IN THE COMPETITION Case Nos 1083/3/3/07

APPEAL TRIBUNAL 1085/3/3/07

Victoria House
Bloomsbury Place
London WC1A.2EB

21 April 2008

Before:
MISS VIVIEN ROSE
(Chairman)
PROFESSOR ANDREW BAIN OBE
MR. ADAM SCOTT TD

BETWEEN:

HUTCHISON 3G (UK) LIMITED
("H3G") Appellant/Intervener

and

OFFICE OF COMMUNICATIONS
("OFCOM") Respondent

And

BRITISH TELECOMMUNICATIONS PLC
("BT")

Appellant/Intervener

and

OFFICE OF COMMUNICATIONS

Respondent

With interventions by:

O2 (UK) LIMITED ("O2")
ORANGE PERSONAL COMMUNICATIONS SERVICES LIMITED ("ORANGE")
T-MOBILE UK LIMITED ("**T-MOBILE**")
VODAFONE LIMITED ("VODAFONE")

Interveners

Also present:

COMPETITION COMMISSION

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CASE MANAGEMENT CONFERENCE

APPEARANCES

Mr. Brian Kennelly (instructed by Baker & McKenzie) appeared on behalf of Hutchison 3G

Miss Sarah Lee (instructed by BT Legal) appeared on behalf of British Telecommunications PLC

Mr. Josh Holmes and Mr. Ben Lask (instructed by the Office of Communications) appeared for the Respondent.

Mr. Meredith Pickford (instructed by Miss Robyn Durie, Regulatory Counsel, T-Mobile) appeared on behalf of the Intervener T-Mobile.

Miss Elizabeth McKnight (Partner, of Herbert Smith) appeared on behalf of the Intervener Vodafone.

Miss Kelyn Bacon (instructed by S.J. Berwin) appeared on behalf of 02(UK) Limited.

Miss Marie Demetriou (instructed by Field Fisher Waterhouse) appeared on behalf of the Intervener Orange.

Mr. Tom Sharpe QC and Mr. David Caplan appeared on behalf of the Competition Commission

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THE CHAIRMAN: Good morning ladies and gentlemen. Thank you to everybody for your submissions. There are just a couple of points I want to raise by way of introduction for the parties. The first is directed at Ofcom and the interveners in particular, which is that we would welcome, as you go through the different parts of the material which are in contention, if you could particularly focus on which, if any, would require additional work on the part of Ofcom and the interveners in order to respond to that. I know this has been covered a little in the submissions, but it would be helpful if you could pinpoint that where appropriate.

As far as H3G's submissions are concerned, again we would welcome you being very clear about which parts of the existing amended appendix you rely on as justifying the particular aspects of the pleadings which are again in contention.

The third point is a more general one, which is what we intend to produce at the end of today's hearing. The first is that we will, of course, indicate which parts, if any, of the H3G supplementary material are not to be relied on. By the "supplementary material" we mean the supplemental submission of 7th March, which includes the schedule of evidence and the three witness statements of Mr. Ross or Mr. Dyson and Mr. Westby, and the tab 5 costs information. Secondly, to indicate which parts, if any, of the outlying statement of intervention cannot be relied upon, or to which the other parties are not required to respond. We know, of course, that we are expecting the full statement of intervention by close of play today and it may well be possible for us, in the event that we decide that there are some aspects of it which should not be allowed, to point to those aspects in the full statement as well.

As far as the challenge that the parties have raised to some of the material that was canvassed by H3G in the plenary session on 9th April before the Competition Commission. We were not planning to make any order in relation to that on the assumption that if it becomes relevant the Competition Commission will be able to read across from our decisions on the first two points any repercussions for that material.

We are therefore not intending that the outcome of today's hearing will be a direction under our Rule 5 powers to the CC in the context of its investigation. So if the Competition Commission want us to give them a direction of any sort then they need to make that clear during the course of the day.

So that is all that we wanted to say by way of introduction. I think, Mr. Holmes, you are going first.

MR. HOLMES: Thank you, madam. I am grateful for those indications and I shall endeavour, in developing my submissions, to identify those aspects of the supplemental submissions which we consider would require additional work. I hope, madam, that you will have a skeleton argument which was prepared by Ofcom for today's hearing. Unfortunately it was only served on Friday afternoon. We were responding to submissions that we had only received on Thursday morning. We have today an additional version of the skeleton argument which simply adds cross-references for the Tribunal's convenience.

Madam, you will see from the first paragraph of our skeleton that we make three general submissions today. The first is that the supplemental submission contains new grounds and/or argument not to be found in H3G's amended notice of appeal. Second, that H3G's application to amend, which we anticipate being made in their submissions this afternoon, should be refused. Third, H3G's intervention as currently pursued in the BT appeal is inadmissible.

Turning to my first submission that the supplemental submissions raised new issues, by way of clarification I shall refer to the supplemental submissions as including not only the submissions of 7th March, but also the additional submissions and new material that were served by H3G on 14th March, and the new material served with H3G's submissions for today's CMC. We think that they stand or fall together.

THE CHAIRMAN: Also 14th March.

MR. HOLMES: Indeed, the WIK report, madam, and a letter explaining its significance.

THE CHAIRMAN: That is the 14th March material, and then the other material?

MR. HOLMES: A Morgan Stanley report which is served with the submissions for today's CMC.

THE CHAIRMAN: Yes.

MR. HOLMES: Madam, we say that there are four key features of H3G's case as it is pleaded in the amended notice of appeal. If the Tribunal will allow me, I shall take a little time with the amended notice of appeal and the accompanying appendix to illustrate the case as we see it to be as it is set out there. We know that H3G has relied in their submissions on various passages from the appendix, and we think that these need to be set in their proper context.

THE CHAIRMAN: Yes.

MR. HOLMES: So, if I may, I will take you, madam, to bundle A, the index for the case management conference on 25th February 2008, and that contains at tabs 1 and 2 H3G's notice of appeal, as amended, and the price control appendix.

The first key feature of H3G's case as we see it as it appears in the notice of appeal is that H3G was proposing quite different approaches in respect of mobile-to-mobile, or M2M MCT rates on the one hand, and fixed-to-mobile or M2M MCT rates on the other hand. This emerges very clearly from the relief summary in the notice of appeal which is at para.3.2 of tab 1. Madam, you will see there that at 3.2(a) Hutchison submits that the CC should determine:

> "The level of mobile-to-mobile MCT rates so that the MCT rate paid and received by H3G to and from other MNOs equals zero pence per minutes or otherwise leads to a neutral net revenue position."

This is what is referred to as the "Net payment zero alternative approach to remedy". It is clearly there confined to mobile-to-mobile mobile call termination rates.

Madam, H3G advance an alternative case in relation to the level of M2M MCT rates, which is set out at 3.2(b). That alternative case is that the level of mobile-to-mobile MCT rates received by H3G and an appropriate glide path for the same should be determined by the CC in such a way that takes account of actual market circumstances, including the availability or otherwise of effective MNP.

So, madam, two cases in respect of mobile-to-mobile rates – on the one hand, an alternative approach to remedy, net payment zero; and on the other an approach which we have characterised as asymmetric regulation whereby H3G's rates would be adjusted to take account of actual market circumstances, including the availability or otherwise of effective MNP.

So that is the case in relation to mobile-to-mobile termination rates.

THE CHAIRMAN: As far as the rates set by other mobile network operators are concerned, is that affected by 3.2(b), or does 3.2(b) relate only to H3G's rate, the rate received by H3G?

MR. HOLMES: Madam, our reading of 3.2(b), and I can develop this when we turn to the approximate, is that Hutchison was seeking a different rate for itself by comparison with the other 2G/3G MNOs in respect of mobile-to-mobile MCT rates to reflect the actual market circumstances that it faced, and specific disadvantages which it identifies and expands upon in the appendix.

THE CHAIRMAN: Thank you.

MR. HOLMES: Then, madam, at 3.2(c) one comes to H3G's only remedy in respect of fixed-to-mobile MCT rates. H3G there contends that:

> "… the level of the MCT rate paid by fixed operators to all UK MNOs …"

- that fixed-to-mobile termination rates –

"… [should be] based on long-run average cost, with separate controls for 2G and 3G call termination; and/or

(ii) the level of the MCT rate for 2G call termination paid by fixed operators is at a rate based on long-run average cost, reduced so as to reflect the lower risk that attaches to the investment in 2G networks; and

(iii) the level of the MCT rate for 3G call termination paid by fixed operators is at a rate based on long-run average costs (combined with an appropriate glide path which takes account of actual market circumstances), increased so as to reflect the higher risk that attaches to the investment in 3G networks and the fact that H3G as a later entrant needs to recover efficiently incurred CARS costs."

CARS costs, you will recall, madam, are "Customer acquisition retention and service costs".

So there we see in relation to fixed-to-mobile call termination rates not the net payment zero remedy which was sought in the alternative in relation to mobile-to-mobile MCT rates, but instead a rate fixed by reference to long-run average costs, separate rates for 2G and 3G termination and an adjustment also to reflect H3G's different market circumstances, including the need for it to recover efficiently incurred CARS costs, so a quite different package of remedies of fixed-to-mobile MCT rates by comparison with those sought in relation to mobile-to-mobile termination rates.

MR. SCOTT: Just pausing on long-run average costs, are we right in assuming that this is long-run average costs not long-run average incremental costs?

MR. HOLMES: Indeed. I am grateful for that intervention. Absolutely, Ofcom understood LRAC, and I think it is clear that LRAC was intended when we turn to the appendix, not to be LRAIC, long-run average incremental costs, but to be LRAC – in other words, an alternative method of depreciation taking basically fixed costs as Ofcom itself did in determining the level of charge controls.

MR. SCOTT: As the day develops I think we will be returning to the subject off and on.

MR. HOLMES: Indeed.

Madam, the first key feature then, different approaches to mobile-to-mobile and fixed-to-mobile MCT rates. I will not take you now, for reasons of time, to the appendix, but the same distinction is to be observed there, and just for the record I give you the references – para.1.2 of the appendix, 4.1, 4.2 and 4.7 of the appendix. I can take the Tribunal to those references if it would assist, but I am aware of the limits on time for today.

So the second key feature is Hutchison's case is that the net payment zero remedy sought in respect of mobile-to-mobile calls is supported by reference to a relatively narrow set of arguments focused almost exclusively on specific features of H3G's competitive position vis-à-vis the other 2G/3G MNOs.

Madam, to demonstrate this, I would like to take you, if I may, to para.4.5 of the appendix at tab 2 of bundle A, p.10 of the appendix. By way of context I should perhaps take you to p.9. You will see at the middle of p.9 there appears the heading "Alternative Approach to Remedy". This, madam, is the net payment zero option sought in respect of mobile-to-mobile calls. That emerges clearly from para.4.2.

At para.4.5 H3G sets out its reasons for preferring such a remedy, and those reasons commence at para.4.5(a) with a reference to the material net out-payments that H3G is obliged to make to the 2G/3G MNOs as a result of a traffic imbalance – the famous traffic imbalance. That point is further developed at para.4.5(d) over the page, p.11. You will see there that H3G returns to the material net out-payments to its competitors which are said to reduce the ability of H3G to play the role of a maverick competitor.

At 4.5(e) H3G builds on this submission by saying that Ofcom should have been reluctant to put in place a price control regime that worsened the competitive dynamics of the market, or at least should have scrutinised the decision to do so closely.

At 4.5(f) another disadvantage that H3G claims to suffer, this time as a result of the ported number arrangement. Madam, the point here anticipates the argument which H3G develops separately as a basis for asymmetric regulation in s.9 further on in the appendix – I will not take you to that now – but so far all specific features of H3G's circumstance.

There are a couple of broader arguments to be found at 4.5(b) and (c). You will see at 4.5(b) that H3G commends the net payment approach as assisting in avoiding the risks of regulatory error as the difficulty of forecasting the various components which comprise a charge control and which Ofcom has always accepted as subject to uncertainty.

At 4.5(c) the same point is developed in relation to the set of ranges which Ofcom has advanced in light of that uncertainty. But again, the point is brought back by H3G to its own specific circumstance. H3G's point appears to be that if one looks at the range of possible costs scenarios that Ofcom considered on one of them at least the costs are only as great as H3G's estimates for its own potential net out payments to the operators at the end of the charge control, so this point as it appears to us is again a point which goes specifically to H3G's position.

MR. SCOTT: Just sticking with (c) what we see here appears to be an attempt to embrace the LRIC to reach a net wholesale payment zero – see the last line on p.10, rather than an attack on that approach.

MR. HOLMES: Indeed, sir, I am grateful for that. Just to reinforce the point, at para.4.6 one sees again a focus upon H3G's specific circumstance. It is said that Ofcom could and should have given more weight to (1) an assessment of an appropriate remedy that reflected the special position of the new entrant, i.e. H3G; and (2) the actual impact on competition in relevant markets of increasingly symmetrical rates.

Now, that reference to increasingly symmetrical rates is a reference to the fact that H3G's rates as a result of the charge control were to be brought increasingly into line with those of the 2G, 3G MNOs. So clearly then the second fundamental feature as we see it of H3G's pleaded case, net payment zero, supported by reference to a relatively narrow set of arguments, focused exclusively – or almost exclusively on specific features of H3G's competitive position.

Madam, the third fundamental feature of H3G's case as pleaded in the amended notice of appeal is that in relation to fixed-to-mobile termination rates H3G seeks not one single rate but instead various rates differing as between 2G and 3G technologies, and as between H3G and the other MNOs. I do not think I need to take you to anything in particular in support of that proposition, we have already seen it very clearly from which the relief is pleaded at para.3.2(c) of the notice of appeal.

The fourth and final key feature of H3G's case as pleaded is that H3G is not contending for fixed-to-mobile rates to go down across the board. On the contrary as regards its own MCT rates, H3G argued for an increase in Ofcom's target average charges. One sees this very clearly at para.6.1 of the appendix. There, H3G sets out its case in the alternative to a net payment zero approach. There, H3G considers that Ofcom's estimate for the appropriate cost benchmark for the provision of call termination on H3G's 3G network is too low, not only because it is based on an inappropriate path of cost recovery, the long run average cost point developed in s.5, but also for the reasons set out in sections 8 to 10 which follow.

To reinforce the point without taking you through each of the grounds that H3G advances as to why its own rate is too low I would simply draw your attention to the fact that in relation to CARS costs (Customer Acquisition Retention and Service costs) para.8.40 of the appendix, H3G indicates that the exclusion of CARS costs on the part of H3G is

significant. It included, H3G submits, that they would lead to an increase for it in the order of 5p per minute.

THE CHAIRMAN: Is that 5p per minute for costs or for its charge?

MR. HOLMES: As I understand H3G's submission they argue that allowance should have been made for its CARS costs, in other words these CARS costs should have been added in because it was a later entrant and an appropriate model would have allowed for the efficiently incurred costs of a late entrant to a saturated market. One sees that at para. 8.1 on p.19 of the appendix. So Ofcom is criticised for making no allowance for H3G's CARS costs in setting a price cap for call termination.

> "As a late entrant into a saturated market, H3G must incur significant levels of CARS' costs in order to attract subscribers to its network in competition with the established MNOs. Ofcom erred in relation to the treatment of CARS costs and breached its duties to promote competition."

Although the matter is not entirely clear, it appears, madam, that they were seeking to have CARS costs included and CARS costs on their estimate were in the order of 5p per minute. You will recall, madam, that Ofcom's charge control – the target average charge for the final year of the charge control for H3G is set at the level of 5.9p per minute. So this would suggest a very significant increase in the level of H3G's fixed to mobile MCT rates.

MR. SCOTT: And this then implies an economic approach to the total system, not a marginal approach?

MR. HOLMES: Indeed, sir, on that point one sees at para.8.11 of this section of the appendix, in relation to CARS costs that H3G specifically contents that CARS costs are a common cost as against Ofcom. So it can only be assuming that those common costs should be included as is required under the LRIC model, the model relied on by Ofcom now referred to by H3G as fully allocated costs, but not under the LRAIC model, or marginal cost model, which H3G now seek to base their case upon.

MR. SCOTT: Yes, but we are going to have to be difficult because LRIC can be used either in the total system sense, or in the much narrower sense of looking at the margin very specifically associated with incoming calls, and that is going to make ----

MR. HOLMES: Yes, but we would say that Ofcom's position has always been ----

MR. SCOTT: No, understood, and this appears to be taking the former view not the latter view.

MR. HOLMES: Indeed. So taking those four fundamental features, I should say briefly it is in the light of the fact that H3G MCT rates were, on its pleaded case, to go up but one must read the various references in the appendix to the advantages of lower MCT rates, and in

places H3G is explicit that it is only referring to lower 2G/3G MNO MCT rates for fixed-to-mobile, but in other places it omits that qualification, which it has been suggested against us indicates that H3G were always seeking lower MCT rates across the board. We say in relation to the passages we have already shown you that is simply unsustainable. Just to give you references, madam, H3G specifically qualifies its statement about lower MCT rates at paras. 2.6 of its notice of appeal and at para.1.1 of the appendix. In both of those places H3G makes clear that it is referring to lower MCT rates in respect of 2G/3G MNOs.

THE CHAIRMAN: But where is it in the appendix that it sets out how Ofcom would go about lowering the 2G/3G – is that because the separate MCT charge for 2G termination is to be reduced and the termination charge for 3G is to be increased.

MR. HOLMES: Madam, yes indeed. There may be several reasons but the one in particular which springs to mind is the application of the LRAC cost model contended for by H3G. Now, H3G's LRAC model involved replacing the method of cost depreciation adopted by Ofcom which, as I understand it, was constant across the period – or flatter in any event – with another model of depreciation which turned on the actual demand experienced for services in respect of the different technologies 2G and 3G. Now, the effect of their adjustment is that in relation to networks, or technologies, which are heavily utilised, the cost recovery will be greater during the periods of heavy utilisation, whereas in relation to technologies which are less heavily utilised the effect will be to reduce the amount of costs' recovery during the period where they are less intensively utilised.

I am so sorry, I am just taking instructions – I am afraid the complexities of LRAC have defeated me. (After a pause) I fear the complexity of this may be too great for me to answer the question fully now, but as I understand it, on the basis of what I have just been told, you see a much steeper decline in cost recovery as utilisation increases, so the effect is basically that because 2G networks are already heavily utilised, the amount of costs recovered now will be higher and therefore the charge per unit will be lower and the charge control will be fixed at a lower level. They will be allowed to recover less of their costs for now.

THE CHAIRMAN: So is it the case, and you may want to come back to this, that it is s.5, the path of cost recovery section of the appendix which, if accepted and implemented, would result in a lowering of the MCT rates of the 2G/3G MNOs?

MR. HOLMES: I would like to reserve my position, but that is certainly, as I understand it, one of the bases on which a reduction in the MCT rates of the 2G/3G MNOs is contended for.

Yes, madam, I am grateful for that. The other point that I wished to make in relation to the appendix is just to draw your attention to put the matter absolutely clear and beyond doubt, so the fact that the structure of the appendix clearly reflects the fact that H3G's MCT rates are expected to go up and those of the 2G/3G MNOs are expected to come down. We see that from the contrast between s.6, to which I have already taken you, sets out the case for H3G's MCT rates to be raised by reference to s.5 above and sections 8 to 10 below. If one then goes past s.10 to s.11, one sees a heading on p.33 of the appendix: "The 2G/3G MNOs' MCT Rates". This in other words is the move from H3G's case in relation to its own termination rates to its case in relation to the 2G/3G MNOs termination rates, and drawing on some of the material that they previously advanced they contend here that the target average charge imposed on the 2G/3G MNOs should be lower and set out there the reasons why.

Perhaps in terms of the substance of that I might answer that question more fully after I have had an opportunity to take instruction, but for now, and given the time, I would like to move on, if I may.

When one turns and looks at H3G's case as it appears in supplemental submission, one finds that there there is advanced a new approach – I am picking up here at para.13 of my skeleton, if I may. That new approach involves a single MCT rate for mobile-to-mobile and fixed-to-mobile calls alike, fixed at the same level of around 0.4ppm as one of BT's wholesale fixed call termination rates. So a common level for fixed and mobile-to-mobile termination rates, fixed at the level of BT's fixed termination rate. One sees that very clearly, I think we should probably now open H3G's supplemental submission which is in a separate bundle.

THE CHAIRMAN: Just to go back a moment, in their appendix what do you say they were saying should be the actual numbers set for fixed to mobile MCT?

MR. HOLMES: Madam, they do not propose specific rates and they have not done so until now, until their supplemental submission. They indicated asymmetric regulation with H3G's rates going up for various reasons, and the 2G/3G MNOs rates for fixed to mobile going down. Obviously in relation to net payment zero we say the only practicable method by which that could be implemented would be a rate of zero pence per minute.

THE CHAIRMAN: But that was only ever for mobile-to-mobile.

MR. HOLMES: That was only ever for mobile-to-mobile, indeed, madam.

THE CHAIRMAN: But as far as fixed-to-mobile, you say they did not in their appendix say what those rates should actually be, but that what they said about how they should be

arrived at indicated that the H3G rates should be higher and the 2G/3G MNOs should be lower.

MR. HOLMES: With the qualification that they say in terms that the H3G rates should be higher, and that the 2G/3G MNO rates should be lower. It is not merely that they rely on reasons which lead to that result, they are quite explicit in contending for higher rates for themselves and lower rates for everyone else.

THE CHAIRMAN: And that it should be a different rate for 2G and 3G?

MR. HOLMES: Yes, madam.

MR. SCOTT: We will be coming to this later when we have H3G, but the rate about which you are now talking seems to be associated with the word "pragmatic", and if you think there is an underlying economic theory which has been introduced here, do let us know.

MR. HOLMES: Sir, it will be my submission that the new approach for which H3G contends is not some happy coincidence of rates as between fixed-to-mobile and mobile-to-mobile, it is not simply a pragmatic solution, it is based upon arguments of principle which are new arguments of principle and I will come to that point in a moment.

THE CHAIRMAN: I am sorry to keep interrupting, but another point which has not quite emerged from what I have seen is that can we assume that this 0.4 ppm rate is a general fixed network termination rate? It is sometimes referred to as that and sometimes referred to as a "CT" rate, but we have not seen, as far as I am aware anything that indicates what the other fixed networks' charge each other or the mobile networks' for termination?

MR. HOLMES: Madam, I believe that is correct. We can certainly supply you with that information if it will assist the Tribunal.

THE CHAIRMAN: Well it should be a non-contentious fact insofar as there is such a thing in this industry, but it would be useful, I think, for us to know the answer to that.

MR. HOLMES: Yes. So returning then to the supplemental submission, one sees the first flavour of the new approach at para. 1.2(c)(i)(a) on p.2. In the final sentence of the first incomplete paragraph at the top of p.2 H3G explains that its approach would require end-to-end rates being at or close to zero and F2M MCT rates being in order of magnitude lower than at present.

"Mr. Russell, on behalf of H3G suggests less than 0.4 ppm being one of BT's wholesale charges for fixed call termination."

Now there still a slightly qualified presentation of the new case, but if one turns to the proposed approach to remedy at p.13 of the supplemental submission, the position has somewhat hardened. One sees at para.3.1:

"To the extent that the CC feels that it is able to recommend a precise remedy or at least suggest one as guidance to Ofcom, H3G proposes that prices for M2M and F2M calls should fall to the level of fixed call termination."

That is the remedy they now seek, that is their new approach. I am sorry, madam, do you have that? It is on p.13, para.3.1: "... prices for M2M and F2M calls should fall to the level of fixed call termination." So it is quite clear what H3G now seeks, there is no real dispute about that.

MR. SCOTT: Just staying on that page, if you go to 3.2 this is the part at which we see the reasons.

MR. HOLMES: Yes, sir. These are only some of the reasons I should say, they are by no means all of the reasons which H3G advances, but you will see that these are arguments of principle in support of low or no MCT rates. I will enumerate the arguments in a little more detail in a moment if I may.

Although H3G refers to this new approach under the label of NPZ it bears little resemblance, we say, to anything in H3G's original pleaded case. It applies without distinction to mobile-to-mobile and fixed-to-mobile calls. I am reading, madam, from para.14 of my skeleton.

It does not achieve net payment zero for mobile-to-mobile calls, but instead a rate pragmatically close to zero which would still to net out payments from H3G to the 2G/3G MNOs, albeit that we accept that those net out payments would be radically reduced.

It applies neither LRAC nor asymmetric regulation in the case of fixed to mobile calls, and it substantially decreases H3G's MCT rate for fixed-to-mobile calls relative to the rates set by Ofcom. So those all differ from the fundamental features which I draw your attention to.

Finally, there is a new and wholly novel fundamental feature added, which, apart from anything, one cannot find any hint of it in the original notice of appeal. H3G now seeks to align fixed and mobile termination rates. The point I make here is not a distinction between fixed-to-mobile, and mobile-to-mobile but the distinction between mobile termination rates and the rates paid to BT and other fixed network operators for termination on their networks. There is now an explicit linkage made by H3G between those rates and there is not a flavour of that to be found anywhere in the original notice of appeal, the amended notice of appeal or the appendix.

THE CHAIRMAN: There is a 0.4p figure, it is presumably arrived at looking at BT's costs rather than the MNOs' costs?

MR. HOLMES: Yes, it is fixed by reference to BT's costs. Madam, to pick up the point made by Mr. Scott, the new approach is supported by a significant number of novel arguments that go well beyond those used to promote NPZ in respect of mobile-to-mobile MCT rates in the H3G notice of appeal. I enumerate various novel arguments which are sweeping in their generality. They are basically a broad range of policy arguments. I do not propose to go through them in any detail now, unless it will assist the Tribunal, but basically the new approach is commended on the basis that you would approximate them closely to marginal cost less the network externality – it would appear that is the network externality, it is not entirely clear – which now appears to replace LRAC as H3G's preferred costs' standard fixed-to-mobile calls. As we discussed earlier, we say that LRAC is quite different and distinct from the marginal cost model which is now proposed.

MR. SCOTT: Yes, I perhaps should, for H3G's benefit, explain what I meant earlier on. It seems to me that in raising the marginal cost point they are putting in a theoretical argument for taking what appears to be a radically different approach to how you do a calculated cost.

MR. HOLMES: Yes.

MR. SCOTT: What we are seeing in what we have been talking about – the reason why it seems pragmatic – is yes, it is placed against a policy background, but that policy background does not lead you to a calculation that takes you to 0.4. It leads you to using 0.4 as a proxy for where you might get were you to apply the alternative econometric approach for which they may be ---

MR. HOLMES: Yes, sir, these are basically arguments in support of very low MCT rates, they are not arguments for deriving a specific figure, and is helpfully clarified by a question from madam Chairman, the 0.4 ppm is not calculated by reference to the marginal costs of mobile operators at all, it is calculated on a quite separate and different basis.

Secondly, it is said that the new approach will produce a result more consistent with efficiency than Ofcom's approach, which is now referred to by H3G as a "fully allocated cost approach" rather than an ED approach as it was previously described.

Thirdly, it is said that the new approach would avoid unspecified competitive distortions in the mobile market, which Ofcom allegedly failed sufficiently to investigate. Now, pausing on this point, madam, this we say can only be a reference to on-net/off-net price discrimination. This is the plea that dare not speak its name ----

THE CHAIRMAN: Where are you reading from?

MR. HOLMES: Madam, one sees this at para.2.12 of 7th March submission. Madam, over the page at p.7, you will see that H3G identify the substantial net payments that have been made by H3G to other incumbent 2G/3G MNOs. Then H3G continues that it is argued that these payments arise as a result of underlying competitive distortions.

Pausing there, madam, you will recall that the case as put in the appendix was not that traffic imbalance was caused by underlying competitive distortions, it was that competitive distortions resulted from the traffic imbalance and the net out payments that were made by H3G, which limited its ability, to act as a maverick competitor. That was how the case was put in the appendix, so the chain of causation was from the traffic imbalance to the competitive distortion.

THE CHAIRMAN: But they do argue that the traffic imbalance arises from the competitive distortion of the current mobile number portability arrangement.

MR. HOLMES: They do, madam, that is true, but this competitive distortion, which is not identified here, is ----

THE CHAIRMAN: You think it is referring to something more than the mobile number?

MR. HOLMES: We say that it is at least surprising that H3G do not identify what competitive distortion they have in mind. I think that is the only point I wish to make in respect of that.

The fourth argument relied on by H3G is that its new approach would increase consumer welfare on the basis of a new model, which unlike H3G's previous welfare updated in the proceedings, now seeks to determine the welfare gains of the move to marginal cost pricing. We have, of course, seen already two previous welfare models by H3G in these proceedings, neither of which proceeded on the basis of the new welfare model. There is then reference made to academic analysis. There is an argument about the costs of the current regulatory regime which is novel. There is an argument based on the appropriateness of the new approach for avoiding distortions as the new technologies are introduced – again novel. There is an argument about competitive distortion between fixed and mobile operators, and this again is an argument of principle for the alignment of fixed and mobile call termination rates. At point (I) of my skeleton at p.5 I draw attention also to H3G's reliance on the need to avoid regulatory arbitrage by aligning mobile-to-mobile and fixed-to-mobile, and fixed call termination rates. There is sometimes a suggestion in H3G's pleadings for today that there is simply a happy accident whereby their very low level of mobile to mobile call termination rates, which they now propose as a pragmatic alternative to net payment zero, simply happens to approximate or align with the low level of costs which they now say should be attributed by a new ... in respect of fixed-to-mobile

calls, and that this in turn aligns by happy circumstance with the rate of BT's fixed termination charge.

The argument in relation to regulatory arbitrage shows that this is not the basis of the new approach; the new approach is not simply a pragmatic alignment of three different variables, which happened to equate. This is an argument supported by a basis of principle concerning competitive conditions between fixed and mobile operators and the need to avoid arbitrage as between mobile-to-mobile and fixed-to-mobile, and fixed termination rates.

Finally, madam, H3G also commenced the new approach by reference to retail price competition and greater pricing transparency.

We say, and here I am reading from para.16 of my skeleton, taking the new approach and the new arguments in its support together, it is apparent that the supplemental submissions seek to transform H3G's case. H3G no longer seeks net payment zero in relation to mobile-to-mobile calls alone as a means of addressing its specific commercial position vis-à-vis the other MNOs, which was how the case was put in its amended appendix. It now wishes instead to use these CC proceedings as a platform for advocating a shift from the current regulatory arrangements involving cost related charge caps to a bill and keep, and potentially receiving party pays model, in which mobile networks recover their termination costs from their own retail customers without MCT payments from other fixed or mobile operators – in other words, root and branch reform of the system of mobile call termination regulation in the United Kingdom.

THE CHAIRMAN: That shift would take place if the CC adopted the NPZ model?

MR. HOLMES: Madam, with respect, Ofcom would not agree with that proposition. The NPZ model which was proposed was exclusively in relation to mobile-to-mobile termination charges. Remember, madam, with the exception of H3G there is a broad equilibrium between the levels of traffic going to and from the various 2G/3G MNOs with the consequence that, in fact, the impact of removing mobile-to-mobile rates as between the 2G/3G MNOs might be very minor indeed. There would not be a significant effect on their financial position. This is obviously an empirical question but we submit that there is at least a possibility that the effect would be relatively contained.

MR. SCOTT: Just to pause on receiving party pays, and we have noted the reference to the article from 2004, so this is not new either in practice or in academic literature. We need to be clear about two forms of receiving party pays. Here we are talking about wholesale receiving party pays as distinct from retail receiving party pays. We just needed to make

sure that we had that clear so that when we are talking we are talking about wholesale receiving party pays.

MR. HOLMES: Yes, sir, the technology is rather vague and overlapping as it has been used by various parties in these proceedings. As you say, receiving party pays, properly speaking, is the retail manifestation of an arrangement in which no transfers take place, assuming that the parties decide to recover the costs of call termination from the party receiving the call. That is an empirical question on which there may be differences of opinion. As you say, that is a phenomenon in the retail market.

When H3G refers to RPP they sometimes refer to it in order to draw the distinction between wholesale and retail and receiving party's network pays, which is to draw attention to the fact that they are using the term as it applies at the wholesale level. Properly, we would suggest, the term "bill and keep" should be used to describe the wholesale issue – that is to say a situation in which each network operator bills from its own clients and keeps the revenues which it thereby attains without a transfer of termination rates in respect of termination costs.

Madam, if there were any doubt as to the breadth of H3G's new position we say it is entirely dispelled by the quotation from Dr. Littlechild extolling the virtues of RPP and bill and keep with which H3G chooses to conclude its 7th March submission. You will find that, madam, at 4.5 on p.15. You will see there that Dr. Littlechild is said to have eloquently stated the case for change, and there can be no doubt as to the breadth of his attack on the existing regulatory arrangements in place in the United Kingdom.

Madam, we say on our first submission that there is no mystery involved in the supplemental submissions. They clearly transcend H3G's case as pleaded. We are not engaging in hair-splitting exercise here, or attempting to engage in fine distinctions. The new approach is quite plainly outside H3G's case as pleaded. It differs from the fundamentally from the features of H3G's case to which I drew the Tribunal's attention during the course of my submissions.

That leads me to the question of whether H3G should be permitted to amend its notice of appeal. If the Tribunal accepts that the new approach is indeed nowhere to be found in the notice of appeal, I believe it is common ground between the parties that H3G will need to apply to amend its notice of appeal. We say that the new approach is a new ground. If anything is a new ground the new approach must be that, whatever the fine points of Continental pleading as between a *moyen* and an argument, there is no doubt that what we

are dealing with here is something fundamentally new which is not foreshadowed in the notice of appeal. So we say that the higher threshold set out in Rule 11.3 therefore applies. Madam, in our submission, H3G's application to amend should be refused under either Rule 11.1 or Rule 11.3. There are compelling reasons why it should be refused. The first of those relates to the consultation process prior to the publication of the MCT statement. Mr. Scott has made the point already that RPP is hardly new, bill and keep is hardly new, to communications policy debates. It has now a long lineage. Indeed, Ofcom has floated the idea of a move to RPP and bill and keep on several occasions now. It has raised the possibility of such a move. Indeed, it did so during the consultation process which led to the adoption of the MCT statement. We say that it is relevant in considering whether H3G should be allowed to amend to look at how they put their position in relation to this dramatic shift of regulatory policy during the course of that consultation process.

Madam, if the Tribunal will allow me, although I am aware that I am now at the limits of my time, I think it would be helpful to take you to specific passages in that consultation process to see how the debate evolved and to see the limits of H3G's submission during the course of that consultation process.

THE CHAIRMAN: Is it contended by H3G that they did raise this point during the consultation?

MR. KENNELLY: Madam, if the point is, do we contend what we now contend is our situation, that is not in dispute. We do not contend that the consultation is what we are now contending. There are further arguments about how Ofcom characterise our position, but if the narrow point that Mr. Holmes now makes is that we did not seek what we now seek in the consultation then that is not in dispute.

THE CHAIRMAN: Is it accepted that this idea was floated by Ofcom during the process?

MR. KENNELLY: No, we disagree with that point. We say that it was not. What we are now proposing in the formal proposal was not floated by Ofcom in the course of the consultation.

MR. SCOTT: Would you accept that it was present in the academic literature prior to the making of the decision with which we are concerned?

MR. KENNELLY: I will take instructions on the extent to which it was in academic literature. Certainly, sir, you have seen our argument that the academic literature, as we would argue quite radically ----

THE CHAIRMAN: Has been developing.

MR. KENNELLY: -- has been developed. We will obviously make submissions as to why that ought properly to be put before the CC, but on the narrow point I will just take instructions.

(After a pause) It will not surprise you to know, we obviously do not dispute that the bill and keep was floated.

THE CHAIRMAN: The bill and keep was floated during the consultation period or was in the academic literature?

MR. KENNELLY: In the academic literature, yes.

THE CHAIRMAN: Mr. Holmes, you have heard that.

MR. HOLMES: Madam, on the basis of that, I think we have little choice but to look at how the point was put in the consultation, because we say it was squarely raised by Ofcom.

Madam, as by now the Tribunal will be well aware, there were three consultations prior to the adoption of the MCT statement. The first is to be found in trial bundle F1, p.303. You will see it is dated 7th June 2005. It deals with the issue of RPP and bill and keep at the very front of the document. On p.305 at the summary you will see that the heading half way down the page or two-thirds of the way down the page, "Scope for fundamental change removing the causes of SMP". You will see that Ofcom referred during the Telecoms Strategic Review to the possibility that RPP moved to bill and keep and RPP in para.16 might be a means of addressing the market power which results from the calling party pays model. There is a clear reference to bill and keep as well as receiving party pays.

Over the page at para.1.7 Ofcom notes the very frosty reception that its proposal in relation to RPP receives during the course of the Telecoms Strategic Review. I should note that the Telecoms Strategic Review was published on 18th November 2004, so as to the novelty of this debate I think that point is a telling one.

At para.1.8 Ofcom indicates that it is "keen to stimulate further serious consideration" of changes without limiting those changes to the retail level, changes generally having referred to bill and keep and receiving party pays,:

> "… which the industry might implement, or which future technological developments might enable, which would remove the underlying causes of Significant Market Power. The prospect of SMP, and regulation, enduring into the indefinite future is not one which Ofcom finds attractive. Ofcom therefore encourages the mobile industry to renew its efforts to identify a change to market structures which would lead to a competitive market from which all regulation may be removed, and which would be beneficial to consumers."

So at this crucial shaping stage of the consultation process when Ofcom was considering what matters it would take into account, how it would go about this market review, it was

positively inviting parties in the position of H3G to come forward with proposals to make the case for bill and keep.

Madam, if there were any doubt as to what Ofcom means by these fundamental structural changes from the very outset of the consultation process, they are dispelled if one turns to p.315 of the first consultation document. You will see at the beginning of para.3.2 Ofcom clarifies:

> "Where the RPP principle applies, there is a direct commercial relationship between the terminating operator and the customer which pays to receive the call; under this scenario, the cost of receiving calls would be taken into account by purchasers selecting a provider of mobile services, and this is likely to cause MNOs to compete, in part, on charges for receiving calls."

That is the argument in favour of RPP in a nutshell, that you would basically by ensuring that the retail customer, when choosing a mobile phone package, will be paying for the cost of terminating the calls, that will be factored into the consumer's choice, they will look very carefully to see what different operators charge by way of the termination cost to the receiving party. So that is again a retail consideration. Ofcom recognises full well that the retail and the wholesale are inextricably linked, and its consultation clearly extends to the wholesale level. One sees this further down the page, you will see a sentence a few lines down, about the middle of the paragraph beginning: "It is conceivable …". So Ofcom first recognises in the passage between the passage I quoted and that sentence that you are not going to be able to achieve RPP voluntarily and the reason for that is because each MNO who is permitted to charge a termination charge would have a strong incentive to continue doing so. In other words the mobile network operator that originates the call, if it were entitled to charge, would obviously have a strong incentive to continue doing so, and therefore you would have a free rider problem; there is no way you could really bind all of the MNOs, other than by regulation to ensure that they did not continue levying a termination charge.

But Ofcom then notes that it is conceivable that MNOs could be required to operate RPP principles perhaps by having termination charges set below cost or indeed at zero, so that the cost of termination cannot be recovered from originating operators, sometimes known as the bill and keep approach.

Now, this is exactly the approach for which H3G contends. They contend for zero, or close to zero termination rates for mobile and fixed call termination alike. They contend in other words for the bill and keep model, and they do so in terms. If there is any doubt about that,

if the Tribunal is in doubt I am very happy to take you to many, many references in the new materials where bill and keep is indicated as the relief which H3G now seeks.

Then you will see, madam, just to conclude on the first consultation, on p.316 a question is posed:

> "Could RPP principles be made to work to the advantage of consumers in the UK? If so, how?"

Of course that question must be read in the light of the previous reference to the need for wholesale intervention in order to achieve RPP.

H3G responds to the invitation that Ofcom has offered in its consultation response, which is at p.489 of the same bundle, bundle F1. You will see there a document dated 30th August 2005, and at p.499 H3G turns to consider: "Receiving party pays" and "Bill and Keep". In the first paragraph H3G recognises in common with para. 3.2 of the consultation, that:

> "… such an approach would need to be imposed as an operator retaining a calling party pays (CPP) approach would potentially be at an advantage if competitors had moved to charging on a RPP basis."

Now, the imposition as we have seen could only be at the wholesale level, and H3G candidly recognises as much when it heads this section not only receiving party pays, but also bill and keep. We see what H3G makes of this proposal to mandated RPP by a wholesale intervention to MCT rates of zero.

THE CHAIRMAN: We will read what it says.

MR. HOLMES: Yes, madam. (After a pause) There is just one specific point I would like to flag up madam, one which I will return to later. You will note that at the third bullet point in the second half of the page: H3G specifically relies on the fact that:

> "… effective introduction of RPP would require an EU wide change to this form of charging, else there would be on-going confusion and a reduction in the benefits of roaming."

Madam, just to complete the first consultation, you will see on p.513 the specific response that H3G made to the question raised in the consultation:

> "Could RPP principles be made to work to the advantage of consumers in the UK? If so, how? No, the overall effect of enforcing RPP is likely to be to hinder the development of the mobile sector for all the reasons set out above."

In the second consultation -----

THE CHAIRMAN: Well let us see if we can speed this up a little bit, Mr. Holmes. Perhaps it would be enough if you just point us to the paragraphs rather than taking us through, we can look ----

MR. HOLMES: Certainly, madam, you will find in the second consultation document, which is at p.1, bundle F2, a paragraph at 6.4 setting out RPP and I would just note that in that paragraph Ofcom specifically says that the way you would achieve RPP is typically by setting mobile voice call termination charges at zero, in other words, by wholesale intervention of the kind that H3G now contends Ofcom should have done in the MCT statement.

Then carrying on from there over a number of paragraphs, para.622 Ofcom develops its interim position in relation to RPP and the merits of it. I would just note that in para.6.6 Ofcom points out that while numerous countries have moved from the RPP system to the CPP system, Ofcom has not been able to identify a single example of the reverse. In other words, there has never been in Ofcom's knowledge, and there still has never been in Ofcom's knowledge an example of this experiment, which H3G contends should now be mandated by the Competition Commission in these appeal proceedings, having been implemented.

At 622 Ofcom then poses another question: "Do you feel that Ofcom has understated the benefits to consumers of a mandated move to an RPP charging regime? Ofcom are particularly interested to hear from consumer groups." It did not hear from consumer groups but it did hear from H3G, whose submission is to be found at F2, p.243.

Unfortunately, madam, H3G deals this time with bill and keep very briefly, at p.282 it says that it broadly agrees with Ofcom's approach in this area for the purposes of this market review.

In the third consultation document where, of course, Ofcom did not pose specific questions, as you will see from one point in para.1.11, but instead basically sought responses in relation to the whole document in accordance with its obligations under the Telecoms' regulatory framework.

At para.8.4 on p.655 through to 8.5 on p.656, Ofcom set out its interim conclusions which were that bill and keep was not an appropriate method, and again made reference to compulsory RPP or bill and keep being equivalent to very low or no wholesale termination charges at para.8.7. No doubt about this being a wholesale intervention.

At para.8.8 Ofcom notes that the situation may change over time and in the event that fresh evidence on the matter is brought to it. Ofcom will consider any such evidence and any potential implications for structural remedies.

The final H3G response at p.193 of bundle F3. H3G basically deals with bill and keep, it does not directly address it but it deals with it in the context of the duration of the price control at p.235 and p.253. The key point that Hutchison makes – I think, madam, with respect, on this point I would like to take you to one specific passage, because I think it is important to see how H3G concluded the consultation process.

THE CHAIRMAN: It is at p.253.

MR. HOLMES: Yes, indeed. "Conclusion on the appropriate range for any price control". You will see that the heading is 8.2.3. H3G sets out its preferred approach for now, that is to say a glide-path which takes all of the various circumstances specific to H3G into account, and is therefore likely to be shallower and a higher long run cost benchmark. We have seen of course that in relation to the fixed-to-mobile call termination rates, that is exactly what H3G went on to plead for in its notice of appeal.

Further down the page in the paragraph immediately following you will see H3G draws attention to the uncertainty about the evolving market, and urges Ofcom to:

> "… be prepared to keep this under review during the current market review period. It may be that other approaches to wholesale pricing will become more appropriate … during the period of the proposed price control, for example, based on some form of bill and keep wholesale arrangements."

Then again, the final paragraph on the page:

> "Given Ofcom's approach to regulating mobile wholesale markets and the market analysis on which it is based, the proportionate regulatory response is therefore to base any remedies on cautious assumptions and keep the situation under review."

So there H3G says yes, in the future bill and keep may be appropriate, just as Ofcom did in the third consultation document. But for the purposes of this charge control H3G said what it wanted was a shallower glide path and a higher MCT rate, a higher TAC. That is what it sought, and of course Ofcom itself had offered to keep the situation under review and we are certainly not here debating whether Ofcom was wrong to impose the period of charge control, that is just not a ground of appeal in these proceedings. If H3G had wanted to challenge the fact that we had chosen a four year period it could have done so; it has not done so. Instead, it seeks now, having contended against bill-and-keep at the start of the consultation process, and having recognised at some future point that bill-and-keep might

become appropriate during the final consultation process H3G seeks now, having not raised the matter in its original notice of appeal, to turn these proceedings into a wide ranging debate about the merits of bill-and-keep. We say quite simply our first compelling reason why their application to amend should be refused they should not be permitted to do so, and therefore the new approach, and the many new arguments which are set out in their additional supplemental submissions should not be admitted today. Madam, that is my first point.

My second point is that a proper appraisal of the new approach would require very substantial additional work by the Competition Commission, Ofcom, and the other parties. I am picking up here on p.8 of my skeleton at para.27. The approach Ofcom took in the MCT statement was shaped very much by the reaction that it encountered to bill and keep during the consultation process. The almost universal negativity from other parties, including H3G, to the suggestion that bill and keep was now appropriately to be introduced. Ofcom identified various potential merits and demerits but acknowledged uncertainties and doubts about the available evidence, and invited parties to come forward with any fresh evidence relating to the matter. Now, madam, because of the time I will not take you to it, but if you go to the MCT statement, and specifically to paras. 8.24 to 8.28, Ofcom there deals with mandated RPP by which it means imposing a zero NCT rate on the wholesale market. That having been accepted during the consultation process, as the only method to achieve RPP at the retail level. The flavour of those paragraphs, without taking you to them, is of uncertainty. Ofcom identified risks, but it lacks the evidence as to the extent of those risks. It thought the evidence that it had before it was uncertain, and problematical.

The second additional work is the need to examine likely consumer reactions to changing pricing structures, a point of course which H3G laboured in its response to the first consultation, also a need to examine economic justifications for efficiency of bill and keep as against the current cost based regime which I understand Ofcom simply has not yet done, but which will be a very significant job involving ----

THE CHAIRMAN: You say the reason why you do not have to do all this just to deal with a current NPZ case is because apart from H3G, because of its traffic imbalance, the move does not have that great an effect on the 2G/3G MNO.

MR. HOLMES: Three points: We do not have to do it in relation to H3G's pleaded case because they have not made a broad based for a route to bill and keep, they have sought to identify specific competitive distortions.

THE CHAIRMAN: Right, and you are content that you can knock those out without having to do all this fundamental work?

MR. HOLMES: Yes, madam, the second point is we think there are compelling practical objections to H3G's approach which makes it simply unmanageable. The third point is, yes, we say that the effects of a move to zero mobile-to-mobile MCT rates would be more contained.

THE CHAIRMAN: Right. Okay, perhaps you can move on to your next point.

MR. HOLMES: You have my submissions then in terms of the ----

THE CHAIRMAN: Yes, we have your submissions on the amount of work that would be involved.

MR. HOLMES: I should just briefly say, madam, in Ofcom's letter of 2nd March 2008, it was a letter in which we said we needed basically until 2nd May 2008 to deal with the new material. We intended there to deal with the material at a very high level because we say it is simply impossible really within the confines of the Competition Commission proceedings to do this other than at a very high level, and what Ofcom would be doing is basically pointing out the significant uncertainties and risks involved in a transformation just to warn the Competition Commission of what this would involve, especially given that it is an experiment which has never been attempted anywhere else in the world, so that would be the flavour of our submission.

We obviously are not here arguing the merits of that submission, but we would say that it would involve significant additional work merely to make those points, and if the Competition Commission were to grapple seriously with the merits or demerits of the move from CPP to RPP via bill-and-keep that is a huge piece of work which Ofcom certainly has not attempted as yet.

My third point is that the Competition Commission proceedings are not an appropriate forum for debating the new approach. We say there that because of the way in which the consultation process evolved these issues were not properly ventilated, that the detailed empirical work was not done. Ofcom at the beginning was enthusiastic to undertake such an exercise, but it was pushing at a closed door, not least as a result of H3G's well argued and cogent submissions in the first consultation. So, as a result, the work has not been done, and we now find ourselves before the Competition Commission with at most six months in which to attempt this exercise.

MR. SCOTT: Presumably, if we were to permit this to go before the Competition Commission we would then be in a situation where the parties before the Competition Commission

would only be a very small subset of the parties who would have an opportunity to comment were this to be done in a proper consultation. For example, the other MNOs would not be there, the MVNOs would not be there, the public generally, users of various sorts would not be there.

MR. HOLMES: Indeed, sir. The whole point of the consultation process is to capture all of the relevant interests and that simply is not the case in these proceedings. We have seen that the FNOs, while they intervened in the termination rate disputes are not here today. You will also have seen from the consultation process that Ofcom specifically invited consumer groups to make their views known – they will not be here to make their opinions heard in this set of proceedings before the Competition Commission.

MR. SCOTT: Just to complete that point, that is because in this sort of Competition Commission proceeding they move straight to their recommendation not via a consultative phase?

MR. HOLMES: Sir, even if they did proceed via a consultative phase they will be doing so within a very compressed period of time. You know that two years was taken over the last market review, Ofcom may very well take the same period again, especially given that it is not opposed to considering a move to RPP and bill-and-keep in the next round. Indeed, if anything it is open to all reasonable and relevant suggestions during that process.

THE CHAIRMAN: Mr. Holmes, is there anything on the statement of intervention in the BT appeal which is a different point from the point that you have made in your submissions?

MR. HOLMES: In relation to the BT appeal, madam, I think that can be dealt with very briefly, you will be pleased to hear.

We say simply that the points that H3G now tries to advance are clearly not related to the specific matters raised. BT itself notably accepts as much in its letter to the Tribunal and given its generally supportive stance towards H3G in relation to the new material. I think that is a clear indication of whether these matters are within or without. The Tribunal has also, of course, warned H3G of the need to raise matters in its own appeal rather than by way of an intervention, and it would be an extraordinary result if it were able to circumvent the constraints imposed in relation to its own appeal by pleading matters in the BT appeal. The general pleadings on which H3G relies in the appeal we say do not support its attempts to raise new matters. We simply point out para.65 of the BT notice of appeal which clearly circumscribes and brings back the general submissions to the specific matters raised by BT in its appeal.

As regards the Yarrow and Richardson witness statement, it is true that Professor Yarrow ranges quite widely and as Ofcom noted in correspondence at the time, but Ofcom did not

pursue the point, given that BT has maintained its focus on the specific objections. We would only say that if it were the case that the Richardson or the Yarrow witness statement has indeed broadened the scope of BT's notice of appeal then we would wish to pursue an objection in relation to those documents in the course of these proceedings today.

Madam, I obviously have not had the benefit of hearing how H3G puts its application this afternoon, and if any new points are raised during the course of that application I would like an opportunity if I may to respond to them, but subject to that proviso those are my submissions.

THE CHAIRMAN: Thank you very much, that is very helpful, Mr. Holmes. Mr. Pickford?

MR. PICKFORD: Madam, I am grateful. I am going to adopt the same tripartite approach that Mr. Holmes did. I can obviously go much more swiftly because he has already covered a great deal of ground, and we support and adopt everything that he ha said on behalf of Ofcom. First, I will be dealing with the main new points in the supplementary submissions, then the core points advanced by H3G in support of its application to amend, and finally the legitimate scope of its stepped intervention in BT's appeal.

Turning first to the new points in H3G's supplementary submissions, we have put those in a table which we appended to a letter which is at tab 23 of the bundle for today. It may just be helpful to go very briefly to that – I am not going to go through it in any detail – just to make a few points. Madam, do you and the members of the Tribunal have the table to hand?

THE CHAIRMAN: Yes, I think we do.

MR. PICKFORD: The first preliminary point to make is that the paragraphs that we cited in the left hand column are only intended to be illustrative of points where submissions arise and in that respect we therefore support and adopt the submissions of all the other parties where they have identified other paragraphs that they say are relevant to the particular issues. So we are not merely seeking to strike out those particular paragraphs insofar as another party, such as Ofcom, has identified other paragraphs that it says are relevant to the same points we support and adopt that approach.

THE CHAIRMAN: Well what are we to do then if, at the end of the day, we decide that there are some aspects, because we have not heard what H3G have to say yet, but if we were to decide that there were some aspects of their supplementary material which should not be allowed to go forward, is there something we can rely on that points us in the direction of what we would order, depending on which bits we found were objectionable?

MR. PICKFORD: Yes, madam, it is the consolidated table, H3G has been good enough to put together a consolidated table where it takes everyone's points together, and in that table everyone has identified particular paragraphs that concern them in its pleadings and in its witness evidence, and it takes them against the main submissions that are made against each of those paragraphs. That is the most convenient place to deal with striking-out if the Tribunal is inclined to do so. I have merely taken the Tribunal to this document because it is an easier means for me to explain T-Mobile's particular concerns. That is the first preliminary point.

Then if one looks at items 1, 2, 3 and 4 – item 1 is the "Reciprocal low MCT point". Item 2 is the "Application of the reciprocal low MCT to fixed to mobile termination", item 3 is the attack on "The calling party pays", and item 4 is a point that Ofcom really should have focused on, marginal costs rather than its LRIC approach. All of those four points fall within the scope of the broad attack that Mr. Holmes has made this morning on H3G's supplemental materials. They all concern in essence the metamorphosis of the NPZ case into the new case that you have described this morning. I really am just going to add a very few points to what Mr. Holmes has said. The first is that it is really very surprising that we have a situation where Hutchison was of course present for the hearing when the particular questions to be referred to the Competition Commission were decided upon and clearly articulated by the Tribunal. I am afraid I do not think we actually have in the bundles for today those particular questions, but it would be helpful if I could just remind the Tribunal of what question 7 said, because this is the key question concerned with NPZ, and I just quote. It was whether:

> "…Ofcom should have exercised its powers in such a way that net wholesale payments between MNOs were zero with suitable cost based price controls retained for fixed-to-mobile calls."

At that point we did not hear Hutchison standing up and saying, "Hold on a minute, that is not our case at all, when we say zero we do really mean zero, we mean potentially tens of millions of pounds", because they say, "Well, it is all a bit of an approximation", but we are talking of still very large sums of money potentially, even at a termination rate of 0.4 pence per minute. Neither did we hear Hutchison standing up and saying, "Well, when we talked about a different remedy for fixed-to-mobile, what we really meant was the same remedy, 'fixed' merely means the same in this context". We did not hear them say that either. It is really not credible or sustainable for Hutchison now to say that these points

were always in their notice of appeal, because they clearly were not. If they had been they would raised it quite obviously at that point in time.

If further proof were needed at this point we can go very quickly to Hutchison's own submissions for today and they are contained at tab 1 of the second file. It would be helpful not to put away my table just yet. If one turns to p.10 of their submissions for today, there is a lengthy section here which actually begins on p.9 where Hutchison sets out the key passages of its notice of appeal on which it relies on this application in order to persuade the Tribunal that, in fact, none of this is new. On p.10 one sees quoted para.1.2(a). We find there a definition of net payment zero. It says:

> "A net payment zero outcome between MNOs, that is no actual wholesale payments would be made by H3G to the 2G/3G MNOs or *vice versa*."

So they define quite clearly what they mean by NPZ there. Firstly, it has nothing to do with fixed-to-mobile termination; and secondly, as the name tends to imply, it means a zero net payment not a potentially significant one, albeit less than would otherwise be the case. If one looks at para.4.2, again we find effectively the net payment zero solution being defined again:

> "The payments made by H3G to the 2G/3G MNOs in relation to call termination on their prospective networks are wholly offset by the payments it receives from the 2G/3G MNOs for call termination on its network."

Again the same points can be made.

H3G's essential response to all of this is to say, "What we really meant by NPZ was something that would address the consumer benefits and the distortions of competition".

THE CHAIRMAN: They do go on then to say in 4.3 that one way and the simplest way of achieving this would be for all rates to be set to zero. So they were contemplating other ways of achieving it. What do you say was your understanding then of what ----

MR. PICKFORD: No other way of achieving this particular solution, which is net payment zero, was ever actually articulated by Hutchison, because of course what they are now seeking to achieve via reciprocal low, as we might term it, is not net payment zero because it extends across the board generally, including to fixed-to-mobile and it is not zero. That is we say in response to that.

If one returns then to T-Mobile's table, I have taken you through items 1 to 4 very briefly, because essentially those are the points that have already been covered by Mr. Holmes and I do not want to duplicate. If we then turn to items 5 and 6, these are particular points that T-Mobile has identified that Ofcom I do not believe do identify. They concern factual

matters in the third witness statement of Mr. Russell. The first of those is an alleged inability on the part of Hutchison to discriminate between customers depending on the balance of outgoing and incoming calls. That is point 5. Point 6 is another inability on the part of Hutchison to target customers, it says, because of lack of calling history. These are said to be yet more disadvantages that Hutchison suffers in the market place. We say these are completely new factual allegations and they were not previously raised in its notice of appeal.

THE CHAIRMAN: These would fall into the category – Mr. Holmes was telling us that, in arguing for NPZ, H3G focused on competitive distortions in the market which particularly disadvantage them. His point is that the arguments they are now putting forward in favour of reciprocal low are much broader than that. These would fall within the class of competitive distortions which arise from their particular place in the market, but you would say are nonetheless still points which were not specifically raised in the notice of appeal?

MR. PICKFORD: That is true, and whether one says that they are new grounds of appeal in that the implicit allegation here is that Ofcom failed to take these differences into account or whether one says that these are merely new arguments in support of existing grounds of appeal, one still has to consider whether they should be permitted because they do not fall within the scope of notice of appeal and obviously the difference there is between is Rule 11.3 and Rule 11.1 in essence. I will come on to deal with that point very shortly.

Then, finally, in this table we have point 7, and this is, of course, our old on-net/off-net price discrimination. I will return to this issue in the context of H3G's statement of intervention in BT's appeal, because there we see that the issue is pursued in all its naked glory yet again.

Here it is raised in slightly different contexts from the way it was previously raised. It is raised effectively in two contexts: firstly, it is evidence for prices being above marginal cost, it is said; and secondly, it is also relied upon to drive the results of the welfare analysis. What we say is that even to respond to the way on-net/off-net issue is raised here it would still potentially require us and others to grapple with, firstly, the alleged existence of, and secondly, the extent of, and thirdly, the implications of, and fourthly, the correct inferences to be drawn from on-net/off-net price discrimination to the extent that it exists. The Tribunal will of course remember that it was the requirement on the parties to potentially engage in further factual investigation about on-net/off-net price discrimination, which was one of the core reasons that was relied upon previously for not permitting Hutchison to amend its pleadings. Moreover, we know now from somewhat bitter

experience that Hutchison does take a somewhat liberal approach, we might say, to what has been pleaded. So, for all we know it, as soon as we see on-net/off-net price discrimination creeping back in here under these particular guises, it really becomes a stalking horse for the whole issue to be reopened later on before Competition Commission. We say that for that reason the Tribunal really should be very careful about letting it back in at this stage.

In response to the point that Hutchison make about the fleeting reference to on-net/off-net price discrimination as a so-called commentary on the appendix to their notice of appeal, that, of course, as the Tribunal has already noted, arises in a completely different context, which is really an attack on the reliability of Ofcom's market shares. Ofcom, and indeed all the other parties, are able to deal with that issue without getting into the underlying points about on-net/off-net price discrimination at all, and indeed they have done. That issue as pleaded there is certainly not sufficient to bring that on-net/off-net price discrimination at large.

Could I then turn to the question of whether the Tribunal should grant permission to amend. In relation to the reciprocal low reincarnation of the NPZ remedy that is quite plainly, as we have heard from Mr. Holmes, a new ground of appeal and therefore it falls for consideration, if at all, under Rule 11.3. In respect of that we say it plainly could have been pleaded earlier. It was not, and there are no exceptional circumstances justifying its inclusion now. Quite the contrary, to respond to that new case now will require considering extra work, and Mr. Holmes has helped explain some of the concerns that Ofcom has.

Could I just expand very briefly on some of those because I appreciate this was a point that the Tribunal was particularly concerned about. It is now said that really termination rates should be based on marginal costs. I think we understand what is meant by that is short-run marginal costs. It is also said that BT's termination rate is somehow a good approximation for this, certainly as I understand Hutchison's pleadings. This immediately raises the question, what are the true marginal costs here? This is not any longer a LRIC approach, this is a different costs approach. If we are going to respond to this properly we need to assess what marginal costs are and whether indeed it is true that BT's tandem rate is a good approximation. That is one factual issue that we would need to go into.

There is also the question of the economic implications of equalising fixed and mobile termination rates because, of course, that was never part of NPZ. That raises a whole host of new economic issues that would need consideration and investigation.

THE CHAIRMAN: Presumably the effect of that would be dramatically to reduce the income of all the mobile net operators, because at present BT pays their higher MCT charges, but only receives the 0.4 pence per minute itself – is that right?

MR. PICKFORD: That is probably right, madam, in general terms, but of course the winder economic implications of setting mobile termination rates on the basis of BT's costs would need to be considered and investigated.

MR. SCOTT: Just going back to the point we had earlier on which arose in the context of economic depreciation, if you have a network which has been built and has plenty of capacity the marginal cost of carrying incoming calls is likely to be very small. If you have a network which is already heavily loaded at peak times and needs to be expanded in order to carry incoming costs, then you are likely to have a very different picture. So we could well have a situation in which the effect of moving to a marginal cost basis would be dramatically to reduce mobile call termination payments to H3G compared with rates that could well be higher for the other MNOs if they could demonstrate that they needed extra capacity because of the existing heavy load?

MR. PICKFORD: Indeed, sir, and we would say that that is illustrative of the wider general issues that would need to be considered and grappled with if one really does get into this new territory. They are not points that we have currently dealt with. I do not need to remind the Tribunal that of course we are here today and the questions have already been referred to the Competition Commission. This is really beyond the 11th hour that we are talking about here. When one considers additional extra work it really should be considered against that backdrop.

As Mr. Holmes said a little earlier, what the challenge really amounts is a wholesale attack on the previous LRIC approach in favour of something that really is going to go down the road of bill and keep. That opens up a comparative international analysis that we simply have not got into yet at all. Certainly if it is advocated that we really should be going down that road and taking this experiment, as Mr. Holmes has characterised it, we would wish to engage considerably in analysing those international comparisons. Again, we say we should not be getting into that now.

As to the points that I have highlighted concerning H3G's inability to price discriminate and target on the basis of calling history, those clearly raise new factual matters.

THE CHAIRMAN: That is items 5 and 6?

MR. PICKFORD: Items 5 and 6.

THE CHAIRMAN: Can I just check with Mr. Holmes, do you also take a point on those passages or are you content with those passages?

MR. HOLMES: Madam, we do. I think we have raised the points in our table.

THE CHAIRMAN: Yes, I am sorry, Mr. Pickford, go on.

MR. PICKFORD: Even at its very lowest, they raise new factual allegations which would require investigation and response. For that reason we say again that they should not be permitted now. The same goes, of course, for the reintroduction of the on-net/off-net issue for the reasons that the Tribunal has well on board.

If we turn to Hutchison's counter-arguments, and I am going to go through these very briefly, it sets out the essence of its case on why it should be allowed to amend its notice of appeal at para.4.6, which is again at tab 1 of folder 2, p.18. The first thing it says is:

> "In summary, the amendment application should be allowed as:
>
> (a) H3G is arguing in its notice of appeal for much lower ppm rates to remove a competitive distortion that also translates into inflated retail call prices in the context of litigation that has the interests of consumers at its heart."

Putting aside Hutchison's touching concern for the interests of consumers, this does not actually take Hutchison's case on amendment any further. Anyone at all could come up with totally new arguments that they say are based on the latest economic thinking. Of course, ultimately these arguments would lead to consumers being made much better off. I think that is not the test for the matters that should go before the CC for consideration unless the issues are raised fairly and squarely within the scope of a notice of appeal; or secondly, are raised in the context of an intervention in a manner that is properly responsive to the matters that are put in issue by that intervention. They are not issues with which the Competition Commission should concern itself unless permission to amend is granted, and for the reasons that I have already given we say permission to amend should not be granted.

Point (b) is the allegation that the weight of support for H3G's case has increased materially over the past 12 months. That is really no good either, firstly, because, in fact, a number of the key papers that are relied upon pre-date the submission by H3G of its notice of appeal; but more fundamentally because we say Rule 11.3(a) and 3(b), which we understand is what is being alluded to here, really are not about the existence of new academic papers. They relate to the question of whether there are underlying facts or matters that have since come to the attention of the parties that could not have properly

been known previously. There are no such underlying matters of fact or law which would support a case based on 11.3(a) or (b), we say.

Point (c), Hutchison prays in aid the interests of the Competition Commission. In response to that we say that the Competition Commission is not at all hindered by having a clearly defined set of issues based strictly on the notices of appeal and the legitimate responses to them in statements of intervention. Obviously Mr. Sharpe is here today so we can hear further from him on what he considers to be in the Competition Commission's best interests. What we do say is, by definition, if Hutchison requires permission to amend its notice of appeal because something is not contained within it currently then that is not something that needs to be addressed by the Competition Commission to adjudicate upon that notice of appeal.

Point (d), at that point Hutchison prays in aid the novelty of proceedings. BT does not seem to have had any terrible difficulty in complying with and understanding the rules set down by the Tribunal for these proceedings. We say that, if anything, Hutchison has already been indulged to some extent in being allowed to advance supplemental submissions, and it really should not be allowed to abuse that opportunity that has been granted to it.

Point (e), it is now said that the points are foreshadowed in its statement of intervention in BT's appeal. I will come to deal with the substance of that in a minute, but this lacks all logic as a coherent basis for allowing the amendment in the present case. If the points are legitimately raised in response to BT's notice of appeal then they do not need permission to amend their own notice of appeal, because they are within the scope of BT appeal. If the points are not legitimately raised in the context of their response to BT's appeal, then we say that cannot possibly assist them to illegitimately raise the point previously as a basis for now being allowed permission to amend. We say that is just not a logical basis on which to proceed.

The same of course goes for Dr. Littlechild's statement. Either they canvassed points that were legitimately raised previously, in which case there is no problem; or if they were illegitimately raised previously, then that cannot assist Hutchison now, we say. Indeed, we note that at the time of the last substantive hearing in this matter in January and February, prior to that hearing we took issue with certain parts of Dr. Littlechild's evidence as going outside the scope of Hutchison's notice of appeal. The response to that was to say, "Disregard those aspects of the witness evidence". So it really does not lie in Hutchison's mouth now to come back and say, "But we raised these points before in witness evidence".

Then, as to whether the points would require additional work to respond to, for the reasons that I have already set out we say they would require additional work. Even if they would not, however, that is not sufficient to support an application under 11.3. That is not the test under 11.3. Even under 11.1 we say that is simply too late in the day now irrespective of the degree of extra work that is required for this Tribunal to be entertaining reformulating the questions the Competition Commission has to address and allowing an amendment to H3G's pleading. We say it would be wholly antithetical to the orderly and just conduct of these proceedings to allow that to happen.

Finally, if I could address the statement of intervention. As a preliminary matter there is a general mistake that is made by Hutchison in that it seems to think that in a joined appeal it should be able to develop points in relation to its own appeal in the context of its intervention in BT's appeal. We say that is simply wrong a matter of principle. There is no reason at all why Hutchison should be in a different position from any other intervener in the context of BT's appeal. Every intervener is constrained at its intervention to be entirely responsive to the matters that are put forward in the appellant's notice of appeal. That is not of course the same thing as saying that they have to support them or that they have to support Ofcom. They can advance their own case in relation to those matters, but it is only in relation to those matters that are raised in the notice of appeal.

So BT's appeal really puts in issue three matters: firstly, what is the correct approach a matter of principle and in practice to the valuation of H3G's spectrum; secondly, on the facts of the present case can a network now be justified; thirdly, should Ofcom have been less generous in the amounts it permitted the mobile network operators in respect of administration costs, because of course BT has now dropped its network sharing point so we only have those three issues remaining.

What BT's appeal does not do in the slightest is, for example, raise the issue of whether on-net/off-net price discrimination causes traffic imbalance as between H3G and the other mobile network operators. That is not an issue falling within the scope of the three points that I have just articulated.

Hutchison does not have any need to advance its own case in BT's appeal. All it needs to do in its pleading is say, "Everything we say in this statement of intervention is without prejudice to what we say in our own notice of appeal, see para.X which we still pursue". That is the approach that we adopted in the non-price control appeal which of course is inter-related termination rate dispute appeals in which T-Mobile did have its own appeal. We simply said, "Without prejudice to what we say there here are our submissions on these

particular issues". That is the right approach to adopt here. If you do not adopt that approach, firstly, a party has the opportunity to introduce by the back door a whole host of new issues that are not properly relevant to the matters in issue, and it completely muddies the waters in relation to what is actually in issue in its own appeal and what was in issue in someone else's appeal. Regrettably, we say, that is actually what is happening in this instance. Secondly, it is procedurally quite wrong to advance one's own substantive case in a statement of intervention which is supposed to be responding to someone else's notice of appeal. Statements of intervention are necessarily responsive and if H3G now starts advancing points in support of its appeal in a responsive document then we have not, for example, and nor has Ofcom, responded to H3G's statement of intervention and, quite rightly, the Tribunal has not provided for that in the case management of these proceedings. We should need to, but if one is allowed to pursue one's own substantive case in someone else's appeal, then one just seeks that it is a recipe for confusion and prolongation of these proceedings.

One can see the concern this is obviously causing the Competition Commission because they have written to the Tribunal and they are here today.

If we turn very briefly to the statement of intervention itself, which is tab 22 of bundle A1, I believe.

THE CHAIRMAN: Outline statement of intervention?

MR. PICKFORD: Yes. Can we first look at para.1.4, save for the first two sentences which are, we say, unobjectionable, that paragraph advances Hutchison's case on bill and keep. It has got nothing to do with BT's grounds of appeal.

I am going to go relatively here because there is not long enough to read through all of the relevant passages. The next section is section 2 which is the context in which to assess the imposition of the price control remedies. This sets out a context which is not relevant in any way again to BT's appeal. It is a context which is purely relevant to H3G's appeal. Moreover it is now embellished to include the on-net/off-net point as a justification for traffic imbalance, and we see that that is at point 2.1(d)(i). There it is again in all its glory, traffic imbalance allegedly caused by on-net/off-net price discrimination which we thought was something that had been confined to the dustbin in these proceedings. We say the whole of s.2 is illegitimate.

Paragraph 3.1(a) again advances H3G's case that termination rate should either be zero as between MNOs or much higher for H3G, so that is again nothing to do with BT's appeal.

Then s.4 sets out the relief sought and again the relief all concerns ----

THE CHAIRMAN: You said 3.1(a), what about (b) and (c), do you also object to that?

MR. PICKFORD: No, we do not.

THE CHAIRMAN: Then in 4, sorry?

MR. PICKFORD: In 4 we see the relief that is set out, and that is all relief that really goes back to Hutchison's appeal, it is not relief that is connected with an intervention in BT's appeal. Again, s.5 also is illegitimate in its entirety and one has a clue to that from the title to it, because it says:

> "BT's MCT appeal incorrectly assumes that Ofcom's overall approach in setting the price controls was correct."

So this is simply a vehicle under the guise of being responsive to BT's appeal, to do with issues that had nothing to do with BT's appeal whatsoever. One sees that even more clearly when one gets on to the next section, which is section 6, which is in fact the only section of this outline statement, statement of intervention which purports to deal with BT's grounds of appeal. So we say this is the only bit to which serious consideration really needs to be had at all.

THE CHAIRMAN: So you are content with s.6 in its entirety?

MR. PICKFORD: No, we are not, we say it needs to be considered.

THE CHAIRMAN: No, I do not mean you are "content" in that sense, I mean you are not asking for it to be struck out.

MR. PICKFORD: We are not asking for the entirety of s.6 to be struck out, but certain paragraphs within it which we say are still illegitimate. What we are content with is that at least in s.6 H3G is doing what it is supposed to be doing, which is grappling with BT's notice of appeal.

The two issues which we say are raised within this that should not be raised because they are not part of BT's appeal find themselves articulated firstly at para.6.25, where we see in the first sentence that the on-net/off-net price discrimination point is coming back again. Then if I could just briefly take the Tribunal to 6.29, we see the case that Ofcom's costs are already well above any reasonable estimate of marginal costs of termination. Then from 6.29 through to 6.34, those paragraphs develop a combination of the on-net/off-net price discrimination point again, and also the allegation that really what Ofcom should be doing is setting prices equal to marginal cost, which is the point, of course, Hutchison is now trying to advance in its own appeal. I am not going to read all of those because I am not sure it is actually in contention that those are effectively the points that Hutchison is advancing there.

What Hutchison says firstly is that these points are all bound up with the externality issue. It says because a higher termination charge aggravates the incentives for 2G/3G MNOs that they already have to engage in on-net/off-net price discrimination.

We say that is no more related to the externality point than to any other aspect of Ofcom's reasoning, because Hutchison's logic is essentially this: Because argument X pushes the termination charge in one particular direction, and another completely different point we would like to make, then we should be allowed to argue our completely different points because they both happen to be going in the same direction, and therefore we say that this point, this legitimate point exacerbates something that we have identified in relation to our point.

If one adopts that approach then there really is no constraint on the statement of intervention at all, because for instance T-Mobile could equally say "BT argues that there should be no externality charge, but that is wrong and it merely exacerbates the problem that the charge control is in fact far too low because of these other completely unrelated issues that Ofcom failed to address. So we say that obviously cannot be the test for whether something is within the scope of a legitimate response to a statement of intervention.

The second point H3G advance is that they say BT has already raised the on-net/off-net price discrimination point as causing traffic imbalance in para.63 of its notice of appeal. I am going to come back to para.63 very shortly, but we say that is just simply wrong, para.63 does not raise Hutchison's points that on-net/off-net price discrimination causes traffic imbalance.

Thirdly, they also say that on-net/off-net price discrimination is raised in Mr. Richardson's evidence. Now, the first point to make in relation to this is that if a point is not raised in BT's notice of appeal, it is not raised in BT's appeal; it does not really matter what Mr. Richardson does or does not say. Secondly, even in the context of Mr. Richardson's evidence, one has to look at the context in which the point is made. For the sake of time I am not going to take the Tribunal there, but to explain: Mr. Richardson does mention on-net/off-net price differentials, but it is in the context of an allegation that fixed and mobile networks compete directly. Now we are able to meet that point and indeed have met it without getting into the nitty-gritty of on-net/off-net price discrimination at all and it would be quite wrong to allow Hutchison on the back of that different point to then reintroduce on-net/off-net by the back door.

Fourthly, Hutchison say their case is also related to the evidence of Professor Yarrow, and in relation to that we make the same point: Professor Yarrow's comments are necessarily conditioned by the points that BT actually takes in its notice of appeal. We make the same points that of course if BT tries to widen out the scope of its notice of appeal to bring in points that are tangentially mentioned by Professor Yarrow, we would have the same concerns, but BT has not done that it has played by what we say are the rules.

Finally, Hutchison's last resort is to say that BT has pleaded general points on competitive distortion and harm to consumers, arising from the criticisms that BT has of Ofcom's approach, and all our points are more points about why there are competitive distortions and harm to consumers arising from Ofcom's approach. Again, we say that cannot be the right test in this case; it is far too vague, it is far too broad brush, and indeed it is completely contrary to the way that all of the parties have conducted themselves so far in relation to these appeals. Again, it can be said of literally any point, almost by definition, if one says that Ofcom has erred in some way in setting its price control then if it said a different, better price control, that would be better for consumers and it would not distort competition, so that really cannot be, we say, the appropriate approach.

Unless I can be of any further assistance those are the points I wish to make on behalf of T-Mobile.

THE CHAIRMAN: Thank you very much, Mr. Pickford.

(The Tribunal confer)

THE CHAIRMAN: Miss McKnight, you are down then for having 15 minutes, would it be possible for us to finish you before the short adjournment? I should say that what the Tribunal is currently minded to do is to hear Vodafone before lunch, and then to hear H3G after lunch, and then come back, if appropriate, to the other interveners thereafter if there are points on which we wish to hear further argument from them.

MISS McKnight: I am content to go before lunch, certainly. Thank you. Obviously, Vodafone is largely supportive of the points made by Ofcom and T-Mobile and that will assist me in being somewhat briefer.

If I could take you to the February bundle, to tab 1, which is the original notice of appeal and price control appendix of H3G. In the price control appendix at p.10 we see in s.4 the way in which H3G first set out its proposal for the NPZ remedy. It is made clear in para.4.2 that the NPZ remedy is one which would ensure that payments made by H3G ----

THE CHAIRMAN: I am sorry, I am not with you.

MISS McKNIGHT: Sorry, we were asked to bring along the February case management conference bundles, and at tab 1 ----

THE CHAIRMAN: It is tab 2 in ours.

MISS McKNIGHT: Sorry, I was looking at the original, we can look at tab 2, para.4.2.

THE CHAIRMAN: "Alternative approach to remedy", right.

MISS McKNIGHT: Yes, that is right. H3G makes clear that what it regards as the appropriate remedy is one which ensures that the payments made by H3G to the 2G/3G MNOs should be wholly offset by the payments it receives from them. It goes on to say that one way, and the simplest way of achieving this, would be for all rates to be set to zero. I think this morning it was suggested that the very fact that they say that would be one way and the simplest way of achieving this would be for all rates to be set to zero. I think this morning it was suggested that the very fact they say that would be one way and the simplest way implies they must have had other things in mind.

I would wish to remind the Tribunal, this is a point which was aired when we were contemplating the terms in which the questions should be referred to the Competition Commission – I think the original question which the Tribunal proposed was a question whether all mobile-to-mobile termination rates should be set to zero. Vodafone, in its comments on the draft question, pointed out that that was not actually what H3G specified to be the objective of their remedy. The objective of the remedy is not to deal with every bilateral relationship between each pair of MNOs, but to look at H3G on the one hand and the aggregate of 2G/3G MNOs on the other. If one did not have all rates set to zero, the other way of achieving what H3G are requesting would be for essentially cost reflective charges to apply as between each bilateral pair, and then at the end of the year for balancing payments to be made so that H3G was revenue neutral vis-à-vis other 2G/3G MNOs in aggregate.

I think at first blush the Tribunal was attracted by our interpretation of this part of the price control appendix, but in the end the question was put in terms of should all mobile-to-mobile termination rates be zero, and we are content with that because we think that is the only sensible way of implementing this.

I think it was clear from that exchange in correspondence, and at the February hearing to determine the scope of the questions, that those two approaches were understood to be the ways in which H3G's proposal could be implemented. I do not think it was ever contemplated, and this is a point which Mr. Pickford has already made, that zero was to be interpreted as near zero, and in our view that is clearly not the case. We would say that the

essence of the NPZ remedy which H3G was proposing was that it was designed to, and bound to result in a net payment of zero from H3G to the other MNOs. Whereas once you introduce a positive MCT charge, however small, it will merely be coincidental if it results in a net payment of zero at the end of the day and that cannot therefore be characterised as an NPZ remedy. That is the first point I would make.

The second point is that the case which H3G now seeks to put proposes the NPZ remedy, or the close to NPZ remedy for entirely different reasons from those which were put forward in the original notice of appeal price control appendix. If we stay with this document we see that after the section that I have been describing H3G explains what are the reasons for preferring the NPZ remedy. It focuses on the fact that if one has positive MCT charges flowing among MNOs, in the light of the traffic imbalance it results in material net out payments, so it is looking at the outcome of having positive MCT charges as being a bad thing and something which is avoided by net payment zero.

It then says that estimating the appropriate MCT charge for end-to-end calls is difficult because costing uncertainty is forecasting uncertainties. It notes that Ofcom has not modelled a base case, just looked at scenarios and this merely emphasises the uncertainty. It goes back to saying that the NPZ approach avoids the difficulties of material net out payments. So it is looking very much at avoiding the difficulties of setting a charge control, having to worry about what is the proper charge control, and avoiding the alleged competitive detriment to H3G of having to make out payments.

In contrast, if we now look at the way in which the case is put in the new price control submissions, which is in a separate bundle – I think it is just called "Price control submissions.

The first item in the bundle is the price control submission itself, then followed by the witness statements. As you know from what has been said this morning, the position of Ofcom and the interveners who support Ofcom is that what H3G is now saying is it will be best to have very low MCT charges both for mobile-to-mobile and fixed-to-mobile, for a variety of reasons. One of the reasons which it clearly puts forward is that this would approximate to the true cost of mobile call termination. This is clear from para.2.11(b) by implication because in this section the criticism that is put of Ofcom's determination of MCT charges is that it results in their being set significantly above marginal costs, and above average incremental costs.

This then goes on to cite various ways, sort of proxies or insights into the fact that the marginal cost or the true cost of call termination is much lower. Paragraph 2.11(b)(i) – (iv)

sets out a number of reasons why Ofcom's estimate of the true cost, or the relevant cost of call termination is much higher than what H3G now puts forward as being the relevant cost, or the true cost.

> Previously, Vodafone's expectation was that in addressing the case for NPZ that H3G had originally put, it had to focus on whether NPZ was the best thing that could be done in the light of s.88, whether H3G was right in putting the positive case for NPZ is avoiding competitive detriments to H3G. Clearly that would have to be weighed against whether NPZ was a good thing, given its relationship with the relevant costs of call termination. The way in which H3G put its case on costs, it did not say "NPZ is a good thing not only because it avoids competitive detriment, but because it is also more truly cost reflective". On the contrary to the extent that H3G's notice of appeal addressed cost at all, it suggested – as we heard this morning – that if prices were to be cost reflective they would be higher for H3G and they would be lower for the 2G/3G MNOs, but they would only be lower for those MNOs to the extent that a different depreciation model would be adopted. Without wishing to add possible further confusion to the different depreciation models the way I understand it is that if one imagines that a mobile network operator makes a capital investment of £1 million in an asset which is to last 10 years, if one were to apply – in simple terms – a straight line depreciation of recovering a tenth of that cost through charges in each of the 10 years of the asset's life, then if the utilisation of the asset is common from year to year, there is no growth or fall-off in utilisation the amount of depreciation charge recovered on each unit of output will be common from year to year.

Conversely, utilisation of the asset is building up over the 10 years. The same aggregate sum of depreciation charge will be recovered in year 1, year 2, year 3, but the per unit charge will fall off in later years because that aggregate charge for the year is recovered over a large number of units of output. Conversely, if utilisation is falling off one sees a higher per unit charge for depreciation in later years.

Ofcom's proposal was you estimate the total unit of output for the whole life of the asset and apply a uniform depreciation charge per unit of output over all of those units without looking at a straight line depreciation year to year. H3G propose something different, which it says would work better for the 3G network, which is growing in utilisation and would disfavour the 2G/3G networks which are already highly utilised. So in other words the cost benchmarks that they were expecting the NPZ remedy to be measured against was

a cost bench mark derived from Ofcom's call termination charges as proposed, subject only to the adjustments put forward in the H3G notice of appeal. So Vodafone's argument would have been NPZ is a very bad thing because it forces Vodafone to sell a mobile call termination unit to H3G for nothing, when in fact the cost of that MCT unit is either what Ofcom said it was, or it is what Ofcom said it was subject to the adjustments that H3G proposed if they turned out to be correct. We would have argued that forcing us to sell MCT for less than its cost would have inefficiency consequences, which would be a bad thing.

Now we are being told that the true cost of call termination is much lower. If that is so, and of course we dispute that it is, we have to examine and answer the request for the NPZ remedy by reference to an argument that in fact is roughly cost-reflective, which is a quite different case, and as has already been aired this morning it will call into question what is the marginal cost of call termination if H3G has an inefficiently large network which is built long before it needs it and it can carry much, much more traffic at no incremental cost – is that relevant? Is that an efficient benchmark. If Vodafone has built a well structured network to which it adds further modules as they come into use and its marginal cost therefore goes up, or there are additional marginal costs, what does that tell us? It also calls into question how one decides what the marginal unit is, because an increment of infrastructure is added to carry incoming and outgoing traffic indifferently, and therefore what assumptions does one make. So all of these questions are raised for the first time by allowing in – if one does allow in – arguments that the true marginal cost and the relevant cost of call termination is quite different from anything that has been aired to date.

THE CHAIRMAN: You say you would have to deal with that because even though it is generally accepted that the 0.4ppm figure is not derived from the mobile operator's costs, part of the justification put forward for it is that it is not out of line?

MISS McKNIGHT: Yes, it is not for us to say what H3G's case is, but the way I understand it is ----

THE CHAIRMAN: No, your understanding of it.

MISS McKNIGHT: They are saying that if you went for 0.4 ppm because that equates to what BT charges, then it certainly would not do much detriment because the true costs of call termination on mobile networks are much lower than Ofcom or anyone else had previously thought, and we say that is a substantial new matter to be answered, and not something for which we were at all prepared. That is why we think that this change to the NPZ remedy on mobile-to-mobile is a very substantial change to the case.

If I could take you back to the original price control appendix we were looking at, the way in which H3G put their case originally, looking at not so much what they wanted for mobile-to-mobile, but what they wanted for fixed-to-mobile.

In para.4.7 they indicated that whilst they thought that lower MCT rates generally would benefit consumers, they were proposing that there should be a suitable cost base price control taking account of the differences between 2G and 3G costs, and for all fixed-to-mobile rates. In 6.1 they then go on to explain that their case on what H3G's rate should be is that Ofcom has set too low a rate because, as we have heard this morning, they should have been allowed additional CARS costs and so on (section 8).

In a later section still we get the argument that the 2G/3G MNOs rates should be lower. So again, this is the section which caused us to conclude that this is the only case that H3G was making as to areas in which Ofcom had essentially erred in setting a cost reflective termination rate, so that was essentially the benchmark against which you measure whether NPZ is a preferable remedy. Now we are being told that that is not the case at all.

THE CHAIRMAN: The ED methodology seems to be only the first of those reasons or the second reason in 11.5 is the assumption about H3G's market share is too optimistic.

MISS McKNIGHT: Yes, you are quite right, that is presented as a separate element.

THE CHAIRMAN: That would be related to CARS costs.

MISS McKNIGHT: Yes, subject to whether my understanding of the different depreciation methodologies is correct, I see them as related points because the more quickly H3G goes to market share parity, the less significant is this debate about the number of units, about put over which one recovers the depreciation charge, but you are correct that it presents as a separate error.

MR. SCOTT: This is all on the basis of commenting on Ofcom's model, not replacing Ofcom's model with something profoundly different?

MISS McKNIGHT: Yes, in my view that is clearly correct. So in other words, there was no suggestion by H3G at this stage that Ofcom's model just needs to be torn up and we need something different altogether. They were saying by implication the model is substantially correct, but there are these potentially major, but adjustments to the model to be made, or to the inputs to the model.

We would argue therefore that on the basis of what I have said this is clearly something which is novel and goes beyond, and indeed in some ways contradicts what was said in the amended notice of appeal. So we would say that if H3G are to be permitted to pursue these arguments, it must be on the basis that they persuade the Tribunal that they should be

allowed to amend their notice of appeal so as to introduce these matters by way of elaboration to the Competition Commission. We say that what they are seeking to do is essentially to introduce a new ground. We agree with Ofcom in this regard. What they are now arguing is that Ofcom erred in adopting a long-run incremental cost model using the increment of total traffic and allocating appropriately, and that instead Ofcom should have gone for an NPZ, or close to an NPZ remedy one justification for which is that a close to NPZ remedy, a 0.4 ppm remedy would not depart far from a truly cost-reflective level, and we say that is entirely new ground.

If it is not treated as a new ground, it is certainly a new argument, and we say that in deciding whether to admit to such an amendment, the Tribunal should be mindful of the fact that to do so at this stage would lead to very substantial additional work for the parties along the lines that I have described. We see no countervailing benefit which would justify putting us to that extra work at this late stage in the proceedings.

We note that one reason that H3G puts forward is that the economic literature has developed to some substantial extent in the 11 months or so since the appeal was first launched. We do not see the relevance or merit of that point; it seems to us that the notion of NPZ was well aired in the literature, and indeed was considered by Ofcom, and Ofcom sought views on it during its consultation process.

The close to NPZ remedy does not seem to us such a substantial departure from that in terms of thinking, if one is thinking either cost reflective, zero, something in between, the notion of setting charge controls that would be mindful of the extent to which fixed and mobile operators compete with one another is certainly not novel. There is plenty in the Ofcom consultations that look at that and BT frequently raises concerns about distortions of competition through the very different levels of charge control rates.

So whilst I do not wish to dismiss the relevance or importance of economic literature we do not think it amounts to new facts or legal considerations such as to justify this kind of amendment and, as we say there are very serious concerns about the work to which it would put the parties to in the meantime.

We would also make the point that to the extent this literature is very novel it is really looking at what will be the next generation of charge control regulations, to the extent it is relevant at all. What this case should be doing is deciding whether Ofcom made the right decision as to the charge controls when it made that decision in March 2007. We do not really think the fact that there may be future evolutions in thinking on how charge control

should be set should be something which should entirely overtake a consideration whether Ofcom made the right decision at the time it took it.

Clearly, if some revelation had occurred since March 2007 to the effect that all previous price controls are entirely misconceived and damaging then perhaps the Tribunal would have to think: is this new insight of such substantial importance that we have to just stop in our tracks and start again? We do not think that this can be portrayed as that, and we therefore think that this is something which, at most, is going to be of significance next time around.

My submissions so far have focused on the H3G notice of appeal. As regard the statement of intervention in the BT case we would make the point that again, when we were last before the Tribunal to consider the questions we referred to the Competition Commission there was some substantial debate as to the role of interveners in CAT proceedings, and the extent to which it was open to an intervener to ask for a different remedy from the principal parties, or to adduce new arguments. The Tribunal was taken to the Tribunal Rules, which make clear, I think, that where an intervener supports the position of a principal party it should say so in its submissions but by implication it will not always do exactly that.

The point we made then by reference to the *Coke-Cola* case before the Court of First Instance was that Vodafone, to the extent that it seeks to make points different from those raised by Ofcom in these proceedings, it is raising points which it could not have raised in its own independent appeal. Vodafone thinks Ofcom got the price control substantially correct but it does not necessarily agree with every building block of the reasoning, so we would not have been able to appeal to say that we have no objection to the ultimate order but we do not like the reasoning.

When others appeal and take issue with the outcome that Ofcom reached, it is open to Vodafone in an intervention in support of Ofcom to say: "Ofcom have not reached the right decisions for the reasons it has stated, and what is more, for these extra or different reasons", that is a proper form of intervention which goes beyond what either of the principal parties is arguing, but we entirely adopt what Mr. Pickford has said about what H3G are seeking to do now in a BT appeal.

BT has said Ofcom got it substantially right but made three or four errors – I think they have dropped the fourth one now – but they adopt the model and ask for it to be tweaked. For H3G to come in and say BT is arguing that Ofcom got it wrong, so there are loads of other ways in which it got it wrong is simply not acceptable, particularly when it has itself already appealed. The question as to whether H3G should be permitted now to introduce

new arguments must be measured by whether it is proper in the context of its own appeal for H3G to be permitted to amend. They cannot be given more latitude to introduce new arguments via an intervention appeal relating to much more limited issues.

That completes my substantive submissions, but I am conscious, madam, that you asked at the outset that, if we were successful, we identify how this would affect H3G's price control submissions.

THE CHAIRMAN: Well I think we have been taken through some of that material.

MISS McKNIGHT: Yes.

THE CHAIRMAN: We have been pointed to H3G's table, I know you presumably put in your own table?

MISS McKNIGHT: Yes, we put in our own table, all I would say about that is that we identified the paragraphs that we felt went beyond what was permitted within the scope of H3G's notice of appeal. But in many cases a paragraph appears to say: "We should have an NPZ remedy bracket or something close to it", so clearly parts of those paragraphs will be acceptable to the extent that they merely elaborate on what was always in the notice of appeal. So we feel that it would require quite a lot of careful blue pencilling to get it right; it will not always be a matter of just taking out whole tranches of the document, but we are happy to co-operate on whatever basis the Tribunal would wish to assist with that. Thank you.

THE CHAIRMAN: Thank you very much. We will adjourn now until 20 past 2 at which point we will hear from Mr. Kennelly.

(Adjourned for a short time)

THE CHAIRMAN: Yes?

MR. KENNELLY: Madam, members of the Tribunal, I propose to deal with this in two parts, to deal first with the H3G appeal and the issue of the admissibility of our supplementary submissions; and then, finally, to deal with the BT appeal. The vast majority of my submissions will relate to our own appeal. That is by far the most important matter for H3G.

In relation to H3G, I will be submitting that our supplementary submissions in full are admissible – these were referred to in brief earlier by Mr. Holmes for Ofcom – that is the supplementary submissions served on 7th March, the letter with the two further documents served on 14th March, and the short Morgan Stanley report served with the submissions for this hearing. Those, in their entirety, are the supplementary documents which have been served for the purposes of H3G's case before the CC.

Madam, I will be taking the Tribunal at some length and with some care to our notice of appeal, price control appendix and commentary. That has not been done so far and it is critical for the purposes of this hearing for this Tribunal's determination.

Before doing that it is useful, in my submission, to recall just for a moment what the background to this issue is. This Tribunal at the CMC of 18th March made it clear that they would appreciate the most robust guidance possible from the CC. The CC is engaged with the task of finding, if possible, the correct figure. This Tribunal has asked that the CC give it the most robust guidance possible in determining the issues in this appeal. For the CC to do this they must necessarily have all of the relevant materials before them, and this Tribunal should be astute to avoid any artificial limits or deadlines to this end. I refer in particular there to such documents as have emerged very recently and which, in our submission, are extremely material to the CC's examination.

The second background point that I wish to draw the Tribunal's attention which the Tribunal will not have lost sight of is that we are engaged in determining the figure which is of the greatest possible benefit to end users. My learned friend Mr. Pickford for T-Mobile, if I may say so, rather sarcastically referred to his when he quoted from our own submissions, but it is central to this point and central to the examination in which the CC is engaged. It is not an over-simplification to say that if H3G is correct in its case it is highly likely that prices for end users would fall substantially. That is the interest which this Tribunal is astute to protect, not the maximum possible benefit for MNOs but for consumers and end users.

Finally, again I would, in the course of my submissions, ask the Tribunal to bear in mind that some degree of flexibility is appropriate in the deliberations before the CC. These are very complex and developing areas and it is entirely unreal to suggest that a party can set out in full its entire case on the facts, on the economics, on the law from beginning to end for all purposes in circumstances where there would be a price control reference to the CC.

Those are my background points. Could I ask the Tribunal now to turn up bundle A, which is the bundle where we find H3G's notice of appeal. I would ask the Tribunal first to turn up the notice of appeal itself behind tab 1. In the course of taking the Tribunal through this document I would ask the Tribunal to recall, and I will draw the Tribunal's attention to some of the submissions that have been made earlier today, because our case is that this document and its accompanying documents have been quite seriously mischaracterised before the Tribunal. Some of the confusion which we have heard from the representatives of the MNOs may be understandable and some of the points may be fairly made, but other

points we would ask the Tribunal to treat with great care, particularly in relation to the treatment of what is plainly an alternative case in this case.

Taking the notice of appeal first and turning to para.2.6 – and I shall go through the notice of appeal itself quite quickly because the price control appendix is the central point in this matter – this introduces the summary of grounds of appeal on the price control matters. It states that the decision constitutes an error or law and assessment as to fact or analysis relied upon and/or reasons given. The Tribunal is familiar with the case that it further tilts the playing field against the recent entrant and makes it more difficult to compete in the retail market, unnecessary and/or disproportionate. There are a number of reasons for this, including, and I will be reading quite a lot of this document and if the Tribunal gets bored with my rather nasal tones and my cold then I will be grateful to have an indication to stop.

What is stated there is:

> "… the price control imposed on the 2G/3G MNOs has a TAC that is not justified by the underlying cost model and is too high (both for mobile-to-mobile calls and fixed-to-mobile calls); and it generally ignores or fails to take sufficient account of the impact of the price controls in terms of payments by H3G to its competitors and the resulting distortion of competition and dynamic incentives."

In my submission, what H3G is saying there is that the price control in general is not justified by the underlying costs model and it is too high in general both for mobile-to-mobile calls and fixed-to-mobile calls.

In 2.7 H3G submits:

> "In addition or in the alternative, Ofcom errs … regarding its decision to impose a price control on H3G in that …"

Then a number of points are made on p.10, which are plainly set out in the alternative to the case referred to at 2.6.

Turning in that same document to the reference to relief sought ----

THE CHAIRMAN: When you say in 2.7, "regarding its decision to impose a price control on H3G", that is actually dealing not with the non-price control matter that we have covered in the hearing in January, but with the price control itself?

MR. KENNELLY: That is correct, madam, yes. That wording could be clearer, I have no doubt, but you are absolutely right.

MR. SCOTT: In 2.6 you do not say that the price control on H3G had been set too high?

MR. KENNELLY: We do not say that expressly, sir, absolutely not. That point has been already made and I shall have to ask the Tribunal's indulgence in looking at this document

in full, much as BT did its in letter, to look at this document as a whole. It is possible to cherry-pick certain references and to characterise this case not as H3G intended it. So I shall ask the Tribunal for some patience in perhaps forgiving some of these omissions, but reading this document as a whole and seeing, as BT did, what the case truly is, and, in my submission, what the other parties and Ofcom plainly understood the case to be when one looks at Ofcom's defence and the points that H3G made in its submissions before the CMC in February.

Turning then to the relief sought at 3.1 – I shall not read that, the Tribunal has seen it already.

Then 3.2:

> "In relation to the issue of which MCT rates (both in relation to cost benchmark and glide path) should apply if the Tribunal adopts the approach in paras.(c) – (d) above … H3G submits that the CC should determine:
>
> (a) the level of mobile-to-mobile MCT rates so that the MCT rate paid and received by H3G to and from other MNOs equals zero pence per minute or otherwise leads to a neutral net revenue position …"

The Tribunal has the case which we set out in writing that if our remedy which we proposed would address the competitive distortions and other problems which are identified elsewhere in this document, and if this was strictly limited to zero pence per minute, the words "or otherwise leads to a neutral net revenue position" would be entirely superfluous and unnecessary. Some meaning must be given to these words and, in my submission, these words are used to indicate the flexibility which H3G intended to argue before the CC, and it is plain from this document that this was intended. The figure itself did not necessarily have to be zero, it could be close to zero provided the problems that H3G identified were addressed in the ultimate figure set by the CC. Zero was and is still H3G's best case so, but it may not be possible, and H3G may have to make some concessions.

Turning then to 3.2(c) and the vexed question of fixed-to-mobile MCT rates, plainly here there has been some development because at 3.2(c) H3G submit the level of fixed-to-mobile MCT rates should be fixed so that:

> "(i) the level of the MCT rate paid by fixed operators to all UK MNOs is based on long-run average cost, with separate controls for 2G and 3G call termination; and/or

(ii) the level of the MCT rate for 2G call term … is at a rate based on long-run average cost, reduced so as to reflect the lower risk that attaches to the investment in 2G networks …"

– and (iii) the Tribunal has already been taken to, the separate treatment H3G seeks in relation to its call termination.

I will come later to how H3G's case has developed in relation to fixed-to-mobile.

Staying with that document and turning to the price control appendix, I would ask the Tribunal to turn up para.1.2. It is necessary to read this paragraph quite clearly because it has been mischaracterised, in my submission, by the submissions of my learned friends.

"… H3G considers that a more appropriate package of remedies would:

(a) eliminate or mitigate the distortionary effect on competition …"

So there plainly we are saying that this is intended to eliminate or mitigate the distortionary effect on competition, which is a general problem:

"… by producing a result that is or is at least equivalent to a 'net payment zero' outcome between the MNOs."

True it is that this is limited only to mobile-to-mobile termination.

"That is no actual wholesale payments would be made by H3G to the 2G/3G MNOs or vice versa. This would eliminate an artificial cost floor on competition in the mobile sector at the retail level."

One of the points made against me is that H3G, for the first time in these supplementary submissions, refers to retail problems and talks about the fact that these rates proposed by Ofcom have led to improperly high retail prices. This is the first time the point has been made by H3G. In my submission, that is not true. Here we refer expressly to the fact that the existing rates create an artificial cost floor – that is they are too high, they create an artificial cost floor on competition in the mobile sector at the retail level. If H3G's remedy were adopted that cost floor would go and it is plainly implicit in that that retail prices should fall.

In relation to fixed-to-mobile calls H3G submits slightly differentially. It says that the average MCT rates should be reduced through applying an appropriate methodology for assessing costs. Our starting point here is a reduction in the average MCT rates.

My learned friend Mr. Holmes took the Tribunal very quickly from this case to the alternative case made by H3G where we ask for greater asymmetry. If we fail NPZ we have to impose greater asymmetry for H3G's benefit. That is the alternative case. We only get to that case if we fail on our main case which is that all the rates should be

dropped. It is very important that the Tribunal makes that distinction because much of our economic analysis is devoted to the alternative case, the case which seeks greater asymmetry and higher prices for H3G. We only get to that case if we fail on our NPZ case which is our primary case.

THE CHAIRMAN: You maintain that as an alternative case, and now an alternative to what has been dubbed "reciprocal loan case" or in your nomenclature a "different NPZ case"?

MR. KENNELLY: Madam, I am afraid this, the 0.4 or something lower between zero and 0.4, is simply a refinement of our NPZ case. It is the same case as our NPZ case. As I shall show you later in this document NPZ does not need to be zero or zero right now. There can be a glide path, for example.

THE CHAIRMAN: I am saying, you still maintain the alternative case of the bigger asymmetry in the event that the NPZ case fails?

MR. KENNELLY: Yes, that case is maintained. We are perfectly entitled to change the emphasis on our pleaded case. We are perfectly entitled before the CC to place a much greater emphasis on our primary case. It is perfectly permissible for us to have an alternative case which may rely on entirely different economic methodology. That is the way one can bring these points. We should not be punished in our NPZ case by virtue of the fact that we are running a different case in the alternative case. That, with respect, is what Mr. Holmes' submissions sought to do. He sought to prejudice the arguments we make by reference to our alternative case. Plainly there is inconsistency between them, but it is permitted inconsistency.

Sticking with the vexed question fixed-to-mobile, here one can have some sympathy for the points made by my learned friends. They say, "You said very little about fixed-to-mobile in this document, in this notice of appeal and the appendix and now you have produced quite a lot of detailed work on it and this is very different". One must focus on what one says at 1.2(b). We say that the rates should be reduced and we say there should be an appropriate methodology for assessing costs.

MR. SCOTT: Sorry, that is not what you say. What I would like you to do is go back for a moment. You have just said the result is higher than justified MCT rates for 2G/3G MNOs. That is what you say in 1.1.

MR. KENNELLY: Yes.

MR. SCOTT: What you then go on to say in 1.2(b) is reduce the average MCT rates. In the context of what you have just said about 2G/3G rates that means that you have said nothing in particular about H3G's rates, because it is very easy to reduce the average by reducing

the other fours' rates and leaving your own rates either where they were or at a higher level. I think you have got to be careful in how you characterise what you have just read out to us.

MR. KENNELLY: Indeed, and I am grateful for that intervention, because it is true that we say very little about our own fixed-to-mobile rates. That is a point that we have well in mind and we shall come later to how we address that. Again I will be submitting that it is open to us in this proceeding to, for example, recognise that the point made against us is a valid and to make a concession. That is a perfectly acceptable route one can adopt, particularly if the detriment falls on H3G. The point is one we can take but I will come to that later. I have well in mind that what we were talking about earlier is 2G/3G, and so far we have said very little about H3G. What we have said in general terms, which applies equally to H3G, is the appropriate cost methodology. We have opened the issue of whether or not Ofcom have applied the appropriate methodology for assessing costs. That is something that we have done and that is something I will come to, because really, in essence, the problem here is that we have, subsequent to this plea, done the work in relation to what is the appropriate methodology and that is what we presented in the supplementary submissions. That is what created this storm of protests. We reserve the right to do it implicitly in this plea. We have done it and that is what has excited the objections of my learned friends.

Then turning to para.3.2, I shall not read that. For the Tribunal's reference, I am doing a comprehensive analysis of these documents. Some parts are less central than others, but I just ask the Tribunal to note that. It says:

> "An 'effects' based analyse against the regulatory background as referred to in section 1 of the Notice of Appeal indicates that, as a whole, the price control remedies are disproportionate/inappropriate."

At 3.5 there is a reference to the imbalance in H3G's cash flows. That relates to the financial effect on H3G individually.

At 3.8 there is in italics the heading "*Consequential adverse effect on competition give H3G is the 'maverick' competitor*". The Tribunal will see that at 3.10 there is a reference to:

> "The financial impacts of the price controls, as outlined above, are bound to reduce H3G's ability to act as the maverick competitive force promoting price reductions and innovation …"

There is a direct reference to a reduction inhibiting the ability to promote price reductions and innovation – two points it is said we raise for the very first time in our supplementary submissions.

At 3.11 we make a more general submission. We say:

> "Moreover, H3G submits it is likely that the additional monies passing to the MNOs will either lead to an increase in the incumbent MNOs' profits or will be spent in retaining customers (further disadvantaging H3G's ability to compete). With a lesser competitive threat from H3G, H3G submits that it is unlikely that the situation will result in significantly lower retail prices or other consumer benefits."

I take the point that is made against me that these refer only to H3G. We do not make the general point that it is damaging competition between the other MNOs. The point is made there that consumer benefits are reduced, there is less competition and innovation is harmed, albeit in relation to the prejudice suffered by H3G.

Turning to the most important section of all, which is section 4, "Alternative Approach to Remedy", at 4.1 there is a reference in the very first line to "The sections that follow set out the issues". I need to clarify this for the Tribunal because the reference to the sections that follow is a reference to the sections that follow section 4. The reference there to sections that follow actually refers to section 5 and following, not to the sub-paragraphs in section 4. This deals with the NPZ argument.

> "4.2 However, H3G also submits that there is an alternative approach to a price control remedy regarding mobile-to-mobile calls which have substantial benefits for consumers in general …"

There again we refer to consumers, this is not the first time this has been raised in supplementary submissions.

> "… promote competition and not have the detrimental effects of the current price controls which Ofcom has determined. That, the appropriate remedies should ensure that the payments made by H3G to the 2G/3G MNOs in relation to call termination on their respective networks are wholly offset by the payments it receives from the 2G/3G MNOs for call termination on its network – in other words, the resulting position for mobile-to-mobile calls should be 'net wholesale payments zero' or 'NPZ'."

Again, I take the point made against me that the word "wholly" seems to refer to a single route.

In 4.3 that ambiguity is clarified, it is washed away, because we refer plainly to more than one route. We say that one way, and the simplest way, of achieving this would be for all rates to be set to zero. That plainly envisages other ways of achieving the NPZ solution. The favoured route is zero. True it is that H3G does not set out a detailed case for a different figure, but hg3 submits that zero is one way and the simplest way, but the wording of the notice of appeal and the price control appendix permits, in my submission, H3G to make a submission in favour of a slightly different figure achieving the same end. I will come in a moment to 4.4 which makes that clearer.

MR. SCOTT: But the end is still wholly offset, not simply offset?

MR. KENNELLY: Sir, with respect, no. The word "wholly" I cannot get around. The word "wholly" is inconsistent with what I am saying. The end, which I hope is plain, is that what H3G is seeking to do is to remove the competitive distortions caused by the transfer in these termination payments. The point that I made at the very first CMC in these proceedings far too long ago, that is the end that we seek to address. Sir, I would hope that this Tribunal will have some sympathy with my submission which is that technical pleadings points are not what this case is about. I completely understand what Mr. Holmes says about Ofcom having a right to know our case, having a right to address it, and us having to be clear so that our case can be properly met. That submission I cannot dispute, and I will show in a moment why Ofcom are not only in difficulty in that regard and, in fact, in their defence have addressed the points that we make.

One way and the simplest way indicates that it envisages more than one way. At 4.4 H3G say that, in the alternative, it could be considered as part of a glide path approach while a decent MNP system is brought in. If H3G is proposing a glide path it is entirely unlikely that the glide path is going to begin with zero. A glide path envisages a different figure reducing, we would say, quickly to the zero pence per minute. H3G there is plainly acknowledging that some flexibility may be necessary in dealing with NPZ beginning with a figure above zero and reducing quickly, or slowly depending on what the CC wants to do, to the preferred figure. The glide path envisages the flexibility which H3G now seeks before the CC.

H3G then at 4.5 set out a number of reasons for preferring this remedy. The Tribunal has been taken through this and it has been argued against me by Ofcom that these are very limited grounds, that H3G has put its case on a very narrow basis and therefore it can be knocked out for doing any of the difficult work that Mr. Holmes suggests.

Again, we would hope that Ofcom would not take narrow pleading points such as that but instead would seek to address the substance of H3G's case and if it is misconceived it ought properly to be dismissed, but on the substance not on the individual narrow particulars which are given by H3G. As I shall submit to you, looking at Ofcom's defence, Ofcom have addressed the substance in their defence.

I am reminded that there is a reference to retail charges at the end of 4.3 for the avoidance of doubt. This is a point that operators' interconnect payments would be reduced as well as their interconnect revenues, while network costs would be recovered through retail charges. This is a point that operators then put aside for themselves where they could recover their, we would say, very low costs, and those could be recovered through increased retail charges. That would be at the election of the operators. I shall make the distinction between and mandated RPP but I will come to that in a moment.

Then 4.5 sets out the various reasons given by H3G at that stage as to why NPZ is the appropriate remedy. There is a reference at 4.5(b) to the uncertainties around Ofcom's estimates. Ofcom fairly admits that it is extremely difficult to have accurate estimates of cost benchmarks and there are risks of regulatory error and H3G submits that these would be removed by its NPZ solution. This a general point of general application between all of the MNOs.

Then 4.5(c) refers to the fact that Ofcom's cost model could encompass the solution which H3G proposes, and Mr. Scott made the point earlier today that that is not a root and branch attack on the Ofcom costs model, and that is absolutely right. I will come in a moment to why H3G in 1.2(b) said that they would look to the appropriate costs methodology for fixed-to-mobile and came to the 0.4 ppm or something like it, which ultimately it put forward.

Then at 4.5(d) H3G returns to its own interests from the general point that it said that the NPZ approach does not require to it to make material net out-payments. Here I would ask the Tribunal to pause on the word "material". The submission here is not that H3G must never made an out-payment. Because H3G is concerned at removing the competitive distortions, it is concerned with reducing the out-payments to the extent that they distort competition. That is why H3G here refers to "material" net out-payments. In my submission, that could envisage a very small out-payment that was *de minimis* or an out-payment that did not have the distorted effects that H3G is anxious to avoid. This again is inconsistent with a strict case that only zero will do, and it is consistent with the submission that H3G now makes that what it offered in this appeal and before the CC is not a simple

binary choice between Ofcom or zero, but something close to zero would work if it addressed H3G's concerns. That is consistent with the NPZ case put forward by H3G in this document.

At 4.7, in the same section as the NPZ, section 4 is the NPZ case, there is the references to fixed-to-mobile files, and H3G submits that lower MCT rates generally would benefit consumers. There, and I referred this to Mr. Scott, is a general submission that in relation to fixed-to-mobile calls in general H3G submits that lower MCT generally would benefit consumers.

Maybe it has taken me a long time to get to the point, and, Mr. Scott, you might well say that that point ought to have been flagged more clearly at the beginning of the document, but it is there and it is of general application. This is:

> "In circumstances where the effects on competition between the MNOs have been addressed, H3G submits that a suitable cost based control (taking account of the differences between 2G and 3G costs) is appropriate for all fixed-to-mobile rates."

H3G there is still asking for some distinction to be made between 2G and 3G in its own interests.

Turning to section 6, which is on p.16, 6.1 – I take the Tribunal to this section just to draw the Tribunal's attention to the first three words of the section, which are "In the alternative" to the NPZ approach. This section has been canvassed before the Tribunal on at least two occasions today as this is in some way linked to NPZ case and in some way inconsistent with it. The point here is that it is an alternative to the NPZ approach. The sections that follow in this document set out H3G's rationale for its alternative case for the greater asymmetry for the fact that H3G seeks recognition of its higher costs which H3G submits should give rise to a higher termination payment for H3G. This is alternative to its case on NPZ between all the MNOs.

THE CHAIRMAN: So there is nothing that you rely on after section 4 that you took us to, there is nothing in these later sections 6 to 12 that you rely on as foreshadowing the 0.4 reciprocal rate?

MR. KENNELLY: Not in the price control appendix. In the commentary we refer to the importance of efficiency in the cost methodology.

THE CHAIRMAN: Which commentary?

MR. KENNELLY: The commentary at the end of the appendix. Madam, you will recall that there is the notice of appeal, the appendix and then there is a commentary attached to the appendix.

THE CHAIRMAN: The model?

MR. KENNELLY: Yes, indeed. There are several references in that to the importance of efficiency in the appropriate cost methodology, and that led H3G ultimately to its case on marginal costs, by reference in part to Ofcom's own analysis of MCT statement.

MR. SCOTT: One of the points you have already made in relation to the development of your case is that it has taken you some time and some work to get to the point that you have reached. The implication of that, it seems to me, is that it is going to take others in the room some time and some work to catch up with and then to respond to the work that you have doing.

MR. KENNELLY: I take the point, sir, but the answer to that is, first of all, the reason why H3G has come to the fixed-to-mobile point with rather less detail in the notice of appeal was because, of course, it was not central to H3G's case on NPZ. H3G's greatest prejudice comes from the out-payments to the other MNOs, and that is why it was at the forefront of its case. H3G sought to expand its case based on its pleaded case before the CC and that is when it did the work for the purposes of fixed-to-mobile. The important point here is that, first of all, Ofcom, which is by far the most important party here, guarantor of the public interest and the right of consumers to low prices, is that it has addressed these points in its full defence. Ofcom, I would submit, has done the work. I take what Mr. Holmes says about the remaining work that will need to be done and I will address that, but plainly on the defence one can see a great deal of the important work has already been done by Ofcom, we will submit wrongly and we will submit that they are in error, but some very important work has already been done.

Secondly, one must not exaggerate the shock that the other MNOs have in seeing these points. Since November 2007 it has been plain to all the world, at least those that saw our statement of intervention in the BT appeal, that we had done the work on fixed-to-mobile costs methodology and we were proposing a very, very low rate on the basis of low fixed-to-mobile costs. That was November 2007. It may be that it has decided to take the point against us, take the risk that they would not do the work and hopefully come to the Tribunal and persuade you to knock us out, I think was the expression used today, but the fact is that the evidence of our work was demonstrated in November 2007. If they had wanted to start addressing it they could have done so then. That is a risk we all take in dealing with these points. H3G, it could be said, has taken some risk in not doing the work behalf it lodged the notice of appeal, but all the parties take these risks. Provided something is pleaded we ought properly to be able to adduce further material on it.

Turning to the commentary itself and just addressing the point raised by the Chairman, at p.3 – this is, as I said earlier, the commentary on the model – I think it is important to draw the Tribunal's attention to one point about H3G's understanding of the Ofcom model. The point has been made that there is a great distinction the LRAC approach which H3G favoured at this stage and the Ofcom LRIC model. Could the Tribunal just read footnote 6 on p.3. H3G there acknowledge that:

> "Strictly speaking, to the degree that Ofcom's LRIC model includes elements of common costs, the approach to calculating LRAC described here will include some pre-allocated common costs. Hence more than one estimate of 'long-run average cost' for any period be derived by changing the allocation of common costs. Ofcom assumes that the level of network common costs are negligible, however, so this should not materially alter our conclusions. Indeed, Ofcom's definition of the LRIC of voice call termination as 'the additional cost an MNO incurs to provide termination' or 'the cost that the firm would avoid if it decided not to provide voice termination' would appear to preclude the existence of any pre-allocated common costs in its LRIC model."

It was on that assumption that H3G proceeded with its case for LRAC.

H3G's emphasis on producing the most efficient cost methodology should have been in no doubt, because the references to the importance of efficiency appeared throughout this commentary. Just to give the Tribunal the references – it is not necessary to read through each one – p.5, under section 5(ii), p.7, section 6, the second full paragraph on that page, and pp.8-10 all refer to the importance of efficiency in determining the appropriate cost methodology.

THE CHAIRMAN: That was always, you say, relating to fixed-to-mobile as well as mobile-to-mobile?

MR. KENNELLY: Yes, certainly for fixed-to-mobile. At 1.2(b) in the price control appendix we said that fixed-to-mobile should be reduced for all parties. I take the point that it was not clear. We certainly said that it should be reduced, fixed-to-mobile for all parties on the basis of an appropriate costs methodology, but we did not explain at that stage what the appropriate figure would be having applied the appropriate costs methodology.

THE CHAIRMAN: I am confused now as to what is an alternative argument to what. You accept that in the original amended notice of appeal appendix what was being suggested was NPZ or something like it for mobile-to-mobile and a costs based price for fixed-to-mobile based on an appropriate costs methodology.

MR. KENNELLY: Yes.

THE CHAIRMAN: Is the case that you are putting now that NPZ incorporates the prices charged to both mobile and fixed and is not now zero but 0.4 p, but that is how you are now putting the NPZ case? In which case is the cost methodology then an alternative to that still for the fixed-to-mobile and then the increased asymmetry is the alternative case as regards to mobile-to-mobile? Is that how it fits together?

MR. KENNELLY: (After a pause) Madam, I just wanted to make sure I was not going to mislead you. NPZ relates only to mobile-to-mobile. That is what we pleaded and that is what we have set out in the price control appendix. Separately we argued for lower fixed-to-mobile rates on the basis of an appropriate costs methodology. We have suggested in our supplementary submissions what that costs methodology should be, and we say it produces a very low termination rate. That is not our NPZ case, that is a separate case based on what the appropriate rate should be for fixed-to-mobile termination. The alternative, if we are wrong about that, is our greater asymmetry on mobile-to-mobile rates which we have set out also in the notice of appeal.

THE CHAIRMAN: I thought that the appropriate methodology result for fixed-to-mobile was 0.6 to 0.8 ppm, but you do seem to be arguing for 0.4 ppm which is for fixed-to-mobile, but that 0.4 ppm is not based, as I understood it, on any cost methodology as far as the mobile costs are concerned, but is the alignment with the BT rate which you may say is a fair rate is because it is just about the same as what you arrive at on the appropriate costs methodology but it is not derived from that methodology. Are you now saying that you are not pursuing the NPZ remedy for fixed-to-mobile, but are pursuing an appropriate costs methodology basis, in which case what is the figure that you are arguing for fixed-to-mobile derived from that methodology?

MR. KENNELLY: Just to be clear, as we say in our submissions for the CMC, 0.4 may not ultimately be the figure which we will propose to the CC. 0.4 is, we think, close to the figure which it will ultimately arrive at, but that is a pragmatic choice. It is not clear to us at the moment what that figure should be. The basic point, the economic rationale, which Mr. Scott referred to, is that because the marginal costs are so low the termination charge ought to be extremely low, as close to zero as good as, in our submission, for fixed-to-mobile. That is the costs methodology I have referred to. We have referred to LRIC or marginal costs. That is what we suggest is the appropriate costs methodology in determining the appropriate figure for fixed-to-mobile.

THE CHAIRMAN: So you are not arguing that the NPZ remedy should apply to fixed-to-mobile?

MR. KENNELLY: (After a pause) Madam, the concern is simply this, that NPZ in section 4 of our price control appendix applies to mobile-to-mobile. That is what we are referring to. At 4.7, the end of that section 4, we refer to fixed-to-mobile. Although it is in the section 4 section, we have sought to explain why termination rates for fixed-to-mobile should be reduced. We have argued that on the basis of this appropriate costs methodology which we have preferred in the supplementary submissions. It has been developed separately to the NPZ solution for mobile-to-mobile.

MR. SCOTT: Just to be clear then, were you able to argue for this alternative methodology for F2F and to convince the CC that that is the most appropriate approach to efficient price of F2M. As I understand it, you would, for other reasons, still be saying to the Competition Commission that you want an NPZ approach to the M2M?

MR. KENNELLY: Absolutely, yes.

MR. SCOTT: So if the Competition Commission were convinced that this was a wonderful methodology for getting efficiency out of the F2M market, you would not want them to be persuaded that it was an equally efficient approach to the M2M market?

MR. KENNELLY: Well that is setting out our case before the Competition Commission as it stands. As I will come to, when I look at the Ofcom defence, it may be that the presentation of the fixed-to-mobile case and how it has developed, and to the extent it contains some concessions from H3G is in order to secure the primary case which is NPZ. For that reason we rely on ----

THE CHAIRMAN: Well ----

MR. KENNELLY: Sorry, just to address the point about fixed-to-mobile, the Armstrong & Wright Article, is what we rely on for that, that is the economic rationale, it is in that document which was before the Tribunal in the SNP appeal and by the Tribunal's order ----

MR. SCOTT: I think the difficulty the Competition Commission are going to have is that the Competition Commission have got to bear in mind the overriding requirements are not unduly to discriminate between F2M and M2M, and between the interests of fixed and mobile network operators, and so they are going to have an interesting task trying to work out how to deal with your various arguments.

MR. KENNELLY: Sir, perhaps I have not been clear enough, that is precisely why we have characterised the case in the way we have. Why, for example, H3G is proposing, effectively foregoing a substantial termination revenue is precisely because it may well be

the Competition Commission prefer to say if we are going to lower rates for you (the MNOs) on the basis of NPZ it will be necessary to be fixed-to-mobile otherwise it will not work. Ofcom make the point fairly in their defence why should H3G not now be able to say, even though H3G came to the same conclusion itself earlier than the Ofcom defence, what is to stop H3G saying to the Competition Commission "that may be a very valid point, we may concede our pitch for higher 3G termination rates fixed-to-mobile and accept the point that is made against us", in order to remove the risk of distortions by having a difference in M2M and F2M rights, and produce a workable, pragmatic solution which is our primary goal.

THE CHAIRMAN: So is this how it fits together then, that as far as mobile-to-mobile are concerned, your case is MPZ set it all to zero, or MPZ (plus/minus) set it all to 0.4 ppm, or have a bigger asymmetry between 2G and 3G and separate 2G/3G rates. As far as fixed-to-mobile is concerned, your case has always been this should be based on some appropriate cost methodology, now you have done the work and what you think is the appropriate cost methodology results in a much, much lower rate, less than 1 ppm, which could then either be – well it is up to the Competition Commission then to work out precisely what that is.

MR. KENNELLY: Yes, precisely, madam, yes. Moving on just in the chronology, our statement of intervention in the BT appeal – I shall not take you to it (bundle A, tab 22) – there H3G submitted that having done the work on the cost methodology the appropriate fixed-to-mobile rate should be about 0.4 ppm, that is at para.5.9, footnote 20, and the reference there is also made to marginal costs, para. 5.3.

Following this, Ofcom changed its defence, its full defence in this case, and it is important to look at this document because it goes directly to the points made by my learned friend, Mr. Holmes, as to the catastrophic results that will flow from permitting H3G to make these arguments before the Competition Commission. Ofcom address H3G's NPZ points and its points in the BT appeal, s.6, which is at p.72 of the full Ofcom defence which is behind tab 52 in bundle A. I refer to these points to demonstrate that Ofcom, although it is said it has not done the work, and I do not mean to call into question the truth of the statement, but it is important to see what they have done, and how it addresses many of the points – if not all of the points – that H3G are making in supplementary submissions, and in fact addressing the points that Mr. Holmes made to you earlier today.

First, Ofcom summarises its own position. It refers to H3G's proposal at para.6.2. At 6.2.3 Ofcom refer to H3G's suggestion that the simplest way to achieve NPZ would be to set all MCT rates at zero and then implicit in that is a recognition that there are other ways to get

to NPZ other than zero pence per minute. Ofcom recognises also at that stage that H3G is not asking for NPZ at any stage, asking that NPZ is the appropriate rating for fixed-to-mobile calls and asks for a suitable cost based price control.

Turning through the document, 6.3 refers to Ofcom's view on the consequence of traffic imbalance, I do not need to take the Tribunal to that because mercifully for this point we are not looking at traffic imbalances. 6.4 is the consequences of NPZ for efficient pricing. This is the substance of Ofcom's response to H3G's case on NPZ.

> "As discussed in paragraph 6.2.3 above, H3G suggest that NPZ could be achieved by setting all MTM MCT rates to zero. While in theory other mechanisms may exist in Ofcom's assessment, setting termination rates to zero would be the only realistic method of achieving H3G's proposal.

Again recognising the possibility of other mechanisms than zero pence per minute. At 6.4.2 Ofcom refers to the rationale for its own MCT charge controls, and refers to H3G's submissions in relation to NPZ. Ofcom acknowledges at 6.4.2(i) that the efficient costs of MCT are inherently uncertain. But then Ofcom makes a positive case that NPZ is not the appropriate response to those uncertainties, and for the reasons given below:

> "Ofcom has described how those uncertainties are managed when setting the charge control levels. In particular, Ofcom has attempted to identify bounds on uncertainty using its scenario based approach (within which Ofcom exercises its judgment) whereas NPZ involves rejecting entirely the information provided by Ofcom's benchmarks; and
>
> Insofar as H3G is proposing the introduction of NPZ as part of a move to a RPP system, Ofcom addresses this argument [below]"

Pausing there, it is no part of H3G's case that this Tribunal has asked Ofcom, or that Ofcom should introduce mandated RPP, and as Mr. Holmes fairly said – and I think Mr. Scott made the same point – you have to be very careful with the use of these terms, because the references to RPP made in Ofcom's submission, in our submission refer to retail RPP. On no view is H3G asking for mandated retail RPP, and Professor Littlechild expressly states in the point upon which Ofcom rely that he is not suggesting that RPP is the best solution. On the contrary he is saying the solution of NPZ captures the best bits of RPP without the problems of RPP, that is what Professor Littlechild actually says in the part of his article to which Mr. Holmes referred.

Sticking with what Ofcom said in addressing NPZ, at 6.4.3 Ofcom then set out their reasons for why NPZ rather than improving price signals will create new distortions. The

Tribunal can read to itself how Ofcom makes its case. There is no reference there to a difficulty in gathering information or understanding the points in H3G's case.

6.4.5 Ofcom also considers the possibility that the introduction of NPZ would result in pressures on MNOs to move in whole or in part to an RPP system. Here the Tribunal might have been forgiven, after listening to my learned friend for Ofcom to day, for thinking that Ofcom never had to consider the RPP system, or a proposed move to the RPP system before because it was not demanded by any of the MNOs in consultation, nor was there any Ofcom suggestion and therefore to look at it now would involve a great deal of new work.

First, H3G is not asking for a mandated RPP, but in any event if Ofcom is right, and NPZ leads to something like RPP, Ofcom here addresses the point in its defence, and Ofcom puts, what I am sure Ofcom will say is compelling case why MPZ does not work to the extent that it moves in whole or in part to an RPP system. The Tribunal can read to yourselves, but I think it is important to read those passages down to 6.4.8 and over to 6.4.9 because they go directly to the point that Ofcom made today that they would have to do further work to consider these points which have come as a complete shock to them.

I will just take the Tribunal to the point raised by Mr. Scott earlier, and the point which is made against me that an inconsistent approach to fixed-to-mobile could lead to distortions and Ofcom make the very point at 6.4.8 and 6.4.9 which our submission is designed to address.

At 6.4.9 Ofcom say:

> "If there were a significant differential between FTM and MTM charges, because of the high volumes of FTM traffic concentrated in a small number of FNO customers, incentive problems could arise for fixed operators."

The point made by Mr. Scott, and there is a reference there to the fact that there could be use of GSM Gateways because of the arbitrage issue. Ofcom acknowledge at 6.4.10 that:

> "In H3G's Statement of Intervention in the BT MCT Appeal H3G further proposes that FTM termination charges be set at a substantially reduced level, at a level at or just below marginal cost, which for practical purposes suggests could be the current level of MTF termination rates, 0.4 ppm.

Ofcom say:

> "A differential as small as 0.4 ppm, as proposed by H3G SOI is unlikely to cause a material distortion."

Ofcom go on to say:

"It is Ofcom's understanding that any differential between FTM and MTM MCT charges would be likely to introduce possible implementation difficulties for operators …"

And sets out the reasons for that point. Again, this is the very point which H3G's supplementary submission would address. Ofcom might say: "You, H3G, ought to have come to your FTN case earlier, but in circumstances where Ofcom make the point, address the difficulty, and where H3G has already done the work, which we can see by the reference to the very low rate in the statement of intervention in the BT appeal, why should H3G be barred from agreeing this point before the Competition Commission? How is that in the public interest? In our submission our supplementary submission addresses the difficulty. Ofcom may disagree but this is not about substance, this is about what H3G can or cannot debate before the Competition Commission. In our submission it is in no way in the public interest to bar H3G from making what might be viewed as a concession in relation to its case on high fixed-to-mobile rates for 3G operators.

MR. SCOTT: You are mentioning the public interest, and as we put earlier, one of the difficulties about this form of Competition Commission proceeding is that it is not a public proceeding, it is a proceeding between a limited number of parties, and the questions which we will face is whether it is proper to proceed in a way which may look to some outside the parties immediately in this room, as a way of subverting the normal approach to consultation that we have heard about before; the usual way in which Ofcom, through an iterative process can consult with a much wider group than is present in this room, so that is one of the issues with which we will have to wrestle and that you should probably address?

MR. KENNELLY: Yes, that, with respect, is a very good point, because as you say this is a point that goes and influences and affects a great number of people. This is still a well canvassed case. The issue of the appropriate level of both mobile to mobile charges and fixed-to-mobile charges is always going to go before the Competition Commission in the price control reference. True it is that the detailed point that H3G makes in relation to fixed-to-mobile has not been set out before in detail, but the general nature of this proceeding is well known and very closely followed by the industry at large. I will make submissions on what may be done about the point that you made, sir, but it is possible for other parties to make submissions to this Tribunal. It is very late to intervene, but there may be methods in which the points could be addressed.

In any event, the primary guardian of all these interests is Ofcom. Ofcom has a submission of all of the parties here and is very well placed to address the points that H3G makes in the

public interest. If Ofcom, in its expert role, has good arguments for saying that H3G's proposals do not work, or are superficially attractive, but will prejudice parties not represented, Ofcom will do so before the Competition Commission, and it maybe that Ofcom will succeed on that point. But Ofcom is well placed to take that expert view in the interests of all parties affected; it is not ideal, so I take the point but it is a route whereby this potential prejudice could be avoided, and Ofcom, because of the extensive consultations to which you have been taken, is well placed to decide what is or is not in the wider public interest in relation to this proposal of H3G.

As I say, the point is made to me, that it may go to the relief that this Tribunal takes in remitting matters to Ofcom. It may be that this particular narrow issue will need to be looked at separately by Ofcom in a wider way. The points raised may be addressed through the relief this Tribunal gives if we are ultimately successful.

Turning to Ofcom's submissions themselves – I can do it relatively quickly because I have already taken the Tribunal to the notice of appeal and defence in detail. It would be useful if the Tribunal could take up the skeleton argument which Ofcom produced for the purpose of this hearing, to which you were taken earlier today. If the Tribunal could turn to para.7 on p.2, where Ofcom summarise H3G's case as pleaded. They first refer to H3G's differing approaches to the regulation of M2M and F2M. I have explained to the Tribunal why that was and how H3G has sought to reconcile it.

At para. 9 Ofcom argue that H3G has sought to justify NPZ on the basis of a very narrow set of arguments based almost exclusively on aspects of H3G's own situation. The reference to "almost" is my learned friends very fairly conceding that there are broader points that we make, and which we supplement.

I pause there to say the Tribunal gave us permission to put in further supplemental material with the very clear qualification that no new issues would be raised, no new grounds of appeal would be raised. To the extent that we were to put in further submissions, clearly we were not going to duplicate exactly what we had put in before. We were permitted by the Tribunal to expand our existing arguments, and that would include in my submission producing further particulars of an existing argument to support an existing ground of appeal in our pleaded case. If we could not do that it would beg the question what was the purpose, what would be the use of having any supplementary materials if we could not produce further particulars in support of our existing grounds. What we were not allowed to do was produce a completely new issue, or a completely new ground of appeal. That we acknowledge, and that is why my submission in the first instance is that we do not need

permission to amend, these are simply supporting our existing case. I will come to the application to amend at the end of my submissions because I will have already explained why we should come under 11(1) rather than 11(3), but I will come to that when I come to the end of Ofcom's submissions on the substance.

THE CHAIRMAN: As far as the F2M position is concerned, you say well what we have always pleaded is that this should be based on an appropriate costs' methodology and I think you accept – though tell me if you do not – that there was nothing in the price control appendix that indicated that what you were going to argue was an appropriate costs' methodology was something which is quite substantially far away from the cost methodology that Ofcom based its decision in the MCT statement on. There was nothing there to say that you were approving of that for fixed-to-mobile, but there was nothing to say that you were going to be putting forward something very different from that. But your case is still: "nonetheless we are entitled to flesh out what we meant by appropriate methodology and the fact that it is rather more different than what people might have been expecting does not mean that it was not covered by the pleading in the first place" – is that what you say?

MR. KENNELLY: Subject to two qualifications. First, we would submit that part of our case on marginal costs, for example, is based on the Ofcom/MCT statement. Ofcom themselves say in the MCT statement that for efficiency one looks to marginal costs. That is stated expressly in I think it is A.17 of the MCT statement – perhaps it is better to go to it so the Tribunal has it now. It is in bundle B and the MCT statement is behind tab 1, and it is appendix A17. Annex 17 is at p.371 (in the internal numbering). It deals with "Common Costs and Ramsey prices. A.17.8 over the page Ofcom state that:

"Economic theory suggests that, in general, static efficiency is maximised when prices are set equal to marginal costs."

I do not seek to say that that is in any way flagging H3G's argument.

> "However, in the presence of fixed and common costs of production, firms can break even only by setting prices that are higher than marginal costs. Ramsey prices are defined as those prices that maximise static efficiency under the constraint that firms recover all costs of production."

Just to complete the picture – to the extent that it can be completed by reading this single annex – at A17.15, and this is just to demonstrate another part of Ofcom's analysis:

> "Ofcom considers that the use of Ramsey pricing to set regulated charges is not appropriate for the following reasons:

* In order to estimate the level of welfare-optimal termination charges, it is necessary to account not only for the impact that prices have on demand, as in a basic Ramsey model, but also for a variety of other important factors such as externalities, imperfect competition and price discrimination …"

That deals with the second part of 17.8. We are not suggesting that Ofcom decided to follow marginal costs. Ofcom for its own reasons wanted to take account of and include a number of factors which H3G submits it ought not to have done, and the true cost figure should have been much lower. But Ofcom's starting point was, as I say, beginning at 17.8 marginal cost is the appropriate place to start. The difference between H3G and Ofcom is that H3G stays there and Ofcom moves on and includes a whole range of other factors which lead to a higher cost.

THE CHAIRMAN: Such as spectrum costs and CARS costs which you are now saying with regard to fixed-to-mobile should not be included in the costs' base?

MR. KENNELLY: Nor mobile-to-mobile. We are arguing for a much lower cost.

THE CHAIRMAN: Sorry, for fixed-to-mobile?

MR. KENNELLY: And for fixed to mobile, yes. That is an argument that we will make before the Competition Commission and we will see how we get on, but the point is that is it appropriate for us to be blocked from making that argument before the Competition Commission when Ofcom itself acknowledges that the starting point is marginal cost.

MR. SCOTT: Meantime your shareholders, because you have mentioned the small problem of being profitable, will be hoping that you recover your fixed and common costs from somewhere?

MR. KENNELLY: Indeed, because that, with respect, sir, is our problem, and the interests of consumers is quite a separate concern.

Turning to the Ofcom submissions, I was at the stage where Ofcom had gone on to describing at para.11 of their submissions the fact that H3G is expressly contending for higher MCT rates for it, higher than those set by Ofcom – that is the alternative case which I have taken you to at s.6 of the price control appendix.

Moving on to para.16 of Ofcom's skeleton.

MR. SCOTT: Sorry, just to go back to that for a moment, I realise that you are stressing the consumer benefit, but in the past one of the things that you have stressed is that the Tribunal, and presumably the Competition Commission should have regard to the need to encourage investment and innovation, and whereas it is arguable whether you are a new

entrant or an established player now, Ofcom will have to have regard to future auctions, and future potential new entrants, and to the signals that may be sent by whatever emerges from this process to those who may in future be thinking of investing in a licence, and in a network.

MR. KENNELLY: Indeed, and the pricings which follow from NPZ are squarely in issue. H3G has sought to address them, and Ofcom has sought to rebut them in its defence. Ofcom deals expressly with profit signals in the NPZ sense, and the distorted effects that may arise from them. That will be a debate before the CC, and with respect, that is a debate that is going to happen in any event. I come, in examining Ofcom's arguments, to draw the Tribunal's attention to the risk and a concern of ours that Ofcom's case to exclude the supplementary submissions looks very worryingly like a case to exclude NPZ. NPZ is before the CC we have permission to debate it. Many of the points that Ofcom raises against us for these submissions are points that are against NPZ as a whole, and not against any new case that we are accused of having raised.

Just returning quickly, because I am aware of the time, and I always get the graveyard slot in this Tribunal, it is a hard day and ----

THE CHAIRMAN: Oh we are wide awake, Mr. Kennelly, do not worry about that! (Laughter)

MR. KENNELLY: I am sure you would not like to be hearing me at 5 o'clock, I want to finish on time. Paragraph 13 of Ofcom's skeleton deals with H3G's case in the supplementary submissions, and it is plain from para.14 and the submission of Mr. Holmes that all that has really changed in Ofcom's submission is H3G's case on fixed to mobile. In my submission there is no basis for Ofcom's case or Ofcom's submission that H3G has abandoned NPZ or is asking for a mandated RPP. NPZ or bill and keep is squarely before the Tribunal and before the Competition Commission. What Ofcom's submissions boil down to is their objection to H3G's case on fixed to mobile rates.

THE CHAIRMAN: But according to what you were saying before, this whole submission then is a misunderstanding of your case, because you are not extending NPZ to fixed-to-mobile, you are just adopting appropriate methodology for assessing the costs of terminating fixed-to-mobile calls which comes to something like 0.4p but might be slightly higher.

MR. KENNELLY: Madam, that is precisely the point. It is based on a misunderstanding of our case, and we see that from the fact that it can be addressed, and to some extent has been addressed in Ofcom's own defence. There was a contradiction between the way they have addressed it in defence, and the submissions that you see before you today.

Turning through that to this point about RPP, because I want to put that to bed, because that would be a very radical change if we were asking for mandated RPP; that is not what we are asking for. If the Tribunal could take the time to look at Dr. Littlechild's statement, and indeed the paragraph referred to at the end of H3G's supplementary submission. In fact, if you could go to that, it is in the supplementary submission bundle. The submission is the first document in that bundle, and at p.15, para.4.5 there is the reference to Dr. Littlechild's statement.

THE CHAIRMAN: What are you looking at now, Mr. Kennelly?

MR. KENNELLY: Paragraph 4.5, the very last paragraph of H3G's supplementary submission on 7th March 2008, p.50.

MR. SCOTT: Where is that?

MR. KENNELLY: It should be in this supplementary submission bundle which contains the supplementary submissions.

THE CHAIRMAN: Yes, which paragraph?

MR. KENNELLY: Paragraph 4.5. I take the Tribunal to this first because it was the one that was referred to by Ofcom.

THE CHAIRMAN: Oh yes. It is a quote from Dr. Littlechild.

MR. KENNELLY: It is a quote from Dr. Littlechild, and Ofcom, at para.16(c), say that Dr. Littlechild is extolling the virtues of RPP and that this is the basis for their case, that what we are seeking is for the Tribunal to order or require them to mandate RPP. What Dr. Littlechild said is that NPZ has essentially all the beneficial consequences of RPP but offers the prospect of avoiding the downside. For the avoidance of doubt, at the beginning of our submission, note the footnote at p.2 – if you could turn back to p.2 of the same document and I would be grateful of the Tribunal could themselves just read the note – I shall not read it out loud – it clarifies for the avoidance of any doubt that H3G is not seeking a mandated RPP.

THE CHAIRMAN: (After a pause) Yes.

MR. KENNELLY: I hope that is clear. But then turning back to Ofcom's skeleton argument (p.7), Ofcom took you to the various consultations where bill and keep was raised, and we submit squarely that whatever Ofcom was proposing there is no doubt that H3G could have raised the argument – at least in outline – that it is raising now, in relation to appropriate cost methodology and bill and keep. There is no suggestion by us that somehow one can find lingering in the consultation little gems on which we can build our case. We face squarely the point made against us that we did not raise this in the consultation. I

understand Ofcom's frustration that having raised the issue we did not address it, and then having done the work later we did address it. But as the Tribunal knows that does not preclude us from making the point in the notice of appeal. If that were the case we could not raise NPZ at all, and while therefore I have some sympathy for Ofcom's submission it is not an objection in principle to H3G making its NPZ arguments before the Competition Commission, because all of Ofcom's objections apply to our NPZ case, and they were points which may be made before the Competition Commission again to attack the merits of our underlying case, but that is not an argument to exclude us entirely from the just ... in relation to these points.

Then turning to Ofcom's objections and the work they say they will have to do if the supplementary submissions are admitted. That is at p.8 of Ofcom's skeleton, and it is to Ofcom that we address these submissions. The other MNOs – we have not heard from all of them – T-Mobile spoke for nearly an hour about the various points and mentioned two or three times the very great work that had to be done to address these various points. No particulars were given to the Tribunal, no details were given, and the Tribunal should be careful to treat with caution very exaggerated submissions about enormous amounts of work that have to be done to address these points bearing in mind that the consequences of H3G's case – if successful – may well mean far lower revenues, certainly termination revenues, for the large incumbent MNOs.

Ofcom turned to the work that they will have to do if we are successful and various jobs are set out at p.9 of the skeleton. In my submission when one looks at these points one sees that this is the work that Ofcom should be doing in relation to NPZ. These are the jobs that if Ofcom has not already done they may well have to do them for the purposes of our NPZ case. But, as I have already demonstrated before the Tribunal, in Ofcom's defence they have already addressed many of these points where they have sought to address the bones of the NPZ case already. If one looks at the various points that Ofcom say are linked exclusively to the new points, which they say bear no resemblance to the old NPZ case, first they say determine the consequences of a move to zero MCT for retail pricing structures. Putting to one side the mandated retail RPP point, which we do not raise, that could equally be said to be necessary in relation to NPZ. Similarly, examining the likely consumer reactions to changed pricing structures. Again, that applies equally to the case of NPZ which is before the Competition Commission.

Examining economic justifications for efficiency bill and keep as against the current cost base regime, Ofcom will be arguing before the Competition Commission that bill and keep,

or NPZ, is less efficient than the current costs' regime; that is not new. A detailed consideration of international comparators to determine the appropriateness of comparisons and indications as to the merits and demerits of the respective regulatory approaches: Ofcom say because H3G's case is so narrow, and potentially so weak, it is not necessary to do this very difficult work, but we will have to do it if these new points are admitted. But equally, it could be said that those international comparisons will have to be made in any event. H3G certainly will be arguing before the Competition Commission that it is important to look beyond the UK in support of its NPZ argument, and Ofcom will have to address those points.

Then identification and quantification of potential disruption resulting from a shift to zero MCT rates, existing contractual arrangements, etc., again, Ofcom in relation to NPZ will be identifying and quantifying if it chooses to, but certainly it will be arguing that NPZ will be disruptive and harmful to consumers; they make that point in the defence. That is not a radically new case that Ofcom will have to develop with evidence.

Then implementation questions about how to minimise such disruption, again that applies equally to the existing NPZ case which is before the Competition Commission. True it is that Ofcom may have decided not to do that work, and may feel that if this supplementary material is adduced they will have to do it, but that is choice for Ofcom. Certainly, as a matter of principle, it could be said that all of this work would have to be done to deal with the existing NPZ case, which is before the Competition Commission in any event.

To the extent that the supplementary submissions simply develop our existing NPZ case, all of Ofcom's arguments which they make in their defence apply equally to the new case. If it is new, Ofcom's arguments address it.

I have taken you to the defence, which sets out Ofcom's opposition to the points which we now seek raise, which we say we are developing – Ofcom say we are raising for the first time.

THE CHAIRMAN: I can see that point if your case was now: "Well it for mobile-to-mobile it should be either zero of 0.4, but as far as fixed-to-mobile is concerned we are content with the rates that were fixed in the MCT statement. If that were your case then I can see that you could say: "Why does 0.4 instead of 0 make a difference?" But what seems to make the difference is the idea of the substantial reduction in the fixed-to-mobile rate, whether you arrive at that by saying: "Well actually this new way of putting the NPZ argument encompasses fixed to mobile as well as mobile-to-mobile, so we get to 0.4 by that route, which it seems to me is what some of the parties thought you were saying; or, whether you

are saying: "No, we do not get to it by that route, we get to it by fleshing out our appropriate costs' methodology pleading and saying that actually the appropriate cost methodology is a marginal cost and that then brings us down to 0.6p and well, you might as well say it is 0.4p and then you get over the arbitrage problems. It seems to me it is that second step that is causing the contention.

MR. KENNELLY: Indeed, and it is that second step that Ofcom say they could not have seen, or could not have anticipated previously, and that involves further work. We say that we flagged that we would be challenging the cost methodology and that would lead to lower fixed-to-mobile rates. So we say Ofcom ought to have been allowed the risk that was coming, that we had not accepted their cost methodology and what we were going to oppose was going to lead to lower rates.

Dealing with the detail though, it may be inevitable that that analysis of the effect of lower fixed-to-mobile rates will take place in any event, because if we are right about NPZ, if NPZ is the best solution – let us assume that we are completely correct, and the Competition Commission adopts that in total, it may be necessary to adduce fixed-to-mobile rates in any event to avoid this arbitrage problem.

It may have been an implementation issue, but if NPZ is very clearly the right solution, if the Competition Commission finds that without doubt this is key, it may be necessary in any event, in order to avoid arbitrage, to seek to reduce fixed-to-mobile rates as an implementation issue among other things.

That is one argument, but that cannot of itself be determinative of fixed-to-mobile ----

MR. SCOTT: Just pause there and let us understand what we mean by NPZ in this particular context?

MR. KENNELLY: Yes.

MR. SCOTT: Because when you talk about NPZ in this particular context, are you meaning that there will be no net payments between any MNO?

MR. KENNELLY: Yes.

MR. SCOTT: So it is not just between H3G and any MNO, but no net payment between any MNO and any other MNO. So if we look at the matrix every space on the matrix says zero.

MR. KENNELLY: Yes, or as close to zero as makes no difference, yes, that is correct, sir.

If we were running that case for the first time again, I could see Ofcom saying that is going to require a lot of work, but that is not being run for the first time, that we ran from the beginning. Unpalatable thought it may be for Ofcom to have to do this further work,

justice and convenience are very often not on speaking terms. This maybe something that they have to do and if it is in the best interests of consumers, and it is necessary among other things, to secure he best possible solution – which could be NPZ, then they will have to do that work.

Of course, before the Competition Commission the extent to which that work will need to be done is a matter for the Competition Commission. The Competition Commission has jurisdiction to say we are going to limit the ability of the parties to examine this issue. H3G expect various things to be done while the Competition Commission will say we will set deadlines, we will give people limited windows in which to make the points. There was an element of control which could avoid the timetable spiralling out of control and one must not forget that the Competition Commission itself is able to control its process.

What we are talking about here is blocking H3G from even making the submission, and that, in our submission, is not correct and is contrary to the notice of appeal itself, the point is made, and the simple inconvenience of having to look at this further issue of fixed-to-mobile should not be enough to block H3G from developing the point which is in its notice of appeal in any event.

PROFESSOR BAIN: Mr. Kennelly, you seem to be saying now that determining what the cost for F2M should be by an appropriate methodology falls within what you were saying before. If I can take you to p.2 of the Ofcom note, at (b) here they suggested that in your appeal the contention was that the rate should be set by reference to long run average costs, and on the basis of asymmetric regulation, including actual market circumstances and in particular CARS costs, and these were rather important matters.

I thought I recognised that when it was put to us this morning. I find it very difficult to see what you are now saying about an appropriate cost methodology bears any relation to that particular cost methodology. Can you explain to me how it does?

MR. KENNELLY: Well that was the very first point, sir, that I made, which is that there is an alternative case. The case we made about asymmetric termination rates, and various reasons why H3G ought to get higher rates, based on the cost model we developed, that is all in the alternative.

THE CHAIRMAN: But that is just mobile-to-mobile.

PROFESSOR BAIN: That is mobile-to-mobile.

MR. KENNELLY: Yes, indeed. It is not, with respect, necessary, for our case on fixed-to-mobile fixed methodology to be exactly the same as the one that we ran for mobile-to-mobile LRIC.

THE CHAIRMAN: I see, so insofar as people read across from what you were saying in your alternative case about mobile-to-mobile if NPZ was rejected, insofar as people thought that that then might say something about what the appropriate methodology for fixed to mobile charges would be, that that was a mistaken assumption that one could read across from what you were saying in that part of your case on mobile to mobile, into what you were going to be saying about fixed-to-mobile?

MR. KENNELLY: Yes.

PROFESSOR BAIN: So why is the appropriate methodology for estimating costs so different in these two cases?

MR. KENNELLY: Sir, one may well say when one has two alternative approaches that are, I would say, not diametrically opposed here, because you recall, sir, that when we looked at LRAC we assumed on the basis of Ofcom's assumption that the fixed and common costs were negligible, and so we thought adopting what Ofcom had done at that stage, subject to our difficulties with their adjustments, was appropriate.

THE CHAIRMAN: The point that Professor Bain makes is right. So what happens then – suppose the Competition Commission say: "No, we do not agree with this NPZ, or this 0.4 case." We then move for your mobile-to-mobile case we are going to focus on what you say that you should have said – 5p more for CARS, and the depreciation methodology was wrong, and therefore we are going to tinker with the M2M costs on the basis of your alternative case in relation to M2M costs.

Now, where does that leave your case on fixed-to-mobile? Do you still, in those circumstances say, that the appropriate methodology for determining fixed-to-mobile charges is the marginal cost of about 0.6p. Or do you then go back for fixed-to-mobile, to what?

MR. KENNELLY: We go back to fully allocated costs of fixed-to-mobile. I am afraid, madam, we go back to the original view, to Ofcom's view. The Tribunal smiles, but the Tribunal sees that there is a conflict between the two approaches, but again, this is an important point, the Tribunal knows very well that we are entitled to run cases that may on their face be contradictory for very good commercial reasons; we may decide to give something up for a bigger price. We are allowed to run different economic cases as alternatives. If we ran them at the same time there would be an inconsistency and we could be criticised for that, but there is nothing to stop us from ----

THE CHAIRMAN: Well I can see that you can say: "Well it should not be a cost-based race at all, it should be zero or 0.4, it should not be a cost based rate – either fixed-to-mobile, or

mobile-to-mobile, then I can see. But if you say: "But in the alternative, if you disagree with that and you think it should be a cost base rate, then these are the costs that you should take into account, but I cannot see how you can argue in the alternative that the appropriate cost base for fixed-to-mobile, is a marginal cost basis but the appropriate cost base for mobile-to-mobile is fully allocated on costs.

MR. KENNELLY: No, no, madam, that is a misunderstanding of our case. That is not what we say. We say that NPZ for the purpose of mobile-to-mobile, and the very low marginal costs for fixed to mobile.

If we lose on NPZ, then we revert to our original case on fixed-to- mobile, and we say that it should take into account the costs that Ofcom has suggested – of course, and for mobile to mobile, if we lose on NPZ then we are back to our greater asymmetry.

THE CHAIRMAN: Yes, that is clear, thank you.

MR. KENNELLY: I fear that the Tribunal members may find there is a certain intellectual dishonesty in running those two points, but it is important the Tribunal recognises that we are entitled to trade off certain things in order to choose the case that we plead.

THE CHAIRMAN: Oh no, we are fully able to deal with arguments put in the alternative, Mr. Kennelly, we just want to work out what the alternatives are and how the structure of our case fits together. It is absolutely right that you can argue, well (a), but if not (a) then (b), and if (b) is inconsistent with (a) then that is absolutely normal in terms of litigation ----

MR. KENNELLY: There is nothing new in that.

THE CHAIRMAN: -- there is nothing new in that.

MR. KENNELLY: And also in our notice of appeal there is nothing new. That is how we have run the case from the very beginning.

MR. SCOTT: We also recognise that there are a variety of ways of looking at costs. We were a bit concerned when Miss McKnight referred to "true" cost because what we recognise is – two economists, three views of costs ----

MR. KENNELLY: At least.

MR. SCOTT: -- that you have a multiplicity of view and that what you have to do is to decide what is appropriate in what circumstances.

MR. KENNELLY: Indeed, and no doubt Ofcom will address this point in the Competition Commission, and will have the opportunity to attack our cost methodology in the Competition Commission, and they are well placed to do that. Ofcom did a great deal of work in relation to marginal costs for the purpose of the MCT statement. Ofcom is well placed to attack our costs methodology before the Competition Commission – Ofcom have

done that work in relation to the appropriateness of marginal costs and we saw some of that in the MCT statement itself.

THE CHAIRMAN: Yes, thank you.

MR. KENNELLY: Dealing briefly with the question of amendment; I shall not take the Tribunal to the authorities, we are well experienced now in the principles governing rule 11(1) and 11(3). For the reasons I have given, in our submission there is no need for an amendment at all. The notice of appeal is sufficiently broad to deal with this. I take the Tribunal's point well in mind in the BT Ruling that one cannot rely on generally drafted paragraphs in a large notice of appeal document to support brand new points. But I took the Tribunal very carefully through the bundles in order to demonstrate that these arguments we make in supplementary submissions are not new, and simply develop the points made in any event. To the extent that permission is required we ask it under 11(1). If the Tribunal is against us in 11(1), we say that it is appropriate under 11(3) to give us permission to make these amendments for two reasons. First, in the public interest, as we say, it is important that these matters be brought before the Competition Commission in full so the Competition Commission can give the Tribunal the robust answer that the Tribunal requires and come to the correct figure.

Secondly, some of the materials could not physically have been produced by H3G at a time that we drafted the notice of appeal, or indeed when the Tribunal gave us time to produce the further supplementary materials, referring in that regard to the WIK Report, and to the final version of the ERG paper.

THE CHAIRMAN: Just going through the list of materials that you outlined at the very beginning of your submissions and just to check which of those documents, and which of the witness statements stand and fall with which parts of the pleading which are in contention. Taking the 0.4 gloss on the NPZ ----

MR. KENNELLY: Madam, the only sensible way of doing this is by doing it through the table. This is a very laborious task. H3G has produced a 40 page table setting out all of the objections of the MNOs and Ofcom, and I pity the poor person who had to do it, setting all the reasons for the objections and H3G's response by reference to the pleading. That document was served on the Tribunal – I really do hope you have that; that is a critical document. It is not possible, in my submission, for me to take you through the 40 pages today. If the Tribunal wishes to sit for a further day then I am happy to do that, but that is something I think the Tribunal will have to go through themselves and see it. I only have

time to deal with the broad objections that are raised against us by Ofcom, and by the MNOs.

THE CHAIRMAN: Yes, fair enough, Mr. Kennelly.

MR. SCOTT: We are grateful to everybody who has, not at our request, produced the tables, and to those who have consolidated them. Having spent some time trying to go through it all, you are right, because you are trying to hold together the general principles, and the minutiae and that is not easy.

MR. KENNELLY: It is not easy but very important.

MR. SCOTT: I understand.

MR. KENNELLY: The risk in this case – as one often finds in these proceedings – when Ofcom and the MNOs are against H3G there is a great deal of mud being thrown, and I do not use that word pejoratively, it is a figure of speech to describe their opposition, it is difficult sometimes to focus on the detail. The detail is critical because it is too easy simply to dismiss it all as another attempt to raise something new. The table demonstrates that if one goes through it slowly and carefully one gets there in the end and sees how all of the points tie in to the existing notice of appeal, or are otherwise permissibly raised – much indeed as BT came to the same view in their own letter on the new material. Madam, if you will permit me, I shall not take you to the table, but simply commend it to you. I am sure if the Tribunal has questions arising out of it the parties could deal with it in writing, and maybe scope for a further round of written submissions dealing with the points arising out of the tables themselves; it is simply not possible for all of us to deal with all of the items in the table.

Drawing the Tribunal's attention though to the documents themselves because, madam, you did raise the point: what is actually sought to be adduced? As I said at the beginning there are three sets of documents, the first are the supplementary submissions dated 7th March; the second 14th March letter, which contained the WIK Report, which is the report prepared for the European Commission, and the ERG final common position paper.

Finally, the Morgan Stanley Report which is adduced really to demonstrate to the Tribunal that matters are afoot, the European Commission is clearly planning something and the Competition Commission needs to have that in mind otherwise it will potentially produce a ruling on a false basis. It goes no further than that; there is no trick or trap, it is something that is happening in the public domain, and the Competition Commission needs to see what is going on.

Turning to the supplementary submissions themselves, and as I said I do not propose to go through each and every item, but my learned friend, Mr. Holmes, took you to one point in relation to on-net/off-net. I have to deal with this because all of the parties have laboured it in their submissions.

Before I take you to the point itself, the Tribunal will recall that we are forbidden from mentioning the words "on-net/off-net" – one certainly gets the impression that it is some terrible taboo and heresy. The Tribunal said expressly at para.30(e) of the Ruling on this issue that to the extent that we referred to it already in our notice of appeal in relation to market share clearly that puts in issue the existence of on-net/off-net. We say its existence is in issue, the extent of it is in issue. The further consequences relating to traffic and balance are off the table and that is crystal clear. I hear what my friends say that sometimes when we refer to it there may be some room for misunderstanding, well for the avoidance of doubt there is no attempt – and there will be no attempt – by H3G to rely on on-net/off-net for the purposes of showing traffic imbalance. That was clearly ruled on by the Tribunal.

THE CHAIRMAN: By saying that in relation to traffic imbalance, what we ruled – from what I recall – is that insofar as you are relying, not only on the existence of a differential in fact in the pricing of the tariffs of the 2G/3G MNOs, but that you are also mounting an argument which depends on consumers being aware of that differentiation and possibly that influencing their choice of network, that is the fact which led us to conclude that in order to make good or refute that substantial survey evidence, etc. of consumer knowledge and preferences would need to be undertaken, and it is that which we ordered should not form part of the case. If by referring to traffic imbalance you are using that as a shorthand term for that issue then we are in agreement, I think.

MR. KENNELLY: Madam, yes. What I wanted to make clear was the existence of on-net/off-net and the fact that it does produce effects. I will take instruction on the point that you raise, madam, because that could be a very important point about how the Competition Commission is run – I was not at the last Competition Commission hearing so I will check to ensure that what I am saying is correct. My starting point is simply limited to the existence of on-net/off-net pricing differentials, because that input in our welfare model we submit ignores reality, to ignore the existence of on-net/off-net pricing differentials. It has been recognised by Ofcom in the Communications' Report 2007 – I will take you to – that the existence of it is recognised. Vodafone themselves have referred to it in their own

internal and external work, and it is referred to by the parties, so we can use that as an input in our own welfare model – the existence is an input we can use.

MR. SCOTT: If one goes way back now to the days when there was a Mr. Barling in the case, one of the points which BT withdrew was the issue of self-supply which is being treated differently in the case of fixed networks to the way it is being treated in relation to mobile networks. So we are conscious that that was flagged up right at the beginning but then went away again. I suppose the difficulty is that this is one of those instances where there is an important point which might be considered in some future consultation, but where it is an example of where we are going to be self-disciplined in these proceedings, both here and in the Competition Commission, in terms of keeping some boundaries on the considerations in which the Competition Commission need to engage.

MR. KENNELLY: Absolutely, sir. I think the important point we make is that in drawing the line between our permissible references to on-net/off-net and our impermissible references to on-net/off-net, we would ask the Tribunal not to favour the approach of T-Mobile which is: "You cannot trust H3G, better go hard on them on on-net/off-net, block it entirely because you never know what arguments they will run in the Competition Commission", that precautionary approach that T-Mobile have canvassed today, we would say you can reject that approach, because on-net/off-net does exist; its name ought to be spoken – not in the way in which we have been forbidden from speaking, but in every other way; in every other permissible way to the extent that it exists and may influence the welfare analysis, it would be absurd to exclude its existence, to exclude it from a welfare model, and that is not what the Tribunal ruled when they prevented us from relying on on-net/off-net pricing differentials as a cause of the traffic imbalance.

PROFESSOR BAIN: I think, Mr. Kennelly, that when we made our ruling before, our concern was that in order to determine the practical importance of on-net/off-net in the particular circumstances of the UK, a lot of practical work would need to be done. We took the view that since this had not been raised specifically at the appeal initially, it was unreasonable to expect people to have to do that now. I notice that the ERG Paper that you took excerpts from in your submissions said exactly the same. They said that if you are going to look at this in practice, you have to look at A, B, C, D, E, F, the number of different items, all of which will need to be investigated in the practical situation before you can use it.

The conclusion I draw from that, subject to your persuading me otherwise, of course, is that as a theoretical proposition that on-net/off-net mixed can make a theoretical difference, I do not really think there is an issue. Where I think there is a problem is if you argue that

this is important in the UK in the current circumstances, because if you are going to demonstrate that, or you are going to have the opportunity to demonstrate that this may or may not be so, they have to do all this work, and it is the work that has been ruled out. So, so long as you confine it to pure theory I do not think I have the slightest problem, but as soon as you try to say: "This matters in the UK", I do; that is what I think we ruled out.

MR. KENNELLY: Indeed, I am very grateful for that intervention and I am sure my clients are formatting my response (laughter) because this is central to points we make in the Competition Commission, so it is important to get it clear now and then there is no ambiguity.

However, I do say this, sir, that we are entitled to say that it is important in the context of market share. We raised on-net/off-net as one of the causes of the market share problems that we set out in our notice of appeal. The Tribunal has not sought to limit our ability to argue about the significance of on-net/off-net in that context. That does not mean we can use it for all the other purposes, but I just want to qualify, if I may, sir, my agreement with your observation that we should be blocked from arguing it is important at all, but I completely take your point that outside the area of market share our ability to argue that the significance in practice in the UK of on-net/off-net is barred by the Tribunal's ruling. If the limitation on theory allows us to refer to the existence of on-net/off-net in our welfare model, and the theoretical implications in our welfare model, then again we would have no objection. Our submission is that, on the application of the other parties, we are being barred from using this as an input for our welfare model, which simply recognises that on-net/off-net exists, and its effects; it is an input which goes to the ultimate effects of NPZ. We seek to argue NPZ is effective, and recognising on-net/off-net is an important input in our welfare model. (After a pause) I should say this, in our submission no more practical work is necessary on that basis. In our submission, there is no need to do any further survey work, and to the extent that it is then we accept we are barred; we are barred from arguing something which requires that kind of survey work – that was the very reason the Tribunal gave.

There is a limit to how much clarity I can give because we will be arguing about our welfare model in the Competition Commission, but the Tribunal's ruling is crystal clear. We have it, the parties have it and the Competition Commission has it. We do not suggest today to go behind that in any way, and really it should be sufficient to have the Tribunal's ruling, which is clear, with all the parties and the Competition Commission, and H3G should be trusted, with respect, to respect that ruling before the Competition Commission.

If the parties think that we have gone further than is necessary then they can say so, but I would counsel caution because both Ofcom and T-Mobile said in terms that we were forbidden from making any reference to on-net/off-net and that is plainly not correct. Forgive me, Ofcom did not say that, T-Mobile did – it will be in the transcript – and we just want to make clear that there is some limited scope for referring to it.

THE CHAIRMAN: I think the position is that insofar as you mentioned it in your notice of appeal in relation to market shares then obviously you are allowed to refer to it. Insofar as you want to rely on it in relation to traffic imbalance, which was expressly the amendment that you sought to make and leave was refused then you cannot refer to it. Insofar as you are seeking to rely on it for some third reason, which is neither market share nor traffic imbalance, then you would have to apply for permission to amend your pleading to introduce it, and unless and until that permission was granted you cannot rely on it.

MR. KENNELLY: But if its existence is a matter of undisputed fact, surely it can be used as an input ----

THE CHAIRMAN: Yes, insofar ----

MISS McKNIGHT: We can explain why but we certainly do not admit that.

MR. KENNELLY: Well I said "if", madam. I am fully aware my friends dispute the existence of it, then we would say that we ought properly to be able to use it as an input as well – just the existence, not the implications or consequences of what it leads to.

THE CHAIRMAN: Well we must leave that to the Competition Commission.

MR. KENNELLY: Forgive me, I have gone over my time, but the Tribunal will appreciate why. BT's statement of intervention – again, there may be very little between ourselves and the points of principle that are raised. We cannot use the BT appeal to run arguments that we cannot properly run in our own appeal, that bear no resemblance to the BT appeal. We must stay within the four corners of the BT appeal. The Tribunal is well aware, having heard arguments about what the MNOs can do in our appeal; it is possible to disagree with both the appellant and the respondent, and seek the relief which is sought by neither the appellant nor the respondent provided we are addressing issues that are raised in the BT appeal.

My learned friends draw a distinction between the notice of appeal and the witness evidence put in by Professor Yarrow and Mr. Richardson. We say that is a false distinction. As the Tribunal is well aware the notice of appeal which goes before the Tribunal comprises both notice of appeal and the supporting evidence, that is the whole point of producing all of the documents at the very beginning of the process. The case has

to be seen as a whole. It maybe that the parties want to raise with BT the inadmissibility of parts of Professor Yarrow's evidence, or Mr. Richardson's, but the extent that those statements are live before the Tribunal in the BT appeal we ought to be able to address them in our own statement of intervention. It is our submission that we go no further than that.

We are entitled to say, as a starting point, that both Ofcom and BT have the wrong starting point. BT have, in Professor Yarrow's statement, put through a much more general challenge to Ofcom's approach than exists in the strict paragraphs referred to by Ofcom. We respond to that by saying the starting approach is wrong, and we say it should be this. We have rehearsed parts of our own appeal, we take the point that it may be completely unnecessary for us to rehearse our own appeal in the BT statement of intervention, and if the Tribunal feels that that is inappropriate, that is something I will not trouble you with. What we are allowed to do, within the BT appeal, is to raise the general challenge made by Professor Yarrow, raise our own point, which is that the starting point is wrong and that Ofcom have taken the wrong route. I should take you – because no one has – to the relevant passages in Professor Yarrow's and Mr. Richardson's statements. If the parties want to take an objection to those then that is a matter against BT and not for this Tribunal today.

Professor Yarrow's statement, and Mr. Richardson's statement should be in the second volume. (After a pause) If you would go to paragraph 6 b). This is the summary of Professor Yarrow's main conclusions. I should say I have not taken the Tribunal to the notice of appeal because the Tribunal has our detailed submissions in writing about the admissibility of our statement of intervention, and there is not time to take you to all of that. These are the important points to which you have not been taken. Professor Yarrow says: "Ofcom's general methodology is not consistent with the MF/MOC approach." Then he says:

> "The methodology appears to be unduly influenced by cost principles in traditional utility regulation, whereas the determination of Mobile Call Termination ("MCT") charge calls for something rather closer to a market assessment that focuses on effects (of alternative, possible determinations) on competition and consumers."

I do not need to repeat the broad nature of that submission made by Professor Yarrow in support of BT's appeal.

Turning to para.11 he raises the issues at stake. Again, typically the part of the witness evidence which would show the four corners of their appeal, the extent of the challenge. At para.11 Professor Yarrow says:

> "A first, critically important point to make here is that the issues at stake in relation to wholesale MCT charges are, for the most part, dissimilar to those traditionally facing a regulator when determining the retail prices that a regulated undertaking might be allowed to set in selling its products/services to its customers. Wholesale MCT charges are prices charged by an MNO to another operator, whether of a mobile or fixed network, for services that are upstream of those operators' interactions with retail customers. Retail mobile prices are not regulated ..."
>
> The revenue-recovery questions that figures so prominently in classic price control determinations – '*Will this set of price caps allow a reasonably efficient firm to recover its costs*? *Might investment be discourage if prices were set any lower*?' Wholesale mobile voice call termination charges should be set at zero, yet operators could still be able to recover their costs."

THE CHAIRMAN: "... could be set at zero" it says.

MR. KENNELLY: Oh indeed.

THE CHAIRMAN: No, but I think you said "should" when you read it out.

MR. KENNELLY: Forgive me, sorry. I would be surprised if I got away with that in this particular room – forgive the slip. But the Tribunal sees there that Professor Yarrow has put squarely in issue the point that H3G is addressing in its statement of intervention. Paragraph 13 deals with the role of LRIC and he says:

> "In the relevant market context, I cannot see any compelling reason for believing that Long Run Incremental Cost ("LRIC") estimates of the conventional kind will, by and of themselves, necessarily constitute appropriate benchmarks for regulated wholesale MCTs".

That is referring to the Ofcom version of LRIC which, as everyone has seen from our notice of appeal is, we say, the true LRIC because it includes FAC. That is the Ofcom case which Professor Yarrow is addressing. He says:

> "Thus, whereas the logic for the argument for LRIC pricing is that the termination of extra calls imposes incremental costs on a network operator, which it is appropriate to reflect in charges, the reality is that there are many more things going on in the relevant markets than are encompassed by the 'standard'

conceptual framework/model that underpins LRIC pricing. To give one example, termination of calls originating from another network can be expected to confer benefits, as well as costs, on the relevant network operator."

In para.15 he says:

"At first, sighting-shot estimate of what an efficient MCT charge might look like is, therefore, that it should be equal to the incremental cost imposed on the terminating MNO *less* any consequential incremental benefits to that MNO. This is a sighting-shot only, because the consequential incremental benefit will depend upon the relationship between the charges paid by a calling party and the costs of the call, and the charges paid by the calling party depend upon retail prices, which will depend in part on wholesale call termination charges. As always, therefore, there is a requirement to look at the market equilibrium as a whole."

Referring then to the summary and conclusions, para. 117(a) at p.28 of the statement, he says:

"In summary my main conclusions are as follows:

a) Ofcom's general methodology appears to rely, at least in part, on approaches that are more appropriate to the determination of *average* or *across the business* price levels of monopolistic utilities than to the determination of inter-operator charges in a context where charges for only one (of many) products is at issue and where, in particular, retail markets are competitive and not subject to price regulation."

In particular, in relation to the reference to zero it is incorrect to suggest that H3G's statement of intervention is entirely outside the issues at stake in the BT appeal. This is how Professor Yarrow sees them, perhaps that would be clarified by BT on an application by the other parties, but as it stands at the moment at least it is within the four corners of BT's appeal for H3G to raise the points it raises. As we saw from the previous time the scope of the interventions was canvassed, we are entitled to see the different relief from that sought by BT and opposed by Ofcom.

Turning to the second witness statement of Robert Richardson, which is over in the next tab, tab 4. He discusses how high MCT rates distort competition. This is illustrated by an example in relation to the pricing that on-net have their calls. If the Tribunal would turn to para.7 on p.3, and I would be grateful if the Tribunal could read paras. 7, 8 and 9.

THE CHAIRMAN: (After a pause) Yes.

MR. KENNELLY: I do not wish to go into further detail about the scope of the BT appeal. Those statements, in my submission, demonstrate the broad nature of BT's challenge and it is appropriate in the circumstances for H3G to raise its own statement of intervention and to say, by reference to its own case, what it believes a correct starting point should be and the ultimate solution.

THE CHAIRMAN: Do you rely on those paragraphs (7 to 9 of Mr. Richardson's witness statement), which refer to the cost of the tariff for on-net calls, and what that says about the MNO thinks are its network costs? Are you pointing us to those paragraphs in support of the points H3G wants to make about on-net/off-net pricing, or why are you drawing our attention to that?

MR. KENNELLY: Yes, we, in our submission, are entitled to refer to on-net/off-net to the extent that it is raised in the BT appeal. We are not allowed to run separate and unconnected on-net/off-net arguments in the BT appeal, but to the extent that BT is raising on-net/off-net arguments, we are entitled to address them in our intervention. But we are well aware, as I said at the very beginning, that we cannot run new a new on-net/off-net case. What we can do though is run something which addresses the issue. There is a fine balance to be drawn, we are not confined to adopting BT's argument, or adopting Ofcom's argument. We can offer our own view, but what we cannot do is seek to run our appeal through the BT appeal, outside the four corners of the BT appeal. The Tribunal should be astute not to prevent us – within the BT appeal – from arguing about on-net/off-net to the extent that it is raised in the BT appeal.

MR. SCOTT: So what you are saying is that what, for example, Mr. Richardson presents to us, is a factual analysis of how such calls are differentially priced?

MR. KENNELLY: Yes.

MR. SCOTT: He makes no inference as to the impact of that on traffic imbalance as I recall, and you are entitled to reiterate that before the Competition Commission, so that the Competition Commission have that in mind in a contextual sense.

MR. KENNELLY: Absolutely, except for this, that BT does raise the issue of distortions which it says will be eliminated if it is successful.

MR. SCOTT: That I understand because what this is doing is pointing out that there are distortions. This is not going on to draw inferences on inferences if you see what I mean.

MR. KENNELLY: Indeed, BT are saying there are distortions which include these, and they say at para.62.5 of their notice of appeal therefore there is a risk of anti-competitive behaviour by charging higher MCTs to some MNOs than others, and to fixed network operators,

again a general point about the distortions, which they say would be eliminated. We are entitled, in my submission, to intervene to say that we agree, and we agree by reference to the on-net/off-net distortion. We cannot then run an entire case about, for example, matters which do not go to BT's argument, or run a case about how it causes our traffic imbalance. What we can do is say that on-net/off-net leads to competitive distortions which would be eliminated if BT was successful, and that is raised properly in the four corners of BT's appeal, and of course BT's appeal would eliminate the price differential if we were successful.

So again, for the reasons I gave, this is within the four corners of BT's appeal. The issue may not be with us, but BT if the parties feel that this goes too far. But in our submission it does not go too far, the points are fairly raised by BT and our statement of intervention does no more than support them. Our error, if anything, was simply to use the language which came from our existing case, and perhaps that is what excited the opposition of the MNOs. But the substance does not stray outside the four corners of BT's appeal, and for those reasons it ought to be admitted.

Finally, turning to the WIK Report, and the RG report, I think I may, in view of the time, have to rely on the written submissions put forward, except to say this. The WIK Report needs to be seen in terms of its chronology. This is perhaps one of the more surprising submissions which is made against us, that it is too late to produce this document. This document, as you see from the chronology in our submissions was presented by the European Commission on 11th March 2008 and it deserves and rewards a close reading; it is directly on the points raised by H3G in the submissions before the Competition Commission, and it would be of very great assistance, in our submission. It could not have bee raised previously because it was presented by the Commission in March, and it is extraordinary, in my submission, for Ofcom in particular to suggest that it not be permitted to be shown to the Competition Commission. The Competition Commission is able to decide itself how much weight it places on it; the Competition Commission is acting in the public interest. This is a document not expressing the views of the Commission but presented by the Commission and is clearly of the greatest importance, particularly in the context when the Commission itself, as we all know, is preparing to produce guidance or recommendations on the very issue of lowering MCT rates, and this again is something which the Competition Commission ought properly to have before it. The risk of producing an incomplete answer, and one inconsistent with guidance from the European

Union, is great in circumstances where these materials are not allowed to be shown to the Competition Commission.

PROFESSOR BAIN: Just on that particular point, Mr. Kennelly, I feel I must put this to you, what you are proposing it seems to me really is a radically different system from the current one. The EU are thinking about moving towards it, that is what the WIK Report is saying, they are thinking about it – they may, they may not. You expect a report from the EU with a guidance or a recommendation or something of that sort, perhaps, August/September, around that time, maybe.

The normal process, as I understand it, is that if the EU come out with a guidance or a recommendation, that goes out to all the NRAs throughout Europe. This lands on their desks and they start thinking about it, and deciding: "What are we going to do about it?" So if such a recommendation comes out it is for Ofcom in the first instance to take a look at it and decide what action they wish to take, and receiving such guidance or recommendation they will almost certainly want to consult, and they will consult rather widely – the point that Mr. Scott was making earlier on – there will be a consultation process. At the end of all this they will decide what they want to do, and probably come out with some kind of decision. It is open at that point to all and sundry to appeal it if they wish. If they appeal it, it will be a price control matter, and it will go to the Competition Commission at that stage, but not before that stage.

In the meantime what we have here is an appeal against a decision that has been taken in the past on the basis of the guidance that was available at the time. It goes to the Competition Commission to look at that appeal, it is not a wide-ranging, open-ended investigation as we keep emphasising, it is on that particular appeal. Does it not seem a bit odd to ask them to get involved in what would be a wide-ranging investigation, this particular thing that the EU has not yet decided, at the same time as we know the EU is actually thinking about it; it just seems a little odd to go about that process – could you comment?

MR. KENNELLY: Sir, that point which you have made is one which, no doubt, Ofcom could make in the Competition Commission, but what is being proposed in this Tribunal is that the Competition Commission be prohibited from seeing a document which has been presented by the European Commission in public, which goes to the heart of H3G's case. I understand the Tribunal has been deluged with paper and you may not have had the opportunity to read the WIK Report, but I would be grateful before ruling on this issue if

the Tribunal could take the time to read it. The point will not be lost on you that it goes to the heart of H3G's case.

PROFESSOR BAIN: I was trying to make a slightly broader point, it was not about this particular document, but about the whole process of asking the Competition Commission to go through all the work that the EC at the moment are going through where they may or may not come to a conclusion of a particular kind and do it all simultaneously with what the EU are doing, coming up with a decision that may well be in advance of anything the EU come out with.

MR. KENNELLY: In general terms it would be very odd, sir, if the Competition Commission were not permitted to see a document which goes directly to the issues before it, produced by a consultancy instructed by the European Commission. It does not bind the Competition Commission, submissions can be made upon it. The Competition Commission may well say: "We will have regard to this, but we bear well in mind the fact that there will be consultation upon it and it may ultimately be rejected and Ofcom may adopt it in a different form." All these points can be borne well in mind. We bear well in mind ourselves, it does not bind anyone.

THE CHAIRMAN: The problem here though is that this is being introduced by you, a party to an adversarial process, in a course of proceedings which the other parties then feel it is incumbent upon them to make counter-arguments, which in relation to a document – whether this document or other documents – are bound to crop up between now and 31st October, where the Competition Commission perhaps in other proceedings it would be dealt with slightly differently. The Competition Commission would say it would know from its own researches that there has been this new development. It would decide whether it thinks it is relevant, if it thinks it is relevant it might say to the parties: "What do you think about this WIK document?" Then the process would be within the control of the Competition Commission and the parties would know that they are not being called upon to devote time and expense to commenting on a document which the Competition Commission may in fact not be interested in. Now, what concerns us is that if, during the course of the proceedings before the Competition Commission more documents are produced by economists, or are produced by other NRAs or the EC Commission, how can we limit the obligation that parties feel under to adduce these and comment on them at length in a way which may well not be helpful to the Competition Commission? Or would it be better for us to leave it to the Competition Commission to notify the parties: "This report has been produced, what do you think about it?"

MR. KENNELLY: I will make two points to that, madam, and then I will make a short point about the Competition Commission's own position. The first is a question of degree. Of course, every document that is produced between now and the end of the reference period cannot simply be brought forward, there is obviously a need to distinguish between those things which were very important – which need to be brought to the attention of the Competition Commission – and things which are less important, and we should not delay or hinder, or make more difficult or awkward their deliberations, so a line has to be drawn. We look at the WIK Report. It is necessary to determine how important and relevant it is, because if it is important, if it is highly relevant then there is a real risk the Competition Commission will make a determination in ignorance, that they will miss an important point; that they will not have the opportunity to judge themselves, a point of great importance which may be adopted by the Commission at a later stage. The fact that it is not immediately binding the Commission can be trusted to bear well in mind, but there is the risk, to which I draw the Tribunal's attention, of an incomplete or incorrect decision because an important point in this report, which is missed by the Competition Commission, and which we H3G would be forbidden from mentioning by reference to the WIK Report, and this is adversarial, as you say, madam, but this litigation is also in the public interest, it is producing, as I said at the very beginning, the right result for consumers. So the difficult job for the Tribunal is to decide: "Is this report so important and relevant that it ought properly to be shown to the Competition Commission?"

THE CHAIRMAN: But that would be better for the Competition Commission to make that decision, not for us to make that decision. So what I am struggling towards is some kind of procedure that we can set up, maybe by a direction, and Mr. Sharpe may well want to have a think about this, that you may adduce the WIK Report and the ERG Report, and then before all the other parties feel they have to pile in and produce expert witness statements and counter arguments and articles, whether there can be some indication first from the Competition Commission to say either "No, we do not want to hear any submissions on this", or "Yes, we think this chunk of this is important, and we would be glad to hear what other people have to say", or "Yes, we think this whole thing is a very important document, and we would be grateful to hear what people say" just to ensure that the Competition Commission is not overwhelmed with helpful suggestions put forward for reading material from the parties which then just generates a whole amount of potentially unnecessary work for the many different parties participating in these proceedings.

MR. KENNELLY: We would be content to have an opportunity to request before the Competition Commission permission to produce documents. It may well be useful to hear from the Competition Commission at this stage, if it is not too late, as to what their position would be. But if we had an opportunity to put written submissions before the Competition Commission, for example, asking them to tell us whether or not they want to read the WIK Report or the ERG Paper – that is a document Ofcom signed off on and if it is relevant it really ought to be before the Competition Commission also, but it is for the Competition Commission to decide and if we had opportunity to make written submissions to them we would be very grateful for that opportunity.

THE CHAIRMAN: Well we do not want then to get into a two-stage procedure where everybody has to make submissions on whether the Competition Commission should read it and then make submissions on the document itself, we are trying to shorten matters rather than increase them.

In view of the time, Mr. Kennelly, how much longer do you have on your submissions?

MR. KENNELLY: My last point was on the Morgan Stanley Paper, and I shall not take you to our explanation for why that is necessary, Professor Bain has already made the point. He referred to the fact that the European Union has been proposing radically reducing termination rates, Morgan Stanley have taken that on board, and it is really for the purpose of that, demonstrating that this is coming and the Competition Commission wants to be aware that it is there, and avoid the risk of an inconsistent or incorrect determination which would not be in the public interest. (After a pause) And of course they say the rates are too high, of course, that is exactly what it is saying, that is why we are relying on it. But to the extent that I have omitted anything from our written submissions, obviously I hope the Tribunal will have a chance to read through them, there is a great deal of material to cover and there is unfortunately no alternative to reading that 40 page schedule ----

THE CHAIRMAN: No, that is all right.

MR. KENNELLY: -- demonstrating how the case made in the supplementary submissions is within the four corners of our own appeal.

Unless I can be of any further assistance?

THE CHAIRMAN: We will rise now for 10 minutes, after which, Mr. Sharpe, I gather you want to address us briefly.

MR. HOLMES: Madam, I would ask, if necessary, to make responsive submissions.

THE CHAIRMAN: Well I realise that we have a number of people who came prepared to make submissions today who we have not yet heard and we are reluctant, for obvious reasons, to

go over to a second day, so can I just have an indication whether there are people in the room who have not yet said anything who have a burning desire to make a point which has not yet been made by anybody?

MISS BACON: For our part I think it is actually more important for Ofcom to have a proper right of reply. There are a number of points I would make but they would be mostly responsive to what Mr. Kennelly has just said, and it seems to me that would be better coming from Ofcom, because it developed its submissions fully in opening, so I was going to suggest that for 02's part at least we would be content to wait until after Mr. Holmes had developed his reply.

If the Tribunal then considers that it would still like to hear from people on this side, not of the room but of the case, then we would be happy to make such further submissions as we have, but let us put it like this, if the Tribunal were then to say it is not necessary for me to make my submissions then I would not wish to take further of your time unnecessarily.

MISS DEMETRIOU: We take the same view as that so I would also rather wait until Mr. Holmes develops his submissions in reply and if there is anything to add at that stage – which there may not be – then I could deal briefly with it then.

THE CHAIRMAN: Thank you, Miss Demetriou. Miss Lee?

MISS LEE: For our part, in relation to the comments in H3G's appeal, we have set out our position in our letter of 10th April. Some of the points there would echo the points Mr. Kennelly makes, with one or two other refinements, but I do not think I really need to address that. The one point that we do seek clarification on is whether it is a suitable cost-based approach or whether it is NPZ for fixed-to-mobile, because when you look at 7th March document it seemed rather different from the points that Mr. Kennelly was making today, because they seem to be saying you would extend NPZ to fixed-to-mobile, and that is what we had understood from that submission, so clarity in terms of what we have to plead to in the future – that was the only marker really I wanted to raise on that. We do have some brief submissions in relation to our appeal and the role of H3G's intervention which would like to make, orally probably.

MR. PICKFORD: Madam, could I just say that subject to what Ofcom says, we did have some very, very short responsive points but we may not have to make them at all because, of course, Ofcom may make them for us.

THE CHAIRMAN: Well perhaps you could use the next 10 minutes, Ofcom, to liaise with your confreres in the room to try and make sure that you cover in your reply the points that they want to make. So we will hear Mr. Sharpe briefly and then we will hear Mr. Holmes, and

then we will see where we are up to at that stage. So if we come back at 5 past 5, thank you.

(Short break)

THE CHAIRMAN: Yes, Mr. Kennelly?

MR. KENNELLY: Madam, I know that you were not expecting to see me, but I will be very brief. There was one point of clarification I wanted to make in relation to where Mr. Scott's questions were coming from, and it relates to the labelling for this word "NPZ", because in our supplementary submissions at p.2, we appear to be saying that NPZ is advocated as an appropriate remedy to address market distortions in the mobile sector including both mobile-to-mobile, and fixed-to-mobile, and that may have given rise to some confusion which Mr. Scott referred to. As I said earlier, the basis for a case on mobile-to-mobile and fixed-to-mobile is slightly different. The economic theory is slightly different, the calculations are slightly different, so it is not strictly correct to say NPZ can just be extended to fixed-to-mobile, and the reference for the economic methodology is in the main bundles before the Tribunal for the SMP appeal, it is bundle C1A, p.217 and it is the article of Mr. Harbord and Panozzi of 30th November 2007. They summarise there the calculation for fixed-to-mobile (p.13) and the calculation for mobile-to-mobile is at p.14. Those are the references for the Tribunal and I hope that provides clarification.

THE CHAIRMAN: Yes, but just to repeat a question which I think I asked you earlier, but just to be sure I know what your answer is, if you succeed on the NPZ ground, as regards mobile-to-mobile, then you say that fixed-to-mobile should be based on a cost methodology which results in the cost being about 0.6 to 0.8 ppm. If you do not succeed in relation to the mobile-to-mobile pricing, if you do not succeed on your NPZ, whether that is a zero or a 0.4 figure, then you go from your mobile-to-mobile to your alternative case which is that you should have had more CARS costs and there should have been a bigger differential and a different depreciation model, etc. You would then argue that the prices that you arrive at for mobile-to-mobile should also apply to fixed-to-mobile?

MR. KENNELLY: Yes, that is correct, and that is the point that I made earlier today. We revert to that position if we fail on our primary.

THE CHAIRMAN: So the fixed-to-mobile prices are always cost-related, it just depends on how you determine the costs, but the mobile-to-mobile are either cost-related in your alternative case, or are just reduced to zero, or a nominal amount if you succeed on your NPZ ground?

MR. KENNELLY: That is correct, subject to the point that we have cost arguments in favour of mobile-to-mobile as well. We argue for NPZ and mobile-to-mobile on the basis of costs' arguments as well as the competition arguments that we have pleaded.

THE CHAIRMAN: Yes, but it is not derived from costs, it is just supported by the fact that it is also close to being costs.

MR. KENNELLY: Yes, that is correct, but the analysis is in the article to which I referred the Tribunal and the reference you have.

THE CHAIRMAN: Well now I hope everyone is clear as to what the alternatives of your case are. Thank you. Mr. Sharpe?

MR. SHARPE: Madam Chairman, members of the Tribunal, I hope to be very brief. I shall begin by disappointing my learned friend, Mr. Pickford. It is not part of our presence here today to take sides between the various parties. Our position is one of studied neutrality. We are not here to attempt to influence you as to the terms of what it is that we should be determining. I will make no submissions on the merits or whatever.

We are not neutral, however, in seeking two objectives. One is clarity, and the other one is finality; at the last CMC I submitted that we needed both. For neutrality's sake clarification, expansion or indeed formal amendment of the H3G cases proceeds. It is very likely there will be new evidence, and appropriate orders made in respect of that new evidence. It is inevitable, in the face of that, that the Commission's timetable will be threatened. I lay a marker there, and I think it is a fairly obvious point, one that it would be useful to bear in mind. That is not a case for not permitting any application, it is a consequence of that action and I inform you to that effect.

In relation to clarity, in an ideal world what the Commission seeks as a result of this hearing today is essentially a piece of paper – or pieces of paper – which have within them either a ratification of the paper we have already received with no amendments or changes; or, clearly described deletions and/or amendments to the supplementary statement, to the witness statement. I think the model probably stands or falls in its entirety – that will be a matter for you to determine. But my submission here is this, anything less than total clarity in relation to a document would simply store up trouble and add to the Commission's uncertainty.

I am sure that the Tribunal is more than aware that perhaps the best way to proceed would be for the Tribunal to make a sufficiently detailed judgment so that the parties can, informed by the judgment, go forward and come back to you with an agreed document with any deletions that may or may not be appropriate. We would expect to see that, though we

probably will not want to make any comments, and we would respectfully submit that would be the way forward.

As far as finality is concerned, this goes back to the question of timing – the longer this process takes, the more in jeopardy the Commission's timetable will be, and you are very much aware that the plenary session we had anticipated to include H3G has had to be postponed – we are now five weeks into the Reference. It is at least likely that the Reference itself may be subject to amendment, quite apart from the possibility of new evidence. So you do not need me to emphasise the necessity for some degree of speed after which we may be in some considerable trouble in due course in relation to the timetable.

You made a point earlier about the plenary material and the read across, that seems entirely appropriate, if I may say so – anything else would be a sledge hammer to crack a nut – and if we go wrong I dare say others will remind us.

There was a point about evidence raised just before our short break. The Tribunal itself made an order in relation to evidence and documentation. I am referring to your order made on 25th February, which in relation to the appellants gave them until 5 o'clock on 7th March of this year to submit evidence. I am instructed that the WIK Report, and so on, was submitted somewhat after that – I think a week later. It is not a narrow procedural point, because the Commission really has to treat all parties equally. All parties had to observe that deadline and here we are faced with evidence which was later. You can, of course, make a supplementary order to that effect and allow them the ability to put it in with their evidence to the extent you regard it as going to an admissible issue, on which I make no comment.

The issue I want to emphasise is that the way the Commission is proceeding (and wishes to continue to proceed) is as follows: we do not want, we do not welcome or invite a ceaseless barrage of new paper at irregular intervals. The Commission is at the stage now when it has begun to isolate the issues which it thinks is important, and in due course will be contacting the parties for specific targeted pieces of evidence in relation to the issues which arise, and that is how we wish to proceed. That does not mean to say, and let me emphasise this, if something of importance or relevance does emerge, and the parties are terribly keen to let us know about it, we are not going to say: "Inadmissible, we do not want to know". What we would like to do is for them to make us aware of that evidence and we will consider whether we wish to seek it, and to use it. We think that is the appropriate way forward and respectfully we would wish you to endorse that.

There is one further point, which perhaps does not need emphasis, but when we go from today there will be, under any scenario, the opportunity for the parties to reply to each other's submissions. We would hope in your judgment that you would make it abundantly clear to all parties that they should not regard the reply as a suitable extra opportunity to develop the themes that they may have been prevented from developing today. There is just the possibility, I put it no higher than that, that the temptation may not be resisted. Madam Chairman, those are my submissions and unless I can help you on any specific matter.

THE CHAIRMAN: So as far as the WIK Report and the ERG Report, those are things which you think the best way to proceed in relation to those and anything like that that occurs in the future, namely published material which may be relevant to the deliberations, the best way to proceed would be for the parties to write to the Competition Commission and draw your attention to the existence of it in a neutral way, and then you look at it and decide whether you want to ask either them or anybody else to comment on it.

MR. SHARPE: That is the way forward and that is how the Commission wants to proceed. It also reflects the inquisitorial approach that now is very much with us at the Commission. The alternative and, as I said, the fear we have is an excessive use of the photocopier and a good deal of information which, frankly may not be relevant or important.

THE CHAIRMAN: Yes, Mr. Sharpe, we are a bit concerned about whether question 7 of the Reference is adequate, either on the case that was understood before the latest round of supplementary material, or certainly if the case which has been put forward today is allowed to proceed, in particular I think it refers to retaining fixed-to-mobile charges which might suggest that they would be the same, that if the NPZ for mobile-to-mobile was accepted, what would then be the price for fixed-to-mobile, whether it is assumed in the question wrongly that that should be the current rate set in MA3, or MA4 – whichever one it is.

MR. SHARPE: Certainly, if you are minded to accept the amendment application, which is in the alternative, we will, I think, require a careful look at question 7 and possibly others actually – I flagged that a moment ago. Certainly question 7 is absolutely clear and needs amendment.

In the absence of a formal amendment it is at least possible, the way in which H3G is now expressing its case – and I make this as a personal observation, I had not comprehended earlier when the Reference was drafted – if you are minded to accept that as an appropriate interpretation with its consequences for the admissibility of the supplementary matter, then

I think we are going to have to look at question 7. What I would submit is that if we are going to go down that road there should be an invitation to the parties to look at all the reference questions to see whether any of them require amendment in the light of the admissible, or to be admitted material, and not just focus only on question 7.

THE CHAIRMAN: Thank you. Mr. Holmes?

MR. HOLMES: Madam, thank you. I discussed during the short adjournment whether it was possible to run points on behalf of the interveners as well as Ofcom. I think there is a broad consensus as to the points that needed to be made, but some of the other parties may have additional points to make, and it probably would not be appropriate for Ofcom as the Regulator to speak on behalf of the interveners, so after I have concluded my closing submissions, they may have additional points to add – but I hope that is not the case, there did seem to be a broad consensus.

The first point relates to the suggestion that Ofcom has misunderstood the case as pleaded by H3G, and that NPZ is intended only now to refer to mobile-to-mobile rates in the supplemental submission. I am grateful to my learned friend, Mr. Kennelly, for pointing out what he described as a "mistake" in para.1.2(c)(i)(a) on p.2 of the supplemental submission. Madam, in our submission it would be wrong to characterise that as a mistake, because if one looks throughout the supplemental submission one finds NPZ described as a label for M2M and F2M rates, and if I could give you the references to that: one sees it at para.3.1 of the supplemental submission where it is stated that NPZ can take various forms. H3G proposes the prices for M2M and F2M calls should fall to the level of fixed call termination.

I would refer you then to Mr. Russell's statement, on p.8 under the heading H3G's proposed solution NPZ. He states in para.32:

> "One option for achieving NPZ is to reduce interconnection rates to zero whether just for calls originating on mobile networks, or for all calls."

And in Mr. Westby's statement at para.6 he states:

"Although 0 ppm MCT might be implemented quite easily if applied to all operators, both mobile and fixed line I conclude that there are a number of practical implementation considerations to be addressed.

Later in that paragraph he states:

> "As an alternative I was asked to examine a situation close to NPZ in which all MCT rates for all MNOs for calls originating on any network were fixed at the same uniform level."

So I think it is hard to describe Ofcom's reading of NPZ in the supplemental submission as any kind of ----

THE CHAIRMAN: Well now we know what their case is and the question we have to decide is whether they should be able to proceed with that.

MR. HOLMES: Madam, the second point I would make is that in relation to fixed to mobile it is simply not credible to suggest that the references to "appropriate cost methodology" and to "suitable cost based model" in the appendix are references to anything other than LRAC (Long Run Average Cost). I was left in some confusion as to what H3G's alternative case exactly was, but if one looks at their notice of appeal in bundle A, at para.3.2(c)(i), it emerges there quite clearly that the cost measures proposed for fixed-to-mobile MCT rates, the only cost measure proposed for fixed-to-mobile rates is Long Run Average Cost. Do you see that, madam, 3.2(c)(i):

> "The level of fixed-to-fixed mobile rates should be set by the Competition Commission so that the level of the MCT rate paid by fixed operators to all UK MNOs is based on Long Run Average Cost."

There is no alternative pleaded to that case, madam. We say that the cost measure was Long Run Average Cost. The attempt to hang a new marginal cost measure on para.4.7 of the appendix, and the reference there to suitable cost based model is simply unsustainable to rely on four words as allowing H3G at any subsequent stage of these proceedings to advance a wholly different cost model to that which was set out in their notice of appeal as amended we say does not wash.

Madam, it was also suggested that LRAC is somehow equated with marginal cost, and this seemed to be in reliance on a footnote to be found in the commentary to the appendix to H3G's amended notice of appeal (footnote 6, p.3 of the commentary to the appendix). Madam, you see there the statement: "Ofcom assumes that the level of network common costs are negligible, however, so this should not materially alter our conclusions." Well, madam, Ofcom nowhere in the statements suggests that common costs are negligible. It suggests that they may be difficult to measure, but it nowhere suggests they are negligible. We have never had any supporting indication as to why H3G reached the conclusion that common costs were negligible, and you saw from the passage which my learned friend, Mr. Kennelly, read from annex 17 of the MCT statement that Ofcom clearly regarded common costs as necessary and appropriate to be counted in determining the LRIC measures, as it was then called, the "FAC measure" as H3G now refers to it.

Madam, it is also quite clear from the submissions in the appendix, that H3G did not at that time consider that LRAC resulted in very low levels of termination charge. On the contrary, if one looks at the figure on p.11 of the commentary you will see there a bar chart with various components, somewhat difficult to read, but you will see the PC cost measure which, as I understand it, is the third of the three lines in the chart, is the LRAC model that H3G relies upon. Just to make clear that PC and LRAC are the same thing, the Tribunal ill see on p.8 in the final paragraph on that page the statement that "PC generates prices equal to LRAC at every point in time." So PC is LRAC, and the rates there are in the third row, as you will see, well above the 0.4ppm rates which are now proposed. LRAC was the only costs' measure. All references to cost-based models in the notice of appeal must be read as references to LRAC and LRAC does not generate the current marginal cost rate of 0.6 to 0.8 ppm, which is now contended for.

Madam, it was also suggested that mobile-to-mobile was never argued, indeed, the alternative approach to remedy was never argued to be zero or a net neutral position, but something approximating to that a the figure above zero would achieve broadly the same result and is therefore to be encompassed within NPZ. In support of that proposition, my learned friend, Mr. Kennelly, drew attention to the reference to glide-paths as an alternative approach to remedy, to show that zero was not the only approach. The reference to that is 4.4 of the appendix – you will see there:

> "In the alternative it could be considered as part of the glide-path approach. While fit for purpose MNP is introduced in the UK. (see below)"

Madam, it was suggested that this showed that a zero rate was never proposed. One might imagine a rapidly declining glide-path to take one towards zero. Madam, we say that cannot be what H3G meant by this rather obscure passage, which actually falls to be read in the light of submissions that were made during the prior consultation process.

Madam, if I may, I know that I have taken us for extensive periods this morning to the submissions and the responses during the consultation process, and if I might take us again to H3G's response of 22nd November 2006, to the third consultation, p.193. On p.60 (internal numbering), p.252 (bundle pagination) you will see a figure labelled "Averaged net neutral glide-path". You will see that this does not show a rapid glide-path towards zero. On the contrary, it shows rates which remain extremely high for the net neutral rate excluding "MMP effect" as it is referred to, but none of the lines come anywhere near zero during any of the quarters of the charge control. So the net neutral approach for which H3G was contending by means of glide-paths ----

THE CHAIRMAN: But these are not glide-paths linked with the NPZ remedy, are they?

MR. HOLMES: Madam, we are instructed that they are. If you will give me one second so that I can take instruction, I will take you to the relevant passage. (After a pause) Madam, the suggestion is, if you will see over the page at p.251, under the heading "8.2.2 An appropriate glide-path for H3G", the second sentence there set out:

> "H3G has calculated what glide-path the charges might ensure, that over the price control period as a whole, it was a neutral competitive position with regard to its direct competitors".

Then one sees the heading: "Average net neutral glide-path" and Ofcom at least interpreted this to be the glide-path approach which was proposed by H3G in para.4.4 of its price control appendix. I agree, madam, that para.4.4 of the price control appendix is a rather obscure passage in the appendix, but ----

THE CHAIRMAN: I the vertical axis not pence?

MR. HOLMES: Yes, madam. This shows that we do not have here a steep glide-path that produces zero pence per minute in order to overcome the neutral competitive distortion between the mobile network operators ----

MR. SCOTT: I confess that when I read 4.4 I read it in a rather different way, that what was contrasted was in the first part of 4.4 this remedy would potentially be applicable indefinitely, i.e. zero indefinitely. By contrast the suggestion was that we should start with zero while we were sorting out MNP and then move to a positive figure; that was how I had read that. I had not read it in the context to which you have now taken us, which does put a very different complexion on it.

MR. HOLMES: Well, sir, clearly it is not for me to say what was in H3G's mind when it wrote this passage, but it appeared at least to Ofcom, in the light of the proceeding consultation process, with which of course my client was very familiar, having discussed with H3G over a number of months what would be the appropriate approach to remedy, that this neutral glide-path approach might not have been intended to refer to a very steep glide-path leading to zero termination rates in a very short period of time. So madam, that is my point in relation to net payment zero as regards the M2Ms.

To go back to the broader submissions that I was making. On any view, what is being proposed here is not what one finds in the appendix, there is a totally different cost methodology being applied, and moreover although it was suggested today that the fixed-to-mobile, and the mobile-to-mobile rates were some happy coincidence, that they coincided at roughly the same level of 0.4, 0.6, 0.8 ppm, in fact there are arguments of

principle advanced by H3G to explain the appropriateness of aligning the rates of fixed-to-mobile, mobile-to-mobile, and fixed call termination rates at a single level, because it is said to avoid arbitrage, and it is said to avoid competitive distortions between fixed network operators, and mobile network operators. So there is a principled case in support of this new reciprocal remedy which brings all termination rates, or the vast majority of termination rates payable in the UK at the wholesale level under a single overarching charge control, and that is nowhere to be found in the amended notice of appeal.

The fourth point I would make, madam, is that the references to competitive distortion and efficiency effects to which my learned friend referred you in the course of the appendix and the notice of appeal are to be read in their context. H3G were identifying on each occasion specific efficiency effects, specific competitive distortions. Those terms indeed are to be found in the statutory tests that have to be applied by Ofcom in formulating the charge control, and it would be surprising if one did not find those general terms used in any appeal which was lodged against a price control remedy. The mere fact that those terms are used does not then enable a party to advance any further competitive distortions or efficiency effects which may occur to it.

Madam, this brings me to my next point: many other new arguments are advanced in support of the bill and keep model, this new approach to remedy which unifies fixed-to-mobile and mobile-to-mobile rates. My learned friend did not really address those new arguments. Insofar as he did he seemed to suggest that new arguments could be raised not new grounds, without the need for an amendment. If that was his submission it is, of course, not in accordance with Rule 11, and I would also remind the Tribunal of the comments that were made at the CMC on 25th February which invited all new issues to be raised – new arguments, new grounds – without distinction.

It was then suggested, and I assume that this was really in response to the consultation point, that H3G did not regard mandated RPP as the same thing as bill and keep. Well, madam, I went through the consultation documents at some length and we saw there that mandated RPP was to be achieved by a zero MCT rate, that is to say the bill and keep solution that was proposed.

As regards additional work, Mr. Kennelly attached great importance to the full defence which Ofcom has served in the price control proceedings. Madam, the passage on which he relies responds only to NPZ as regards mobile-to-mobile, as that case was originally put in the notice of appeal as a amended. It does to deal with the broad bill and keep based arguments, and that is where we say the additional work lies, that is where we say the

prejudice lies. Certainly H3G has not attempted to arrive at its own marginal cost estimates, that is not a process it has ever undertaken. None of the other parties besides H3G has done so. It has taken H3G a considerable period of time during these appeal proceedings to arrive at its own marginal cost estimates. That would be a significant project in its own right, and to do it properly would take a considerable period of time. Also, no reference was made to the consumer surveys on retail impact, which would need to be done we say in order to respond properly to the bill and keep arguments. Nor has Ofcom attempted to assess the academic economic merits and, madam, the fact that Ofcom in a surfeit of conscientiousness has addressed in outline points that were made by H3G, while making clear that these points had not been raised in its view in either H3G's notice of appeal, and that those points were not responsive to any point raised in BT's notice of appeal, should not be used against them now in order to justify H3G admitting a whole host of new arguments which we say have not been addressed in anything like the detail that H3G would wish to do so if they were recognised to be within the scope of these proceedings.

It was also suggested, madam, that Ofcom would need to undertake international comparisons in relation to mobile-to-mobile net payment zero. Madam, no international comparisons have been advanced by H3G in its original or amended notice of appeal or in the appendix thereto. So those arguments will lonely need to be addressed if permission were granted to introduce the new material. This is not work which Ofcom would need to undertake anyway.

I think the Tribunal has the point but the fact that the European Commission may be planning something is, if anything, an argument against admitting the new material and allowing these proceedings to be transformed at a late stage into an assessments of the merits of bill and keep, without all of the usual consultation procedures which would proceed such a finding. I would remind the Tribunal of the point to which I drew its attention this morning, that in the context of the consultation process H3G argued against bill and keep on the basis that it would require a co-ordinated approach at the European level, so that is another good argument against doing this in the context of the Competition Commission proceedings.

Turning to the statement of intervention, I believe Professor Yarrow, or Mr. Richardson have strayed outside BT's notice of appeal. We say that cannot be relied on. BT did not attempt to rely on it in support of their appeal. If one looks at the supplemental material they have served, they seek a remedy of 3.73 ppm, exclusively on the basis of their

conventional pleaded case in relation to spectrum costs and all of the other points they raise. They do not rely on Professor Yarrow's arguments concerning marginal cost and they make no reference to on-net/off-net in support of the remedy which they seek.

BT therefore have recognised that these statements are not a part of their appeal properly pleaded and have not sought to make anything of those arguments in the proceedings before the Competition Commission.

As regards the WIK Report and Morgan Stanley, we rely on the point made by my learned friend for the Competition Commission, and we also say that those materials are not relevant unless H3G is permitted to amend its case. They are relied on for points specific to the supplementary submission and the new approach which is set out there. If the new approach falls away then WIK and Morgan Stanley have no relevance to these proceedings and should therefore be disregarded.

Finally, my learned friend, Mr. Kennelly, urged the Tribunal to adopt a principle of charity in construing the notice of appeal as amended, and now the supplementary submission. H3G is not a small enterprise, it is not lacking in professional advisers, it is not lacking in expert economists, it made substantial submissions supported by expert evidence throughout the consultation process, and its notice of appeal was also prepared with the assistance of expert economists, and one of the world's largest law firms. Occasions such as today cost the parties who attend an enormous amount of resources in order to discuss what may or may not be meant by random phrases scattered through the documents with which we have been grappling. Madam, we would urge you to take a firm line in relation to H3G's pleadings, in order that there is not a continual process of discussion and debate as to what obscure passages may mean and to look at the overview of what they argued in their notice of appeal, and not allow a few ambiguous phrases to permit them now to expand their case greatly in a way that would cause substantial prejudice after Ofcom has served its full defence, at a late stage of the proceedings, and in relation to matters which were not originally argued and which are now being debated at the European level.

Madam, those are my submissions.

THE CHAIRMAN: Thank you very much, Mr. Holmes.

MR. PICKFORD: Madam, we wholeheartedly endorse those submissions. There were three minor points of clarification if I may ----

THE CHAIRMAN: Well I am not sure it is your turn, Mr. Pickford. You have already spoken and there are some people who have not spoken at all.

MR. PICKFORD: Abundance of caution in case you were about to say something more final than you were going to say.

(The Tribunal confer)

THE CHAIRMAN: Miss Lee, is there anything you would like to say?

MISS LEE: There are one or two brief points I would like to make about our appeal. One of them is a practical point which is that if the Tribunal may not have time to rule tonight on the scope of H3G's SOI in our case, and indeed the full one which has arrived back at BT but we have not seen yet, in relation to that obviously BT has a particular problem in that it is due to reply by 6th May, so it needs to know very soon what it needs to be replying to in BT's own appeals – that was the first point.

Generally, we agree with the approach taken by Ofcom in relation to the intervention in BT's appeal in that a large part of it does seem to us to go beyond the scope of the four corners of BT's own appeal. We, in our letter, (folder 1, tab 34) had taken a broad approach to saying that some of the points that H3G seemed to be making simply seemed to us to be setting out what the scope of their position was in their own appeal, but that when one got to s.5 of the statement of intervention there there were detailed arguments developed which do seem to us to go beyond the three points that BT has raised in its own appeal, namely, spectrum costs, admin costs and network externality.

Section 6 of H3G's SOI we do take a slightly different point on because we consider that that goes to the externality point and we think that some of what H3G says is actually responsive to our appeal. It is very difficult when considering s.6 because some of the points do raise the causes of traffic imbalance and to us those seem clearly to go beyond the scope of what H3G is entitled to say because we adopt the point made by Ofcom, that it should not be a back door to introducing points that H3G are not allowed to raise in their own appeal. But we do think that some of the points about distortion that relate to the position of fixed operators, and also to H3G as a mobile operator, are within the general scope of what we say on externality, and we think some of what H3G says should be admitted at a point of intervention.

Going back to the general points: on s.5 BT does not think it is responsive to its appeal, does not see why H3G needs to raise these points in its appeal since if they are legitimate it can raise them in its own appeal and we should not have to plead to them twice.

Secondly, there was a point made specifically in relation to relief by my learned friend, Mr. Kennelly, who said that it was open to parties to seek their own relief in an intervention. We do not read the Tribunal's Ruling of 18th March as going that far; I think it left

flexibility to the Competition Commission but at the end of the day said that it is not necessarily the case that people can seek their own relief, and we still adhere to our view that it would not be appropriate, H3G can either support our relief or they can make arguments against it, but they could not advance a broad general case. Indeed, that is why they have served their own notice of appeal so that seems relevant to us.

In relation to the specific points made about the evidence of Mr. Yarrow and Mr. Richardson, various points were made that they may be beyond the scope of our appeal; we do not accept that. I think it is clear from our appeal what our three grounds are, and in relation first to Mr. Yarrow's points, obviously it is his expert report and he gives his views about the appropriate principles to regulation as an expert would and he sets them out. Those views do not alter the fact that BT has challenged three particular things really using Ofcom's cost model. Secondly, the comments that he makes do seem to us to overlap with some of the comments that Ofcom itself makes in the defence, and in the MCT statement relating to the question of what the appropriate goal is of regulation and whether it is setting appropriate price signals, or whether it is recovery of efficiently incurred costs. We do not think that they are so broad so as to be ignored in relation particularly to our case on spectrum. We do consider that they form part and parcel of our appeal.

In relation to Mr. Richardson, the point that Mr. Scott made about stating factual points about distortion that seemed to us to be entirely right, and it is not that Mr. Richardson then goes on to make inferences about the courses of traffic imbalance or the use of on-net/off-net price discrimination in any way. So we consider, again entirely within the scope of BT's appeal it does not provide a springboard for H3G to introduce broader questions about the marginal pricing approach or about on-net/off-net price discrimination.

Those are our submissions in relation to that evidence. The only question I really leave with the Tribunal is a plea that we know what we should do in relation to our reply in relation to 6th May. Thank you.

THE CHAIRMAN: Now, Miss Bacon and Miss Demetriou, do you have anything that you would like to add? Miss Bacon?

MISS BACON: I have three very short points, the latter two of which are just practical considerations. The first point arises out of an exchange that you had with my learned friend, Mr. Holmes, at the start of his reply. Mr. Holmes made a submission which we entirely endorse, but our reading of the supplemental submissions put in by H3G is completely different to the reading that Mr. Kennelly put forward today. We had understood that he was suggesting a remedy that applies across the board, M2M, F2M, and

you made the comment, which I did not quite understand: "Well now we know what their case is." Just for clarification our understanding is that what we have today is an application for permission to amend along the lines that Hutchison has set out in its supplemental submission and its witness statements. What we are not dealing with is an application that H3G might in the future make to amend its case in a completely different direction, along the lines expressed by Mr. Kennelly. So at the end of the day what we have to decide is not whether Mr. Kennelly's submissions today fall within the scope of their original notice of appeal, but whether the pleaded case in their supplemental submissions falls within that. So that is just a clarification from our part; I am not sure if you meant anything different.

The second and third issues are also practical matters. If Hutchison's application to amend fails, we have a real concern as to what we have to plead to on NPZ and that was something that we raised in our letter to the Tribunal.

From our perspective, whatever Mr. Kennelly said about the alternative cases, and I must confess I got completely lost as to how many alternatives there were, but from our understanding from the pleaded case, which is the only written case we have in front of us, is that Hutchison is no longer proposing a zero NPZ remedy, and that is as explained in the witness statement of Mr. Westby and Mr. Russell. They are no longer proposing what they originally advocated in their notice of appeal which is net payment zero, or zero pence per minute. Now if that is the case we do not need to plead to this. If there is some remaining case at the end of it, then I am not sure what it is, because Mr. Kennelly said today that essentially it was all one and that what they were saying today was a refinement of what he said earlier. So our position and our understanding is that Hutchison has abandoned its original NPZ case and replaced it with something different. If that is the case, if they fail today then we do not have to answer any of this in our statement of intervention. I just raise that as a practical concern as to what my happen following your ruling on the issue.

The third point is again a practical question which you raised earlier today, how we dissect the arguments as pleaded in the supplemental submissions and do we have to go through paragraph by paragraph what Hutchison has said and try and blue pencil it. In our submission you will have seen from our schedule that we would propose a somewhat broader brush approach. We read most of what Hutchison has said in its supplemental submissions as going to its new NPZ argument – what it terms NPZ, but which is reciprocal low MCT rates, and on that basis we would submit a broad brush approach. We would not suggest going through line by line and trying to work out what is the old NPZ?

What is the new NPZ? We read this as all falling squarely within the new NPZ argument, and on that basis we would say, as we said in our schedule, that simply large sections of the witness statements, and most of the supplemental submissions should be struck out.

That is all I had to say in addition to what Mr. Holmes has already very eloquently said.

MISS DEMETRIOU: Madam, I do not want to add anything substantive, but I do – since we are here – just want to register Orange's very strong concern about the prejudice that is being caused by this very late application in terms of cost and expense to the intervening parties, and to say that really no good reason has been put forward by Mr. Kennelly today to demonstrate why these matters are raised so late when the notice of appeal was lodged in May – almost a year ago – and amended again in November. No good reason has been put forward to explain why it is only being dealt with now. Indeed, on the contrary he has relied in his favour on the fact that much of this work was done before November. So in those circumstances I do echo what Mr. Holmes said and urge the Tribunal to adopt a firm line in this case. I do not have anything to add to the points made by Mr. Holmes, and the other intervening MNOs, which we endorse.

THE CHAIRMAN: Thank you very much. Mr. Pickford, please be very brief.

MR. PICKFORD: Madam, I will be very brief – I only have two and a half points now. The half point is on the first point that Miss Bacon made, which is a plea for clarity, because I can quote from Hutchison's supplementary submission ----

THE CHAIRMAN: Well let me just ask Mr. Kennelly. My understanding was that you strongly resisted any suggestion that you had abandoned NPZ in its pure form of zero ----

MR. PICKFORD: Sorry, that was the second point that Miss Bacon made. The first point she made concerned something different, but I am happy to get clarification on that too.

THE CHAIRMAN: Would you like to answer the question I put, Mr. Kennelly?

MR. KENNELLY: Madam, yes. I refer my learned friends – all of them – to our written answer on this point. It is for us to abandon our case and we will decide when to abandon our case. We do not abandon our case in favour of zero pence per minute. It may not be practical in the end before the Competition Commission, and that is why we flag other practical solutions to achieve the same goal. Rightly or wrongly we do not abandon the zero pence per minute ----

THE CHAIRMAN: But if you were to have made no headway with us today so that you are put back effectively in the position that you were in before you lodged your supplemental material, then other parties would still have to respond on the NPZ as it appears in your amended notice of appeal as people understood it before you explained it to us today.

MR. KENNELLY: Certainly, madam, yes, we would expect full responses on that point and we would argue it before the Competition Commission also.

THE CHAIRMAN: Yes, Mr. Pickford?

MR. PICKFORD: Thank you, madam. The half point is that Hutchison's supplemental submissions currently say in terms that s.3 sets out the precise form of the remedy; that is what it says. The precise form of the remedy is that Hutchison proposes that prices for M2M, and F2M calls should fall to the level of fixed call termination. We have now been told that that is not the remedy they are seeking and quite clearly there needs to be some clarification given in relation to this. We have proceeded on the basis of what is written **here** and what has been said today is wholly different to that.

Secondly, the Tribunal's reasoning on on-net/off-net price discrimination, it might benefit from a very short point of clarification, and we have indeed today in the bundle of authorities which Hutchison has provided, the Tribunal's ruling on refusal of permission to appeal to the Court of Appeal. If the Tribunal would turn very, very briefly to para.13 of that ruling, at tab 3 of the authorities.

THE CHAIRMAN: Yes.

MR. PICKFORD: If the Tribunal would be kind enough to turn to par.13(e). In my submission this has been slightly mischaracterised by Mr. Kennelly. "The reference in the price control appendix to the on-net/off-net in relation to market shares", and if one goes to the end we see the Tribunal saying: "H3G refer to this in order to cast doubt on the accuracy of the market share forecast used by Ofcom." Then: "Countering this point would not require Ofcom to undertake the investigation analysis referred to in paragraph (c) above." If we go to (c) above we see that there are three things that the Tribunal noted would need to be considered and the first of those is: "An analysis of the tariff structures of the other MNOs to see if there is indeed a differential between on-net/off-net retail price as H3G allege." So it is not merely the repercussions of the on-net/off-net price discrimination to the extent that it exists, it is the very fact of it and if one goes further back ----

THE CHAIRMAN: Yes, I seem to remember it was because the tariff structure, and if you are on a monthly contract then you get a certain number of minutes per month then you may pay exactly the same whether it is on-net or off-net.

MR. PICKFORD: Absolutely, madam, and that is the point that is being made in para.37 of the first ruling that the Tribunal is referring back to. So the very existence of the differential to the extent that it exists would be a matter in dispute, in issue, and is not accepted and that was quite clearly contained within the Tribunal's reasoning there.

The third and final point is that Mr. Kennelly suggested that we offered no particulars whatsoever of the extra matters that we say would need to be undertaken. To my knowledge I offered six – I do not need to remind the Tribunal of what they were, unless the Tribunal would like me to – but certainly we did offer particularisation of the additional matters.

THE CHAIRMAN: Well that will appear in the transcript.

MR. PICKFORD: I am grateful.

MISS McKNIGHT: I have only two very small points. First, I would like to support what Ofcom has said in reply but I would like to go back to bundle F3, to which Mr. Holmes took the Tribunal, at pp.250, 251 of the bundle numbering. Mr. Holmes was seeking to clarify para.4.4 of the original price control appendix to the notice of appeal. You need not look at that but I will just remind you that in explaining that the NPZ remedy did not necessarily entail a zero balancing payment, but might have entailed something immaterial, Mr. Kennelly took us to 4.4 and pointed out that it says either you can have NPZ indefinitely, or in the alternative it could be considered as part of a glide-path approach, while fit for purpose MNP is introduced in the UK and takes effect. So he saw this as possibly a short term measure until one of the key factors of the alleged distortion is addressed.

I think it is quite clear, having heard Mr. Holmes, that what H3G was saying in response to the earlier consultation was exactly this point, and glide-path did not mean gliding from 0.6 down to zero, but clearly meant some interim flexing of the cost-reflective charge controls to achieve a net payment of zero in light of actual traffic balances. The point that Mr. Holmes made is quite right, that p.251, para.8.2.2 does make clear that H3G is looking for a glide-path which would achieve a neutral competitive position. The graphs over the page show that he has in mind very high pence per minute charges. The point I want to add is that if one goes on to look at the top of p.253, H3G goes on to say that:

"H3G notes that Ofcom's recently published proposals for amending general condition 18 in relation to MNP will not take effect until 2009."

– well into the proposed price controlled period. He goes on to say therefore you have to take account of this continuing distortion in the glide-path. So it is quite clear that the reasoning in the pages of this response to consultation, exactly mirrors the reasoning in para.4.4 which is the glide-path which is contemplated is a high pence per minute glide-path pending resolution of the alleged problems of MNP. That is my first point.

Just one more point and that is I note that Mr. Kennelly's submission is that when H3G put in its notice of appeal and just said that if we were to end up with NPZ for mobile-to-mobile charges, there should be a suitable cost-based fixed-to-mobile charge control. It is now his case that H3G did not know what it meant by a suitable cost methodology at that stage, and it admits that it is only later that it has elaborated what would be a suitable cost methodology. I do not see how that can comply even with the requirements that the put in a proper outline of their price control case, since I think the Tribunal has made clear that whilst there was a permission to elaborate on the price control matters, post the notice of appeal, the notice of appeal was intended to comply with the Tribunal rules which require a succinct statement of the facts and arguments on which the appeal is based, and on his own admission they did not know what case they were going to advance at that stage.

We say the only possible reading of the notice of appeal in a manner that would bring it into compliance with the rules is to read it as meaning that the only cost based methodology in contemplation is either Ofcom's methodology, or Ofcom's methodology as adjusted in light of the specific criticisms made in the alternative case. Nothing we have heard today makes us think otherwise and we consider that what is now proposed is such a material departure from anything that was contemplated that it would self-evidently require a massive amount of work and result in what Professor Bain suggested was a radically different approach, which the European Commission is only now beginning to contemplate. Thank you.

THE CHAIRMAN: Thank you very much. No one else is jumping up? So thank you to everybody for sitting late, we decided to sit late this evening rather than go over to tomorrow morning, not least because our shorthand writers are not available tomorrow, and may I take this opportunity to thank them for working late; of course, that means that it may take a little longer to get the transcript than would normally be the case but that will be got to you as soon as possible. We have in mind, of course, Miss Lee's point about the need to clarify the position as soon as possible, given that the timetable for the further proceedings before the Competition Commission is ticking away, but this is a complicated matter and we will notify you as soon as we have come to a decision. Thank you very much.

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