IN THE COMPETITION APPEAL TRIBUNAL 1517/11/7/22

Salisbury Square House
8 Salisbury Square
London EC4Y 8AP

Monday 18th November- Friday 20th December 2024

Before:

The Honourable Justice Michael Green
Ben Tidswell
Professor Michael Waterson

Merchant Interchange Fee Umbrella Proceedings

A P P E A R AN C E S

Ben Lask KC and Thomas Sebastian on Behalf of Allianz (Instructed by Pinsent Masons)

Sonia Tolaney KC, Matthew Cook KC, Owain Draper & Daniel Benedyk on behalf of Mastercard (Instructed by Jones Day and Freshfields Bruckhaus Deringer LLP)

Daniel Jowell KC, Jessica Boyd KC, Isabel Buchanan, Ava Mayer & Aislinn Kelly-Lyth on behalf of Visa (Instructed by Linklaters LLP and Milbank LLP)

Kieron Beal KC, Philip Woolfe KC, Oscar Schonfeld, & Reuben Andrews on behalf of the SSH Claimants (Instructed by Scott + Scott UK LLP and Stephenson Harwood LLP)

Mark Simpson KC, Jack Williams & Alastair Holder Ross on behalf of Walter Merricks CBE (Instructed by Willkie Farr & Gallagher)

Friday, 29 November 2024

(10.00 am)

In open court

THE CHAIRMAN: Good morning.

Good morning, Mr Holt.

MR DEREK HOLT (continued)

THE WITNESS: Good morning.

Cross-examination by MR BEAL

MR BEAL: Good morning, Mr Holt. I think you have acknowledged, have you not, the general imprecision of estimates of pass-on based on public data?
A. Yes.
Q. Could we look, please, in your eleventh report, {RC-F/19/130} at table 6.1, and we see here the statistically significant results in bold; is that right?
A. Yes.
Q. In the "P-Value" column?
A. That is right.
Q. So a sizeable number do not pass the test for statistical significance, do they?
A. That is right. It is 8 of the 25 I carried forward.
Q. The P-value essentially tests the null hypothesis, which would recognise that the independent variable may have no correlation with the dependent variable?

A. Yes, and to be precise, it is a test on the joint significance of all four variables, so --
Q. So a coefficient of zero would represent no effect?
A. Yes. A coefficient -- a coefficient of zero would represent no effect between the dependent and independent variable, that is right.
Q. A statistically insignificant result means one where the outcome range within a confidence interval would include that zero coefficient?
A. That is correct.
Q. Generally, a P figure above 0.05 means the analysis cannot, with 95% confidence, be found to produce a non-zero coefficient?
A. That is the interpretation of a P-value, yes.
Q. Now, if we look in this report, please, at page 150 {RC-F/19/150}, paragraph 421, you have nonetheless chosen to take into account these statistically not significant calculations in your estimate of pass-on; correct?
A. For these eight cases, yes.
Q. If we look, please, at paragraph 422 over the page {RC-F/19/151}, you also recognise that removing these results would lead to a lower overall pass-on estimate?
A. Hang on, I am not sure that is correct. (Pause).
Q. You say:

"Further, removing statistically insignificant estimates would lead to lower overall estimates for most sectors, which makes my inclusive approach ... conservative."

A. Sir, I think there is an error there. In general, removing statistically insignificant estimates which are more likely to be closer to zero, for the reason that you are more likely to not have a result pass a significance test if it is closer to zero than if it is further from zero, so, therefore, I think I have made an error in saying that -- in terms of the direction.

As a general matter, removing the insignificant results would lead to somewhat higher estimates overall for the remaining statistically significant ones, rather than perhaps what it says here. I should clarify.

Q. Please go to page 129.

PROFESSOR WATERSON: So it is the opposite of what you --

A. It is the opposite, I am afraid. The correct part is that the inclusive approach is conservative. That is indeed what I meant to say. There was an error, I am afraid, in the drafting; "lower" should have been "higher". Because some of the insignificant ones on average, and there are some that are high, and I have excluded some high ones as well, and some low ones, but on average the insignificant ones are lower than the significant ones.

THE CHAIRMAN: Can I just ask, I have got a new hard copy bundle which says "Updated Versions of Expert Reports of Derek Holt".

MR BEAL: Yes, there have been some redactions removed.

THE CHAIRMAN: That is as a result of the confidentiality ...

MR BEAL: There have been some revisions to the confidential treatment, yes.

THE CHAIRMAN: All right.

MR BEAL: I am sorry about that. If you have previously marked up a hard copy, I do not think it matters, strictly speaking, until obviously we need to worry about what the confidentiality marking should be.

THE CHAIRMAN: Right. Okay.

MR BEAL: I appreciate, of course, it is really not helpful to have bundle changes at this stage.

THE CHAIRMAN: Well, yes. Never mind.

MR BEAL: It is just the process that has happened, sadly.

Page {RC-F/19/129}, please, of this report, paragraph 348, you end up with a pass-on rate for the legal and accounting services of 93%; can you see that?

A. Yes.

Q. I mean, I did not increase my fees as a result of MIF charges. I do not know if your firm increased your

consultancy hourly rate as a result of MIF charges?
A. Again, what I am looking at here is an overall effect over a period of time. I am not looking for specific, individual changes of that nature; they would be accumulated into an overall set of costs.
Q. How have you accounted for demand in your public data analysis?
A. I have accounted for demand in my public data analysis in the inclusion of a time trend and seasonal dummies.
Q. But no specific demand variable?
A. I have also had a sensitivity for a specific demand variable, which is consumer expenditure, but as I mentioned I think the other day, I put less weight on that because of some problems with that variable in relation to the impact of Covid.
Q. You did include a demand variable in your analysis of the claimant data?
A. In the claimant data, which in general is a panel dataset because of the disaggregated nature of it, I have used time fixed effects, which is a very flexible way to account for any variation in the impact of factors, other than the costs in the model over time to have had an impact on price. So that includes demand.
Q. You have accepted, I think, there are large standard errors in your public data analysis?

A. In some of it, not all of it, but for the seven cases where there are insignificant results, I -- sorry, eight, rather. Eight cases where I have carried forward results, those clearly do have quite high standard errors.

Q. Now, in terms of what you are comparing with what, you are using the Consumer Prices Index for prices; correct?

A. In general, yes. There are a few exceptions where I use more specific prices relating to a sector, such as data in relation to fuel prices and things like that. But generally, yes, the CPI is the usual approach.

Q. For costs, you use a mixture of the PPI, Producer Price Index, the Import Price Index, the IPI, and then the Average Wages Index that we have already looked at, the AWE?

A. Yes, again that is generally true, and there are some exceptions where I have specific sectoral costs, such as the oil price, for example, for the fuel sector.

Q. The PPI output price essentially captures the main changes in the costs of goods made by producers, doesn't it?

A. Yes.

Q. So it typically reflects the price charged for a good at manufacturing or wholesale level?

A. Yes, it would be the costs -- the prices associated with the production of the upstream input that the downstream product relates to.

Q. There is also an index for input price for manufacturers, is there not, but you have not used that measure?

A. I have used input prices -- indices of input prices, although I am aware that Ms Webster has raised some concerns regarding the precise definition of those and how appropriate they are to take into account.

Q. The AWE you have used as a proxy for labour costs; is that right?

A. Yes.

Q. You would accept, wouldn't you, that the PPI and the CPI measure different things?

A. Well, they are intended to measure different things. One is an output price and one is an input price.

Q. Well, the CPI measures price increases for both domestic sales of domestically produced goods as well as domestic sales of imports?

A. Yes, I think that is fair, yes.

Q. Whereas the PPI only measures the price of domestically produced goods?

A. I think it depends on which PPI you are using.

Q. Could we look, please, in your twelfth report, at 272, which is {RC-G/17/90}. Now, you explain there about unit aggregation effects.

A. Yes.

Q. In essence, you say:

"Unit aggregation effects arise if the relevant units are not known, which ... may [for example] arise when attempting to calculate costs from aggregate data."

Correct?

A. Yes.

Q. That is the first line of 272(b). Would you agree that a unit aggregation effect is quite prominent in the CPI/PPI analysis?

A. At one level I would disagree, because the indices are, by definition, intended to capture the price change from one period to the next, and that is controlling for mixed effects as a general matter.

Q. Well, it is controlling within a single index for that over time.

A. Yes.

Q. The point I am making is you have a different basket of goods for the CPI from the basket of goods you would have in the PPI?

A. Yes, that is a different issue which I have recognised in my report. That is an issue of the closeness of the match of the products between the price index and the cost index.

Q. That would produce a mismatch, would it not, between the publicly available price and the costs measures that lead to the same effect in the above examples that we have just been looking at?

A. Yes, I agree with you that there are a number of factors that could lead to a mismatch between the cost and the price index. One is the definition of the actual indexes to which products are included, and the other may be the extent to which imports are taken into account.

Q. Well, if a customer goes into Marks & Spencers and buys Italian wine, French cheese and a German sausage, that would all feature, would it not, in the CPI, but the relevant inputs would be in the IPI, not the PPI?

A. I think that is fair, and that would be one cause of a potential reduction in the degree of the matching of the two series. The general implication of the reduction of the matching, however, is essentially a measurement error, or an attenuation bias.

So essentially what is happening is some of the price variation that you might have hoped would be explained by the cost variation is not, because it is not measuring quite the same thing, and that would tend to add noise to the estimate. Or, in the case of the cost variable being broader, some of the variation of the cost variable would not be actually relevant to the price and that would lead to downward bias.

So there is either a noise effect or a downward bias effect depending on which of the indices is the broader one.

Q. Well, you say there is a downward bias effect. What evidence do you have for that?

A. I think it is a well understood proposition amongst all the experts that if you have variation in the dependent -- sorry, yes, in the dependent variable, which is not related due to measurement error, of which a mismatch is an example, then that would lead to a downward effect on the parameter estimate.

Q. Well, you say it is not a measurement error. If you have compared the wrong thing with the wrong thing, why is that not a measurement error?

A. It is equivalent to measurement error. The measurement error is that you do not have a like-for-like exact match that introduces some error, the impact of the error is either adding imprecision to the estimate or downward bias to the estimate, depending on --

Q. Well, you say downward bias. Can we look, please, at {RC-J1.6/56/283}. This is an extract from the seventh edition of Greene, which I assume you are familiar with?

A. Sure.

Q. {RC-J1.6/56/1}, that is the right one, and then at {RC-J1.6/56/283}.

My marking has disappeared. Give me a moment.

(Pause)

Thank you very much. Right at the top of the page it says:

"A badly measured variable contaminates all the least squares estimates. If more than one variable is measured with error, there is very little that can be said. Although expressions can be derived for the biases in a few of these cases, they generally depend on numerous parameters whose signs and magnitudes are unknown and, presumably, unknowable."

That is not suggesting you can predict a downward or upward bias, is it?

A. Well, I think it depends on the nature of the error. In this case, if there is additional variation in a cost variable, which is something that is not something that you would expect to be explaining the dependent variable, in that case there would be generally a downward bias estimate.

Q. You say generally downward, but why? It does not make any sense statistically, because the errors could go either way.

A. In general, there is -- the additional noise associated with the variable that would not be expected to be related to the variable in question would mean that there is unlikely -- it is essentially an averaging. Let us say there is a true effect and an additional effect. Let us say the true effect, is for the sake of argument, 80%, if you had a good match. You then say, well, let us have the cost variable, add on an irrelevant amount of further products, there is going to be a lot of variation associated with that product.

As a general matter, that would typically lead to a downward bias, because the variation in that will not be perfectly correlated with the underlying variation that is relevant.

PROFESSOR WATERSON: I think, perhaps, in fairness to Mr Holt, we should read the previous part of this paragraph on the previous page.

MR BEAL: Yes, the previous sentence says "biased toward zero".

A. Yes, that is my point, thank you.

MR BEAL: That is if there is one measurement error, is it not?

PROFESSOR WATERSON: Yes.

MR BEAL: So if you have multiple measurement errors it is unknowable?

A. I think the main measurement error we have here is known in terms of the nature of it, which is additional cost variation, which is not relevant to the price variation, and that is the case where it would be bias towards --

Q. If you had known what the magnitude or extent of the downward bias was, I have no doubt you would have excluded it, and led to a higher estimate of pass-on in your report?

A. No, I have not done that. I do not know the extent of it, so that is one reason why I have not tried to make any particular adjustment. I have just noted that while I would have preferred perfect matches, they are obviously not always available. In that regard, I think it is still an informative and helpful estimate despite the fact that there is some risk that it is conservative for this reason.

Q. Now, your price variable in the case of the operation of personal transport equipment is the CPI; is that right?

A. Yes. Yes.

Q. Would you say that all the variation in the average weekly earnings in retail trade and repairs is related to a variation in your CPI variable?

A. No.

Q. So, for example, if there is a variation in wages paid to opticians that is reflected in the variation of the CPI in operation of personal transport equipment, there would not be, would there?

A. Yes, I think that is fair. It is an example of my general point, which is if the labour or PPI index includes costs that are not pertinent to the output, the product, which is the CPI index, then that part of the variation would not obviously be expected to be relevant, and that is an example of the attenuation bias I referred to earlier.

Q. Now, more generally, obviously if you are using a significant price index like the PPI, and using that effectively as a proxy for the key variable costs in the given sector, what you are tracking is the correlation between a very significant index of costs and prices; is that fair?

A. Yes.

Q. Ie, PPI is likely to capture a very significant component of the key variable costs in a given sector?

A. Yes, that is the idea, that PPI is intended -- I have selected PPI in order to try and represent the variable costs relevant to the product, yes.

Q. If the MIF is not a key variable cost, that is not going to help us very much, is it?

A. I think that is down to the small size debate we had yesterday. My point is that the MIF changes would be essentially accumulated with other cost changes.

The simplest example of that is perhaps just to say: well, let us say there are ten possible changes, but you are not really looking out for anything that is less than a 10% change. So if you have ten 1% changes, then you might say none of them have any impact because they are all below the threshold by which you bother looking. But obviously if you take them together, then that does lead to an effect, and I would say that --

Q. The difference in our case is we are only interested in one change, are we not, which is 0.2%?

A. Yes, that is right. But the analogy is, let us say it is the third of the ten sources of change, but the actual rate of pass-on would be essentially the same for the entire group.

Q. Could we look, please, in your eleventh report, paragraph 365, that is {RC-F/19/135}.

You say here you:

"... do not include relatively minor variable costs. For example, I do not generally include energy costs in my --"

A. Sorry, which paragraph?

Q. Paragraph 365, the last sentence or second to last sentence:

"... I do not generally include energy costs in my analysis, other than for my analysis of the utilities sub sector ... energy is not a proportionally significant cost."

A. Yes.

Q. So you stripped out energy on the basis that it was perceived to be an insignificant cost, is that right?

A. Yes, again there are trade-offs in the modelling approach. Obviously you could try and add more and more potential variable costs, but that comes at a cost of over-fitting in the model, and also would tend to remove the degrees of freedom available to estimate the parameters of interest, so essentially that is the modelling choice I have made.

Q. Linking the PPI with the CPI also gives rise to the risk of reverse causality, does it not?

A. This goes back, I think, to the debate that we had in the hot tub, the simultaneity point. I already gave a very brief answer to that. I am happy to either repeat that or expand a little bit.

Essentially, to be extremely concise, I do recognise that in principle that could be an issue in the public data. I do not consider it likely to be a major concern for a number of reasons: one, I have accounted for a demand variable, although, as I noted, it is an imperfect one; secondly, I have carried out the analysis at a disaggregated level, whereas the literature that Dr Trento refers to in this regard focuses on the aggregate macroeconomy areas where it is more likely that there would be bi-directionality between output prices and input prices, because obviously at the macroeconomy level you do not have any possibility of substitution of all the inputs throughout the economy, because the entire -- prices across the entire economy set of inputs are all going up. So I do not think that is certainly as significant a concern when you are looking at more disaggregated subsector levels, as I am.

Then the final point I think I made in the hot tub is that were this to be a concern, it could potentially lead to an upward bias, I agree. But I also look across at the claimant data evidence in relation to pass-on and I find that, if anything, those estimates tend to be higher. So that gives me some comfort that there is no significant effect here.

Q. Well, you say there is no significant effect. Let us think of a recent example. When we had very high inflation, 10%, 11% CPI rates, which was obviously fed through to rent increases, telecoms bills increases and various things, but principally it also triggered a wage increase, did it not?

A. Yes, I think -- well, there are a number of factors that

could be going on.
Q. You are using AWE. It is being triggered -- the CPI reports inflation, that gets fed into labour costs. AWE then reports labour costs, and you have CPI influencing AWE rather than the other way around; no?
A. Well, again, this topic came up in the hot tub, as to whether general inflation has an impact on wages in a way that would be detrimental to the modelling approach. Given that all the experts -- and myself included -- are looking at essentially a lagged approach to the effect of wages on the output price, the concern here is that you would be looking ahead to output prices and saying: well, okay, wages are then going up, because people are saying: well, I have got a purchasing power problem, I need to increase my wages. That would be, essentially, a forward-looking model and that is not what we have got here.
Q. Please can we look at {RC-F/19/137} where you have conducted regression analysis over the length of the claim period.
A. Yes.
Q. Paragraph 376. You explain what you have done there.
A. Yes.
Q. But you only regress costs up to a year before the analysis of price, do you not?

A. Yes, so that is the case for 28 of my 30 public data estimates. Those are the ones that are based on first divergences, so this is back to the Q3 minus Q2 approach, and in those cases I did need to have a particular structure to capture pass-on, because I would not have expected it all to happen within a quarter, and I took it back to a year. So there is -- the costs going back up to a year are examined to see if they affect price changes.
Q. If we then look at paragraph 379, please, over the page {RC-F/19/138}. It should be at {RC-F/19/139}.
Now, you say:
"The risks of including too many or too few lags are not symmetrical. Including too few lags will certainly bias estimates of long-run pass-on towards 0, leading pass-on to be underestimated."
A. Yes.
Q. "On the other hand, including too many lags will not bias pass-on in one direction or another, but will cause pass-on to be estimated less precisely."
Essentially, the degree of correlation becomes less precise the longer your analysis goes over a period, does it not? Or the longer the period is?
A. So what I am saying here is I have chosen a one-year pass-on timeframe. It is possible that some of these

cost indices that I am looking at will take longer than that to work into the output prices, in which case I may not be capturing that, and I think it would be conservative as a result.

One option would have been to say: well, instead of one year worth of lags, let us have more quarters going back to, say, two or three years.

There are two problems with that. One, I would then significantly reduce the degrees of freedom associated with the model, because there is only a certain amount of observations, and then I would have more and more effective parameters to estimate.

So my judgment was that a one-year approach is appropriate, particularly given I am mainly focusing here on variable costs, and I am expecting the variable costs to have a relatively rapid transmission mechanism.

Q. Can we look, please, at {RC-F/19/141}, paragraph 390. At 390, you seek to exclude a regulatory period from 2019 for gas and electricity because of price caps; is that right?

A. Yes.

Q. That necessarily excludes from the analysis the period where pass-on is intuitively going to be lower because of the effect of the price cap?

A. I do not agree that it is intuitively going to be lower.

It is a different mechanism. Obviously price caps are set specifically on a basis to allow for the average supplier to earn a reasonable margin, so they will be updated over time to take into account changes in costs. Indeed, that is what happened in the period of the high energy inflation that you referred to earlier. That is when Ofgem did make cap changes to the retail energy price.

Q. When we look at regulation in other areas such as university fees, you have accepted that you cannot show pass-on into domestic regulated university fees precisely because they are regulated?

A. I have accepted that in the case of universities, because the price has been locked in for -- at a capped tuition level for many, many years, that it is unlikely that variation in costs over time would have been passed through into those tuition fees.

I then also noted that 90% of the MIFs, as I understand it, are paid by international students for which the tuition fees are not capped.

Q. Could we look, please, at paragraph 396, {RC-F/19/143}. You have chosen to exclude the Covid period as well; correct?

A. I have in the specific context of the public data, where I am using first differences, and it is essentially for the reason I described earlier. With the lag structure, to exclude a period has a bigger impact than if you exclude a period in a level structure. The reason is that, in addition to excluding the period in question, you have to exclude the observations where the lags would have had an impact as well. So that is, essentially, four extra exclusion observation points.

The cost of that in terms of the impact on my overall data series I judge to be too great in the context of the first difference modelling where there is already, in general, more imprecision as a result.

Q. The SSH Claimants carried on trading throughout the Covid period, did they not?

A. Yes, I imagine they did.

Q. You have not taken into account external price shocks that might well go the other way, such as the invasion of Ukraine, for example?

A. I think it is slightly complicated. In my baseline results for the cases where I have used first differences, that is a fair statement, because I have not included in my baseline the Covid period, and obviously the Ukraine event happened -- sorry, that is not quite true. Actually, sorry, I have excluded the Covid period. I have not excluded from the Covid period onwards.

So, therefore, to the extent that the Covid period would have overlapped with the Ukraine impact, then that is perhaps true. I cannot quite recall -- so I had April 2020 to late 2021, I think. When was the Ukraine invasion? Some time in 2022.

Q. February 2022.

A. So that is not correct: I have got the Ukraine effect.

Q. Now, are you aware that some of our claimants did not start trading until 2021?

A. I was not specifically aware of the precise data for individual claimants. I am not looking at individual data for individual claimants in any of this analysis, other than the willing claimants.

Q. Your extrapolation necessarily excludes the period in which they began trading?

A. That is true. But the purpose of all this analysis is to get an over time estimate of the rate of pass-on of an industry-wide variable cost. I have no reason to believe that it would, at least as an underlying relationship that would apply in the longer term, be different.

Now, perhaps I could see that if conditions were different, specifically since 2021 when some of these claimants came in, then maybe that could lead to an impact on the pass-on rate. That is a possibility.

Q. Could we look, please, in your eleventh report, at page 33, paragraph 31. I am moving on to surcharging.

PROFESSOR WATERSON: Could I, just before we do that, could I come back about energy costs?

A. Yes.

PROFESSOR WATERSON: So to the extent that energy cost changes are related to the general CPI changes, excluding energy costs will mean that the effect from the regression will mean that the effect of that is to -- is for the CPI variable to pick up any changes, which potentially enhances the coefficient on the CPI variable?

A. I think -- so if it is a sector where energy costs are materially important.

PROFESSOR WATERSON: Yes.

A. Yet not one where I have said it is important so I should include it. So in the cases where I have not deemed it to be sufficiently important to include, but it is still important, let us say, hypothetically, then if there is variation in those costs but they are not in the model, then there would generally be imprecision in my estimate, because I would be having price variation that would move around in the output variable. Some of it would, of course, in this hypothetical case, be due to energy cost changes, potentially, and yet those are not there.

Now, the impact of that could either be imprecision, because you have got some price variation but nothing to explain it. So that would just be the model is trying to find the variation in the variables that are there, of course not really finding it because energy costs are not there, and therefore it is less able to precisely identify the effect of what is there. So that is, I would generally say, an imprecision point.

If, on the other hand, there was a high correlation between energy costs and the variable I have, and it was affecting price as well, that would be an omitted variable bias problem, potentially, and that could lead to an upward impact on my elasticity estimate.

But we discussed this in the hot tub as well. My response to that at that point was: I acknowledge that that can be a possibility to some extent if I have not included all the relevant potential costs, and, furthermore, if one would assume they are also highly correlated with one another, I am not sure that is a fair ... you know, that is a reach to say that was necessarily the case. But even if it was the case, because I am then using a gross margin mark-up, the price-cost ratio to convert the elasticity to the pass-on rate, and that would capture all the variable costs because that is what a gross margin does, then it would neutralise that impact. The reason being that, to the extent I have overestimated the elasticity, I have then under marked up, because I have marked up for a full set of costs rather than the costs in the regression.

So if they are closely correlated, which I am not sure they would be, I have got an admitted variable bias problem potentially pushing up the elasticity, but I am using a price-cost ratio that is overencompassing the variables I have, and therefore I am marking up too low compared to the variable costs I am actually measuring.

PROFESSOR WATERSON: I think I follow that, yes.

A. So basically there would be two problems. One is the admitted variable price, and the other, it would not offset it.

MR BEAL: Back to an area I feel more comfortable with, which is surcharging.

A. Okay.

Q. Page 33 of your eleventh report, paragraph 31 {RC-F/19/33}.

A. Yes.

Q. You say:

"Surcharging is a distinct channel ... While it was open to the Claimants to impose surcharges throughout most of the claim period ..."

Just pausing there. You would accept, wouldn't you, that that is largely a legal matter?

A. Yes. Yes.

Q. I assume you are not trying to make a legal submission?

A. No.

Q. I also assume that you are not seeking to go behind the submissions that were made on behalf of Visa at Trial 1 as to the period over which surcharging was or was not lawful?

A. No.

Q. Now, do you recall in Trial 1, Visa's position was that surcharging was very uncommon --

A. Yes.

Q. -- and therefore the no surcharge rule was said not to have any effect?

A. Yes.

Q. Can we look at {RC-F/19/81} in this report, paragraph 207. You say there:

"In practice, only a minority of merchants appear to have decided to make use of surcharging."

I think we know, do we not, if we look at page 198, please, paragraph 623 {RC-F/19/198}, you have identified 20 SSH Claimants out of some 2,000 who brought claims who are identified to have surcharged in practice. Is

that fair?
A. Yes.
Q. So it is right that the vast majority of SSH Claimants did not impose surcharges?
A. I think that is fair. Obviously there is a little bit of uncertainty as to whether the information is accurate as to who surcharged, but otherwise I am agreeing --
Q. You are not seeking to extrapolate and apply a surcharging rate on a sector or UK-wide basis, are you?
A. I am not. I am treating it as a claimant-specific issue.
Q. Now, in terms of the analysed claimants who were surcharging, we have Travix, who has settled its claim against MasterCard, and Pendragon, is that fair?
A. I cannot recall the precise details as to which ones were SSH Claimants, and so on, but yes, I am happy to accept that.
Q. Can we look, please, in your twelfth report, paragraph 494, that is {RC-G/17/156}. You say:
"Contrary to Dr Trento, I consider that surcharging above 100% could be causally linked to the MSC and needs to be taken into account for the quantum assessment."
A. Yes.
Q. But that is speculative, is it not? You are not saying it would have been, you are saying it could have been?

A. Yes, that is correct. I do not think any --
Q. Higher --
A. Sorry, yes, I am happy to stop there.
Q. Higher surcharges could have caused, for example, customer friction and jeopardised sales, so there are good reasons why merchants might not choose to surcharge in their given circumstances?
A. But this issue is, for those who are surcharging, how much less they would have been surcharging if you change the MIF. The debate between Dr Trento and I is that he says if the MIF would have gone down by 0.3, then the surcharge must only have gone down by a maximum of 0.3. I am saying that if the surcharging is, say, twice the MSC, then the ratio might be 2:1.
Q. But you would not be able to show that the higher level of surcharge was causally connected to an increase in the MIF itself, would you?
A. No, because there is no data to do that. Obviously again we are talking about counterfactuals here that we have not had the opportunity to examine that.
Q. Now, in this paragraph 494, I think you also seek to allow for surcharging pass-on rates to exceed 100%; is that right?
A. That goes back to my prior point. It depends on whether the claimant in question is surcharging, let us say, 2%

when it is MSCs or 1%. If that is the case, I am indicating that a change in the MIF, leading to a change in the MSC, could have had an impact on the degree of surcharging.

Q. Could we look, please, in this report starting at page 200, you have a series of estimated figures over a series of tables for what the pass-on rates would be for various surcharging entities; is that right? {RC-G/17/200}

A. Yes. Sorry, which report is this, is it 12, or 11?

Q. This is the twelfth, volume 1.

A. Yes.

Q. We see, for example, there you are dealing with FRF Motors, and then the following pages, we can scan through them and take each of them in turn.

A. Yes.

Q. Now, in relation to somebody like the University of York, your analysis ends up producing a figure to be knocked off the quantum that actually exceeds the surcharging revenue they received; would you accept that?

A. If that is the case, then I am happy to accept it.

Q. Well, let us look at page 211 {RC-G/17/211}. We have here the University of York figures. I see they are marked in green, so could I perhaps invite you to read

... well, the 2015 to 2017 figures, on your analysis, sum to -- if you just do the maths in your head, you can see what it sums to.
A. Sorry, bear with me.
Q. Well, I do not think the total ... well, the total would be confidential. But the far right-hand column, you see --
A. Yes, possible mitigation of claim.
Q. -- there is a figure there --
A. I can see that.
Q. -- which is produced.
A. I have it in mind.
Q. If we look at {RC-F/2/304}, this is in Dr Trento's first report, he gives us a figure here, again confidential, for the total revenue derived from surcharging over the same period in the first column. Strictly speaking, the second --
A. Yes, I see that.
Q. That total figure is substantially less than the total figure you have essentially deducted from the claim?
A. Yes.
Q. So your analysis, does it not, leads to a situation where the estimated mitigation for a given claimant is actually higher than the mitigation they achieved in practice?

A. I think that is a fair point. I have not really thought about it. It seems like a fair point and it would, subject to further reflection, clearly be the case that if the total surcharge amount in Dr Trento's report was correct, then I think that would be a reasonable upper bound for the impact on the mitigation calculation.

I would say that there are quite a number of uncertainties here, at least in respect of data I had. I did not have the actual totals, I had general policies that were applied and under what circumstances, so I was making some estimates based on that information.

I fully appreciate that -- and I think I have noted it, and I believe Dr Trento also noted it -- that the topic of surcharging is such a claimant-specific, data-specific issue, that there may be need for more information from those claimants to be precise as to what they surcharged, how much, and under what circumstances in order to then adopt the general methodology that either I or Dr Trento has put in place.

Q. I think you would accept, would you not, that the surcharging deduction from quantum should only be applied to transactions that were actually surcharged?

A. Yes, although I think there is a question as to whether the way in which the surcharging was done could have captured MIFs on a range of types of transactions, but sort of uniquely applied the surcharge on a certain set of them.

So, for example, let us say there were debit and credit card MIFs that were taken into account but only credit ones were surcharged. In that context, under my methodology, I think it would be relevant to look at the implications of the changes in MIFs in the round, rather than just say the impact would be limited to any change in the credit card ones, because they might have taken into account all of the MIFs but then made a decision that from an operational perspective, or how they were precisely applying the surcharge, they were only doing it on certain transactions.

Q. Well, it is not going to be appropriate to over-deduct, is it?

A. No, I am not saying over-deduct. I entirely agree with you that the amount of surcharging that they actually did almost certainly must be the maximum that the mitigation could be in terms of surcharging. I am not disagreeing with that at all.

Q. So page 159, please, of this report {RC-F/2/159}.

THE CHAIRMAN: Which report?

MR BEAL: This is number 12, volume 1. We are in the document already.

THE CHAIRMAN: I think we are in Dr Trento's report.

MR BEAL: You are quite right, I am so sorry.

So it is {RC-G/17/159}, paragraph 507(a).

As I understand your modifying approach, what you have done is you have calculated a mitigation rate, effectively, a surcharging pass-on rate, and then applied it to the Visa claim values provided by Dr Trento; is that right?

A. Yes, I think so.

Q. But of course in some cases the Visa claim values include transactions that were not subject to surcharging?

A. Yes.

Q. So, for example, the University of York only applied surcharging to card present transactions and not to any others; correct?

A. That may well be the case.

Q. If Dr Trento's quantum of the claim has not been able to split out the card present transactions from the others, then you are applying that pass-on rate to transactions which were not actually surcharged?

A. I think that seems possible, yes.

I think this is back to my prior point: I would need more information on what was surcharged, the amounts and under what circumstances, in order to apply this methodology in a more precise way.

Q. I mean, cutting to the chase, the simplest way of doing it, surely, would simply be to deduct surcharging revenue from the quantum recovered from Visa?
A. Yes, and that is actually the approach I have taken in the cases where the claimants acknowledged, or said in their pleadings, that that was what they thought was reasonable.
So all these approaches are on the alternative case where the claimant is not, presumably, already accepting that the surcharge should just be removed from the claim.
Q. My next topic is supplier pass-on, but I think I can take this very shortly. You do not really have a view on supplier pass-on, do you?
A. Not much, no.
Q. That is that one done.
That leads me on to claimant data. It is at this stage probably going to be easier for us to go into closed.
THE CHAIRMAN: Right.
Do we need to rise for that purpose or can it just be done?
MR BEAL: I think it can just be done, as long as the live feed is turned off.
THE CHAIRMAN: Everyone here is within the confidentiality

ring, yes?

MR BEAL: I think we have an extant undertaking from both Ms Robertson and her solicitor?

THE CHAIRMAN: We do, which still applies. So no one is objecting to Ms Robertson staying?

MR BEAL: No, not on our side.

THE CHAIRMAN: Thank you.

In Private - Redacted

In open court

THE CHAIRMAN: Thank you, Mr Beal.

Ms Tolaney.

MS TOLANEY: I have no cross-examination.

THE CHAIRMAN: No cross-examination, right.

Shall we do re-examination first, or ...

(Pause)

MR JOWELL: If it may be of assistance, I have no re-examination.

THE CHAIRMAN: That resolves that debate, then. Thank you, Mr Jowell.

All right, we have got a couple of questions for you.

A. Great.

Questions from THE TRIBUNAL

MR TIDSWELL: Mr Holt, I want to ask you a little bit about the long-run treatment of variable costs on profit maximisation. I think, as I understand it, you said in the long run, a variable cost will be taken into account for the purposes of profit maximisation as a general principle?

A. Yes.

MR TIDSWELL: If we assume for present purposes, and I appreciate there may be some argument about this, but let us just assume that we have got a claimant which does not take the MIF into account when it sets the gross margin in that part of the real time price setting process.

A. Yes.

MR TIDSWELL: I am not here asking you about any of the evidence, I am asking you as a point of principle and common sense, if I can put it that way.

A. Yes.

MR TIDSWELL: I think you say that the variable cost will find its way through in other channels.

A. Yes.

MR TIDSWELL: I want to focus for a moment on setting the target margin, which I think largely refers to the budgeting process.

A. Yes, correct.

MR TIDSWELL: I think you are saying that the variable cost will be treated differently and will have a different

effect from a fixed cost in the budgeting process; is
that right?

A. I am not making a statement as a matter of fact, because I do not think the factual evidence is comprehensive enough to reach any detailed views as to which types of overheads might be treated in which way.

I did comment in my reports on some evidence that different operators within a sector seem to categorise MSCs in a different way. The examples were in the retail sector where -- and I acknowledge that it is online providers like ebay and Etsy do refer in the public domain to MSCs in their cost of goods sold equivalent, and that other -- I think it was the travel agency sector, there was a mix.

So some did and some did not treat MSCs in that way. But my point was not really about the facts of how they would, but rather that the incentives for the firm would differ according to whether an overhead was a variable industry-wide cost, a firm-specific cost, a fixed cost, and so on.

In other words, the underlying characteristics of overheads, which is a mix of things, vary according to the type, and that the upward pressure for a cost increase would be different if it is an industry-wide variable cost compared to a fixed cost of a firm-specific nature.

MR TIDSWELL: Yes, that is helpful. I think that is the bit I wanted to drill down into.

A. Yes.

MR TIDSWELL: Because it seems to me, and I really am not asking you to comment on the evidence at all, but just to think about this from the point of view of principle.

A. Yes.

MR TIDSWELL: I think the question I am asking you is: is it necessary as a precondition for your theory for the firm to be able to make that distinction, in other words, in the budgeting process, to be able to distinguish between variable and fixed costs and to treat them in a different way. Are you saying that is something that would need to happen in order for this to work?

A. No. The reason I am saying it is not a precondition is I am not saying that there is a conscious -- so I guess I can see that if they treated -- if they treated the overheads costs differently, then that would be a more direct mechanism. So in other words, if they examined and looked at different components of the overheads, and said: look, the nature of some of these costs are different, we have recognised that, we have opened a distribution centre, but that is not a basis on which we can raise costs.

An example is Three having said it could not expect to recoup the extra cost it had in its wider network. But other costs that were in its overheads of a customer and retention cost type were the sorts of costs that were industry-wide and variable and therefore potentially relevant.

So to the extent that there is a distinction drawn, then I can see that that would be potentially relevant, at least to the timing.

If a distinction is not drawn, which I think is really your hypothesis, or at least sort of the scenario that we are discussing, then the question is: okay, well, how might that lead to a higher price in time? The answer to that is that either it would be through the approach to looking at financial information over time and recognising that a whole series of costs are taken into account, and if there is a movement you might have a change to the margin, and then that change to the margin would filter into individual prices, or it would be through the competitive reaction aspect.

MR TIDSWELL: Yes, can we put that to one side for a moment. I understand what you say about all that. But just focusing on the budgeting process, I am just not sure we are quite on the same page. When you are talking about the distinction between variable costs and other overhead costs, I am talking about it simply in the context of the budget-setting process.

A. Yes.

MR TIDSWELL: So we are now in the longer run. We are not in the short run, we are in the longer run, and we are in the long run in circumstances where no distinction has been made and, in fact, let us say the merchant has set its prices in the short run through COGS which does not include the MSC or any reference to it. That is the hypothesis.

A. Yes.

MR TIDSWELL: So my question is, I am just trying to work out how this works in the longer run and where you talk about the upward pressure on the price, and I think you are saying to us that that is likely to be a pressure from variable costs more than from fixed costs, but I am trying to get from you in a way what is the practical way in which that flows through a normal budget process, if one can postulate such a thing.

In other words, when somebody sits down and looks at forming a budget and going through a process of testing that with a business, the finance people testing it with the business people and the executors finally signing it off, are you saying that somewhere in that process the variable costs will be treated differently from fixed costs as far as pricing is concerned?

A. I am saying that, but I am not doing it from a bottom-up approach of saying let us examine all the processes and identify process 800 out of the many thousands of processes that any firm will have, and say that is the process by which this will happen.

That will be a potential bottom-up way to say: here are all the ways in which things can happen. You can set new incentives, you can monitor the overall movement and profitability and recognise that, as a result of the trends in profitability, certain business decisions have to be made, and identify a number of particular business operations that would change as a result.

I have not adopted that sort of detailed bottom-up assessment. I have said as a result of the change in an industry-wide variable cost, I cannot see that it would be reasonable to suppose that a firm would act against the incentives of that cost change over the longer term, and that there are a number of channels through which that could operate, they being either direct pricing strategy or some of the other channels that we have discussed.

I have not then really tried to say: well, let us unpick the individual firms' budgeting, management incentives, pricing. You know, obviously within pricing there are all sorts of potential variations around how they might do that. I have not really gone down that road.

MR TIDSWELL: No. Thank you.

So I suppose we might, just to get your characterisation of top-down and bottom-up, we might take that as being the top-down, your position being the why, because of the economic incentives. My question is really about the how, because I think you are rightly identifying I am asking you about the how.

A. I understand.

MR TIDSWELL: You are saying, I think, you have not got any specific how in mind, but that you believe that, what, the economic incentive will drive people to find a how?

A. At a broad level, I have identified the general channels through which it could occur, ie monitoring various types of movements in profitability, and that creating incentives for people to act differently. Or through reacting to competitors. I have not then traced it through in a more disaggregated way to say: here is the step by step, or here is the precise information that this management team would take into account and feed into that management team. In my view, that would be a very large potential exercise requiring a very comprehensive assessment, perhaps.

MR TIDSWELL: Yes, of course. I suppose I am almost inviting you to tell me one way in which it might happen. Just to take an example, you can see that if someone were to say: as a result of that view of profitability the costs have gone up, we need to do something about it, and one response to that might be to look at cost efficiencies.

Now, obviously if you do that someone is going to need to think about whether the costs can be changed, and that probably is an assessment of how variable they are. So you can see as you go down the chain of logic there, if you are dealing with this as a businessperson, one assumes at some stage you are going to start thinking about the distinction between the costs you can change and the costs you cannot.

But when it comes to thinking about the impact of those costs on pricing, I am not so sure I see that logical flow. I think I am inviting you to tell me whether there is some logic that would lead someone to think that I should think about my fixed and my variable costs differently if I am thinking about going back and looking at the price.

A. Well, I think the logic is that the -- the simple logic is that the benefit of bringing in more customers depends on the margin, and if there are changes that affect the margin, and that is where the distinction between variable and fixed costs comes, then you will either have an incentive to move the needle in the way of let us get more customers in, with a price discount, or generalised or targeted price discounts, or move it the other way. Look, the margin is tighter, we at the margin are not as keen to sort of expand, in terms of our customer base, and let us dial the needle back the other way, ie through price increases or less frequent use of discounting and so on. So that is the mechanism.

MR TIDSWELL: So you are saying that there is a benefit to the firm in getting its gross margin calculation more accurately predicted, and therefore that is the incentive, if you like, to think about the variable costs separately from the fixed costs. Is that another way of putting what you have just said?

A. Yes, I think that is fair. The gross margin is, in a sense, the equivalent to, you know, how much money are we making from each given sale, and if there are changes in that, then it makes sense to sort of try and get more sales if the margin is going up, or fewer sales if the margin is going down. So I think that is --

MR TIDSWELL: Could I ask you just to switch topics slightly, to talk about another channel, to talk about the management incentives.

A. Yes.

MR TIDSWELL: Again the same analysis, really: do you have in mind any particular way in which the pressure of management incentives would encourage anybody to think about particular costs as being variable as opposed to fixed, or is it really the same answer, which is that the general incentive to get (inaudible) margin right would drive that sort of behaviour?

A. Yes. I think it is more the top-down approach, really. The management incentives, in my view, will be said to improve the outcomes for the firm, and I do not think it would make sense for the incentives to do anything other than that.

To the extent that reacting to changes in costs is consistent with that, ie because it is an industry-wide variable cost it would be better for the firm to react to some extent to that type of cost and to not react to the fixed costs, then if there are management incentive programmes that relate to profitability -- and that profitability is affected by those decisions -- then that is the channel that I have described.

Exactly how the management incentive would transmit to the change would, of course, need to then filter through into information it disseminates down the road into the pricing decisions.

But essentially I am identifying the channel as being one where the general profit maximising incentives that I have described and recognise may not happen immediately, and certainly no one is monitoring in real time all the information.

But if the management incentives focus on profit maximisation type things, like profitability, then my expectation is that they would take decisions and require their staff to take decisions that are consistent with profitability.

That draws the link back to, okay, well it is more consistent with profitability to respond to competitors when there is an industry-wide change than it is to try to raise prices for a firm-specific cost increase where we will just lose business to a much greater extent because the rivals are not doing it.

MR TIDSWELL: Just one last question. If, a firm, instead of doing it perhaps the way you are suggesting that they should, instead they decide that they are just going to look more generally at their costs, and not distinguish between fixed and variable, and their decisions about pricing, or indeed other matters, are made by reference to that wider bucket, what are the implications of that for, if you like, the causal connection between MIFs and the pricing outcomes? Do you think that makes any difference?

A. Well, I think if that were right, then that would limit the use of some of the channels, ie some of the channels, I think by the definition of what you have described as applying over the long term, would mean that the direct pricing strategy, and possibly even the target margin approach, would not be necessarily ways by which you would distinguish an industry-wide fixed cost. Sorry, a variable cost from a fixed cost.

In that context, it would seem that the more relevant likely way in which the underlying incentives of the firm, and indeed for the whole sector, would take effect, would be through the fact that any of the close rivals would take into account any of the channels.

It would not have to be a direct pricing strategy, it could be also an indirect channel. But it would require, I think, that at least one other firm, amongst your rivals, is, in the counterfactual, doing something different. That is a fair statement.

MR TIDSWELL: Yes, and the reason for that is because, effectively, your proxy is no longer necessarily the right proxy in either of the gross margin calculation or the targeted budget setting process. You cannot be sure that that proxy is replicating the real drivers of price.

A. Yes. If the evidence were to be, I think, that there is no capability of distinguishing, and no interest in understanding the distinction between the nature of the different costs, then I think that would be fair to suggest that somehow firms would be -- well, what it would mean is that firms are just not engaging with the underlying economic incentives associated with the different types of costs. I could sort of see that as an argument for a limited period of time. I would be surprised if that would be a sustainable position in the longer run, because it would mean all sectors are always out of equilibrium and not reacting to incentives, so I would not really see how that would be sustainable.

But it would then, I think, primarily leave one to focus on the competitor reaction channel. If, you know, the proposition you had made was really absolute and there was no way in which any decisions could be made based on cost type, then I think sure, okay, well then you are sort of almost by assumption ruling out quite a broad range of potential ways in which the underlying incentives could be put into practice. But still leaving the competitor reaction one.

MR TIDSWELL: Thank you. That is very helpful. Thank you very much.

A. Thank you.

THE CHAIRMAN: Could I just ask one further question on that.

So you are saying -- I understand what you are saying about the incentives and the indirect channels, but you still have to explain, do you not, how through those indirect channels it will still filter down into a pricing decision?

A. Yes. Well, I think the way in which it would filter down into a pricing decision would be -- so obviously the direct one is direct.

THE CHAIRMAN: Yes.

A. So let us put that to one side.

The indirect ones are: first, target margin; second, management incentives, and; third, the competitive reaction. So what are the ways in which that might happen?

So target margin first. The general point is, if there is management information regarding operating margins, profitability, things of that nature, then if they are monitoring that and trying to maximise their margins and their profits, which I would expect they would do --

THE CHAIRMAN: Yes.

A. -- then if there are changes in the market or changes in their costs, then they would react to that by -- in any of a number of ways.

One way would be to say: look, the pressure is that we need to raise prices so we are going to raise our gross margin target from 30% to 35%, for example, because of a range of costs outside of the gross margin calculation have moved and we want to, therefore, recoup that broader set of costs through a higher gross margin target. That would then be taken by the individual pricing managers and they would update with that target individual pricing or change the frequency of discounts and so on.

THE CHAIRMAN: So there would have to be something specific going to the pricing department, or managers, in that respect?

A. Well, I mean, I have not tried to identify exhaustively all the precise ways by which this information could get transmitted down into pricing. It could be that it is done centrally. It could be done by any number of product level teams. It could be done through generalised statements. It could be done through directions on how often to do discounts per month.

You know, it is an almost -- virtually infinite number of particular ways in which that could actually happen, and I have not tried to say: look, here are 100 ways, and 40 of them seem to make sense and 60 do not.

It seems to me that, given the underlying strength of the incentives, the fact that the incentives can be considered to operate over the longer term, one can suppose that there are so many channels that some of them are going to be adopted. I do not know which ones.

THE CHAIRMAN: So, one way or another, it is going to filter into the price setting?

A. Yes. There are, in a sense, too many potential challenges, and too much uncertainty about the distinction between a general rule and how it is applied in practice and how it is moved over time, and whether different staff apply the rules in the same way.

I think it is just clearer and not -- sorry. It is certainly not, in my view, necessary to try and go down and navigate that precise path because there are just too many potential variables.

PROFESSOR WATERSON: So to sort of summarise, you have said -- you had a phrase some way back, "reasonable to suppose".

A. Yes.

PROFESSOR WATERSON: That is essentially your top-down approach to looking at this?

A. Yes. Yes. I am not saying that I have identified a factual proof that draws the precise path. I think that would be extremely difficult, in my view, sort of impossible with the amount of evidence actually available in the case.

One could, of course, try and massively expand the evidence base, and then say: well, now let us try and identify the path with all of the evidence of cost changes, all the evidence on price changes, every incentive plan that has ever been produced, every target margin that has ever been produced, and now try and navigate the pathway. Maybe you could do it. I -- you know, it might be quite an industry for a lot of people to investigate it.

My point is that we can bypass that because the underlying incentives are so clear, and the general economic principles so clear, and that while I recognise that there are some real-world short-term considerations, that in the longer term all of these channels exist, and which ones will be adopted in any particular set of circumstances is almost impossible to say. Therefore, in my view, on a balance of probabilities, or what is likely to happen, it is better to look to the economic principles.

PROFESSOR WATERSON: Thank you.

THE CHAIRMAN: Can I just ask one further question?

You have been instructed by Visa since 2015, I think it was your evidence.

A. Yes, that is right.
THE CHAIRMAN: Or been involved advising them.
A. Yes. Yes.
THE CHAIRMAN: Presumably pass-on has been quite an important issue throughout that time?
A. It is a reasonable question. It is actually not the case, and the reason is that the first period of time was only a liability case.
THE CHAIRMAN: Right.
A. The 2015-2017 case against Sainsbury's and Asda was about the liability points and not the damages calculation one. So no pass-on assessment was carried out in any great detail at all in that context.
THE CHAIRMAN: Presumably it was a concern of Visa, looking further down the line, that this would be a potential defence that ...
A. It may well have been, in the sense that depending on had that proceeded to a further trial on quantum, then no doubt it would have been a factor.
But then after the liability trial and the Court of Appeal's decision, all those cases settled, so it never went there.
Again, the EC one was about exemption, not pass-on. So again relating to a liability question.
So this is actually the first time that merchant

pass-on has been dealt with in any detail by Visa.
THE CHAIRMAN: I think it was dealt with in one of the earlier cases, or was that Mastercard?
A. That was Mastercard against Sainsbury's.
THE CHAIRMAN: Yes.
A. So they had a full damages case before the CAT, and some of the experts -- at least one of them -- was involved in that. I was not involved in that.
THE CHAIRMAN: Right. So when did you first consider this question in relation to Visa?
A. Well, in these proceedings it was always identified as a relevant issue. Obviously it was put as a Trial 2 issue, not Trial 1. So essentially it has been my approach in respect of this trial, which is where the pass-on debate that I have been thinking about has arisen --
THE CHAIRMAN: So it was in the context of this --
A. Of this.
THE CHAIRMAN: So relatively recently, then?
A. Yes. I am trying to think is there any other occasion. I mean, not really, because of the fact that the other cases were focused on liability and not a quantum estimate.
THE CHAIRMAN: Right.
A. I mean, I think there might have been some evidence

discussed at some level around what has been the impact of regulatory interventions in Australia on the broader market, and some comment, a bit like what Counsel was putting to me on Australia, for example, about what have been the broader consequences of regulation.

But certainly no detailed evidence on pass-on of the type that we are dealing with here.

THE CHAIRMAN: When did you sort of come to the conclusion that COGS was going to be the most appropriate proxy?

A. Quite early on. So you will have noticed that the numbering of my reports looks high, ie Holt 11 and Holt 12. I am not sure if you had the pleasure of going back to some of the earlier reports.

THE CHAIRMAN: I tried to avoid that!

A. I do not blame you for that at all, and I was glad that I did not have too many questions on Holt 8, to be honest, myself.

Because it was always contemplated that there were pass-on issues and that that was a significant evidential issue in the context of the proceedings for 2,000 plus claimants, early reports amongst the experts -- including myself and a few of the others -- were trying to engage on what is the right methodology for dealing with the pass-on question.

I cannot remember the Holt numbering, but it was probably around 3 or 5 where I started to investigate this in more detail. That is when I identified some of the top-down methodologies as being a relevant source of evidence, like existing studies and public data, and that claimant data would be potentially helpful for gaps, and that that, in my view, was the overall methodology that would be helpful.

So I think --

THE CHAIRMAN: You came to quite an early conclusion that COGS was going to be the proxy that you would think was most appropriate?

A. Yes. I think that reflects the approach I took to the economic principles, which was captured in the Joint Expert Statement in, whenever it was, December 2023. But on which there had been some earlier reports that basically covered similar issues. So in some of my earlier reports I covered all that type of ground about what are the principles of pass-on.

I think the reason I came to a view about COGS relatively early is that the evidence in relation to the parts of the economic principles I deemed most relevant was actually quite obvious; in other words, the variable nature of it, the industry-wide nature of it, and the fact that the counterfactual requires a long-term assessment. It was largely that combination of understanding of that data and information that led me to a view.

THE CHAIRMAN: I understand that. Okay.

Well, I think that is the end. So that is the end of the marathon. You can go away and relax, and we have got an early finish.

I assume we are not going to start with any other witnesses now?

MR BEAL: An early bath, because the next witness is not until Monday.

THE CHAIRMAN: All right.

Thank you very much, and well done for doing it within the time.

MR BEAL: A first time for everything!

THE CHAIRMAN: Hopefully the other witnesses will follow a similar form.

So we will start at 10.30 on Monday.

(12.51 pm)

(The hearing adjourned until 10.30 am on Monday, 2 December 2024)