that you consider that principle E3, to which you have agreed, records Royal Mail's position that financing losses claim represents a combination of trading expenses and income and, as we agreed earlier, those are pre-tax expenses and income, are they not?

A. They are, but, again, if I may return to the point I made before, in terms of the timing of the report that was provided 12 months ago in terms of the principles and the subsequent report from Mr Earwaker which then provided -- or which then calculated the cost of equity on a post-tax basis, which was something that was not and could not have been envisaged at the time of the principles.

Q. Sorry, I am a bit confused by this timing point. As we saw when we went to paragraph 4.40, at the time, when, in your first report, you referred to E3 of the tax principles, you did have Mr Earwaker's report and you did know it was post tax, his assertion in the report.

THE CHAIRMAN: But he goes on to say -- he says "However" and then refers to the post -- I am not really sure what this line of questioning is going to because -- I do not know -- do you have any pre-tax figures?

A. In respect of ...?

THE CHAIRMAN: In respect of equity financing.

A. None were provided. Both Mr Pritchard and I go on to say that if the tribunal determines that the cost of equity is not as I have treated but in fact has to be grossed up to a pre-tax equivalent, then there are mechanisms to do that, but Mr Earwaker did not provide that. He provided a post-tax cost of equity.

MR BEARD: I will move on, but the point is that, in relation to the tax principles, the only matters that are being identified as being relevant within E3 for the marginal tax effect are all pre-tax considerations and those are what are being referred to in the reports, not just in this one, but later.

THE CHAIRMAN: We do not actually have those figures.

MR BEARD: In relation to pre tax -- well, because we are in Alice in Wonderland world here, the idea of pre-tax cost of equity is --

THE CHAIRMAN: Well, I understand that, but I do not know how Mr Earwaker calculated the tax that made it a post-tax figure.

MR BEARD: We will come on to deal with those issues just in a second but I just wanted to deal with these tax principles which are all focused on pre-tax considerations being fed into the model because the difficulty we have here is that, because Mr Singer treats Mr Earwaker's approach as being post tax, in fact what happens is he does not put these figures into his model. That has an effect on how these things are calculated and the point in relation to the principles is the principles are all geared round pre-tax considerations.

THE CHAIRMAN: You are saying because he treats Mr Earwaker's approach as being post tax; it was post tax.

MR BEARD: Well, let us go on and deal with that. Let us go to Mr Earwaker's --

A. It was, and in fact Mr Pritchard himself does acknowledge that keeping it in as it stands without adjusting it -- if it has to be included as a post-tax number in the model, Mr Pritchard does say that that would constitute double taxation.

Q. He does. Let me go to Mr Earwaker's report, which are the paragraphs you refer to here, which is {E/IC9/48}, tab 2 in your hard copy bundle, Mr Singer. Do you have that?

A. Yes, I do. Thank you.

Q. Picking it up at 6.62, so this is the table that Mr Earwaker uses to present what he refers to as the "vanilla" WACC with a cost of debt and a cost of equity; yes?

A. [Nods]

Q. At 6.62 it says:

"The measure of WACC that I present in Table 11 above is the 'vanilla' WACC. The vanilla WACC is distinguishable from the post-tax WACC and pre-tax WACC metrics that Royal Mail uses in its Particulars of Claim in that the vanilla WACC measure makes no allowance for Royal Mail's corporation tax payments -- ie it assumes, in effect, that tax does not exist."

So he is distinguishing -- he is saying it is distinguishable from the post-tax WACC and the pre-tax

WACC metrics. Now, how did you read that paragraph in terms of the tax treatment?

A. Well, I read it in the context also of paragraph 6.63.

Q. I am coming to 6.63. I am just asking about this paragraph though. He says it is "distinguishable from the post-tax WACC and pre-tax WACC metrics" used by Royal Mail. So on the face of it he is saying it is different from a post-tax WACC that is used by Royal Mail. Is that what we should understand from that for your purposes?

A. As I said before, I am not a financing tax expert -- a financing losses expert, I beg your pardon, but I will take it as read.

Q. Right. So he is distinguishing a post-tax WACC and referring to it as a "vanilla" WACC. What you then rely on at 6.63, {E/IC9/49}, as I understand it:

"I can arrive at vanilla WACC figures by undertaking my calculations using pre-tax debt rates ... and post-tax equity returns ... as the main inputs (together with the gearing ratio)."

So, as I understand it, what you are saying is, because he refers to post-tax equity returns as being used in the calculations, we should treat that as meaning that the cost of equity is a post-tax measure. That is correct, is it?

A. Yes. I am not sure if that is the only place it is referred to as post tax, but that is correct.

THE CHAIRMAN: When it is referring to tax, it is referring to it being taxed at source; is that the point?

A. Not necessarily. I think when he is talking about post-tax equity, the way I read it is he describes the cost of equity using a model which -- with which I am not particularly familiar, but the capital markets model, which is the return that the investor might expect in relation to Royal Mail as adjusted for its own risk rating, which is a post-tax measure in itself and I think he refers to it elsewhere. In other words, tax is -- it is implicit in there that it is after tax -- and many other things, not just tax. I am not sure that tax is particularly special here.

MR BEARD: Shall we just go on because there is a tax bit underneath.

"I understand that Royal Mail's claim is pleaded on a 'post tax' basis and that tax-related matters are being dealt with in a separate report by Mr Singer of PwC. My report does not address tax-related matters, hence my presentation of the relevant figures on a vanilla WACC basis that is neutral as to tax."

Now, what did you understand "neutral as to tax" to mean here?

A. That it is calculated only on a basis that is post tax in respect, particularly as it says in 6.63, of the cost of equity.

Q. I see, and that constitutes neutrality?

Let us go on to 6.65:

"I consider that the vanilla WACC rates that I have calculated are the appropriate rates to use (adjusting for tax as Mr Singer considers appropriate) within Mr Singer's calculation of Royal Mail's financing costs in relation to any corporation tax payments that it incurred (or would have incurred but for incurring the overcharges) during the relevant period. I consider that it is reasonable to assume that Royal Mail met (or, in the counterfactual scenario, would have met) corporation tax payments from corporate debt and equity financing -- ie they were costs that contributed to its aggregated financing requirement ..."

Then he goes on to say why he says that is a reasonable assumption.

But in 6.65 he is saying that -- is he not saying that the question of how you treat these matters for tax is one for you, Mr Singer?

A. Yes, he is saying adjusting for tax is either appropriate and adjusting for tax, although he does not say it specifically, in relation to the measures that he

has included in his report, one being pre tax and one being post tax.
Q. I see. When you took this as being post tax as a measure of equity returns, you did not make any adjustments or scrutinise how that post-tax rate was created, did you?
A. No, I took it as described as post tax, which it is, and because it was post tax I did not adjust for it.
Q. But did --
THE CHAIRMAN: What did you understand was meant by "post tax"? Post what tax?
A. Well, it is the cost of equity after tax and any other matters have been dealt with, so all factors including tax and, for that matter, other costs of the business and revenues, for that matter, are calculated, and this is -- sorry, I am not explaining that very well. It represents a return that an investor might require in relation to its investment in shares in Royal Mail.
MR BEARD: Right, but that is the investor's position, is it not? I may be wrong but I think what the chairman is asking about is what taxes are we talking about in relation to the company.
A. Okay.
SIR IAIN MCMILLAN: Can I --
MR BEARD: Please.

SIR IAIN MCMILLAN: There is the income, there is all the allowable expenses and so on and then the taxable profit figure is struck.

A. Correct.

SIR IAIN MCMILLAN: Corporation tax is applied to that figure.

A. Yes.

SIR IAIN MCMILLAN: Is that the post-tax figure that you are referring to --

A. The post-tax figure --

SIR IAIN MCMILLAN: -- from which the distribution to shareholders is made?

A. The post-tax figure is the one after the calculation of and deduction of corporation tax -- undeferred tax by the way for that --

SIR IAIN MCMILLAN: Yes, of course. Thank you.

THE CHAIRMAN: How could Mr Earwaker have determined that figure because he would have to know what is the position of the company in order to calculate what corporation tax was payable on its overall profits?

A. My understanding -- and I am not a financing losses expert -- is that it is calculated using an accepted methodology which provides, in this instance and in other instances for other businesses, a specific post-tax rate.

MR BEARD: Sorry, I am going to come back in slightly more detail to follow up the chairman's question, but, before I do that, in other words how these things --

THE CHAIRMAN: Sorry, I should not have taken you out of turn.

MR BEARD: No, it is fine. You are anticipating stuff I am going to go to, it is fine. I think we can deal with this bit relatively quickly. The methodology you are talking about is the capital asset pricing model; correct?

A. That is my understanding.

Q. Do you understand anything about the ingredients of the -- the three ingredients of that capital asset pricing model?

A. I have no expertise whatsoever but I do understand that they include a risk-free return --

Q. Yes.

A. -- a return on a diversified portfolio and, as adjusted for the particular risk rate, the risk attaching to Royal Mail described as its beta.

Q. Yes, and you understand that Mr Earwaker used Royal Mail's parent beta for these purposes?

A. Yes.

Q. Yes, but none of these measures -- all of this is a corporate finance modelling approach that I think you have perfectly fairly said you are not particularly familiar with. But I think you accept that it is not looking at the details of the actual levels of corporate expenditure, corporate cost and corporate revenue in relation to Royal Mail Group Limited; correct?

A. I do not think it looks at any -- my understanding is it does not look at any of those specifically, tax or any other for that matter.

Q. No. So the idea that -- although Mr Earwaker is calling this a post-tax measure, it is not looking at it from the point of view of any detailed tax analysis in relation to Royal Mail Group Limited, is it?

A. Not in that respect, no.

Q. No, it is not. Let us, if we may now, just go to the joint expert statement, so that is {E/IC86/23}. I think it is at page 23. I am sorry, I know it is in your hard copy bundle but I have completely forgotten the reference.

A. I have it. Which page -- sorry -- did you say?

Q. I am going to page 22, {E/IC86/22}. Apologies to Opus. Sorry, that is my fault. I wanted to pick it up just at the top of "Equity financing Losses". Do you have that?

A. Yes.

Q. So E1, "Issue":

"Inclusion of Equity Financing Losses in the

Counterfactual Scenario tax modelling."

You set out your position, where you say:

"I understand the Equity Financing Losses are quantified on a post-tax basis."

Then you enter into a debate with why it is you disagree with Mr Pritchard and things. I am not going to focus on that for the moment but let us just move across to Mr Pritchard's position.

Now, you know that Mr Pritchard does not, frankly like me, understand the inclusion of the cost of equity as a financing loss for the purposes of interest but he leaves that to one side. Then you will see, if you read down that column, he says, well, if that is what you are doing, you have got to turn these amounts into pre-tax amounts and put them through the model, particularly since it is important. He then repeats the point that you have accepted that --

THE CHAIRMAN: Are you on the next page?

MR BEARD: Yes, I am so sorry. I am looking at hard copies. My apologies.

THE CHAIRMAN: That is all right.

MR BEARD: Just going down the next page, {E/IC86/23}, there is a reference to your third report, which is just reiterating your position that you do not need to put it through the model. Then if we go further down, it says:

"Mr Pritchard considers that Mr Singer's reasoning is misplaced:

"As a matter of theory, Mr Singer has not identified how the specific effects of the Claimant's tax position on the Equity Financing Losses claim could (and would) somehow be reflected in Mr Earwaker's calculation of the cost of equity."

I think you accept that you have not identified any way in which the specific effects of the claimant's tax position would be reflected in Mr Earwaker's calculation of the cost of equity. You accept that, do you not?

A. I do accept it.

Q. Yes. If we go to (2):

"In any event, Mr Earwaker has calculated the cost of equity for the Royal Mail Group and not the Claimant. Any tax effects in Mr Earwaker's calculation will therefore not relate specifically to the Claimant ..."

So, here, Mr Pritchard is saying, "Well, look, the problem you have got is, using this capital asset pricing model, using the Royal Mail parent beta, is you are finding a group equity losses calculation". You understand that?

A. I understand, but whether that is valid or not I do not know.

Q. I am not going to ask about Mr Earwaker's calculation.

What I am asking about is how this works for you. The point that is been made by Mr Pritchard is that that means that none of this analysis focused specifically on the position of the claimant, and you understand that -- the claimant being Royal Mail Group Limited, rather than the parent company?

A. Yes, I understand.

Q. So you do not disagree with that. Then the third point is, {E/IC86/24}:

"Mr Earwaker's calculation of the Royal Mail group's cost of equity uses data did for the period October 2013 to July 2021, only ..."

That is following the IPO of Royal Mail.

"... and so cannot reflect the tax effects for the period relevant for the Claimant's claim."

So he is there highlighting that there is another part of the process which has been undertaken by Mr Earwaker which means that no consideration of the claimant's position prior to 2013 has been fed into Mr Earwaker's account. You understand that?

A. I understand that.

Q. Yes. So, taking those points together, is not the underlying issue here that, although you have talked about just accepting Mr Earwaker's calculation as being post tax, this notion of post tax is not one that is actually engaged with anything to do with the particular financing or tax position of the claimant throughout any period up to 2013 at all; is that correct?

A. I do not know whether that is correct and the reason I do not know is because, if this is how Mr Earwaker has calculated it -- and this is presumably in the discussion between the financing losses expert about whether to accept this or not -- I am not in a position to comment on the comments here that are made about the cost of equity and how it is calculated. I do not have expertise in that area.

Q. No, I am not asking for you to have financing expertise. You are not here as a financing expert. What I am testing here is how you can say that the equity costs that you are referring to are to be treated as post-tax costs when there has been no consideration of the particular situation of the claimant between 1997 and 2013, for example, in any assessment that Mr Earwaker has carried out and you know that there is no consideration of the position of the claimant in that calculation, do you not?

A. Yes, taking this as read I do know, but what I do not know -- sorry, taking that as read -- I take that as read and I do know that.

Q. Yes.

A. However, I have proceeded on the basis that if the cost of equity provided by the financing expert is being used in a calculation of vanilla WACC on this basis, then I follow what the financing losses expert says because I have no expertise to do otherwise.

THE CHAIRMAN: Sorry, what do you mean "on this basis"?

A. In other words that if the financing expert has calculated the cost of equity for the Royal Mail Group, that that is -- the financing experts are applying that to Royal Mail Group Limited and that is on the post-tax basis, then I do my calculations using that number or using the financing losses expert's calculation.

MR RIDYARD: When Mr Earwaker talks about the "vanilla" WACC, I thought he described that as a sort of theoretical construct in a world with no tax, so it does not matter whether it is post or pre tax, there is no tax so there is no tax adjustment to be made.

A. Though I think he does go on to say it is a combination of a -- from memory -- from what we saw --

THE CHAIRMAN: Well, he is saying there is no allowance for Royal Mail's corporation tax payments, but then he goes on to describe that he is taking into account post-tax equity returns --

A. Yes.

THE CHAIRMAN: -- which means -- because dividends are paid

out of after-tax earnings. So it goes back to what I was suggesting to you that we are talking about different taxes here basically. So the equity returns are taxed -- effectively taxed at source.
A. But they are made out -- they are paid out of post-tax income at source in that respect, yes.
THE CHAIRMAN: Of the payer?
A. Tax has already been accounted for.
THE CHAIRMAN: Yes, so how is that then taken account of in the recipient's accounts and tax returns? Do they get a credit for the tax that has been paid?
A. No, they would not, and if it were, for instance -- it depends who the recipient is. Of course there is not a single recipient.
THE CHAIRMAN: So dividends that are received by Royal Mail --
A. Sorry, sir.
THE CHAIRMAN: Well, this is --
MR BEARD: This is dividends paid by. This is what is so odd about all of this, that essentially you have a construct where the financing losses are being put forward on the basis of a calculation by Mr Earwaker which is related to the dividends being paid by Royal Mail Group Limited. Now, the next round of questions just briefly that I was going to ask Mr Singer

was whether he knew whether or not any dividends were paid by Royal Mail Group Limited, but I am guessing from the answers you have given so far that is not something you have looked at?

A. There have been some dividends paid. I do not know which periods.

Q. Well, we know that there were no dividends paid before 2014, do we not?

A. In the period up to IPO.

Q. So if Mr Earwaker is relying on dividend payments to provide this equity cost, again we have a problem, do we not, from a tax perspective because you are not analysing anything in the period from 1997 to 2013 in relation to any of these issues, you are just taking as read what Mr Earwaker has given you?

A. Yes, we say we have a problem with that. That is dealt with in here if, in the event that this has to be grossed up to a pre-tax number -- that point about that period where there are no dividends or no tax paid, for that matter, is dealt with further down.

Q. So you are saying actually now that the grossing up is the way that you deal with this problem?

A. No. No, I am not. I think I say -- in fact I do say in this report that, because it was presented post tax, we have modelled it on a post-tax basis and not grossed it up. However, if the tribunal determines that in fact it should be presented on a pre-tax basis, then Mr Pritchard and I go on to discuss how that might be done.

Q. Mr Pritchard provides a rather simple example that I do not think you like very much of the concerns that exist with this sort of slightly blithe treatment of equity costs as being just taken at face value from Mr Earwaker's vanilla WACC, which is supposedly, as Mr Ridyard has mentioned again, tax-neutral. He says but you are not then taking into account for the period trading profits that might have existed in relation to those matters or historical trading losses that might have been used to offset those liabilities. You are just ignoring all of that.

A. Would you mind referring me to the --

Q. Yes, of course. I am so sorry. That is not fair. Let me go to it. So it is in his third report. Let me go back because I am moving around my notes slightly. Tab 5 for you and it is {E/IC75} and I think it is probably best to begin at page 32. Sorry, let us start actually at page 30 so we have the context, {E/IC75/30}. Yes, it is his second report. I am sorry, have I given the wrong reference? I have. I am so sorry. It is {E/IC50/30}. Yes, here we are.

A. This is his second report.
Q. Yes, second report, and it is tab 3 in your hard copy bundle. I am so sorry for the ...
A. Which page, please?
Q. So page 30. So he is here dealing with the statement, "All Financing Losses should be included in the tax analysis", and in saying that he is saying all of these financing losses should be passed through the tax model.
You will see, if we go over the page to page 31, {E/IC50/31}, the heading, he is then picking up "The nature of the Claimant's Equity Financing Losses". Then if we go over the page again, {E/IC50/32} -- so he is quoting Mr Earwaker and so on -- to 4.15, he says:
"As described in Mr Earwaker's report, I do not understand the nature of the Claimant's Equity Financing Losses ... that is, the specific additional costs (or foregone income) of the Claimant to which it relates."
So this Mr Pritchard echoing the much broader issue that exists here, which is "What on earth are we talking about in terms of tax treatment?", which I think you understand as being quite a fundamental issue; yes?
A. Yes.
Q. Yes. It is a wry laugh, Mr Singer, but you have my sympathy in relation to this.
Then we go over the page, {E/IC50/33}, "The

Claimant's Equity Financing Losses should be included in the tax analysis".

A. Sorry, which paragraph are you on, please?

Q. I am now going to go to paragraph 4.17. Sorry, I was just giving you some context of the section we are in so that it was not coming -- flying at you from left field. 4.17:

"As I explain above, I understand that there is no suggestion from the Claimant, Mr Earwaker or Mr Singer that the Claimant's Equity Financing Losses relate to some form of cost or income that is exempt from corporation tax. To the extent that the Equity Financing Losses claim represents additional amounts which (on the Claimant's case) would have been available to the Claimant but for the Defendants' actions, it follows that the Claimant's Equity Financing Losses claim would have affected:

"(1) the tax paid (or that would have been paid) historically by the Claimant; and/or

"(2) the tax benefits that it expects to receive in the future."

I think in broad terms you accept those two heads as to what it is this tax exercise needs to scrutinise; correct?

A. Yes, correct.

Q. You are not suggesting that equity financing losses are somehow exempt from tax? That is no part of your analysis, is it?
A. Not that they are exempt from tax, but, as we said before, they are presented as something that is calculated after accounting for tax.
Q. Yes, but I think the points that Mr Pritchard is making and I am putting to you is that, because of the way you have accepted Mr Earwaker's calculation, you just have not, in relation to equity financing losses, considered how they would have affected tax paid or the tax benefits that they expect to receive because you have not put them through your model or Mr -- and you would not put them through Mr Pritchard's model for those purposes, would you?
A. Not as they stand because, if we put them through, given they have already -- they are post tax, they have already been taxed -- as Mr Pritchard said, if we put them through the model, that would amount to double taxation.
Q. Mr Pritchard I think says that, because of the way they have been calculated, they need to be grossed up, but he is not for a moment suggesting that you should not include the equity financing losses in the model in order to look at how they would have affected the tax

paid or the tax benefits that would be received, is he?
A. No, I -- no, well, I am not sure what he is suggesting from there.
Q. Well, he is suggesting here that those are the two criteria that are particularly important to have in mind for a tax analysis, which I think you both agree.
A. Yes.
Q. In order to assess those matters, you need to put it through either your model or Mr Pritchard's model -- we are being agnostic about that for the moment -- and you are saying, "No, no, no, we do not need to do that with equity financing losses because of the way Mr Earwaker has calculated them"?
A. Yes.
Q. I am saying to you that there is not a good basis for that given the way that Mr Earwaker has calculated them, given that they are supposed to be tax-neutral, as he put it, and in going about the exercise in that way you are completely omitting any specific consideration year on year in relation to the claimant's financial and tax position in this assessment, are you not?
A. I do not believe I am because -- and I know I have said this before but I am presented with something that is on a post-tax basis, therefore tax has already been dealt with. It is implicit in there. Tax and other matters,

not just tax.

Q. Just a couple more questions on this. I am sorry. It is going slightly slower than I anticipated. I do not imagine it is going to take vastly longer but I do not know whether now is an appropriate moment to have a short break and then I will --

THE CHAIRMAN: Okay. Is that a convenient time?

MR BEARD: Yes, I think it is a convenient time because I may be able to curtail some of the other questioning I have in the light of what has been said so far.

THE CHAIRMAN: All right. We will have a ten-minute break and, Mr Singer, as you probably know, whilst you are in the witness box you cannot talk to anyone about the case.

A. I do.

(11.39 am)

(A short break)

(The hearing continued in private - see separate transcript)

(1.50 pm)

(In public)

THE CHAIRMAN: Good afternoon.

Good afternoon, Mr Pritchard.

So Mr Pritchard needs to be sworn in.

MR PAUL PRITCHARD (sworn)

THE CHAIRMAN: Thank you very much, Mr Pritchard. Please sit down.

Examination-in-chief by MR BEARD

MR BEARD: Mr Pritchard, good afternoon. You have provided three reports in the course of these proceedings and signed a joint expert statement on tax matters. Is that correct?

A. Yes.

Q. Are those reports and your contribution to that joint expert statement true to the best of your knowledge and belief?

A. Yes.

MR BEARD: Mr Pritchard, I do not have any questions for you. Mr Lask will do. If at any point there is material you want to refer to which might be confidential, then please do indicate that and we will make sure there are arrangements that you can give answers where the livestream in particular is stopped so that it is not available to the general public.

A. Okay, understood.

THE CHAIRMAN: I assume we have gone back into open?

MR BEARD: We have gone back into open, which is why I was just providing that.

THE CHAIRMAN: Yes, thank you. Mr Lask.

MR LASK: Thank you, sir. Just to be clear on that last point, there are some documents I am going to go to which will appear confidential but I have confirmed with those instructing me that the material in them no longer needs to be treated as confidential. If at any point I have got that wrong, no doubt someone will shout at me from behind.

THE CHAIRMAN: So you are not proposing to go to anything that will require us to go into private?

MR LASK: I am not proposing to, but just to warn Mr Pritchard, some of the documents may still have yellow shading on them but I am told they no longer need to be treated in that way.

THE CHAIRMAN: Okay, fine.

Cross-examination by MR LASK

MR LASK: Good afternoon, Mr Pritchard.

A. Good afternoon.

Q. A significant amount of agreement has been reached between you and Mr Singer in relation to the tax modelling; yes?

A. Yes.

Q. What I am going to do is ask you some questions about the two remaining areas of disagreement. The first issue is whether Royal Mail's equity financing losses should be included in the tax modelling and, just for some context -- Mr Beard discussed this with Mr Singer this morning, but just by way of recap, the purpose of

the tax model, at least at the first step, is to reduce Royal Mail's claim by an amount representing the tax saving that it benefitted from as a result of the losses it is said to have suffered; yes?
A. Yes.
Q. That involves identifying the additional tax that would have been payable in the counterfactual as a result of Royal Mail's profits being larger or its losses being smaller; yes?
A. Yes.
Q. Mr Singer's view is that the equity losses should be excluded from the modelling precisely because they had been calculated on a post-tax basis. You understand that to be his view?
A. I understand, yes.
Q. You disagree. Your view is that they should be included in the modelling; yes?
A. Yes.
Q. But you do recognise that, in order to do this, it would first be necessary to convert the figures into a suitable pre-tax loss form; yes?
A. Agreed.
Q. In other words, it would be necessary to gross them up by an amount representing the tax that would have been payable on the equity losses in the counterfactual?

A. Yes.
Q. It is necessary to do that so that they can then be run through the tax model in order to determine a different post-tax quantification for those losses; yes?
A. To determine the incremental tax effects, yes.
Q. Sorry, just to be clear, the ultimate aim, from your perspective, of running the equity losses through the tax model is to produce a different post-tax quantification from the one that has been produced by the financing experts; yes?
A. It is to undertake a -- the model compares the actual tax position with the counterfactual tax position, the counterfactual being if the overcharge had not occurred, and that is the purpose of the model, to compare those two positions and then include that in the overall claim -- into the claim for the damages.
Q. Yes, but if, having grossed up the equity losses and run them through the tax model, you were left with the same figure you started with, it would be a pointless exercise, would it not?
A. If that were the case -- I see your point. However, I think you are referring to part of my report where I am talking about my concern about grossing up financing losses.
Q. Well, yes.

A. Yes.
Q. You have agreed that it is necessary to gross up the losses in order to put them on a pre-tax basis before you put them through the model. What I am just trying to establish with you is whether it is right to think that, once you have done that and then run them through the model, you are ultimately -- at least with your modelling, you are going to end up with a different figure --
A. Yes.
Q. -- because otherwise it would just be a waste of time, would it not?
A. Yes.
Q. Thank you. You are aware that the equity losses have been considered by the financing experts, Mr Earwaker and Mr Delamer; yes?
A. Yes.
Q. Are you aware that there is a disagreement between them as to whether using equity capital to finance an unlawful overcharge involves a cost to the company?
A. Yes.
Q. Mr Earwaker's position in a nutshell is that it does. Mr Delamer says it does not because it does not involve any cash outflow. Do you understand that?
A. Yes.

Q. But on the assumption that Mr Earwaker is right, you are aware that the financing experts have in fact calculated Royal Mail's cost of equity?
A. Yes.
Q. Then they have used that to calculate the weighted average cost of capital?
A. Yes.
Q. Yes. Could we turn, please, to the financing joint expert statement, which is at {E/IC85/3}. I do not know, Mr Pritchard, if you are using a hard copy bundle or the screen. If you are using the hard copy bundle, it will be tab 8 and it will be page 3, I believe. Do you have that?
A. Yes.
Q. Can you see towards the bottom of page 3, issue C, "The weighted average cost of capital ..."?
A. Yes.
Q. Sorry, I am just checking I have the right reference. Yes, if you -- so, yes, this is the weighted average cost of capital and C1, "What is the WACC?", and then you see:

"The WACC is a standard textbook measure ..."

Yes?
A. In this book, yes.
Q. You see that?

A. Yes.
Q. If you turn over the page because C1 continues over the page, {E/IC85/4}, you will see there is a reference there to the formula that is used for calculating the WACC. Then in the middle of that box do you see it says:
"In our reports we both focus on the 'vanilla' WACC, meaning that we calculate the pre-tax cost of debt and the after-tax cost of equity."
Do you see that?
A. Yes.
Q. Do you see that this entry has only one column which means -- which reflects the fact that it is agreed between Mr Earwaker and Mr Delamer? Do you see that? You can also see that from going back to the previous page --
A. No, I can see. I can see in the hard copy.
Q. You see it says "Agreed" in the final column --
A. Yes.
Q. -- so that is their joint position. Then if you carry on to issue C2 on page 4, do you see the issue is "WACC rates"?
A. Sorry, did you say "C4"?
Q. Did I say "C4"? I am so sorry, I meant C2. C2, page 4. Apologies.

A. Yes.
Q. Do you see "WACC rates"?
A. Yes, agreed.
Q. You will see again in the final column it says "Agreed"; yes?
A. Yes.
Q. Then in the middle column:

"We applied slightly differing methodologies in our reports when calculating the Claimant's WACC over the period 1997 to 2022. Given how close our WACC rates are to each other, and to assist the Tribunal by narrowing the issues in dispute between us, we have agreed to adopt Mr Earwaker's WACC rates in Table J1 as agreed vanilla WACC rates."

Do you see that?
A. Yes.
Q. So you see that, assuming that the use of equity does involve a cost to the company, the relevant financing experts have agreed how Royal Mail's equity losses should be calculated and they have agreed the actual calculations; yes?
A. Yes.
Q. In particular they have agreed on post-tax figures for Royal Mail's equity losses; yes?
A. In respect of equity, yes.

Q. Sorry, could you repeat that?
A. In respect of equity, yes, post tax.
Q. I would like to look a little more closely, if I may, with you at how the equity losses were calculated. If we could turn, please, firstly to Mr Delamer's first statement which you should have in tab 9. For Opus, it is {E/16/21}. So again it should be 21 of your bundle as well. It is paragraph 35 I would like you to look at.
A. Yes.
Q. Do you see that is under the heading "Cost of Equity"? This is Mr Delamer's report. He is the expert for DAF on financing losses. He says:

"The cost of equity represents the expected rate of return required by the firm's shareholders. It is often computed through the CAPM [which is the capital asset pricing model], one of the most widely used methods for calculating the cost of capital. In essence, the CAPM postulates that the opportunity cost of equity is equal to the return on risk-free securities plus the beta, representing the company's systematic (non-diversifiable) risk, multiplied by the market price of risk (ie, market risk premium)."

Then he sets out the formula. Are you familiar with that?

A. Yes. Just to qualify, I am not an expert in it but it is part of the training of an accountant to be aware of the CAPM model, so ...

Q. Great. Okay.

A. So I am not an expert on it but I know about those terms.

Q. Thank you. That may make things quicker.

If we could turn next, please, to Mr Earwaker's first statement which you have at tab 10. I would like you to go to page 30. For Opus it is {E/9/30}. What I am going to show you briefly is how Mr Earwaker applied the CAPM methodology to produce the figures that were then ultimately agreed between the experts. So on page 30 -- do you have that?

A. Yes.

Q. -- at paragraph 6.7 he says:

"The CAPM states that it is possible to estimate a firm's cost of equity with reference to three input numbers."

Then he identifies the risk-free rate, which is the level of return investors can earn by investing in a riskless asset; then the expected market return, the level of return investors can expect to earn by investing in a diversified portfolio; then the beta, which reflects the level of risk exhibited by the firm in question relative to an average company. Then he explains what the formula says at 6.9. Do you see that?

A. Yes.

Q. "This formula says that:

"(a) the cost of equity for any company will always be higher than the return that investors can obtain ... by investing in a riskless asset; and

"(b) the amount by which [it] exceeds [that] ... return will be a scaled-up or scaled-down version of ... (... the additional return that equities in general tend to offer over riskless assets) ..."

So one sees that what CAPM enables you to do is calculate the expected rate of return on an investment in a particular company and then that is taken to be the company's cost of equity; yes?

A. Yes.

Q. If we turn next, please, in the same document, to page 34, {E/9/34}, do you see the heading "Risk-free Rate"?

A. Yes.

Q. So this is the first input into the CAPM. Mr Earwaker explains at 6.19 that there is no such thing as a truly risk-free investment. Then, at 6.20, he explains he therefore uses a proxy. In this case he uses Government gilts; yes?

A. Yes.

Q. Then next he goes on to deal with the second input, the "Expected Market Return". This is on page 36, {E/9/36}.

A. Yes.

Q. 6.25 at the bottom of the page, we see he says here:

"The return that investors expected to earn historically from a portfolio of stock market investments is also not something that is observable. Practitioners use a range of approaches to infer investor expectations, including: analysis of historical rates of return; surveys of investors; and modelling of the returns that are implied by share prices and current dividend yields. However, all of these methods are inherently imprecise and the value of the expected market return ... in CAPM is often the subject of considerable debate among experts."

Then he explains at 6.26, {E/9/36}, that rather than do the exercise himself, he relies on extensive analysis carried out by UK economic regulators. What he is aiming to do is identify the rate of return that investors could expect to earn from a diversified portfolio. Do you see that?

A. Yes.

Q. Then at 6.30, over the page, {E/9/38}, he summarises the findings that emerge from the body of work he has

considered. He says at 6.30(a) that regulators have tended to place most weight on historical experience, so historical rates of return; yes?
A. Yes.
Q. Then you see the outcome of all this at 6.38 on page 40, {E/9/40}, where he has table 5, "The expected market return".
A. Yes.
Q. He gives a slightly different figure for each of the three periods. So these rates that he gives in table 5 represent the percentage returns that investors would expect to earn on their investments, so in the form of dividends and capital appreciation. Do you understand that?
A. Yes.
Q. You would agree, presumably, that dividends are typically paid on a pence per share basis?
A. Yes, if that is what is declared.
Q. Yes, and that dividends are paid out of after-tax earnings; yes?
A. Yes.
Q. So when a company is working out how much it can pay by way of dividends, it will assess this by reference to its after-tax earnings; yes?
A. Yes.

Q. Therefore the pool of profits that it bases its assessment on is smaller than it would be if it were looking at pre-tax earnings; yes?
A. Agreed.
Q. All else being equal, the pence per share it can pay out will therefore be smaller than it would be if it was looking at pre-tax earnings; yes?
A. Agreed.
Q. It follows that the rate of return expected by investors is smaller than it would be if this were done on a pre-tax basis; yes?
A. Mathematically, yes.
Q. So the expected market return, this second key input into the CAPM, will reflect the fact that dividends are paid out of after-tax earnings and ultimately it will be a lower percentage figure than it would be if dividends were paid out of pre-tax earnings?
A. Yes.
Q. Yes, if we could turn next, then, to the first key input that Mr Earwaker deals with, the beta. This is on page 41 of the report you are looking at, {E/9/41}.
Do you see paragraph 6.39?
A. Yes.
Q. Mr Earwaker explains here that the beta parameter is intended to capture the riskiness of a particular equity

investment, so in this case Royal Mail. First is the average stock market investment; yes?
A. Yes, when you say "Royal Mail" --
Q. I am going to come on to what you say about that, do not worry. But just as a general approach to the beta --
A. Sure, agreed.
Q. -- that is what the beta is trying to do.
With the second key input, the market rate of return, one is looking at market-wide expectations and then, at the third stage, the beta, one is looking to adjust that by reference to a firm-specific risk adjustment; yes?
A. Yes.
Q. He explains at 6.39 that a company will have a beta of more than 1 if it is riskier than the average or less than 1 if it is less risky.
You see at 6.40 he says:
"A company's beta can be estimated empirically by measuring the extent to which its share price tends to move in tandem with the value of the wider stock market."
Do you see that?
A. Yes.
Q. Then at 6.41 he explains that he has used Royal Mail plc's share prices in order to calculate --

or share price volatility in order to calculate the beta. I appreciate this is one of your concerns, but you will see he sort of pre-empts the concern that you articulate, which is that he is looking at plc rather than Royal Mail Group Limited. He says:

"Royal Mail plc, the ultimate parent company of Royal Mail (the Claimant entity), has been listed on the London stock market since 2013. The business of Royal Mail (the Claimant) has historically been by far the largest business within the Royal Mail plc group of companies."

You will see he has a footnote there illustrating his point. Do you see that, footnote 54?

A. I do. What this is saying to me is that the group has 10 billion, so let us clarify that, the 10,840 million, and that Royal Mail has 7.7 billion, so it is about a 70/30 split between the Royal Mail business and the rest of the group.

Q. Yes. He is saying that the Royal Mail claimant has historically been by far the largest business within the Royal Mail plc group of companies; yes?

A. It is -- it looks like two-thirds of the majority, yes.

Q. By definition, there cannot be a larger one, can there?

A. No.

Q. He goes on to say:

"I am therefore able to use eight years of share price data for Royal Mail plc ... to estimate Royal Mail's beta notwithstanding that [they] are separate corporate entities."

So what he is saying there is that he considers the parent company to be essentially a good proxy for the claimant; yes?

A. I think that is his view.

Q. Yes, and you pick up on this issue in the joint expert statement, where this is one of your -- where you raise this as one of your concerns with what has been done here. But you do not mention the explanation he gives there. Had you seen it when you --

A. I was aware that the beta was computed for the overall group and not for the claimant.

Q. But were you aware that he had considered the sort of concern you were raising and given an explanation as to why he thought it was nevertheless appropriate to rely on plc's figures?

A. I had read this report, so yes.

Q. So you were aware of that?

A. Yes.

Q. Okay, and you were aware, as I have said, and you have indicated you understand, that these are all inputs into a set of figures that had been agreed between the financing experts?

A. Yes.

THE CHAIRMAN: Did Mr Delamer agree the calculation of the beta then? I suppose it is implicit in his acceptance of the --

MR LASK: He agreed everything. There was -- at an earlier stage in the process between the financing experts he produced his own beta calculations which I -- I am not sure I -- I should be able to show them.

THE CHAIRMAN: Do not worry.

MR LASK: Anyway, the point is --

THE CHAIRMAN: They agree the ultimate figure?

MR LASK: Yes, but even during the process the beta figures were broadly similar, which no doubt explains why he ultimately felt able to agree the overall figures.

MR BEARD: I am sure Mr Lask will refer to it at some point, but all the agreements obviously in relation to the WACC rate that Mr Delamer put forward in the alternative -- obviously he put the primary position on WACC -- were setting aside the tax aspects underlying Mr Earwaker's analysis and he made a specific caveat in that regard, but I am sure Mr Lask was not trying to traverse that.

MR LASK: No, absolutely not. I think it is clear that neither of the financing experts have purported to explicitly analyse Royal Mail's tax position. That is not intended to be suggested.

If you look, please, at paragraph 6.42 of Mr Earwaker's statement, {E/9/42}, where he says that he believes the sort of analysis he has considered is uncontroversial. I am not suggesting he is referring there to the use of plc's figures as a proxy, but generally his approach to the beta he considered to be uncontroversial.

Then at 6.43 you see the outcome, you see the calculation, which shows that the beta -- it shows that Royal Mail is a slightly less risky investment than the average; yes?

A. If that is the outcome.

Q. Yes.

A. Yes. Just to add, the number in 6.43, it is then rounded to 0.8 in paragraph 6.44.

Q. Yes, thank you.

A. Good.

Q. If you look then at 6.47 and 6.48, {E/9/43}, Mr Earwaker here deals with another of your concerns, which is that the beta has been calculated only on the basis of the post-2013 share price. Do you remember expressing that as a concern in the joint statement?

A. In the tax joint statement, yes.

Q. In your tax joint statement, yes.

A. Yes.
Q. Do you want to take a moment to read 6.47 and 6.48?
(Pause)
A. Okay.
Q. So you see at 6.47 he expresses the view that he thinks that the data he has been able to use is a reasonable proxy for the riskiness of Royal Mail pre-privatisation; yes? Do you see that in the second sentence of 6.47?
A. Okay.
Q. Then at 6.48 you see that he cross-checked this against some analysis produced by Postcomm for the pre-2013 period and he found that his beta was broadly in line with the analysis of Postcomm. Do you see that?
A. Yes.
Q. So had you read these paragraphs when you articulated your concerns in the joint expert statement?
A. My concern with the --
Q. Sorry, could you just answer the question first and then explain, please?
A. Yes. I read this report quite a while ago. This is the first Earwaker report.
Q. Yes.
A. Yes. So I have read this a while ago.
Q. I see. Sorry, you wanted to say something.
A. With tax it is very -- it can be very complex and

detailed and the claimant had a very complicated tax position. The claimant's group has the two components, it has Royal Mail and GLS, so I still had concerns from a tax perspective about how these amounts were determined. But I think what you are saying is the consensus view is nobody else has any concerns from a non-tax perspective.

Q. That is what I am putting to you and I think you recognise that at least.

A. Yes.

Q. You did not -- when you were articulating your concerns in the joint expert statement, you did not mention that, at least from a non-tax perspective, they had been addressed by Mr Earwaker?

A. No, I did not.

Q. So what we see from the explanation of the beta is that it captures the level of risk involved in investing in the specific company in question, in this case Royal Mail. I am going to keep saying "Royal Mail" with the caveat that, you know, you have this concern about the distinction between the two --

A. Understood.

Q. -- which I will not keep coming back to. But that is what the beta is trying to do; yes?

A. Yes.

Q. It is doing that based on the company's share price volatility; yes?
A. Yes.
Q. Then that risk, as we have seen, is then used to adjust the expected market rate of return either upwards or downwards to produce a company-specific rate of return; yes?
A. Yes, that is what the formula does.
Q. That is what is going on. You would accept, presumably, as Mr Singer said in his evidence this morning, that share price volatility may reflect a company's tax position amongst other things; yes?
A. It is a cost on the company, so it affects returns --
Q. So tax is a cost on the company, is that what you mean?
A. Tax is a cost in the company, yes, so it is deducted in arriving at profit after tax, the earnings number, which is then the returns.
Q. Just to be clear, I think you are accepting --
A. Yes.
Q. -- that as a first step a company's tax position can affect its share price?
A. Yes.
Q. Yes, and it can therefore be reflected in the sort of share price analysis that is being carried out for the purposes of the beta; yes?

A. In theory, yes.

Q. Thank you. If we could go next, please, to paragraph 6.63 of this statement on page 49, {E/9/49}. Just for context you may want to look at 6.62 first, which Mr Beard took Mr Singer to this morning. You will see that is where Mr Earwaker says he assumes that tax does not exist; yes?

A. Yes.

Q. Then he says at 6.63 -- this is Mr Earwaker:

"I can arrive at vanilla WACC figures by undertaking my calculations using pre-tax debt rates (despite interest charges being tax deductible) and post-tax equity returns (since firms pay out dividends out of after-tax earnings) as the main inputs (together with the gearing ratio)."

You accepted -- you agreed with me before that dividends were paid out of after-tax earnings and that therefore an analysis of equity losses or of investor expectation as reflecting the cost of equity is likely to produce a lower figure -- ultimately, a lower percentage figure -- than it would be if dividends were paid out of pre-tax earnings. Do you remember that?

A. Yes.

Q. Then if we look -- if we turn to another document, please --

A. Just to note down -- obviously Mr Earwaker says it at 6.62 -- it makes no allowance for Royal Mail's corporation tax payments; okay? That is in 6.62.

Q. Yes.

A. Just to clarify, from an accounting perspective, the tax charge in the accounts is not always the cash payment; okay? So in the accounting world, the tax charge that is accounted for, it is a mixture of something called -- it is a combination of current tax and deferred tax, and you probably heard Mr Singer refer to deferred tax; okay? Current tax -- the way to think about current tax is the tax liability with HMRC. So if you pick up a tax return and it has profits, statutory rate and the tax liability to HMRC, that is current tax; okay?

Accountants -- because we like to make things complicated, accountants say, "Oh, because there is a different allocation of accounting profits, of profits on economic transaction for accounting purposes and in the tax return, you end up with a different set of -- a different computation of profit in a tax return to in the accounts", and so the accountants compensate for that with something called "deferred tax", and deferred tax is actually a complex area of tax accounting; okay?

So the reason I am drawing this up, this distinction, is because if one looks in the profit and loss account and we have revenue, costs, operating profit, financing, deductions, and we arrive at profit before tax, the tax charge that then goes in the accounts is not the cash charge. It is a combination of current tax and deferred tax and that then produces the profit after tax; okay?

This is quite an important concept because the accounting rules for deferred tax, it is the future tax effects, and some of the tax charges that are booked in the tax line are required to be booked by accounting rules, so Royal Mail would have no way of not booking certain tax effects; okay? But they are future tax effects and if you have -- say, your pension fund is on the balance sheet and it is an asset, you would book a tax charge for the fact that that pension fund asset increased in value. At some point you may pay tax on that in the future. So there is tax charge associated with that. That is just an example I am giving.

Also, if you have losses, tax losses, then if they can -- you can demonstrate that those could be used in the future, that future tax saving can be booked as an asset today, so you could have a deferred tax asset on the balance sheet, and to recognise deferred tax asset, it is debit balance sheet, credit, income statement, credit in the tax charge.

So the tax charge -- there is a lot of other matters being undertaken in the tax charge. It is not just the cash payment to HMRC; okay? So if you are looking at a set of accounts -- if a person looks at a set of accounts, looks at profit after tax, which then becomes the earnings number, the tax charge can sometimes be -- it may not make sense because it may not align with the cash position -- well, there can be different effects and I just want to point that out because it is quite a critical point in terms of if you are looking at earnings, profit after tax. It is not profit after a cash payment in a tax return, cash liability. It is because of the accounting effects and it is quite a complex area because accountants have to compare the balance sheet with the tax return and undertake a detailed analysis.

So I just wanted to draw that out because Mr Earwaker talks about tax payments and not the tax charge in the accounts.

Q. Yes, I see. What he is saying -- he is saying that the WACC that he has calculated makes no allowance for Royal Mail's corporation tax payments. I do not think you are suggesting that it does make allowance for the other side of the analysis that you were just describing, the deferred tax issue?

A. This point resonated with me when I read the report because it was evident to me it is not tax payments, it is the tax charge in the accounts, which is different. So when I read this, I just -- I noted it did not quite make sense to me.

Q. Right, but if he was saying, "I have calculated the WACC and I have made full allowance for Royal Mail's corporation tax payments", then presumably your response would be, "Ah, well, that is not telling the full story"; yes?

A. Well, that involves knowing what the payments are.

Q. Yes, but he is not saying that he has made allowance for the payments. You see that. He is saying he has not.

A. I think -- okay, carry on.

Q. The point is you have made this criticism -- you have made a criticism in the joint statement where you say, "Well, I do not think that the post-tax equity losses calculated by the financing experts take account of Royal Mail's specific tax position"; yes?

A. Yes.

Q. 6.62 is consistent with that and Mr Earwaker is not purporting to have analysed Royal Mail's specific tax position, is he?

A. Well, if we go back -- can we go back to the formula for the vanilla WACC?

Q. To the formula?
A. Yes. There is a formula for the vanilla WACC, is there not?
Q. I think it is in the joint statement.
A. That is 6.60 in Mr Earwaker -- is it Mr Earwaker --
Q. Yes, on page 47, {E/9/47}.
A. So in 6.60 where he states, "Weighted average cost of capital equals g x cost of debt + (1 minus g) x cost of equity", what he is saying is for cost of debt he has not assumed a tax deduction because the formula for cost of debt -- I did say at the start it is part of the training for accountants, so I am not an expert on how you work out WACC but if I see this formula, the cost of debt would be 1 minus t times the interest rate because it is normally -- when you compute a WACC, there is normally a tax saving associated with the cost of debt.
Q. Yes.
A. So what he is saying is he set t to zero in this formula. So you have a vanilla WACC, which is a combination of a pre-tax debt return and a post-tax equity return. It is a bit of an odd beast because it is --
Q. Yes.
A. Yes, okay.
Q. But we are only concerned for present purposes with the

equity component of the WACC, are we not?
A. Yes.
THE CHAIRMAN: Again, that approach, using pre-tax cost of debt and post-tax cost of equity has been agreed by Mr Delamer --
A. Yes.
THE CHAIRMAN: -- that approach to the WACC. Right.
MR LASK: Yes, that is indeed what I was going to come on to, which is Mr Delamer's third report. You have it at tab 11.
THE CHAIRMAN: Could I also, just while we are here -- footnote 61, {E/9/49}, I noticed he says:

"For the avoidance of doubt, this does not involve me undertaking any tax analysis in respect of Royal Mail's actual tax position."

So does that confirm what you were saying?
A. That is part of the concern, is that is this a general analysis but has not taken into account, as you say, the specific position of Royal Mail's tax position?
THE CHAIRMAN: Yes, which could be very different to what the accounts show.
A. Yes.
THE CHAIRMAN: Well, will be.
A. Yes, the cash tax position might be different.
MR LASK: Yes. Just to summarise, one, if not your

principal, concern with relying on the experts' post-tax equity losses, taking them at face value, is that, as Mr Earwaker says at footnote 61, they do not purport to reflect an assessment of Royal Mail's particular tax characteristics; yes?

A. Yes.

Q. But you would accept, I think, that what they have calculated is the return that investors would expect on post-tax earnings adjusted to reflect Royal Mail's specific position insofar as the CAPM analysis allows it?

A. I think that is reasonable.

Q. You also accepted that Royal Mail's tax position would at least in principle affect its share prices and that that will therefore be picked up by the beta -- I appreciate at a rather general level, but in principle?

A. I do not think I can comment on the beta because that is quite a complicated thing to calculate.

Q. No, but you accepted a few moments ago, did you not, that Royal Mail's tax position may affect its share prices and the beta --

A. I did.

Q. -- measures share price volatility and therefore, at least in principle, that may reflect at a broad level

the tax position?
A. Agreed, yes.
Q. Thank you. Sorry, we were going to go to Mr Delamer's third statement. You have it at tab 11, page 52. The Opus reference is {E/72/52}. This is really just to confirm what we have been discussing, which is at paragraph 71. This is in the context of an analysis that Mr Delamer is carrying out comparing the WACC against Royal Mail's returns. I do not need to take you to that. It is really just what he says at 71(c), where he refers to:

"The average vanilla WACC estimated by Mr Earwaker ... (which is a hybrid of pre- and post-tax elements)."

I think you used those words yourself a moment ago.
A. Yes.
Q. Just to draw these strands together, the financing experts are agreed that the equity loss component of the WACC is post tax; yes?
A. Yes.
Q. It is post tax because it is based on the return that shareholders would expect to receive from Royal Mail after Royal Mail had paid tax on its profits; yes?
A. Yes.
Q. Therefore it is lower than it would otherwise be; yes?
A. Yes.

Q. Now, at the time of your second report, you said you did not understand the nature of Royal Mail's equity losses, but now that I have taken you through the analyses and shown you how they were calculated, would you agree that your proposed approach of grossing up the losses is simply unnecessary?

A. I think they -- so the nature of those losses from a tax perspective.

Q. I see.

A. So the loss is being computed by the financing experts but from a tax perspective the question in my mind is, because tax is complicated and not every -- what is that income? Royal Mail had a very complex tax position because for many years it made losses or it had the ability to shelter taxable income with losses or reliefs. So the question is: what was this income? What did it actually represent? Because certain types of income can be exempt. Dividends. If a UK company receives a dividend, there is a dividend exemption. If it is trading income, then it is taxable as trading income. But the question is: what type of income was this loss so it could be treated in the tax calculation? That is the point.

Q. I am going to come on to discuss the second issue in dispute, which is if you are going to gross up, how

do you gross up.
A. Sure.
Q. I think it is right to say, is it not, that at that stage of the analysis you treat the equity losses as if they were taxable trading profits; yes?
A. Yes.
Q. But the point I am putting to you now is that, given the agreement between the financing experts that these equity losses have been calculated on a post-tax basis, is it not simply unnecessary to go on to that second stage of grossing them up?
A. No, I do not agree.
Q. Can we go then to your second report which you have at tab 4? If you turn to page 34, please -- sorry, for Opus, this is {E/50/34}.
A. Which page?
Q. Page 34, tab 4.
A. Thank you.
Q. Do you see paragraph 4.24?

"To include the Equity Financing Losses ... in the tax model, it is necessary for them to be expressed in pre-tax terms. As I explain above ... I do not know the precise nature ... that he purports to quantify. On this basis, it is not possible to determine how the purported post-tax Equity ... Losses should be adjusted to reflect their pre-tax equivalent figures."

So that is at an earlier stage, but you are recognising there, are you not, that it is a potentially complicated process in order to do this grossing up?

A. Yes.

Q. Then you say at 4.27, {E/50/35}:

"I recognise that the vanilla WACC as determined by Mr Earwaker is stated to incorporate the post-tax cost of equity, and that my alternative tax model calculates the tax effects in relation to these amounts. Therefore, any Equity Financing Losses are potentially 'taxed twice' in my alternative tax model and the Claimant's losses may be understated as a result. If the Claimant or its experts are able to clarify the appropriate pre-tax figures ... then I can update my analysis accordingly."

So at that stage it is being taxed twice in your model because you have not been able to perform the grossing-up analysis?

A. Agreed.

Q. So just to recap, the grossing up, in order to avoid taxing twice, you would need to gross up the losses by an amount reflecting the tax that would have been payable on these amounts if they had been available to Royal Mail in the counterfactual; yes?

A. Yes, it needs to be grossed up so it can be put into -- it needs to be grossed up to a taxable amount so it can go into the tax calculation.
Q. So it can then be taken off again; yes?
A. Then it can go to the tax model, and I think the examples at 4.2 and 4.21 show -- illustrate that point.
Q. But you would accept, would you not, that performing that conversion adds a whole further level of complexity to the tax modelling exercise, does it not?
A. It is an input in the model. I do not think it creates complexity. The question is this so-called post-tax financing loss needs to be included in the tax calculation so it needs to be updated for the tax effect and then it is put into the model.
Q. Well, that is your view, is it not, but it is not Mr Singer's. Your view is that it needs to be grossed up so it can be put through the model. But the point I am making is that that grossing up in itself gives rise to a range of further issues between you and Mr Singer. It gives rise to a further debate and therefore a further level of complexity in the exercise?
A. Agreed. There is a disagreement on -- this is the disagreement we have.
Q. So would it not be much better, much more straightforward, to accept the financing experts'

figures rather than unravel and reconstruct them, as you want to do?

A. The examples at 4.2 and 4.21, I would just like to explain those so you can understand what those are about. If you assume that the post-tax amount which is being determined is, let us say, £100, the point I was illustrating is that Royal Mail had a complicated tax history because it had -- it made losses in many years and, although you can look at a post-tax result, so a profit after tax amount, if you try and convert that back into a profit before tax amount, the quantum of the financing loss can change.

So the two examples show the situation where, if Royal Mail paid cash tax on its profits, so it had a profit after tax of £100, if it -- if the tax rate were 19% -- so this is the example in company A -- then it would have to be grossed up, so it would be divided by 1 minus 0.19, so it would become a pre-tax financing loss, a pre-tax loss of £123; okay? Whereas if it had tax losses to shelter the income, it would have a profit after tax of £100 but the pre-tax amount would be different. It would be £100. So depending on its actual tax position, there is different -- this is about the grossing-up point.

This is why it becomes relevant, because you have to work out for the tax model what was the pre-tax amount and that can be difficult to -- that is the relevance of this because the way the tax model is working, it has been agreed between the experts that we will model the tax position each period in the counterfactual analysis and we will measure at the end, at the valuation date, what tax attributes are remaining because Royal Mail itself has tax losses and it has a tax depreciation in the form of capital allowances, and the use of those losses and allowances needs to be measured because it was agreed between the experts that, at the valuation date, in the actual position there will be more losses, allowances and reliefs than in the counterfactual world. So those need to be valued and a tax benefit put on -- that future benefit needs to be quantified and then included in the overall claim because there is a tax benefit to Royal Mail in the actual position versus the counterfactual if there has been an alleged overcharge and that needs to be measured.

In order to measure that, you have to model each tax period, but because tax losses and reliefs flow from one period to the next, then you have to model every tax period and know exactly in the model what is going on, what is the extra income, and it is relevant to what is the extra income that goes into the tax position.

The issue -- the sort of mathematical question is, if you had an after-tax result and there was no -- £100 of profit after tax but there was no cash liability on that because there was losses to shelter it, your pre-tax position is £100, whereas if you had to pay tax on the £100, you have a higher -- your starting point is £123. So these examples are to show the difference -- that there is a different starting point if you convert back the pre-tax -- the post-tax amount to a pre-tax amount.

Q. Thank you, Mr Pritchard. Let me put the point to you this way, if I may: given the obvious complexity in grossing up post-tax equity losses to convert them into pre-tax equity losses and given that the financing experts have agreed these figures and have agreed that the equity losses are post tax, it is at least a reasonable position, is it not, for Mr Singer to take to say that this whole exercise is unnecessary?

A. I do not agree with that.

Q. I know you do not agree, but it is at least a reasonable position; would you agree with that?

A. As a tax practitioner -- and tax is complicated. You know, it always depends. In this situation, with Royal Mail's tax position being very complicated because it was not -- it did not consistently have taxable profits in the actual position and pay tax on those profits, you know, for the 25 or whatever -- 26 years -- that did not happen. There was a lot of volatility, shall we say, in its tax position. It made profits at the start, and that was period 1. Then it went through turbulence in the second period, with losses in profit and the restructuring. Then it came out of it in period 3 with an IPO.

Q. It is a complex picture.

A. Indeed, and there are concerns about just accepting a post-tax result, a post-tax number and then saying, "That is fine".

Q. Well, I have put the point to you. I put the point that it is unnecessary to go to that second stage and that Mr Singer's view to that effect is at least a reasonable one.

A. It is an area we disagree on, and that is E1 in the joint statement.

Q. That is understood. Thank you.

Let us move on then to the grossing-up issue. If we assume for the sake of argument that these equity losses should be converted into pre-tax figures, then, as you said, they need to be grossed up and it then becomes necessary, does it not, to decide on the method and rate by which they are grossed up; yes?

A. Yes.

Q. Unfortunately this gives rise to another area of disagreement between you and Mr Singer; yes?

A. Yes -- only regarding the third phase, yes.

Q. Yes, and as I have put to you, it is a further level of complexity. Could we turn, please, to the joint tax expert statement, please, which you have at tab 7. Issue E3, page 26. For Opus, it is {E/IC86/26}. I think at the very least it is helpful to have this open, even if what I am putting to you is well understood probably by everyone now, given this morning's session.

You and Mr Singer agree, do you not, that it is reasonable to distinguish between three distinct sub-periods; yes?

A. Yes.

Q. Those periods are 1996 to 2000, 2000 to 2013 and 2013 onwards; yes?

A. Yes.

Q. But you disagree on how to identify the appropriate tax rate by which to gross up the equity losses; yes?

A. Yes.

Q. Mr Singer says that it is reasonable to use a statutory rate of corporation tax, but you say, "No, one should identify Royal Mail's effective tax rate for each period"; yes?

A. Yes.

Q. Then one sees from page 27, {E/IC86/27}, of the joint statement --

A. Sorry, the second period it was -- we both agreed zero.

Q. Yes, I was going to take you to that --

A. Sorry.

Q. -- to actually where you come out in relation to each period. That is why I am taking you to page 27.

You will see that your respective approaches result in a relatively small difference for the first period, no difference for the second period because you both say zero and a significant difference for the third period -- yes?

A. Yes.

Q. -- because for the third period -- I am sorry, I think you have to also look at page 28, {E/IC86/28}, to see Mr Singer's position. But for the third period you say use the effective rate of 11.9 and Mr Singer says use a statutory rate of between 19 and 23.01; yes?

A. Yes.

Q. You do not say, do you, that Mr Singer has somehow identified the statutory rate incorrectly, do you?

A. No. The statutory rate is the statutory rate.

Q. It would be pretty hard to get it wrong, would it not?

A. Well, there is only one rate.
Q. Exactly. It is objective and readily ascertainable, is it not?
A. Yes.
Q. Yes, but you nevertheless prefer to use the effective tax rate, and we can see the explanation you give in relation to the third period on page 28 of the joint statement, {E/IC86/28}, and you say:

"Mr Pritchard does not agree with Mr Singer's reasoning for the 2013/14 onwards period. This is because the Claimant's effective tax rate during this period is significantly lower than the statutory tax rate. This is because, although the Claimant had £160.8 [million] of trading losses extinguished at the end of 2012/13, by the end of 2013/14 the Claimant had carried forward trading losses of £521 [million] and a capital allowance main pool value in excess of £2 billion. These losses and reliefs significantly reduced the cash taxes that the Claimant paid during this period (and hence the Claimant's effective current tax rate ...). The carried forward trading loss figure of £521 [million] is greater than the carried forward trading loss figure for 11 of the 13 years during the ..."

I think that is the second period.

A. Yes.

Q. ... for which Mr Singer considers a gross-up tax rate of nil ... is appropriate. As at 28 March 2020, the Claimant still has carried forward trading losses in excess of £200 [million]. For these reasons, Mr Pritchard considers that Mr Singer's proposed assumption with respect to [this] period ... onwards is inappropriate and will overestimate the Claimant's losses."

So I think it is fair to say that you are dealing there with the complexities, are you, of Royal Mail's tax position?

A. Yes.

Q. Your core concern is that the statutory rate is too high compared to the effective tax rate?

A. Yes, because Royal Mail has tax losses and capital allowances.

Q. Yes.

A. So the cash tax liability is very low in the phase 3 period. So post IPO, Royal Mail had tax losses and a large amount of capital allowances. So as it became profitable again and it was creating economic profits, it had tax attributes, these losses or allowances, to deduct against those profits. So its cash payments are very low in that period, it is zero for many years and then it increases.

Q. Yes. So it has got these losses it can use to set off its new-found profits?

A. Yes.

Q. I think what you are saying is that you have to take all of that into account. You have to take the cash tax payable, you have to take the loss utilisation -- you have to take it all into account in calculating the effective tax rate; yes?

A. It is relevant to the consideration of the tax rate for that period.

Q. Yes. Your basic rationale for grossing up these losses and running them through the tax model is that, if these funds had been available to Royal Mail in the counterfactual, they would have been subject to corporation tax; yes?

A. Yes.

Q. So rather than use a statutory rate, you prefer to try and identify the actual rate that Royal Mail would have had to pay on those sums in the counterfactual; yes?

A. Well, yes.

Q. I think you agreed earlier that your -- I think both you and Mr Singer proceed at this stage of the analysis -- you proceed on the basis that the equity losses should be treated as taxable profits; yes?

A. Yes.
Q. Could we go, please, to table 1 in the joint statement? So same document and it is {E/IC86/44}. Do you have that? Do you have that, Mr Singer -- sorry, Mr Pritchard. I do apologise.
A. Yes. No, that is fine.
Q. I am not focusing on the figures for present purposes but really just opening this up so that one can see the calculation behind your effective tax rate. It is pretty straightforward, I think, the actual arithmetic, in that what you do is you derive the tax charge in your third column and the profit figures in the second column, you derive those from Royal Mail's accounts; yes?
A. Yes.
Q. Then you divide the tax charge by the profit before tax to produce the effective tax rate?
A. Yes.
Q. Yes, so once you have settled on an approach, the arithmetic is straightforward.
    If we go, please, to the BCLP letter of 10 June, please. You have it at tab 15 and it is in the Opus at {J4/IC446}.
A. Tab 15?
Q. I think it should be at your tab 15, yes. Do you see

that?

A. Yes.

Q. Do you recognise this letter? Have you seen it before?

A. This is the one that came in late over the weekend.

Q. On Friday, yes.

A. I have seen it.

Q. You have, thank you.

A. I have not had time to fully consider it though; okay?

Q. All right. Fair enough.

Could we scroll down, please, to paragraph 12, {J4/IC446/2}?

A. Yes.

Q. You see:

"Mr Singer notes that, as set out E3 of the Tax [joint statement], if it is necessary to gross-up the post-tax cost of equity for the accounting periods March 20 ..."

I think that might --

A. I think it is supposed to be --

Q. 2014 onwards, yes.

A. Yes.

Q. "... Mr Singer considers that this should be done by reference to the statutory rate of corporation tax, whereas Mr Pritchard considers that this should be done by reference to the average effective rate of corporation tax for [the period]."

Then paragraph 13:

"Mr Singer remains of the view that the correct rate for any such gross-up of the post-tax cost of equity of this period remains the statutory rate of corporation tax. However, he has sought to test this view by comparing this to the effective tax rate suffered by Royal Mail in respect of its taxable profits. Mr Singer considers that this rate -- rather than the headline effective tax rate suffered by Royal Mail -- is the correct rate to use for comparison because (as Mr Pritchard says at E1 of the Tax [joint statement]), there is no suggestion that the Equity Financing Losses relate to some [if we could scroll on, please] form of cost or income that is exempt from corporation tax. Indeed, both experts' models treat pre-tax Equity Trading Losses as taxable trading income. As such, the headline effective tax rate, which is depressed as a result of the recognition of non-taxable income by the Claimant, does not accurately reflect the tax burden that would be suffered by the Claimant on receipt of taxable income of the type which the Equity Financing Losses are intended to represent."

So you see there that Mr Singer is disagreeing with your approach to calculating the effective tax rate;

yes?

A. Yes.

Q. If we turn, please, to the calculations that he produced alongside this letter. You have them at, I hope, tab 15.1. On Opus, they are at {E/IC95}.

THE EPE OPERATOR: Would you like both screens?

MR LASK: I do not think it is necessary. Just the calculations are fine, thank you.

I think we saw this tab earlier when Mr Beard was cross-examining Mr Singer, but if we can go to the second tab, please, "Adjusted tax charge calculation", if we can make it a tiny bit smaller so we can see a bit more of the page. Yes, thank you. That should do, I think. We can always zoom in if we need to.

I appreciate you have not had a chance to fully consider this material but have you seen this document before?

A. I have seen this, yes.

Q. What this does is it sets out Mr Singer's own effective tax rate calculations. Like you, he uses the figures from the accounts, as he confirmed this morning, but he splits out adjustments for taxable profits from adjustments for non-taxable profits.

Just for the tribunal's benefit, what is going on here is that one starts in the top two lines, lines 6 and 7, one sees "Profit before tanks" and "Tax at [corporation tax] rate".

MR BEARD: I am slightly concerned. This is material that was put in late. It is not for Mr Lask to give evidence as to what is going on. He can put questions to Mr Pritchard on it if he wants, but --

MR LASK: I was not intending to give evidence. I was just seeking to explain what the spreadsheet is telling us.

THE CHAIRMAN: Yes, I do not think there is anything wrong with that.

MR LASK: Of all the expert issues on which I am unqualified to give evidence, tax is probably top of the list.

THE CHAIRMAN: We will take that into account!

A. I would agree!

MR LASK: What one sees in line 6 is "Profit before tax" and then below that, line 7, "Tax at [corporation tax] rate". So, as I understand it -- you can tell me if you disagree, Mr Pritchard -- as I understand it, what is happening here is that it is starting with an assumption that the profit before tax is all taxable at the statutory rate, and that is what one sees in the line 7 figure. Would you agree with that?

A. No.

Q. No?

A. No. What this statement is, it is called a "tax reconciliation", and accounting rules require that in a set of statutory accounts the total tax charge can be explained by reference to what would have been the statutory tax rate; okay? So I explained earlier about current tax and deferred tax and we have got future consequences and we have got the cash consequence, the current tax. So what goes on in the accounts is that bottom line there, row 28, that is the tax charge, so that will be the number in the accounts which will see profit before tax, tax, profit after tax; okay?

Now, a user of accounts will pick it up and will say, "Oh, why do we have this tax charge? Oh, well, let us start off and perform a reconciliation". So there is a reconciliation performed where you take the profit before tax and multiply it by the statutory rate and then you explain all the movements between the tax charge and the theoretical statutory charge -- all the movements are explained as reconciling items.

THE CHAIRMAN: The question to you was just whether that was -- it was being taxed at the statutory charge rate.

A. Sorry, it is not --

MR LASK: I think you actually confirmed what I was intending to say and it was not intended to be controversial. I think what you just said is that -- I cannot quite see the transcript from here, but all

I was seeking to explain at the outset was that the figure in line 7, "Tax at CT rate", is the tax charge that would arise if one assumed that everything in the row above it was taxable at the statutory rate.

A. Correct.

Q. Brilliant. Thank you.

A. It is a hypothetical charge.

Q. Yes, I was just trying to sort of set the scene and then briefly work through the table so we can all understand what is going on.

So you see that in the first two lines. Then what follows are various adjustments or reconciliations; yes? What those adjustments do -- so we are looking now at lines 10 to 18 and then 21 to 25 -- is they identify items that either increase or decrease the effective tax charge from that starting assumption; is that fair?

A. These are the reconciling items to explain the hypothetical tax charge to the accounting tax charge.

Q. Yes, so they explain how you get from the figure in line 7 -- at the moment I am not distinguishing between the two columns, but just generally, taking the first column which I think reflects your approach, the adjustments explain how one gets from the figure in line 7 to the figure in line 28, do they not?

A. They are what the company presents as its version of the

adjustments.
Q. Okay.
A. So I have received the schedule but -- I have looked through it, but the issue I have is I cannot prove back all of these line items back to the underlying information because -- and this is because the information that was disclosed were the tax returns with the statutory accounts. So this is information within the statutory accounts which has been aggregated and Mr Singer and his team have sought to look in the accounts at the aggregated disclosures and then try and work out what the nature of the adjustments are to determine the tax charge in this approach, but none of them have been confirmed or verified. So I can see what he is seeking to do.
Q. Yes, that is entirely fair and I can make clear now that I am not going to be asking you to agree these figures.
A. No, that is fine --
Q. I appreciate you have not had a sufficient opportunity to consider them. DAF's solicitors have made clear in correspondence that you do not accept these figures so I am not trying to get you to accept them --
A. No, no, no.
Q. -- but, rather, deal with it at a level of principle. But in order to do that, I would still like just to be

sure that we are all on the same page when it comes to understanding what is going on in this table.

So I was suggesting that the various lines that are not in bold, the adjustments, help one to understand how one gets from the figure in line 7 to the figure in line 28. Just to take an example, if one looks -- for the 2016 set of figures, if one looks in line 10, one sees "Expenditure disallowable for tax" and a figure of 8 million. Do you see that?

A. Yes.

Q. So that is identifying that the tax charge increases by 8 million, the effective tax charge when one factors in expenditure that cannot be offset against tax; is that correct?

A. Yes. There is a negative but it increases -- the signed convention, just to understand, is the profit is positive, the tax at the CT rate is negative, but that represents a charge, so we start at 20 and then we have disallowable expenditure which increases the 20 -- increases the tax charge by 8. The ones that are positive are the good numbers and the ones that are negative are the bad numbers.

Q. Yes. So it starts at 20, it goes up by 8, then down by 7, then up by 3; is that right?

A. Yes.

Q. Then down by 2?
A. Yes.
Q. Then, just looking in the bottom half of the table, one sees a figure for non-taxable dividend received, a figure of 16 million, and that line identifies that the effective tax charge decreases by 16 million when one factors in --
A. Agreed.
Q. -- that the total profit before tax figure includes a non-taxable dividend?
A. Yes.
Q. So that is what is going on.

So we have these various adjustments and it is right to say, is it not, that the effective tax charge comprises both the tax paid to HMRC and the costs incurred in using up tax losses; yes? That is all reflected in the charge?
A. The tax charge is the total of the current tax and the deferred tax. So if we could open up the statutory accounts, we could see the statement in the statutory accounts and then there is other disclosures which would tell you the current tax and the deferred tax element because this is a reconciliation. It is not -- it is a note added to the accounts rather than being part of the accounts. It is a note to explain to the user of

the accounts.

Q. Well, I can give you a reference to where the 2016 figures come from in the accounts if that would be helpful --

A. No, no, that is fine.

Q. No. All right. So back to this spreadsheet, we have two columns for each year. It does not really matter which year, but if we just take 2016 as an example, and the first column shows us the total effective tax charge, does it not? So if one looks at 2016, line 28, one sees a figure of 6 million. That is the total effective tax charge reflecting the tax consequences of all of Royal Mail's profits, not just its taxable profits?

A. That is the -- yes, that is the current and deferred tax.

Q. Yes.

A. The total.

Q. So it represents Royal Mail's overall tax burden for a given year rather than its tax burden on its taxable profits only?

A. It depends how you define "burden". If burden is viewed as a tax payment, that is not the tax payment.

Q. No, its overall burden, so taking account of tax payments and losses or deferred losses.

A. Well, there is a lot of -- there must be a lot of deferred tax in this year because -- I am looking at the joint expert statement. So for 2016 --
Q. Is this table 1 you are looking at?
A. Table 1b, because it has the current tax charge. It is zero.
Q. Yes.
A. I think 2016 is a year when there are tax losses available which can fully shelter the profits chargeable to corporation tax, so there was actually zero cash tax paid.
Q. But that is why you end up -- in your table 1 of the joint statement, you end up with the 6 million figure as your effective tax charge for 2016?
A. Effective accounting tax charge, yes.
Q. Yes, because focusing only on cash tax is only half the story; yes? You have to look at the whole picture; is that fair?
A. It is worth looking at all -- understanding all the elements of the tax position.
Q. Yes.
A. Yes.
Q. But you are not saying that the effective tax charge for 2016 is zero; you are saying it is 6?
A. It is 6 because it includes other effects, yes.

Q. So looking back at the Excel document, that first column for 2016 that produces the 6 million figure, that reflects your view of the effective tax charge that should be used to calculate the effective tax rate?
A. That is the -- that will be the effective tax rate for that year.
Q. Well, effective -- at this stage we are looking at the effective tax charge which is obviously one of the key inputs into the effective tax rate, but the 6 million is not a rate, it is a charge, is it not?
A. Sorry, yes, 6 million is a charge.
Q. So those are the figures that you are using to calculate an effective tax rate, but, of course, not all of Royal Mail's profits are taxable, and we see that from this reconciliation, do we not, because we see it refers, for example, to non-taxable dividends. Do you agree?
A. Yes, there is non-taxable dividends in there.
Q. When non-taxable income is taken into account, it tends to reduce the overall tax charge. One can see that from comparing the 6 million figure in the first column for 2016 --
A. Of course.
Q. Yes.
A. It is not taxable.

Q. Sorry, it is an obvious point. It may seem obvious to almost everyone except me, but I just want to make sure I have understood it.

Then just looking at the second column, the second column is the effective or seeks to present the effective tax charge excluding the effect of non-taxable income, such as the dividends. Do you see that?

A. Yes, so the number 16 in column F has been deleted in column G.

Q. Yes, it is quite a --

A. Yes.

Q. It is not a small difference in monetary terms but it is a sort of narrow difference in the sense that there is only, I think, that one difference for 2016. But you see that the second column produces a higher figure so it reflects a larger tax burden because it excludes items that reduce the effective tax charge; yes?

A. Yes, it produces a larger tax charge.

Q. So one sees immediately that whether one uses Royal Mail's total effective tax charge, as you have done, or its effective tax charge only on taxable profits was going to make a difference to the effective tax rate; yes?

A. Yes.

Q. Now, as you have agreed, the purpose of this whole

exercise of grossing up is to identify the effective tax rate that Royal Mail would have paid in the counterfactual on its equity losses which are treated as taxable profits; yes?
A. Yes.
Q. We therefore need to identify, do we not, the effective tax rate on Royal Mail's taxable profits? That is the rate you need to use to gross up, is it not?
A. You need to -- because it is a counterfactual, we need to look at incremental effects.
Q. What I am putting to you -- and if you disagree, please explain why -- but what I am putting to you is that, in order to identify the rate by which you need to gross up the equity losses, you would need to focus on the effective tax rate on Royal Mail's taxable profits, not an effective tax rate derived from its overall effective tax charge?
A. So the challenge with the grossing up was that we do not have all the information about Royal Mail's tax affairs. We do not have the accounting working papers. I do not have the accounting working papers. I do not think any of the experts do. That is mentioned in E3.
So the true understanding of the tax position, not only -- we have the knowledge for the understanding because we have the tax return. We do not have the

tax -- the working papers which explain how the accountants have now recognised the cash tax and the future tax consequences, the deferred tax. It is quite a complex area of accounting. So we do not have the true underlying picture because the way the choreography of the events took place with the reports and the expert statement, we only got into this debate about how to do the grossing up very late in the process.

So my proposal, which is in the joint expert statement, was I suggested as a reasonable alternative potentially modifying Mr Singer's original approach and using an effective rate over this period post IPO.

THE CHAIRMAN: Is there an accepted way of calculating an effective tax rate?

A. "Effective tax rate" is an accounting term. It is required by -- so "effective tax rate" from an accounting perspective is the tax charge in the accounts divided by the profit after tax.

THE CHAIRMAN: So do you include non-taxable income in that calculation?

A. From an accounting perspective -- yes, from an accounting perspective, just an effective tax rate includes -- it is the tax charge -- it is the actual tax charge in the accounts.

THE CHAIRMAN: On all income, whether it is taxable or not?

A. Yes.

MR LASK: But are we not seeking to do something a bit more nuanced here, a bit more sophisticated, in the sense that we are trying to gross up these equity tax losses? It is common ground between you they are being treated as taxable profits and therefore, in order to be as accurate as you can -- bearing in mind the whole reason we are here at this stage of the analysis is because you do not think that the post-tax equity losses sufficiently reflect Royal Mail's specific tax position. That is why we are at this part of the analysis -- in those circumstances, are we not seeking to identify an effective tax rate that is relevant specifically to taxable profits rather than everything in the mix?

A. Seeking to find an adjustment and that could be achieved by a gross-up of the rate or by incremental effect, but it is very difficult because I do not have the full information. When I say "full", I do not have the accounting working papers which explain how Royal Mail actually accounted for its tax charge in the accounts. So because tax is complicated and detailed just by its very nature, including the accounting effects, my experience has been that access the detailed working papers and then work through those to work out an appropriate adjustment. That exercise has not been undertaken. So if you are putting the question to me, "Is an effective rate the approach?", I cannot say because I do not know. It will be an effective rate or it could be an incremental rate, but I need to see how the accounting nuances apply as well as the tax return. I need to see the true picture.

It is not just the tax return and the accounting information. We have aggregated numbers in the accounts, we do not have the detail about how the deferred tax applies, and deferred tax is a future consequence that is booked in the accounts, but accounting rules do not require deferred tax to be discounted. So you could be required to put on the balance sheet a tax liability that may not be payable for ten years' time, but it will be in -- not in the net present value, it will be in absolute terms.

So it is quite complex. Using -- where we are at the moment in terms of the grossing up, it is quite complex to actually come to a definitive view about which way to go.

Q. Yes. Just to be clear -- that is helpful, thank you. Just to be clear, I am not putting to you that the effective tax rate is the appropriate rate. You will have seen Mr Singer's position is that the statutory rate is the appropriate rate. But what I am putting to you is that, if one is going to try and identify an effective tax rate, then one needs to strip out the effects of the non-taxable income, which is what Mr Singer has sought to do in this document because -- I will just explain why and then you can tell me if you disagree -- but because using the overall tax charge is introducing irrelevant factors.

So, for example, the fact that a non-taxable dividend reduced Royal Mail's overall tax charge by 16 million in 2016 tells us nothing, nothing at all, about the rate that Royal Mail -- the rate of tax that Royal Mail would have to pay on the equity losses in the counterfactual. That is why you need to focus on taxable income only in order to identify a reasonable and an accurate effective tax rate. That is the point I am putting to you.

A. Say that again. Sorry.

Q. That is very fair. It was quite a long question in the end.

So the point I am putting to you is that, if you are going to try and identify an effective tax rate, if you are going to try and use an effective tax rate for this grossing-up process, then it is more appropriate to use an effective tax rate that is based only on the taxable effective charge or the effective charge attributable to taxable income so as to avoid introducing irrelevant factors.

A. I do not quite agree with that. Sorry, can you say that again -- sorry, explain the question again?

Q. Yes, of course.

A. Sorry, I am just ...

THE CHAIRMAN: I am wondering whether we should perhaps have a break and we can --

MR LASK: I would certainly be happy if Mr Pritchard wants to, but I should say I am pretty close to the end.

THE CHAIRMAN: We did start at 1.50 so you have had an hour and a half. Are you okay to keep going? The stenographer as well I am thinking of.

MR LASK: I think we are looking at five minutes max.

THE CHAIRMAN: Okay, let us carry on then.

MR LASK: Perhaps if I break it down into stages. The first proposition is that -- this is one with which you have agreed -- the purpose of the exercise when you are grossing up is to identify the effective -- when you are grossing up on an effective tax rate basis is to identify the rate that Royal Mail would have paid in the counterfactual on its equity losses which are treated as taxable profits?

A. So the rate at which Royal Mail would have paid -- that is a gross-up by reference to payment of tax, not --

I think that is what you are saying.
Q. Yes, well, the purpose is to identify the tax rate it would have paid in the counterfactual on the equity losses that we are concerned with.
A. That is what I am seeking to do, is find out the incremental cash cost.
Q. Yes.
A. Yes.
Q. The equity losses are being treated as taxable profits by both you and Mr Singer?
A. Agreed.
THE CHAIRMAN: Can you just, for my benefit, explain why that is, why the equity losses are treated as tax profits?
A. It was agreed in the -- this was debated this morning. There was an agreement in the tax principles table that the financing losses would be treated as taxable income and I think that that was agreement -- correct me if I am wrong, but I think that agreement was it would be trading income. Because it is expressed in an after-tax, a post-tax, context, it needs to be converted back into an amount that could go into the tax return.
Tax returns are based on profits -- the starting point for a UK tax return is the profit before tax but we have a number that is profit after tax, so it somehow

needs to be adjusted to be a profit before tax number
because it can go into the corporation tax world.

THE CHAIRMAN: I understand that. I am just having a bit of
difficulty -- maybe I am being slow -- as to what this
issue actually goes to. The equity losses are treated
as taxable profits --

A. The equity losses --

THE CHAIRMAN: -- in the counterfactual?

A. Yes. The way I view that is something has happened
in -- something should have happened and did not happen
in Royal Mail because of the alleged overcharge --

THE CHAIRMAN: That is because they suffered the losses in
the actual world and they did not suffer them in the
counterfactual?

A. Yes.

THE CHAIRMAN: So it is effectively a profit in the
counterfactual world?

A. Yes.

THE CHAIRMAN: Right. Thank you.

A. Just to clarify, it has never been specified exactly
because it is post tax. What really was going on that
would have given rise to that? What was the economic
activity that would have given rise to that profit after
tax? Was it selling more stamps or postal services or
did they do something different? We do not know. It is

not expressed. No further details are given.

MR LASK: Sorry, but you have agreed with Mr Singer to treat them as taxable trading profits in the counterfactual; yes?

A. Yes.

Q. So the point I am putting is that one therefore needs to identify the effective tax rate on Royal Mail's taxable profits, not an effective tax rate based on its overall tax position, which is what you have done?

A. It depends what -- I am struggling with the -- I am struggling with how to do the gross-up because I do not have all the information. So the effective rate approach put forward was one way -- potentially one reasonable way suggested. But to do the gross-up by -- to do the gross-up, it could be a rate approach, it could be an incremental approach.

Q. Yes, so does this not demonstrate that there are complexities in performing this gross-up analysis and indeed there are even more complexities when you try and do it using an effective tax rate? That is what this debate we are having demonstrates, does it not?

A. It does.

Q. On the other hand, if you are going to do grossing up, you have a statutory rate that Mr Singer is putting forward which is completely objective and readily

ascertainable?
A. Okay, the effect -- the way tax accounting rules work is that the effective tax rate, it tries to get you back to statutory, but it is -- because the current and deferred tax, it is trying to normalise the tax rate. The issue I have with that is that the accounting normalisation of the tax rate, the effective rate, it is not always the cash tax rate, and trying to figure out how all the dynamics of the tax work is not straightforward.
Q. It is not straightforward, I accept that.
A. Yes.
Q. Just finally then, if one goes back to the Excel spreadsheet and looks at the first tab which Mr Beard took Mr Singer to this morning, this is the product of his effective tax rate calculations. You will see that he produces an effective tax rate of 22.56%. Do you see that?
A. Yes.
Q. That is similar, is it not, to the statutory tax rate for this period?
A. Yes.
Q. So this demonstrates, does it not, that it is reasonable for Mr Singer to use the statutory rate because, when the effective tax rate is calculated correctly, it produces a very similar figure?

A. No, I do not agree because the tax charge in column C includes significant amounts of deferred tax is my -- that is what I think is going on and, therefore, the cash tax that is paid on those profits is considerably less.

Q. But do your figures not also include considerable amounts of deferred tax?

A. They do because I proposed an approach based on the effective rate because it effectively -- it is a blunt instrument. I do not really have anything else really to use to work it out, so I proposed it as a reasonable alternative in light of the fact that I did not feel -- consider I could do anything else.

Q. But if the objection that you just articulated is valid at all, then it applies equally to your approach, does it not?

A. Agreed, because it is quite difficult to do this without further information.

Q. Sure, but you described your approach as a blunt tool. What Mr Singer has sought to do with his effective tax rate calculations is sharpen it a bit, has he not?

A. I do not agree.

Q. All right. Thank you.

Could I have a moment, sir, please?

THE CHAIRMAN: Yes. (Pause)

MR LASK: Thank you. I have no further questions.
THE CHAIRMAN: Re-examination?
MR BEARD: Yes, I think I have four questions.

Re-examination by MR BEARD

MR BEARD: So the first is if we could just go back to the joint expert statement, {E/IC86/26}. I think this is just confirming, I hope, what -- the answer that was given by you to the chairman. You were asked by the chairman about there being an agreement as to how to treat equity financing losses and you referred to the tax principles. Is it E3 that we are looking at for that agreement?
A. Oh, the tax principles table?
Q. No, no, sorry, the joint statement -- I am so sorry, I was misleading you.
A. Apologies, the question ...?
Q. I am just clarifying. Essentially the chairman asked you a question about why it was that equity financing losses were being treated as trading losses and -- I am so sorry, I am looking at the wrong document. It is the tax principles table.
A. I was right the first time.
Q. You were right the first time. You are well ahead of me, and it is E3 in there. It is my note. Sorry.
THE CHAIRMAN: Too many E3s.

MR BEARD: Too many E3s, exactly.
THE CHAIRMAN: Do you have a reference for that?
MR BEARD: Yes, I am just finding it. I am so sorry. {J3/IC401}. I am grateful to Mr Bourke.
If we could just go through to page 13, {J3/IC401/13}. If we can go down, I think it will be 18, {J3/IC401/18}. Thank you. Sorry, I gave you the wrong reference. It is because there is a letter at the front of it. Sorry, back up one. I miscounted. There we are, E3. I am just clarifying for the chairman's benefit, is that the point where the agreement is set out in the tax principles?
A. Yes, that is.
MR BEARD: Do you want to scroll down, sir?
THE CHAIRMAN: That is all right. I have done.
MR BEARD: That was just one clarification.
The next thing I wanted to go to was if we could go back to the attachment to the letter of 10 June 2022. So I think the letter is at {J4/IC446}. Do you recall that? Then I think the schedule that goes with it is at {E/IC95}. Yes, thank you very much.
So this was the table that was provided by Mr Singer and on which you were asked questions. If we just click on the next tab along, on the bottom, this was what Mr Lask focused on. He looked in particular at the 2016

column, if you remember. You referred to this coming out of the accounts and a note in the accounts.

Now, Mr Lask kindly offered to provide the reference -- to take you to it, but I think it is at {I3/79/38}. So this is the 2015/2016 reports. If we just zoom into 9, it says "Taxation". It has got "Tax gains/(losses) ..." and you referred to a reconciliation. If we can just go down to the next page, page 39, {I3/79/39}, note 9 continued. Is this the reconciliation you were referring to?

A. Yes.

Q. So are you able to explain? It says:

"Reconciliation of the total tax charge.

"The tax assessed for the year differs from the standard rate of corporation tax in the UK of 20% (2014-15 21%). The differences are explained below."

So could you just explain by reference to this table, where it is saying that tax assessed is different from the statutory rate, what is going on here?

A. Okay, so there is a profit of £99 million in 2016 and so -- bear in mind what the bottom line shows, the 6 in brackets, that is the charge, so that is what the accountants have booked as the expense for tax. So this reconciliation, it has been a standard disclosure for as long as I can remember. So you start off and apply the statutory tax rate by default to the accounting profit. So UK tax of 20% on 99 is not actually -- it is a charge of 20. In the tax return -- and all the numbers now are expressed in tax terms; okay? So it was estimated when the accounts were prepared that there is a disallowable expenditure so the tax effect of that would be an additional tax charge of 8 million.

There were some adjustments in respect of the prior year, so that is where actually the tax returns are filed to HMRC, but they are scrutinised and amended and therefore there is a true-up in the accounts. So that is actually -- seems to be -- because that number is a credit, so actually that must have been that they overprovided for tax in previous years and now they have agreed a position with HMRC.

There is this line here, the 3 million, which is -- that is in brackets -- which is a charge. Now, what this represents is -- this is bad. This is bad for the company because it has given away its tax losses to another group company for nil. It has surrendered losses by way of group relief. So this pops up in the tax reconciliation because that represents an asset no longer available to the company, so yes.

Then we have got a non-taxable dividend of 16. So in tax terms there was a dividend received which --

probably quite sizeable because it is similar to the 20. Then there was "Effect of change in tax rates". Do you remember --

THE CHAIRMAN: It is the same figures as we saw in the Excel, is it not?

MR BEARD: Yes, but it is going through and explaining them as reconciliation because the follow-up question was just: in terms of what you have referred to as the effective tax rate, can you derive an effective tax rate from these figures that we are referring to here?

A. Not easily. Not easily. The interesting point about this disclosure is there is further narrative below. So it says:

"At 27 March 2016, the Company had unrecognised deferred tax assets of £13 million ..."

So that is a future tax saving available to the company, but I think if we had the tax return, the number in the tax return would be significantly higher, which means that the tax losses in the return are somewhere in the accounts on the balance sheet because accountants have been required to book the future tax saving.

This is why using the accounting rate becomes difficult because the accounting world and the tax world are different and the counterfactual -- the tax model is about cash tax payments and we have priced into -- factored into the model the benefit of the future tax losses. We have had to price in future cash -- additional future tax -- additional tax losses and capital allowances. We have had to compare those positions in the actual and the counterfactual to put a value on it because it represents a benefit in the actual world over the counterfactual. So we have to reduce Royal Mail's claim because they actually effectively have a tax benefit in this case, in this situation.

You know, we do not need to go through this in detail, but you will see there is pages of disclosure about tax and Mr Goldring gave evidence because he is the head of tax. He spent -- his team would spend -- in my experience with a listed company, they would have a tax team focused on all these disclosures and all the complexities about the accounting because it is not a straightforward area.

I have got half of the picture, shall we say, to do the grossing-up analysis. I do not have the deferred tax, the tax accounting working papers. I have got the tax returns. That is one of the challenges I have to sort of finish off the work on the grossing up. That is why it is difficult at the moment.

Q. If we can just go back to {E/IC95}, as the chairman rightly said, my questions were based on carrying across exactly the same numbers that are set out here. I think you have given the answer that you cannot get an effective tax rate from these numbers, but that is precisely what Mr Singer is purporting to do. So can you just summarise for us what your effective tax rate calculation is doing that we saw in table 1b as compared with Mr Singer's approach, but in a compressed manner?
A. So I simply took the actual effective tax rate in the accounts over the eight-year period and just worked out an average effective tax rate. So I took total accounting profits for their profits before tax in those periods, total tax charges. It is in the table --
THE CHAIRMAN: That came to zero, did it?
A. It came to 11%.
THE CHAIRMAN: Right, 11% for this period?
A. Yes, and bear in mind in this period the UK tax rate is between zero and 20, so it is around the middle. There is nothing -- I do not have a better approach, but it just seems objectively -- just to the broad brush approach, it came out around 11%, so that felt like a reasonable alternative rather than getting into all the complexities of all the detail because the information was not available.

THE CHAIRMAN: In very broad brush terms, what is the difference in figures then, that that translates to as between you and Mr Singer?

MR BEARD: Let us go to table 1b. This is in the joint experts' statement and that is at page {E/IC86/46}. That is the correct table, is it not?

A. No, sorry, it is the one before.

Q. Okay, let us go up the page, {E/IC86/45}. Is that what you were referring to?

A. Yes, the 11.

Q. Let us just go up to the top so the tribunal can see, {E/IC86/45}. So it is table 1, "Effective tax rates". So I was taking you to the one that compared with statutory rates.

THE CHAIRMAN: Sorry, what I was referring to was in calculating the actual financing losses to which -- this is ultimately going to that.

A. Yes.

THE CHAIRMAN: How much difference is there between you by applying the different tax rates?

A. In terms of the model output?

THE CHAIRMAN: Yes.

A. I think it modelled Mr Singer's model version B2II, and the difference between that and my model, it is about £7 million or £8 million, in terms of whether

Mr Singer's view on statutory gross-up for period three versus the approach at the moment for mine, with the 11.9%, so it is worth about £8 million.

THE CHAIRMAN: Okay. Fine. Thank you.

A. That is the size of the problem.

MR BEARD: Sorry. I misunderstood the question.

Just two more clarifications. I think you have probably answered the first one. At [draft] page 140, line 7, you said that focusing on cash tax is only half the story, but I think you have just referred to a whole range of other issues in the model. What were you referring to when you were saying that focusing on cash tax in the model is only half the story?

A. Oh, because we were looking at future tax benefits which is tax losses and we have measured the use of the tax losses. So in the counterfactual model the 500 million of losses has been used -- which arose in 2014 -- those are used in the model and there is about -- I think there was about 80 million left at the end of -- I cannot remember which year -- 2021/2022 and it has now been agreed, between Mr Singer and I, that those losses be used in FY24, when the tax rate changes to 25% the model is all about the cashflow approach to tax.

Q. I have got one more. Again it is a clarification. Page 142 in the [draft] transcript you referred to the fact that in the counterfactual we need to look at incremental effects. What did you mean by "incremental effects" in that context?

A. So differences between the actual position and the counterfactual position. So that means you do not just look at -- apply rates blanketly; you are looking for the incremental change because that is what -- I think that is what you are concerned with, about the loss. So we have to quantify the loss, not just apply rates to the whole position. It is what would be the slight -- the incremental change.

Q. You referred in passing, I think, to Mr Goldring's evidence. Did you review that then when you were considering the position prior to today?

A. Oh, Mr Goldring's witness statement. Yes. I was here for that.

Q. Right. Do you recall Mr Goldring referring to lost restrictions being imposed on Royal Mail?

A. Yes, and there was a question put to Mr Goldring where he clarified that the trading losses in Royal Mail up to -- what? -- 21 April 2017 they can fully shelter taxable profits, taxable trading profits, but after 21 April 2017 there had been a change in law and the offset is restricted to 50%. So what that does is it makes the cash tax rates prior to 2017 -- it changed it.

If you have losses that can offset profits, you may find that the cash tax rate is half of the statutory rate.
Q. So if you have losses and you can offset profits, you might find that the cash tax rate is half that of the statutory rate. So is that akin to the effective tax rate that you were then calculating?
A. Yes. So when the rate -- the approach -- my reasonable approach, the result was 11.9, one of the reasonableness views I took was that it is about 50% of the statutory rate because there is a loss restriction and the losses could still be used at that rate.
MR BEARD: I do not have anything else. Thank you very much.
THE CHAIRMAN: All right. Thank you.
Thank you, Mr Pritchard.
A. Thank you.
THE CHAIRMAN: That is the end of your evidence and that is the end of the evidence.
MR BEARD: It is.
THE CHAIRMAN: Excellent, thank you. Well, I am conscious that the stenographer has not had a break at all but I think we have just got a couple of perhaps housekeeping matters that we need to discuss. It should not take too long.
MR BEARD: Happily. However you want to proceed. If you

want to have a break -- I do not know whether the stenographer would like a break or ...

THE CHAIRMAN: Yes, we will just be five minutes. Thank you very much.

You are free to leave the witness box.

I am pleased we only had two issues on tax!

MR BEARD: We had worked hard to narrow them down. I know that you suggested a degree of scepticism when you were repeatedly told that there were efforts to narrow things down, but it was going on in the background.

THE CHAIRMAN: Right.

Housekeeping

THE CHAIRMAN: Anyway, yes, so we are now having a break for written closing submissions.

MR BEARD: Yes.

THE CHAIRMAN: We have an issue in relation to rail strikes next week. I do not know whether that affects anybody here or the way we will need to conduct the hearing. It may affect one or more of us and it may be that, you know, somebody needs to attend remotely, but I think we should try, so far as possible, to carry on in person.

MR BEARD: We would all very much prefer that.

THE CHAIRMAN: Yes.

MR BEARD: Obviously the rail strike next week is deeply inconvenient. The only thing I would note is that we are planning, on the timetable, starting the oral closing in the afternoon of 20 June and therefore maybe that --

THE CHAIRMAN: No, I think 22 June.

MR BEARD: I am so sorry, 22 June. I am reading the week of, but yes, on the Wednesday. I do not know if that is useful to those that have transport difficulties but I ...

THE CHAIRMAN: Well, I think the feeling is that obviously the strikes are on the Tuesday and Thursday but the Wednesday is going to be heavily disrupted as well as a result of coming between those two days, but yes.

MR BEARD: On our side, we remain --

THE CHAIRMAN: You are all okay to attend in person?

MR LASK: We are on our side.

MR BEARD: We are on our side as well, but we recognise the fact that we are does not necessarily mean --

THE CHAIRMAN: Well, there may be staffing difficulties here as well but at least we do not have witnesses to deal with. Yes, all right. We will assume, unless anything dramatic happens, that we are starting in person on that Wednesday.

MR BEARD: Yes, and we are submitting written closings at close of business on 20 June. The sooner the better I think is the general admonition.

THE CHAIRMAN: Yes, clearly. I do not know how much you are proposing to produce. Probably vast volumes.

MR BEARD: There will be a substantial amount of material I imagine on both sides.

THE CHAIRMAN: Yes.

MR BEARD: We are obviously conscious that concision is a benefit and, on the other hand, there is limited amount of time and therefore --

THE CHAIRMAN: I am not going to put a limit on anything, but if you can try and confine yourself to the core issues and including, so far as possible, the key references to the evidence.

MR BEARD: Yes, that is what we are intending to do, but I am always conscious -- I am not sure who it is. Was it Blaise Pascal? -- if we had more time, it would be shorter, and I am sure that will apply in relation to digesting the previous weeks' evidence.

THE CHAIRMAN: I am sure it would be very helpful in whatever form.

There is one other thing that I think we would find quite helpful, if it is possible to produce some sort of table setting out, perhaps on both of your sides' best and worst cases, the effect -- assuming there is an overcharge -- the effect of complements, supply pass-on, loss of volume. If you could just sort of work through that seeing how it affects the overall figures. Obviously it will make lots of assumptions as to outcome, but that will be just so we can get a handle on exactly what we are talking about in terms of numbers.

MR BEARD: Understood. I have in mind that with our skeleton argument we submitted a sort of flowchart as to how all the different elements linked together and we might try and look at whether or not we can plug some range figures into that and see how that worked. That might be a methodology that takes things through, but yes.

THE CHAIRMAN: That would be helpful if that --

MR BEARD: We will work on that.

MR LASK: We will too, sir. It sounds very sensible, if I may say so.

THE CHAIRMAN: All right. Is there anything you want to raise?

MR BEARD: I do not think so. No, we are most grateful.

MR LASK: No.

THE CHAIRMAN: Thank you very much, everyone, and well done for getting it done in the timetable. We look forward to receiving whatever you are going to provide to us and we will see you in over a week's time.

MR BEARD: Yes, thank you very much.

(3.54 pm)

(The hearing adjourned until 22 June 2022)

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