IN THE COMPETITION COMMISSION APPEAL TRIBUNAL **Case No. 1007/2/3/02**

New Court,
Carey Street,
London WC2A 2JT

Monday, 20th January 2003

Before:
SIR CHRISTOPHER BELLAMY
(President)
PROFESSOR JOHN PICKERING
DR ARTHUR PRYOR CB

B E T W E E N:

FREESERVE.COM PLC — Applicant
and

THE DIRECTOR GENERAL OF TELECOMMUNICATIONS — Respondent

supported by

BT GROUP PLC — Intervener

Mr Nicholas Green QC (instructed by Messrs Baker & McKenzie) appeared for the Applicant.

Mr Jon Turner and Miss Jennifer Skilbeck (instructed by The Director of Legal Services (Competition), Office of Telecommunications) appeared for the Respondent.

Mr Barling QC (instructed by the Head of Competition and Public Law, BT Retail) appeared for the intervener.

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P R O C E E D I N G S

THE PRESIDENT: Yes, Mr Green.

MR GREEN: Professor Pickering, Dr Pryor, President, good morning. I appear today for Freeserve. Mr Jon Turner and Miss Jennifer Skilbeck appear for the Director General, and Mr Barling appears for BT.

In my submissions today I wish to focus on three points only. The first topic concerns the procedural points raised by the Director General in his defence and in his skeleton argument and endorsed, at least in some part, by BT. As to this issue I wish to address the question of the conduct of the Director General in relation to this inquiry, whether he has acted reasonably and lawfully and how this bears upon the, we say, misguided submission of the Director that the nature of the Tribunal's review in this case should in some way reflect the level of detail in the complaint.

The second topic I wish to address concerns dominance and I will address that one pretty shortly.

The third issue concerns predatory pricing and cross-subsidy. As to this there are a number of sub-issues and, for the sake of convenience, I will summarise those before I start my submissions on predatory pricing rather than doing it at the outset.

As to all the other issues, these have been canvassed very fully in written submissions and I do not propose to deal with them today unless the Tribunal has any questions for me on them.

Before embarking upon the detailed submissions, I would like to provide a quick sketch of the essential elements of Freeserve's case. As the Tribunal is aware, Freeserve submitted a complaint to the Director General objecting to the way BTOW was marketing its internet services. It complained of a number of issues, including illegal cross-subsidy and predatory pricing ----

THE PRESIDENT: Let me take out the original complaint, Mr Green. This is annex 1 to the notice of application?

MR GREEN: Yes, sir. The matters complained of generally included, as I said, illegal cross-subsidy, predatory pricing, illegal cross-marketing, misuse of a telephone census and misuse of sensitive commercial information to extract a commercial advantage.

Now, although the complaint letter was divided into broad headings, it will be seen, as the Tribunal recognised in its judgment on admissibility, that there was at base a single complaint to the effect that at a critical point in time in the evolution of the broadband market BT was using its market power to lever advantages from its existing dominant position into this new service sector, and in effect to steal a march upon its competitors. The covering letter of 26th March from Mr John Plotheroe, who is the CEO of Freeserve, referred to "an orchestrated campaign of anti-competitive behaviour aimed at achieving dominance by the incumbent in the market for retail ADSL services".

It is notable that nowhere in the complaint does Freeserve allege what is sometimes

called colloquially margin squeeze abuse. This is significant because again, as the Tribunal knows, the Director General in the decision gives the appearance of having treated this case as a margin squeeze case. To this effect he records in his decision that, in earlier decisions in March 2002 taken under the Telecommunications Act 1984 in respect of BT's licence, he had given BT a clean bill of health, and he relies upon those decisions as in effect conclusive of the present investigation.

Now, in order to put the case into a broader context, it is helpful to consider for a moment what is meant by a margin squeeze allegation and how it differs from Freeserve's complaint. I would like to start by simply setting out what we understand to be the gist of a margin squeeze allegation.

Oftel has conducted a number of margin squeeze investigations under the Telecommunications Act in the past and they are treated as possible licence condition infringements. They do not involve allegations of dominance, though the Director General states that he requires some degree of upstream market power but falling short of dominance. In these cases the gist of the complaint is that the upstream supplier charges a non-discriminatory wholesale price to its retailers, and these retailers broadly can be divided into two categories. First, there is the tied service provider, sometimes referred to as the TSP for convenience; this is generally an undertaking which is either a subsidiary or a division of the upstream supplier and therefore forms part of the same economic undertaking with the supplier. Secondly, there is the independent service provider, sometimes referred to as an ISP; this is an independent undertaking, in other words a separate economic entity as that term is understood within the meaning of article 81 in chapter 1 and chapter 2.

The allegation of licence breach in these cases is that the service provider upstream, in other words the wholesaler, offers a price which is very high as a wholesale price, and in principle this does not enable either the ISP or the TSP to make a sufficiently large margin. Usually, both the independent service provider and the tied service provider can make some margin but it is deemed to be inadequate. It is therefore not usually the case at least that the ISP or the TSP cannot cover its costs, at least to some degree.

The effect of this non-discriminatory but high price is said to restrict competition between the tied service provider and the independent service provider, and that is because the ISP cannot realistically compete on a horizontal level with the tied service provider.

The modus operandi of this form of restriction of competition lies in a form of deemed cross-subsidy whereby the upstream supplier of the service or the product is prepared to sell high, in other words at a high price, to its own tied retailer, its own retailing arm or subsidiary, because that retailer can and will still be relied upon to charge a lowish price at the retail sector, and the upstream supplier can guarantee this because, of course, the tied retailer is under its corporate control. In effect, there is simply a transfer price from upstream wholesaler to downstream retailer which reflects the stage or the level at which the undertaking as a whole

seeks to take its profit. Now, that may not be problematic for the TSP, the tied service provider, but it is plainly problematic for the independent service provider. For the independent service provider it is in the position of purchasing the good or the service at a high price, therefore having to add a significant margin on top of that and thereby not being able to make a reasonable profit.

The essence of a margin squeeze case therefore is a focus upon the margin that the wholesale price affords to the retailer.

THE PRESIDENT: It is a combination of the two, is it not? It is a wholesale price that is too high and a retail price that is too low. It can be either or both.

MR GREEN: It can be either or both, and it is the deemed cross-subsidy between the upstream and the downstream tied sector that the supplier is taking its profit at the wholesale level rather than at the retail level. That is where the notion of cross-subsidy comes into it.

THE PRESIDENT: That is in a regulatory context.

MR GREEN: That is in a regulatory context. It is within the same product market so it is not as between product markets, it is simply an analysis of the way in which the undertaking as a whole seeks to allocate its costs and take its profit margin.

THE PRESIDENT: In a competition case, in a case like National Carbonising for example, you would very often find some kind of dominance at both ends, as it were; that is to say, you would find that the independent provider had no other source, or very little other source, for the wholesale product and, because of market circumstances, could not charge a retail price any higher than the retail price being offered by the downstream subsidiary of the allegedly dominant supplier.

MR GREEN: Certainly under article 82 and ECSC in terms of National Carbonising, there is an assumption that there is market power to some degree upstream, and certainly that was the assumption which Oftel took in its previous margin squeeze allegations and investigations, that there was some market power upstream, albeit under the Telecommunications Act falling short of dominance.

So far as this case is concerned specifically, a number of points can be made. Freeserve's complaint was that BT was making a loss in the provision of its broadband ADSL service and BT had an incumbent form of monopolist advantage such that in any artificially stimulated market it was BT which would be advantaged to the prejudice of new entrants and potential entrants.

THE PRESIDENT: When we are talking about, as Mr Plotheroe does in his letter, "the incumbent in the market for retail ADSL services", it is not completely clear to us what market we are talking about and what is meant by "the incumbent" there. My general impression at least is that this market at retail level, certainly at March 2002, was being contested by a number of suppliers, Freeserve, AOL, BT OpenWorld and others, so it is not quite clear whether BTOW at this stage was an incumbent in the sense of some dominant player in that market.

MR GREEN: No. Freeserve's allegation is that BT as an undertaking has dominance in number of

closely associative markets, both surrounding broadband and upstream of broadband, and that it was leveraging its market power from one product market into another.

THE PRESIDENT: We are cautioned by the respondent and the intervenor not to get into dominance very far ----

MR GREEN: Indeed you are, yes.

THE PRESIDENT: But I think we need at least to be a little clearer in our own minds as to what your case is on dominance, which markets we are talking about and what exactly this idea of leverage from one market to another is all about.

MR GREEN: Yes. In one sense the respondent is correct because they have singularly failed to engage with either us or the Tribunal on the question of dominance, and therefore the analysis of dominance in this case has not progressed very far. There has been little or no dialogue between Freeserve and the Director on this and therefore it is difficult other than in broad terms to express our position.

THE PRESIDENT: What is your position? You must have one.

MR GREEN: We have indeed.

THE PRESIDENT: Your case is alleging abuse of dominance and you must be able to show what dominant position has allegedly been abused.

MR GREEN: Can I come to that?

THE PRESIDENT: Come to that under dominance.

MR GREEN: There is one point of law to which, when I come to dominance, I will wish to refer you, which is the Commission's view that in Telecoms markets, if you have a sufficiently broad range of product markets where the incumbent, the former statutory monopolist, is dominant and it is seeking to leverage its market power into a new segment, then you may treat the new segment as being subject to the incumbent's dominance. The Commission have mooted this notion of a form of portfolio dominance extending into every sector in which the incumbent is operating and seeking to operate. We have set out the quote in the skeleton: it comes from the Commission's notice on telecoms.

THE PRESIDENT: The conceptual situation or the conceptual framework in this case, which I think is fairly common ground, is that this is a new market that a number of "players" are seeking to develop. It is probably the case in a market such as this that needs to be opened up that nobody is going to make a profit in the early stages. You are looking to build the market by a market promotion strategy of some kind, and it is not at the moment clear to me at least what the rules are in such a situation that apply to an allegedly dominant undertaking. It cannot be the case that, just because it happened to be dominant in another market, you cannot build a new market in an ordinary commercial way.

MR GREEN: Yes. I think we understand that argument and I don't think it is being suggested that, as of day one, the first subscriber contract that BT concluded had to cover all of its costs to date. Again I am jumping forward but I am happy to just explain what the point is. It seems to be

common ground between the Director and BT that the relevant time frame for measuring any form of anti-competitive conduct is the life cycle of the product. That begs the question as to what is meant by "the product", but the life cycle of the product would be the life cycle of broadband internet, whether that be three years, five years, ten years, fifteen years or some other figure. It appears to have been common ground between BT and the Director that it was sufficient for BT to determine what the life cycle of the product was and then to set its price so that by the end of that life cycle it would have come into profitability and made some form of margin to cover its costs incurred during that period.

There are certain consequences which flow from that which we say give rise to anti-competitive conduct. As I will explain later, that analysis is inconsistent with the approach which the Director has himself taken, for example in the Air Time margin squeeze case, where he says that the life cycle for determining anti-competitive conduct is the contract for the product or service, not the product or service itself. In the Air Time mobile phone investigation he tried to work out what the average length of a subscriber contract was or would be and then to ensure that over the course of that contract costs were covered.

The European Commission in its cases, for example Deutsche Post which we have cited, has identified the notion of covering costs in the medium term. Whatever that may mean, it is going to be less than the life cycle of the entire product.

THE PRESIDENT: What the decision actually says in paragraph 16 is that your case was based on a one year loss, a loss in the first year of operation, and what the Director is saying in the decision, whatever he may be saying now, is that it is perfectly possible for a service to make a loss in the first year without pricing being judged predatory in competition law terms, provided the product shows a positive return in a reasonable period. Then he goes on to say that the pay-back will occur in a period which, by implication, the Director considers to be reasonable.

MR GREEN: Yes.

THE PRESIDENT: The heart of the case I think is whether that part of paragraph 16 is a proper and adequate treatment of the issue we have in competition law terms.

MR GREEN: Yes. I think we would agree with that. Freeserve's complaint was that BT would make a loss over 12 months and beyond. The Director accepts that.

THE PRESIDENT: Where does the "and beyond" come from?

MR GREEN: It comes from the next sentence where the Director General says ----

THE PRESIDENT: It is longer than a year.

MR GREEN: Yes - "shows that pay-back will occur over a longer period than one year". Now, we do not know what period that will be but we do know from the defence and from BT's statement of intervention that both the Director and BT suggest that the relevant time frame is the life cycle of the product. It is not stated in the decision, which is one of the grounds we object to when it comes to an allegation and a submission that the decision is inadequately reasoned but, setting that aside for one moment, the Director's defence is that he has taken BT's business case and

looked at it according to his plausibility test. BT is postulating a test of the life cycle of the product. I think we are entitled to infer that that therefore reflects their business case. The Director has a number of formulations between his skeleton argument and his defence as to what the relevant life time is, but at least one of them postulates the life cycle of the product.

Now, if one assumes for the sake of argument that the product is going to have a life cycle of four or five or six years, you are then hypothesising that BT will at some point over that period come into profitability and thereafter earn a sufficient margin to cover the totality of its costs.

THE PRESIDENT: What would cut short the life cycle of a product like this? A more advanced technology perhaps.

MR GREEN: Possibly a new technology. It rather depends upon the assumptions made at the outset and who decides whether they are reasonable or objective. If BT says broadband as a product is going to last for ten years and we therefore aim to make a reasonable margin but only really at the end of ten years, that in its own right involves a number of assumptions as to what is going to happen in the interim. The longer the assumption as to the life cycle of the product, the longer the period of time in which you are going to make a loss before you come into profitability.

Take an extreme example. If the life cycle of the product is ten years and you do not aim therefore to come into profitability until year six, then you are going to make your profit in years seven, eight, nine and ten. That presupposes that for the first six years you are going to make a loss. Now, if the average subscriber contract is twelve months, and that is certainly the period which is advertised as the normal contractual period in the broadband adverts in the papers at the moment, you may have a whole series of contracts which are sold very substantially below the cost of providing the service. That in turn will profoundly affect the way in which market share is allocated as between the various competitors.

The gist of our case is that BT has an incumbent's advantage and that, if it is artificially stimulating the market during this ----

THE PRESIDENT: What is this incumbent's advantage exactly?

MR GREEN: It is in the notice of application at paragraph 5.27 on page 16. What we say here is this. "BT is a former state monopolist in the telecommunications sector, enjoys significant advantages over competitors due to the size, strength, nature and quality of its relationship with its residential retail voice telephony customers and this is in part based upon those customers' strong association with BT for residential retail telephony services. Most customers have an inherent predisposition to obtain residential retail telephony related services from BT arising from the fundamental link in the minds of consumers between BT and retail telephony services and customers' predisposition to obtain all residential retail telephony related services from BT."

THE PRESIDENT: Yes, I follow that point but it does not seem to be completely true in the narrow band sector, if I have understood it correctly. BT OpenWorld in narrow band could not be regarded as stronger than a number of the other parties.

MR GREEN: No, that is certainly true. Let me give you some most recent figures which I think demonstrate the point. Over the past twelve months BT's share of the ADSL broadband market has moved to, as Freeserve understands it, in excess of 50 per cent. Its narrow band ADSL share is approximately 20 per cent. If you are seeking to persuade subscribers to switch from narrow band to broadband, Freeserve's deep concern is that BT's incumbent advantage will encourage the shifting towards BT, and that is what Freeserve views as BT's incumbent's advantage. It has acquired a broadband market share which is vastly superior to its narrow band share and it attributes this in significant part to the fact that BT has, as it sees it, an incumbent's advantage which you can exploit when consumers are somewhat nervous about the new technology and there are switching costs. Freeserve's position is that you are likely to switch to the operator who provides your residential retail telephony services.

That is the gist of the point made in paragraphs 5.27 and 5.28. In paragraph 5.28 there is a quotation taken from one of Oftel's reports in which that very point is made. It is trading on consumer nervousness or sensitivity about switching from narrow band to broadband and the market share figures do seem to bear this out. These are present market share figures but they are in line with the projections which we say are made for BT as set out in the application.

THE PRESIDENT: So it is in relation to customers who are switching from narrow band to broadband that this alleged advantage exists?

MR GREEN: And it would apply equally to any customer who did not have narrow band but was going to go straight into broadband. So, if you are trying to expand the existing internet market because it still is open to expansion, then you can use your predisposition probably to a greater degree than in relation to the customer who has taken up an AOL or Freeserve narrow band and now is seeking to switch into broadband but goes to BT.

THE PRESIDENT: I am just trying to get the shape of the argument. You started by saying there was no margin squeeze allegation made, and the absence of that allegation would imply that, in Freeserve's view, there is a market between the wholesale and retail price at which they can supply.

MR GREEN: Freeserve's position, as matters stand, is that at the present price there is no margin. My point simply is that the complaint made just under twelve months ago was that BT was engaged in predatory pricing. Freeserve's experience is that they cannot make money at the present rates but, if the matter were to be started all over again, no doubt that would be part of the allegation. That is Freeserve's position. They also infer that, if they cannot make money, it is unlikely that other rivals will also be able to.

There is also an analysis of BT's incumbency advantages at paragraph 5.33 of the notice of application. These are other factors which Freeserve believes give BT this nexus between itself and its potential customer base.

Can I jump ahead just to make one point, and again I will come back to it. One of the reasons why the original complaint does not contain a great deal of detail and therefore why there

is not as much detail before the Tribunal as would otherwise be the case is because of the Director's refusal, we say an unlawful refusal, to engage with Freeserve pursuant to its section 47 application.

I will take you to the correspondence in relation to this but you will recollect that Freeserve, through Baker & McKenzie, because they had instructed external lawyers at this stage, sought to engage with the Director in the section 47 application by putting forward new evidence, by indicating that it intended to put forward economists' evidence and asking for meetings. They had the door slammed in their face on that. The net effect is that, instead of having a more refined analysis for the Tribunal to examine, one has a more limited number of documents, and obviously we appreciate that this creates its own problems.

THE PRESIDENT: They do not say a great deal about dominance in the section 47 request.

MR GREEN: What was proposed in the section 47 request - and again I will come to the letter because it needs to be examined. What was stated in the letter was that they were going to provide an outline of the case, that they were preparing a detailed submission which they proposed to submit at the same time as the so-called further complaint. The further complaint was going to deal with the matters already addressed plus new material. That was under way with the assistance of an economist, but that was then truncated by the Director's refusal to receive any further material in relation to the existing complaint, but he said he would consider submissions in relation to a fresh complaint. He was quite clear that he would not accept submissions in relation to the existing matter.

So Baker & McKenzie and Freeserve's strategy necessarily bifurcated at that stage the material which was going to have formed the basis of the further discussions and submissions to Oftel, necessarily found their way into the notice of application, and the material which formed the basis of the fresh complaint obviously went forward as part of the fresh complaint.

THE PRESIDENT: Yes.

MR GREEN: No further discussions were engaged in between the Director and Freeserve and so matters could not be progressed in that way in the less contentious procedure than we found here, but at that stage battle lines were drawn because the Director simply pulled down the shutters and said "no further material". So the entire analysis came to a grinding halt and that is why the snapshot that the Tribunal has is necessarily a truncated one.

That is the Freeserve case in broad terms. The gist of the submission is that any abusive conduct such as artificially low prices will exert a disproportionate effect in stimulating demand in favour of BT, and which we say is especially the case with the advent of a new technology or when customers may, for good or bad reason, be nervous about switching from an old technology to a new technology, or taking on a new technology afresh if they are not previous narrow band internet customers.

THE PRESIDENT: One of the issues is, or may be at some stage, in what sense these low prices are, as you put it, "artificially low". It seems a matter of common sense that, when you are building a

new market, you need to pitch your price sufficiently low to start to build up volume, you are getting the monthly rental once you have started it so you have to generate the cash flow. It is no use having a high price to start with because you will not get anybody in to generate the cash flow, so it is clearly a balance between your initial price and what you hope ----

MR GREEN: We entirely agree. One of the difficulties we face is that the decision does not address this at all.

THE PRESIDENT: What the decision says is that "you have showed us a year and we don't think that is really a basis for going any further than we have already gone".

MR GREEN: As to that, I must say that we do find the Director's submission on this surprising because, as of the date that that business case was submitted, which I think was 28th March, the Director had on his desk three BT business cases. These are referred to in the March decisions where he actually identifies the sequence of business cases that BT submitted to him. So he actually had in his possession three actual BT cases in which BT's position was explicitly set out, and it does seem a little odd that the Director should criticise Freeserve in its attempts to hypothesise as to what BT's case might be, when plainly Freeserve cannot, by definition, be in a position to provide a perfect BT business case. The Director General was in a position to know what BT's case was because, almost to the day, he was expressing his decision in relation to the previous BT business cases, and he therefore had a mountain of evidence as to BT's position on his desk at that very time. So he would have known what BT's assumption was as to the life cycle of the product and at what point in time BT intended to break even, if that is the meaning of the word "pay-back". He also states in his earlier decisions that he had some inkling as to what assumptions were made as to market share.

THE PRESIDENT: What he is saying is, "You have given me one year's figures; I did at one point ask you to give me three years' figures but you did not come back to me on that; I have looked at all this in the margin squeeze investigation; you did not challenge the margin squeeze investigation and, frankly, I am not going to re-do it all again on the basis of what you have told me so far". That is his case.

MR GREEN: Yes. Well, his margin squeeze investigation did not investigate the question of predatory pricing of a dominant undertaking with a special responsibility. That was the gist of Freeserve's complaint as it was drafted, not a margin squeeze allegation.

THE PRESIDENT: That takes us on to how one looks at so-called alleged predatory pricing in the circumstances of this particular case and this particular industry.

MR GREEN: Yes.

THE PRESIDENT: The original complaint was based on AKZO and a lot of the application is based on AKZO. Part of the argument seems to be that AKZO has very little to do with it in this particular case.

MR GREEN: That is what I think is suggested in footnote 11 to my friend's skeleton, where he suggests that one equates variable cost with long run incremental cost, but the way in which

footnote 11 is formulated seems to copy the AKZO formulation. That is that price above AVC, whether calculated by reference to LRIC costing or something else, a price below that would be abusive, a price above that but low average total cost might be abusive. Even in the way in which it is formulated in the skeleton there does not seem to be a major difference between AKZO and the test which the Director General suggests is in fact very different.

It comes back to this. If it is in fact the case, as it appears to be, that the Director has accepted that one looks at the entire life cycle of a product in order to measure profitability and cost, the point in time at which cost is recovered and the exclusionary effect, we submit that, first of all, that reasoning is not evident from the decision. We are having to infer a great deal from subsequent pleadings. That is supported by the Director's position set out in the skeleton, which is that he did not ----

THE PRESIDENT: Do you have any cross-references to hand, Mr Green, just for my notes so that I can find them. If you have not, don't worry.

MR GREEN: I will in due course.

THE PRESIDENT: Yes. Carry on.

MR GREEN: The reasoning, we submit, is thoroughly defective, that there is simply no explanation of methodology whatsoever in this decision, a crucial decision for the purposes of the industry. In his skeleton he actually disavows the reasoning in the earlier March decisions. We had assumed in his favour that he was incorporating the reasons for his March decision. He says in the skeleton no, he is not, he simply incorporates the result but not the reasoning. But elsewhere from his skeleton and indeed from the submissions made to you recently in response to the Tribunal's questions, we see what I understand to be three possibly different tests which he might or might not have applied.

So we have what we submit is a substantive submission that the decision is woefully inadequately reasoned.

But, even if one takes the Director's position to be that you look at the life cycle of the product, we would submit that that is wrong in principle. It is not evident from the decision. We are inferring from subsequent and other documents that that is his case. We would submit that that is profoundly wrong.

If one pulls the strands together, the Director permitted BT to decide what the product life was. He cast his wand of plausibility over it and accepted it, and there is a necessary implication in this that BT will be selling below cost for a number of years and therefore offering contracts which will have been completed but at substantially below the cost of providing the service.

Now, if that is the case, given at least any degree of incumbency advantage, that is going to stimulate the market but in favour of BT. It may not be wrong to stimulate a market but, if the stimulation operates upon an inherent predisposition in favour of the dominant undertaking, then we would submit that that is an abuse. The special responsibility inherent in chapter 2 would

require BT to ensure that, even if it were stimulating the market, it did not exert any disproportionate effect in favour of itself.

These are matters which we infer from the Director's subsequent explanations in particular in his defence and in the material that he has submitted to the Tribunal in response to its questions. Nowhere is this set out in the decision, and I freely confess that, in order to make my submission, I am necessarily hypothesising as to what the Director did or did not do. It seems to us at least a reasonable inference that this is what he did do and, that being the case, we submit that he erred in principle.

That in broad terms is the submission we make about predatory pricing. It is fair and proper to point out that this is a crucial decision for the industry. This is a pivotally important market which is developing, or segment of a market, and, if any third party ISP sought to gain guidance as to what BT was or was not allowed to do from this decision, they would be sorely disappointed because you have to read between the lines and even go beyond that and just see the pleadings and the defence and other information to have even a remotest idea of what the DG did or did not do in this case.

THE PRESIDENT: I think we do need to tie down the particular passages in the defence and other documents or the skeleton that you are criticising.

MR GREEN: Absolutely. Yes, I will do that. What I have done so far is provide you with an overview, but at various points I will delve more into detail. Perhaps I can go back to base point and start more systematically.

THE PRESIDENT: Yes.

MR GREEN: I want to start with the procedural issues. The first point is in substance a response to the Director's criticism that the complaint was inadequate and that the Tribunal's power of review should be linked to the detail contained in the complaint. The essence of our case is that the Director placed himself in a position whereby he made it impossible for Freeserve to make the fuller submissions that it wished to make to him on the merits of the case.

THE PRESIDENT: This is in the section 47 application?

MR GREEN: Yes. There is another strand to this, which is what was actually said at the meetings on 16th April, to which there was a short answer, which is that on 17th April the Director wrote to Freeserve and said in terms, "We have not formed any views; we will let you know our provisional views and our conclusions on our provisional investigation by the end of May". So far as the section 47 application is concerned, we submit that it is clear from the terms of section 47 that the Director has a statutory duty to give due consideration to the sufficiency of the reasons in his decision, and Freeserve's application was intended to start a dialogue with the Director whereby the sufficiency of those reasons would be challenged.

The section 47 is in the notice of application file at tab 4.

THE PRESIDENT: Yes. No doubt the Director will say in due course that, by the time you get to section 47, you really ought to have put in most of your argument, that really it is a bit late to be

trying to start a dialogue when you have 47 ----

MR GREEN: Whatever the merits and demerits of section 47 as a whole, it does exist to entitle a complainant to challenge the sufficiency of the reasons in the decision.

THE PRESIDENT: Yes.

MR GREEN: One must not forget that in this case the Director was on his own admission conducting what he viewed as a provisional investigation which could always have broadened out into a second stage broad investigation and, had that been the case, Freeserve could reasonably have expected to have engaged in dialogue with the Director. What one has in effect is the first shot, but in any full blown complaint case a complainant would ordinarily expect to engage in dialogue through meetings, through requests for information, through the submission of further comments or evidence on particular points, and you twist and turn and duck and weave according to the expectations of the regulator as they evolve. That is what normally happens. In this case the initial salvo was met with a straight bat, the shutters then came down and nothing further evolved.

The section 47 procedure, for all its faults in other respects, at least in this case would have permitted a complainant that had put in a complaint which lacked in relative terms detail, would have given that complainant the opportunity to take matters further. It was in June that Freeserve instructed Baker & McKenzie, and in this letter from Baker & McKenzie to the Director General of 20th June Baker & McKenzie say in the second sentence:

"We attach a document setting out the reasons why the decision should be varied or withdrawn as required by section 47(2)(b) of the 1998 Act. A more detailed description of the reasons for this application will follow shortly. At the same time as providing the more detailed description of the reasons in support of this application Freeserve.com will submit a new complaint that will raise additional concerns in relation to BT's behaviour regarding broadband products and services.

"In support of the new complaint and the more detailed description of the reasons for this section 47 application Freeserve.com has instructed an economist to prepare a report addressing the issue of abuse of dominance by BT in relation to broadband products and services, and in particular issues relating to the new BT broadband no frills product. We anticipate that we will be in a position to send you this report within six to eight weeks. We would suggest that you decide on the merits of this section 47 application at the same time as taking the decision regarding the new complaint we will submit. We consider that this would be the most efficient and convenient way to deal with the matter.

"It follows therefore that we will not be asking you for an early determination of the section 47 application in order to avoid it becoming divorced from the new complaint. We would also suggest a meeting to discuss all the issues once you have received the additional complaint together with an economist's report in support of the complaint and this section 47 application. In the meantime, if you have any queries, please do not hesitate to contact me."

So a detailed review of the reasoning in the decision was suggested, together with economists, in the context of the new complaint. Freeserve was not going to push for an early determination of the section 47 application so as to permit the Director to run the review in conjunction with the new matters. Freeserve considered this to be a sensible and, it hoped, convenient way to progress matters.

The document on the next four pages of the file was the attachment to the letter and was simply the outline of the reasons whereby Freeserve suggested that the decision should be withdrawn or varied, but it was really the taster which Freeserve was suggesting would be then followed up with the full submission and economists' evidence.

As the Tribunal knows, the Director's response on 8th July at tab 5 was a legal response, namely, "We have not conducted this investigation under the Competition Act and therefore we do not consider your section 47 application to be a valid one". It necessary followed that he did not consider it and all he said was in the last sentence, "We will of course carefully consider on its merits any fresh complaint that Freeserve.com wishes to make". The word "fresh" meant "new" and was a reference to the new complaint that was contemplated, but in no circumstances was the Director prepared to engage with Freeserve on the merits or demerits of his existing decision.

With respect, Freeserve's offer was a sensible and convenient one, which was deal with the two complaints together, "we will not press you for a quick section 47 decision". Indeed, the Director in his skeleton seeks to point out the fact that the old complaint which is before the Tribunal and the new complaint are similar. It is a point which he has been at pains to point out. There would have been every common sense in those two matters being addressed at the same time.

For the Director to criticise Freeserve upon the basis that its initial salvo was in some way inadequate, we submit, is an argument which can only be founded upon the Director's own unlawful failure to apply the section 47 procedure.

The points that the Director makes in paragraph 4 of his defence on this are, with respect, unfair points.

First, he says that the letter from Baker & McKenzie of 20th June does not provide any reason for the Director to change his view that the original complaint did not merit further investigation. In paragraph 4 of the defence (page 2 internal numbering), last sentence, he says, "Nor did the subsequent letter from Freeserve's solicitors dated 20th June provide any reason for the Director to change his view that the original complaint did not merit further investigation". With respect, that simply is not a fair statement. It was not that it did not provide reasons, it is that he refused to listen to anything which Freeserve had to say.

THE PRESIDENT: Yes.

MR GREEN: The second point that he makes, which is that he addressed the first complaint fully and carefully, is, with respect, at odds with the approach which he adopted in the preliminary

issue, which is that he conducted a first stage analysis. He accepts that it was rough and ready, but that was sufficient in his own mind to enable him to come to the view that there was no case to answer.

THE PRESIDENT: Yes.

MR GREEN: In paragraph 6 of his defence he points out in the last sentence that there is a heavy overlap between the content of the new complaint and the issues that are raised in the notice of appeal particularly as respects the questions of market definition and dominance.

Well, they certainly would have been, had the Director acceded to Baker & McKenzie's suggestion that the two matters be run together for the sake of administrative convenience, but it is the Director's refusal to deal with the section 47 application that means that they necessarily have been split up. Freeserve had no option but to launch its application to the Tribunal because time was running.

The other point which the Director takes in his skeleton is that the duty on the part of the Director to give reasons is affected and mitigated by the fact that Freeserve had a meeting with the Director. Now, you have a number of versions of the attendance note of this meeting and the Director's note and Freeserve's note diverge in some respects.

THE PRESIDENT: Yes.

MR GREEN: But there is an important point to be made about this, which is that on 17th April 2002 the Director sent a letter to Freeserve. This letter is in the Director General's supplementary bundle at tab 2 and it was sent the day after the meeting between Freeserve and the Director. It therefore gives an indication of what the Director had obtained from the meeting and what he perceived his position to be as of the date of the meeting. He says:

"Following your letter of 26th March" - that is the complaint letter - "and our meeting of 16th April" - which was the day before this letter was sent - "I am writing to let you know that I am investigating the issues you have raised. In dealing with representations and complaints Oftel normally adopts a two phase approach ..."

THE PRESIDENT: Yes, we have read it.

MR GREEN: You have seen that letter. At the bottom in the penultimate paragraph he says, "I hope to inform you of the conclusions of our preliminary investigation by 28th May at the latest". He is not saying he has formed any view at the time. He is saying he will investigate. In so far as it is suggested that the meeting of the day before was a forum in which the Director could give reasons to Freeserve for the position that the Director might adopt in the future, that cannot be. The Director here was saying that he was about to start his investigation or was in the course of investigating, and he would only be in a position to inform Freeserve of his conclusions at some time before a period of approximately six weeks from the date of that letter, by 28th May.

THE PRESIDENT: Yes.

MR GREEN: Now, that was the only meeting that Freeserve had with the Director. That was the meeting on the 16th. Nowhere in the letter of the 17th is there a reference to a request for further

information. The Director was investigating the complaint set out in the 26th March letter, which was predatory pricing by an incumbent.

We submit that the correct legal analysis of what happened can be summarised as follows.

First, the Director was under a legal duty to consider the section 47 application.

Secondly, Freeserve sought to supplement its case by introducing legal factual and economic submissions. Freeserve's letter via Baker & McKenzie of 20th June was sensible and co-operative and proposed a logical way forward.

Thirdly, the Director unlawfully refused to entertain this new material.

Fourthly, Freeserve was therefore forced to split its approach between material supplementary to its original complaint, which would then have to form the basis of the notice of application to the Tribunal, and new material alleging new abuses which went forward as a fresh complaint. Fifthly, what we submit is the absurdity of the Director's rejection is highlighted by his acknowledgment in the defence that there is material overlap between the first complaint and the second complaint, and the absurdity is made all the more greater by the Director's own acceptance in the defence, paragraph 15.4, which is that the section 47 procedure was a procedure which was designed to enable problems such as this to be overcome. This is on page 6 of the defence, where the Director says as follows:

"Moreover, at least under the procedure currently laid down in section 47 of the Act parties whose complaints are rejected by the Director must, before they may appeal, first apply to the Director for the complaint rejection decision to be withdrawn or varied, and they must give reasons. It would be particularly odd if, given that special requirement to apply to the Director with reasons, a party were nevertheless permitted to introduce new material for the first time at the appeal which could have been produced beforehand."

We take that as an explicit acceptance that the section 47 procedure in a case such as this could have been used to supplement the economic and factual basis of the complaint, and indeed should have been used.

The sixth point is that the Director's unlawful response is in fact the reason why the complaint and the notice of appeal contain different levels of detail and why the only explanation of the Director's conduct in this case is the single case closure decision. Again, had the section 47 procedure been worked through, the Tribunal would have had before it not only the original case closure decision but a section 47 decision, which may have advanced the transparency of the reasons which were available to the Tribunal, to Freeserve and to third parties.

A seventh point is that the Director's present argument that the Tribunal should exercise something of a light touch or a light hand, because he alleges that the complaint was not detailed and because, as he now sets out in his skeleton, Freeserve had meetings with the Director, these arguments conveniently overlook the Director's unlawful refusal to consider Freeserve's section 47 application.

This brings me to a different but related topic, which is the statutory duty upon the Tribunal to investigate complainants' decisions.

THE PRESIDENT: Just before we go on to the Tribunal, I suppose you say, do you, that, strictly speaking, under section 47(6) this appeal is against the rejection of the section 47 application? It brings up the original decision.

MR GREEN: That is right. I think it was in Bettercare or in Jiske that the Tribunal said that it was two decisions which were effectively being appealed against.

THE PRESIDENT: Yes.

MR GREEN: We say that the duty on the Director to consider an application is implicit in section 47(4).

THE PRESIDENT: Yes.

MR GREEN: This brings me to what is a related point, which is the statutory duty upon the Tribunal and the inferences that one draws from the statutory language for the review procedure. We have set out in some detail our position in writing but I would like to just highlight the main points.

We submit that the reason why the Tribunal's duty is to examine the merits of this decision flows from the statutory language in the Act, and we do submit that it is the Tribunal's statutory duty to determine all appeals on the merits. That necessarily includes examining questions of fact which might arise, and this flows out of Schedule 8 to the Act. I ask you to turn that up, please.

Schedule 8(2) states that the notice of appeal sets out the grounds of appeal, and the level of detail in the notice of appeal is only that it be in sufficient detail to indicate three matters: (i) under which provision of the Act the appeal is brought; (ii) to what extent, if any, the appellant contends that the decision against or with respect to which the appeal is brought was based on an error of fact or was wrong in law; and (iii) to what extent, if any, the appellant is appealing against the Director's exercise of his discretion in making the disputed decision.

The Tribunal's decision is identified in Schedule 8(3), and it comes under the broad rubric that the Tribunal must determine the appeal on the merits by reference to the grounds of appeal set out in the notice of appeal. First of all, the duty is mandatory. The Tribunal must. It is not discretionary. Secondly, the duty of the Tribunal is to determine the appeal on the merits, and those are important words, and they are by reference to the grounds of appeal set out in the notice of appeal.

A combination of Schedule 8(2) and 8(3) means that, where an error of fact is referred to in the notice of appeal, the error must be decided by reference to its merits. Nothing in Schedule 8 contemplates that the scope of the review will be determined by reference to a complaint or indeed any other document. The parameters of the appeal are explicitly stated to be determined by the notice of appeal. We would submit that Schedule 8 deliberately refrains from using language which suggests a less intrusive form of review and that is why the inclusion of the words "on the merits" is particularly significant. There are many other statutes in the United

Kingdom which incorporate procedures of statutory review to the administrative court in which a fairly standard form of wording is used which makes it clear that it is not a merits review, that there are limited grounds of appeal. So that, when Parliament seeks to limit an appeal jurisdiction or standard of review, it is perfectly capable of saying so in language which is well understood. There are none of these limiting words such as "manifest" in Schedule 8. Indeed, the use of the words "on the merits" strongly suggests that, with regard to all decisions which fall to be adjudicated upon by the Tribunal, they are to be determined by reference to their inherent correctness or incorrectness.

Again, Parliament could have sought to differentiate between decisions whereby a complaint is rejected and decisions whereby an infringement is found. It sought to do so elsewhere in the Act - in section 47 it contemplates that there are different types of procedure - but it has adopted uniform language in relation to the standard of review.

THE PRESIDENT: If you are postulating a standard of determining the inherent correctness or incorrectness of the decision, you are really postulating a re-hearing, are you, that the complainant re-makes its case in the application and the Director defends it, and off we go into a de novo decision on who is right and who is wrong?

MR GREEN: I would accept that the use of the words "by reference to the notice of appeal" may serve to limit what would otherwise be an entirely open-ended obligation on the Tribunal to review a case. It does not say the Tribunal must determine the appeal on the merits. It does say "by reference to the grounds of appeal set out in the notice of appeal".

THE PRESIDENT: Yes, but, if the grounds of appeal allege that the facts are thus and so, there is dominance in all these markets and so forth, the Tribunal, according to you, has to go into all that and decide it?

MR GREEN: We would submit that that is a necessary corollary, but there is a lesser route that the Tribunal can take because, again, it is part of our submission as set out in the notice of appeal - in fact, it is one of our primary submissions - that the decision is inadequately reasoned. Now, if the Tribunal finds that the decision is inadequately reasoned, then under Schedule 8(3)(ii) it has a discretion, and at this point a discretion plainly arises, as to the remedy that it can adopt, for example, set aside and remit or set aside and decide itself.

Reading Schedule 8(1), (2) and (3) together, we would accept that, if the principal submission is inadequacy of reasoning, the Tribunal may say, well, having found in favour of an applicant upon that basis, the proper remedy is to remit with directions, for example as in Aberdeen Journal, and possibly as an alternative to decide.

What we do not accept is that there is some limited form of hands-off review whereby the Tribunal will only intervene if it concludes that there is a manifest error, which is the formulae which the Director, for reasons which are plain, suggests is the appropriate remedy. Notice that BT do not adhere to that formulae; they have wider formulae but they may need to invoke it before the Tribunal themselves at some later stage.

We simply say that the words "on the merits" mean "on the merits". If there is an allegation of fact in the notice of appeal, the Tribunal will need to resolve that. If it finds that it cannot resolve it, it has a series of remedies available to it which involve remission with directions or deciding it itself. We think it is implicit in the structure of the Act that the Tribunal has that discretion, that it can decide to decide things itself and it may therefore need to make directions to enable a matter to be decided.

As the Tribunal knows, we are dealing with this case in something of a layered way and we have accepted that, for the purposes of this hearing, our challenge is primarily an attack upon the logic and the reasons of the decision. We have our case that the business case is in fact defective, but that is something which has been put aside to be dealt with on another day if it becomes necessary.

We do submit, therefore, that the power of the Tribunal is to conduct a review on the merits, that this includes determining the merits of all arguments in the notice of appeal, that the Director's suggested approach involves a very substantial re-writing of Schedule 8 to fetter the Tribunal's hand by reference to the content of the complaint itself, and to introduce limits where Parliament has used inconsistent words.

THE PRESIDENT: Is it not probably the case, or arguably the case, that the original complaint sets the parameter for the whole procedure, as it were? It is as to the original complaint that the Director takes his initial decision; it is in relation to that decision on the original complaint that there is a request to withdraw or vary; the request to withdraw or vary is probably arguably not an occasion to make a new complaint but to ask it to deal with the original complaint; and the question before the Tribunal as to whether or not it dealt adequately with the original complaint, either on the facts or the law or the reasons or the investigation, are the matters that come before the Tribunal "on the merits". "On the merits" is a rather broad expression. It may well be that it does not mean that you are confined to the heads of judicial review as sufficiently understood. It does not necessarily mean that at the other end of the spectrum you have to assume an original jurisdiction that means that you do it all the first time.

MR GREEN: We would submit that there is no necessary correlation between a complaint and a decision - that is where the logic breaks down - and that is particularly the case when one is dealing with a specialist regulator. That is because a complaint by a body such as Freeserve about an undertaking such as BT will necessarily always be based, at least to some extent, on imperfect information. In a case such as this the Director General has a vast wealth of specific and particular information about BT which nobody else can replicate. He has a statutory duty under the Telecommunications Act to monitor on a permanent basis the telecoms market.

A complaint may be served on the Director General where a sensible, rational Director General would say, "Well, I can see what they are getting at; I of course have a vast store of information which Freeserve does not have access to", and he begins to take that investigation forward. Freeserve is not privy to the discussions between the Director General and BT; we do

not have access to BT's business case; BT would object, and does object very strongly, to Freeserve having access to its confidential information. There are extreme limits to the information that a company such as Freeserve can advance to a Director General, particularly one in a highly specialised market, and the point is that the nature of a complaint may change substantially in the course of the investigation. The investigation procedure is not transparent and it is not one in which Freeserve has an automatic right to be informed by the Director of the stages that it has arrived at. We all know from one's own experience of doing complaints that, depending upon the identity often of the case handler, one's client is either actively involved or not actively involved. Complaints change in their nature over time.

So to draw a connection between an original complaint and then a decision is, in our submission, not warranted by the structure of the Act.

THE PRESIDENT: It may not be necessarily so in every case, but would not at least one issue possibly be whether the Director's response was proportionate to the complaint that he had received? It cannot be the case that, by putting in a rather badly argued and flimsy complaint, you can trigger an investigation which you can then demand to be re-done in a section 47 request, and then bring before the Tribunal a whole panoply of serious arguments all on the basis of a complaint that was pretty light in the first place. Surely the Director is entitled to say, "Well, this is pretty light; I am not going to take it any further"?

MR GREEN: He would be entitled to do that but in this case he did not. He would be entitled to say, "This complaint is flimsy; I don't know whether there is anything in it at all; go away and do it again and, if you then submit to me a properly formulated complaint, I will investigate it".

THE PRESIDENT: Well, he has really said in the decision that the original complaint did not really get off the ground. He does not quite use words to that effect.

MR GREEN: It is not quite that. What he has actually said in his letter of 17th April ----

THE PRESIDENT: He uses slightly different expressions in different parts of the letter.

MR GREEN: Yes, he uses different expressions but they are significant and important. He says in the first bullet point of the 17th April letter: "The preliminary investigation phase, when initial consideration is given to decide whether there is a case to answer which requires further investigation ..." There is an important distinction to be drawn between a rejection of a complaint on the basis that the complaint is flimsy, which is an Automec type of rejection, and a rejection where he has actually examined the merits.

THE PRESIDENT: Well, he says the information supplied does not provide evidence of anti-competitive behaviour.

MR GREEN: But that ignores the fact that he did conduct his own investigation and he made enquiries of BT; he sets out his reasons, which include a factor that he carried out, he says, a detailed investigation hitherto and he simply brought forward the conclusion and incorporated that by reference into his decision. So he is saying, "I have investigated; I am relying upon my prior investigation; I have conducted an investigation with British Telecom and I am satisfied

that there is no case to answer".

We would divide the legal point into two. He is entitled to reject a complaint upon the basis that it is flimsy and it should be withdrawn and re-submitted. That, we submit, is not a decision as to whether or not there has been an infringement. Once he goes beyond that stage and decides that there is no infringement, then Schedule 8 makes it clear that the merits of that decision that there is no infringement are to be reviewed. We submit that we have got past the stage where he is entitled to say, "The complaint was flimsy, I don't have to consider it". Even if one assumes that the complaint was flimsy, he did investigate it and he did come to a conclusion that there was no infringement because he decided that there was no case to be answered by BT.

With respect, he cannot have his cake and eat it. He cannot say, "I am not going to reject this complaint because it is flimsy and I am going to conduct an investigation but, when I am challenged as to my conclusion, I am then going to say oh well, I should have rejected it upon the basis it was flimsy". He could have done that but he did not.

In the context of a specialist regulator it would, in our submission, be a most unfortunate thing if the regulator could say that. All the documents which are annexed to the various parties' submissions show that the Director is monitoring on an almost daily basis the development of various markets and market segments, and he has the ability to conduct an investigation which nobody else can. To then say to a company such as Freeserve "Well, I think your complaint is flimsy so I won't investigate it even though I can see that it is an important issue" would really be a denial of his statutory task under the Telecoms Act.

THE PRESIDENT: I don't think we can muddle up the Telecoms Act and the Competition Act for the time being.

MR GREEN: It does not alter the analysis, which is that he is a regulator addressing his mind only to one market. We are entitled to say that he has seized himself of the investigation and he should do it properly. Once we have got past the stage of the preliminary issue, we are entitled to say that, if he says he has carried out only a rough and ready investigation, we rely upon that to show that it is an inadequate investigation, but he cannot rely upon it to show that we are not entitled to ask you to review the merits of our notice of application. The analysis shifts across the court room from us having to show that he took a decision and he now having to show that his decision was correct on the merits.

The BT business case does provide an example. Perhaps I can make the point by reference to tab 11 of the Director's original supplementary bundle, which is our file 2. I am starting at paragraph 2 under the heading "Oftel's original consideration" and this is the residential decision of 28th March 2002.

THE PRESIDENT: Yes.

MR GREEN: In paragraph 2 and onwards the Director refers to three BT business cases of which he was in receipt. You will notice that the date upon which the case was closed was 28th March 2002 and the Freeserve complaint was submitted two days earlier on 26th March. In paragraph 2

he says:

"In our original consideration of this complaint between June 2000 and January 2001 Oftel considered BT OpenWorld's business case and the assumptions underlying it in some detail. BT OpenWorld initially believed it could supplement revenues from subscription fees with revenue from advertising and E-commerce. On the basis of what was known at the time about retail markets Oftel had no basis for concluding that BT OpenWorld's business case was implausible. As such there was no evidence to suggest that BT was operating a margin squeeze."

THE PRESIDENT: Yes.

MR GREEN: He had a business case. The price at which wholesale ADSL broadband was being supplied was at that point to be supplemented and offset by revenues from advertising and E-commerce, and the DG accepted as plausible BT's business case at that point.

He then in paragraph 3 refers to a change in circumstances. He says: "By the time Oftel began its review in July 2001 BT OpenWorld had decided that its original business strategy needed to be revised". You will see that he then refers to a reduction in price and a conclusion on the part of the DG that the new business case was implausible.

THE PRESIDENT: Yes.

MR GREEN: That conclusion is set out in paragraph 4.

In paragraph 5 the third business case is referred to, and he then says that that is the business case and the conclusions he arrived at in relation to that, which he relies upon in the present decision.

THE PRESIDENT: Yes.

MR GREEN: So he had three business cases at the very least, and he presumably engaged in dialogue with BT since some time after June 2000 as to their business case. We do not know what level of detail the dialogue was in but we do know that there were three business cases. Two days before this case closure decision Freeserve put forward its hypothetical BT business case.

That is an example of why the Director's position is different to a complainant's decision. The Director is in possession of information which may bear directly upon the point which the complainant could never in a million years be expected to generate or provide to the Director. It is just simply not credible that the Director could base his analysis upon a hypothesised business case put forward by Freeserve necessarily containing assumptions which may or may not be accurate when, at the very same time, he has in his possession, because of his privileged position at the centre of the market, a great deal of information about the very issue in question. He may analyse that rightly or wrongly, he may draw the correct or incorrect inferences from the information in front of him, but the complainant never would be in a position to advance that level of detail to the Director.

That is why the Director, in moving matters forward after a complaint, will almost inevitably deviate from the complaint. He will investigate matters which the complainant could

not have been aware of. That is why Schedule 8 says that one examines the merits of the decision. If the merits of the decision could be linked through some legal umbilical cord to the complaint, it would be to create immense uncertainty in the appellate procedure.

THE PRESIDENT: On your submission, would that involve us examining whether or not BT's business case was plausible?

MR GREEN: I think one would have to examine all of the steps which the Director undertook in investigating BT's business case, and one would have to try and devise a chronology of what happened after the complaint to see what the Director did or did not do, what inferences he drew from evidence and whether they were correct or incorrect. Freeserve simply does not know. All we can do is observe from the outside what we see. But the Director, in the privileged position in which he sits in the telecoms market, obviously does a great deal more.

In posing the question in that way, in my submission, it really highlights the fact that you cannot link the complaint to the decision. So much water may pass under a bridge in any particular case that to have that nexus would impose an intolerable and impossible burden on both an applicant and the Tribunal. In every case in which you are reviewing a complainant's application the Tribunal would have to investigate what happened after the complaint before the decision, but the complainant could not put that in the notice of application because we don't know. It is an invisible procedure.

THE PRESIDENT: What do you say we should do?

MR GREEN: Our principal submission in this case is based upon the inadequacy of the reasons in the decision. We submit that there are two fatal flaws in the Director's decision. One is the failure to provide adequate reasons and, secondly, we believe there are errors of law which are implicit and indeed express in the decision. Our application at this stage is, therefore, primarily focused on those two issues.

If the Tribunal is with Freeserve on those issues, then the question arises what do you do, and I think we have canvassed this before and in writing, which is this: does the Tribunal then simply remit for the decision to be properly reasoned, or does it then make its own directions so that the matters can be decided upon by the Tribunal. That is a second stage.

THE PRESIDENT: Yes. How are you getting on, Mr Green, from the point of view of time?

MR GREEN: I have certainly finished my overview introduction and I have dealt with a large number of issues. As I go through them systematically, I will be able to abbreviate some of them very substantially, so I am probably doing reasonably well.

THE PRESIDENT: Are you likely to be through by lunch time?

MR GREEN: I suspect it is unlikely but I don't think I will probably go much into the afternoon.

THE PRESIDENT: Thank you. We will see how we get on.

MR GREEN: It goes without saying that I am obviously happy just to continue to answer questions and be probed.

THE PRESIDENT: You go on, I think, Mr Green. Where are we going now?

MR GREEN: I want to make some brief submissions upon the duty to give reasons. We have set out the law in relation to this fully in paragraphs 7 to 17 of the skeleton and I am not going to go over those points. Since, as we have set out in the notice of application, a substantial part of our application is focused upon the inadequacy of the reasons, I would like to just set out what we say are the bare minima that would be required in a case of this sort.

The first point is that, according to the case law, the duty upon a decision maker to give reasons is because it affects three categories of interest. We have made our submissions that it is ----

THE PRESIDENT: Yes, we have that submission.

MR GREEN: I would like to just make a point about the position of third parties. Plainly, Freeserve's interest and the Tribunal's interest is well understood. So far as the position of third parties is concerned, this is a very important case involving important issues of fact and important issues of law in an acutely important market. Other industry participants inevitably will be looking to the Director's decisions, and indeed to this Tribunal's ruling, for guidance as to the Director's future conduct in regulating the market. We submit that there is a very strong public interest in a specialist regulator's decisions being informative and properly reasoned.

We do submit that the Director himself recognises this. At the April 16th meeting both Freeserve and the Director accepted a need for third party transparency. There is an interesting passage in the note of the meeting in the Director General's disclosure documents at tab 1 of our file 2. On the second side of that page under the heading "Rules governing BT's marketing of internet services" there is a paragraph which says this:

"Freeserve confirmed that it did not have a particular problem in marketing rules shifting from structural approach to behavioural approach". So that is the shift from Telecoms Act type regulation to Competition Act type regulation. "Freeserve then says that it felt it was important for the industry that there was clear visibility on marketing rules and asked whether Oftel was likely to make a public statement or consult. Oftel expressed the view that there was no locus for it to consult on marketing rules and that it was for BT to comply with its regulatory obligations. However, Oftel agreed that it would be helpful if there was transparency on those rules and said that it would consider making some form of public statement."

There really cannot be any doubt but that transparency of reasoning is of great importance to third parties. That is an additional reason why we say the reasons in this case should have been particularly clear and unequivocal.

We submit that the duty to give reasons is not mitigated by the size or the sophistication of a complainant. The duty is a free standing one and it cannot be dependent upon Freeserve's size because otherwise you would not be protecting the interest of the third party or the court or the Tribunal. If you say, "Well, Freeserve is big, bad and ugly and can look after itself; therefore, we give them pithy reasons", that makes it difficult for Freeserve to know what those reasons are to review it, the Tribunal has difficulty in identifying the reasons to adjudicate upon

it and third parties are left completely in the dark.

Indeed, Freeserve is just the sort of company that in the public interest one can expect to carry the torch to the Tribunal. Smaller undertakings may find it too daunting a prospect, but it may very well be the larger undertakings who will be the very undertakings who will wish to bring cases before the Tribunal and therefore carry the banner for the rest of the industry. To say that, because Freeserve is big, bad and ugly, it is entitled only to short reasons or pithy reasons would be contrary to that public interest.

Equally, the Director's point that there is no duty to give reasons if these are communicated informally is, we would submit, unsound because, again, an informal expression of reasons does not enable the Tribunal to conduct a review, or third parties to conduct a review. In so far as it is suggested that that was the case here, there is no evidence that the Director communicated his reasons in an informal manner. All we have is the attendance note of 16th April followed by the letter of 17th April.

THE PRESIDENT: Yes.

MR GREEN: We accept that it is adequate reasoning to cross-refer to another decision and we have set out our position in writing on that, but for this to be so the secondary source must adequately cover the proposition advanced in the impugned decision, and indeed the impugned decision itself must make clear precisely the relevance that it seeks to draw from the other decision. It is pertinent in this case, because of the reference in the decision to the March decisions, but as to this the Director in his skeleton now suggests that none of the reasons set out in those March decisions were in fact incorporated into the decision. (That is Mr Turner's skeleton, paragraph 36, page 15.) Here he says, "The Director did not incorporate by reference in the decision letter the detailed reasoning for the margin squeeze investigations. The reference to the result of those investigations in the decision letter simply provided an additional reason for concluding that Freeserve's one year mock business case was insufficient evidence of an unfair cross-subsidy on the part of BT."

We had always assumed that we were doing the Director a favour in submitting that he incorporated by reference his earlier reasons. It appears that we were misguided in this, in which case it highlights what we submit is the even greater paucity of reasoning in the decision letter itself.

THE PRESIDENT: Yes.

MR GREEN: The next point that I was going to make, which I think I have dealt with, was what can reasonably be expected from the Director under the Competition Act in a position of the Director General. I have dealt with that but I just want to see if there are any references to documents to which I would like to alert you.

THE PRESIDENT: Yes. Take your time.

MR GREEN: (After a pause) Can I ask you to look at the May 2002 statement, which is notice of application, tab 2. This is an illustration of the fact that the Director considers himself to have a

duty independently to monitor BT's position.

What this document reflects is an acceptance on the part of the DG that he has a duty and a function to monitor on a constant basis the marketing issue, and including BT's conduct. On page 3 of the document, for instance, under the heading "S3", he refers to his high level strategy of obtaining best deal for consumers, the prevention of anti-competitive conduct and practice, and promotion of a well-informed and adequately protected consumer. At paragraph 2.1 on page 7 he says, "In assessing how it should oversee BT's marketing and billing of internet services Oftel has sought to address three objectives", the second of which is to put in place robust proportionate controls to prevent anti-competitive behaviour. But he views it as his function to oversee BT's marketing of internet services.

Those two references - and indeed there are many others - simply highlight the dangers of any appeal being determined, even indirectly, by reference to a complaint.

THE PRESIDENT: I suppose we have a specific situation in this case where the existing regulatory regime is apparently progressively giving way to a Competition Act orientated regulatory structure, which will itself develop even further in the context of the new communications bill and the relevant directives when they come into force in the summer. So it is a somewhat special situation.

MR GREEN: Yes. I think it is fair to say that there are dangers in drawing too many broad parallels from the facts of this particular case because things may change in the future. Our submission to you in this case is that, whatever may be the position once section 47 has disappeared and in the future, on the facts of this case it would be irrational, unreasonable and unlawful for the Director to be able to get away with the notion that the complaint should govern the scope of the appeal, and indeed your functions in reviewing the decision. Whether it be the case or not that otherwise complainants may be expected to put more in, that is not something we are really addressing. We are addressing very specifically the facts of this case.

THE PRESIDENT: Yes.

MR GREEN: Can I move from procedural issues to predatory pricing.

THE PRESIDENT: Is there any more on dominance because dominance is your second point?

MR GREEN: Yes, dominance was my second point. I wonder if I can leave that until last. I think I will probably be able to get through predatory pricing before lunch, and I would like to just consider one or two things over lunch and come back to you on dominance in the afternoon.

THE PRESIDENT: Yes, by all means.

MR GREEN: We have set out fully in writing our criticisms of the reasoning of the decision. One point I do wish to address, which is a quasi procedural point, is that the Director in his skeleton says that the points we have addressed are new points. I would like to comment shortly upon this suggestion before making substantive submissions.

Now, in fact, it is the Director in his defence who has introduced a series of new points about the scope of what he did and did not do, and BT likewise has sought to support the

decision by reference also to new points of principle.

THE PRESIDENT: Yes.

MR GREEN: We obviously have not served a reply in this case, given time constraints, and so our skeleton serves the purpose of both responding to the defence and the statement of intervention and pulling threads together.

In his defence the Director has introduced what appears to us to be three different explanations of the test for a predatory or exclusionary cross-subsidy. These are at paragraphs 28, 66 and 67 of the defence. Paragraph 28 is page 11 (internal numbering) of the defence. Now, in the combination of paragraphs 28, 66 and 67 the Director introduces at least five notions, important notions, which are not in the decision but which he none the less apparently intends to rely upon to justify the decision.

I will just identify the paragraphs and what they contain.

First, paragraph 28 says, "The nature of a cross-subsidy such as may infringe the chapter 2 prohibition in the Act is usefully summarised in Oftel's Competition Act guidelines", and he there sets out paragraphs 7.20 and 7.21. He says, "In 7.21 a cross-subsidy will normally be judged to occur when an undertaking's revenues from an activity, for example a new service, may be expected to fail to cover the costs associated with that activity over its economic life time". Two notions are thereby introduced: (i) that you measure the revenues over the economic life time, and (ii) that the economic life time is that of the activity. He then says that he would introduce as his test a test of long run incremental cost as the basis for determining whether the revenues over the life time of a service exceed cost.

In paragraph 66 he makes the point, having cited paragraph 7.21 of his own guidelines, in the last sentence that "assessing profitability over the initial year after launch by itself has little probative value".

Then, thirdly, in paragraph 67 he states that along similar conceptual lines he would refer to his own decision in the ATM direction case, and he cites paragraph 4.31 of that direction where it stated as follows, "In undertaking a test for margin squeeze the relevant time period will be chosen over which a business case is reasonable and also, in the case of new services, the test will generally be whether the relevant service has a realistic commercial case at the time of its launch".

So five matters are introduced by the Director in his defence which we submit are relevant. They are as follows.

First, that he has relied upon his own guidelines on margin squeeze which define an abusive margin squeeze or cross-subsidy as one where revenue from an activity may be expected to fail to cover associated costs over the economic life time of the activity (paragraph 28).

Secondly, that the appropriate cost is long run incremental cost (paragraph 28).

Thirdly, that assessing profitability over the initial year after launch by itself has little probative value (paragraph 66).

Fourthly, there is a nexus or link between the relevant time period and the chosen business case (paragraph 67).

Fifthly, in the case of a new service, the test is generally based upon the realism of the dominant undertaking's commercial case at launch (paragraph 67).

Now, Freeserve is entitled to infer that the Director is relying upon these statements as part of his defence, and they therefore squarely put in issue such matters as the relevant time period for measuring abuse, whether twelve months following launch is an irrelevant time frame with no probative value, the relevance to be attached to a dominant undertaking's business case, whether the time frame is to be measured by reference to the economic activity or a contract for that activity and what the proper measure of cost is.

BT has also put these issues into play and I will just give you references rather than take you to the statement of intervention. In paragraphs 44 and 46 BT says that in cross-subsidy and predation cases it is necessary to examine periods of more than twelve months. They say that it is appropriate to examine and evaluate the activity over its economic life time, and they therefore agree with the Director on this. They say that any analysis of abuse entails an analysis of the reaction of rivals (paragraph 46A).

We set out our response in our skeleton, but it is also relevant that in the Director's response to the Tribunal's own questions the Director makes a number of similar points. Again, without taking you to them, can I give you the references now.

First, that he applied his own guidelines on cross-subsidy (paragraphs 2.1 and 2.2 and footnote 11).

Secondly, that he suggests that margin squeeze and cross-subsidy are similar concepts (paragraph 2.4).

Thirdly, he says that a margin squeeze will not normally involve predatory pricing behaviour (paragraph 2.4).

THE PRESIDENT: I just need to find these references, Mr Green, to follow what you are saying.

MR GREEN: (After a pause) Paragraphs 2.1 and 2.2 are that he applied his own guidelines on cross-subsidy. Paragraph 2.4 is margin squeeze and cross-subsidy are similar concepts. Paragraph 2.4 is that margin squeeze will not normally involve predatory pricing behaviour.

Then he suggests, though he does not say so explicitly, that predation is to be viewed by reference to a service viewed end to end. We would infer from this that he is referring to the life cycle of the product.

THE PRESIDENT: We will find out what a service viewed end to end is, no doubt, later on.

MR GREEN: Yes. Paragraphs 2.7 and 2.8 appear to suggest that the Director relies upon the state of mind - there is some indication of what the state of mind of the actual author of the decision is. He says that the terminology used in the decision was used neutrally to refer to the behaviour of BT which could be anti-competitive. I am not entirely certain what that is meant to connote.

Then, finally, paragraphs 2.11 and 2.12: in relation to the waiver of the activation charge

the Director goes further and he actually seeks to give evidence as to what he did with regard to BT's business case.

Again, I have some trouble in understanding what is meant by paragraph 2.12. It seems to be economic double-speak but, when boiled down to its essentials, it appears to suggest that the Director was taking BT's position as assumed but that BT would continue to make substantial losses.

THE PRESIDENT: Well, according to this, he seems to have done some kind of DCF calculation that showed that you would get back your initial losses within some undefined but reasonable period.

MR GREEN: Yes. One can deduce that with some imagination from the March decisions. Those are the sorts of points which are now introduced by the Director apparently as part of his defence of his decision. None of this is stated in the decision, of course.

THE PRESIDENT: Well, he does talk about a pay-back within a reasonable period.

MR TURNER: Sir, I don't wish to interrupt.

THE PRESIDENT: But you are going to anyway!

MR TURNER: It is only on one point. My learned friend has said twice that in paragraph 2.4 he said that the margin squeeze from an unfair costs subsidy will not normally involve predatory pricing behaviour. It says "necessarily" and I think it must have been a slip of the tongue.

THE PRESIDENT: Thank you.

MR GREEN: Just for the record, we do not accept that these issues were not canvassed, at least in broad terms, in the notice of appeal in paragraph 7.30. I don't want to spend time giving you a long list of paragraphs or sub-paragraphs.

THE PRESIDENT: No, we can read it for ourselves. Don't worry.

MR GREEN: Indeed, paragraph 7.16 on inadequate reasoning, paragraph 7.31(8) and sub-paragraph 1.10.

With those points in mind, as to the substance of the predatory pricing complaint, our submission is that the 26th March letter provided an adequate starting point for an investigation into predatory pricing. Freeserve advanced prima facie evidence that BT was loss making and that it states that it was not generating sufficient revenue to cover its variable and incremental costs, and that at least, applying AKZO and assuming no modification to that test, that was evidence of predatory pricing.

I will not take you back to the complaint letter. We submit that it squarely raised the question of predatory pricing. It refers explicitly to AKZO and that any regulator would or should understand what was meant by a reference to AKZO in the context of the Competition Act.

It is relevant to note that a great deal of the Director's argument seems to suggest that there is no necessary connection between cross-subsidy and predation, and again I will not take you to the reference in detail, but paragraph 43 of BT's statement of intervention states, "It is true that cross-subsidisation leading to predatory pricing by a dominant undertaking may in certain

circumstances constitute abuse".

The first criticism that we make of the decision itself is that the test that the Director has purported to apply is simply not set out. It is not set out either in the decision or in the March decisions, albeit that the Director now says that he does not incorporate the March decision's reasoning into his impugned decision.

We do know that the Director in his letter of 8th July rejecting the section 47 application expressed the clear view that he had acted under the Telecoms Act but not the Competition Act, and it may very well be inferred from this that he never addressed the question of AKZO style pricing, whatever he subsequently says in his defence and submissions to the Tribunal. This would appear to be the most plausible explanation for his failure to set out the test that he did apply.

THE PRESIDENT: He does refer to competition law at one point without elaborating in great deal.

MR GREEN: Without elaborating. If you think that the competition law you are applying is that under the Telecommunications Act, then you would not necessarily consider that you had to apply or even address your mind to AKZO style pricing. We would submit that, this being so, it follows from his reasons for rejecting the section 47 letter that, almost by definition, the decision is defectively reasoned, because it contains no reasoning at all relevant to the Competition Act 1998. That conclusion is not affected by his subsequent concession that necessarily he was addressing the Competition Act.

We submit that, at the barest minimum, case law requires the Director to set out the test that he purported to apply, and he has failed to do this.

The second point is that the Telecommunications Act is plainly different to that for AKZO style pricing. We have set this out fully in the skeleton and I will not go into it further. The Telecommunications Act investigation was based on condition 78.12 of the licence which prohibits cross-subsidy but, as the Director accepts, there is no necessary connection between cross-subsidy and predatory pricing. There is no prohibition in the licence on predatory pricing of an AKZO or Tetrapak style.

The third point is that, in an AKZO type case the bare minima that should have been set out would have included an indication that the Director had applied the AKZO test, an indication of the conclusions he reached with regard to dominance, whether it was dominance in the same market or in an associated market, an indication of whether British Telecom's rates were below average variable cost or average total cost or some other measure of cost such as long run incremental cost, an indication of the Director General's conclusions as to intent in so far as the price was within the AVC to ADC type of range, and also an indication as to whether there were any modified rules for new and emerging markets and, if so, how that applied to the AKZO style test.

THE PRESIDENT: Do you say that he was obliged to come to a conclusion on dominance or could he have gone straight to the alleged abuse?

MR GREEN: We submit that he should at least have set out the assumptions that he was making with regard to dominance because it is at least arguable that the analysis of abuse may turn upon the assumptions you make about dominance. In a nutshell, if you are assuming that BT was dominant in the ASDL broadband market, then you may apply (let me call it) Test A. If you assume that they are dominant in an associated market but not in the ADSL broadband market ---

THE PRESIDENT: You mean the retail market?

MR GREEN: Yes, in other words a Tetrapak type case - then there may have been an argument that some form of different abuse test applies.

THE PRESIDENT: You have to make some kind of link, have you not? If it is an associated market case, you have to get a Tetrapak type link or some analogous link to get you there at all.

MR GREEN: Yes. But, even if there is a link, it is at least arguable that a Tetrapak type abuse may be subject to slightly different rules to an AKZO type of use. If you are dominant in market A but not in market B, you may - I am not saying you do - get a greater latitude in market B than would otherwise be the case. That is why the assumption needs to be expressed, because it may affect the analysis of abuse.

In his skeleton the Director says at footnote 14 that, "It is widely accepted that AKZO has no application to telecoms because of the high level of capital cost". Well, with respect, that is an untested assumption and there is no authority in European Court case law for that proposition. He refers to a Commission statement but it is not a self-evident proposition. But, if it were a relevant proposition, it should have been set out in the decision because it is a crucial matter of importance to the telecoms industry. If AKZO is no longer to be the test, or it is a modified form of AKZO, then that was a very important matter which should have been set out.

As to the logic of the approach adopted, I would like to draw a contrast between the approach which the Director has adopted in this case and the approach which he has adopted in earlier cases because it seems to us that he has engaged in a significant departure from his previous approach.

I have attached Oftel's earlier review to the skeleton so there is as an annex to the skeleton a copy of the Director's 1999 consultative document. In annex 3 of this document the Director describes the approach he traditionally takes in the margin squeeze cases. I refer to this to highlight the difference between the approach apparent in the present case as set out in the decision, the plausibility test which was applied, and the more detailed approach taken here, and indeed the different analysis taken here. The relevant section is chapter 3 which starts on page 10, fair prices for service providers. I do not propose to read chunks of this but I can pick up some points from various paragraphs.

It concerned an investigation by the Director General into an alleged margin squeeze against Vodafone and Cellnet, and the object of the exercise was to see whether or not an adequate retail margin was being offered to independent service providers, ISPs. An important

point arising out of paragraph 3.2 is that the Director was looking to see whether or not the independent service provider would either have to show losses or an abnormally low margin. So you are not necessarily looking at a price below cost, you are looking at a price which may be above cost, which enables the retailer to make a margin, but it is an abnormally low margin. It is also made clear that margin squeeze cases are not necessarily dealing with discriminatory pricing.

Paragraph 3.3, under the heading "the Oftel formula" describes how the Director required operators to provide detailed returns on a quarterly basis, demonstrating adherence to pre-determined formulae set by Oftel, and paragraph 3.4 describes the pre-determined formulae. It is to be noted that it requires profitability over the life of an average subscription, not the life cycle of the product. The Director says that, following consultations in 1997, Oftel set the length of an average subscription at 27 months. Previously it had been 35 months. So the object of the exercise was to see whether costs were covered over the life of a contract and not over the life of the economic product or the activity in question.

Paragraph 3.8 is the next paragraph to which I would like to refer. Here the Director says that, if the operator's rates are below the Oftel formulae, this does not automatically connote anti-competitive behaviour. Returns must be considered in the light of prevailing circumstances.

A few general points of relevance may be made about this. Margin squeeze cases do not stand or fall on plausibility slide rules, which is the Director's position in the decision. Here we have an example of the Director conducting an extremely detailed analysis, not based on plausibility but on the pre-determined formulae which he has devised in conjunction with the operators to see whether or not there is in fact exclusionary conduct at the retail level. The relevant time frame, according to this, is not the life cycle of the activity but the life of an average subscriber contract.

Now, there is no indication of the relevant time frame in the decision in the present case. All we have is the Director and BT's subsequent statements that it is the life cycle of the activity as a whole which is to be looked at.

Could I ask you in that context of timing to look at the European Commission's statement in Deutsche Post on predatory pricing. I think it suffices just simply to show you one paragraph in the decision, paragraph 36.

THE PRESIDENT: Is that quoted in your skeleton?

MR GREEN: I am not certain it is quoted in the skeleton. I have referred to it in the skeleton. It is the bundle of authorities, tab 4, paragraph 36. I wonder if I could ask the Tribunal simply to read that. (Pause for reading)

The reasoning of paragraph 36 is relatively limited but the Commission appears to be saying that, measuring Deutsche Post's costs over a five year period, they failed to cover costs and implicitly they were abusive because they failed to cover costs in the medium term. It appears to have been a criticism levelled by the Commission that every sale by DPAG in the mail

order parcel services represented a loss, and they appear to be looking at the contracts which were being offered.

The reason I rely upon this is simply to show that, when one looks at Oftel's own past practice and present Commission procedure, there is nothing to suggest that, by setting prices to recover your cost to make a profit by the end of the product life cycle, it could be anything other than abusive.

THE PRESIDENT: Deutsche Post is about an established service, is it not?

MR GREEN: It is about an established service, but we submit that timing is plainly a key issue in this. Perhaps I can make the point in the following way. Timing is a key issue because the short to medium term price that a dominant undertaking charges its subscribers will depend upon the length of time over which it seeks both to cover its costs and then earn a profit. The crucial importance of duration can be seen by reference to an example. If we assume for the sake of argument that BT postulated in its business case that the life time of the broadband product would be four years, then it would set a price whereby it would seek to cover its costs incurred to date, let us say for the sake of argument after three years, and in the final year earn a profit which was of sufficient magnitude to generate a positive return over the entire period.

Now, on this basis BT would sell, if I can use that term, for the first three years at a rate which did not cover the cost of providing the service to the customer. If the typical customer contract is twelve months, which at the moment appears to be the case, at least as is evident from the adverts in the newspapers, the economic impact of pricing in that way could be quite profound. One only has to assume that subscribers would be modestly sensitive to price for it then to be inferred that they would respond to BT's below cost price, and BT's market share would therefore grow at a faster rate than it would have done if they had calculated the time frame over something less than the life of the product. If they had had to make their profit at a return to profitability at an earlier stage and generate the sufficient margin at an earlier stage, they would have to have set initial prices at a higher level. If they had done that, presumably they would not have acquired precisely the same amount of market share because rivals would have had greater latitude to undercut or to respond. The rate at which BT acquires its market share is profoundly affected by the period of time over which BT postulates that it is going to break even and then make a profit.

THE PRESIDENT: If we are looking at it in competition law terms, quite a lot might depend on what is really driving BT's decision in a case like this. Is it to build a market in a way that will result in profitability by starting off with promotional efforts that involve low prices, or is it more directed against exclusionary behaviour of the classic kind to exclude competitors? The Deutsche Post decision was really a case of exclusionary conduct. This, says the Director and BT, is really a case of building a market.

MR GREEN: The Tribunal in Napp said that the notion of an exclusionary intent was both a subjective and an objective test. You said that you do not need smoking gun documents; all you

need is some foresight, and it can be objective or subjective, that your conduct will cause some form of competitive harm to a rival.

Freeserve's case is that, by setting prices in this way, given its predisposition in the market, it will suck in a greater percentage of the market share than it is otherwise entitled to. By stimulating a market against the backdrop of the predisposition of subscribers to switch to BT or take up BT, it is going to get a greater share of market than it would get if it were pricing otherwise.

We have set out in the notice of application the number of statements made by BT where they talk about their aspirations for growing very substantially their broadband market, and Freeserve's understanding is that BT already has over 50 per cent of the broadband market in circumstances where it has 20 per cent of the narrow band market. So, if you set out to stimulate the market in a very targeted way by a combination of advertising, promotions, waivers of activation fees and basic low pricing, knowing that that will shift demand to you and away from rivals, we submit that that is tantamount to recognising that you will harm your rivals.

THE PRESIDENT: All competition to an extent harms one's rivals.

MR GREEN: Indeed it does.

THE PRESIDENT: There is no law against BT existing and no law against consumers having a particular view of BT's qualities and the service that it provides. If it gets a good market share by adroit marketing and appropriate service, well, that is life.

MR GREEN: But, if you do that at an artificially low price, knowing that that artificially low price will stimulate demand in your favour, then we submit that that is abusive. If you do that, knowing that that will stimulate demand in your favour and that becomes your deliberate strategy, we submit that is contrary to the dominant undertaking's special responsibility. The best way possible one can think of to do that is to set a time frame for recovering costs a long time into the future, calculating therefore your break even also on a distant horizon time frame, thereby justifying selling initial contracts for a number of years at or below cost, thereby knowing that you will stimulate demand in your favour, and you will force rivals to sell at a rate which is at or below their cost. It creates a powerful deterrent to entry into the market and it creates a powerful obstacle to expansion if you know that BT has set its time frames well into the future so that you, in entering the market, are going to have to suffer no profit, or modicum profit, or negative margins over a period of a number of years. That follows automatically from the fact that you have set your recovery process deep into the future.

So it does come down to whether it is proper to set your recovery over the life cycle of the product itself, or over some other measure such as a typical subscriber contract or the medium term.

It is very important that none of this is set out in the decision. I freely accept that we necessarily are guessing as to what the DG actually did because he has not told us what he did. These are crucial issues and we submit that the Director should have set them out explicitly in the

decision.

If I can turn the proposition around, in a classic even Sherman Act style predatory pricing campaign, the dominant undertaking sells below costs for a period of time and then recoups, even assuming his recoupment to be an ingredient of the monopolisation. If this was not a new market, one would simply say that BT is selling at below cost for a sufficient period of time and is then going to recoup. During that first two or three years it is going to acquire a much higher market share than it would have done so, and it is therefore going to harm its competitors. Then it is going to recoup over the residual period.

That, we would submit, is just classic predation. Does it alter matters that we are in a new market? That is a key question. We submit that it may alter matters because we would accept that contract number one may not cover all of the costs. That is begging the question somewhat, but the very first contract that you enter into plainly is not going to cover all of your costs that you have borne to date, so there may have to be some sort of period of time at which one accepts that cost recovery will not take place.

The Director does not set out what test he has applied or what assumptions he has made as to cost recovery, or as to the period of time over which it is proper for BT to set that point of time. Without knowing what those assumptions are, all we can do is to submit that, by setting a time frame over the life cycle of the product, it automatically is an error.

THE PRESIDENT: His case I think is that, "never mind exactly what the test is or the pay-back period, one year's losses as presented by Freeserve do not convince me sufficiently to go over the ground I have already gone over and I am going to stop there".

MR GREEN: If that is his case, then we say it is evident from the decision and subsequent documents that it is based on an error of principle, because the error of principle flows from the fact that we now know, though it is not apparent from the decision or the earlier decision, that he says he set the relevant time frame over the life cycle of the activity. Now, if that was part of his reasoning and he had set that out in the decision, we would say that that was an error of principle.

THE PRESIDENT: Yes.

MR GREEN: It does not matter what we said in the complaint. We cannot be expected to know what BT said in its business case. We could not possibly ever know that.

I wonder if that is an appropriate moment?

THE PRESIDENT: I am sure it is. I will say five minutes past two. Perhaps, when we re-start, we could have a view from everyone as to whether we are going to finish today or whether it might go over.

(The Short Adjournment)

2 pm

THE PRESIDENT: Mr Green, just before you carry on, I would like you, and perhaps everybody, just to give a little bit of thought to what, at the end of the day, you are going to be asking us to do and where from that point of view this case is going. We are conscious of the fact that there

has been a lot of development in this market since this time last year. Because we do watch the television and read the newspapers there does seem to be quite a lot of promotional efforts going on. It may well be that there are continuing issues in the case that need to be looked at - or looked at again - from the perspective of today as much as from the perspective of a year ago.

MR GREEN: Yes.

THE PRESIDENT: There is from the Director's point of view, although we have not heard from the Director yet, the possible difficulty that the letter of 8th July did not, as far as we can see, address the Competition Act issues in the light of a request that had been received, and that decision is before us, as well as the main decision. How far has the main decision, as it were, been overtaken by events, and how far is it useful for us to go into some of the issues in that decision rather than in some way or other this whole issue be looked at again by the Director in the light of more experience than we had at the time. I do not know, we are not pushing you in any direction whatever, we would just like to know how everybody feels about that?

MR GREEN: Yes, it will not surprise you that we have given this some thought because those self-same points are evident to us and no doubt they are evident to my learned friends.

We are aware that the principal thrust of our application has been on the basis of the failure of the duty to give reasons and an apparent lack of cogency or logic in the decision. We are aware that if you are with us on that, or on some of our procedural points, that what might be uppermost in your minds is a remission that there then arises a question as to what, if any, conditions are attached to the remission, whether it should be remitted with a direction to the Director to review these self-same facts in conjunction with the ongoing complaint or in isolation. We do have a concern that if the matter goes back in that way it will fall into some regulatory black hole and we will not see another decision for 12, 18, 24 months. I have to say we have not formed a final view on this.

So far as timing is concerned I think we all feel that it is unlikely that we will finish today. I have got 20 minutes to half an hour approximately, and I think the combination of Mr Barling and Mr Turner will take us to beyond 4.30-ish, in which case it may be that we could think long and hard about it overnight and give you a more formulated view tomorrow.

THE PRESIDENT: Yes, well maybe it is a point we can come back to at the end of the day or first thing in the morning to see where we are.

MR GREEN: Yes.

THE PRESIDENT: Yes, thank you.

MR GREEN: Before lunch, Sir, you suggested that the Director General might say in response to Freeserve's submissions that all he did in the decision was to say that Freeserve had not done sufficient to shift him from his previous firmly held view.

THE PRESIDENT: Yes.

MR GREEN: But were the Director to say that we submit it would be seriously in error. It would

be tantamount to the Director saying to the Tribunal as follows: "I know what BT's business case is. I know what assumptions BT has made in its business case as to the point in time at which costs will be covered, as to the expected life of the product, and as to BT's assumptions as to market share. However, I will not tell you, Freeserve, what those assumptions are. I will tell you, however, only this: I have formed a view that they are plausible. But, as to this, I now say you must shift me from my position - come and shift me". Freeserve put in an application to shift the Director and he says "Go away". He says "I will not listen to your attempts to shift me, which is really another way of just describing what is in s.47, because I refuse to be shifted."

The net effect is that we seek to appeal his refusal to vary his view and his view, as expressed in the decision, implicitly relying on his March decisions, that he was correct - there was no case to answer.

THE PRESIDENT: What is he supposed to do? Is he supposed to reveal BT's assumptions?

MR GREEN: The assumptions that he would have to reveal either would not involve revealing commercially sensitive information because you would simply say BT's view as to the life expectancy of the product market is X years, would you like to comment on that? You may want to put in economic evidence as to what you think the life expectancy of the product is going to be.

It may be that if there was commercially sensitive information to be revealed it could be done under a ring fencing arrangement. If it could not be done then it highlights the artificiality of saying "Well, you cannot have a proper review before the Appeal Tribunal because I am not going to tell you what the assumptions are because I cannot, but I am still going to require you to shift me from my previous view - all be it I cannot and will not tell you what has led me to form my previous view.

THE PRESIDENT: That would lead to a situation in which nothing could be sorted out until you did get to the Appeal Tribunal where there might be procedures for ring fencing?

MR GREEN: Yes. That is, in one sense, why it is an unsatisfactory argument on the part of the Director to say that the review by the Tribunal has to be conducted by reference to the complaint.

THE PRESIDENT: Yes.

MR GREEN: And it is unfortunate in this case that the high water mark of Freeserve's knowledge about the Director's approach has come through the pleadings and subsequent submissions. We would never have been in a position even to know, in rudimentary terms, what the Director was thinking had we not started the appeal process.

THE PRESIDENT: Yes.

MR GREEN: There was one other point I wished to address before moving on to the waiver---

THE PRESIDENT: It is a bit of a Catch 22 situation from BT's point of view, is it not, because unless there is a clear existing finding of dominance they have not yet actually got any

particular Competition Act type duties, so it is a bit difficult to say that they are subject to some special regime to which nobody else is subject in terms of revealing their commercial assumptions or clearing things with the Director.

MR GREEN: Well they did clear things on three occasions with the Director in three business cases. My point is really a very simple one, the Director General knew precisely what assumptions underlay the business case. His argument is, or might be, that we should have shifted him from his ground, to which we say "How?" It is an impossible task.

THE PRESIDENT: I think there are a number of Greek myths about people who would have to guess the riddle of one sort or another. The chap knows the answer to the riddle all along so there is no getting warm, no getting cold. It is that sort of situation.

MR GREEN: There is the myth of Sisyphus as well, he is the chap I think who had to push the.... well, anyway, it might or might not be Sisyphus! [Laughter] I will tell you tomorrow. I will ask Mr Barling, he knows about these things.

THE PRESIDENT: The classicists will be able to help us out. Is it the Sphinx perhaps?

MR GREEN: He was certainly inscrutable!

THE PRESIDENT: Right, yes, go on.

MR GREEN: I would like to turn to the relevance of rivals' reactions which forms a part of the Director's logic in particular paragraph 16.

THE PRESIDENT: Yes, I think we know your point on that, Mr Green.

MR GREEN: Can I then make a related point. I have cited the *CMB* case, in particular paragraph 117 of the ECJ's Judgment. It seems to us that, notwithstanding what the Director says in his skeleton, where he says that we have misunderstood paragraph 16 of the Judgment, in his skeleton he says that the Director did not take the view that just looking at a third party's reaction was an error, he simply says it is a matter which is "relevant".

Our submission is that that simply is not a fair reflection of the decision. The decision squarely relates the observable fact that the third party matched or undercut. As evidence of a sufficient margin there is a clear unequivocal equation between that observable fact and the legal inference which the Director draws.

We have cited the *CMB* point, and the *CMB* simply says that even in relation to a price above cost if a dominant undertaking, because it has some incumbency benefit like a shipping conference and it is treated as a more reliable, wider service operator by shippers, if it can charge a premium over small independent lines who come into the market, then if you match, and if you force rivals to match, then that is the same as excluding because an independent line must undercut in order to negate the shipping conference's price premium advantage, its incumbency advantage.

If the Director, as we say is evident from the decision, has simply equated the observable fact that certain ISPs that can match or undercut with an ability to compete, that is simply wrong as a matter of law.

THE PRESIDENT: Well, the *CMB* case is a case of a dominant shipping conference with 98 per cent of the market. This case is a situation of quite a number of competitors in the retail ADSL market of which BT is one. There is at least some indication in the papers that Freeserve at the time led the market in setting the price, they came out with a price the day before BT and that at certain stages Freeserve was itself considering itself as the market leader rather than BT.

MR GREEN: Yes. With respect that does not really address the legal point, and there is a factual question here because as I understand matters rumours abounded as to the price at which BT was coming out into the market, and there was a great deal of predictive conduct, and one simply does not have the background facts on that in the decision, and certainly that is not a point which is taken in the decision. The decision simply is the Director says "I can observe that ISPs match or undercut and therefore that is sufficient evidence of a reasonable margin, ignoring the fact that the rivals, either on a predictive or a reactionary basis felt compelled to price at such and such a level in order to be able to retain even a shred of market share.

The decision, paragraph 10, refers to BT's Chief Executive having heavily trailed the price announcement. There was a great deal of debate in the industry as to where BT was going to come out at. It was relatively predictable so far as Freeserve was concerned, where the BT pricing point would be.

Our submission, at least for the purpose of this part of the analysis, one has to assume dominance, I mean the Director General has not said anything about it in the decision - of course, if there is no dominance everything is irrelevant. But if there is dominance, then on that hypothesis because a third party predicts a price and comes out and matches it or undercuts it, we simply mean that they are forced to do so. It may not mean that they are making a profit at that level, and as you rightly observed at the outset this afternoon a year on Freeserve is able to say that the price which it is being supplied at for ADSL broadband does not enable it to make a proper margin.

THE PRESIDENT: Well you tell us that through counsel, as it were.

MR GREEN: Absolutely.

THE PRESIDENT: You do not have any evidence about it.

MR GREEN: No, that is absolutely right, and we are talking about a decision which was taken some nine months ago.

THE PRESIDENT: Professor Pickering tells me that the current Freeserve advertisement on television claims that Freeserve is number one in the broadband sector?

MR GREEN: That is narrow band, not broadband.

THE PRESIDENT: Not broadband?

MR GREEN: Well I will check that, that is what I am being told that it is narrow band not broadband.

PROF PICKERING: Well, you better check.

MR GREEN: Yes. Can I turn to the question of the waiver of the activation charge which is a

related and important aspect of predatory pricing.

As you are aware BT Wholesale charges ISPs #50 exclusive of VAT to connect a user to ADSL. In practical terms this involves a BT wholesale engineer at the BT exchange simply plugging the user into an ADSL conduit which, in the documentation is referred to as a "D slam". The cost of this is included in the #50 plus VAT.

Retail ISPs charge this on - I understand the prevailing price is #65 plus VAT, which covers the BT cost and the ISP's administrative costs, and it is in this context that BTOW has waived the activation charge to its own customers, but it continues to charge this to the ISPs.

The nub of the point in relation to the----

THE PRESIDENT: Waived to own customers?

MR GREEN: But ISPs are still being charge the activation fee.

THE PRESIDENT: Yes.

MR GREEN: The nub of the point was that in the decision the Director, in effect, concluded that a waiver for three and a half months was *de minimis* or immaterial. In the decision he states that he had examined this in his March decision. In fact, he did not.

The residential decision, which forms the preponderant part of the substance of this case is utterly silent as to this, but as to the business case there is there recorded that there was a 50 per cent. waiver of the charge only to business customers. Business customers form a very small part of the ADSL broadband market, and there is no evidence in his residential decision that he addressed the effect of a waiver whether partial or total on uptake in that segment.

THE PRESIDENT: Yes.

MR GREEN: Now in is decision the Director does not explain why he came to that view or what he understood by "immaterial". What we do know is that the Director got his facts wrong, because the waiver was, in fact, extended from the three and half months for another three months.

THE PRESIDENT: But did he know that at the time?

MR GREEN: He says he did not. He says he learned about this the day after the decision. We submit that is a remarkable admission because he should have known about it. Either he should have asked BT or BT should have proffered the information.

THE PRESIDENT: Yes, just on this particular point, it rather looks as if the decision, we cannot quite tell when the decision was sent to BT, bt the decision was sent to BT apparently by Mr Russell's email of 21st May, at 16.57, that is the covering email, annex 3 to the application.

According to annex 9 to the defence the Director is informed of the extended offer at 6.05 pm on that day, so there is about an hour between the two events.

MR GREEN: Yes, but the real question is why did he not know? Even if one assumes he did not know, this was a point which was the subject of the complaint, it had been discussed. How could he not know that BT was going to extend the waiver, and if he did not know it certainly puts in context his conclusion that the waiver was immaterial and *de minimis* because his view,

which he simply lifted from his March business decision, was that it was *de minimis* whereas that was a three and a half month duration, 50 per cent. reduction to business customers who, for obvious reasons, will not find #65 to be substantial and it is tax deductible, but it does not relate to a six month 100 per cent. reduction to residential customers, and for whom #65 is a more substantial sum of money.

Moreover, in the evidence which BT has itself submitted to you in response to your questions, they freely admit that it is in fact highly effective as a means of stimulating demand for broadband and encouraging switching from narrowband to broadband.

Going back to the basics, in an investigation of which one aspect is the economic effect of a waiver, the provision of something free of charge, even a rudimentary, skin-deep investigation would have unearthed that BT was planning to extend the waiver. It rather suggests that they did not even ask BT, because I cannot imagine for one moment that had a forthright question been asked BT would have misled the Director. They would have been bound to have given a full and frank answer. So one can only infer that no question was posed of BT.

What one deduces from the decision is that the Director simply said "I recollect having looked at this last March, and I did not find there to be a problem then, and I will simply repeat that conclusion". But his conclusion then was in relation to the smaller segment of the business, and it was a 50 per cent. reduction, not a total waiver.

BT's evidence to you, and indeed Freeserve's evidence to you in response to the Tribunal's questions makes the following points, and without taking you to them, can I just summarise the points, and I will give you the references. First of all, Freeserve have stated in their evidence that the waiver coincided with a point in time when BT Wholesale was slashing its wholesale price by 50 per cent., and there was a reported 10 million advertising campaign about to be launched by BT. So it was a combination of events which gave rise to Freeserve's concern.

Secondly, the waiver charge was a significant revenue stream to ISPs at a critical point in time in the evolution of the market, and at just that time BT was waiving the charge, thereby imposing an additional pressure on the ISPs.

Thirdly, Freeserve predicted that as a result of the waiver it would lose substantial sums of money, and BT would lose even more.

Fourthly, Freeserve's evidence to you explains that BT would gain substantial numbers of new customers as a result. Now, on pages 4 and 5 of BT's answers to your questions, they accept that the waiver was implemented for strategic reasons, and the strategic reason was to reduce the switching costs between narrow band and broadband, because in their explanation they say that by its very nature a greater obstacle to residential customers is this activation charge, relatively that is to business customers.

BT had this earlier experience where they had implemented 50 per cent. reduction to

business customers - and I am quoting from pages 4 and 5 of BT's evidence - this had stimulated, and this is the quote: "*a marked increase in broadband take up*".

So BT's logic was that a full waiver, over and above the 50 per cent. to business customers would create an even greater take up of broadband in favour of BT. Again, it is not hidden in the evidence to you on the part of BT that the rationale was, and again I quote: "*...to increase BTO sales' volume*". The waiver did stimulate demand in its own favour. This plainly was not an acto f charity. It is, however, as an afterthought that BT seek to justify the waiver on the noble basis that it would grow broadband for the overall sector. So far as this is concerned, Freeserve takes the view that BT's shareholders might understand that to be the case, but Freeserve's do not.

The evidence, therefore, is that even a limited waiver of 50 per cent. to business had a tremendous effect, a very powerful effect, that they then increased it, made it 100 per cent. for residential, which is by far and away the preponderant part of the market, in the knowledge and expectation that it would stimulate demand for BT, and at the same time they were still charging the ISPs, the waiver charge, so that they could not easily replicate that marketing facility.

MR BARLING: I am so sorry, Sir, can I just clarify?

THE PRESIDENT: Yes, Mr Barling.

MR BARLING: Of course, notionally BT was charging itself in its BT Openworld part of the business, the same charge as well. I think my learned friend was giving the impression that we somehow were not charging ourselves that. Of course, we were. It was only waived by the retail----

THE PRESIDENT: I was just wondering whereabout in the BT accounting structure, which I do not think we have actually got, this charge falls. Is it a charge that BT Wholesale makes to BT Openworld?

MR BARLING: Yes. So it has to be taken account of in the regulatory accounts.

THE PRESIDENT: It would be a cost in BT Openworld's accounts---

MR BARLING: Precisely.

THE PRESIDENT: ---showing this?

MR BARLING: Yes, and that cost was charged to BT Openworld in the accounts as it was to outside service providers. Otherwise no doubt the Director would have said that we were granting undue preference under the licence if we had to do that.

THE PRESIDENT: Yes. And the accounts to which you refer are these ----

MR GREEN: Are the regulatory accounts.

THE PRESIDENT: They are the regulatory accounts, but they are not, at least at present available as far as I know. We do not have them.

MR BARLING: A great deal of them are publicly published.

THE PRESIDENT: They are publicly published. Are they published in sufficient detail for this

point to be publicly known?

MR BARLING: They are in whatever detail the Regulator requires them to be placed.

MR TURNER: Sir, you wouldn't see that level of detail.

MR GREEN: The net effect is the same. The BTOW was not charging customers, therefore exacerbating any loss that it was going to make. ISPs were being charged and would have found it exceedingly difficult---

THE PRESIDENT: ISPs have to absorb the same charge and therefore increase their losses by the same amount.

MR GREEN: Yes, at the very least, even if it can be seen from the accounts that there is full transfer of cost passed on to BTOW, it is still the same pincer movement on the ISPs. It is simply wrong for the Director to say that he can simply extract the reasoning from his earlier decision and apply it willy-nilly to the later decision.

THE PRESIDENT: Yes.

MR GREEN: Can I clarify one matter in response to Professor Pickering's question. Freeserve's adverts claim to be the UK's number one because they have the largest number of registered users, and apparently there are 2.54 million users, of these 47,000 are broadband and the others are narrowband. So only a very, very small number are, in fact, broadband.

PROF PICKERING: Registered Freeserve users?

MR GREEN: Registered Freeserve users, yes, for the internet as it were. Very shortly, our criticism therefore of the Director's approach is that nowhere in the decision does he explain the test he applied or the methodology contained in the test as it applied to the facts. He says he relied upon his earlier decision, but as to these there is no reference in the residential March decision to the waiver of connection charges, and there is no reference in the business decision, save for a reference at paragraphs 1 and 4 to a reduction in 50 per cent. for its business installation but this is a very different proposition for a business customer, than for a residential customer.

It is illogical, we submit, to draw inferences from a very limited 50 per cent. reduction directly to an entirely different segment to the market, namely residential customers. BT's own evidence, and indeed Freeserve's evidence to the Tribunal supports the conclusion that this was anything but immaterial, but was part of BT's own deliberate object of stimulating demand in its favour. It had proven, as it says in its evidence, effective with the limited exercise to business customers, and they also draw from evidence that they found in the United States as to the best means of switching narrow band to broad band customers. His admission that he did not even know of the extension from three months to six months services only to indicate that his review of this segment of the market in this issue was rudimentary, to say the least.

Can I now turn to consider briefly the question of dominance just to make sure our position is clear. Our Notice of Appeal says that BT is dominant in two different markets: the residential voice telephony market and the wholesale call activation market. We have set out

the sources for those conclusions, namely, in relation to the residential voice telephony market we have referred, amongst other things, to the May 25th statement where the Director actually says that he has concluded that BT is dominant.

If I can just show you the relevant paragraph of that. It is the May 25th statement, Notice of Application, tab 2. There are two references: first on page 3, S5, where the Director summarises his position.

"*The main points to note from this statement are BT is not allowed to use customer billing information which only it has access to by virtue of its dominance in the provision of residential, local and national voice calls to specifically target customers for its internet services*."

So they refer to the dominance in the provision of residential, local and national voice calls, and they refer to the BT surf time investigation.

Then on page 5, paragraph 1.1:

"*The current policy governing BT's marketing of internet services was developed in 1998 when Oftel received a complaint to the BT telesales' for that using customer calling information to identify customers who already use the internet, these customers were then being offered promotional material on BT Click...*" [BT's pay-as-you-go internet service] "*...Oftel was concerned that BT was using information which only it had access to and which was derived from a market in which it had a dominant position - residential, local and national voice calls - to promote this internet service, thereby leveraging that position and giving it an unfair competitive advantage over other internet service providers.*"

Now although it refers to the BT Surf time investigation on page 3, in that report, as one can see from the references, the Director referred to a SNIP test for determining whether or not BT had dominance. The same approach is adopted in the ATM direction so far as wholesale call activation is concerned. The references are in the Notice of Application, and I do not think it is necessary to go into them now. Those are the two product markets in respect of which we have alleged dominance. So far associated links are concerned, we have set these out at 5.21 of the notice of application in that paragraph and the following paragraphs.

Just to complete this overview, if you could look at paragraph 54 of our skeleton argument we have cited the EC Commission's Notice in the telecommunications' sector, and there is a quotation there from that - paragraphs 65 to 67 of the Notice, and if you just look at the last paragraph following the discussion of *Tetrapak*, it says:

"*If these circumstances are present, it may be appropriate for the Commission to find that a particular operator was in a situation comparable to that of holding a dominant position on the markets in question as a whole*."

That is referring to the previous paragraph where the Commission identify a situation where there are a series of closely related markets with an operator having a high degree of market power in at least one of those markets. So the Commission introduces the notion of a form of

portfolio dominance whereby if you have dominance in market A, B, and C, but not D, you can treat the undertaking as being dominant also in D. That may be no more than another way of reformulating the *Tetrapak* test, but the Commission appears to believe it is particularly apposite for incumbent monopolists or former statutory monopolists.

So far as the relevance of dominance for today's hearing is concerned, our case is that the working assumption of the Director was that BT was dominant, because that is what he says in his 19th May statement, and he accepts in his pleadings that he did rely upon that in relation to the telephone census point. So he has accepted that in relation to some of the issues in this case he did rely upon his 19th May statement, and in that statement he does say that BT is dominant in a market that we have pleaded in the Notice of Application that BT is dominant in. But, at the very least, so far as the duty to give reasons is concerned, we say that the Director should have set out what assumptions he was working on at least because of the arguable possibility that the analysis of abuse might depend upon how one analyses dominance.

THE PRESIDENT: Just help me on how the wholesale call activation market fits in to this case. In relation to broadband what is the relevance of the dominance in that particular market?

MR GREEN: It is highly relevant to the advance notification submission, and probably of greater relevance to the predatory pricing, his residential voice, because it is that which gives you the links with the customers who you are seeking to persuade.

THE PRESIDENT: Sorry, residential voice----

MR GREEN: ---telephony market. Those are precisely the customers you are seeking---

THE PRESIDENT: Residential voice telephony market is the one most relevant?

MR GREEN: Primarily relevant to the predatory pricing.

THE PRESIDENT: To the predatory pricing, yes.

MR GREEN: Wholesale call activation primarily relevant to the discrimination, which is the advance notification issue, which I have not addressed orally.

THE PRESIDENT: Wholesale call activation and the wholesale price of buying capacity for broadband are different things, are they not? Or are they the same thing in your mind?

MR GREEN: It is the same thing. There is no doubt that this is a complex issue. At the very least we are entitled to have been told in the decision what the Director's assumptions were. As it is again we are forced to concede that we are speculating as to what he did or did not do.

THE PRESIDENT: Presumably it is retail telephony again that would be relevant to the advertising.

MR GREEN: Yes.

THE PRESIDENT: Broadband Britain.

MR GREEN: It is pointed out it depends on who is paying for the adverts because it could be any part of BT, but the customers you are seeking to persuade to shift are the same.

By way of conclusion we do submit that this decision is inadequately reasoned. It is silent as to dominance, and what assumptions are made in respect of dominance. It is silent as to the test to be applied for any of the alleged abuses. It is silent as to the methodology which

the Director has deployed in arriving at conclusions.

In so far as the defence and the skeleton and subsequent submissions purport to describe the reasoning, they simply highlight the failure to put that material into the decision.

Even in his subsequent submissions the Director has set out a series of at least arguably inconsistent tests in paragraphs 28, 66, and 67 of his defence. Nowhere has he set out what he believes the AKZO test to be or how it is modified in relation to this market, and if he is correct that it is in some way modified it was surely crucial that he should set out why it is modified.

So far as it is possible to discern the test applied we submit it is an erroneous one because it entails erroneous assumptions about the life cycle and measuring the life cycle over the product, but not the contract, for the product. It is inconsistent with his earlier margin squeeze cases, but with no explanation given as to why there is this inconsistency, and it is erroneous in that the Director seems to assume, without more, that if he can observe as a fact that rivals can meet or undercut BT's price then *per se* that is sufficient evidence that BT's pricing is innocuous.

So far as connection charges are concerned, he has not explained what he means by immaterial or what test he applied. His reasoning is illogical in that he appears to wrongly shift his conclusion from one decision in March to another decision. It is inconsistent with the evidence submitted by BT and Freeserve that in fact the waiver of the activation charge performed a highly significant task upon the market place.

Procedurally we say the director's conduct was unlawful. The matters might have proceeded very differently had he entered into a dialogue with Freeserve over these issues, but that he unlawfully slammed the door in Freeserve's face, preventing a more refined dialogue ever having taken place. He admitted in the earlier proceedings that his procedure and his inquiry was rough and ready, and it was made even more rough and ready by his deliberate refusal to comply with the s.47 application, and it is for those reasons that we invite the Tribunal to quash this decision.

THE PRESIDENT: Thank you, Mr Green. Can I just ask one question, and forgive me if I appear a total idiot. I am still worrying about the wholesale call activation market. If I am an ISP and I want to obtain wholesale broadband access, the market we are talking about is the wholesale broadband access market, rather than the wholesale call origination market. I am on 5.15 and 5.16 of the application at page 12.

What I am worrying about is whether the wholesale call origination market is really relevant to broadband, because as I understand it with broadband you do not really make a call as such, it is there, and what you are trying to do is buy an ADSL or GSL capacity in the local exchange?

MR GREEN: I had better take instructions on that and just clarify it before I give you an incomplete answer.

THE PRESIDENT: Yes.

MR TURNER: I may be able to help on that. You will see that the reference in the footnote is to the BT Services to get a decision. It is concerned with narrowband, and you are absolutely right to suppose that it has nothing to do with broadband.

THE PRESIDENT: Well, that is the Director's view, Mr Green. If you have something else to add we an come back to it in due course?

MR GREEN: I will do, yes.

THE PRESIDENT: Yes, thank you very much indeed. Mr Turner?

MR TURNER: Sir, this case is concerned with the justifiability of the Director's decision to reject a complaint on the basis of the evidence that was available to him at that time. Listening to Mr Green just now, summing-up, not least, it is striking that a peculiar feature of this case has been the extent to which the basis of the complaint has shifted. First, between the time of the complaint and the very detailed Notice of Appeal. And then again between the time of the Notice of Appeal and the even longer skeleton, and Mr Green's oral submissions. In particular, as Mr Green was speaking about the need to show what is an appropriate time period to recoup investment when an intention to stimulate demand in one's own favour can be said to be an unlawful intention, and matters of that kind. One sees immediately that it has no parallel at all in the complaint, in the s.47 letter, or in the Notice of Appeal itself. In my submission the real questions for the Tribunal in these proceedings boil down to the following four:

* What was the gist of the case that Freeserve actually put to the Director in its complaint in March 2002?
* Was the rejection of that case by the Director justifiable?
* Was the basis of the rejection adequately communicated to Freeserve so that it knew why the Director had reached his conclusions and so that it could exercise its right of appeal.
* This is particularly in the light of what you were saying after the short adjournment, Sir. If, contrary to my case, the Tribunal does conclude that complaint rejection was not justified on the evidence, or that the reasons that were given for it were not clear enough, then the question arises as to the course that the Tribunal will have to take. Freeserve is apparently still arguing that the Tribunal should proceed to take an infringement decision against BT, based on the very limited evidence----

THE PRESIDENT: I am not sure they are still arguing that.

MR TURNER: Well, he has referred to a layered approach, and perhaps it would be useful if Mr Green would clarify that?

THE PRESIDENT: I am under the impression, Mr Green, you are really asking us to send it back?

MR GREEN: I would like to take express instructions on that but I suspect that is true, but we may want to make submissions as to the manner in which it is sent back.

THE PRESIDENT: Yes, yes.

MR TURNER: That is helpful, Sir. on that basis that Mr Green's submission is that the matter

should be re-admitted to the Director, then our case - if we ever do get that far - is that the appropriate course for you to take would be to take no action, not least because the market has moved on, but also primarily because it is perfectly plain that there is no substance in Freeserve's convoluted case.

THE PRESIDENT: When you said take "no action", you mean make no order.

MR TURNER: Make no order as to remission.

THE PRESIDENT: As to remission, yes.

MR TURNER: I propose to adopt the following course in the remainder of my submissions. First, to review briefly the propositions that emerge from the relevant European case law, and the provisions of the Act on the Director's duties when faced with a complaint such as Freeserve's. Having done that, then to consider Freeserve's original complaint and how it was dealt with by the Director in the light of Freeserve's specific grievances in the notice of appeal.

The first case that I would ask the Tribunal to look at is *Control Data* which featured in Mr Green's submissions but unfortunately was omitted from the authorities' bundle. I do have some copies here for the Tribunal.

THE PRESIDENT: It is about the duty to give reasons, is it not?

MR TURNER: Yes, it is. The first few cases, and I shall not detain the Tribunal long, are all concerned with the duty to give reasons.

THE PRESIDENT: Well, the test - actually I think you articulated it a moment ago - the reasons have to be sufficient for the addressee to understand the decision and for the Tribunal to exercise its control, it is a fairly standard test.

MR TURNER: One would hope so, Sir. It may be that I do not need to go into the detail.

THE PRESIDENT: I would not have thought we needed to go into the detail of the case law.

MR TURNER: In that case, Sir, let me just say----

THE PRESIDENT: **That** is the test you say is the right test?

MR TURNER: Yes, but the burden of Mr Green's skeleton was to make a few ancillary submissions, and the first of those was that a decision cannot be taken to be sufficiently reasoned if the person affected has to deduce the basis for the decision from an earlier administrative procedure, and I am quoting from paragraph 12 of Mr Green's skeleton. He relies on *Control Data* for that proposition. It may not be necessary to take the Tribunal to it but it is not authority for that.

THE PRESIDENT: So you had better just tell us which paragraphs you want us to glance at.

MR TURNER: Well if the members of the Tribunal have the decision, paragraphs 1 to 8 simply set the scene on the facts, and I can summarise that by saying that this was a case in which the company concerned was applying to another Commission decision on custom tariffs, and the Commission decision was addressed to the Member States - we see that from the first few paragraphs.

Here you had a case where the company concerned, the applicant, had not been

involved at all in the procedure leading up to the decision. It had involved the Commission and the Member States and in those circumstances it was not reasonable to expect the affected individual - the applicant - to rely upon the Member State's explanation of the administrative procedure, or to deduce the reasoning by comparing the decision with similar earlier decisions.

If you turn to paragraphs 12 to 15, which is where the breach of the duty to give reasons is referred to, you see in paragraph 13 that the Commission's case that the statement of reasons was brief but that it was sufficient; that the Member States participated in the procedure, and were fully informed of the reason for the Commission's attitude. With regard to the applicant - a different point - that it was clear from its own arguments that it was perfectly aware of the Commission's policy.

Then the court gives its finding. First, that the duty to give reasons, in paragraph 14 is really there to give an opportunity to the parties of defending their rights and so on.

Then in 15 that it was not sufficient that the Member States, as addressees of the decision were aware of the reasons as a result of their participation in the preliminary procedure, and that the applicant, who was the person directly and individually concerned, could deduce those reasons by comparing the decision with similar earlier decisions.

So the proposition in the skeleton on that point was incorrect, because it did not say that the applicant in such a case, through participation in the administrative procedure is a consideration that can be taken into account when reasons are given in a decision. For that proposition one goes among other places to the *Max Mobile* case, which is in the authorities' bundle and I shall take the Tribunal to that only if you feel it is necessary, Sir, otherwise I can simply state the point and give the Tribunal the references.

THE PRESIDENT: Just do that, I think, Mr Turner.

MR TURNER: The relevant places to look are paragraphs 1 to 5, which are the facts, and 73 to 79 which is a short section on the duty to give reasons.

There are really two points that arise. First, that a decision is not defective if it fails to address arguments that were not there in the original complaint, which is a factor that may have assumed increasing significance as this hearing has progressed; and secondly, that the degree of reasoning in the decision can take into account the fact that there have been meetings between the Commission and the complainant, in which the Commission's thinking has been explained. That is particularly important because, of course, there is a clear parallel with this case because Oftel met with Freeserve and explained their position and what they would need from Freeserve if they were going to take the investigation further.

The next case I was going to refer to, but again I shall simply state the proposition, is one that appears from the *Metropole* case, and Mr Barling has quoted a parallel authority for the same point which is that when giving reasons in a decision the European cases suggest that it is not necessary to go into all the facts and points of law which have been raised. It is sufficient to set out the facts and legal considerations which are of decisive importance in the

context of the decision. One sees that in paragraph 44 of *Metropole*.

One may contrast that with Mr Green's submission in his opening, that in rejecting, for example, the cross-subsidy complaint the Director General here had to go into what his view was of recovery of average variable costs, or of average total costs that he failed specifically to reject the application of AKZO in the telecommunications sector in this decision. Those things are obviously true, but the point is that he gave the decisive consideration in the decision letter and that has not been alleged by Mr Green in anything he said this morning, or earlier this afternoon, to be wrong in any respect.

THE PRESIDENT: According to you the decisive consideration is what?

MR TURNER: I am coming on to that. Decisive consideration is the one, Sir, that you mentioned at the opening of the hearing, namely, that you have provided one year's data and it does not take us anywhere,and that is particularly underlined in a situation where there has been a meeting and they have been told "**This** is what you can do to improve it". I will come to that but there were a number of things that they were asked to do, and they did nothing.

Finally, on the duty to give reasons point, it will be part of my submissions that it is important to bear in mind the context of the decision - context is all. A number of the cases are referred to in Mr Green's skeleton, and specifically *Branco*, *Consorgan*, *Cipeke* and *Lisrestal* - a whole collection of cases which are cited are referred to for the proposition that a decision which has serious consequences for a person should have a fuller statement of reasons than one which does not have serious consequences.

With respect, we agree with that, but what we say is that this is not such a decision at all. All of those cases concerned decisions to reduce financial assistance to an applicant from the European Social Fund - every one of them. They were all cases where the decisions themselves produced serious adverse consequences for the applicant. In our case the decision does not adduce binding, legal consequences for Freeserve. It is a complainant, it is not the objective of investigation.

Mr Green mentions in his skeleton that the reason why this case can be taken to produce serious consequences results from s.58 of the Act. Now, he did not deal with that at all in oral argument, and again I am in your hands as to whether I need to address you in the light of what is in the skeleton already?

THE PRESIDENT: It seemed to us at first sight - I address myself to Mr Green as well - that the Director's points on s.58 were probably well founded, so I do not think I need the Director to say anything more about that at the moment, but Mr Green you might like to come back to that point at some stage.

MR TURNER: I am obliged. Sir, the next issue then that arises as a point of law is the issue of the level of scrutiny that the Tribunal should adopt in the case, and this does require some attention.

The starting point, as Mr Green rightly says, is that this is an appeal on the merits.

MR GREEN: Yes.

MR TURNER: Schedule 8 paragraph 3. So it can extend to matters of fact or law or discretion. But in my submission that does not, in itself take the analysis very far. It does not mean, as might have been suggested some *de novo* analysis. As in the case of the appeal courts governed by the civil procedure rules primarily this Tribunal is engaged upon a review of the decision in the light of the material that was before the Director when he made his decision, and above all that includes the original complaint. Nor does the phrase "appeal on the merits" in any way mean that the Tribunal has to adopt some inflexible standard of scrutiny which cannot vary depending on the type of case before it, or the nature of the issues that arise on the appeal.

Now, I have referred to *Napp* for a point on this in the skeleton.

THE PRESIDENT: Yes.

MR TURNER: I am not sure if you wish me to develop that.

THE PRESIDENT: Just give me the paragraph first, Mr Turner.

MR TURNER: The paragraph in the skeleton is paragraph 22(a) on page 11. Again, it may not be necessary to go to the detail. There are three paragraphs of final *Napp* Judgment which are referred to. But the points which arise I hope are not controversial. First, that even applying a test that the Director, if he makes a decision that the Act has not been infringed in some way, and makes a relevant finding of fact, for example a finding that BT did not give advance notice to BT Openworld, that the cogency of the evidence required to accept the Director's finding may vary depending upon the seriousness of the matter at hand.

If an infringement decision had been made against BT and penalties imposed because, say, it had preferred BT Openworld by giving advance notice to it, in my submission this Tribunal would more anxiously study the basis of that finding than in a case such as the present, which is merely to say that on the basis of the available evidence there is not sufficient proof to show any anti-competitive behaviour.

Secondly, the point that the ordinary diet of competition law does include issues of complex assessment often issues of product market definition, the existence of abuse, objective justification will arise to be dealt with and such matters can be regarded as matters of fact, but they are obviously quite different to matters of simply objectively verifiable fact, because they involve the application of judgment, or to use another word "appraisal", and there is a scope for a difference of expert view.

An example that arises in the present case might be the Director's decision that Freeserve's hypothetical spreadsheet was not of significant weight in assessing cross-subsidy because it only extended for one year, and the Tribunal is asked, that was the decisive consideration on that point and the Tribunal is being asked to review that on appeal. In my submission on a matter of that kind it is especially appropriate to allow the Director a margin of discretion in the context of a complainant's appeal.

Finally, that is consistent with the approach of the European Court to complaint

rejections and I fully recognise the different context in which that arises because that is a form of Judicial Review rather than appeal, but the context is very similar - the question of how the responsible public Body is dealing with complaints made of infringements of the competition rules. In that context, the European Courts have recognised that there needs to be a margin of discretion and they have framed it in terms of manifest error. So for those reasons we say that there does need to be a lower level of scrutiny - it is more appropriate in this sort of case than in a case dealing with an infringement decision where a party is penalised.

With that I turn to the facts of this case, and it may be convenient if the Tribunal would just have open the original complaint itself, which was barely touched on in the course of Mr Green's argument, and that is tab 1 to the Notice of Appeal.

To begin at the beginning, the first point to note, as a general matter, is that this was an allegation of an orchestrated campaign of anti-competitive behaviour, aimed at achieving dominance as one sees from the cover letter, and as the Tribunal pointed out in the admissibility Judgment paragraph 87. Mr Green himself confirmed, and indeed emphasised that point. That is a strong allegation but it is not entirely an allegation in Mr Green's favour because one result of it is that if one part of this four pronged complaint is manifestly unfounded, then it tends to undermine the others by reason of this suggestion of a unified campaign of anti-competitive behaviour.

The second general point to observe about the original complaint is that it was a call for urgent and draconian action, and again casting one's eye over the cover letter one sees the reference to urgency at least three times -in the first paragraph, in the penultimate paragraph (second sentence) "*the issues raised require urgent investigation by Oftel*", and then again at the end "*I look forward to your urgent confirmation*".

What Freeserve urgently wanted Oftel to do is set out in the "action required" section of the complaint in the three page attachment, and in short it wanted Oftel to require BT to cease all its cross-marketing activity, to defer its advertising campaign, to prevent BT Openworld from introducing any promotions until the conclusion of Oftel's investigation - I am sorry I am not giving you the references for these - but the point is that in the light of that strong tone one might reasonably have expected Freeserve to produce some evidence to back up its claims, either at that stage, or at least in the reasonable future, for example to show how its own business case would be unsustainable if it were forced to compete with BT Openworld on price - something to show a material effect on competition. But such evidence was never forthcoming, even though it was asked for.

Sir, Mr Green concentrated, almost exclusively, again on one element of this case. He has not dealt with cross-marketing, advance notice or the telephone census almost at all. I was proposing to address those, and subject to the Tribunal's view I will do so, because in my view it is important not to forget exactly the nature of this complaint in the round when looking at the decision letter.

Beginning then with cross marketing, one turns to the very beginning of the examples of anti-competitive behaviour by BT. Clearly this is a complaint about a particular newspaper campaign, the Broadband Britain campaign which ran for about a month. Sir, if you read the second paragraph you will see that it says:

"*These cross marketing activities ensure that BT Openworld benefits from BT's name, reputation and brand awareness. The European Commission has recently claimed in a case in France that an ISP's ability to benefit from the incumbent's reputation and brand awareness is evidence of abuse of a dominant position*."

Sir, there one sees the gravamen of this complaint set out that they object to BT Openworld benefitting from the BT brand in the course of its marketing. Under the "action required" in consequence that Oftel should require BT to cease immediately all ADSL cross marketing activity and ensure that BT Openworld are not unduly preferred in the market for supply of ADSL internet access to the consumer by leveraging corporate campaigns by BT Group.

The complaint also goes on to say, secondly, that the BT.com website, so far as one can discern, provides a direct link to BT Openworld without making reference to the other competing ISPs. That becomes a source of complaint and you see at the end of the section "action required" that Oftel should also, as a minimum, require BT.com to link to the BT/broadband site thereby ensuring even distribution for all competing service providers and not just BT Openworld.

With that, if I may, I would ask the Tribunal to pick up the note of the meeting between Oftel and Freeserve on 16th April, which is in what I believe is your bundle 2 at tab 2.

THE PRESIDENT: Yes.

MR TURNER: Again, perhaps the Tribunal would care just to have that available, because I would like to read these two documents together. The heading "*Cross Marketing*" comes in the first column about half way down. You will see it reads:

"*Freeserve believes that BT's Broadband Britain newspaper ads are aimed at generating customers for BT Openworld, and therefore BT Openworld should pay for them. Alternatively, any generic broadband advertising should not be specifically branded with the BT logo, or linked to BT websites. Oftel pointed out that BT was entitled to advertise its services as was Freeserve and that the adverts in question linked to a website which listed all ADSL SPs, including Freeserve. In these circumstances it could be argued that Freeserve benefitted from that advertising. Freeserve referred to the European Commission's statement of objections in the* ***Wanadoo*** *case....*"

so this is picking up the reference in the complaint to the legal case.

"*Freeserve complained that the Commission has argued that an ISP's ability to benefit from an incumbent's brand awareness could constitute an abuse of a dominant position....*"

Pausing there, therefore, what they rely on their legal case for is the proposition that someone

in the position of BT Openworld could not benefit from the brand awareness of the group without an abuse of a dominant position.

"*...and Oftel has not been able to obtain that statement of objections and asked if Freeserve could provide a copy, and there is the action point that Freeserve agreed it would ask its parent company, Wanadoo, whether it could disclose the Commission's statement of objections to Oftel*".

It is in the light of those points that the decision on this aspect of the case must be read. The relevant part is paragraph 3 in the 21st May decision letter. What one sees there is a concise and clear response to the gist of the points that were made, and that were of decisive importance for rejecting the complaint.

The point is made that no legal principle prevents a company absolutely from using its brand collectively or individually and to date, and to the day of this hearing, Freeserve have produced nothing to gainsay that point.

The *Wanadoo* case, as discussed in paragraph 6 of the decision letter is, in fact, not on point. It is a case relating to pricing. In the light of the material available to the Director, what one observes according to the decision amounts to ordinary competition on the merits, and that is why, in paragraph 3, one sees the decision referring to the fact that other service providers, including Freeserve, can also advertise their services in order to create brand awareness of themselves as broadband service providers, and that many ISPs, such as Freeserve already undertake substantial mass media campaigns for their narrow band products and are beginning to do this for broadband.

There was no reason, in other words, to think that this was anything other than ordinary competition on the merits, and that was the gist of the decision on that point.

Paragraph 4 dealt smartly with the other point that had been made, on the basis that there was a simple mistake of fact. The Broadband Britain campaign did not take one to the BT.com web page which linked only to BT Openworld. It directs the reader to the broadband website where all the competing ISPs were given equal time - a point that had already been made at the meeting on 16th April.

Against that background, it is simply odd to suggest that the Broadband Britain campaign was aimed at, directed at, benefitting BT Openworld. The decision is unimpeachable, and it is quite simple. Subsequently Freeserve say that their real case on this head all the time was abusive cross-subsidy - one sees that most clearly in paragraph 7.28 of the Notice of Appeal. The burden of their point at 7.28(iv) is summed-up thin the sentence that "*...advertising tailored specifically to benefit the retail business should be paid for by the businesses which benefit*". But the point of the decision is that there is no basis for this assertion in fact, because the Broadband Britain campaign was not advertising tailored specifically to benefit BT Openworld.

THE PRESIDENT: Mr Turner, there is a slight problem here because in the preliminary stage of the

proceedings, the Director was arguing quite strongly that this last cross-subsidy point was not dealt with at all in the decision and therefore could not be appealed to the Tribunal.

MR TURNER: Yes.

THE PRESIDENT: He now seems to be arguing that he did after all deal with it all along.

MR TURNER: Well not as such, Sir. He is not saying that the point was originally put to him on the basis that there was abusive cross-subsidy nor, as I said at the time of the hearing on the preliminary issue: "is there any mention of abuse of cross-subsidy in this?" The reason is that it simply does not arise. The first time the allegation arises is post the decision, and that is why it is true to say---

THE PRESIDENT: Well does it not arise in the note that you have just read to us?

MR TURNER: It arises in the Notice of Appeal.

THE PRESIDENT: Well what about the note of the meeting where Freeserve apparently says that it is aimed at generating customers for BT and therefore BTOW should pay for them - the point is made?

MR TURNER: Yes, Sir, I accept that. I did recognise at the time of the preliminary hearing that there was that reference in the note of the meeting, but the point that I made was that this was not the burden of the submission that was being made by Freeserve, and it was not addressed at all because it did not arise. It is true that it does not arise---

THE PRESIDENT: Is it being addressed or is not being addressed in the decision?

MR TURNER: That point is not being addressed in the decision. The point of my submission now is to point out that now that it is being raised, as having been the point all the time, there is no factual basis for it that is disclosed in that part of the complaint.

THE PRESIDENT: So is it the Director's view that no part of the Broadband Britain newspaper campaign should be chargeable, if only partly, to BT Openworld, in preparing the regulatory accounts of the latter?

MR TURNER: Yes.

THE PRESIDENT: "BTOW does not need to reflect costs for generic advertising".

MR TURNER: One may test that in addition, Sir, with the point that BT Openworld is required to pay costs for that advertising by the direction to its link. By the same token is it being suggested that Freeserve should also pay and the other service providers who are equally given a reference in that link? There is no obvious basis----

THE PRESIDENT: I think the idea is that both the advertising campaign and BT Openworld use the initials "BT" and therefore there is some free advantage that BT Openworld gets that in some way should be reflected in the costs that you allocate to them, as if it were a free-standing business then it would have an advertising cost which should, in some way be borne by it, that is the argument.

MR TURNER: Sir, yes. In the original complaint it was said by Freeserve that there was a legal case, subsequently identified with the statement of objections in *Wanadoo*, where it was

decided by the European Commission that there may be an abuse of a dominant position where someone in the position of BT Openworld benefits from the brand of the group. That turned out to be a red herring.

In the absence of any obvious principle or authority, and indeed any reasoning to support that position in this complaint, it is my submission that the Director had no business or duty to produce a treatise, or indeed a closely reasoned argument on that point. It did not arise.

Now Mr Green's skeleton deals fairly briefly with this cross-marketing complaint. It devotes some four pages to analysing the *UPS* case in order to arrive at the conclusion that the Chapter II prohibition can catch cross-subsidy. However, that has never been in dispute and indeed it is in the published Competition Act Guidelines of the Director at tab 3 to the Director's defence, and we have referred to that. [para 7.20-7.25]

Mr Green says it is an error to assume that there is no abuse of a dominant position just because other ISPs can also undertake campaigns, mass media campaigns. However, that is simply, as I have said, indicative of ordinary competition on the merits. There is no reason, if I may turn it the other way around, to think that there is an abuse in those circumstances.

Mr Green, in his skeleton at paragraphs 131 and 132, questions the assumption that all service providers benefit from the Broadband Britain campaign through specific references to their own services because he says that this is an untested assumption. Well if that is an untested assumption it is my submission, and again this is the first time it has been put in those terms, that it is a perfectly reasonable assumption to make. So subject to any points that you or the Tribunal have on that issue, I propose to move quickly on to the advanced notice leg of the complaint.

THE PRESIDENT: Yes.

MR TURNER: The essential point about advanced notice is that the original complaint again was based on almost no evidence at all.

THE PRESIDENT: Well it is a bit difficult for them to have any evidence, is it not, apart from what they are able to say?k

MR TURNER: Come to that, what they said in the original complaint amounted to three points only, that BT Openworld had said that they were shortly going to launch a large advertising campaign and so on. When you say, Sir, it is difficult for them to add anything more to that, they could, for example, have added the additional points that they chose to include in their Notice of Appeal, because there in the Notice of Appeal you do find a number of hard further points and what Freeserve sought to do there was to say, by reference to these aspects of its own experience it cannot be that BT Openworld did not get advance notice, and those are set out in the defence at paragraph 44 with noting cross-references. They included notably, the claim by Freeserve that there was a two month advance booking period for booking advertising slots, the claim that it would take ten weeks, using the arithmetic, to produce the necessary number of CD-Roms (assumed to be 2 million). You find those new points in the Notice of

Appeal at paragraph 1.5(b). There is no reason why matters of that kind, which could have improved the original complaint, were not put forward originally. But even when they are put forward in the Notice of Appeal they are still entirely unsupported to the Tribunal by any evidence. There is no documentary evidence, no witness statements, merely their assertions raised at this stage to bolster the point that advance notice must have been given.

Mr Green says in his skeleton that those points arise somehow from the decision, but in my submission that is plainly wrong, they are all matters that could have been raised originally.

Finally, at paragraph 137 of his skeleton, Mr Green raised a number of points in reaction to what was said in the defence on advanced notice. The most important ones seem to be these: he says that the Director General should have checked Freeserve's point about the lead time that was needed to produce these CDs. However, since that was not raised at any time prior to the Notice of Appeal that was not possible. He says it is wrong for the Director to have dismissed Freeserve as a comparator against which to measure BT Openworld's performance in getting off the starting blocks. However, even if that had been raised expressly before the Director General, one would have expected Freeserve to provide the details to show why its position ought to be taken as the benchmark.

One moves on to the third leg of the complaint, which is cross-subsidy.

THE PRESIDENT: Just before we go to there, in relation to the advanced notification of wholesale price reductions, the Director's conclusions are couched using, as it were, the conditional tense: "*BT Openworld could have moved quickly to amend existing CD-Roms*", etc. What happened in this particular case is that the Director asked BT some questions and BT gave the answers, and the Director accepted the explanations.

MR TURNER: Yes.

THE PRESIDENT: Although one can see that it is reasonable in many circumstances to do that, we are just wondering to ourselves whether it should not be a more general practice for BT to supply the documents which it says it has got to support what it says and for the Director to have the relevant documents so that you do not have to resort to the conditional, you can actually say "Well, we can establish that this is so", or "We have been able to confirm with BT what happened."

MR TURNER: Yes.

THE PRESIDENT: It would avoid any later challenge, or make it more difficult for there to be any later challenge, and also demonstrate from the Director's point of view that there had been corroborative material upon which he based himself, which would again negative any suggestion that the Director had been too ready to accept the explanation of the regulated.

MR TURNER: Yes.

THE PRESIDENT: Whether that is a legal criticism or a point of practice is probably a matter that needs to be argued, but it is a point that strikes one when one reads this decision.

MR TURNER: Yes, I see, Sir. The point is that there cannot be a universal rule about when, in

response to a complaint, the Director needs to obtain a series of documents from BT, and pour through them, and match them up with what has been asserted. To do that in every single case cannot be right. It must depend on the nature of the complaint that has been made. Here, as the Tribunal knows, the Director wrote to BT and obtained a full, written response, and in my submission the question whether that was a reasonable course to take, which of course is for the Tribunal, has to be judged in large part by reference to the paucity of the original complaint itself. There was not any good reason suggested by Freeserve in the original complaint and prior to this, to believe that advanced notice had been given. Therefore, in my submission, it was entirely reasonable for the course to be adopted that was adopted.

THE PRESIDENT: Just flicking back to the questions that were asked - you will be able to find them for me quicker than I can - I think it is in the supplementary---

MR: GREEN: Tab 6.

MR TURNER: Sir, are these the December questions?

THE PRESIDENT: Yes, I am on tab 6, yes, the questions that were asked by Mr Russell.

MR TURNER: In the disclosure bundle?

THE PRESIDENT: Yes. The question that he does not ask there, among those questions that are not asked is the question "When did BTOW know of the decision to reduce the wholesale price?" He asks a whole lot of questions about CD-Roms, and advertising, and when things were booked, and all the rest of it, but he does not ask what is perhaps the obvious question of any question, "When did they know?"

MR TURNER: The first point, I think I would make, and Mr Russell is in the room so I can confirm this, is that this is an email, and this is an email reporting that a conversation has taken place with Mrs Brown, or Miss Brown of BT Openworld.

THE PRESIDENT: Yes.

MR TURNER: And one cannot exclude from the short list of the detailed questions here that Mr Russell did not actually say "This is the complaint that has been received". Indeed, it is perhaps reasonable to expect that he did say that this is what has been alleged. I can perhaps take instructions from Mr Russell on that, but you have the response from Theresa Brown in the following tab, tab 7, and if you read that in my submission it does suggest that the nature of the complaint that had been made had been made perfectly clear to her, thus the way that it finishes on page 15 - "*In closing, I hope this information is helpful. Good planning and swift response on BT Openworld's part should not be confused with anti-competitive behaviour*" sums-up the flavour of the letter, which is that the allegation had been put to her.

THE PRESIDENT: I suppose it is said - I am not quite sure whether this is the correct reference or not - on page 13

MR TURNER: Yes.

THE PRESIDENT: In the first bullet again "*BTOW took part*". The last sentence reads: "*Those working on the BT Openworld ...launch after the trial had no prior knowledge of the price*

changes nor do we need it to prepare ourselves".

MR TURNER: Yes, Sir, that is a direct reference to the point, and it is a direct statement on the issue. Indeed, I have now received a note from Mr Russell, he had actually provided BT Openworld with a copy of the complaint.

THE PRESIDENT: Yes, that is clear from the documents.

MR TURNER: So they did give a precise answer to the essential question. So, as I say, in this particular case there was no reason to have asked that to be backed up with chapter and verse or to go further, as Freeserve say, with notices issued under s.26 of the Act, backed by criminal penalties because it cannot just be that if someone makes an allegation without any supporting evidence that you have to do these things.

Thirdly, cross-subsidy. Freeserve now says in its skeleton argument, and orally with vehemence today that the claim was "AKZO predatory pricing." It has always been that and it has been misunderstood. That cannot stand on any fair reading of the complaint, and I do invite the Tribunal to return to the complaint to see for themselves the artificiality of that fundamental submission.

Under the heading, which is entitled unambiguously "*Cross-subsidy*", it begins: "*In January last year Oftel determined that cross-subsidy would be unfair in circumstances where margin squeeze was taking place, and it was having a material effect on competition.*"

Now, pausing there, because this sets the scene for the remainder of the section, that reference is, and can only be, to the residential margin squeeze investigation itself. That was the investigation that had been initially concluded in January, 2001 - January the previous year. You can see that, and I do not ask you to turn to it now, immediately from paragraph 2 of the residential margin squeeze investigation decision.

Freeserve, of course, had been parties to that investigation, or at the very least they had been closely involved in it. Perhaps on that point, if the Tribunal would care to pick up the defence and turn in it to tab 7, the Tribunal will be better appraised of an integral part of the context.

The first page is a letter from a Mr Richard Sweet who was the Chair of the ex-DSL Wholesale Products industry group. That was a letter of February 2001 to the Director General enclosing a s.47(1) application under the Competition Act, requesting Oftel to vary its decision on a complaint of margin squeeze by BT, and you will see, just turning the page, at paragraph 1.1, that the application is brought by the industry group, which is listed in annex 1, and turning to annex 1, Freeserve is one of the listed industry supporters of this application.

The point for the Tribunal to note here is that therefore at the beginning of their complaint under the title "Cross-subsidy", what Freeserve are doing is referring back to the residential margin squeeze investigation at an earlier stage in which they had been involved. They continue that that determination was in response to complaints relating to the alleged existence of cross-subsidies within the BT Group which were allowing BT Openworld to

provide short term promotions, subsidised connection fees, and in some instances zero cost connection to the consumer.

It then says: "*At that time, given the uncertainty of the emerging broadband market, Oftel was unable to demonstrate that BT Openworld's business case in such circumstances was implausible, and no action was taken. Attached on a strictly confidential basis is our own analysis of the BT Openworld business case".* Then it continues.

In my submission, against that background, how can it be said that this is anything else than a continuation of the dialogue that had been taking place in relation to the issue of whether BT Openworld was the vehicle for a margin squeeze.

THE PRESIDENT: I think you have to read on, do you not, to the bottom of the page, and the top of the next page?

MR TURNER: As such this constitutes abuse of a dominant position and so on?

THE PRESIDENT: Yes. That point is taken up again in the decision, rightly or wrongly. The decision says that "....a loss in the first year without the pricing being judged predatory in competition law terms." So the author of the decision was perfectly clear he was dealing with an allegation of predatory pricing.

MR TURNER: Well, let us take it in stages. Certainly in the complaint itself it is clear that the burden of it, in my submission, is concerned with cross-subsidy and arises in a particular context. The issue that Oftel is requested to consider concerns this hypothetical one year spreadsheet moreover. What Mr Green relies upon to turn the whole thing around and say that actually one was concerned with an allegation of AKZO predatory pricing is that bare throw-away reference which was muddled, may well have been ill-advised, in the complaint but which does not alter the fundamental character of what had been alleged. But one cannot simply leave it there. One ought next to go to the note of the meeting, because the meeting then takes place on 16th April, to see what discussion takes place about this head of the complaint.

At the bottom of the first column of the page, under the heading "*Cross-subsidy*" in Mr Russell's contemporaneous note: "*Freeserve also believes that BT Openworld is currently being cross-subsidised by other parts of BT's business. Freeserve pointed to its analysis of the BT Openworld business case provided in its complaint, which showed BT Openworld making a loss in the year 02/03.*" Then Oftel pointed out that it was normal for a new service to make a loss in the first year. "*Oftel also made it clear that it had just closed its margin squeeze and predatory pricing investigations, and it would be unlikely to reinvestigate these issues at the current time without strong evidence to indicate anti-competitive behaviour.*"

THE PRESIDENT: That again confirms that predatory pricing was one of the things that they were refusing to reinvestigate, does it not? That is what it says.

MR TURNER: The words "predatory pricing" are used, but here what is being analysed on any view is the sustainability of BT Openworld's business case. In my submission the way that it is being understood and was understood in the decision itself, where there is a reference to being

predatory in competition law terms, is whether or not BT Openworld's business case, viewed on a stand alone basis, was a sustainable proposition or not.

The reference to predatory in that context means no more than that, and certainly does not mean that the hypothetical spreadsheet which had been advanced by Freeserve could, or needed to be understood in any different way. There is no suggestion that the spreadsheet needs to be read in a way that one extracts variable costs and compares them with revenues. There is no basis at all, in my submission, for thinking that so far as the Director is concerned at any rate, there was any consideration of AKZO predatory pricing, and the extent to which it was mentioned in the decision, what Mr Russell intended was to refer to a situation where BT Openworld's business case was loss making, or at any rate where an insufficient margin was being made to recoup the cost of capital.

THE PRESIDENT: The sentence: "*Oftel has also made it clear that it has just closed its margin squeeze and predatory pricing investigations*" refers to predatory pricing and, in fact, we know though hardly anyone has made anything of it so far, there are in fact three decisions on 28th March.

MR TURNER: Yes.

THE PRESIDENT: Two margin squeeze and one predatory pricing decision.

MR TURNER: Yes.

THE PRESIDENT: That predatory pricing decision I think is the one that talks about LRIC as a relevant measure of cost. When that note refers to Oftel having just closed its margin squeeze and predatory pricing investigation it is presumably referring to that third decision. I do not know whether that is a reasonable assumption?

MR TURNER: It is a reasonable assumption, Sir.

THE PRESIDENT: Anyway, whatever the right assumption, it does look as if the Director is declining to reinvestigate the issue of predatory pricing on the basis of one year's figures, which could be a perfectly reasonable thing to do, I do not know - it might not be - but that is what he seems to be doing.

MR TURNER: Sir, if I may put it like this: the analysis from the Director's point of view does not differ. One has to distinguish the complainant using the term "AKZO predatory pricing" and the Director using the term both in the decision and as, Sir, you picked up in the note of the meeting by reference to the predatory pricing investigation. As far as the Director is concerned, what is referred to will be nothing other than the fact that he, among other things, has not only looked at the issue of margin squeeze in relation to these precise products, but has also looked at the question of whether there has been predatory pricing by the wholesale arm of BT, not on the basis of average variable cost, but in relation to long run incremental costs.

THE PRESIDENT: I am sorry, I have lost you now. You are talking about the decision letter?

MR TURNER: In the decision letter itself, where cross-subsidy is referred to is in paragraph 16. First of all, in paragraph 15 there is the reference there, it is slightly different from the note of

the meeting, to the detailed investigations into cross-subsidy and margin squeeze. Then when we come to paragraph 16, and one looks to see what is being said in the reasoning, Mr Russell does say that it is perfectly possible for a service to make a loss in the first year without the pricing being judged predatory in competition law terms, provided that the product shows a positive return in a reasonable period.

THE PRESIDENT: That is nothing to do with the wholesale price, is it?

MR TURNER: No, that is nothing to do with the wholesale price at all. In this decision all he is saying at that stage is that it is perfectly possible for the BT Openworld part of BT to make a loss in the first year in relation to the new broadband product without its pricing being judged, and he uses the term "predatory", but he means essentially unlawful, or contrary to the Chapter II prohibition, contrary to competition law, in competition law terms, but he is not using that to suggest any separate or different analysis such as appears to be suggested now by Freeserve in terms of AKZO predatory pricing.

THE PRESIDENT: Well that is Freeserve's criticism. Freeserve's criticism is that it is not at all clear what the Director is saying here. Is he saying that there is an AKZO test that is satisfied? Or is he saying that there is no AKZO test, it is some different test and, if so, what test? Or what are the criteria being applied here, and on the basis of what authority? What is being meant here by "predatory"? Do you mean variable costs, or incremental costs? What is meant by "a positive return", and what is meant by "a reasonable period"?

MR TURNER: Yes.

THE PRESIDENT: That is what they are saying.

MR TURNER: Well, that is what they are saying now, Sir. I smile because, of course, none of what you have just said is in the Notice of Appeal, not one word.

THE PRESIDENT: They have criticised in the Notice of Appeal, surely, the misapplication of what they say. They say the AKZO test is the correct test.

MR TURNER: Well, if one turns to paragraph 1.10(c) of the Notice of Appeal, we have the reference to predatory pricing - this is on page 7, the Notice of Appeal - and I would just invite you to read the first sentence: "*In relation to predatory pricing, Freeserve presented a strong prima facie case...*" well that is the spreadsheet--

THE PRESIDENT: Yes.

MR TURNER: "*...that BT would not recover its average total costs at least and referred to evidence indicating an exclusionary intent*".

THE PRESIDENT: Yes, then he goes on: "*The respondent accepted BT's case in general without giving sufficient reasoning*". So maybe they have not developed it there particularly but they have certainly taken the point, have they not?

MR TURNER: Sir, with respect, no. In so far as it is being said that there is some different test which should have been applied in relation to this spreadsheet which was submitted to the Director General, not in the complaints, not at the meeting, not at any stage - not even today -

do we know what this test is.

THE PRESIDENT: Well, I have always understood their case to be, all the way through, that the test is, in principle, an AKZO test and if there is some different test to be applied then the decision should have explained what it was.

MR TURNER: In my submission the decision is clear on that, because the decision sets out, as it was bound to do, the decisive considerations for rejecting the complaint. It points out that the business case relates to only one year, and that that information taken alone will not breach competition law - the word "predatory" is used there - provided that the product shows a positive return in a reasonable period, so that it is clear from paragraph 16 that the test that has been applied is whether the reasonable return shown by the business case is made in a reasonable period or not.

Now, whether one uses one label or another what you do see from paragraph 16 are those two propositions: first, that the test is whether a positive return can be made within a reasonable period - that was the test that was applied; and secondly, that in relation to that test one year's information in the hypothetical spreadsheet was insufficient.

THE PRESIDENT: Is, for example, the Director applying in this decision, the same analysis as he is in the predatory pricing decision of 28th March?

MR TURNER: I am sorry, in **this** decision, **here**?

THE PRESIDENT: Yes. Is he applying an LRIC test - do we know? How can we tell what he is doing? I am not necessarily saying that this proposition, as a proposition is wrong. It is just a very telegraphic and telescoped expression of what is quite a complicated point.

MR TURNER: That again needs to be seen in context. The Tribunal will also bear in mind not just that Freeserve have been intimately involved in the previous margin squeeze investigations themselves, for which this complaint appeared to be a continuation, but also that the Director's methodology is published and well known in the guidelines, and in that methodology the Director does explain how he approaches issues of this kind, so that it is not appropriate to treat the situation as though Freeserve is a member of the public starting from scratch because they are not, and nor that there is no place on which the methodology of the Director is stated. One sees that in the published guidelines.

But here what one sees is the statement that the test is whether a positive return can be made on BT's business case in a reasonable period. You, Freeserve, seek to persuade us that it cannot, but your only way of doing that is to advance a one year hypothetical spreadsheet which does not take the matter any further.

Sir, I will need to go back to the predatory pricing investigation if it would assist the Tribunal, to see whether any further submission in relation to that is needed. But in so far as the methodology of that is concerned, that was also in accordance with the guidelines, namely, that one does not take average variable cost in an industry of this kind. One looks to the long run incremental cost of the service, and compares revenues against that.

THE PRESIDENT: What do you say about the various points Mr Green has made about possible lack of clarity as to the period we are looking at? Are we looking at the economic life of the product? Are we looking at the length of the average contract? Are we looking at the period over which the business case is reasonable or what?

MR TURNER: I make two submissions in relation to that. First, I return to the essential point which is that the decisive consideration which led to this rejection of complaint was that a one year period was not enough to get you anywhere.

Secondly, that in relation to the appropriate period, or methodology that the Director did apply in relation to looking at BT's own business case, first, that that methodology is plain and stated in the published guidelines. Secondly, that Freeserve, of all people, was well aware of the methodology that had been deployed, indeed, it sought to challenge the application of that methodology in the earlier decisions.

THE PRESIDENT: Well, the point that is being made is that in the earlier decisions that different methodologies are used, and we do not know quite which methodology is being used here, that is the point that is being made?

MR TURNER: Yes.

THE PRESIDENT: One sort of methodology used in the mobile phone case and another sort of methodology being used in the Director's Guidelines.

MR TURNER: Sir, may I pick up the Guidelines and perhaps take the Tribunal to the relevant paragraph---

THE PRESIDENT: Yes.

MR TURNER: ---because what you will see from that is that the reference in the guidelines as to how one conducts this sort of exercise specifically mentions the situation of a new service. It says that when you are dealing with a new service you look to the costs over the economic life time.

THE PRESIDENT: You had better take us to the Guidelines.

MR TURNER: Those are to be found attached to the defence at annex 3. if you turn to pages 30 and 31, under the heading "Cross-subsidy", I have already quoted 7.20 and 7.21 in the defence, but 7.21 says specifically that:

"*A cross-subsidy will normally be judged to occur when undertaking's revenues from an activity, for example, a new service, may be expected to fail to cover the costs associated with that activity over its economic lifetime. The Director General will consider whether the revenue over the life time of the service would exceed the LRIC, including the cost of capital. If the revenue would exceed the LRIC the service would be sustainable in the long term, that is providing the service would not require a cross-subsidy*".

THE PRESIDENT: Right, and are you saying that that is the teste he applied here?

MR TURNER: Yes, I am - although when I say "here", of course, what happened was that he is refusing to reopen the margin squeeze investigations in which that methodology had been

applied.

The mobile airtime report, which was referred to by Mr Green, and attached to his skeleton, is a different situation entirely. It deals with a mature market where one is not looking at the future up front capital costs that will be incurred, and one needs to find a different measure of cost which is appropriate to compare against price and revenues in order to determine whether predatory activity has taken place. That is an entirely different situation, and the fact that Mr Green plucks out of the air that different situation in a different context, does not affect the fact that the rationale that was applied here was clear. It was clear in paragraph 16 of the decision itself that the test that was applied was whether on the BT Openworld business case a positive return would be made within a reasonable period.

THE PRESIDENT: Well, that is different from over the economic lifetime of the product. The economic lifetime of the product may be 25 years, or three years, or five years, we do not know.

MR TURNER: Yes, the economic lifetime was the test that was applied in this case over a reasonable period because the Director General himself assesses the reasonableness of the period said to be the economic life.

THE PRESIDENT: But there are two quite different tests here. One is the test of what, at least in Community law, would be called "the prudent commercial investor test". What sort of return would a reasonable investor look at over a period in order to put his money if he was in the private sector? Answer he would be looking for a payback period of three years or whatever. That is one test.

The other test is "how long is this product likely to have a viable, economic life - six years or whatever". If I take the six year period as a whole, will it make a profit over that period? They are completely different in concept.

MR TURNER: Perhaps not, because here one, of course, is dealing with the position of the producer, as it were, BT. BT at the start of launching a new service, engaging in a new activity, has to work out whether the activity will be financially worthwhile, whether it is going to recoup its costs including its costs of capital, and from the point of view of a person in that position, which is the situation applicable here, one looks to see over the life time of the activity whether the costs, including the costs of capital, will be recouped. At least whether that is right or wrong, it is my submission that that is clear enough and is stated in the Guidelines, and clearly applied in this case as it was in the previous margin squeeze investigations.

THE PRESIDENT: It is a great pity that this decision does not refer to the Guidelines, or the paragraph in the Guidelines, and explain what the Director is up to. It is very difficult for the layman to read into the decision the precise he was applying, apart from saying well, one year is not enough, it is enough if there is a reasonable return over a reasonable period. But I thought, the language of the decision was talking in terms of payback rather than in terms of economic lifetime.

MR TURNER: Well it is payback but it is over the economic lifetime to see whether, over the economic lifetime, a reasonable return will be made.

Sir, you mentioned the position of the layman. Again, it is my submission that the relevant person to consider here is Freeserve because it cannot be the case that in formal rejections of this kind the Director's officials have to write out in detail the tests that they are applying and to explain things as if to people with no background knowledge whatsoever when the tests that the Director General does apply are already established and set out in his published Competition Act Guidelines.

THE PRESIDENT: The point that Freeserve make, among others, is that all this is extremely important for the industry. It is a very important new market, and that if you look at the decision it is extremely laconic, I think is really what they are saying. There is a number of different approaches that you could apply, and it is rather difficult to puzzle out what he has applied. That is their case.

MR TURNER: That is their case, and one comes back to---

THE PRESIDENT: Perhaps we ought to look at the recent margin squeeze investigations to see what was done in those decisions.

MR TURNER: Well that is as may be, Sir, but one comes back to the point that they are proffering a one year hypothetical spreadsheet, and they are saying on the basis of that there is evidence to suggest that BT is infringing competition law. Now, it can be put in terms of cross-subsidy, margin squeeze. They mentioned in a straight phrase "AKZO predatory pricing", but the gist of the Director's decision - and it was explained to them in the meeting as well as in the decision - is that one year is not good enough.

Sir, if I may just add to that, the Tribunal will recall that at the meeting Freeserve was specifically asked to produce their own model extending over a longer period. They failed to do that.

THE PRESIDENT: Yes.

MR TURNER: Freeserve were also asked to produce a copy of their business case, and they failed to do that.

THE PRESIDENT: Yes.

MR TURNER: It is against that background one can see that on the facts as much as anything else the complaint is being rejected as too thin. The relevant principles for rejecting that complaint are sufficiently stated, in my submission, in paragraph 16. It is true that the director here does not explain his test of margin squeeze or predation, or cross-subsidy and that is clear. But the question for the Tribunal is whether the decision taken in context sufficiently explains to Freeserve why its complaint was rejected.

It is difficult to see how Freeserve can say that it cannot understand that on any test that one cares to mention the one year hypothetical spreadsheet offered by Freeserve was insufficient. My point about their Notice of Appeal is simply to point out that they do not

themselves suggest any basis on which the Director could have found that one year spreadsheet to be helpful or informative. Nor indeed, did they press that upon the Director at the meeting or subsequently. Yet they stand here in the Tribunal in order to argue that the decision either should have not been made at all, that it should have been picked up and taken to some further conclusion without any basis for that. Alternatively now, that they cannot understand why it was rejected.

THE PRESIDENT: Are you submitting that if we get to the next sentence: "BTOW's own business case presented to Oftel shows pay back will occur over a longer period than one year"---

MR TURNER: Yes.

THE PRESIDENT: ---could equally read: "BTOW's own business case presented to Oftel shows pay back will occur over the economic lifetime of the product.

MR TURNER: Subject to corrections, yes.

THE PRESIDENT: That is what that means?

MR TURNER: Yes, the correction that has been made to me is that instead of the word "product" one should substitute the word "activity".

THE PRESIDENT: "...economic lifetime of the activity".

MR TURNER: Of the activity, yes. But the answer is "yes".

THE PRESIDENT: Yes.

MR TURNER: Now, I took you off track, and I apologise for that---

THE PRESIDENT: No, no, that is all right, Mr Turner.

MR TURNER: ---because you said "Let 's look at the previous margin squeeze investigations because they do form part of the context.[pause]

THE PRESIDENT: Yes.

MR TURNER: Sorry, Sir, this is really to see whether you had any particular points?

THE PRESIDENT: Just remind me where they are?

MR TURNER: Tabs 10 and 11 of the second bundle. I am not sure---

THE PRESIDENT: That is the disclosure bundle?

MR TURNER: The disclosure bundle, yes. If one turns to the residential marketing squeeze investigation in particular, tab 11 I think?

MR TURNER: There is in the case summary an explanation of the allegation that was made that profits were being used to subsidise losses in retail activities. Then under the "Findings" section, first of all a helpful definition of how margin squeeze might arise in this case, if BT were using profits from the upper stream business to subsidise losses in the downstream retail market, the effect of which would be to prevent other service providers from competing effectively.

Then to determine whether BT was operating margin squeeze, Oftel considered whether Openworld's business case relied upon a subsidy from BT to be sustained. Now, as was explained in the additional material submitted in response to the Tribunal's questions, the test

that is applied for cross-subsidy in the regulatory sphere, does not differ in this material respect from that applied under the competition law regime.

Now, one can drop down to paragraph 5, because 3 and 4, as Mr Green said to you, reflects the history, and it reports that BT Openworld has drawn up a new business case which incorporates the new wholesale prices; that the business case incorporates a number of important forward looking assumptions and, having analysed that business case, Oftel believes that no cross-subsidy or margin squeeze exists at the new wholesale and retail prices. But the current retail business case, and the assumptions on which it is based are not implausible in the light of current market information.

So those are the essential facts that were stated, and the Tribunal will be aware that to go into more detail in a public document of this kind is not possible, at least in relation to detailed factual information without fear of breaching confidentiality.

THE PRESIDENT: We will obviously have to be very, very sensitive to confidentiality. Just let me understand what paragraph 5 of this decision is saying.

"*Having analysed BT Openworld's new business case, Oftel believes that no cross-subsidy, or margin squeeze exists at the new wholesale and retail prices.*"

MR TURNER: Yes.

THE PRESIDENT: One could take that, and shall we take margin squeeze first, I think that is the easier concept, that could imply a finding that at these new current prices there is an adequate margin, particularly for ISPs, to compete with BT Openworld.

MR TURNER: Yes.

THE PRESIDENT: When it says that "*Oftel believes that there is no cross-subsidy exists at the new wholesale and retail prices*", is that meant to imply that at those prices Bt Openworld is, in fact, covering it current costs, or that it will do so at some future time, bearing in mind the economic lifetime of the product or a reasonable period or something?

MR TURNER: Yes.

THE PRESIDENT: What does it mean?

MR TURNER: It means the latter of those. It does not mean that BT Openworld is necessarily currently profitable at all. It means applying the test that was laid down in the guidelines, that looking at the business case going forward, and hence the reference to a number of important forward looking assumptions, and sensitivity to volumes and input price, that the business case is sustainable, and hence the express reference to that concept. But it is not looking at the particular point in time at which the investigation has concluded. It is looking over the economic lifetime of the activity.

THE PRESIDENT: Yes. Yes?

MR TURNER: Well, Sir, I believe we have covered the ground on that adequately.

THE PRESIDENT: Yes.

MR TURNER: Finally though, it is appropriate just to note, in relation perhaps to the Competition

Act Guidelines, and the justifiability of this Tribunal taking them into account as the context for the decision and explaining the basis of the decision, that at paragraph 1.6 of the Notice of Appeal Freeserve says in terms, that the Oftel statement of 19th May itself has to be taken into account as the analytical framework for assessing the case closure letter. Once sees from paragraph 1.6 and perhaps we should just turn it up - this is on page 5 of the Notice of Appeal, towards the end of the paragraph.

"*The express statement that the 19th May statement provides the analytical framework for assessing the case closure letter states that it forms guidance for the respondent in his assessment of complaints regarding the breach of the Chapter II prohibition*."

So Freeserve cannot have it both ways because they rely on 19th May statement as incorporated providing the analytical framework for assessing the case closure letter. And, at the same time, they say that the published guidelines are out of bounds. Well it is not, in my submission, the case and the Tribunal should take into account those guidelines to the extent necessary in understanding what is in paragraph 16 of the decision.

When one comes to the decision letter, just to draw these points together ---

THE PRESIDENT: Yes.

MR TURNER: ---in essence the points are that the one year spreadsheet is said, in paragraph 16, to be: "*...of no significant weight because it is one year only in relation to the analysis of the business case for a new service.*" Whether that is right or wrong is not distinctly contested by Freeserve. It is not clear whether Mr Green says that there is anything wrong with that approach. In my submission there is not.

Secondly, the point is made in paragraph 16 that Oftel had only recently examined the actual BT figures, and those included all the relevant business considerations up to that time, and in particular the three month waiver of the activation fee, which was built into the business case.

THE PRESIDENT: I mean we are told that but the 28th March decisions do not actually say that that is the case.

MR TURNER: That is true, I accept that.

THE PRESIDENT: Nor does **this** decision say that that is the case.

MR TURNER: However, the complaint itself, the activation fee waiver has sprung out as rather a separate point. But if one reminds oneself----

THE PRESIDENT: I think we ought probably to take it as a separate point.

MR TURNER: I understand that, however, in the original complaint to which this was responsive, what was said to Oftel by Freeserve was that it had to analyse the business case taking into account in particular special offers such as the waiver.

THE PRESIDENT: Yes.

MR TURNER: And unsurprisingly, that is what the Director did. So what is said under "Action required" at the end of the complaint is that Oftel should immediately investigate and challenge

the viability of the business case, behind Openworld's current offers, in particular their waiver of the ADSL connection charge.

THE PRESIDENT: Yes.

MR TURNER: And so that is the only way in which it came into the picture and featured in the decision. What was being said was "When you are looking at the business case take into account the effect of special offers, and in particular this waiver of the ADSL connection charge.

THE PRESIDENT: Yes, but what the contested decision does not actually say is that that waiver had already been taken into account and the business case looked at and the earlier decision does not say so either.

MR TURNER: No, it does not expressly say so.

THE PRESIDENT: Very well. I do not know how you are getting on, whether we are coming to the end of this particular part of the argument.

MR TURNER: Well, Sir, perhaps this is an appropriate moment to break off because I was just going to turn to the waiver of the activation fee as a separate topic.

THE PRESIDENT: Yes, I think it is probably as good a moment as any. Could I put to you the rather unstructured comment I was putting to Mr Green earlier on. Quite apart from these interesting points, relevant points, you have been developing on the decision of 21st May, we have also - technically at least - got the decision of 8th July.

MR TURNER: Yes.

THE PRESIDENT: And speaking for myself, it might be said that the Director might be in some difficulty in maintaining the legality of that decision which says that this is not a Competition Act decision and that is the basis of refusing to have another look, as it were. I do not know where that takes us in relation to where this case really ought to go now - if it goes anywhere. I do not know if you have any views on that and if you have whether you would like to think about it overnight or react in some way now, or what.

MR TURNER: Sir, if I may give an initial reaction.

THE PRESIDENT: Yes.

MR TURNER: The letter of 8th July I cannot deny does not contain any reasoning in response to the s.47 application - plainly it does not - which was Oftel's belief at the time, that it had not made a decision under the Competition Act. But then the Tribunal must ask itself what arises from that? In particular, in relation to the s.47 letter are there any - and if so what are they - material new points arising in it which are alleged now in the Notice of Appeal to have been ignored, because if there is in truth nothing of any material significance there, then one has at most a technical point. Therefore one comes back to my original submission that this would not be an appropriate case to remit - even if the Tribunal were minded to make a technical finding of that description.

THE PRESIDENT: Very well, perhaps we could have another think about that overnight and see

where we are in the morning. Thank you all very much. 10.30 tomorrow morning.

(Adjourned until 10.30 am the following day)