IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1047/3/3/04

Victoria House
Bloomsbury Place
London WC1A.2EB

23rd May 2005

Before:
THE HON. MR. JUSTICE MANN
(Chairman)

MR. ADAM SCOTT TD
PROFESSOR PAUL STONEMAN

BETWEEN:

HUTCHISON 3G (UK) LIMITED

Appellant

and

OFFICE OF COMMUNICATIONS

Respondent

supported by

BT GROUP PLC

Intervener

Mr. Nicholas Green QC (instructed by Freshfields Bruckhaus Deringer) appeared for the Applicant

Mr. Peter Roth QC and Miss Kassie Smith (instructed by The Director of Legal Services (Competition), Office of Communications) appeared for the Respondent.

Mr. Gerald Barling QC and Miss Sarah Stevens (instructed by BT Legal) appeared for the Intervener.

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HEARING DAY ONE

MR. GREEN: I appear today for the Appellant Hutchison, my learned friend Mr. Peter Roth QC and Miss Kassie Smith appear for the Respondent; Mr. Gerald Barling QC and Miss Sarah Stevens appear for the Intervener BT.

As you know, this is an appeal by Hutchison 3G, who I will call H3G, against the designation of SMP made against us in the Ofcom Decision of 1 June 2004. Under the Framework Directive, article 16, sub-paragraph 4, once an NRA (National Regulatory Authority) – here of course Ofcom – designates a company as having SMP, it is legally obliged to impose one or more of the regulatory obligations set out in that directive upon the undertaking concerned – in the present case Ofcom imposed a reporting obligation on H3G. This is a matter of the greatest concern to the company, for a number of reasons. First, the basis upon which Ofcom imposed SMP is, in Hutchison's submission, deeply flawed. However, because NRAs across Europe are required to apply the same legislation, and because at least in theory there is a requirement that they co-operate and act consistently, one bad decision can lead to another.

The second reason that this decision concerns Hutchison is that the designation of SMP involves, in H3G's case, a price reporting obligation and, contrary to the impression given by Ofcom in its skeleton and in its submissions, this is far from trivial. Indeed, at the EC level it is explicitly acknowledged in the legislation that even reporting obligations are to be applied only sparingly and are treated as administratively burdensome obligations which should be avoided unless absolutely necessary – see, for example, the recital 28 to the Authorisation Directive.

The third reason that this decision is unacceptable to Hutchison is that the designation of SMP is, in principle, an administrative step towards an NRA actually imposing price control. For a new entrant such as Hutchison to stimulate demand for new technology, 3G technology, in an overcrowded subscriber market, the threat of de registe price control is, for obvious reasons, most unwelcome. This is, for Hutchison, an extremely important appeal; it raises serious points of principle and serious points about proper administrative practice. So far as we are aware, the judgment of this Tribunal will be the first in Europe on these issues and, as with other decisions of the Tribunal, its rulings are, and this one will be, examined with great interest and care outside of the United Kingdom, both in the administrations and courts of other member states and certainly within the European Commission. Upon the occasion of this matter, in some member states, rather finding its way to Luxembourg, it will be treated with great interest in Luxembourg. It is therefore an important case and it raises significant issues for the appellant.

What I want to do by way of introduction is to provide an overview to the entirety of our case before descending into the detail, and I want to start by just itemising some of the salient facts about the Appellant.

THE CHAIRMAN: Before you do that, Mr. Green, can we deal with one or two points of housekeeping. First of all, what is the position going to be in relation to witnesses and the evidence that we have in the form of witness statements? There are two questions there: how much of it is relevant at all, which will be dealt with by the various parties' cases on campaigning buyer power once and now; secondly, in connection with that, are we to have cross-examination of any of the witnesses? Can we deal with that point first: what is your understanding, and then I will ask the others?

MR. GREEN: My understanding is that there is no cross-examination, nobody has applied to cross-examine any of our witnesses and we have been told expressly that Miss Laurent's witness statement is not to be cross-examined and is treated as unchallenged.

THE CHAIRMAN: Is there going to be any significant reliance, as far as you are concerned, on any of that evidence? It seems to us to fall into probably two categories: one, the evidence dealing with what happened when the BT Agreement was negotiated – and we will lump Miss Laurent's evidence in with that, even though it deals with a slightly different point – secondly, there is the evidence relating to cost and accounting principles. In relation to the second of those it does not seem to us that any of that is made relevant by any of the parties at all in relation to this appeal as it is currently constituted, and for my part I had not really paid any attention to it. If I am to pay some attention to it, somebody had better tell me sooner rather than later. As to the former, we have paid some attention to it, but it is not clear really whether it is actually going to arise in relation to the issues as they seem to be being crystallised in this appeal, which do seem to be focusing on the post-agreement phase. Am I wrong about that?

MR. GREEN: That is predominantly correct.

THE CHAIRMAN: It is a start, I suppose, Mr. Green.

MR. GREEN: It is a good start. I certainly will be referring you to Miss Laurent's statement and to Mr. Eatery's statement, but certainly not in relation to factual matters which are at the forefront of the appeal, they come in relation to both the relevance of regulatory constraints as a constraining impact upon the ability to set excessive prices, and on countervailing buyer power, but they are more relevant as context rather than the essential points in the appeal. That of course, you will recollect, was why, in particular in relation to Miss Laurent, my learned friends were given the opportunity to cross-examine if they so wished, and it was only just a week or ten days ago that we were told definitively that Miss Laurent was not to be cross-

examined. We did have her ready to be cross-examined for the last hearing, but matters have now changed.

THE CHAIRMAN: Can I just check with the other parties what their position is on evidential matters.

MR. ROTH: On your questions on the two categories, what happened when the BT Agreement was negotiated, that is not something that, as you will have seen, Ofcom places reliance on. Mr. Green for H3G may need to comment on that in response, but we do not think that is of particular relevance, and on cost and accounting principles we think, thankfully perhaps, that is of less relevance. I hope one will not be going into that because I have to confess that there are certain parts of that evidence that I have not fully understood myself. I might refer to a very brief paragraph in one of the witness statements, but it does not require any looking into the calculations and models and all the rest of it.

As far as Miss Laurent is concerned, it is not quite right, with respect, to say there is not some challenge, because I think BT has served a witness statement from Mr. Locker, which does challenge it in various respects. We are not seeking to cross-examine her; insofar as it is of any relevance to the period that we say the case is properly concerned with, which is the period forward-looking from the time of the Decision, I will make some comments on it, but I am not seeking to cross-examine her and dispute what she says. I will seek to put it in context, but I will not comment.

MR. BARLING: Sir, I very much endorse what Mr. Green and Mr. Roth have said. One of the reasons – though not the main reason – that BT sought leave to intervene in these proceedings was because of some of the things that Mr. Westby said, and indeed that were said in the Notice of Appeal. We then put in evidence by Mr. Locker, and there are three statements by Mr. Locker, replies by Mr. Westby and so on, so in a way what is there is mainly commenting on the negotiations that took place leading up to August 2001 and for a short time thereafter until the agreement was made. It is fully canvassed; clearly there are differences of emphasis between those two witnesses but, happily, most of what we would want to get out of that is available from the documents themselves which we say speak for themselves. You can see what comments are made by Mr. Westby and Mr. Locker and we may make some comments about Mr. Westby's evidence, but just as my learned friends have not sought to cross-examine Mr Locker, we have not sought to cross-examine Mr. Westby. That does not mean as it were that Mr. Westby's comments are unchallenged by us, or indeed that Miss Laurent is not challenged to some extent, but that can be done by way of comment. All parties have taken the pragmatic view that you will probably, and we will invite you in due course to, look at the

documents about the negotiations. If you need to draw any conclusions – and it is by no means clear that you do need to now the way the case has developed, as you have said, sir, it has become very much more focused on whether the reasoning of Ofcom was sufficient, rather than on whether at that stage of 2001 there was countervailing buyer power either in existence or being exercised by BT, or indeed whether there was later, but we for our part hope that that will not cause the Tribunal any difficulty. It did not really seem worth increasing the length of the hearing when we can make our comments perfectly easily on the basis of the documents.

THE CHAIRMAN: One of the reasons it may cause us difficulty is if somebody asks us to disbelieve something that is said by one of the witnesses, but we will have to see where we go and what your respective reasons are.

MR. BARLING: I do not think that is the position, it is really a matter of comment.

THE CHAIRMAN: Thank you very much, so we know where we are. Next, Mr. Green, a question of definitions. It is pointed out between members of the Tribunal that from time to time the definitions of significant market power slip and words appear in definitions and then occasionally disappear from definitions. We think we would find it helpful, subject to your wanting to adopt some different course, which of course as an advocate you may, if as far as possible there was common ground as to what the words of the definition are. You are the victim of this, Mr. Green, because we have identified one or two slight discrepancies in the way you approach the matter in your skeleton argument, simply because we have picked up yours first, but at page 7 of your first skeleton argument you set out article 14.2 which I think we would find helpful if it were the prime definition in front of us, subject to anybody's right to say a different form is more appropriate. I think there is an "it" missing from that, but it does not matter. You set it out and that is the definition we think we should all work from, but when you summarise it in paragraph 48 of your skeleton on page 19, you adopt a slightly different formulation, you talk about "Suppliers, competitors and customers" whereas the definition talks about "competitors, customers and ultimately consumers". It may be that it is just a paraphrase, but I think there are one or two other occasions in which slightly different formulations creep in and we would find it helpful if we either stuck to the definition and did not use paraphrases just so there was no confusion. Or, if there was some deliberate using of slightly different formulation if that were flagged on the occasions on which that were to happen. We are not sniping, Mr. Green, we just do not want any sort of accidental emphases to be given to things when it should not be given, or there is an emphasis which should be given which gets lost because a change of wording has not been done. It is something that we would find helpful. Obviously you will present your case, and so will your colleagues, in the

way you think fit, but we just flag that up as being a potential difficulty if an eye is not kept on what we are actually talking about.

MR. GREEN: I think the difficulty arises because the definition in Article 14 of the FWD is itself a paraphrasing of the definition of dominance which comes from Article 82 and the recitals make that clear that it is intended to be no more and no less than dominance under Article 82. Under Article 82 the court has, on occasion used slightly different terminology, but the essence of dominance is well understood and if I have used different phraseology it is because I view dominance as having an essential meaning which can be expressed in a number of different ways, but certainly I am happy to address it through the optic of Article 14.

THE CHAIRMAN: We are not seeking to constrain you, Mr. Green, we are just seeking to achieve clarity and make sure there are no accidental emphases or failure to emphasise which is important.

The third point is purely a question of housekeeping and administration. Subject to strong representations to the contrary for the day following today we are minded to have a 10 o'clock start in the morning, but to have a quarter of an hour/twenty minute break mid-morning, which will help the shorthand writer to catch up and make for a speedier delivery of transcripts at the end of the day and makes the morning a little easier. We will assume that that creates no difficulties for anybody unless they say so, I think preferably now. (After a pause) In that case, from now on for the rest of the hearing we will start at 10. Depending on how we are going we might also take a short break mid-afternoon which will help us to gather our thoughts as things go on, but we will see where we go on that, we do not want to overrun. Good, thank you, Mr. Green.

MR. GREEN: Let me start with a quick reminder of who the Appellant is. Hutchison became a potential entrant in the mobile market in May 2000 when, for a price of £4.4 billion it acquired a 3G licence. Hutchison has subsequently spent multiples of billions, because the figure is confidential, it is in the papers, you would have been aware of it, multiples of billions on building a network. Hutchison competes for subscribers with the other mobile network operators (MNOs) who have been in the market for a number of years and the market for mobile subscribers is highly competitive. As you will appreciate for Hutchison to win subscribers it has either to force existing subscribers of other MNOs to switch to them, or it has to expand the market and sign up customers who have not used a mobile phone before. Hutchison launched its service for 3G on 19th March 2003 (agreed facts, para.22). At this point in time it had secured an interconnect agreement with BT but so far as Hutchison was concerned (and is concerned) BT is and was an unavoidable interconnecting partner.

In April 2004 Ofcom reported that BT originated approximately 79 per cent. of fixed calls in the United Kingdom (agreed facts, para.30) BT interconnects with all fixed line and mobile operators in the United Kingdom. BT has, according to its own evidence, concluded more than 250 interconnection agreements based upon a standard form which it is the progenitor of, but which has been negotiated with some regulatory influence in the market place.

According to BT's own published data in 2001, when the agreement was being negotiated, BT had over 28 million subscribers. Of course, at this point in time Hutchison had none. Shortly before the date of the Decision, in March 2004, according to Mr. Westby's statement in a paragraph which is not disputed Hutchison had acquired 361,000 subscribers. So as of the date of the Decision in terms of mobile subscriber numbers, Hutchison's share was fractional. Although it has made progress since then its share of the mobile subscriber market remains very much based on the published figures, modest. Notwithstanding these facts ---

MR. SCOTT: In relation to the published figures, so that we are on a common basis, what is the latest published figure for H3G's subscriber base?

MR. GREEN: Can I come back to you on that?

MR. SCOTT: Yes, of course.

MR. GREEN: I know what the figure is and I have to just make sure I was aware of its source. I will clarify that in due course.

MR. SCOTT: Thank you.

MR. GREEN: Notwithstanding what, I think on any view, is an unusual market, notwithstanding these facts on 1st June Ofcom concluded that H3G was dominant in the market for call termination. Ofcom stated in its Decision that it would be difficult to argue that Hutchison could not set successive charges to BT (Decision, para.3.32). The Decision, as you know, adopted against Hutchison, found SMP, imposed a reporting obligation upon it – we say this is a flawed Decision in principle and in execution – and we submit it reveals every sin known to Community law.

What actually happened in this case is that Ofcom conducted a very detailed analysis of the position of the other 4 MNOs, Vodafone, O2, T-Mobile and Orange. Ofcom analysed the prices charged by these operators for call termination and they did this according to the standard LRIC cost – standard for 2G networks. They then concluded that these operators charged rates which were excessive, notwithstanding the existence of formal or informal regulatory constraints. I should emphasise at this point that it is no part of Hutchison's case that Ofcom's Decision on these other MNOs was either correct or incorrect. My comments are

observational only and they are certainly not as to the merits of those Decisions, but we do contrast the approach taken by Ofcom to the other MNOs, which was based upon a detailed analysis of costs and prices, with the approach adopted towards Hutchison which was minimalist in the extreme.

PROFESSOR STONEMAN: Mr. Green, could we clarify before we go too far what the market definition actually is. You are talking about call termination?

MR. GREEN: Yes.

PROFESSOR STONEMAN: Is the definition not "wholesale voice call termination"?

MR. GREEN: Wholesale call voice termination, yes.

PROFESSOR STONEMAN: Which is somewhat smaller.

MR. GREEN: On their own network. Of course, as you k now, Ofcom came to the conclusion that each call terminator was dominant over its own network, because you are terminating a call only to your own group of subscribers, that is the market and by definition you have 100 per cent. of it.

PROFESSOR STONEMAN: I was assuming you were going to get to that bit in a little while.

MR. GREEN: Yes.

PROFESSOR STONEMAN: But wholesale voice call termination, what I would find useful if w could clarify, given its wholesale voice call termination and given the definition of SMP is competitors, customers and consumers, if you could clarify for us who falls into each of those three categories, given that it is wholesale voice call termination?

MR. GREEN: Well, this takes you straight into Ofcom's core minimalist case. Ofcom says that the definition of product market is wholesale voice call termination. There are no competitors by definition, because you have 100 per cent. of your own market, even if you have no subscribers, you have vast costs, you have 100 per cent. of your own market. Your customers, well that is the person who is purchasing call termination from you, BT and/or the other four MNOs. Consumers – consumers generally means the person who purchases from you under Community law bit it is capable of being a person further down stream, so one is not precluded from taking account of the ultimate consumer. You may have two levels of consumer, the person who acquires the wholesale service, but you may have ramifications or ripples in another market downstream so that it may be you or I, the end consumer. That, we will submit to you, is not the end of the story, and that is why one has to look at Article 14 in the light of its Community Treaty context, which is one of dominance and I will come to this. But all one is concerned with under Article 14(2), as the Commision emphasised in its guidelines, is whether the undertaking concerned has the ability to act independently in the market place.

Traditionally you do view this by those who encircle the undertakings, suppliers, competitors, customers, because those are the people most likely, in an immediate sense to constrain an ability to set excessive prices.

We will be submitting that, in addition to that category of persons, regulators – insofar as they have the ability to constrain the price – are relevant as a matter of law, because the essential test you are going to be concerned with is whether or not Hutchison has the ability and incentive and in all likelihood would set excessive prices. You then have to ask yourself, as a pure question of fact, is that ability and incentive constrained? Do purchasers constrain it, suppliers, competitors? Do ultimate consumers? Does anybody else, including regulators? It is a pure question of fact - nothing is included, nothing is excluded as a matter of principle. So one simply looks at everybody and everything which circles the allegedly dominant undertaking, and you simply ask yourself what, amongst that galaxy of pressure points actually works? That is the essence of dominance, and that is what Article 82 will take you to and that is why we say, following the European Court's jurisprudence, that is the question you will be asking yourself.

PROFESSOR STONEMAN: I was going to say, we might have some arguments about some of that, but the essence of the point is you are saying that there are no competitors, BT and other mobile network operators are the customers, and the consumers are the subscribers to other mobile networks and BT?

MR. GREEN: And the other MNOs. I am not taking a narrow technical definition of consumer as per Article 14, I am simply taking the definition as would apply under Article 82, which simply says de facto, who is it who is subject to this price? It is the immediate person that is the wholesale customer, and then it may be other people as well if you can show a downstream effect.

PROFESSOR STONEMAN: I was trying to draw a distinction between the customer and the consumer being a wholesale market. Most of the argument here is between the relationship between 3G and BT, BT being the customer, not the consumer.

MR. GREEN: I am not certain it is sensible to get into a semantic debate about it, I do not think it matters. Under Article 82 and under the Directive as a matter of economic commonsense one would look at anybody who would be affected, directly or indirectly, and whether you call them the customer or the consumer I do not think really matters. I accept that as a matter of principle one is entitled to take account of the position of the ultimate consumer.

THE CHAIRMAN: Mr. Green, staying with this question of the ultimate customer, much of the argument in the papers has revolved around the relationship between H3G and BT. BT, we

have heard, has in excess of 250 interconnect agreements with those who are authorised under the general authorisation provided for in the framework, so there is a group of potential customers, those who have not got interconnect agreements with H3G, but who would be entitled under the framework to have agreements with H3G. As a matter of convenience they may well, at the moment, be using their interconnect agreement with BT so that they can provide end to end connectivity with H3G, but at the level of the wholesale customer it seems that we should embrace, presumably, all 250 insofar as they have general authorisation to provide voice services.

MR. GREEN: I do not think the entirety of the 250 are relevant and I do not think we have evidence on who they are.

THE CHAIRMAN: It is not so much the detail as the fact that between H3G and BT there seems to be an important interconnection agreement, which appears to us to be removing not the possibility but the likelihood of a multiplicity of interconnection agreements arising between Hutchison and others who are authorised. It therefore may fall to us to consider the position of that agreement as a matter of the power exercised in relation to those customers and consumers.

MR. GREEN: I take that point, that is a point which arises in the Decision in relation to Ofcom's analysis of the other MNOs, and it is addressed in Mr. Westby's evidence.

THE CHAIRMAN: Yes.

MR. GREEN: It is really the fact that BT operates as an effective gateway for other MNOs to interconnect to.

THE CHAIRMAN: Absolutely.

MR. GREEN: So the gravitational pull in the Decision is the BT Agreement, and I do not think there is any dispute about that. Indeed, the point that Mr. Westby makes is that we cannot possibly have market power against other MNOs if we do not have it against BT, for the simple reason that anybody can avoid H3G by directing through BT and simply paying the 0.1/0.2 ppm transit fee. That in its own right is a matter which, as you have seen from the Decision,, Ofcom did not grapple with, but we say is simply a very self-evident fact. So the BT Agreement is really the pivot for controlling competition because everybody else, if they do not like the price we offer them, can simply circumvent the negotiation with us by going through BT.

THE CHAIRMAN: That may then lead us to consider the possibility that as in the definition one party with another party may be exercising SMP, and we will no doubt come to that in due course.

MR. GREEN: Again, by way of introduction at this juncture I wish to emphasise one matter which is of significant importance, which is that Ofcom's analysis focused exclusively, and I emphasise the word exclusively, on power over price. That was the sole and exclusive focus of Ofcom's consideration in this case; it was whether Hutchison had the ability to set an excessive price. In any competition case the authority has to decide how competition actually occurs and manifests itself on the ground, i.e. in reality. Competition invariably focuses upon price, but often quality in relation to a service or a good can be important, as can service levels or even advertising, promotion and marketing, they can all form the focus of competition. The price, for example, may not be critical in the case of a luxury yacht, but quality may be paramount regardless of price. Price may, on the other hand, in some markets be absolutely pivotal – petrol supply is one where you have a homogeneous product and competition turns substantially upon price.

In the present case, Ofcom has decided, having addressed itself very deliberately to the question, that price and price alone is the indicia of SMP and dominance. The issue for Ofcom was whether or not Hutchison could charge an excessive price.

PROFESSOR STONEMAN: Could you give me a reference that shows that Ofcom ---

MR. GREEN: I am just about to do that. If I can, I am going to provide an overview and then I am going to take you back and show you the key documents which actually address all of these matters. It grappled with this first of all in May 2003, at which point it addressed, very, very deliberately, which factors were not relevant to SMP – it excluded a whole series of factors – and it expressly discarded, amongst other things, technological advantages and superiority, product and service differentiation, it expressly excluded the extent of the development of distribution and sales networks and expressly excluded non-price matters. It went through these matters and set out in a table those which it thought were relevant and those which it thought were not relevant. The consequence of this analysis – and I will show you the document shortly – was that Ofcom from May 2003 onwards viewed power over price as the sole touchstone of SMP or dominance.

Having decided that price and the ability to charge excessive prices was the sole relevant criteria, so far as the existing 2G MNOs were concerned, Ofcom was in its view nigh on bound to come to a conclusion that they had SMP. Again, I will come back to that later. There is some support from the Commission's own SMP guidelines that price is the paramount indicia of SMP or dominance – because the Commission again in its guidelines states that the essence of SMP is an ability to charge a price which is excessive. It is also relevant at this juncture to point out an obvious point, which is that there is a wealth of difference between an

ability to raise prices per se and an ability to raise price above the competitive level to an excessive price. Merely because a company has the ability to raise price by, let us say, 5% or 10% is not an indication that it has SMP; all companies in all markets will seek to raise prices, for example because their input costs might increase or in line with RPI. That does not mean to say they are dominant. What Ofcom was looking for was a particular level or quantum of increase which was to a level above the competitive level.

THE CHAIRMAN: Or a failure to decrease price.

MR. GREEN: Or a failure to decrease its price in line with a reduction in costs, yes, paragraph 332 of the Decision.

When Ofcom turned its attention to Hutchison, rather than conduct any analysis of cost or prices as of the date of the Decision or at any date into the future, it simply down-tooled. As you know, Ofcom made no finding that Hutchison's prices were excessive (amended defence, para 42, 19, 86 and 96A). Ofcom also conducted no cost base analysis. Ofcom says it had no means of calculating what an excessive charge was (see the amended defence para 88). Ofcom also did not conclude that the price embedded in the BT Agreement – and again that is a confidential number so I shall not refer to it – would enable Hutchison to maintain prices at above costs, either at all or at a level which was excessive over the course of the Decision (amended defence para 85). Importantly – and I am going to show you this document now – Ofcom did not conclude that Hutchison had any incentive to raise prices to a supra-competitive level; indeed, Ofcom expressly acknowledged that there was no evidence to suggest that Hutchison had an incentive to raise prices to an excessive level. It first of all concluded this in the December consultation paper, and it recorded it again in the actual Decision. This is one document I would like to show you, even at this early stage. The relevant document is in bundle A2, tab 4, starting at page 812 of the bundle. The paragraphs in this section were then incorporated by cross-reference into the Decision itself. Page 812 of the bundle has a heading, "Treatment of 3's 2G Voice Termination Services". You do not need to read all of this, but the relevant paragraphs start at 5.125 on page 813, and here Ofcom says the following:

> "The Director is still of the view that '3' has the ability to set excessive charges for 2G termination services. As with all MNOs, '3' is the only MNO that can terminate calls through its subscribers, hence it has the freedom to set charges above the competitive level."

If you just pause for one moment there, you will see that Ofcom's analysis at this stage, December 2003, was that because Hutchison was the only operator in its own market it

had the freedom to set charges, hence the word "hence". It was a direct read-across from product market definition to ability to set excessive levels of rate.

At 5.126:

"Costs incurred by '3' when terminating 2G calls include a payment to O2 as part of a roaming agreement. This might suggest that charges set by '3' for 2G termination will be above the industry norm. The Director's concern, however, is whether '3' uses its ability to set excessive charges for voice call termination (i.e. charges well above those costs incurred).

5.127 In its response, '3' argued that as a new entrant it has an incentive to implement interconnection quickly, whereas those interconnecting with it do not. '3' believes that it is this imbalance that leads to negotiated termination charges not reaching excessive levels.

5.128 The Director recognises that, whilst it has the ability, whether '3' has the incentive to set excessive charges for 2G voice call termination service is less certain. The Director accepts that so far, '3' has set charges for 2G voice call termination services in line with those of the other MNOs. This does not mean however that charges will remain so indefinitely or that '3' lacks the ability to significantly raise the level of charges for 2G termination services."

If you drop then to paragraph 5.132 on 814, Ofcom says as follows:

"The Director has therefore concluded that a LRIC-based obligation is not proportionate because:

(a) so far there is insufficient evidence to suggest that '3' will set charges for 2G voice call termination at levels significantly above the established industry levels by adding an excessive margin on top of costs."

I do not think the rest of that is relevant, though if you wish of course you can skim-read it. This was tracked, effectively, into the Decision, and if you jump forward in the same bundle to tab 6, page 1125, Ofcom says as follows at 5.70:

"The third point raised by Orange is the fact that in forcing a LRIC obligation would place a significant burden on '3' to provide accurate and updated information (paragraph 5.132, December consultation) is not a reasonable justification for the decision to treat '3' in a different manner to other MNOs".

5.71:

"In terms of 3's 2G voice call termination services, Ofcom believes that the expected decline in 3's 2G traffic would mean a 2G specific LRIC obligation would be

disproportionate. As part of its voice termination, '3' combines 2G with 3G and, unlike with 2G call termination there is significant uncertainty concerning the costs associated with 3's provision of voice call termination. Ofcom is still of the view that there would be a significant burden on 3 meeting the LRIC obligation. However, this is not the sole basis against imposing such an obligation".

Full explanation to Ofcom's position as regards the regulation of 3's call termination is provided in paras. 5.129 thro' to 5.132 of the December consultation. Ofcom remains of the view that at transparency obligation, including the reporting requirement is a proportionate obligation to impose on 3 at this stage, as explained in 5.135 to 5.137 of the December consultation. However, this does not prevent Ofcom from setting additional remedies at a later date if such action is justified and compliant with all relevant tests in the Act."

So Ofcom's position between the two documents in December and June is that there is no evidence that Hutchison has the incentive to set an excessive price. Ofcom's position rests exclusively on what it perceives to be a theoretical ability, and there is an important distinction which I wish to emphasise at this early point between ability and incentive. There is no analysis in this Decision anywhere of Hutchison incentive to set an excessive price, there is simply reliance upon what we criticise as being an entirely theoretical ability and it takes that theoretical ability from the product market. It leaps from product market, in effect, to a conclusion of SMP.

MR. SCOTT: Mr. Green, you have mentioned to us the technical advantages, service differentiation and distribution and sales, as factors that were discounted implying, it seemed to me, that there might be matters to which you would return there. As you develop your argument, are you disputing the point made by the European Commission that here we are dealing with voice termination? In other words, we are not dealing with technical sophistication of third generation networks, we are dealing simply with a voice call?

MR. GREEN: I am not certain I understand the relevance of the question. Obviously, voice call termination, the call is terminated on a 3G mobile phone or a 2G mobile phone, and in order to establish a 3G network the costs are greater, substantially greater, that is a matter which Ofcom is considering at the moment.

MR. SCOTT: That is right. Taking the point that you were just making about 5.73, Ofcom are engaged in an ongoing process. The period, as we now understand it is running to 2007, and Ofcom are seeking to model the costs at the moment, so that is an ongoing matter. But this is a much narrower point. If you are thinking about what a competitive price might be, then in a forward looking costs analysis, you are going to be considering the costs of voice termination

and not of any bells and whistles; and in terms of distribution in sales we are talking here about voice calls into 3, where we seem to have established the number of customers effectively involved is rather small, and I do not think you need to do much advertising to BT to let you know that 3 exists, so it seems to me that we have to be careful about introducing factors which, although they may be relevant to other considerations of 3G, may not be relevant to wholesale voice termination.

MR. GREEN: I think that is the point I am making, which is that Ofcom, having addressed its mind to this issue decided that price was the only thing that mattered, and everything else was to be discarded. We rely upon that fact, because once we focus upon what really matters in terms of SMP, it is price, we are not concerned with other matters, we are concerned with ability to set an excessive price, and that is the only thing that has to be examined.

MR. SCOTT: Yes, as we shall see, the Ofcom case is based on one or two other things before you get to that, like 100 per cent. market share and the absolute barriers to entry, but no doubt we will revert to those matters in due course.

MR. GREEN: It excludes a number of matters and obviously I will deal with them. The nub of Ofcom's Decision can be found at para. 3.32 of the June document, and this is at p.1102, and if you would turn to that I would be grateful. It is a short decision, it is contained within the June statement, which contains a number of other decisions. It does not run for many paragraphs, but there are a relatively small number of absolutely critical paragraphs, one of these, indeed, it seems to us that this is one of the pillars, if not the central pillar of the decision, is 3.32. I would like to focus upon that by way of introduction.

You will see here in 3.32 that, even though Ofcom has not done any price or cost analysis, were they even at the back of the cigarette packet, it is able to conclude in part of the first sentence:

> "It would be difficult to argue that 3 could not set excessive charges for the termination services provided to BT."

That is an extremely strong statement.

> "It would be difficult to argue that 3 could not set excessive charges for the termination services provided to BT."

In other words, Hutchison can now and in the future charge an excessive price to "poor little BT." When you look at the reasoning in the remainder of this key paragraph, you find it addresses two issues. One, contractual constraints on price; and secondly, absence of constraint on price reduction if costs fall. If one takes both of those two central propositions separately. First, as to increase in price you will see that the tenor and flavour of 3.32 is an

acceptance that existing contractual arrangements may make it difficult for 3 to raise prices. If I just read 3.32:

> "With such a forward looking perspective, and with delay not such a critical issue for 3, it would be difficult to argue that 3 could not set excessive charges for the termination services provided to BT. With specific regard to 3's evidence, Ofcom believes that it refers to the specific circumstances which 3 was in prior to offering services to the public. However, it does not provide a sufficient indication of how future negotiations with BT would run, given the change in 3's circumstances, i.e. previously it acquired an interconnection agreement with BT to start operating but that is no longer the case. It may be that existing contractual arrangements between 3 and BT make it difficult for 3 to raise charges from their current level, however, there is no arrangement in this contract for BT to ensure that charges fall over time from their current level in line with costs."

I will come back to the last sentence in a moment, but you will see that the logic is that it may well be the case, is what they are really saying, that it is difficult to raise prices. Then they say However, there is nothing which prevents the reduction in price to reflect costs as they fall. So Ofcom is here accepting a constraint on raising the prices through the operation of the BT Agreement, but it says that there is nothing in the contract to ensure that the prices fall. This is a key part of Ofcom's logic, and of course we are challenging the Decision and the key logic in the Decision. It is not that prices will go up, rather it is that prices will not track costs down, and that is, when you look at this sentence, and Ofcom's logic which is, after all, the focus of this challenge of what Ofcom must mean when it says it will be difficult to argue that 3 could not set excessive charges for termination services provided to BT.

But set this against the context. Ofcom has no idea, because it says so in its evidence, how 3's costs will move – it has not done the analysis, and it says it does not know. It did not examine the issue, and I am not diminishing for one moment what it says elsewhere, which I will return to, but its case here is that there was a lack of contractual arrangement to prevent a lowering of prices. What does Ofcom then say about this? I would like you to look at para.68 of Ofcom's skeleton. This is an important part of Ofcom's Decision, and yet when it comes to Ofcom grappling with an explanation of what they have actually said and what they actually mean they plainly have trouble with it. Paragraph 68 of Ofcom's skeleton, in the last two sentences.

"The reference to the absence of a provision for charges to fall in line with costs is little more than a passing comment. It is certainly not central to Ofcom's case as H3G seeks to suggest."

So what to us, and what we say on a fair reading of the Decision, should be evident, is that this is an important, at the very, very least, paragraph of the Decision; Ofcom now says it is no more than a passing comment. With respect that is an unfair and inaccurate statement. H3G was foisted with an SMP determination because of Ofcom's failure to conduct any analysis at all. Here, in relation to prices coming down it plainly does not wish to pursue that point. It says it is no more than a passing comment. We have understood, and I understand from your comment earlier that you understand this to be a not insignificant part of Ofcom's case, yet here it is merely something they say en passant in this Decision.

MR. SCOTT: Mr. Green, we have to be careful here with the timings. As we understand it, Ofcom were in a situation where they had a significant background, and significant evidence in relation to the 2G operators.

MR. GREEN: Yes.

MR. SCOTT: A modelling exercise had been done, they had had a long history of information and of previous inquiries. In relation to H3G there was at this stage what can only be described as a dearth of information that there were no economic models or accounting data upon which Ofcom could conduct any analysis. As we understand it, and as we have already rehearsed, they are now in the process of remedying that. But would you agree with me that if a determination of SMP is made then the burden passes to your client under the access directive, which in bundle 1, p.121 it is the operator who has an obligation regarding the cost orientation of its prices.

"The burden of proof that charges are derived from costs, including a reasonable rate of return on investments shall lie with the operator concerned…"

You keep placing the burden on Ofcom who were in a situation where they did not have any basis of analysis at all.

MR. GREEN: No, absolutely not, I do not accept that for one moment. The duty is on Ofcom to establish SMP and I am going to come back to that later. It is on it to establish SMP. The only sensible interpretation of case law, which has now emanated from the court in relation to merger cases in a highly analogous scenario, the regulator cannot impose a designation such as SMP without having conducted a proper and detailed analysis. I will show you the case law which makes it clear that the theoretical ability is simply not good enough and that in all the merger cases where the Commission was engaged in ex ante analysis of dominance, they are

saying companies X and Y merge, you have to project into the future to see if it creates dominance, or strengthens dominance, and the Commission says that putting X and Y together gives them a big market share and they have the ability to engage in a certain practice which will entrench their dominance, or create their dominance. The court says that that is manifestly insufficient.

The Commission was walloped all around the court in three cases *Schneider*, *Airtours* and *Tetralaval* because it advanced this minimalist case, and the court said that theoretical establishment of ability does not even get you to base point. You have to show ability and real likelihood with "convincing" evidence which you have to do through an economic assessment of likelihood and of all the facts before you can come to a conclusion about dominance. You cannot simply say "ability is enough". The point which the Commission has advanced in its SMP guidelines is law which is best part of three years out of date; and, with the greatest of respect, you responsibility as a court is to apply the European Court's guidelines. You can reject my submissions if you think it is irrelevant, but if you think it is relevant then you have no choice, it is the court as opposed to the Commission's guidance, and you will have to think where you think the balance lies between the two.

Coming back to the point made a moment ago that in some way because Ofcom found it difficult to carry out a cost based analysis in 2004, that is an excuse, well with respect that simply is not an excuse. First of all, there are other tests which Ofcom can perform in order to decide whether a price is excessive, which falls short of full scale 3G cost analysis, and I will show you a recent Ofcom decision which demonstrates that.

Secondly, the evidence suggests that as at the time of the BT agreement, or shortly thereafter, it would be difficult to compile 3G costs, but the Decision was taken 15 months later and it is no excuse for Ofcom to say "I am afraid it is difficult and we have only now just got around to carrying out a cost analysis". If they had not done the cost analysis they should not have imposed SMP. They did not have to take an SMP decision against Hutchison at that point in time, they could have delayed it; it is no answer for them to say it is difficult or it is complex, of course it is difficult and complex, but that is their job and we do not accept for a moment that there was not a means of them testing cost price analysis.

Look at it this way, let us assume that there had been dispute resolution, the dispute referred to Ofcom. Under the regulations, Ofcom had 40 days, a biblical period, in which to resolve the matter. They cannot get out of it, they have to do it in 40 days; if there are exceptional circumstances they can extend for a little while, but they cannot simply wash their hands and say it is too difficult, they have to do it. They would not carry out a full-scale 3G

cost analysis, but they might carry out a mini review, as indeed Mr. Rutnam says they would do in his witness statement for Ofcom, or they may carry out some alternative test to decide whether or not the price offered by Hutchison was excessive. We submit it is absolutely no excuse for Ofcom to say it is all too difficult, we will defer the cost analysis for a couple of years; if you cannot do it, then you use the next best test and if you cannot do it at all then you should not be imposing an SMP determination, you should wait until you have done the homework.

MR. SCOTT: What is the position of Article 13 of the Access Directive; what is the purpose of placing upon the operator the obligation in relation to cost orientation of prices if the entire burden falls on the national regulatory authority?

MR. GREEN: I am just trying to find the Access Directive.

MR. SCOTT: It is in E1 at page 120 or 121.

MR. GREEN: What I was actually referring to is the situation that arises once an SMP determination has been imposed and an obligation has been imposed which says that the company shall apply LRIC plus X. Thereafter, in determining whether or not you have complied with the obligation, the obligation is on the company to simply say "I know what my obligation is, I have complied." We are dealing with a state of affairs which occurs quite a long way down the line, we are not dealing with a state of affairs which has to be examined in order to decide in the first place whether one imposes SMP. If I recollect rightly, I think that is explained fully in one of the recitals.

MR. SCOTT: If you go to recital 16 you will begin to read in on transparency.

MR. GREEN: Yes, thank you. Perhaps I can do that later on rather than take up time now, but the wording of paragraph 13.3 in my submission is really very clear: where an operator has an obligation regarding costs orientation of its prices ---

MR. SCOTT: That is entirely understood, Mr. Green. I am just thinking of the process through which any national regulatory authority in relation to any novel situation such as the situation which Ofcom faced – as distinguished, as you have properly distinguished, between the 2G mobile network operators for whom inquiry has already been made, data already there, models already in place. They faced a different situation on this occasion: they were considering a period which now, as we have said, extends to 2007, and there is a slight chicken and egg situation as between SMP and price justification which is reflected in 13.3 of the Access Directive. In other words, they have to get in somewhere.

MR. GREEN: Yes, but you get in at the appropriate point in time. If Ofcom is right, that the mere ability, without any incentive, to charge an excessive price is the test, and then they can

establish on the facts of this case that there was an ability, then they win. But if they are wrong on either the law or the evidence then they lose, and one facet of that is, is it acceptable for them to throw their hands up in the air and say it is all too difficult? Answer: no. Nothing in the regulation or the directives, or in the Act, permits them to take a premature decision. I am going to go through the price material quite steadily before I get to dispute resolution or countervailing buyer power, and in particular you will need to look at *Tetra Laval* and *Airtours* to see how the Court has approached analogous situations, where the Commission has taken the position that Ofcom has taken, and, frankly, its analysis has been massacred. That is the law we are now dealing with. You may reject my comparison with the merger cases, but if not then in my submission when Ofcom says we do not have to worry about incentive, we only have to concentrate on theoretical ability – and we take that simply from the fact that the product market leads to a figure of 100% – that does not get them even to the starting point. Once you boil down their case to that – of course they have discarded countervailing buyer power along the way and they have discarded dispute resolution along the way – that is what it boils down to. If they are right, it has pretty profound consequences for the companies across Europe.

PROFESSOR STONEMAN: Mr. Green, just to clarify your logic, are you saying therefore that for SMP to exist, despite what we agreed earlier as the definition, you need ability, incentive and actual supra-competitive prices.

MR. GREEN: You do not need actual. This is why the analysis is ex ante, and when you are asking yourself whether Hutchison is dominant, you are asking yourself does it have the ability to act independently. What is meant by "ability", is ability a theoretical ability or is ability something which also has within it an incentive, a likelihood that it will do that which it is said it has the ability to do?

PROFESSOR STONEMAN: Not that it actually does it.

MR. GREEN: No, not that it actually does it. It has the benefit in the case of the other four MNOs in this Decision of the fact that it has three or four years' worth of history of price control, and in relation to those MNOs it was able to come to the conclusion, rightly or wrongly, that the MNOs charged an excessive rate despite regulation, but it was therefore able to look at it with the benefit of some history, which it does not have in the case of Hutchison.

THE CHAIRMAN: Can we establish what you mean by incentive? I do not want to get hung up on the definitions, but what do you mean by incentive?

MR. GREEN: "Incentive" means an actual likelihood or probability that a company would engage in excessive pricing. I can walk out of my house with a knife, I have the ability to stab

someone but I do not have the incentive to do so because I may be morally deterred or the threat of prison might deter me. So I have a theoretical ability. We dispute that Hutchison has the ability, but assume it does have the ability, does it have an incentive to do so? Answer: no, it is not going to use such power as it has to push prices up for a number of reasons which have been set out in the evidence. I am limiting myself to the course of this Decision – I have seen that Ofcom now has extended the period, but you are concerned with the period of this Decision – and in the course of that Decision – we are talking about another year's duration or so – there is nothing to suggest that Hutchison would raise prices. Indeed, on the contrary.

THE CHAIRMAN: It strikes me that your point may not so much be one of incentive but absence of incentive. If you have the ability to raise prices then one might say the incentive is to maximise the profits so your shareholders think better of you, which goes almost with the territory of being able to increase prices – and normally if you can increase the price then one would expect a commercial concern to do so. It may be that your point turns not so much on incentive but the absence of an incentive, and there may be various reasons why, although you have an ability, you choose not to do so. One possible reason is that you have long range marketing plans, there may be other things which are taken into account, there may be general board understandings, there may be all sorts of reasons, but it seems to me that your point concerns more of an incentive not to, which actually qualifies what is prima facie an ability to. Is that the point?

MR. GREEN: I do not disagree with that, save for this, which is that according to the case law Ofcom has the burden of proof of establishing the ability to act independently on the market; in terms of ability it has the burden, it has to prove that we would in all probability push prices up to an excessive level, and then that involves looking at the incentives or disincentives. We would put forward a variety of reasons, saying we have an absence of incentive to push prices to an excessive level, they would then have to come back and say "Ah, but, you do have an incentive to push prices up for the simple reason that you have got voracious shareholders who are banging on the door saying where is the return on our investment?", for example.

THE CHAIRMAN: Where do you get the "in all probability" from?

MR. GREEN: European Court case law.

THE CHAIRMAN: That is going to come from the cases is it?

MR. GREEN: Yes.

MR. SCOTT: Staying with incentive, your clients have no doubt got a business model from their considerable experience as a group of telecommunications, and it will not have escaped their notice that other mobile network operators have been known to produce a model of call tariffs

which tend to result in low on-net call tariffs at the retail level, relatively low tariffs for calls from their mobile network to fixed network operators and relatively high tariffs at the retail level for calls from one mobile network operator to another domestic mobile network operator. As we understand it from the documentation, and from previous inquiries on 2G networks, that is in no small measure due to the competition that exists between mobile network operators at the retail level.

MR. GREEN: Yes.

MR. SCOTT: Competition in which we understand '3' has been very successful.

MR. GREEN: They have been making progress, yes.

MR. SCOTT: Making progress, good low prices, but as we look at those prices the prices in one direction for a call do appear to be different to the prices in the other direction for the call. We have not been served with a lot of evidence for this, but may we take it as common knowledge that that is the case?

MR. GREEN: There is a certain amount of evidence in the CC report of this, but it is no part of Ofcom's Decision and that is one of the reasons why there is no evidence on it, it is not part of the matrix of the case because it is not in the Decision.

MR. SCOTT: But, Mr. Green, what you are talking about is a question of incentive.

MR. GREEN: I am talking about Ofcom's failure to examine a critical issue which it is required to examine in order to establish SMP. If you have a decision which reflects a failure by a decision-maker to examine something which is a relevant matter, then of course you have a silence in the Decision – one can speculate what might have been the case if there had been an examination.

MR. SCOTT: Do you think that the silence in the Decision may have been due to the fact that insofar as we have been here before in relation to 2G operators there are certain things that are understood in the documentation that we have before us from previous inquiries about the way in which mobile network operators have been financing their businesses, and we entirely understand that the shareholders behind your client will be looking for a return from their considerable investment?

MR. GREEN: I do not think one can say that in this case, not least because Hutchison is a new entrant and its business case is quite different to that of the 2G operators, a fact which I think is accepted by Ofcom in both the May and the December statement. It has very, very substantial costs which it has to incur at the outset, it has to create, for example, an almost entire network because it cannot build it up incrementally; it has to build in one fell swoop an entire network because it has got to compete for subscribers with the other 2G MNOs.

MR. SCOTT: That may go to the regulatory level of prices ---

MR. GREEN: I think it goes to its business rationale. I mean, there are a number of quite material differences between Hutchison and the 2G operators which means that you cannot simply read across what might or might not be incentives for 2G operators into 3G, there is a quite different cost structure. You cannot either, I do not think, simply say that Ofcom must have had this in its mind, there is no evidence of that at all – if there had been, we would have put evidence in on it, it would be an issue in the case. I do not think one can say that there are things which are lurking at the back of Ofcom's mind because in a judicial review we would be saying if this was important and it is not in the reasons, that is an independent ground of challenge because they are required to give reasons for their decisions and they have not done.

I have got to the point in providing the overview of looking at paragraph 68 of Ofcom's skeleton, and I want to move on from that and deal in broad terms, before getting down to the nitty-gritty, with what we say SMP means. SMP so far as we are concerned means dominance within the meaning of Article 82 of the Treaty. That is stated to be the case in the recitals to the Framework Directive in the Commission's SMP guidelines: dominance means the ability to act independently of those around you who would otherwise constrain that ability. We submit that it is important that constraint might come from a variety of different sources. It can come from suppliers, but that is not so much of a relevant consideration in the market we are concerned with here, but there are many cases under Article 82 where the European Court and the Commission have found that suppliers can constrain the downstream purchaser. Constraint might come from rivals, whose very presence exerts a disciplining force. Again, if you take the product market in the present case as being each company's own call termination then there are no rivals. Constraints may also come from buyers who have the ability to exert sufficient negotiating clout to prevent a seller from charging an excessive price, so to exercise countervailing buyer power a buyer need not be a monopsonist, in other words a dominant purchaser – I do not think that is a necessary requirement – but it has to have the ability to exercise sufficient pressure to constrain the ability of the seller to push prices up to a supra-competitive level. Whether a constraint on the ability to act independently exists, depends on the facts of each case; there is no excluded category of excluded relevant constraints and this is why constraints imposed by regulators, or by regulations – in other words the Treaty itself or prohibitions in normative instruments – can be relevant in practice. Indeed, I do not think Ofcom challenges this proposition – for example, paragraph 3.39 of the Ofcom Decision, bundle A2, tab 6, page 1103. In relation to the four MNOs countervailing

buyer power Ofcom explicitly recognises that the threat of regulatory constraint is relevant – at paragraph 3.39 on page 1103 Ofcom says:

"The December consultation noted that there were commercial considerations which limited the countervailing buyer power of MNOs. Aside from these commercial considerations, Ofcom also considers that, in relation to whether an operator has countervailing buyer power, the threat of regulatory intervention is relevant. Any failure by Vodafone, Orange, O2 or T-Mobile to purchase call termination from '3' may trigger a regulatory intervention under section 73 of the Act. Ofcom considers that this implicit regulatory threat curbs any countervailing buyer power the MNOs may have in the market for voice termination services on '3''s network."

If Ofcom takes the position that the threat of regulatory intervention can curb buyer power, *a fortiori* seller power, there is no material difference. The question is, as a matter of fact, does the threat of regulatory intervention curb someone's ability to either extract or impose a high price? Answer, says Ofcom: Yes, in relation to BT and the four MNOs. It cannot therefore say that it is not relevant in relation to the supplier on the other side of the equation. As a matter of commonsense, if a particular act, here setting an excessive price, is prohibited or is likely to be curbed – for example if it attracts penal sanctions – then it is not logical to assume that the conduct will in fact arise.

I would not go so far as to say that in every case the regulator, or the mere fact that there is a threat of regulatory intervention, is the complete answer, but the regulator who is trying to impose dominance or SMP must ask itself the question does the threat of regulatory intervention either curb or preclude seller power? We say the answer in this case is yes, but Ofcom has not asked either the relevant question or indeed the question at all, you know that it has fallen into quite a complicated analysis about what its powers are under the dispute resolution procedure.

MR. SCOTT: In what circumstances would the threat of regulation not curb SMP? If one assumes there is always a regulator in the background and therefore anybody in the marketplace would know that, when would it not operate as you suggest?

MR. GREEN: We have five decisions in the June statement. In four of them the decision is based upon the fact that the regulation did not work, so in relation to the four 2G MNOs, Ofcom's Decision was based upon the fact that they found evidence of excessive pricing – again whether right or wrong – irrespective of the fact that at the time two of the companies were formally regulated and two were informally regulated. That is because if regulation, for example, takes the form of RPI-X, so you can only increase your price by Resale Price Index

minus a fixed percentage, it is still theoretically possible to charge an excessive price because you may slash your costs to such a degree that your costs come tumbling down, but you can still set your price, taking into account RPI-X at a very, very high level, and that is what Ofcom was saying in relation to the four 2G MNOs, that notwithstanding regulation, it still found excessive prices.

In relation to a company where there is no such history, as the court made absolutely clear in *Tetra Laval*, you cannot make the assumption that they will brook regulatory intervention, you have to examine it. If you find that there is a probability and an incentive to ignore the regulatory constraint then you can ignore it and you can say it does not constrain the ability, but the court made it clear that if you have a regulatory constraint it is an important factual l matter requiring investigation because, like anything else, it has the ability to constrain the ability to push prices up to an excessive level.

MR. SCOTT: As I understand it, the situation you are describing is a situation which I think is known in the jargon as a "glide path" in which the regulator is seeking to bring the prices down over a period so that we reach a stage where they are appropriately related to cost, and that as I understand it is what Ofcom have been doing in relation to the 2G operators, and implicit in 3.32 is their concern that no glide path provision existed in relation to H3G in the BT agreement?

MR. GREEN: I think that is fair. Whether it is a steady glide path or whether there is an excessive price it is the duty of the regulator to curb it instantly is another matter, but the regulator wants to make sure that companies do not charge an excessive margin in relation to costs. In 3.32 they addressed this matter en passant, so they say, but that was their point that there was no contractual curb on prices coming down as costs fall.

Just thinking about regulatory constraints, let me give you a few examples. The most obvious one is the statutory prohibition in Article 82 of the EC Treaty, which prohibits the abuse of a dominant position.

THE CHAIRMAN: It is very important in this regard to understand the difference between this sort of case, and the ordinary Article 82 case. In an ordinary Article 82 case, such as the Tribunal has had in front of it and the Commission has had in front of it over many years, in Brussels, y you actually have a company, we have got past the stage of dominance, but you have the bodies littered around the floor, and you have the bullet marks on the wall, and you have blood on the ceiling – you have the evidence of abuse. In other words, you have only got an ex post case if deterrents have not worked.

MR. GREEN: If you are looking at the evidence of abuse, when you have Article 82, Article 82 did not do its job. The threat of regulatory intervention did not work, otherwise you just simply would not have the case in the first place. So that although it is theoretically possible that the regulatory constraint could prevent dominance, it has not done so. You know it has not done so and therefore it just is not an issue in all historic ex post cases. When you are dealing with it ex ante, you cannot make that factual assumption because there are no dead bodies littered around you, no skeletons tumbling out of the cupboard. You have to ask yourselves whether the company would engage in an excessive price, what would be an abusive price of course, we are talking about something which is, by definition abusive. But would H3G engage in an abusive price even though (a) it would by definition be prohibited under Article 82, (b) it would be nipped in the bud by Ofcom under its regulatory powers; and (c) if there is a dispute resolution then, as we submit, Ofcom has to impose a fair and reasonable price, and it could not by definition again, permit an excessive price which was abusive. There were a number of ways in which you can express the regulatory constraint.

In *Tetra Laval* it came from Article 82 and it came from some commitments that the company had offered to the European Commission, some undertakings, not to engage in a certain type of behaviour. The Commission then said that to both create and establish dominance, the merger between Tetra Laval and Sidel would engage in certain practices which the court said would be prohibited. The court said "Why are you assuming therefore that this prohibited conduct would be engaged in?" These are examples of regulatory constraints, but it is difficult to differentiate between an ex post case, which is what the Community has been dealing with for 30 years – the ex ante cases are very novel. It is only in the ex ante case that one has to consider in practical terms this question of regulatory constraints.

MR. SCOTT: Can we stay with this question of abuse for a moment, because it seems to me that in the documentation before us, this question of abusive pricing, supra-competitive pricing comes up quite often. In the framework provided for regulation it seems to me that the Article 13 is envisaging a cost related price. It is a fine tuning of the price. It is not necessarily addressed to some mammoth abuse. It is envisaging a situation in which ex ante regulation is taking place in an orderly way against modelled forward looking, long run total system average incremental costs. What the picture you are painting for us is asking us to consider whether there was ability and an incentive to engage in what might be described as a flagrant abuse?

MR. GREEN: No, not at all. It is like saying that you can be "a little bit pregnant". I do not think you can have a flagrant abuse or a non-flagrant abuse; you have an abuse, an abuse which is

defined under Article 82 as one which is excessive, persistently excessive – whatever that may mean.

MR. SCOTT: But Article 82 draws a clear distinction between dominance and abuse.

MR. GREEN: Yes.

MR. SCOTT: But what we are in danger of doing here is suggesting that you are not dominant unless you have an incentive to be abusive. It seems to me that the test we are applying is of independence not being abusive.

MR. GREEN: No, the test that Ofcom has set for itself, of dominance, is the ability to set an excessive price. Inherent in that definition is a price which is a price persistently above the competitive level, and that is no more and no less – and there is a great deal more to it of course than that – than something which may be described as an "abuse". That is in the context of this market when we are focusing on price – not quality or product differentiation or promotional marketing – in the context of this market it is an integral part of the definition of SMP, so says the European Commission in its guidelines, so says Ofcom in its Decision. Does Hutchison have the ability, not just to push prices up, but also to push them up to a supra competitive level? We say (a) they do not have the ability, (b) if they have the ability they do not have the incentive, and they have to have the incentive to get home, but we win on both counts. It is simply a facet of this case that the definition is wrapped up with a single type of conduct, namely an excessive price, and that is just a peculiarity of telecommunications and this market.

PROFESSOR STONEMAN: Can I just return to this point about regulation? Is your argument that absent any specific regulation of H3G, which we cannot have unless there is a finding of significant market power, absent any specific regulation of H3G, are you arguing that the general regulatory environment is itself a characteristic of the definition, or the calculation of SMP? Is that basically it?

MR. GREEN: Yes, absolutely; and what I say is relevant, and these are matters which Ofcom has at least to consider – if necessary only to discard – it has to consider any regulatory power of intervention which could, at least theoretically, curb the ability to set at an excessive price. If it does not address its mind to that category of constraint, then it will not have addressed its mind to the right issues. It may say that there are four potential curbs to regulation and we can discard (a), (b) and (c), but according to the case law it must address its mind to it, and I do not think Ofcom objects to that analysis because it itself has built it into the Decisions – for example in 3.39 it accepts that it has to look at the regulatory situation to see what impact it has on the ability.

MR. SCOTT: Can we just stay with this question of excessive pricing. It seems to me conceptually that prices can be excessive in two rather distinct regards. The first has to do with what we may consider to be the theoretical market, we are dealing here with wholesale voice termination and with looking at a price which seems to be excessive, taking that market in abstract, and having regard to the costs that could be incurred by an alternative supplier. That, it seems to me, is distinct from the question of how prices relate to H3G's actual costs. Do you see the distinction? You have talked about the enormous amount of expenditure, both on the licence for the radio spectrum, and on the network. Now we are not here to discuss which costs it is appropriate to consider on a forward looking basis. But if one was considering in a theoretical sense, as one would when modelling these costs, the forward looking costs of an operator simply providing voice termination, then one would be considering the level of prices in relation to those costs, not in relation to the actual costs of H3G. When you come to regulating H3G were price regulation to come in, yes, you may want to have a debate with Ofcom about actual costs and some of the factors you have mentioned about innovation and new entrants.

But in terms of SMP, it is the ability of H3G to sustain in the market place a price above that that would be charged by a theoretical operator operating on a LRIC basis that we are considering. Is that right?

MR. GREEN: I think it is! We are dealing with prices in a particular product market, so we are dealing with prices for wholesale voice call termination – (1). (2) Ofcom has not yet modelled the 3G LRIC cost ----

MR. SCOTT: But Ofcom does not need to model the 3G LRIC costs provided it has modelled costs for mobile voice termination. That establishes a level of cost because ----

MR. GREEN: This is part of the problem that Ofcom, as indeed one has seen from its most recent letter, accepts that 3G may be different, that is one of the big issues – to what extent is 2G a relevant benchmark? To what extent are there differences? It is not accepted that 2G costs, and 3G costs, certainly from my client's point of view, are necessarily the same.

MR. SCOTT: Yes, you referred us to p.811, whilst the Director considers 2G and 3G call termination to be in the same market, he then goes on to say that his view remains that ex ante regulation is not appropriate for calls terminated on 3G networks. So a distinction was being drawn by Ofcom between the market analysis and the regulatory remedies and, as we understand it, at the market analysis stage, they were not drawing a distinction between 2G and 3G, and indeed a 3 mobile is capable, as I understand it, of being accessed either by the 3G or 2 G route.

MR. GREEN: It is not entirely clear; well they say they did not do any cost analysis. Again, one must not speculate, they did not do any cost analysis in relation to whether the embedded price in the BT Agreement was reasonable or unreasonable. We know from the December statement that they had taken the view that a price in excess of 20p per minute would be what they describe as a monopolistic price, but you know that the price embedded in the BT Agreement is vastly below that. So is it sensibly being suggested, when they have not done any analysis at all, that the embedded contract price is excessive for 3G? It may or may not be, we have not the faintest idea because they have not done the analysis and that is not the case we have to meet. We do not have to meet a case where the embedded price was not excessive, this is where we went down Mickel/Myers exchange and that has been cut off because it is accepted that they did not do the work to prove that or disprove it. They did not suggest either that the cost would fall ----

MR. SCOTT: No, but staying with the distinction between the market analysis stage and the regulatory stage, what Ofcom decide in relation to 2G is that the 2G wholesale prices are above a competitive level?

MR. GREEN: Yes.

MR. SCOTT: It follows that if – and I am not mentioning the detailed prices – but if we are in a situation where the wholesale prices charged by 3 and reflected in the BT Agreement are at or above the level reflected in the 2G agreements, and if we are dealing with the same product, notably wholesale voice termination, then it follows at the market analysis stage?

MR. GREEN: No, with respect, absolutely not. I mean that is no part of Ofcom's Decision, this is why we went down Mickel/Myers, to chase down its assertion and to see whether or not that was actually their case and we rested at great length and after considerable expense the admission that they had not examined costs, and it was no part of their case that costs would fall over the course of the Decision to a level below the embedded contract price which made that excessive. Now, we have chased that down and it is not part of the case, and that begs the question as to whether 3G costs are the same as, lower than or higher than 2G costs, which is now a big issue for Hutchison and Ofcom to investigate. But we have been there and, with great respect, it is not open to the Tribunal to resurrect an issue which we have rested the admission out of Ofcom to the effect that they did not investigate it and it is not their case.

MR. SCOTT: Yes, I think really what we are trying to do is to establish which part of this price thing has to do with market analysis, and which part has to do with the remedies.

MR. GREEN: Ofcom has to show that Hutchison would have the ability to charge an excessive price, notwithstanding, for example, regulatory constraint or BT's buyer power, which we have

not even got on to yet; and moreover that, even having the ability they have the incentive to push prices up to above the competitive level. They have addressed ability simply by drawing a conclusion from their narrow definition of the product market, and by excluding our analysis of BT's buyer power, and by we say getting their knickers in a twist on dispute resolution.

MR. SCOTT: You have not challenged their market definition?

MR. GREEN: No, that is not part of this case.

MR. SCOTT: So expressing concern about its narrowness is inappropriate.

MR. GREEN: No, I am entitled to say that they – as they have – have jumped from product market definition, in other words 100 per cent. to an ability which they say is enough. We say it is just a logical conclusion going from (a) to (b), because once you have stripped out countervailing buyer power and dispute resolution as a curb, that is the bottom line for their case. They do not have to quibble about the product market definition, I am simply observing that that is the irreducible logic of their case.

Can I now just actually identify the three principal attacks made on the Decision? In a sense we have covered a great deal of ground through questions and answers, but before getting into the documents – and again, standing back, I think it is very helpful to have questions and answers because it will speed matters up later – so far as prices are concerned we say, as I have said already, Ofcom failed to carry out the analysis they were required to carry out and, as such, they did not have the proper material upon which to base an SMP determination. It is no defence for Ofcom to say it is all too complex, it just is not a defence.

PROFESSOR STONEMAN: Before we move on, Mr. Green, you were going to tell us what they could have done alternatively. If it were too difficult to go and collect the numbers, you said there were lots of other things they could look at. Is this where you are going to tell us what those other things are?

MR. GREEN: Not quite yet, I am going to though, I am just finishing the introduction, it is a quick introductory overview, which is what I am on at the moment.

THE CHAIRMAN: Or trying to be on.

MR. GREEN: I am cutting out quite a lot of what I was going to say by way of introduction, lest it stimulate more questions. Let me move on from price and try to give you an overview of regulatory constraint. If you set aside the question of price, what is our case on regulatory constraint? It comes down to the very essence of what is meant by an ability to act independently and, as I have said already, this is a pure question of fact. What actually constrains Hutchison, is it buyers, is it suppliers, is it competitors? We say it is two things principally, it is (a) buyers and (b) regulators and/or regulation.

So far as the dispute resolution procedure is concerned, Ofcom's case has blown in the wind. In its pleading it has said that in the absence of SMP, which was the appropriate assumption, Ofcom could not impose price control and therefore, said Ofcom, it had no option on an application under the contract to grant any application which Hutchison liked at all, however absurd or excessive or inappropriate and, equally, it had to reject any application by BT to push prices down. This was the legal maze Ofcom found itself lost in. In its skeleton it latched on to paragraph 5.4 of the Access Directive which allows and empowers NRAs to resolve interconnection disputes, and this was the subject of the Tribunal's recent letter asking for submissions. As to this, Article 5.4, when it applies, imposes upon Ofcom and any NRA an obligation to set a fair and reasonable price. We have always accepted that insofar as 5.4 is the solution, then it has to impose a fair and reasonable solution – and I will return to the details later – but under Article 5 of the Access Directive Ofcom can resolve interconnection disputes but it cannot mechanistically and without thought simply allow Hutchison to raise prices and reject any countervailing application by BT to lower prices. That would not be acting reasonably in setting a fair price.

The dispute resolution is an integral part of the interconnection legal framework. It is an immediate weapon in the hands of BT or Hutchison, or any other negotiating partner, and it exists to curb the excesses or perceived excesses of market power. It is a weapon which Ofcom can wield of its own volition, on its own initiative as well. This is not a distant or aloof regulatory rule, such as one might say that the overarching Article 82 is, it is a close and integral constraint which is at the heart of interconnection parties' negotiating strategy. De facto it does constrain the ability to set prices at will.

Having assumed this in Hutchison's favour, Ofcom states that as to the future BT would no longer have buyer power for the legal reason that in May 2002 BT was subject to an end-to-end connectivity obligation. Ofcom, as you know, says that BT had or might have had buyer power in 2001 but lost it subject to the May 2003 consultation paper. Ofcom assumes therefore that there could be a circumstance in which there could be a reference to dispute resolution, but it then comes straight back into its own maze, namely that it would be forced to permit Hutchison's price increase and forced to reject BT's price decrease.

We say that dispute resolution does create a curb, and when you look at the internal documents which BT is so keen on, never mind Mr. Locker, never mind Mr. Westby, Mr Barling says it all turns on the documents – and I will show you his favourite document later. When you look at that document it blows him out of the water on regulatory constraint; at the very time the negotiation was going on it was quite plain that Hutchison was worried about

regulatory intervention and that was a very real reason why it felt it had to agree a 2G type price. So regulatory constraint through dispute resolution operates at two levels: one, it creates a de facto curb, as well see, in the course of negotiation; two, it creates a *de jure*, a legal block on the ability to set an excessive price. Ofcom accepts its decision that regulatory intervention is relevant – we say we agree, therefore Ofcom when it made its legal error about allowing us to push prices up, rejecting BT's ability to push prices down, failed to address its mind to the correct issue and, as a result, it simply misapplied the law.

THE CHAIRMAN: Two small points on that, Mr. Green. As I recall the evidence in relation to the negotiations between H3G and BT, there was some concern within your client's organisation that actually going to the regulator – and I know the regulator has changed along the way – was an unwieldy, time-taking procedure.

MR. GREEN: Yes. There is a third level, indeed, which was – without being excessively rude, only slightly rude – the bureaucratic inefficiency and ineptitude was in its own right something to be avoided and it meant we had to cave in quicker. The last thing we needed was a lengthy, protracted, delay in negotiations, and Ofcom was telling Miss Laurent and her team at the time that any dispute resolution procedure would take a very long period of time and would be terribly difficult and, frankly, they had better go away and get into marriage guidance counselling with BT, and that was the answer to their woes. That is the third level but that, as you may have seen from some of the internal documents, was also something which meant Hutchison had very little choice but to agree BT's prices. Looking at it moving forward, assuming they are not as inept now as they were then, and they will now live within the 40 day time period, then there is an absolute curb on the ability to charge an excessive price now.

THE CHAIRMAN: Staying with this question of the relationship of this ad hoc dispute resolution mechanism and ex ante regulation, as we understand it from documents recently produced before us, the Commission in *Re TP* in Germany have recently been considering that in relation to the alternative fixed network operators in Germany, and no doubt you will wish to comment on the position taken by the Commission in that decision in due course.

MR. GREEN: The Commission is rather helpful, the Commission did not say that regulatory intervention was not relevant, it simply said it wanted convincing evidence from the German authority that on the facts of its cases before it, it had or had not worked. The implicit assumption in the Decision is that regulatory intervention is relevant and the Germans have not put forward convincing evidence to support their case, said the Commission, so the underlying assumption is that regulation is relevant as a curb. It is very hard to interpret the case because we do not actually have the facts and we do not know, in particular, what the issues in relation

to the price increases were, so it is quite difficult to understand the context and I am not entirely certain whether there was a detailed price analysis carried out by the German authority. But we do not see that as inconsistent with our case, we see it as the European Commission operating on the presumption of administrative law that regulation exists to fill the void. Nonetheless, your task here is to look at the facts as they apply in the United Kingdom, to consider countervailing buyer power, which is a particular relationship between Hutchison and BT, to consider dispute resolution and how it applies in the United Kingdom, and to consider whether or not Ofcom carried out a proper cost price or analogous related review.

The third general matter for which we criticise Ofcom is in relation to buyer power. Again, I do not think there is any doubt that in principle it can be a curb on the ability to charge an excessive price. Ofcom in its Decision, both in the June statement and then earlier in the December statement of 2003, leapt to the conclusion that after the 2001 negotiation BT lost all buyer power because of the May 2003 document. That is clear from the December statement and it is pretty clear from the June statement that it was that May 2003 paper which constituted the material change of circumstance and stripped BT of its buyer power. This is, with respect, utter nonsense, because as the May 2003 document itself says, all it did was continue the existing constraints upon BT; BT was subject to end-to-end connectivity obligations for a very long period prior to 2003, and Mr. Barling in his helpful skeleton has set out a long a peroration on the extent of the regulatory constraints upon it prior to 2003. It is a point they make that they were always subject to regulation and an end-to-end connectivity obligation. If BT exercised buyer power or might have done so in 2001, notwithstanding that it was subject to end-to-end connectivity, then end-to-end connectivity cannot be the key. The key – the only thing which is then left in the Decision – is delay. BT, so says Ofcom, might have had the ability to exercise buyer power because of delay, because Hutchison needed speed to get into the marketplace and dragging of heels by BT could have given it leverage.

Ofcom's Decision. Our submission to you is that it is based upon a legal error, its starting point is simply flawed that there was a material change in circumstance due to the May 2003 paper. As a result of that, Ofcom did not examine the reality on the ground between BT and Hutchison. It committed a legal error to start with and this prevented it from getting into the details of the negotiation to see, relevantly, to what extent those negotiations would either embed the contract price in a way which would be fixed for many years, or would give Ofcom an indication of how negotiations would operate in the future. There were two important matters, therefore, that it needed to look for: one, to what extent is the embedded contract price

there for a long period of time – and Miss Laurent's evidence goes to this – and, secondly, to what extent did those negotiations throw up characteristics which would be durable? In other words, if there was a negotiation in 2004 or 2005 or 2006, to what extent would these negotiations provide evidence that BT would still have buyer power three, four or five years later?

Ofcom did not address its mind to those issues, it did not look at them, otherwise we would have had an analysis, and that is one of the reasons why the parties accept that it is not essential for your decision to find out whether BT did or did not actually have buyer power? It is because there is nothing in the Decision about that, but I will be showing you certain evidence demonstrating that it was a very serious issue that Ofcom should have examined, and it is a serious error that it failed to do so.

That is my short introduction and I want to go through the next section reasonably quickly, because I have dealt with quite a lot of it in introducing the case. The next section of my submissions concerns what is meant by SMP. A lot of this we have gone over and I will simply summarise or skim it. The relevant directive of course is the Framework Directive and it is Article 14(2) (E1, tab 9, page 151). You will note that under Article 16 of the Directive where SMP is found an NRA is obliged to impose obligations, there is no daylight between the SMP finding and the imposition of obligations, one legally follows the other. You will have seen in the Commission's guidelines – and we have set the relevant paragraphs out fully in the skeleton – the Commission actually says there is no discretion here, if you find SMP the NRA must impose one or more of the obligations set out in Article 16, and you will note therefore there is an important distinction here between Article 82 and SMP. In Article 82 a finding of dominance does not have any immediate consequences, a finding of SMP does. That is important from a policy perspective because whereas a company that is dominant acquires no pejorative label, it is simply dominant – and all companies aspire to be dominant – it is only if you abuse your dominant position that you have committed any sort of mortal sin. In the present case, if you acquire SMP you are then subject to regulation, possibly including price control, so the burden on the regulator should be all the greater when it comes to looking for SMP because there are significant consequences which flow from that legal finding, unlike with Article 82.

We say as a matter of policy there should not be any question of prophylactic findings of SMP, it should be a finding based upon a detailed, thorough, economic analysis, because any such finding carries with it negative consequences for the company concerned. One gets the impression from Ofcom's skeleton that they take the view that Hutchison should not have

complained about this because, frankly, what is the beef, it is only a reporting obligation after all. It is a serious matter to find SMP and it is quite unlike dominance.

The SMP guidelines I think are worth quickly looking at. These are in bundle E1 at tab 11.

THE CHAIRMAN: Mr. Green, while we are turning to this you have said there is no daylight between what most of us have in the past thought of as a three-stage process of market definition, market analysis and any assessment of regulations, but presumably there is a pause for considerable thought by the regulator between a finding of SMP and deliberation as to which remedy is applied?

MR. GREEN: Yes, I accept that the only discussion they have is as to which obligation, not as to whether they impose an obligation, but the imposition of an obligation follows from SMP.

THE CHAIRMAN: I entirely understand.

MR. GREEN: They then have a duty under the directives to impose only proportionate obligations.

THE CHAIRMAN: Yes. It has not been part of your case that if your client has SMP this remedy is disproportionate, because as we understand it you accept that if your client were to be found to have SMP, this would be a proportionate remedy.

MR. GREEN: That is not part of the Notice of Appeal. We are not saying it is not an unwelcome burden, because it is, but if we lost on SMP and the directive, assuming it is a valid directive, operates, then they have to impose ---

THE CHAIRMAN: You would rather have this than a whole lot more.

MR. GREEN: I think that goes without saying. Rather than read the whole of it, I just want to take you to the most important of the SMP guidelines. I think only two guidelines are really relevant, 21 and 114. 21 is on page 193:

> "If NRAs designate undertakings as having SMP they must impose on them one or more regulatory obligations in accordance with the relevant directive and taking into account the principle of proportionality. Exceptionally, NRAs may impose obligations for access and interconnection that go beyond those specified in the Access Directive, provided this is done with the prior agreement of the Commission."

Then in paragraph 114 on page 206:

> "If an NRA finds that competition in the relevant market is not effective because of the existence of an undertaking or undertakings in a dominant position it must designate in accordance with Article 16(4) of the framework Directive the undertaking or undertakings concerned as having SMP and impose appropriate regulatory obligations on the undertaking(s) concerned. However, merely

> designating an undertaking as having SMP on a given market, without imposing any appropriate regulatory obligations, is inconsistent with the provisions of the new regulatory framework, notably Article 16(4) of the framework Directive."

In other words, NRAs must impose at least one regulatory obligation on an undertaking that has been designated as having SMP. Where an NRA determines the existence of more than one undertaking with dominance, i.e. that a joint dominant position exists, it should also determine the most appropriate regulatory obligations to be imposed, based on the principle of proportionality.

As to the obligations themselves, these are set out in Articles 8 to 13 of the Access Directive, and I would like you just to skim them if you would, please, p118 to 121 of the same bundle, E1, this is tab 7. In this part of the Directive (the Access Directive) there are a number of obligations referred to. There is an obligation of transparency in Article 9, obligation of non-discrimination – Article 10. Accounting separation – Article 11. Article 12 – obligation of access to and use of specific network facilities; Article 13 – price control and cost accounting obligations. This says:

> "National regulatory authority may, in accordance with the provisions of Article 8, impose obligations to cost recovery and price controls, including obligations for cost orientation of prices and obligations concerning cost accounting systems, for the provision of specific type of interconnection and/or access, in situations where a market analysis indicates that a lack of effective competition…"

means that the operator concerned might sustain prices at an excessively high level or apply a price squeeze to the detriment of end users. Just concentrating on the language of those few words, what inference do you draw from it so far as SMP is concerned? It indicates the "lack of effective competition means that the operator concerned might sustain prices at an excessively high level". It is not just talking about an ability, it is "might". "Might" can mean more than just a theoretical ability. Again, you will get guidance for this from the case law, but "might" in this circumstance means a probability. Then it says:

> "National regulatory authorities shall take into account the investment made by the operator and allow him a reasonable rate of return on adequate capital employed taking into account the risks involved."

Now, if you jump back in the same directive to recital 14, to p.114 you begin to see the policy which underlies the directive, and the policy is to avoid over regulation. Recital 14 says:

> "Directive 97/33/£C laid down a range of obligations to be imposed on undertakings with significant market power, namely, transparency, non-discrimination, accounting

> separation, access and price control including cost orientation. The range of possible obligations should be maintained but, in addition, they should be established as a set of maximum obligations that can be applied to undertakings, in order to avoid over-regulation. Exceptionally, in order to comply with national commitments or Community law, it may be appropriate to impose obligations for access or interconnection on all market players as is currently the case with conditional access system for digital television services."

But one finds in really rather a large number of the recitals and, indeed, in the Commission's own guidelines a reference to a need to avoid over-regulation to prevent regulation occurring in an ex ante field to the greatest possible degree. This is indeed reflected in recital 28 to the authorisation directive, if you turn forward just a few pages to 130 in the same bundle, E1, now in tab 8. There is a comment here in relation to reporting obligations, and here the Counsel of Ministers in the legislation say as follows:

> "Subjecting service providers to reporting and information obligations can be cumbersome both for the undertaking and for the national regulatory authority concerned. Such obligations should therefore be proportionate, objectively justified and limited to what is strictly necessary. It is not necessary to require systematic and regular proof of compliance with all conditions under the general authorisation or attached to rights of use. Undertakings have a right to know the purposes for which the information they should provide will be used. The provision of information should not be a condition for market access. For statistical purposes a notification may be required from providers of electronic communication networks or services when they cease activities."

Again, not even a reporting obligation is viewed as desirable if it can be avoided. It should not be used unless strictly justified objectively, limited to what is strictly necessary, because it is cumbersome, it is an intervention which, generally speaking, should be avoided.

MR. SCOTT: But there seems to be a tension to which you are adverting between the fact that the framework requires some obligation, a proportionate obligation, if the finding of SMP is made and your suggestion that that should be read back into the market analysis itself, and in your recent submissions on our questions, you have referred us to recital 27 of the framework directive.

MR. GREEN: No, what I am saying is really a broader point, which is that over-regulation, or let me step back even further, regulation *per se* can, in its own right, be anti-competitive. You have a Government body interfering in the market place, requiring companies to operate in a way they

would not otherwise operate. Now, there are varying degrees of intervention and some are more intrusive than others, but the underlying principle is that ex ante regulation is, by definition, intrusive. As the Commission says – I am sure you have seen this – in the guidelines, ex ante is really a very far distant cousin to ex post, and should remain so. Ex post is always desirable because then you know the facts and you are only intervening when strictly necessary. Ex ante is prophylactic and there is the risk that you do something in the market place which causes ripple effects. There is one recital which actually makes the point very explicitly in relation to interconnection which, in the context of our discussion here, I would like to show you. It is recital 19 to the access directive, which is p.114/115 of the bundle, which is a cautionary tale for regulators.

If you just cast your eye down it rather than me read it, if you would do that I would be grateful. (After a pause) You will see in the middle of that paragraph, on p.115, there is a statement:

> "The imposition by national regulatory authorities as a mandated access that increases competition in the short term should not reduce incentives for competitors to invest in alternative facilities that will secure more competition in the long-term."

So they are very conscious of the fact that if you mandate access simply because you have a small player entering the market, that you might actually deter new entrants from building out their own networks. So again intervention has to be treated with kid gloves. If you intervene in an ex ante situation in an inappropriate way, it may appear fine and dandy in the short term, but it can have long term repercussions. Again one finds numerous statements in the recitals, and in the SMP guidelines saying that ex ante regulation needs to be treated very cautiously which is why they keep on introducing objective necessity, proportionality and so on, and why the Commission keeps on saying in the guidelines it is better to move to ex post rather than ex ante. So ex ante, as a matter of policy, should not be imposed lightly. How does this then impact upon the general interpretation of the SMP meaning? It means that regulators should not impose an SMP determination without having convincing evidence of something more than theoretical ability.

THE CHAIRMAN: Why would that not apply anyway? It is obviously serious. You do the exercise that you have to do. I confess for my part I am deeply troubled by this notion that somehow the quality of the exercise when you are assessing SMP is affected by the fact that you are going to have to do something at the end of it. It may be that we are forced to that, but ----

MR. GREEN: Under Article 82 there is no consequence. Under Article 82 there is no consequence of a finding of dominance, whereas here, if you find SMP you are going to be walloped with something. So it is just one step more serious than the position under Article 82. You are right in the sense that if the law is that they have to carry out a thorough economic analysis involving a number of stages is not in dispute then so be it. But Ofcom is saying that mere theoretical ability is enough.

MR. SCOTT: But stay with the market as we see it. The market as we see it is an artificial construction of regulation, and if one returns to recital 19 on p.142 we see why. Recital 19 on p.142 speaks of radio frequencies, and as your clients know only too well, the United Kingdom decided to engage in an auction which resulted in your clients deciding to spend a lot of money on some radio spectrum. So we are in a situation where there is already ex ante interference in what might otherwise be a free for all. In other words, as I understand it again, these telephones that your clients' ultimate consumers use are capable of being accessed either by the 3G network or the 2G network. There is a technical framework in which the calls are actually routed, but were BT to say to O2 "We understand that we can route calls to these numbers via 02's network, why do we not just do that under our agreement with you (02)?" I think that your clients would want to take exception to that. You would want the protection of regulation to stop this market becoming competitive. So that we are dealing with a market which is, although technically capable of operating in a competitive mode, is being prevented from doing so by the way in which recital 19 has been interpreted in the United Kingdom. Do you see what I am saying?

MR. GREEN: Recital 19 governs, I think, two things. It governs first of all the original allocation of the scarce resource, namely the radio spectrum, which is the subject of the auction?

MR. SCOTT: Yes.

MR. GREEN: And it is also relevant to the much mooted possibility of spectrum trading.

MR. SCOTT: Yes.

MR. GREEN: I have to confess I am not quite certain how it relates to ----

MR. SCOTT: Let me try and put it to you another way. It is technically possible for BT's retail customers and the customers of the other 250 network operators, to have their calls routed to those holding numbers in the H3G series, either via H3G's network, or by O2's network, or indeed technically in the course of a single call via one in any other. But as we understand it, that does not leave BT free to route calls via the 02 network by virtue of their interconnection arrangements with 02. If that is not the case then the market is a very different market because

it is then a competitive market because BT could use that roaming arrangement to access 3's customers.

MR. GREEN: I am not certain if BT can route via 02 – over lunch I will check the facts ----

MR. SCOTT: Do check over lunch. I think from the documentation it is factually so that the telephones can be accessed by either network.

MR. GREEN: I will come back on that. The only point that I am making at this stage, is that the policy underlying the legislation is quite different for ex ante to ex post. This is just one factor (amongst many others) which the European Court in the trilogy of cases I will in due course come to, took account of when ruling on the relevant evidential burden which the Commission had to meet. It was a relevant factor, that it was ex ante, and therefore it imposed in effect a greater burden on the Commission than an ex post case. All I am saying here is no more than you find many reflections of that in the recitals to the directive and the SMP guidelines.

PROFESSOR STONEMAN: Mr. Green, can I just pick that up? On the basis of that you have argued that a detailed economic analysis is required if we are going to establish SMP. I have in front of me p.201 of E1 which is a listing of what is necessary to establish SMP – it has been in the earlier documents – prior to power 78 on p.201 there is some discussion about market shares and it goes on to say that market shares are not sufficient. Then it says amongst other things, the things that ought to be considered are these items in 78. Now, I can quite accept that a detailed economic analysis that those items is required, not all of them necessarily, but the one that I do not see in that list is prices, or prices relative to costs, or profitability, or anything about the prices that you say are the *sine qua non* of significant market power.

MR. GREEN: You will find the definition of SMP as set out in the guidelines, actually defines SMP as, in effect, power over price. You will find Ofcom, when it construes these guidelines, identifies a limited number of these.

PROFESSOR STONEMAN: I think this is rather important to find, because the very first thing we did today was determine that the definition of SMP was what we had in your outline submission at para.14, which does not mention price, and if you are saying that this document does include price it would be useful to see it.

THE CHAIRMAN: Paragraph 34 on p.195 repeats part of the SMP mantra.

MR. SCOTT: And again in para.70.

MR. GREEN: It is in the skeleton which actually identifies ----

PROFESSOR STONEMAN: Page 199 of E1.

MR. GREEN: Paragraph 73 of the SMP guidelines, p.200.

"In an ex-post analysis, a competition authority may be faced with a number of different examples of market behaviour each indicative of market power within the meaning of Article 82. However, in an ex ante environment, market power is essentially measured by reference to the power of the undertaking concerned to raise prices by restricting output without incurring a significant loss of sales or revenues."

So you have the essential definition is the power to raise prices. Now, Ofcom itself identified four features relevant to the list, and I will take you to the Ofcom document later, and one of those was prices and profitability which it viewed as an extremely important factor.

MR. SCOTT: Just sticking with para.73 for a moment, against the background of the evidence, on 2, we are in a situation where the ultimate consumers are notoriously unaware of the prices that they are paying.

PROFESSOR STONEMAN: Before we get into that, can we go back to this para.73, having read all of it now, in that basically it says "… raise prices by restricting output without incurring a significant loss of sales or revenues." Then in para.74 that goes on to say that is a SSNIP test. So basically this does not say that it is prices that matter. It says that the regulatory authority should undertake a SSNIP test, which is not the same thing as you are saying.

MR. GREEN: Well a SSNIP test is indicative of market power. It is asking whether or not if you raise prices by a certain amount it is going to impact upon volume. A SSNIP test is just one example of means by which you come to dominance.

PROFESSOR STONEMAN: I want to argue that there is a difference between a SSNIP test and actually setting a price that is supra-competitive.

MR. GREEN: Oh well yes, of course.

PROFESSOR STONEMAN: Then this is about a SSNIP test. Your argument was about setting a price that was supra competitive.

MR. GREEN: Paragraph 74 is about SSNIP test, 73 is answering the question: "What is the essence of SMP?" The essence of SMP is the same as dominance under Article 82, and dominance under Article 82 in a case where we are not concerned with quality or service is power over price. This is an explicit reference to Article 82 and how it would be applied in an ex ante case, which is power over price. Of course, you may use a SSNIP test to help you define product market, and it is part of the armoury. Here the Commission is simply addressing the essence of Article 82 and dominance. There is a difference between a SSNIP test and power over price, obviously two tests in relation to price.

Just whilst I am on it, and I will come back to this later, I will just give you the reference at this stage, the Ofcom's own guidelines, on the assessment of SMP, F1, p.36, there

is a table "Dominance criteria further to those in the EC guidelines". So Ofcom in the present case concluded that the guidelines were inadequate and has put as its most important criteria at the top of its list excess pricing and profitability.

MR. SCOTT: And this is the point in the second paragraph where they get to as costs fall prices should be expected to fall too if competition is effective.

MR. GREEN: Yes, you can measure excess pricing at any point in time in relation to the movement of costs.

MR. SCOTT: I think in telecoms talking of raising prices is ----

MR. GREEN: It is usually in relation to falling costs. Ofcom says in its own guidelines:

> "The EC guidelines explicitly state that the criteria other than the ones listed in that document may be considered when assessing competition. Ofcom considers that the following criteria may also provide useful evidence in the assessment of both single and collective dominance."

The first one, "excess pricing and profitability":

> "The ability to price at a level that keeps profits persistently and significantly above the competitive level is an important indicator of market power. The EC guidelines, para.73, refer to the importance when assessing market power on an ex ante basis of considering the power of undertakings to raise prices without incurring the significant loss of sales or revenue. In a competitive market individual firms should not be able to persistently raise prices above cost and sustain excess profits. As costs fall prices should be expected to fall too if competition is effective. Factors that may explain excess profits in the short term, such as greater innovation and efficiency or unexpected changes in demand should, however, be considered in interpreting high profit figures. Conversely, low profits may be more an indicator of the inefficiency of the firm than effective competition."

So they have set out there a variety of factors in relation to cost and price, which they accept are important, and supplement the Commission's own list that come out at para.73. Again, the point I will make to you later, the SMP guidelines were adopted before the European Court of First Instance's rulings. The Commission, quite wrongly, did not change the guidelines, and has not changed the guidelines even pending the appeal of *Tetra Laval* to the European Court, and judgment was given in that case just a few months ago. On the Commission's own analysis of what it has to do to establish dominance ahs been frankly decimated by the court. That is an important consideration. The Commission's own view of what it had to do in an ex ante case to establish dominance has been profoundly rejected by the court. That casts a

serious question mark over the Commission's guidelines, in so far as the Commission is laying down a fairly low and easy test for itself and the NRAs to meet. Your task, with respect, as a court is to construe the directives in the light of the case law and provide guidance for the future, so one has to bear that in mind. One does not want to be excessively critical of the Commission, but they have not changed their guidelines in three years, notwithstanding this very profound change in the case law.

THE CHAIRMAN: So the essence of your submission is that at the end of the day these are guidelines?

MR. GREEN: Absolutely.

THE CHAIRMAN: Right, and so if the guidelines say that if you find SMP you have to impose a subsequent requirement, that is a guideline only.

MR. GREEN: Oh absolutely.

THE CHAIRMAN: So it is not necessarily the case?

MR. GREEN: No, if you take the view that they have got the directive around their necks, then you can say so. The guidelines are there to guide you, and nothing more than that.

MR. SCOTT: I think it is in the ----

MR. GREEN: That is in the directive, I am sorry, but you are quite right, if the Commission expresses a view on the law and you disagree with it then you are entitled to say so.

THE CHAIRMAN: Yes. Is that a convenient moment, Mr. Green?

MR. GREEN: Yes.

THE CHAIRMAN: We will resume at 2 o'clock.

(Adjourned for a short time)

MR. GREEN: May it please you, sir, in respect of Mr. Scott's point about routing via O2, if you will forgive me I will produce a short explanatory note overnight, because I want to make sure that whatever I give you is technically correct.

Secondly, I would like to deal with a point which I hope is clear, which is the hierarchy of precedents between the various documents, statutory provisions and guidelines that you have in front of you. This should be straightforward: at the top of the tree one has the EC Treaty and Article 82, that is the ultimate source of guidance; secondly, we have the European Court's analysis of that provision, what is meant by dominance, so the Court's construction of the Treaty is the paramount guiding force here, but, thirdly, we have the directives. The directives, because they are subordinate legislation, cannot in law deviate from the principles set out in the Treaty. If the directives say they are intending to apply the Treaty and the meaning which comes from the Treaty, dominance in Article 82, then that definition

and the case law on it will guide the directive. There is quite a lot of case law of the European Court of Justice making it clear that directives cannot, in any event, depart from the Treaty, they are way down the line, they are subordinate to the treaty itself, they must take their colour and their meaning exclusively from the treaty. I will give you an illustration, and I can produce the authority if it is of assistance, in relation to the Trademark Directive and the rules on the treaty on free movement of goods that the European Court in a judgment a couple of years ago called *Glaxo v Dalhurst* said that the Trademark Directive could not have a meaning separate from that of the treaty when it was dealing with the free movement of goods provisions; it was subordinate, had to have the same meaning.

Then, at the bottom of the heap, are Commission guidelines. Commission guidelines are produced by Commission officials in Brussels, they are not binding on anybody, they are binding only, by way of exception, upon the Commission because they create a legitimate expectation that the Commission will not depart from those guidelines without notice. The Commission is the only party who would be bound by its own guidelines until such time as it changes them; NRAs are required under the directive to pay utmost regard to the guidelines, so they must pay attention to them; the courts are not bound by the guidelines, they are admissible and you can of course look at them but you are in no way bound by them, your duty as a Community institution applying Community law is to apply the law as it emanates from the Treaty and the Directives. Of course, if you extract guidance from the guidelines then of course so be it, and in relation to the guidelines it is significant in this case that they are now the best part of three years old, and as I will explain to you in some length at a later point, things have moved on following European Court case law. That is a portion of my submissions I need to deal with in some detail.

The only other introductory matter I wish to emphasise before getting on to the Decision and pricing, which comes out of this morning, is this, that this appeal concerns only the logic in the Decision. There was a discussion we had this morning about the relationship between 2G and 3G costs; can I give you an illustration of why we are focusing only on the decision and nothing else? I would like to draw your attention to a couple of paragraphs, first of all 3.46 in the Decision (A2, page 1104). In relation to Ofcom's own view on whether the 3G costs of Hutchison are similar or equivalent to those of 2G operators, Ofcom says as follows:

> "The analysis of 2G termination charges Ofcom presented in Chapter 4 of the December Consultation was limited to the charges levied by Vodafone, O2, Orange and T-Mobile. Ofcom is aware that '3''s termination charges in practice reflect a

combination of its 2G and 3G termination costs, and Ofcom has not performed a detailed analysis of '3''s charges. As Ofcom has noted, 3G networks are new and capable of providing a range of innovative services, and therefore it would be difficult to assess with confidence the relevant voice call termination costs and the appropriate rate of return on capital invested. However, this does not imply that '3' is unable to set excessive termination charges, given the lack of constraints it faces. The constraints facing '3' are similar in nature to those facing the other MNOs, and these are not sufficient to hold charges at the competitive level on a forward-looking basis."

So in relation to costs and charges, Ofcom does not say that they are similar, it says that the competitive constraints may be analysed in the same way but so far as costs and charges are concerned, they are not similar, and of course there is no evidence before the Tribunal of what those costs or charges are, it is an ongoing debate between the parties.

The other paragraphs I would like to show you are 5.30 and 5.31 on page 1119 of A2. This follows a paragraph where Ofcom states that by the end of March, Hutchison had in the region of 384,000 and 420,000 subscribers, approximately 0.75 of the total mobile subscribers in the UK. Then it says:

"At such an early stage of roll-out, the costs of 3G voice call termination are unclear, and robust cost information is difficult to ascertain. Thus, in terms of the charges set for 3G voice call termination, there is currently insufficient evidence to conclude that such charges are excessive.

Ofcom also considers that any adverse effects to consumers associated with charges for 3G voice call termination are likely to be small, given the very limited size of '3''s mobile subscriber base relative to the wider mobile sector. In Ofcom's view, the lack of evidence of excessive charging, combined with the modest effect any charges have on consumers as a whole, mean that it would be disproportionate to impose ex ante obligations on 3G voice call termination at this time. Ofcom does, however, intend to keep this position under review, and will retain the ability to bring forward proposals for regulation if warranted."

The point I am trying to make is simply this, that the Decision has a certain amount of information in it. You can deduce Ofcom's reasoning from the Decision, but it is, we respectfully submit, not open to you to draw conclusions which Ofcom itself has not investigated and which you may think are logical or otherwise from other facts which are found elsewhere in the Decision or in other documents. These are matters which may come up in the next Hutchison against Ofcom case in three or four years time – one hopes not, but

who knows – but they are not, with respect, matters for today and we would invite you to stick to what is in the Decision and our challenge to it.

THE CHAIRMAN: I have two things in relation to what you said. The first is, presumably you accept Ofcom's view that the decision embraces the May and December documents.

MR. GREEN: Those parts of it which are cross-referred to. There is a matter of construction as to what parts of it are cross-referred to, but it is plainly relevant context to this Decision.

THE CHAIRMAN: Mr. Roth may address us on how he sees that, but that is your position. The other point relates to your hierarchy. In your hierarchy recommendations got dropped out, and I think recommendations come in somewhere between directives and guidelines.

MR. GREEN: You are quite right, and I know why you have asked. There is certainly quite a lot of case law on recommendations and opinions insofar as it applied under the European Atomic Energy Treaty many years ago, and the legal force of a recommendation is simply that, it has no legally binding effect, it is a recommendation which addressees are required to take account of but no more.

THE CHAIRMAN: And then the last point goes to the words that the European Court of Justice has applied to dominance. Are the words, particularly the words that are in Article 14, by way of description rather than definition? Why do I say that? We are used in the common law to things being defined in statutory terms, but here we are dealing with a progressive development of dominance in the case law and I wondered whether you saw those words as more descriptive of that which has been found by case law rather than definition.

MR. GREEN: It must be descriptive, for this reason, that if the Directive had said that it was not a definition based upon Article 82, then one would say that the definition in Article 14(2) was self-standing. As it is it is linked squarely to Article 82, so that evolution in the case law under Article 82 would have to be taken into account because it cannot be the case that Article 14(2) creates a definition writ in stone which does not change when it is intended to be connected to Article 82, so I think one would say it is descriptive. The essence under Article 82 of dominance is the ability to act independently, and generally the court then goes on to say that that means suppliers, customers, consumers, but the essence is the ability to act independently of constraints, and in this case we have a wider category of constraints than one would generally have in an ex post Article 82 case.

THE CHAIRMAN: Yes. You will see that I am addressing myself to the fact that you are bringing in regulation and regulators as additional constraints, and if this was a definition that woiuld be difficult to do because they are not in Article 14. What we are saying is that this is a descriptive term, not a definitive term.

MR. GREEN: Yes. Recital 27 of the framework Directive, of course, in our submission makes that quite clear. This is the one which, as you recollect, says that you should not impose we say an SMP determination unless you have carried out both an effective analysis of the market and national and domestic competition law provisions are insufficient. Ofcom says that is nothing to do with SMP, it is only to do with obligations, but we say it is internally connected with SMP.

THE CHAIRMAN: The words at the beginning of recital 27 refer to obligations and qualify they ---

MR. GREEN: That is why the debate has arisen between us, because Ofcom's position cannot be right, it could only be right if there was a logical stopping point after SMP and you had the ability not to impose obligations. Once you have an obligation to impose obligations contingent upon a finding of SMP, then one understands that recital 27 is referring to SMP as a whole. That is how the Commission understand it because in the guidelines they refer to recital 27 in a footnote which actually relates to their general description of the thorough economic analysis they say has to be carried out for SMP. I think we will have to review this one – I am not going to spend a lot of time on recital 27 now, but once you have seen *Tetra Laval* you will see what that same philosophy goes directly to dominance, because it is the same analysis that comes out of the European Court's judgment which is directly, squarely, focused on dominance, not on obligations. I thought I would actually wait and come back to that once you have seen *Tetra Laval* because I think it will make more sense then.

I would like to pick up one or two factual matters quite briefly and quickly. If you could go to the Decision, please, I just want to give you a list of references and page numbers, making it quite clear that the decision was concerned only with excessive prices and not, for example, discriminatory pricing or any other form of pricing. If I can, I am just going to give you some paragraph numbers so that they are on the transcript: paragraph 3.22 of the Decision (page 1101), 3.32 (page 1102), 3.46 (page 1104), 3.48 (page 1105), 3.50 (page 1105) and 3.51 (page 1105). All of those make it clear that Ofcom's analysis is concerned solely with excessive prices and nothing else.

The next point, really to provide the other side to that coin, is that non-price competition is excluded, and this can be seen from the May consultation document and then it tracks back into the Decision. If we can start with A1, please, tab 2, pages 649 to 654. This is the May consultation document, 15 May 2003. The starting page of the document is 471, the relevant part is 649, under the heading "Assessment of market power". Just to provide the context, section B.1 on page 649 says as follows:

"Chapter 4 was devoted to a discussion of whether MNOs have SMP in the relevant market. It discussed the criteria that are most relevant to the assessment of whether there are the conditions for a finding of dominance, given the specific characteristics of the relevant market. The Director concluded that each MNO has SMP in the market for wholesale mobile voice call termination on its network (s).

B.2 The criteria discussed in Chapter 4 were: market share; countervailing buyer power; excessive pricing and profitability; and ease of market entry and absence of potential competition.

B.3 These are only a subset of the criteria listed in the EU Commission and Oftel Guidelines on SMP. Hence, for completeness this Annex will discuss the other criteria and explain why they have been considered to be less relevant in this specific market.

B.4 This market power assessment analysis focuses only on single dominance. The Director considers that in the market for wholesale mobile voice call termination, SMP cannot be held by more than one company, since the market currently is a monopoly and no entry appears likely (see Chapter 3). As a consequence, none of the criteria to assess collective dominance will be reviewed below."

Then in the sections below it identifies a whole series of different factors which it says are not relevant, but can I just pick up first on page 650 the bottom box, "Technological advantages or superiority". The second column is where Ofcom gives its explanation and the third column is where it says analysis or assessment – you take the headings from the previous page. So far as the third column is concerned, the analysis/assessment, Ofcom says:

"This criterion is not viewed as relevant in this market because the presence of absolute barriers to entry implies that each MNO offering voice termination faces no existing or potential competitors. Hence, no comparison between technologies is relevant."

At the top of page 651 they preclude "product/services diversification" and the right hand box says:

"This criterion is not viewed as relevant because each MNO sells termination to originating operators who request it on a stand-alone basis and it is not bundled with other services."

If you go two down, "A highly developed distribution and sales network", Ofcom says:

"The Director does not view this criterion as relevant because the service herein sold is acquired by only a few major purchasers (other MNOs and fixed PECNs) and does not require a special distribution or sale system."

Finally, on the very last page, 654, "Active competition on non-price factors", the document says:

"This criterion is not viewed as relevant in this market because mobile voice call termination does not seem to offer much scope for vertical or horizontal product differentiation. In addition, the presence of absolute barriers to entry implies that competition in the market is not likely to extend beyond existing players and, thus, diversification, even if possible, would not provide any additional advantage."

The essence, therefore, of Ofcom's case is price and price alone, and even within price it is excessive prices. I will pick up one point that I will deal with more thoroughly later. You will have seen from Ofcom's submissions, in particular the supplementary submission submitted recently (paragraphs 24 and 25) that Ofcom invents – and it is an invention – a new reason why they say Hutchison might have power over price, it is because, it says, it can discriminate in price, in particular against other MNOs. You will see that this is not part of its decision, it never has been part of its decision, and for reasons which I will explain later, namely, as you will probably have gathered, things connected with the fact that the other MNOs can route through BT, it means that any MNO can defect any market power or putative market power on the part of Hutchison and can simply say we do not accept your price, we will route through BT, and I think the discussion we had at the opening this morning was that it is really the BT Agreement which is pivotal to this analysis, and that that is the anchor. That actually created alternative options for the other MNO operators, there is evidence to that effect and it has never been challenged. At an appropriate moment I will show you that, but the nub of this is that the case concerns pricing and excessive pricing.

So far as Ofcom's actual finding on price and excessive price is concerned, the Decision itself cross-refers back to the interim statement which is A2, tab 4, p.768. This is all part of the SMP analysis itself. The relevant section of the interim statement, December 2003, runs from para.3.17 on p.768 through to para.31 on p.771, I do not need to read all of the relevant paragraphs but I want to pick up a few of them.

In para. 3.17 Ofcom says:

"The ability to keep prices persistently and profitably above the competitive level is an important indicator of market power. In a competitive market individual firms should not be able to raise prices above costs and sustain excess profits for prolonged periods of time."

So Ofcom views as important, an important indicator, an ability to persistently set prices at above the competitive level. It then goes on to say at 3.18:

"The Director has examined the MNOs behaviour in setting 2G voice termination charges to verify whether this is constrained by competitive forces. If the market for

2G voice termination were competitive charges would be expected to reflect costs. However, voice call termination charges appear to have been substantially above a reasonable estimate of each MNOs costs for a number of years (despite formal and informal regulation)."

That is not unimportant, because Oftel (as was) is saying here we have regulation but they have been able to avoid or circumvent that regulation. At 3.19:

"The Director's view is that the most appropriate basis for assessing whether charges are cost reflective is forward looking long run incremental cost (LRIC) plus a mark-up for common costs. LRIC-based charges most accurately reflect the resources consumed by the provision of services and correspond most closely to the level that would occur in a fully competitive market. Hence, the Director has carried out a detailed modelling of the LRIC of the UK 2G mobile networks, and has estimated the LRIC of voice call termination for a 2G operator, also taking into account cost data from the MNOs. The Director has then added a mark-up for common costs. More detail about how the LRIC and the mark-up have been arrived at can be found in Annex F on LRIC.

"3.20 The total costs of terminating the calls on a 2G network identified by the above exercise are well below the actual charges levied by each of the MNOs."

So here is Ofcom's conclusion that the costs are substantially below the actual termination charges so there is a margin over cost.

"Even in the case of 02 and Vodafone, whose charges have been subject to a price cap of RPI-9%since 1998 (following the 1998 MMC investigation) O2 and Vodafone were required to reduce their weighted average termination charges from 14.8 to 11.7 ppm in 1999/2000 and by RPI-9% in the following two years. This regulatory intervention has not been sufficient to drive charges down to cost. Oftel's estimate of LRIC and the MNOs average termination charges in the last four years are shown below in table 3.1."

And you can see the comparison which Oftel made. If you look at 02 and Vodafone in the boxes for 2001/2002, and then 2002/2003 you will see the discrepancy between the weighted average and Oftel's figures. Oftel then concludes in para.3.21:

"The comparison made above was undertaken within the regulated environment up to 24 July 2003 and extended by means of the Director's Continuation Notices. Between 1998 and March 2003 there was direct regulation of Vodafone's and 02's charges, and informal regulatory pressure on Orange and T-Mobile's charges. Following the recommendations in the

CC Report in April 2003 Oftel required the 4 MNOs to cut their charges by 15 per cent. by 25th July 2003.

> "3.22 In the absence of any ex ante regulation or threat of ex post regulation, the Director believes that MNOs would have an incentive to set termination charges at the profit maximising level. The Director has estimated that unregulated charges may thus be at 20p per minute, or even higher (details of the calculation of the profit-maximising termination charges can be found on Oftel's paper …"

For which they give a website reference. So Oftel looks at incentives, it looks at the impact of regulation to see whether or not it has been overcome by the MNOs. It decides that notwithstanding regulation the prices were excessive, and that is what it describes as "the important evidence of power over price" which it uses to justify its SMP analysis.

If one then goes to the Decision itself at para.3.2. (p.1097, tab 6, A2). Ofcom makes the point that the four criteria that it has set out there – market share, ease of market entry, excessive prices and profitability and countervailing buyer power, are the four criteria which it believes are relevant to this assessment of SMP, and it points out in footnote 7 that these are a subset of the criteria listed in the EC Commission and Oftel guidelines. So one sees that Ofcom takes the view that excessive prices and profitability are one of the four factors which it takes into account.

You will see sub-paragraphs (a) and (b) are self-defining. Once you have defined the product market, there is 100 per cent. market share and, by definition, there is no entry, so you are only left with two points - excessive prices and profitability and countervailing buyer power. Paragraph 3.7, in relation to the 2G MNOs:

"This SMP finding has been further supported by Ofcom's analysis of 2G voice call termination charges, which appear to have been substantially above a reasonable estimate of each MNOs costs for a number of years despite both formal and informal regulation. This ability to keep prices persistently and profitably above the competitive level is a further important indicator of SMP. In addition, Ofcom considers that in the absence of any ex ante regulation (or threat of ex post regulation) the MNOs would have an incentive and ability to set even higher termination charges (i.e. at the profit maximising level – which may be at 20 pence per minute or more)."

Then (c) 3.17 to 3.31 of the December consultation. Now, you will see that they rely upon not only ability but incentive, whereas so far as Hutchison is concerned, it is mere ability; and they take account of the fact that there is regulation and they view as important, indeed,

central, their historical analysis of costs and prices. The difference in approach between the other MNOs and Hutchison could not be greater.

There is one piece of evidence that Ofcom relies upon against Hutchison, which one finds in the last sentence of para.3.32 of this Decision. 3.32 was one of the paragraphs I have referred to as one of the pillars of the Decision, and this is where Ofcom draws a distinction between putting prices up and the absence of a contractual mechanism for prices to come down to reflect cost.

Then in the last sentence of that paragraph, Ofcom says: "Some evidence of this …" this is in relation to the failure of prices to fall – "Some evidence of this is BT's inability to enforce reduce termination payments to '3' at the time of the 15% charge reduction applied to the other MNOs in July 2003" Now the implication is that once the Competition Commission had investigated the four MNOs, that in some way, shape or form, Hutchison should also have reduced its prices, even though it was not subject to the Competition Commission investigation and even because, as Ofcom itself recognises, 2G costs are quite different, or may be quite different to 3G costs. But in fact the implication in this last sentence, which is that BT could not enforce a change downwards is in its own right inaccurate.

This is dealt with in Mr. Westby's statement in three paragraphs, 43 to 45, and if you could look at that, it is in bundle D1, tab 1, p.15. Part of this is identified as "business secrets2 and I wonder if I could just ask you to read it to yourself – paras. 43 to 45, ps.15 and 16 of tab 1 of D1. (After a pause) It has never been suggested by anybody, by BT or Ofcom, that because the four MNOs who had 2G costs were subject to a price reduction that that should, in any way equate to Hutchison – that is the point – which is adverse to the point made in the last sentence of 3.32, but then Ofcom, as you have seen, themselves accept that they cannot assume that 2G and 3G costs are the same. So they are not objectively in the same category, the four MNOs on the one hand, and Hutchison on the other. This is the only piece of evidence that Ofcom has relied upon to support its case. This is the sole piece of actual hard evidence, as opposed to theory on pricing, that Ofcom relies upon.

PROFESSOR STONEMAN: Mr. Green, you are presenting this data and saying that there is no evidence that 2G and 3G costs will be the same, and you refer to competitive markets, and supra competitive prices. Now, if this were a competitive market and 3Gs costs were above 2G costs for wholesale voice call termination, would 3G not be driven out of the market? On the other hand if 3G costs were below 2G costs, would 2G not be driven out of the market, if this were a competitive market?

MR. GREEN: No, with great respect, that assumes a great deal about the make up of costs and indeed other costs, and people will be attracted to Hutchison mobile phone for many reasons. You see, for example, when you look at the documents BT enjoys relying upon concerning the negotiation that Hutchison was extremely anxious when it was negotiating prices to take account of BT's willingness to accept a price, Ofcom's willingness to accept a price and importantly the consumer's willingness to accept a price because as they say in their internal documentation they have to be aware that they cannot overcharge a subscriber because they need to stimulate what is a new brand in the market. So to come back to basics, there is nothing in this case which tells us what the 3G costs are.

PROFESSOR STONEMAN: No, but there is a lot in this case that says "supra competitive" and therefore we must have some idea of what is a competitive market and what a competitive market looks like. Would you agree with that?

MR. GREEN: This is the thing about this decision, the answer is "no", because Ofcom does not itself tell us what a competitive price would be for 3G ----

PROFESSOR STONEMAN: No, no, no, I am talking about what a competitive market is like. A competitive price is a price that exists in a competitive market – can we accept that?

MR. GREEN: Yes.

PROFESSOR STONEMAN: And the way that competitive markets work is that they drive out the inefficient, they drive out the expensive, and with free entry you will actually get a market in which the price is equal to minimum long run average cost.

MR. GREEN: Yes.

PROFESSOR STONEMAN: If the 3G product has a long run average cost that is greater than the long run average cost of a 2G product, then in a free market with free entry the 3G product will be driven out of the market unless the 3G product is considerably superior to the 2G product. We are always talking about voice call termination and nobody has said that voice call termination on a 3G network is better quality or more prompt, or whatever, relative to a 2G network?

MR. GREEN: With great respect, you are now forming conclusions which Ofcom itself has not concluded. This is very much the nature of the debate which is ongoing. What are the 3G costs? If the 3G costs ----

PROFESSOR STONEMAN: No, no, I am not saying anything about what they are. I am just saying to you what would it be like in a competitive market if 2G and 3G costs were different, which one would exist in a competitive market with free entry? They could not both exist.

MR. SCOTT: Let me put it to you another way. As I understand it at the moment a voice caller calling a 3 mobile could be routed by either network?

MR. GREEN: No.

PROFESSOR STONEMAN: That is not necessary for my point anyway.

MR. GREEN: But you have to remember everybody is moving to 3G. This is an entire wave – we may be at the front of the wave, but the entire market costs will be predicated on 3G and there are laggards whoa re a month or a year behind who are coming in behind Hutchison, but the dynamic in the market moving forward, is not based upon 2G costs.

PROFESSOR STONEMAN: But they would not be moving from 2G to 3G if 3G were more expensive.

MR. GREEN: 3G provides a platform for a whole range of interactive and additional services.

PROFESSOR STONEMAN: That does not mean it should be carried by the wholesale voice call termination price.

MR. GREEN: Everybody's 3G service will reflect wholesale voice call termination from and to 3G.

PROFESSOR STONEMAN: All right, we will leave it there, thank you.

MR. GREEN: I should just add another reference in relation to the last sentence of 3.32, which I think is the Statement of Intervention BT para.13, which accepts that BT did not further seek to reduce the appellant's rates in line with the reduction.

MR. SCOTT: That is the point I was not going to mention because it was a business secret.

MR. GREEN: That is BT's Statement of Intervention which I do not think is marked as confidential, but anyway there we are – the world will come tumbling around my ears if it is confidential.

MR. BARLING: It is only our business!

MR. GREEN: It is only BT's business, that is right. (Laughter) I would like to turn from that, which his drawing a comparison between what Ofcom did in relation to us and what was done in relation to the other MNOs, to what Ofcom could have done. I will deal with this quite briefly because there is an authority demonstrating what Ofcom feels it is able to do in relation to new technologies. It concerns the question whether Ofcom feels it has to do a full scale cost based analysis in order to come to a view about whether a new entrant's prices are in fact excessive, and the relevant Decision concerns a company which was called "Freeserve" now called "Wanadoo", and it is a case coming in front of this Tribunal in July – fortunately I am not asking you to express a view on the merits or demerits of the Decision, I simply want to show you an approach which Ofcom felt it was able to perform in that case, and the Decision is I think H3, tab4.

PROFESSOR STONEMAN: Not in mine.

MR. GREEN: (After a pause) I will come back to it and save time – there is obviously something awry. (After a pause) Tab 3 - it should say "Investigation by the Director General of Telecommunications into alleged anti-competitive practice by BT in relation to BT Openworld."

THE CHAIRMAN: We have that.

MR. GREEN: Decision of 20 November 2003. If I can just explain the background and then take you to a couple of paragraphs. As you know Hutchison launched its 3G service on 19th March 2003, in other words, 15 months before the Decision. Ofcom defines Hutchison as a new entrant employing a new version of the old technology, and in such circumstances Oftel and Ofcom do have accounting and other evaluative techniques at their disposal by which they can assess whether a company has dominance, or is abusing that dominance. These techniques involve estimations of costs, cost movements and so on. The BT Openworld case demonstrates an approach to deciding whether or not a company is acting abusively which does not involve detailed cost analysis. The relevance of this is simply that it illustrates, and it is no more than an illustration that Ofcom's view is that it has ample techniques available to it to assess dominance and abuse – even in the absence of reliable historical cost data, because the market is new and immature.

The place to start picking it up is 5.1 of the Decision, p.35 of the internal numbering. That just identifies the issue which is

> "… whether BTOW's margin between its downstream prices and BT Wholesale upstream prices was insufficient to cover its relevant downstream costs."

In other words, where there was a margin squeeze, that was the issue. It was, in Ofcom's view, a feature of the case that the market was immature. If you go to para.5.20 you will see that the decision maker's view was that the market was immature and there was sufficient actual accounting data to make a firm conclusion on anti-competitive behaviour. The Decision therefore says:

> "Second, in an immature market there is often insufficient actual accounting data to make a firm conclusion on anti-competitive behaviour. It is common for firms producing and marketing a new product or service to make initial accounting losses, without engaging in any anti-competitive behaviour. In the current case, Freeserve submitted its original complaint to the Director in March 2002, at t he time when BTOW had just reviewed its pricing strategy and cost structure. By the time of receiving the original complaint no historical accounting data under BTOW's business model was available to the Director. However, the Director did have BTOW's

business plan which showed the reasoning behind its pricing strategy and what conditions were necessary for the business to become profitable. If, under reasonable assumptions, this business could not become profitable without a material adverse effect to competition then the Director believed that it would be appropriate to take action without waiting for historic data to come into being."

Now the underlying principle is simply this, simply because you do not have underlying cost data does not mean to say as a regulator that you are lacking in tools to carry out some form of possibly second best analysis using all the residual data that is available to you. That might be some portion of historical cost data, but there are other techniques which Ofcom can rely upon. Here we have one illustration which is an analysis of business plans, and it simply goes to this, that it is no defence for Ofcom to say it is complex and difficult. The decision was taken 154 months after Hutchison's entry to the market. There was some cost data. It could have started its cost analysis earlier, and it could have supplemented that with the sort of analysis which is available for example for business plans. It did not use best evidence, and regulators always work with best evidence, it is rarely perfect evidence, but they have to rely on best evidence.

So in the present case they jumped to their conclusion without any analysis and we are entitled to say that they should have done some. Mr. Rutnam in his witness statement says "We could have done a mini-review." They do not have to do a maxi-review or if they felt that a maxi-review was proper then they should have waited before they imposed their SMP analysis until they had the cost analysis which was at least equivalent to that which they had in relation to the other MNOs.

MR. SCOTT: Just a quick factual matter which we probably ought to have on the record, we have not had a business plan produced to us.

MR. GREEN: No, of course not.

MR. SCOTT: So we should just say that.

MR. GREEN: Absolutely. My point is that Ofcom did not ask for it. I am comparing the total lack of analysis with the sort of analysis which might have been done, even if it was not full scale cost analysis. So where does this take us? Ofcom's decision rests on price, and it rests on an analysis of excessive price. In relation to the four MNOs who are 2G operators, Ofcom looked at ability and incentive, and it looked at ability and incentive in the light of regulatory constraints. In the case of Hutchison it did not look at incentive, as it did with the other operators. It did not do any analysis whatsoever of cost or price, or movements in cost or price, though it could have done so. Even if it could not have done a full scale 3G cost

analysis there were alternative techniques available to it at the time. Yet in the circumstances it says it is almost unarguable that Hutchison is not able to charge excessive prices.

The next point I wish to raise, and I am moving towards the end of dealing with the facts concerned with prices, and I will be moving shortly to case law and then to dispute resolution and countervailing buyer power. The next point is simply this. Market share is not enough. We dealt with this in our first skeleton argument, paras. 55 to 61. One has to remember that in this case Hutchison's position was extremely unusual. In a normal Article 82 case, the Commission or Office of Fair Trading, or Ofcom will assess market share by reference to sales' volumes or sales' values – that is the normal way in which you work out a company's market share. If you say the total market is worth a billion and the alleged dominant undertaking has revenues of 60 per cent. of that, six thousand thousand, then you say they have 60 per cent. of the market measured by sales, or measured by volume. The oddity about this case, and the reason why market share is a very inadequate indicator derives from the facts. Hutchison, when it first entered the market had no subscribers at all, and it is a very unusual market share. We are not disputing the definition of a product market, so in principle we are accepting that when we took steps to enter the market we had 100%. What I am simply saying is that when the Commission in paragraph 78 says even very high market shares are not conclusive, this case demonstrates par excellence why that is the case. We are not talking about a mature market where you have measurable sales, measurable volumes, we are talking about a company that had no revenue when it first entered into the market, and on Ofcom's analysis we had 100% of the market before we even had a subscriber, when we had one subscriber and two subscribers. Technically, theoretically, one can justify that because of the narrow product market definition, but it gives you an indication of why market share is a very inadequate indicator of market power and power over price. That is why the Commission says that market share is inadequate, even in cases where you have very high market shares. It is important, as we have said in our skeleton, and I will not take you to it at this stage, to compare paragraph 78 of the Commission guidelines with paragraph 75. As you know, Ofcom say they have more than 50%, presumption of dominance, you are entitled to jump to the conclusion that there is dominance. That is fine in cases where you have a mature market and you have a history of sales and volumes, but it is not fine in the present case. We rely upon the Commission saying that very high market shares are not conclusive, the NRA must go on and conduct a detailed economic analysis. Again, even in its December guidelines and in its Decision, Ofcom itself makes the same point, see for example paragraph 3.13 of the December interim statement (A2, tab 4, page 767).

That is what I want to say about price; I want to take you now to put that into the legal framework and to show you the cases, which really emphasise two points: first, that mere ability to act independently is not enough and, secondly, that regulatory constraints and the threat of regulatory constraints are relevant to the very existence of dominance. In order to accelerate matters I have produced a note on *Tetra Laval* which I would like to hand up if I can. (Document distributed). I am going to take you to some paragraphs in the judgment, but the *Tetra Laval* judgment of the European Court is quite long and complex, and it would probably help to have read this note first and then I will be more rapid. You mentioned the possibility of having a break earlier on.

THE CHAIRMAN: You would like us to have read this before you say anything else.

MR. GREEN: I think it is probably an efficient way of dealing with it.

THE CHAIRMAN: In that case we will rise for quarter of an hour to 3.20.

(Short break).

MR. GREEN: Turning to the *Tetra Laval* case, the trigger for the prohibition of a merger is dominance, so the entire analysis focuses upon dominance and nothing more than dominance. The Commission thought that the way in which this creation of dominance for Sidel would come about was through conduct which it described as leveraging. Let me take you to paragraph 54 of the judgment, H2, tab 17, page 383 of the bundle. That was the issue in a nutshell, the merger would be created through pricing conduct, which the Commission described as leveraging, and paragraph 54 of the Court's judgment recites the Commission's Decision in its relevant part, para 364, and the Commission had said that:

> "Leveraging [this position] … in a number of ways, Tetra/Sidel [the merged entity] … would have the ability to tie carton packaging equipment and consumables with PET packaging equipment and, possibly, preforms (in particular barrier-enhanced preforms). Tetra/Sidel would also have the ability to use pressure or incentives (such as predatory pricing or price wars and loyalty rebates) so that its carton customers buy PET equipment and, possibly, preforms from … Tetra/Sidel and not from its competitors or converters."

Sidel produced machines, it had a leading market share but not a dominant market share and it was suggested that Tetra Laval could use its pricing on cartons to send more business in the way of Sidel and create a dominant position. That was to be created through conduct, the leveraging, and the Commission's theory was that all the Commission had to show was an ability to engage in that conduct and, as it turns out, a theoretical ability.

Tetra Laval appealed to the CFI and the CFI held that mere ability was not enough, that the Commission had to go on and establish a likelihood of the leveraging conduct actually taking place, and they had to show this likelihood with convincing evidence, and moreover the evidence had to be particularly convincing because the analysis was ex ante. Two questions therefore arose, and I have dealt with two questions in the note. First, the general question: "What is the standard or burden of proof on the Commission, and then secondly, there are a number of examples in the Judgment where the Commission's analysis was found wanting, but the second concerns the one of most interest to this Appeal, which is what is the relevance of regulatory constraints of different types? That was in the context of whether it was enough to show an ability or whether you had to go beyond that and show a real likelihood with convincing evidence that this pricing would occur in order to establish dominance.

I want to take the two issues in stages. First, what did the court say about the requirement on the Commission as to what it had to prove in order to establish dominance, and one picks this up first at para.19 of the Judgment. Forgive me if I do not deal with all the paragraphs that are relevant, but if I read it all we would be here for a week. I am going to pick up I think the most important paragraphs, para.19, p.376 of the bundle.

> "By its first ground of appeal, the Commission complains that the Court of First Instance, whilst claiming to apply the test of manifest error of assessment, in fact applied a different test requiring the production of 'convincing evidence'. In doing so, the Court of First Instance infringed Article 230 of the Treaty".

So the context of this is that the CFI rejected the Commission's long held belief that it did not have to establish convincing evidence, there was a lower burden upon it, and here was the Commission appealing to the ECJ against the CFI.

> "In doing so, the Court of First Instance infringed Article 230EC by failing to take account of the discretion conferred on the Commission with regard to complex factual and economic matters. It also infringed Article 2(2) and (3) of the Regulation in that it had applied a presumption of legality in respect of concentrations with conglomerate effect."

So all the Commission was saying is that if you impose too high a burden upon us we will never be able to prohibit a merger, and therefore you are creating a presumption of legality.

> "Taking the example of the review of the Commission's forecast of significant growth in the use of PET packaging for sensitive products, the Commission claims that the Court of First Instance distorted the facts, failed to give adequate reasons for the rejection of its arguments and failed to take account of factors, arguments and

evidence put forward by it in the contested decision and in its defence, and even refrained from referring to that defence."

So the Commission launched a full scale attack upon the CFI's analysis. If you jump forward to paras 26 and 27, the Commission says as follows (these are their arguments):

"The Commission concludes that the principles referred to in *Kali & Salz*, [prior Decision of the CFI] and from the review carried out by the Court in that case that it is required to examine the relevant market closely weigh up all the relevant factors and base its assessment on evidence which is factually accurate, is not clearly insignificant and is capable of substantiating the conclusions drawn from it and that it must reach its conclusions on the basis of consistent reasoning.

"27 The Commission takes the view, first of all, that the standard of 'convincing evidence' differs substantially, in degree and in nature, both from the obligation to produce 'cogent and consistent' evidence established in *Kali& Salz*, and from the principle that the Commission's assessment must be accepted unless it is shown to be manifestly wrong. The standard is different in degree because, unlike the standard of 'convincing evidence' that of cogent and consistent evidence does not rule out the possibility that another body might reach a different conclusion if it were competent to give a decision on the matter. The standard required is likewise different in nature in as much as it transforms the role of the Community Courts into that of a different body which is competent to rule on the matter in all its complexity and which is entitled to substitute its views for those of the Commission. The Court of First Instance was inconsistent in that it referred to the test of manifest error of assessment and yet applied a very different test."

Again, the context of this was a Judicial Review, and that is important because you are not dealing with a Judicial Review, you are dealing with a merits' appeal, but you will see that even in the context of a Judicial Review the court has laid down a very strict test for the Commission.

The next paragraph to go to is 37, which is the findings of the court.

"37 By its first ground of appeal, the Commission contest the judgment under appeal in so far as the Court of First Instance required it, when adopting a decision declaring a concentration incompatible with the common market, to satisfy a standard of proof and to provide a quality of evidence in support of its line of argument which hare incompatible with the wide discretion which it enjoys in assessing economic matters. It thus complains that the Court of First Instance infringed Article 230EC by

exceeding the limits of its power of review established by case-law and as a result misapplied Article 2(2) and (3) of the Regulation b y creating a presumption of legality in respect of certain concentrations.

"38 It should be observed that, in paragraph 119 of the judgment under appeal, the Court of First Instance correctly set out the tests to be applied when carrying out judicial review of the Commission decision on a concentration as laid down in the judgment in *Kali & Salz*. In paragraphs 223 and 224 of that judgment, the Court stated that the basic provisions of the Regulation, in particular Article 2, confer on the Commission a certain discretion, especially with regard to an assessment of an economic nature, and that, consequently, review by the Community Courts of the exercise of that discretion, which is essential for defining the rule son concentrations, must take account of the margin of discretion implicit in the provisions of an economic nature which form part of the rules on concentrations."

Paragraph 39 sets out the court's conclusions on what the test in a judicial review is and that obviously had a profound bearing upon the task the Commission has to set itself in future when it takes a decision.

"39 Whilst the Court recognises that the Commission has a margin of discretion with regard to economic matters, that does not mean that the Community Courts must refrain from reviewing the Commission's interpretation of information of an economic nature. Not only must the Community Courts, inter alia, establish whether the evidence relied on is factually accurate, reliable and consistent, but also whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it. Such a review is all the more necessary in the case of a prospective analysis required when examining a planned merger with conglomerate effects."

So again the court emphasises that in a prospective analysis the requirement of a high quality of evidence on the part of the European Commission is enhanced. I think one can jump – unless anyone wants me to read 40 and 41, the court says:

"42 A prospective analysis of the kind necessary in merger control must be carried out with great care as it does not entail the examination of past events – for which often many items of evidence are available which make it possible to understand the causes – or of current events, but rather a prediction of events which are more or less likely to occur in future if a decision prohibiting the planned concentration or laying down the conditions for it is not adopted."

Now, if you concentrate on the language of the court here, a prediction of events which hare more or less likely to occur in future, and it goes on to make this clear in subsequent paragraphs, it is emphasising that simply because the analysis is ex ante it necessarily involves a degree of uncertainty, but it goes on to make the point time, and time again that because of that fact you have to establish a much higher degree of likelihood to justify you intervention.

MR. SCOTT: How does one define that fact?

MR. GREEN: I think it is obviously difficult, but you can see by the way they approach some of the examples. For example, the Commission had said in relation to one of the alleged pieces of conduct that they had counted as leveraging that they had looked at some economic assessments. Now, the economic assessments that the Commission had carried out turned out not to address the problem in any detail at all. The court said simply because you address a matter and you conclude it has the ability, you have actually got to go and look at each, you have to look causally to see whether or not the conduct you are objecting to, predatory pricing, price wars – something like that – you have to see whether that is probable, more than probable, likely. You have to examine each chain of logic which leads you to the conclusion that it is more than likely to occur. I do not suppose it is any more difficult to an English trial Judge when you are looking at exercises of causation. You are looking at a series of probable events, and you are weighing up the evidence to make sure that they exist. What the court is saying emphatically is that merely latching on to an ability to do something is not good enough.

MR. SCOTT: The CAT and the Court of Appeal considered the sequences of probabilities in the context of the IBA merger, but both in that case and in *Tetra Laval* we were dealing with a pre-existent competitive market. If one looks at para.43 in the Judgment, this is talking about

> "…an examination of how a concentration might alter factors determining the state of competition on a given market in order to establish whether it would give rise to a serious impediment to effective competition."

MR. GREEN: Yes.

MR. SCOTT: In the instant appeal we are dealing with a situation in which there is no change in concentration from 100 per cent. to 100 per cent. in a market in which there is no effective competition because there are absolute barriers.

MR. GREEN: No, you are looking here, this is particularly relevant when we look at dispute resolution, when we look at countervailing buyer power to see whether or not it is probable, as Ofcom put it, it is almost beyond doubt they can charge excessive prices. We say when you apply *Tetra Laval* to the factual issues that we have to grapple with, dispute resolution,

countervailing buyer power, it is inconceivable that you could identify a chain of cause and effect under which Hutchison would be able to charge an excessive price within the timescale of the decision or any other elongated timescale, which may or may not be relevant. It is simply not enough to say that Hutchison has a theoretical ability to charge an excessive price without saying "How will this occur step by step?" The court requires a precise examination supported by "convincing" evidence of the steps in the logic which leads you to the conclusion that Hutchison can charge an excessive price within the timescale that we are concerned with. One has to translate the facts of this case and the underlying principle to the facts of the present case.

MR. SCOTT: The situation in the present case, if one leaves aside – and thank you for your note – para.3 of your note refers to "likely to be able to raise prices to an excessive level", and we have already adverted to the fact that we are in a situation here where costs may or may not be falling, but where what you are suggesting is that we have an agreement here, we have FM6 sitting there, and it appears from what was said before the break that BT has not looked for a reduction in the wholesale charges, FM6 is still sitting there, and costs may or may not be moving below that. So in terms of the dynamic we appear to have a remarkably static situation.

MR. GREEN: No, with respect, you do not. Ofcom is in the process of examining costs at the moment. We do not know whether Ofcom will find that costs are going to fall and, if so, over what period of time. Ofcom accepts for the purpose of this appeal that it has not done the analysis.

MR. SCOTT: Oh absolutely.

MR. GREEN: So for the purpose of this decision, with respect, you must take the position thus, that Ofcom has not conducted a cost related analysis. It does not know whether costs will fall, and it does not therefore say that the embedded prices above, or will become above costs as they fall, and ergo how on earth can Ofcom sensibly say that they have convincing cogent precise evidence based upon a proper analysis that over the course of this decision the price is bound to become excessive, or there is nothing that prevents us from charging an excessive price. They have not done their homework and they are therefore not allowed to jump to the conclusion and that is precisely what this case is about. The court criticised the Commission, thumpingly criticised them for simply jumping to the conclusion that the merged entity had the ability to engage in certain pieces of conduct which would create and strengthen dominance, and the court said "That is not good enough. If you are going to come to that conclusion you will have to set out with precise and cogent and convincing evidence each step in the logic

along the way." How on earth can Ofcom do that when they have not done their homework? They cannot. We are looking at a period of time which is not just 18, 24 months of this decision, that is the crucial period of time for this case. We now know that they have extended it, but if they have not done their homework how can they jump to the conclusion? That is the precise parallel to this case, and that is why we rely on it because it is demonstrating that Regulators cannot just simply jump to conclusions about future conduct.

These cases are unique because they concern the ex ante analysis, and this is the first case on ex ante analysis from the European Court of Justice and it is only a few months old. Hitherto we had the CFI's Ruling and everything was in abeyance pending this appeal. This case before this Tribunal is, so far as we are aware, the first case on ex ante analysis in the telecoms field. So we are in new territory, and that is why we have to look very carefully at this judgment to see precisely what its implications are.

I have read 42, can I just take you on further ----

THE CHAIRMAN: Just before you leave 42, since we have to look at this carefully, can we look and see what is meant by some of the expressions in this paragraph to make sure that I at least have understood what is being said?

MR. GREEN: Absolutely.

THE CHAIRMAN: Can we take para.42: "A prospective analysis must be carried out with great care", well I am sure that almost goes without saying. It contrasts the investigation of past events and it says we have to indulge in "… rather a prediction of events which are more or less likely to occur in future..."

MR. GREEN: Yes.

THE CHAIRMAN: We might need to be careful about that expression "more or less likely to occur", as I read that – and I want to make sure we read it in the same way – it is not saying "more or less", which in English one would say "is just about right", it means it is more or less likely, and you have to weigh the probability of each. Do we agree with that?

MR. GREEN: Yes.

THE CHAIRMAN: Good. "… a decision prohibiting the planned concentration or laying down the conditions for it is not adopted." Then it talks about the "prospective analysis", and then it goes on to talk about coming up with a view to ascertaining which of a various chain of events is most likely. Now, there is nothing there which quite says you have to be able to prove something will happen on the balance of probabilities.

MR. GREEN: No.

THE CHAIRMAN: It is all an assessment.

MR. GREEN: Well you will have to actually add together at least six or seven different paragraphs. You begin to get a better feel for what the court means when you look at it in the context of a concrete example, and the one I have chosen is regulatory constraints, and that is the one most relevant to this. There they talk in terms of likelihood, and once one gets to the end of the judgment it becomes pretty clear that they are looking for – when they use words "convincing evidence", when they use words such as in 43:

> "Thus, the prospective analysis consists of an examination of how a concentration might alter the factors determining the state of competition".

They are saying you have to examine the *modus operandi* of this change because we are hypothesising as to the future conduct. *Tetra Laval* and *Sidel* have merged, you are hypothesising they are going to engage in a series of behavioural steps which will then, at some future point in time lead to the creation of dominance on the Sidel path, the machinery path, or strengthen the carton size of the business. So we have a series of steps and the court is saying that we need a detailed analysis of how the concentration (the merger) might alter the factors determining the state of competition in order to establish whether it would give rise, not just is likely to, would give rise to a serious impediment to effective competition.

So *modus operandi* has to be examined. There is none in this decision that we are concerned with would give rise to serious impediment. That is beyond just theoretical ability, and that is why I took you to the paragraph in the Commission Decision which was at the heart of this, where the Commission kept on using the word "ability", which is para. 54 of the Judgment, where you see para.364 the Commission Decision is set out. So looking at para.43 you have first of all detailed examination of *modus operandi* and that is in the context of establishing:

> "… whether it would give rise to a serious impediment to effective competition. Such an analysis makes it necessary to envisage various chains of cause and effect with a view to ascertaining which of them are the most likely."

The context and the language is one of a high degree of certainty, and this comes across in other paragraphs.

THE CHAIRMAN: With respect, I think the language is consistent with relative degrees of probability, not high degree of certainty, but relative degrees of probability, which may be different.

MR. GREEN: Yes, I will accept that.

THE CHAIRMAN: It brings all the ratchets down.

MR. GREEN: If one says a high degree of probability is 75 per cent. I would not put it that high. But if one says can they get away with 48 per cent? No. Have they got to show on a balance of probabilities, yes. But that is sometimes meaningless. What it means is the court is going to look very closely at the evidence to see that the conclusions drawn from this detailed step by step analysis are proper conclusions that can be drawn.

MR. SCOTT: There is a "might" in the first line of 43 which presumably then qualifies the "would" in the third line?

MR. GREEN: You have to read that in the context of the word "how" – "How is the *modus operandi*", it is how it might alter the market and we know what the Commission said about "might alter the market" because that is the conduct which leads to leveraging, the leveraging conduct that leads to strengthening and creation of dominance. I think that is all the court is referring to there.

THE CHAIRMAN: Is it going to follow from your submission, I know we are looking ahead, but sometimes it is helpful to see whether you are going to be going to a particular point. Supposing one does this exercise amongst the Commission and one comes up with three potential routes down which this company may go – two of which will lead to no abuse and the third will. On the cards they can none of them be dismissed, and they are all equally plausible, and if you want to divide it up there is a one-third chance that each of them will occur, but if the abuse were to happen it would be extremely serious. On your analysis the Commission would be powerless to intervene, because it cannot prove on the balance of probabilities that the one-third, albeit very serious risk will eventuate.

MR. GREEN: That is the inevitable conclusion of this Judgment, and that is why the Commission was so adamant that it had to be overturned.

THE CHAIRMAN: That is where you are going, that is what you are saying the result of this is?

MR. GREEN: Yes.

THE CHAIRMAN: In other words, you cannot marry a reasonable degree of probability with the consequences of the risk eventuating, so you have to do something. You have to wait till it has happened and then use ex post facto.

MR. GREEN: Or you have to be pretty certain that it is going to happen. You either analyse it and wallop it ex post, but if you are going to do it on an ex ante basis you have to have a high degree of certainty – forget where on the spectrum the word "high" degree of certainty comes. But that is why the Commission was saying that if the CFI is correct, it means there is a very strong presumption of legality in relation to mergers which they would otherwise wish to prohibit, and they could have prohibited the merger in *Airtours*, *Schneider* and *Tetra Laval*,

and they lost all three because the court in each of those cases took the view that they had not met the standard of proof, they had not got over the hurdle of showing the convincing evidence. It was not enough to pontificate about ability, about what the companies when merged might get up to, they had to show that if they were going to prohibit the merger some pretty, cogent, convincing evidence, step by step of why each piece of conduct was likely and then would lead to the increase in market power. Moreover, and it is not unimportant, the Court of Justice here also said to the Commission that you have to show these consequences within a short period of time, because if, let us say, your analysis of this conduct is that it will take place in three or five years then by definition it has become so remote and speculative we are not going to allow you to take it into account. So the court added a temporal limitation on the Commission's analysis. Identify the conduct, show us that it will occur in a short period of time, and then demonstrate that it will lead to the consequence of a creation or a strengthening of dominance; and only when you got to that stage in proving your dominance can you then interfere as a regulator.

That is a high hurdle for the Commission and that is why this case has created huge regulatory waves through Brussels. It will create a profound change in the way that the Commission look at mergers. To be fair to the Commission they actually started to reform their internal measures and procedures following the *Tetra Laval* and the CFI, but they have still fought this case because it imposes upon them an extremely high burden before they can prohibit a merger.

MR. SCOTT: In mergers both in the new system, and in the United Kingdom we have the possibility of commitments. Part of your argument is that the threat of regulators or of regulation is sufficiently powerful to mean that people are likely to behave in a sensible way. Now, classically you reinforce that in some circumstances by undertakings or commitments. In these merger cases you have the possibility of commitment, this is slightly hypothetical, but would you be suggesting that had H3G committed itself to having the wholesale prices at a non-abusive level, then we would be in a much clearer situation in relation to the lack of likelihood of the exercise of SMP?

MR. GREEN: In another way those are the facts of this case, because if we are right the analysis of the Directives Ofcom can never allow an excessive price anyway, and they are always there to ensure that the price is not a supra competitive one and they are an integral part of the negotiation mechanism. The commitments point was expressly dealt with by the court and the court said it is relevant, because if someone is committed to do something you cannot say there is likelihood that they will do it. But the commitment is simply an illustration of a

regulatory intervention. *Tetra Laval* offered commitments as to its behaviour with a view to securing permission to go ahead with the merger. The Commission said "We cannot take account of these because they are behavioural" – the Commission has never liked behavioural commitments.

MR. SCOTT: No, they prefer structural.

MR. GREEN: They prefer structural, and the court said "That is incorrect", you are wrong in principle, you should have taken account of behavioural commitments and a promise to do something to a regulator is relevant, because it means they are less likely to do it, it is a constraining factor. The court said failure to take into account meant that the Commission got it wrong. But in the present case, we have not made a commitment, but we do not need to because we have other forms of regulatory constraint.

Can I just continue – I would like to make sure I finish this case before close of play today. Paragraph 44:

> "The analysis of a 'conglomerate-type' concentration is a prospective analysis in which, first, the consideration of a lengthy period of time in the future and, secondly, the leveraging necessary to give rise to a significant impediment to effective competition mean that the chains of cause and effect are dimly discernible, uncertain and difficult to establish. That being so the quality of the evidence produced by the commission in order to establish that it is necessary to adopt a decision declaring the concentration incompatible with the common market is particularly important, since that evidence must support the Commission's conclusion that if such a decision were not adopted the economic development envisaged by it would be plausible."

Here the court uses the word "plausible", but one will see later that in fact it uses the word "likelihood" when it gets down to the actual facts of individual cases. That was the general observation by the court about the standard of evidence.

If one turns now to the question of regulatory constraints, one can pick this up on the next page, 383 of the bundle, para.52, a very important point about incentives.

> "By its second ground of appeal, the Commission complains that the Court of First Instance infringed Articles 2 and 8 of the Regulation in that it required the Commission to take account of the impact which the illegality of certain conduct would have on the incentives for the merged entity to engage in leveraging and to assess as a possible remedy the commitments not to engage in abusive conduct."

So the Commission was complaining that it should not have to take account of incentive. This is the Commission's objection.

THE CHAIRMAN: It is a question of what effect the illegality of conduct has on incentives, it is not only what you describe.

MR. GREEN: Well I am probably making a comment about what follows in the Judgment. 53…

Paragraph 53:

"The contested parts of the judgment under appeal are in the section examining the plea alleging lack of foreseeable conglomerate effect, in which, more specifically, the Court of First Instance analysed the likelihood [I rely on the word likelihood there] of leveraging. According to the Commission's line of argument, the merged entity would have been capable of exploiting its dominant position on the market for aseptic carton and would have been encouraged to do so in order to leverage its leading position on the market for PET equipment, in particular that for high and low capacity SBM machines used for sensitive products, so as to create a dominant position."

You will see therefore that they are dealing with creation as well as strengthening.

"The forms of leveraging are described …"

They then set out the Commission's decision and I have shown you that already; the Commission certainly had the ability to engage in various bits of conduct. Then 55:

"In response to the Commission's criticisms, Tetra proposed to enter into various commitments. However, the Commission took the view that those commitments could not be regarded as eliminating the competition concerns identified by it effectively. With respect to the behavioural commitments, the following reasons were stated for the … decision in recitals 429 to 432, under the heading 'Separation of Sidel from Tetra and Article 82 Commitments':"

This is from the Commission decision, so one is going back to that,

"429 The behavioural commitments, namely the separation of Sidel from Tetra Pak [Tetra Pak had offered to keep Sidel separate for 10 years] together with the confirmation of pre-existing Article 82 undertakings, [that refers to the fact that Tetra Laval had been subject to some penalties for breach of Article 82 and was therefore subject to an ongoing prohibition decision] are submitted in particular with regard to the concerns of the ability of the merged entity to leverage its dominant position in certain packaging to gain a dominant position in PET packaging equipment [the Commission decision referring only to ability in order to create a dominant position in PET packaging]. This commitment and the pre-existing Article 82 commitments are, however, purely behavioural. As such, they are not suitable to restore conditions of effective competition on a permanent basis, since they do not address the

permanent change in the market structure created by the notified operation that causes these concerns."

The Commission had three other objections, but the Commission was therefore concerned with ability. One then jumps down to paragraph 56 of the judgment:

"The Commission's argument challenges paragraphs 156 to 162 of the judgment under appeal, which immediately follow paragraphs 148 to 155, which were likewise challenged by the Commission and were examined by the Court in connection with the first ground of appeal. In [these] the Court of First Instance held as follows …"

and then I should read 156 – this is the CFI that we are now looking at indented in quotes here.

"In the present case, the leveraging from the aseptic carton market, as described in the contested decision, would manifest itself – in addition to the possibility of the merged entity engaging in practices such as tying sales of carton packaging equipment and consumables to sales of PET packaging equipment and forced sales … firstly, by the probability of predatory pricing by the merged entity … secondly, by price wars; and, thirdly, by the granting of loyalty rebates. Engaging in these practices would enable the merged entity to ensure, as far as possible, that its customers on the carton markets obtain from Sidel any PET equipment they may require. The contested decision finds that Tetra holds a dominant position on the aseptic carton markets, that is to say, the markets for aseptic carton packaging systems and aseptic cartons … a finding not disputed by the applicant."

Then I think I can go to 159, and this is an important paragraph of the CFI judgment and the Commission made slight headway with 159.

"In this regard, it must be stated that, although the Regulation provides for the prohibition of a merger creating or strengthening a dominant position which has significant anti-competitive effects, these conditions do not require it to be demonstrated that the merged entity will, as a result of the merger, engage in abusive, and consequently unlawful, conduct. Although it cannot therefore be presumed that Community law will not be complied with by the parties to a conglomerate-type merger transaction, such a possibility cannot be excluded by the Commission when it carries out its control of mergers. Accordingly, when the Commission, in assessing the effects of such a merger, relies on foreseeable conduct which in itself is likely to constitute abuse of an existing dominant position, is required to assess whether, despite the prohibition on such conduct, it is nonetheless likely that the entity resulting from the merger will act in such a manner or whether, on the contrary, the illegal nature of the conduct and/or the risk of detection will make such a strategy unlikely."

That part of the judgment was upheld and you ought to note that the remainder of that paragraph was set aside by the Court of Justice, for a reason I will explain in a moment, but here the court was saying that if something is prohibited the Commission cannot assume that it will be engaged in, but equally the Commission cannot assume that it will not be engaged in. In other words, simply because it is prohibited is not an absolute answer, but you have got to examine it to see whether it makes such conduct likely or unlikely.

So we rely upon that because the CFI is talking in terms of likelihood and saying that assessment of extra regulatory constraints is relevant. The bit which the Court of Justice did not like here was the next few words:

"While it is appropriate to take account, in its assessment, of incentives to engage in anti-competitive practices, such as those resulting in the present case for Tetra from the commercial advantages which may be foreseen on the PET equipment market, the Commission must also consider the extent to which those incentives would be reduced, or even eliminated, owing to the illegality of the conduct in question, the likelihood of its detection, action taken by the competent authorities both at Community and national level, and the financial penalties which could ensue."

What the Court objected to, in effect, was the word "must" in line 4 because the Commission, I think with some force, said we cannot possibly be expected to look and see whether this piece of conduct is prohibited in Latvia or Luxembourg and/or Spain and Italy and Greece, because that is just going too far. The Court said yes, that does impose too excessive a burden on the Commission to examine national competition law, but nonetheless the Commission must examine regulatory constraints. So the fact that the court annulled the last sentence of 159 still leaves intact the remainder and the underlying principle which the court actually endorsed.

Can I just read you 160 and 161:

"Since the Commission did not carry out such an assessment in the contested decision, it follows that, in so far as the Commission's assessment is based on the possibility, or even the probability, that Tetra will engage in such conduct in the aseptic cartons market, its findings in this respect cannot be upheld."

Look what the court is saying there – this is the CFI – possibility not good enough, probability not good enough if not in conjunction with an economic assessment. It did not carry out an assessment in the contested decision and therefore theoretical possibility and even probability is not good enough. That comes back to the convincing evidence point at the beginning, it is not enough to look at the case theoretically, you have got to have hard evidence, facts. All the Commission, the court, is saying, is that you have got to have the nuts and bolts. These are

cases where you are interfering with business operations and you have got to have the hard evidence. So this is an important paragraph which was not knocked down by the ECJ: possibility not good enough, probability not good enough in the absence of an assessment in the decision.

THE CHAIRMAN: But you say possibility not good enough full stop. Neither the possibility nor the probability are good enough, whichever might be appropriate, if there is not the evidence to justify it.

MR. GREEN: Absolutely.

THE CHAIRMAN: That is not saying anything about the standard of proof --

MR. GREEN: Yes, absolutely, but it is all of a piece with their analysis that you have got to have convincing evidence. I agree with that, yes.

MR. SCOTT: This all goes to evidence as to probable exercise as distinct from existence, so we are still with your argument about exercise as distinct from existence.

MR. GREEN: I was just simply saying it is very simple, in this case Ofcom says Hutchison has the ability, undoubtedly, to set an excessive price. We say "how"? We say if you are going to say how, you have got to show not only that there is a theoretical ability, you have got to examine the chain of cause and effect to get to the conclusion that Hutchison will, and you have to do it with convincing evidence, whatever that might mean, but the mere theoretical ability is not enough. That was the Commission's position, which was thumped all over the place by the CFI and the ECJ.

PROFESSOR STONEMAN: Mr. Green, can I put my interpretation on this one? If we go back to this critical definition of SMP set out in Article 14(2) as we had it at the beginning of the day, which reads at the current time "enjoys a position equivalent to dominance, that is to say a position of economic strength, affording the power to behave to an appreciable extent independently of competitors and customers."

MR. GREEN: Yes.

PROFESSOR STONEMAN: I think what you are suggesting is that we actually change "affording the power" to "making it plausible that it will act". Having read your paragraph 44 just now, it seems to me that the requirement is that Ofcom must consider, in the hypothetical case where H3G were to be designated not to have SMP, whether the undesired developments that are envisaged would be plausible.

MR. GREEN: Plausible is an inaccurate word, the best word is likely, in other words more likely than not.

PROFESSOR STONEMAN: I took the word plausible from 44.

MR. GREEN: Plausible comes from 44, exactly.

THE CHAIRMAN: Plausible is a different word to likely. In other words, if we were in a situation where we believe that the decision was based on a plausible scenario, whether or not we thought that was likely, and if that plausible scenario was such as to justify Ofcom making a finding and having this one remedy, then would we be safe in disturbing ---

MR. GREEN: If you decided that plausible did not mean likely then you would be, with the greatest respect, adopting the wrong decision. When you look at the judgment ---

THE CHAIRMAN: I am just trying to explore what is this word plausible about. Plausibility seems to be a situation in which we would see the how or the what as being understandable?

MR. GREEN: You have to go further than that, on a merits appeal one has got to decide whether Ofcom is correct. There is one reference to the word plausible and there are any number of references to the word likely or likelihood, and indeed in the paragraph I have just read in paragraph 160 of the CFI the court goes further, but if they do not assess it then it is not enough if it is either possible or probable.

THE CHAIRMAN: The difficulty here is that we are dealing with the future, so the reason why the word plausible is in there rather than correct is because inevitably, when looking forward, you are having to assess the future.

MR. GREEN: Yes.

THE CHAIRMAN: So there must be some measure of discretion, and we have gone round the houses in Europe as to the nature of that discretion ---

MR. GREEN: With respect, not here; in the CFI, yes, but on the basis of this judgment not very much, which is the Commission's concern. They use the word plausible, absolutely, but they also added flesh to what that meant in innumerable other paragraphs.

THE CHAIRMAN: Yes, they did.

MR. GREEN: Bearing in mind the time, I wonder if I can just finish this.

THE CHAIRMAN: Do not skimp yourself, Mr. Green, this is an important passage. Do not feel time-constrained.

MR. GREEN: Thank you. What you have seen is the Commission decision, we have seen what the CFI said about it and you have seen the bit that the court then knocked down, but then what did the ECJ say about it? You can jump over the next bit, you see the arguments of the parties, and then you get the findings of the court as to the second ground of appeal in paragraph 71, and here we see the essence of what the Court of Justice ultimately said about the CFI's ruling and the Commission decision.

"It should be observed, first of all, that paragraphs 148 to 162 of the judgment under appeal, which the Commission challenges under both its first and its second ground of appeal, form a section in which the Court of First Instance described certain specific aspects of conglomerate effects, in particular temporal aspects, and inferred from them certain general rules as to the evidence which the Commission must produce when it considers that a proposed concentration must be declared incompatible with the common market.

"It was in the context of this reminder of the need for 'convincing evidence' that the Court of First Instance made reference to the obligation to examine all the relevant information.

> "Such an examination must be carried out in the light of the purpose of the Regulation, which is to prevent the creation or strengthening of dominant positions capable of significantly impeding effective competition in the common market or a substantial part thereof.

"Since the view is taken in the contested decision that adoption of the conduct referred to in recital 364 [which you have seen] in that decision is an essential step in leveraging, the Court of First Instance was right to hold that the likelihood of its adoption must be examined comprehensively, that is to say, taking account, as stated in paragraph 159 of the judgment under appeal, both of the incentives to adopt such conduct and the factors liable to reduce, or even eliminate, those incentives, including the possibility that the conduct is unlawful."

So a comprehensive analysis of likelihood of adoption of conduct which leads to dominance is required, and that includes the incentives that the conduct in question which is attacked is illegal.

> "However, it would run counter to the Regulation's purpose of prevention to require the Commission, as was held in the last sentence of 159 [the evidence point about all the different member states] of the judgment under appeal to examine for each proposed merger the extent to which the incentives to adopt anti-competitive conduct would be reduced or even eliminated as a result of the unlawfulness of the conduct in question, the likelihood of its detection, the action taken by the competent authorities, both at community and national level, and the financial penalties which could ensue.

"An assessment such as that required by the Court of First Instance would make it necessary to carry out an exhaustive and detailed examination of the rules of the various legal orders which might be applicable and of the enforcement policy practised in them. Moreover, if it is to be relevant, such an assessment calls for a high probability of the occurrence of the acts envisaged as capable of giving rise to objections, on the ground that they are part of anti-competitive conduct.

"It follows that at the stage of assessing a proposed merger, an assessment intended to establish whether an infringement of Article 82 is likely and to ascertain that it will be penalised in several legal orders would be too speculative and would not allow the Commission to base its assessment on all the relevant facts with a view to establishing whether they support an economic scenario, in which a development such as leveraging will occur.

"Consequently, the Court of First Instance erred in law in rejecting the Commission's conclusions as to the adoption by the merged entity of anti-competitive conduct, capable of resulting in leveraging, on the sole ground that the Commission had when assessing the likelihood that such conduct might be adopted, failed to take account of the unlawfulness of the conduct and, consequently, of the likelihood of its detection, of action by the competent authorities, both at the Community and national level, and of the financial penalties which might ensue. Nevertheless, since the judgment under appeal is also based on the failure to take account of the commitments offered by Tetra, it is necessary to continue the examination of the second ground of appeal.

> "With respect to the argument that the Court of First Instance departed from the approach taken by it in the *Gencor* judgment, it must be held that contrary to what the Commission claims the Court of First Instance did not depart from the position taken by it in paragraph 94 of that judgment, namely that there will be a significant impediment to effective competition if there was a lasting alteration of the structure of the relevant market as a result of a concentration having the direct and immediate effect of creating conditions in which abusive conduct is possible and economically rational."

I think one can jump from there to 85, unless anyone wants me to read anything else.

"With respect to consideration of the behavioural commitments offered by Tetra the Court of First Instance was right to hold, in para 161 of the judgment under appeal, that the fact that Tetra had in the present case offered commitments relating to its future conduct was a factor which the Commission has to take into account when assessing the likelihood that the merged entity would act in such a way as to make it possible to create a dominant position on one or more of the relevant markets for PET equipment."

Then in paragraph 87 the Court criticises the Commission for failing to have taken account of the question of commitment, and then 89:

"It follows from the examination of the second ground of appeal as a whole that although the Court of First Instance erred in law by rejecting the Commission's conclusion as to the adoption by the merged entity of conduct likely to result in leveraging, it was nevertheless

right to hold in paragraph 161 of the judgment under appeal that the Commission ought to have taken account of the commitments submitted by Tetra with regard to that entity's future conduct. Accordingly, whilst the ground of appeal is well founded in part, it cannot call into question the judgment under appeal insofar as it annulled the contested decision since that annulment was based, inter alia, on the Commission's refusal to take account of these commitments."

The upshot was that even in relation to the fairly minimal offer of commitments, the Commission had failed to take account of them. They had a deterrent effect even though they would not necessarily result in regulatory sanctions, they may be viewed as a fairly weak deterrent effect, the Commission failed to address its mind to them, it failed therefore to consider whether there was an incentive to engage in the practice which would ultimately lead to the dominance through the illegal pricing practices of leveraging. As a result the Commission decision was annulled, the CFI was quashed only insofar as it had imposed too onerous a burden on the Commission, when it said that it had to look at each and everyone of the Member States to see whether or not the incentive was weak or strong. In the present case, of course, we were dealing with one Member State, the United Kingdom, we had one regulatory regime, that problem does not arise. Now, again, for almost the entirety those paragraphs are addressed and couched in the language of likelihood and over and above likelihood the Commission has to set out the causal steps leading to its conclusion that the conduct will occur and that the conduct will lead to dominance within a shortish period of time. If they do not carry out that analysis then the decision is set aside and the Commission cannot justify its intervention.

THE CHAIRMAN: Can you help me because there is frequent reference to "likelihood", can you point to the references in which it is part of your case where likelihood is intended to connote establishing on a balance of probabilities as opposed to assessing the chances or assessing the probabilities?

MR. GREEN: The court does not tend to think in terms of English law balance of probabilities. I will have a look but I am not certain that there is anything which puts it in terms of balance of probabilities. I think the nearest one gets to it is in the paragraph I read to you where in the absence of addressing your mind to it the court draws a distinction between possibility and probability. I think it is very clear from that paragraph that they do contemplate there is a difference between a possibility and a probability. But I think one has to put this in context. The court says "likelihood", in other words, more likely, which I think the normal meaning would be on the balance of probabilities. You have to put it in the context of the fact that the

Commission has got to set out all the steps in its chain of reasoning and that this is ex ante analysis which the court says has to be more convincing than ex post because it is a de register intervention and one of the really important things the Commission lost on was this "are mergers presumptively allowed, or presumptively prohibited?" The court says they are presumptively allowed. The Advocate General in his opinion, and I can perhaps show you this tomorrow, said that in a grey area, because they are presumptively allowed you do not interfere. Now, they can only introduce this predominantly as a question of policy. You have to get over a high hurdle before you justify interference in the market place. We say the same considerations underlie this area of law. It is not determinative, but you have seen the recitals ex post is better than ex ante, you should only interfere when it is strictly necessary, proportionate and so on and so forth. You have a risk of creating distorted incentives if you force someone in the short term to interconnect. It might create long term problems, so on and so forth.

Just looking at the language of this judgment, regulatory constraints "highly relevant". If you do not address it then that is the end of the case. If you do address it you have to set out all the steps in the chain to show that the regulatory constraints do not work. It is quite plain the burden of proof is on the Commission; there can be no doubt about that following from this decision. It is quite plain that the Commission has the task because it was the Commisison whose decision was annulled for not doing the homework.

That is probably an appropriate moment. There is very little from the AG's opinion I need to take you to.

PROFESSOR STONEMAN: Can I just ask you one point on a point you have just made about presumption? You were implying that this changes presumptions, or there are no presumptions, but we are working under the indication that 50 per cent. market share of greater leads to a presumption of SMP. Are you saying that that should not be held?

MR. GREEN: Yes. That cannot possibly be good law in so far as it applies to this particular regime, not in the light of *Tetra Laval. Tetra Laval* was a case where Tetra already had dominance in one market and it could only have its merger prohibited if either its dominance was strengthened or it created dominance in Sidel's area of the business machines. The fact that Tetra already had dominance did not mean to say that there was any presumption that the merger was prohibited because there was a strengthening or even that it would be able to shift some of its market power into Sidel. How is that to be squared with the presumption of dominance where someone has got over 50 per cent. of the market? That is all well and good in an ex post case where you have a history of sales and volumes to measure, it really does not

make much sense in the present case. I k now Ofcom relies upon it and I know what the Commission said in the German case. But at the very highest it creates a presumption, and we do not accept that that is one which applies in this case, certainly in the light of *Tetra Laval* but even if it does we say that Ofcom's own Decision sets out so little in the way of fact, all we have to do when we are challenging the logic and consistency of the Decision is point you to the illogic and the inconsistencies, and we can point out what they did not do, and then in a challenge to a Decision. You are not taking a decision here on whether there was or was not dominance. We anticipate that if you were with us you would remit it and Ofcom would have to take the decision again, and this time they would look at the facts. So it is really relevant to the administrative stage.

PROFESSOR STONEMAN: I still think we need to consider wither SMP has to be proved or disproved.

MR. GREEN: I think you need to stand back from this judgment and ask what was the European Court's view of the Commission's obligation. Tetra plainly had a very high market share, it already had dominance, that was not enough.

THE CHAIRMAN: We will continue tomorrow at 10 o'clock.

(Adjourned until 10 a.m. on Tuesday, 24th May 2005)