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IN THE COMPETITION
APPEAL TRIBUNAL

Case No. 1299/1/3/18

Victoria House,
Bloomsbury Place,
London WC1A 2EB

26 June 2019

Before:

PETER FREEMAN CBE QC (Hon)
(Chairman)
TIM FRAZER
PROFESSOR DAVID ULPH CBE
(Sitting as a Tribunal in England and Wales)

BETWEEN:

ROYAL MAIL PLC

Appellant

- and -

OFFICE OF COMMUNICATIONS

Respondent

- and -

WHISTL

Intervener

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HEARING – DAY 12

APPEARANCES

Mr Daniel Beard QC, Ms Ligia Osepciu and Ms Ciar McAndrew (instructed by Ashurst LLP) appeared on behalf of the Appellant.

Mr Josh Holmes QC, Ms Julianne Kerr Morrison and Mr Nikolaus Grubeck (instructed by Ofcom) appeared on behalf of the Respondent.

Mr Jon Turner QC, Mr Alan Bates and Ms Daisy MacKersie (instructed by Towerhouse LLP) appeared on behalf of the Intervener.

Wednesday, 26 June 2019

(10.30 am)

THE CHAIRMAN: Good morning.

Housekeeping

MR BEARD: Good morning, Mr Chairman, members of the tribunal. Before we recommence the concurrent evidence section, the tribunal I think may be aware that unfortunately yesterday morning, Mr Harman was taken ill. Mr Harman and we would like to express gratitude to the staff of the tribunal who looked after him and ensured that he got to hospital where he was yesterday. He is in the process of having further investigation, further meetings with practitioners today. He unfortunately, I think in those circumstances, is not going to be available before Friday at the earliest. I don't think that disrupts the timetable. We're supposed to be sitting for half a day tomorrow, I think.

It was envisaged, though, whether or not it was going to be needed, that Mr Dryden could be cross-examined tomorrow morning and that would naturally mean that Mr Harman would start on Friday in any event.

Obviously if we were to go short today, Mr Holmes may take a different view, but that may be the sensible course in any event for Mr Dryden to be cross-examined tomorrow.

1 Obviously if there are further updates and Mr Harman
2 is not going to be able to attend on Friday, I will, as
3 soon as possible, inform the Tribunal, but at the moment
4 I just don't know more than that.

5 THE CHAIRMAN: I think the first thing to say is we wish
6 Mr Harman well.

7 MR BEARD: Thank you very much. I'll pass that on.

8 THE CHAIRMAN: Obviously we were slightly disturbed that
9 the effect of hearing us made him feel ill. I hope
10 nobody else has that effect, but we wish him well.

11 As to the timetable -- and we are at the expert
12 opinion stage -- obviously there's a -- there is
13 something in the sequence that you've all agreed and
14 we've accepted, but it's not set up in stone. There is
15 quite a lot of flexibility. I mean, I can even envisage
16 Mr Harman giving evidence next week, if that's better
17 for him; it would give him a clear run to the weekend.

18 I think keep us informed and I think it's important
19 that you all agree on this. Obviously Ofcom's call is
20 there as well.

21 Mr Holmes, do you want to help us at all?

22 MR HOLMES: Only that we would echo sending our best wishes
23 to Mr Harman, and we're very concerned and sorry to hear
24 that he is unwell and he needs the time that is
25 necessary to recuperate, and as you say, there is some

1 flex in the timetable and we should do what is necessary
2 to accommodate them.

3 THE CHAIRMAN: I mean, I just think he should be under no
4 pressure.

5 MR BEARD: I'm grateful for that.

6 THE CHAIRMAN: So I suggest you work towards -- it on
7 the assumption that we fit him in next week.

8 MR BEARD: I'll discuss that further with Mr Holmes. I have
9 obviously liaised already with both counsel, but we'll
10 discuss that further.

11 THE CHAIRMAN: Okay.

12 MR BEARD: I'm most grateful to the Tribunal.

13 THE CHAIRMAN: That's okay. I'm sorry to hear it.

14 MR NEIL DRYDEN(continued)

15 MR DAVID PARKER (continued)

16 MR DAVID MATTHEW (continued)

17 Questions from THE TRIBUNAL (continued)

18 THE CHAIRMAN: Well, welcome back, gentlemen. We are
19 resuming. Obviously you've had the chance to read
20 the transcript overnight. No doubt there are things you
21 want to tell us that you would have said differently,
22 but we have to just organise that process with a little
23 bit of care. We thought we would begin, if this would
24 be helpful, we have had topics 1 and 2, if
25 Professor Ulph said to you what he thinks, what we

1 think, was common ground, or at least was being said
2 yesterday. So what we have distilled from the results
3 of yesterday's discussion.

4 We're not going to hold you to this, we're not
5 trying to put words into your mouth; we're trying to
6 tell all parties what we think we learned and that will
7 then feed into closings. I don't want a big argument
8 about whether or not we got one full stop in the right
9 place, or, you know, slight emphasis. That's really not
10 very helpful at this stage. We accept that you have
11 your expert views and will hold to them, but we're
12 trying to get a distillation. So if that's a helpful
13 way to proceed, David, would you like to ...

14 PROFESSOR ULPH: Thank you, Chairman.

15 So in the first set of questions I asked you about
16 yesterday, about the general issues relating to the use
17 of an as-efficient-competitor test, two key points
18 I took away from the discussion were
19 the following: first of all in relation to the question
20 of whether the entry of a less efficient competitor
21 would benefit consumer welfare, the points I took were
22 that in deciding whether entry of a less efficient
23 competitor would benefit consumer welfare, account has
24 to be taken of the benefits arising through allocative
25 and dynamic efficiency, as well as possible losses

1 arising through productive inefficiency, arising from
2 the need to recover total costs. It would be a strong
3 presumption of improved consumer welfare in situations
4 of monopoly but no certainty.

5 The second set of conclusions I drew related to
6 the question of whether you could distinguish between
7 anti-competitive foreclosure and foreclosure. So here,
8 what I took from the discussions was that deciding
9 whether foreclosure is anti-competitive is extremely
10 difficult in principle. Although there is some measure
11 of agreement in economics as to whether certain types of
12 behaviour are anti-competitive, the boundary remains
13 fuzzy.

14 Indeed, certain types of behaviour, such as creating
15 greater consumer loyalty, have both pro and
16 anti-competitive effects, or can have both pro and
17 anti-competitive effects.

18 Turning to the second set of topics we covered
19 yesterday about the use of an as-efficient-competitor
20 test in this particular case, the first set of
21 conclusions I drew is that in this particular case, any
22 realistic entrant would not enter every SSC and,
23 according to some definitions, would not therefore be an
24 as-efficient-competitor. Nevertheless, allowing for
25 partial and/or sequential entry is consistent with

1 the methodology of the AEC test. There is scope to
2 consider different orders in which entry to different
3 SSCs would occur and test the sensitivity of conclusions
4 to the order used, but it should be Royal Mail's LRIC
5 that are used in each SSC. For a number of reasons, it
6 is genuinely difficult to say how factors such as
7 Royal Mail's VAT exemption should be treated. While it
8 was recognised that some attempt could be made to
9 incorporate this and some of the other costs and
10 benefits associated with the USO into a price cost test,
11 it was recognised that to do this well was extremely
12 difficult, and there are risks of permitting too much or
13 too little entry.

14 Now, turning to the question of what other possible
15 approaches might be used, what I took away from
16 the discussion was that in addition to the
17 as-efficient-competitor test, it was agreed that there
18 are other tests, for example consumer benefit tests,
19 that could be used to assess whether Royal Mail's
20 behaviour was abusive. There were issues as to how such
21 tests should be designed and implemented. While issues
22 of materiality did not arise in AEC tests, there was in
23 these other tests.

24 The expert opinions lay along a spectrum of views as
25 to what reliance should be placed on the different

1 tests, how they should be formulated and how well Ofcom
2 had undertaken them.

3 THE CHAIRMAN: We are not expecting you to react to those
4 straight away, but please take them away and when
5 the time comes to discuss them with your various teams,
6 they are meant to be an assistance to your understanding
7 of what we are understanding you are saying, if that's
8 not too complicated.

9 I think on that basis we'll now proceed to topic 3.

10 PROFESSOR ULPH: Okay.

11 THE CHAIRMAN: And as I said yesterday, the way we plan
12 this, we will deal with our two remaining topics and
13 then counsel for each party will have the opportunity to
14 ask clarificatory questions but not cross-examination,
15 and we will then close the concurrent evidence session
16 and go back to what we might regard as our normal way of
17 operating, though what is normality?

18 Okay, thank you. Professor Ulph.

19 PROFESSOR ULPH: Okay, as I said yesterday, my third set of
20 questions relate to how the as-efficient-competitor test
21 was actually carried out, and for the start, I ask some
22 very naive questions of you, just so I really understand
23 how the tests were actually performed.

24 So the first set of questions I want to put to you,
25 I think can best be framed if you have in front of you

1 Mr Parker's evidence, which is in the expert bundle,
2 volume 2, and I'd like you to turn to figure 6 on
3 internal page 30 of that report.

4 MR PARKER: Is this my first report?

5 PROFESSOR ULPH: The first report, yes. It's the external
6 page 659. Okay, so this doesn't relate at all to any
7 calculations that were being done, this relates purely
8 to theoretical issues, and I just want to use this
9 diagram to frame some questions for you.

10 So you'll see that in the diagram, there's
11 a long-run average incremental cost of the incumbent
12 shown by the blue line, and there's a long-run average
13 incremental cost of the entrant shown by the red line.

14 In the paragraph on the previous page, Mr Parker
15 explains that this has been drawn on the assumption that
16 on a like-for-like basis, the entrant is more efficient
17 than the incumbent.

18 I really don't want to make anything of that point
19 at all. I want to purely focus on the
20 as-efficient-competitor.

21 So my first question is, would you agree that if we
22 were talking about an as-efficient-competitor, then that
23 competitor's long-run average incremental cost curve
24 would be the blue line as shown in this diagram. Is
25 that something which you would all accept?

1 Mr Dryden?

2 MR DRYDEN: I do.

3 PROFESSOR ULPH: Mr Parker?

4 MR PARKER: Yes, I think that's right. The nature of
5 the applications test -- this may be a point you're
6 coming back to -- is that it is being used only at
7 the pre-entry point, so it's --

8 PROFESSOR ULPH: That's basically the point I really want to
9 get at. So that's a helpful comment.

10 Mr Matthew, do you want to add anything?

11 MR MATTHEW: No.

12 PROFESSOR ULPH: Okay.

13 Okay, so the next question I want to ask is, this
14 long-run average incremental cost curve, the blue line,
15 can that be applied at the level of an SSC, or is this
16 across all the SSCs taken together? How would you
17 intend that? It's your diagram, Mr Parker, so maybe you
18 can start.

19 MR PARKER: Well, as we discussed yesterday, I would say
20 that you would need to have the same unit costs as
21 the incumbent in all SSCs. This is an example, I think,
22 of a cost in one SSC, because I'm really illustrating
23 there the idea that there are probably economies of
24 scale or economies of density in an individual SSC, but
25 that's in this particular circumstance. I'm really

1 making quite a general theoretical point.

2 PROFESSOR ULPH: I understand that. So this could be
3 applied at the level of an individual SSC?

4 MR PARKER: Yes, subject to -- an as-efficient-competitor,
5 I think, has to meet Royal Mail across all SSCs.

6 PROFESSOR ULPH: Let's just be really clear. You accept
7 that for a particular SSC, the downward sloping long-run
8 average incremental cost curve can apply for both an
9 incumbent and an as-efficient-competitor, and they would
10 have the same downward sloping curve.

11 MR PARKER: Yes.

12 PROFESSOR ULPH: Mr Dryden, are you ...

13 MR DRYDEN: If I'm following, the as-efficient-competitor
14 and the incumbent would have the same curve.

15 PROFESSOR ULPH: Okay, right. So we're now getting to
16 the question I wanted to ask, which has essentially been
17 trailed also by Mr Parker.

18 So as you can see in the curve as it is drawn,
19 the incumbent prior to entry has an output of 100 and
20 a long-run average incremental cost of 10.

21 So my question on this is what was the appropriate
22 long-run average incremental cost to attribute to
23 the entrant if it enters the market? To put it
24 differently, the question is how would you think about
25 the way in which the entrant and the incumbent share

1 the market post-entry?

2 Mr Dryden, do you want to start?

3 MR DRYDEN: So I think that in order to avoid productive
4 inefficiency we're using -- in general terms, we're
5 using a LRIC, in this diagram, it would be 10. But the
6 mechanics of how that work, I would defer slightly,
7 hopefully in due course, to Mr Harman, but I can try to
8 explain what I think is happening, which is that we --
9 the conduct is over the bulk mail increment, so we have
10 a LRIC for Royal Mail's supply of the bulk mail
11 increment and its scale. Those LRICs are calculated by
12 zone, and I think there are four different zones. As
13 the entrant rolls out SSC by SSC, some zones -- I think
14 London perhaps -- sorry, some SSCs are just one zone --
15 I think London is; I think all other SSCs, if I'm not
16 mistaken, are a mixture of zones. So as the entrant
17 rolls out across SSCs, what you're basically picking up
18 is a kind of weighted average of Royal Mail's zonal
19 LRICs at Royal Mail's scale.

20 PROFESSOR ULPH: Okay.

21 But does that make any sense? Does it make sense to
22 assume that post-entry, you maintain the same level of
23 scale, both the incumbent and the entrant is also going
24 to be at that level of scale as well? Wouldn't it make
25 some sense to assume that they somehow share the market?

1 I mean, one natural assumption would be they share
2 the market and each of them produces 50% of the market.

3 MR DRYDEN: Indeed, and I -- or at least indeed in the sense
4 of understanding the question, because that was posited
5 as a way of thinking about the problem by Mr Parker, and
6 I think I alluded to it yesterday, which is we could
7 conceptualise, sir, just as you say, a 50:50 split of
8 the market in which each of the two firms would have
9 half the density that Royal Mail does today, but to
10 satisfy the break-even constraint, those -- of each of
11 the two firms, the prices that they charge across, in
12 each case, half the volumes, is going to have to cover
13 the higher combined cost that the two firms have and
14 the monopoly has by itself.

15 So in other words the revenues in that equilibrium
16 are going to have to cover the lost density economies,
17 and what I was trying to sort of say from the beginning
18 is that as soon as we engage in that kind of exercise,
19 there is, by construction, a degree of productive
20 inefficiency, and as soon as there is some productive
21 inefficiency, it becomes an open question whether
22 there's enough scope for allocative efficiency to more
23 than compensate for it, and that's not been
24 demonstrated.

25 So it's perfectly true that we could engineer

1 a situation where there's enough headroom for an entrant
2 that is as efficient as Royal Mail, but on half
3 the density to come in, but that would be productively
4 inefficient.

5 PROFESSOR ULPH: Mr Parker, do you want to respond to that?

6 I'm going to come back to that point, but ... Mr Parker?

7 MR PARKER: Yes, so I think from my understanding of the way
8 that Mr Harman has operationalised the test is you have
9 a target that you need to meet as the entrant, and
10 the target is the LRIC of the incumbent at current
11 volumes, ie before entry, and that target does not
12 change with the level of entry that happens, and it goes
13 a bit back to the discussion about there's the -- you
14 don't need to really take account of the facts for
15 the hypothetical analysis.

16 The -- I think the problem arises here, as you have
17 set it out, when there are -- you would get differences
18 in the LRIC with different levels of roll-out by the
19 entrant and different levels of how much it would take.
20 The test Mr Dryden describes hasn't done that, at least
21 in its form by Mr Harman.

22 I think sort of stepping back to a world where we
23 don't have economies of density at a local level, this
24 issue somewhat goes away, because where we have
25 the classic vertical margin squeeze, the

1 as-efficient-competitor can really match what's --
2 potentially match the current LRIC of the incumbent,
3 there's no economy of scale. All these issues nicely
4 disappear in that world, so it's straightforward. So we
5 are in a world here where it's -- just the facts of
6 the market are very -- are very different.

7 I take the point from Mr Dryden that if all you care
8 about is static productive efficiency, then I think it
9 does make sense to maintain the current LRIC of the --
10 of Royal Mail as your sort of benchmark target for
11 the entrant, but in a world where currently we have
12 a monopoly, so the -- let's imagine -- and I'm going to
13 pluck a number out of the air just to give you
14 a sense -- let's imagine that the price is 20; yes,
15 there is some productive inefficiency moving in this
16 diagram, but there's a very big allocative efficiency
17 benefit that can be gained by an entrant coming in
18 somewhere beneath the price but above the LRIC, and it
19 seems to me there is evidence of those discounts being
20 given by Whistl to try and attract business.

21 So I see the point that if you only care about
22 productive efficiency, then that's the right point to
23 use, but I think once you start taking into account
24 allocative and dynamic efficiency, I'm not sure that's
25 a sensible approach.

1 PROFESSOR ULPH: Mr Matthew, do you want to add anything?

2 MR MATTHEW: Only to observe -- I mean, I think, echoing
3 that point. Essentially what's being suggested is
4 should the dominant firm able to fully exploit its
5 economies of scale and scope to potentially exclude
6 entrants, and as we said yesterday, there may be an
7 argument when -- particularly where you have one entrant
8 and it's otherwise a monopoly, do we need to take that
9 into account in the price cost test we should adopt?

10 I think this is an extension of that discussion.

11 PROFESSOR ULPH: Well, my point was not so much about
12 whether it should -- I wasn't getting at these points
13 about whether it's exploiting its monopoly, I just
14 wanted to ask a more naive question about post-entry:
15 is it plausible to assume that the share of the market
16 will still be the same as when the incumbent was
17 the sole server of that market. I just don't quite
18 understand --

19 MR PARKER: On that purely factual point, I think obviously
20 the answer is no.

21 PROFESSOR ULPH: Thank you.

22 MR PARKER: Because this is all about basically business
23 stealing, isn't it, this type of competitive entry, it's
24 not really about growing the market, as I understand it,
25 and the concerns that have been expressed by Royal Mail

1 are all about potential sharing of the market for
2 delivery between itself and the entrant. So in
3 practice, yes, what you'll see is if you entrant comes
4 in and wins some volumes, that is -- leads to a loss of
5 volumes by Royal Mail, but that's not taken account of
6 in the test.

7 PROFESSOR ULPH: Let me just make a point -- sorry,
8 Mr Dryden, do you want to ...?

9 MR DRYDEN: Just a few remarks, if I may. So I think there
10 is agreement at least that as you move sort of above 10,
11 that one is introducing productive inefficiency, and
12 that follows from the fact Mr Parker said if you only
13 cared about productive efficiency, you would be a 10.
14 So I think we're agreed at least on that. And then
15 the question becomes whether the allocative efficiency
16 -- maybe dynamic efficiency -- outweighs it.

17 The point has been put, I think a number of times
18 that we can just assume -- presume/assume that that
19 allocative efficiency is going to be sufficient just as
20 a general matter to outweigh whatever degree of
21 productive inefficiency there is, including in extreme
22 cases which are almost hard to imagine, like each of
23 the two players having 50% of the density.

24 So I think as soon as productive inefficiency enters
25 it, it has to be outweighed by the allocative

1 efficiency, and it is not a matter of presumption, it
2 becomes an empirical matter, and there are at least some
3 characteristics of the postal market, you know, very
4 high fixed costs, falling volumes and etc, which suggest
5 the scope for allocative efficiency may not be too
6 great.

7 So I can understand the view that the UK postal
8 market would benefit from a good shot of competition,
9 but no one would really contend, I suspect, the idea
10 that the postal market would benefit from a good shot of
11 productive inefficiency. These two things are, you
12 know, intention, and that's why the consumer welfare
13 analysis is a weighing exercise.

14 THE CHAIRMAN: Mr Dryden, could I just ask one
15 clarification. When you say "empirically", you used it
16 yesterday, what actually do you mean?

17 MR DRYDEN: Anything evidential.

18 THE CHAIRMAN: So evidence?

19 MR DRYDEN: Any evidence.

20 THE CHAIRMAN: The market?

21 MR DRYDEN: Sorry, sir?

22 THE CHAIRMAN: Not theoretically empirical but the real
23 world.

24 MR DRYDEN: Any real evidence.

25 And if I may just make a point because it came up

1 yesterday on discounts. So there is a suggestion that
2 because Whistl was observed to be offering kind of
3 a lower price, we can assume that was some scope for
4 allocative efficiency, but that doesn't make -- that
5 isn't evidence for the following reason; which is if
6 the access prices and retail prices are creating some
7 headroom for inefficient entry -- and presumably here
8 we're talking about the prices before the CCNs because
9 we're talking about the prices that Whistl was offering
10 before the CCNs -- so under that matrix of prices which
11 had more headroom for inefficient entry than the CCNs
12 did, Whistl felt able to offer a discount.

13 But imagine a world where Whistl is not an AEC, so
14 it's inefficient, but it's less inefficient than
15 the headroom that's provided, that means it's got scope
16 to come in profitably, but it can use the headroom that
17 it has to offer discounts, and we can see that in
18 the limiting case where -- you know, in the limited case
19 where Royal Mail offered an access price of 0, Whistl
20 could buy the access and offer huge discounts because
21 effectively the headroom that is being created there is
22 funding its offer of discounts.

23 So the fact that we see -- when there is inefficient
24 headroom permitted, the fact that we observe a discount
25 being offered doesn't tell us that there's allocative

1 efficiency outweighing productive efficiency, if that
2 makes sense.

3 PROFESSOR ULPH: One point I want to make is I think we're
4 using the term "productive inefficiency" here in
5 a number of different ways, because in the discussion
6 yesterday it was all about productive inefficiency
7 arising because the entrant might have higher costs for
8 which you might need a whole higher LRIC curve than
9 the incumbent. If it has the same curve but they're
10 both producing the same level of output, then by
11 definition they both have the same long-run average
12 incremental cost and that, according to some
13 definitions, would be consistent with productive -- it
14 satisfies some of the conditions of productive
15 efficiency.

16 I think you're talking about it's productively
17 inefficient because it's not getting the minimum
18 long-run average incremental cost; you're moving it
19 away.

20 MR DRYDEN: That's right, so I'm saying there is a --
21 pre-entry there is factually an incremental cost to
22 the provision of bulk mail. So bulk mail is --
23 the provision of bulk mail by the Royal Mail is costing
24 something and that something -- that is the incremental
25 cost of providing bulk mail.

1 Any other market structure that produces total costs
2 for the supply of that -- those volumes higher than
3 Royal Mail's increment is productively inefficient
4 because it has increased the costs of the supply of
5 the increment. And those costs have to be recovered in
6 one of two ways. They have to be either recovered from
7 consumers in the form of higher prices or lower service,
8 or they have to be recovered through allocative
9 efficiency, in other words Royal Mail taking lower
10 profits.

11 PROFESSOR ULPH: Mr Parker?

12 MR PARKER: Yes, I think -- so let's imagine a situation, we
13 start with Royal Mail having a LRIC of 10 and it has
14 a price of 20; Whistl comes in with a LRIC of 15 and
15 takes some volumes and Royal Mail's LRIC is now 12.
16 Whistl uses some of that to price at 18, which is 10%
17 discount, and Royal Mail potentially then needs to take
18 a hit because previously its margins were 10 on those
19 products; it's now lost 2 because its costs have gone
20 up; it may lose another 2 because it has to start
21 matching Whistl's prices for bulk mail.

22 So, yes, it takes a hit on profits, I totally accept
23 that, but that's a hit on profits, that's
24 the pro competitive effect, that's the allocative
25 efficiency. And that goes back to what Professor Salop

1 is saying, if the entrant can come in facing a monopoly
2 when its LRIC is below the monopoly price -- not
3 the cost but the monopoly price -- you will get
4 improvements in consumer welfare.

5 So for me, actually I think in a world where
6 productive efficiency and the LRIC is below the actual
7 price because we're in a world where the competition is
8 weak and you can mark up a lot, I'm not really sure that
9 the focus on productive efficiency is terribly
10 informative for consumer welfare which, whether you
11 think about -- whatever test you think about in
12 competition law terms, we're trying to promote consumer
13 welfare.

14 MR DRYDEN: Can I?

15 PROFESSOR ULPH: Mr Dryden, yes.

16 MR DRYDEN: So it is true that the price that Royal Mail
17 sets for bulk mail is quite far above the LRIC for bulk
18 mail, ie there is a big margin. In fact, I provided
19 the numbers in my first report to the CAT. So I have
20 a section where I deal with consumer welfare and one of
21 the facts I present is the difference between the FAC
22 and the LRIC, and that is very large, and that's
23 the function of the fact that it's incremental output.

24 The fact that there is a very big margin on the bulk
25 mail increment doesn't mean -- it does not follow from

1 that that there is large scope for allocative
2 efficiency, and the reason for that is that it's
3 a network industry, it's a multi -- or maybe more simply
4 put, it's a multi-product firm, and there is an
5 additional constraint that has to be satisfied, which is
6 the total revenue of all the products, bulk mail plus
7 single piece mail etc. The total revenue has to also
8 cover the total cost; that's the break-even constraint.

9 And if that constraint is nearly binding or becomes
10 binding with a substantial loss of volumes through
11 a productively inefficient entrant, then there is no
12 scope for allocative efficiency. Prices would have to
13 go up or service standards would have to be cut.

14 MR PARKER: Perhaps to respond to that, I think this is
15 getting into the argument about the USO and
16 the financeability of the USO --

17 THE CHAIRMAN: I was going to say -- I think Mr Matthew
18 might have something to say to this.

19 MR PARKER: -- which is there are some other services
20 outside of bulk mail, and Mr Dryden is making an
21 assumption that Royal Mail is completely revenue
22 constrained and will have to recover anything it doesn't
23 make on bulk mail. Mr Matthew will be able to talk
24 about it, but Ofcom has looked at that several -- on
25 several occasions.

1 PROFESSOR ULPH: I'll allow Mr Matthew to have a say now.

2 Do you want to come in?

3 MR MATTHEW: I think we are rehearsing again some of
4 the arguments yesterday. So on the general points, my
5 view is as long as you're not putting a constraint on
6 what the dominant firm can do to react by cutting its
7 prices it is presumptively the case within bulk mail
8 that more competition would put downward pressure on
9 prices notwithstanding any productive efficiency.
10 That's the expectation I would have from the standard
11 economics of how markets work.

12 I understand the point that Mr Dryden makes that
13 a loss of gross margins in bulk mail reduces the overall
14 degree of recovery of the total costs of the Royal Mail
15 network, and there is a risk and an argument and
16 a debate that's been long-standing about whether that
17 network can cover its costs in circumstances where
18 competition -- and competition efficient or
19 inefficient -- occurs.

20 And that's not something that Ofcom has ignored or
21 I've ignored, it's -- I understand the mechanism, and
22 that takes you to a question of, well, how does that one
23 pan out? Is it a reason to say we don't actually want
24 competition in bulk mail at all, as has been argued
25 over -- you know, previously, and Ofcom's decided no, we

1 think on balance it's -- competition in bulk mail is
2 a good thing and while we're on the subject of
3 efficiency, one of the reasons is precisely
4 the potential dynamic efficiency gains that comes with
5 competitive pressures that may have led -- acted as
6 a catalyst for Royal Mail to become itself more
7 efficient and indeed make the USO more sustainable over
8 time. But those are issues that were dealt with in
9 a different arrangement, that they were directly dealt
10 with.

11 PROFESSOR ULPH: The method of dynamic efficiency that we
12 were trying to get at.

13 But that, I think, is my problem. My problem is
14 that the financial constraint is one that goes across
15 all SSCs taken together, whereas we're trying to do this
16 analysis SSC by SSC, and I just -- I find it problematic
17 trying to put those two things together to say because
18 there's this overall constraint, therefore we're going
19 to force the long-run average incremental cost of
20 the entrant to be the same as that of the incumbent
21 operating at the same scale, SSC by SSC, as
22 the incumbent is currently doing. I just find that
23 mildly problematic, but ...

24 Mr Dryden?

25 MR DRYDEN: Yes, I'm not sure that I can add much on that

1 difficulty to what I've said already. I mean, you know,
2 I think I've hopefully tried to make clear my logic.
3 I just want to pick up one thing. It was said a few
4 times yesterday, it's been said again this morning, what
5 I'm saying about the constrained scope for allocative
6 efficiency depends on the USO, and that's not quite
7 right. I think the USO accentuates the point, but if
8 there was no USO and what we simply had was
9 a multi-product firm with some joint costs at the centre
10 of providing all the product and then some incremental
11 costs associated with each of the multiple products, one
12 of which in this case is bulk mail, everything I'm
13 saying would still be true.

14 So there isn't a particular dependence on the USO;
15 the point is simply that as soon as we start incurring
16 productive efficiency, to know that consumers would be
17 better off, we have to empirically/evidentially have
18 some reason to believe that the allocative efficiency
19 would dominate that, and that is not a question that can
20 be analysed on the increment in isolation; because it's
21 a multi-product firm, it has to be analysed at firm
22 level.

23 PROFESSOR ULPH: Okay.

24 Mr Parker, do you want to come back on that?

25 MR PARKER: I mean, I suppose if this boils down to an

1 empirical question, some of, I think, the argument that
2 Mr Dryden is making is about the burden of proof and
3 where the presumption lies; and his view is unless Ofcom
4 can show that allocative efficiency dominates
5 the productive efficiency -- allocative efficiency plus
6 dynamic efficiency, it's not enough.

7 I suppose one could equally think about it the other
8 way, which is if there's a strong presumption that
9 competition brings benefits, then you would want to see
10 strong empirical evidence that the productive efficiency
11 disbenefit is so large that it would outweigh those
12 allocative efficiency benefits, and all I would say to
13 that is we certainly haven't seen evidence on that
14 basis.

15 THE CHAIRMAN: Can I just say, what Mr Matthew said was
16 a fairly broad proposition of regulatory policy, in
17 other words competition can be generally assumed to
18 reduce costs and be beneficial to consumers, and that's
19 presumably an Ofcom judgement taken in the context of
20 the overall regulatory structure. You have to take
21 everything into account. Is that fair?

22 MR MATTHEW: Sorry, I was making a general proposition about
23 policy generally, ie competition is presumptively seen
24 as a good thing, ie more competition is good as long as
25 you're not constraining someone from actually competing.

1 Then there is the second specific question to this
2 particular industry which does recognise the joint cost
3 issue -- sorry, the common cost issue where Ofcom has
4 made a judgement in the round from a regulatory
5 perspective and has taken a view that competition in
6 bulk mail is something that is desirable.

7 THE CHAIRMAN: Yes. I'm not trying to -- I'm not trying to
8 fine-tune the judgement you've made, I am just trying to
9 categorise it as a judgement. Presumably Mr Parker
10 would agree with it.

11 Mr Dryden, you surely would also agree with that
12 broad proposition; your disagreement is with
13 the methodology?

14 MR DRYDEN: I mean, the broad proposition that competition
15 is a good thing, I agree with.

16 THE CHAIRMAN: Very hard to argue with.

17 MR DRYDEN: Sorry?

18 THE CHAIRMAN: Very hard to argue with, is it not? I know
19 some people do, but not in this room.

20 MR DRYDEN: It is, subject to the following, hard to argue
21 with, which is the following. So let's say we all agree
22 competition is a good thing and we set up an
23 as-efficient-competitor test and we get no competition,
24 so then we add Mr Parker's 1p, and we still have no
25 competition; and then we add Mr Parker's 2p, and we

1 still have no competition; 3p -- we keep going until we
2 get some competition, and we say we're entitled to keep
3 going until we get competition because competition is
4 a good thing.

5 That, in my view, is a problematic approach, because
6 at the point that you have added enough pennies of
7 inefficiency to induce the entry, you don't know that
8 consumer welfare is higher than in the factual, because
9 the degree of productive efficiency that has been added
10 in to get the competition may not be outweighed by
11 allocative efficiency.

12 THE CHAIRMAN: I think what I was trying to ask you to agree
13 with was that within the bulk mail, the postal sector,
14 you are not disagreeing with the overall proposition
15 that competition -- the introduction of competition is
16 in principle liable to be beneficial to consumers;
17 you're arguing with the way in which it's being done and
18 the way this judgement has been exercised, but you're
19 not really contesting the overall regulatory judgement?

20 MR DRYDEN: Not in the slightest.

21 THE CHAIRMAN: No, okay, that's fine. Thank you.

22 PROFESSOR ULPH: That is as far as I want to pursue this
23 particular discussion. Mr Frazer, do you have any
24 questions you want to ...

25 MR FRAZER: Probably after the next one.

1 PROFESSOR ULPH: So my next question goes back to something
2 we talked about yesterday but has also been covered
3 a little bit just now, and that is what account should
4 be taken of the common cost of operating a USO in
5 calculating these long-run average incremental costs?
6 Mr Dryden, do you want to start off?

7 MR DRYDEN: So I don't think account should be taken.
8 The LRIC cost standard, subject to a clarification I'll
9 give in a second, doesn't take into account common
10 costs, and it obviously has a lot of pedigree as a cost
11 standard, not just in this arena but across competition
12 policy. So we're not taking -- the exclusion of common
13 costs is not an oversight, it is absolutely
14 the intention, and that's why we adopt LRIC, because of
15 its efficiency properties.

16 A little -- just to be absolutely clear, what are
17 being excluded are really the non-incremental costs. So
18 -- and I'm just being -- this could be perceived as
19 semantic but I'm just trying to be clear. Delivery, so
20 the postmen walking up and down the path, these delivery
21 activities, they are a common cost to the provision of
22 single piece mail, other services and, for our purposes,
23 bulk mail. The LRIC associated with bulk mail includes
24 those common costs to the degree that they are
25 incremental with the extra bulk mail volumes. So if

1 the postman is having to visit more doors or reload his
2 bag more often because it's heavier and etc, that is
3 picked up -- that element of common cost that varies
4 with the bulk mail increment is in the bulk mail LRIC.

5 What we're not doing is adding in anything else that
6 could be viewed as a contribution to the costs that
7 Royal Mail would be incurring anyway. And the minute
8 that we begin to do that, we are effectively funding
9 a degree of productive inefficiency.

10 PROFESSOR ULPH: To some extent you're saying that this
11 observed level of output we have here is an observed
12 level of output including both bulk mail, plus mail
13 being delivered under the USO, and we don't really know
14 how that splits down into those two components, and we
15 don't know how much of the increment is attributed to
16 the bulk mail component, like if you have a downward
17 sloping -- have I understood you correctly?

18 MR DRYDEN: I don't think so, because we do know. So in
19 other words, Royal Mail has a LRIC model of its
20 business, and the LRIC that we're using -- and it has
21 different LRICs for different services in this
22 multi-product firm, and the LRIC that we're using,
23 roughly speaking, is the LRIC for the provision of
24 the bulk mail increment conditional on Royal Mail
25 providing its other services.

1 PROFESSOR ULPH: Doesn't that depend on which way round you
2 do the calculations? If we start with this level of
3 output as bulk mail, then the rest -- all the USOs, the
4 increment, if you start with this as being the USO, the
5 level of output is the increment.

6 So isn't there an issue there about how exactly you
7 define the increment? The increment is the increment to
8 something, so the question is what's the something to
9 which it's an increment.

10 MR DRYDEN: You're absolutely right, the answer would
11 fundamentally depend on that and the answer is it's
12 the increment conditional on in any event providing
13 the other services, including those that are provided
14 down to the USO. I stand to be -- if that's not quite
15 technically correct, I stand to be corrected in due
16 course by Mr Harman, but in essence, I'm sure that what
17 I've just said is correct.

18 PROFESSOR ULPH: Okay, that has been helpful to clarify it.

19 Mr Parker, do you want to ...?

20 MR PARKER: Yes, I mean, I think I agree with Mr Dryden in
21 the sense that if you're doing a pure
22 as-efficient-competitor test, then you should look at
23 the incremental costs of the service in question, which
24 is bulk mail, and in that case that means all of
25 the common costs get loaded on to whatever other

1 services we're talking about here, USO and potentially
2 some other services; and the entrant, looking it from
3 a pure static productive efficiency basis, would need to
4 be able to match Royal Mail's LRIC whilst also incurring
5 all the -- its long-run incremental costs include all of
6 the costs of setting up a postal network and delivery
7 network and hiring the postmen and so on, whereas for
8 Royal Mail it's the incremental costs of Royal Mail.

9 I mean, it seems to me it's an indication of
10 as-efficient-competitor tests not being a very sensible
11 it's to apply in this world where you can't conceive of
12 an as-efficient-competitor, and again, the issue doesn't
13 arise in a classic vertical margin squeeze where
14 the entrant can be as efficient as the incumbent.

15 PROFESSOR ULPH: Mr Matthew, do you want to add to that?

16 MR MATTHEW: So this isn't an area I've focused on but

17 I just make one observation that occurs to me as we talk
18 about it. I mean, my understanding is it's a long-run
19 average incremental cost standard that we're using,
20 which is essentially it says: well, I've got a service
21 and I'm going take into account the fixed costs of
22 providing that service, it's an incremental service but
23 it's the fixed costs of that bit and I'm going to spread
24 them across all the units I sell, and my price cost test
25 is whether or not the price is higher than that cost.

1 So that is taking into account an economy of scale,
2 if I'm right, within that service. It's just
3 saying: unless you take the view of limiting -- assuming
4 a different set of volumes, it's saying you can exploit
5 that economy of scale, but you do have to cover those
6 fixed costs.

7 It just occurs to me conceptually, I'm not entirely
8 sure that that's obviously different from an economy of
9 scope, and whether or not -- it does go back to
10 the discussion yesterday. I think if you were to say if
11 -- if you're going to assume that all of the common
12 costs are recovered from other services, you probably
13 need to extend your test to check that, and that's quite
14 difficult in these circumstances.

15 And again, just an observation -- this came out of
16 the Article 82 guidelines -- the use of long-run average
17 incremental costs makes economic sense as a sensible way
18 of trying to get more of the cost structure that you're
19 looking at than the old sort of allocate total costs,
20 but it is -- at least some people have suggested that it
21 is essentially a more refined version of an average
22 total cost, and you find in the guidelines, there is one
23 footnote that I think says, you know, where it's
24 a single product, then long-run average incremental
25 costs and average total costs are not wildly dissimilar;

1 they're kind of different ways of getting at the same
2 thing. And it references that that doesn't apply where
3 you're talking about the products -- the situation
4 Mr Dryden describes where you have multiple products and
5 there's a common cost and it says in those cases you
6 might have to think further.

7 So it's not to me -- I can see where Mr Dryden is
8 coming from, but to me we're talking about a spectrum
9 from pricing above real marginal costs, which is the one
10 that really gives you full weight to allow(?) productive
11 efficiency back up through how much -- how many fixed
12 costs are you going to bring into the equation, and it's
13 not self-evident to me that as a matter of principle,
14 economies of scope get different treatment in that than
15 the economies of scale. But that's kind of it.

16 PROFESSOR ULPH: Okay, thank you. I think that's been very
17 helpful in clarifying the various points of view.

18 MR FRAZER: I've got a question, but it's to do with common
19 cost but not anything that you've just been talking
20 about, and I don't think it was in your reports, as
21 I recall, so if I'm offending the rules of hospitality,
22 you can just decline and I won't be the least bit
23 offended, I can assure you.

24 THE CHAIRMAN: I may be.

25 MR FRAZER: Yes, indeed, the Chairman may be, but he's

1 easily offended.

2 We heard last week about access prices as between
3 the zones being intended to be cost reflective, and
4 there was some discussion about how to allocate common
5 costs as between the zones, and I wondered if you had
6 any views on the methodology which would be rational in
7 economics as a way of allocating those common costs
8 between zones, so having different specific costs.

9 Mr Matthew, perhaps you'd like to ...

10 MR MATTHEW: On the empirics here, or ...?

11 MR FRAZER: Either hypothetically or on the empirics.

12 MR MATTHEW: On the empirics with Mr Dryden's and
13 Mr Harman's tests, I think there are relatively few
14 common costs between the zones, so the LRIC of bulk
15 mail, that doesn't depend on the number of zones you
16 roll out to, if I remember rightly, it's more that there
17 just are differences in zones so it's more expensive to
18 supply in some areas than in others.

19 MR FRAZER: Yes, that isn't quite what I was getting at. We
20 saw a change in the way that costs have been allocated
21 as between zones as part of the CCNs, and so there's
22 obviously a change in the methodology by which costs
23 were allocated on a zone-by-zone basis between the four
24 zones, not between SSCs, and I wondered whether you had
25 any views on that.

1 MR MATTHEW: Are we talking about the allocation of costs or
2 the zonal pricing changes?

3 MR FRAZER: Well, I think those two probably are somewhat
4 interrelated.

5 MR MATTHEW: So under the CCNs there was a move in the zonal
6 pricing arrangements, and they were made on -- not on
7 a cost-reflective basis, they were made on: we're going
8 to increase the prices in some areas and reduce them in
9 others. My understanding is then that Ofcom actually
10 subsequently did a regulatory review of that and thought
11 that it had gone too far and that it wasn't -- you know,
12 the pattern of those prices wasn't reflecting
13 the differences in costs across the zones, and at one
14 point had a recommendation that there should be changes,
15 which were then dropped because they were primarily
16 there to -- in response to the entry concerns arising
17 here in this case as well, and once entry had been
18 excluded permanently, as it was seen, the regulatory
19 discussion moved on.

20 Sorry, does that answer ... I'm not sure if that
21 answers the question.

22 THE CHAIRMAN: My understanding of what my colleague was
23 getting at was whether it was a legitimate means of
24 altering the prices by changing the allocation of costs,
25 and if so, what is the reasonable methodology that would

1 underlie that from a regulatory point of view. I think
2 that was what --

3 MR FRAZER: Thank you, it was exactly that.

4 MR MATTHEW: I think the first question is was it
5 a reasonable thing to do to change the balance of
6 the prices, and --

7 THE CHAIRMAN: You've answered that, but underlying that,
8 can it derive from a reasonable change in cost
9 allocation and if so, on what basis?

10 MR MATTHEW: I just haven't considered that. I mean, we --
11 Ofcom obviously didn't challenge the zonal pricing
12 arrangements under competition law, so it's --

13 MR FRAZER: Fair enough.

14 MR MATTHEW: -- it's not something I've ...

15 THE CHAIRMAN: What about at a level of theory?

16 MR MATTHEW: At a level of theory, I think taking a step
17 back, if a dominant firm sets lower prices where it
18 faces competition and doesn't do so elsewhere, that's
19 a form of selective pricing and that in itself doesn't
20 raise the same sorts of objections as you would expect
21 from the sort of arrangements we're talking about here.
22 So it seems to me that if all that Royal Mail does is it
23 cuts its prices in the areas where it's faced with
24 entry, you don't -- I mean, in those cases you may well
25 look at price cost tests as the right way to draw

1 the line, and you wouldn't necessarily say: well, just
2 because the prices -- the margins it retains in some
3 areas are higher than those that it's going to get in
4 the competitive areas, that automatically leads you to
5 say this is a problematic arrangement. In fact, you
6 would say, well, you know, normally the competitive
7 process would mean where you get entry in some areas,
8 you'd expect the dominant firm to be -- react to that
9 entry and cut its prices in those areas, and that's not
10 in itself objectionable.

11 THE CHAIRMAN: No, but again, I'm sorry to -- I think what
12 the question is getting at is, as part of that process,
13 if there is also a cut in costs effectively and it's
14 achieved by a different allocation of common costs, is
15 that better or worse from the theoretical point of view
16 -- competition theoretical point of view?

17 MR MATTHEW: So if the allocation of costs feeds into
18 the price cost test you would deploy to evaluate that
19 conduct, then I can see that issues arise, so you'd need
20 to think about that, and in Mr Dryden's model, that
21 doesn't arise because it's effectively an incremental
22 cost standard so you don't need to think about those
23 things.

24 So if we think hypothetically, they cut the price
25 in, say, London to close to real incremental cost, so

1 think of it almost as marginal costs, but we observe
2 there are some common costs that that's not making
3 a contribution to, then you would need to give thought
4 to again whether that was something you should take
5 account of in this environment.

6 And I haven't been through the exercise --

7 THE CHAIRMAN: I'm not asking you to opine on the empirical
8 issues; simply at a theoretical level, it's something
9 that one should give thought to whether one should take
10 account of; is that right?

11 MR MATTHEW: You're looking at -- what are the long-run
12 average incremental costs in London, would be
13 the question you would face and you would need to think
14 about whether there were -- well, firstly, there would
15 be the real marginal costs of just London, which is
16 going to be the police -- sorry, not the policemen,
17 the post people walking the streets and the necessary
18 machines and say: well, are those covered; and that's
19 like sort of the pure version of this test. That's
20 the one that says: have you actually priced below
21 your -- effectively your marginal costs; and that would
22 be a necessary condition for passing, you know, those
23 prices to be okay.

24 But then you need to work backwards and say: well,
25 I have a long-run average incremental cost standard, and

1 if there are some fixed costs that are common to some
2 extent, then there might be a case for either including
3 some element of them here or checking that because
4 they're assumed if there's no attribution made in this
5 -- in London, that they're being recovered somewhere
6 else, imagining that the as-efficient-competitor is able
7 to sort of take over the whole of the services that
8 cover the common costs.

9 MR FRAZER: Yes, thank you.

10 THE CHAIRMAN: Mr Dryden, do you want to come back on that?

11 MR DRYDEN: So let me answer in two parts, first generally,
12 and then with more application to the case. Economics
13 does have a kind of harder-edged answer to this question
14 than I think was just suggested. So if the question
15 is -- I think Mr Frazer's question was what is
16 a rational allocation of the common costs and the answer
17 is that allocation isn't an economic exercise, it's
18 a sort of counting exercise, so there isn't a rational
19 allocation.

20 What --

21 THE CHAIRMAN: You're not suggesting accountancy is not
22 rational, Mr Dryden?

23 MR DRYDEN: There is -- before we get onto this case,
24 there's a general question that can be asked in
25 a network industry about how do you avoid setting

1 predatory prices, and it relates to the question of how
2 do you avoid setting prices that involve
3 cross-subsidies; and I think the second encompasses
4 the first -- and you get this idea of tram lines that
5 I think Dr Jenkins touched on. So imagine
6 a multi-product firm that has got eight different
7 products and we can think of a tree structure, so in
8 the bottom row there's eight products and then they pair
9 off into four groups of two, each with a common cost
10 between them, and then they pair off into two groups of
11 four that each have a common cost, and then there's
12 a joint cost of the whole enterprise.

13 What we need to do, to avoid predation and to avoid
14 cross-subsidies, is a combinatorial test. So each of
15 the individual eight products have to have a price that
16 is above their individual LRIC, taking everything else
17 as given, and which is below the standalone cost,
18 the SAC, of providing that one product. So if it's
19 above the LRIC, it's not predatory and it is not the
20 recipient of a cross-subsidy, and if it's below SAC,
21 it's not -- it's within the tram lines.

22 Then you do the same kind of all the way up for
23 every combination, and if the whole combination is
24 within the tram lines of its LRIC for the combination
25 and the SAC, it's not predatory and it's not receiving

1 or contributing across subsidies. So that's the Baumol,
2 or the Baumol, Panzar, Willig prescript answer to
3 Mr Frazer's question.

4 So you don't get -- you don't get an economics
5 answer of how to allocate; what you get from economics
6 are tram lines within which the prices have to lie. And
7 that is what I understood Dr Jenkins to be saying about
8 how Royal Mail thought about zonal pricing, and
9 the consistency of their zonal pricing, with permissible
10 use of flexibility which was sticking within those tram
11 lines.

12 As far as the application of this -- maybe I should
13 stop there.

14 MR FRAZER: Perhaps either Mr Matthew or Mr Parker want to
15 come back on what Mr Dryden said.

16 MR MATTHEW: Sorry, just to say that the -- the
17 combinatorial test, the idea that you recover all
18 the common costs across the range of services, that's
19 what I had in mind as a sensible way of approaching this
20 that doesn't avoid -- the arbitrary allocations that are
21 understandably or potentially -- potentially quite
22 difficult to deal with.

23 THE CHAIRMAN: It's a slightly challenging word.

24 Combinatorial.

25 MR MATTHEW: I think it's basically just saying: we have

1 a multi-product firm; if we are moving beyond
2 the marginal cost standards of how far you can go, then
3 you should recognise that, you know, a major source of
4 revenue should -- should, you know -- if it's part of
5 contributing to a common cost, those common costs
6 probably do need to be recovered, and if they're not,
7 you have a look. And the combinatorial test merely has
8 an eye to that. It's just saying: do we think generally
9 that's right.

10 MR PARKER: So I suppose I would be in many ways in
11 a similar position. So what we have here is we have
12 a lump of common costs and some of those, for
13 the purposes of setting prices, are being allocated to
14 Royal Mail but that in itself is -- that's an
15 allocation. Essentially, the thing about common costs
16 is you can allocate them anywhere, so I think what we're
17 talking about in terms of the floor being long-run
18 incremental cost and the ceiling being standalone cost,
19 there's a set of common costs, and in principle you
20 could apply, from an economics perspective, any amount,
21 any share of those common costs across any of
22 the services to which they are relevant; and whether on
23 day one you decide to do 1% to this service and 99% to
24 that service, and on day two you decide to do
25 the reverse, economics would not say in a sort of

1 Baumol, Panzar, Williq sense that there's any particular
2 distinction between those.

3 Now, I think in a world where common costs are very
4 small, then it doesn't really make much odds. In
5 a world where common costs are extremely large, then
6 obviously how you allocate those potentially makes quite
7 big differences about the way competition might play
8 out. So if what we started with is the national average
9 price at this level and we had a zonal tilt like this,
10 and then we moved to a zonal tilt like this to get to
11 the same national average price.

12 Mr Matthew has focused, has mentioned the reduction
13 in prices, in access prices where Royal Mail faced
14 entry, which is sort of true up to a point, and there's
15 two things going on. One is, no one's really paying
16 those access prices because people want -- are access
17 operators buying a national service. So what they get
18 if you're an access operator, you get the national
19 price, and the fact that the tilt is this or this or
20 whatever doesn't matter; you get the national price. To
21 a large degree, there aren't people thinking, "I want
22 a service in London so I just want the London price".

23 The relevance, I think, of the zonal tilt is almost
24 not so much the reduction in the prices where Whistl was
25 entering, so much as the increase in the prices where

1 Whistl wasn't entering, because what's going on is what
2 Whistl is buying is access from Royal Mail essentially
3 at the cost of all the bits that it's not entering into.
4 And so what you find is the price of that access was pre
5 the CCNs at, say, this level (indicates) and post
6 the CCNs because those prices have been now tilted up
7 because more common cost has been allocated into them,
8 is very substantially higher; and that's what starts
9 leading you into all these very substantially increased
10 surcharges resulting from the CCNs.

11 And I think essentially that's -- that's the conduct
12 that Ofcom was concerned about and the consequence that
13 Ofcom was concerned about that led to its regulatory
14 investigation and its regulatory proposals that were
15 then subsequently abandoned, because the prospect of
16 end-to-end competition had been eliminated.

17 So I think, if you like, it's a world in which
18 economics -- when common costs are very large, economics
19 doesn't tell you very much, because the allocations
20 become at that point, you know, extremely flexible.

21 THE CHAIRMAN: I was hoping there was a note of agreement,
22 but I'm beginning to lose confidence.

23 MR DRYDEN: Yes, just two points, sir, very quickly. One is
24 just in case there's any doubt, our application of
25 the as-efficient-competitor test includes the zonal

1 tilt, so we're asking the question: could an AEC
2 profitably compete given (a) the differential but also
3 (b) the zonal tilt; so it's just to make the factual
4 point that we treat it as part of the factual matrix.

5 The second point is the proposition is being made
6 a number of times that my fellow experts see some merit
7 in the LRIC standard and the reason why it's adopted,
8 but essentially, the larger the common costs get,
9 the more they suggest it might be appropriate to deviate
10 from the LRIC standard and start adding some of
11 the common costs in.

12 But the short point is just that we adopt LRIC for
13 reasons of principle, and it seems -- and because it's
14 a reason of principle, the fact that the -- as common
15 costs get bigger and LRIC diverges further from
16 FAC through the allocated cost, that's -- it's --
17 you know, that's not a reason to then sort of jump off
18 LRIC onto FAC or some sort of allocation.

19 In other words, if the principle was right, it
20 doesn't -- then if one's going to adopt LRIC wherever it
21 materially deviates from FAC, you might as well have not
22 adopted the principle in the first place, because
23 effectively you're saying, "I'll use LRIC whenever it's
24 close to FAC, but when it deviates, I'll start doing
25 allocations". And in that world, you might as well

1 call a temporal model.

2 So I've got a series of questions I just want to put
3 to you about that. So first of all, do you agree that
4 it is important to distinguish between the decision to
5 sequentially expand a network and the all or nothing
6 decision to have a network of a given size? I think
7 that's the distinction we're trying to get at here.

8 Mr Dryden?

9 MR DRYDEN: So my view is that it's -- let me start again.

10 What the as-efficient-competitor test does is it
11 tests at each level of roll-out, according to a given
12 sequence, whether an as-efficient entrant could properly
13 compete or not, and if we find it's passed at all
14 levels, then it follows from that that an
15 as-efficient-competitor could compete profitably at all
16 levels of roll-out.

17 There is a different question which I don't think
18 it's necessary to address, which is: does an
19 as-efficient-competitor have an incentive to roll out
20 further and further? Because we could imagine a world
21 where at the first stage, the as-efficient-competitor
22 test is passed at each and every level of roll-out, but
23 somehow the configuration of access prices means that
24 the entrant would choose to stop at some level and not
25 keep rolling out further.

1 In the first oral hearing in 2015, I said I don't
2 think that one needs to look at the second question, but
3 for completeness I did so, and I demonstrated that an
4 as-efficient-competitor would -- not only could
5 profitably operate at each level of roll-out but also
6 would find it profitable to keep rolling out.

7 Now, the reason that I said I didn't think it was
8 necessary was you sort of have to imagine in this
9 scenario where the as-efficient-competitor test is
10 passed at every level, that somehow the profit
11 maximising roll-out was less than 100%. You have to
12 believe that the nature of the exclusion was Royal Mail
13 was somehow inducing Whistl to not roll out completely
14 but accept partial -- be induced to only roll out
15 partially in order to hit that profit-maximising point.
16 And it seemed to me if Whistl was strategically
17 committed to rolling out, then it wouldn't necessarily
18 allow itself to be stopped by the fact -- by that fact.
19 But in any case I -- I did both.

20 PROFESSOR ULPH: Okay.

21 Mr Parker?

22 MR PARKER: Well, I think if we think about a pure
23 as-efficient-competitor, clearly you enter 100% of
24 the market and that's it. So if we then turn to
25 something more realistic, I think in a world where

1 the cost changes or the costs faced by the entrant
2 change according to the level of its roll-out, in
3 particular in relation to the -- when you move off NPP1
4 to APP2, and in particular in a circumstance where that
5 is a sharp break because of an eligibility criterion
6 rather than some smoothed halved surcharges, it seems to
7 me in practice there is no scope or expectation that
8 anyone would come in like that across the whole of
9 the country so we are talking about a phased roll-out.
10 It seems to me you should talk about a phased roll-out
11 and you look at how the costs change.

12 Now, the graphs that are presented in Mr Dryden's
13 reports and Mr Harman's reports, subject to the two
14 observations -- the two charts that Mr Dryden has
15 included from the oral hearing presentation and that
16 were in Mr Dryden's sixth report, but all the other
17 charts are based on the hypothetical exercise of --
18 the entrant is at zero and they choose to enter at 10%,
19 and that's what the 10% means. And then the 11% point
20 on that chart is the entrant is starting at 0, does it
21 choose to enter at 11%.

22 That seems to me -- what that doesn't do is tell you
23 the incremental profit between 10 and 11; it tells you
24 if, starting at 0, would it be profitable for me to go
25 to 11, and there could be situations where you have some

1 profits on, say, the first 8 -- just to pick some
2 numbers -- negative incremental profits on 9 and 10, but
3 because you have some profits built up in the bank on 8,
4 the test would say: well, you could come in at 10
5 because on average that's -- as the way that the graphs
6 are presented, you could come into 10 because on average
7 you're still profitable over that increment, and that's
8 the only decision, if you like, we're allowing you;
9 you're either at 0 or you're at 10.

10 So all the charts in -- in Dryden 1 to 5 and Harman
11 1 to 5 and indeed in my report, because I hadn't fully
12 appreciated this until some commentary in the joint
13 statement from Mr Harman that that was actually the way
14 the results were being expressed.

15 It seems to me it's more sensible to think about
16 sequential roll-out and if there is a sharp jump in
17 costs, then you should have -- then you should look at
18 the incremental profitability of that. None of --
19 the charts in Mr Dryden's sixth report do that analysis,
20 but not having taken into account the eligibility point,
21 because obviously that was a point that had not been
22 raised at that -- at that point.

23 If you look at the -- let's suppose we take one of
24 the charts in my report. Let's say -- which are on
25 the same basis so that on this, if you like, all or

1 nothing entry, I'm either at 0 or I'm at 5, I'm either
2 at 50 or I'm at 8, and so on. Sorry, I'm just trying to
3 find the reference. I think it's tab 10 in bundle 2.

4 What we can see -- let's say take figure 4, we'll
5 look at the orange line, does that -- in relation to
6 the other lines. This is on this average basis. You
7 can see that there's a very sharp drop which is at
8 the sixth SSC entered. On average, going from 0 to 6 is
9 still above the AEC downstream cost, but that's only
10 true because you have some profits in the first five
11 areas, not because the sixth SSC is itself profitable,
12 it's -- you can see from the chart that it --
13 the average falls to very near the AEC cost, it's clear
14 that the incremental cost of going into that area is
15 negative -- sorry, it's below the AEC downstream cost in
16 that area; and therefore you can see there would be
17 a strong desire on the part of the entrant, or you would
18 be quite nervous about taking that leap because that
19 incremental world is unprofitable, incremental SSC is
20 unprofitable.

21 And then it becomes a question of, well, if I know
22 that the next leap is unprofitable, how much further do
23 I need to have to get in order for it to be profitable,
24 and how much additional risk and concern do I have about
25 whether that's going to still be profitable when I get

1 back.

2 PROFESSOR ULPH: Thank you, that's very helpful.

3 Mr Matthew?

4 MR MATTHEW: Just one short observation. We're now into,
5 using this analysis to evaluate the incremental
6 incentives of the entrant to do different things, and my
7 point was just simple, that it seemed to me at this
8 stage, the use of an AEC price cost test is not really
9 the primary objective. We're trying to examine how this
10 affects actual incentives, and it will be apparent that
11 this particular pattern is not the one that would have
12 applied to Whistl. They were not planning to enter
13 the entire country and would not have faced the cost
14 structure used here. So once we're into trying to
15 evaluate effects in that way, then I think this sort of
16 analysis is not hugely -- well, not helpful.

17 PROFESSOR ULPH: Okay. Just to follow up on one point that
18 Mr Parker made. If you think about the calculus you
19 would do to think about moving into another SSC and set
20 up direct delivery there, so the two components of
21 the calculation you do would be first of all: what would
22 the access price have been that I would have been
23 charged by Royal Mail in that zone, compared to what my
24 costs of delivery in that zone myself. So that is one
25 component of the calculus. But the other component of

1 the calculus is how would that access price change for
2 all those other zones in which I'm dependent on
3 Royal Mail.

4 And the argument given by Mr Parker is that that
5 could change at an almost infinitesimally fast rate.
6 One extra SSC takes you completely off one price plan,
7 and it wipes you out from that. So that calculus can
8 make it really very difficult to move from one zone to
9 another zone, even if all the other calculus you were
10 doing about, the sort of zero 1 calculus all the time,
11 okay?

12 So I just think there is a distinction between
13 the calculus of moving from one SSC to the next one and
14 the calculus of being -- that number of SSCs being --
15 being in 0 SSCs. So that was just one point I wanted to
16 make here.

17 Mr Dryden, do you want to ...

18 MR DRYDEN: At the risk of being repetitious on my part,
19 there are two different calculus here, the level
20 question and the change question. I did do both in
21 2015; it met with no response. I presented a chapter in
22 this very issue, the second question you raised,
23 the second calculus you raise, I had a chapter devoted
24 to the topic in my first CAT report. That is the
25 chapter on the incentive question, as distinct from the

1 levels question and that met with no response. So
2 I guess I'm just saying that this is something that
3 I feel I've addressed.

4 PROFESSOR ULPH: Okay. Can I move on to a second question,
5 which is this distinction between --

6 MR DRYDEN: I'm sorry, I'm very sorry. I just realised when
7 I said it wasn't addressed, Mr Matthew in his expert
8 report did make two cross-references to the chapter that
9 I'm talking about, but both of them were effectively to
10 say -- I think I'm right in saying because it was on AEC
11 principles, and a kind of product of the AEC test, he
12 didn't think it was appropriate and didn't comment
13 further. So I just wanted to be clearer.

14 THE CHAIRMAN: I don't know if Mr Matthew has a view on
15 that.

16 MR MATTHEW: Yes, it's an extension of the comment I made
17 a minute ago, that when we're into trying to work out
18 what the incremental incentives at the margin are now,
19 you -- it seems to me looking at what the AEC might have
20 done is just simply not helpful, and this assessment
21 just doesn't tell you what those incentives look like.
22 Once you're past that levels price cost test debate,
23 you're into an effects assessment, and I think we do
24 need to be looking at what Whistl would have done.

25 PROFESSOR ULPH: Mr Dryden.

1 MR DRYDEN: Just on the point, essentially it's a feature of
2 the graph that there can be a cliff, a cliff means an
3 infinitesimal change at that point -- sorry, an infinite
4 change at that point, and that is a feature too of
5 the graphs that you get when analysing a retroactive
6 rebate, essentially the same reasons.

7 And we know that retroactive rebates are commonly
8 assessed with AECTs. Now, the other experts may take
9 the view that that is wrong and something is missing
10 from that analysis, but I would merely observe that it's
11 not unique to this case.

12 THE CHAIRMAN: I think we're passing in the night again.

13 PROFESSOR ULPH: Okay, the next question I want to ask is
14 about the interrelationship between the coverage rate,
15 which is the percentage of SSCs that you roll out to,
16 and conversion rate which is the fraction of customers
17 you convert to your direct delivery.

18 So if we take it that large customers have to make
19 some investments in order to switch to direct delivery,
20 and so require direct delivery to be rolled out to
21 a sufficiently large number of SSCs in order to make
22 that investment profitable, how is account taken in your
23 analysis of the fact that the conversion rate is
24 endogenous and will depend on the coverage rate, the
25 fraction of SSCs you roll out to. I just first of all

1 want to understand, have you taken that into account and
2 how you've taken it into account.

3 Mr Dryden?

4 MR DRYDEN: So we have -- I've presented to you results on
5 two bases, and the first is the base case, which I think
6 is undisputed.

7 The second is the sensitivity analysis. In
8 the sensitivity analysis, two things happen. One is
9 there is a change in the sequence to reflect
10 Royal Mail's view of the sequence by which a likely
11 entrant might come in. And the second thing is to
12 change the conversion rate to, if I recall correctly,
13 60%, increasing over time to 80%. I don't think there
14 is in that modelling any attempt to link the two, so the
15 two are designed to be independently reflective of what
16 an entrant might do, the sequence coming, as I say, from
17 Royal Mail's model guessing what an entrant might do,
18 the conversion rate, if I understand correctly, coming
19 from what Whistl itself was expecting to do in terms of
20 conversion. I can see that there could be a linkage,
21 but the assumptions are not mechanically linked in
22 the way that it has been done.

23 PROFESSOR ULPH: Okay. Mr Parker?

24 MR PARKER: So I understand that in the base case
25 conversions seemed to be 100% all the time, so that's

1 what I assume. But in the sensitivity case, yes, as
2 Mr Dryden describes, as the coverage level of
3 the entrant increases, the conversion rate is assumed to
4 increase. Those are sort of just two assumptions put in
5 there.

6 That's clearly a way of thinking about an entrant
7 who is not able to be as efficient as Royal Mail in that
8 regard, but it's therefore not an
9 as-efficient-competitor test, but the question is why is
10 that the only adjustment one would make, the debate we
11 had yesterday, but in terms of how it's taken into
12 account, it's in the sensitivity case, it's not in
13 the base case.

14 PROFESSOR ULPH: Okay. Mr Matthew, you want to ...

15 MR MATTHEW: Nothing to add to that.

16 PROFESSOR ULPH: Then that brings me to another question
17 which is if you're dealing with very large customers,
18 and if the conversion rate is changing as you roll out
19 to more and more SSCs, that means there's another effect
20 taking place when you go from 6 to 7, which is that you
21 might convert another big customer, and that customer
22 will be posting mail typically not just in the new SSC
23 to which you move into, but into all the SSCs into which
24 you've previously set up.

25 So there's an intrinsic dynamic between the number

1 of SSCs you've already moved into and the next SSC you
2 move out to. I just don't see how you can deal with
3 that in a model where there's no time. In the model it
4 seems to me you have to think about all that intrinsic
5 dynamic.

6 Have I misunderstood, Mr Dryden?

7 MR DRYDEN: You know, I see the point and I think it
8 actually links to something I said a little bit earlier.

9 PROFESSOR ULPH: Okay.

10 MR DRYDEN: So I am saying that provided the
11 as-efficient-competitor test is satisfied at every level
12 of roll-out, that is sufficient for there not to be
13 a problem. The as-efficient-competitor could profitably
14 operate at whatever level of roll-out it chooses to
15 have. So that's the first calculus.

16 The second calculus is does the entrant have an
17 incentive to keep rolling out. And I made the point
18 there that I've looked at that, and the answer is that
19 it does. But I also made the point earlier that even if
20 it didn't, so let's imagine somehow that in the way that
21 we've done it, that the profit-maximising point was
22 somehow engineered to be less than 100% roll-out, I made
23 the point that I thought in this circumstances,
24 the entrant might be strategically committed to rolling
25 out further.

1 So that -- you can link what I said there to your
2 idea that there's other things going on which might mean
3 that somebody who's strategically committed to entering
4 as a DDO wouldn't kind of allow themselves to be,
5 inverted commas, emphasised, "bribed", to kind of stay
6 small by the configuration of prices. If they really
7 want to be a DDO and they can, as shown by the first
8 calculus, profitably operate at every level, and there
9 are benefits of rolling out further because you can
10 convert more customers etc; that's a reason in my view
11 to be doubtful that if the second calculus had showed an
12 incentive to stay small, which it doesn't, that we
13 should -- in any case have placed too much emphasis on
14 that.

15 PROFESSOR ULPH: Okay, thank you. Mr Parker?

16 MR PARKER: To me we're starting to get into the situation
17 where we're stretching the AECT approach just way
18 further than you can sensibly go. So, for example,
19 Mr Dryden said an implication of the AECT framework is
20 the profit-maximising point for the entrant is to enter
21 at 100% because it just becomes increasingly profitable
22 to do so, and that just seems to me -- conflicts with
23 kind of consensus position that I think we'd reached,
24 which is that no realistic entrant is going to enter
25 into 100% of the country, and so I do slightly wonder

1 whether we've reached the useful end of where you can
2 push this to.

3 I also think that it is much more relevant to look
4 at incremental profitability because you may get to
5 a stage at X SSCs where moving into X plus 1 is
6 extremely unattractive and there may then be -- you
7 might then think: well, to make this at all attractive,
8 I'm going to have to go to at least some further level
9 on the basis of the current access prices that I face.

10 And so it's not just a matter of saying: well, I've
11 got this target over here and I'll just -- that's my --
12 that's my version -- my -- you know, where I'm going to
13 get to and anything intermediate doesn't really matter.
14 I think it does matter, partly because suddenly you've
15 got a whole lot of money that you're losing in between,
16 as soon as you go into that next SSC, and partly because
17 how do you know that the goal posts won't shift again at
18 some future date, because there's clearly scope to
19 change prices on Royal Mail's behalf every six --
20 six months, I believe, with some notice period. So you
21 wouldn't necessarily believe that it takes time to roll
22 out, that where -- the ground you thought you were
23 heading for may be different ground again.

24 So I think once we -- there's no way you can account
25 for all of that within the framework of

1 the as-efficient-competitor test or even some modified
2 test, I think, so I think I'm then with Mr Matthew, that
3 there's a limit to how much weight you can place on any
4 test of this description, once you start really looking
5 at the full market context.

6 THE CHAIRMAN: Sorry, what's your answer to Mr Dryden's
7 point that this happens in retrospective rebate
8 assessments, cliff edges, sudden changes, and that AECT
9 tests can accommodate that.

10 MR PARKER: Well, I'd say it's clear that in those cases,
11 you're still not talking about an
12 as-efficient-competitor because an
13 as-efficient-competitor would be one who could replicate
14 the cost structure of the -- of the incumbent, and what
15 typically happens, for those retroactive rebate cases to
16 have any force, there has to be some kind of demand,
17 some non-contestable share that is allocated only to
18 the incumbent, because otherwise the incumbent can't --
19 otherwise you can get a competition for every account.

20 So let's suppose I was seeking to sell, I don't
21 know, milk to an individual, you know, coffee shop, not
22 a chain but just an individual coffee shop, and I said,
23 "I'll give you a rebate of 5% if you take more than 90%
24 of your requirements from me". That's a retroactive
25 rebate, but not one which will have any force because

1 clearly there's other people out there who can contest
2 the entire -- the entire demand of that coffee shop,
3 just everyone can get 100% so there's no real effect, if
4 you like, for that retroactive rebate.

5 The retroactive rebate issue starts coming into
6 a case where -- it becomes interesting in a sort of
7 competition context when the incumbent is the only
8 person who can satisfy, say, 80% of all the demand, for
9 example because it is the only person delivering in that
10 area or -- and you want national coverage, or because
11 it's the only person with all the factories, and there
12 is an entrant out there, but can only ever achieve
13 a small amount, so it seems to me that's not as --
14 that's not an as-efficient-competitor test either,
15 because you're building in some world in which
16 the incumbent is more efficient than the entrant.

17 Then, if you do a price cost test in those
18 situations, what you typically see is it -- you can
19 enter at a small scale and then at some point when
20 the rebate kicks in, it becomes very, very unattractive,
21 and the question then is at what point does it then
22 become even remotely plausible for the entrant to get
23 in. And so, if you like, it's the same sort of issue
24 but it's not -- it -- it builds in some level of
25 inefficiency for the entrant, because in that case, they

1 can't compete for the whole demand, and so they have to
2 try and fund this rebate over a small amount.

3 THE CHAIRMAN: So you can do an as-efficient-competitor
4 test, but it's not really an as-efficient-competitor
5 test. It doesn't tell you anything. That's your ...

6 MR PARKER: Well, I think it would tell you something. It
7 would tell you that the incumbent having said,
8 "I want -- I'll give you a rebate if you take 95% of
9 your requirements on me", the entrant who is forced, by
10 some reason can only ever serve a small part of demand,
11 is then potentially materially adversely affected if
12 they seek to contest more than those units, and then
13 it's -- it becomes an empirical question of can you
14 think of the entrant realistically getting to a level
15 where this rebate no longer really has any material
16 effect. And even if you can, is it right for
17 the dominant incumbent then to try and set up that extra
18 hurdle.

19 I suppose the last point I'd make is that's in
20 a world where we're actually offering discounts to
21 customers, so it is a low pricing environment. Here
22 we're not talking about low pricing, we are talking
23 about all the prices went up, that's the new NPP1 price,
24 and then if you roll out end-to-end delivery, you incur
25 higher costs.

1 So I don't see that there's even an analogy from a,
2 it's a low pricing benefit to consumers so you need to
3 be a bit more -- bit more accommodating of the -- kind
4 of selective targeting of price discounts -- I'm not
5 sure that there's a consumer welfare benefit that reads
6 across in the same way.

7 THE CHAIRMAN: So there's a limit to the usefulness of
8 the analogy; is that right?

9 MR PARKER: That's a much quicker way of putting it, yes.

10 THE CHAIRMAN: I think we understand.

11 Does Mr Matthew have anything? I don't know whether
12 I've got out of sequence or what.

13 MR MATTHEW: I mean, Mr Parker has said many of the points
14 that I would agree with, yes, and, yes, to observe, when
15 you're using an AEC test in a loyalty rebate scheme, it
16 is a different nature of AEC than you would expect to
17 use in a predation or margin squeeze case. There is an
18 element of looking at the incremental profitability of
19 contesting one sub-segment, but it's a relatively crude
20 way of approaching it.

21 And I think some of the similar issues that arise in
22 this case could arise in some of those cases, which is
23 where, you know, should the AEC be as clear a bright
24 line as it is in the clear low pricing cases, or should
25 there be more allowance for where we see a loyalty

1 rebate scheme that's only intended to prevent entry or
2 exclude and is likely to have that effect, then that's
3 something you might take into account there as well.

4 So I think what I'm saying is the existence of
5 the use of those tests in some loyalty rebates cases
6 doesn't read across to automatic use everywhere, and in
7 particular it's still not going to be a particularly
8 useful way of trying to examine the actual incremental
9 incentives of an actual entrant because of
10 the construction.

11 THE CHAIRMAN: Mr Dryden, at the risk of repeating yourself.

12 I think we understand your position. You don't need to
13 say it again.

14 MR DRYDEN: I won't, sir. One point -- one new point, at
15 least relative to what I just said. It's being
16 suggested that retroactive rebate cases are low pricing
17 cases, and therefore distinct from this case which is
18 characterised as not a low pricing case.

19 The thrust of Professor Salop is that retroactive
20 rebate cases are not necessarily low pricing cases,
21 because what may be being done by the dominant company
22 is a price above the monopoly level is being charged for
23 disloyal customers, and the reward for loyalty is just
24 to pay the monopoly price and to avoid paying even
25 a supra-monopoly price.

1 So the dichotomy that is being suggested isn't, in
2 my opinion, present.

3 THE CHAIRMAN: Thank you.

4 MR PARKER: I suppose one would only add that
5 Professor Salop reaches the conclusion that one
6 shouldn't do price cuts -- incremental price costs tests
7 at all in conditional pricing cases.

8 PROFESSOR ULPH: My other questions are about two other
9 dynamics one might want to think about if we were
10 looking at this as more of a sequential entry into
11 the market.

12 So one is this: that if we think one of the benefits
13 of competition is allocative efficiency, then shouldn't
14 some allowance be made for the fact that as you roll out
15 to more and more SSCs, put more competition on
16 Royal Mail, the retail price, that, I think, is "PM" in
17 your model, will fall over time through that extra
18 competitive pressure, which is a dynamic which again is
19 not in the model.

20 My question again is this: presumably you have not
21 allowed for that because the price doesn't change, but
22 could one and should one allow for that dynamic?

23 MR DRYDEN: So I think if one had an empirical/evidential
24 basis on day one to believe that some inefficient entry,
25 presumably to a certain degree, not to an unlimited

1 degree, would be beneficial for consumers because
2 the allocative efficiency would outweigh it, if all of
3 those conditions were satisfied, and if one was
4 satisfied about administrability issues etc that could
5 be a reason on day one to implement a REO test rather
6 than an AEC test.

7 So in other words, you're saying: I anticipate on
8 day one that inefficient entry will be beneficial for
9 consumers because the allocative efficiency -- the
10 future allocative efficiency and maybe even
11 dynamic efficiency will outweigh the productive
12 inefficiency; therefore, on day one I will allow for
13 a degree of inefficient entry and provide that headroom
14 from the beginning. So that's one way of thinking
15 about it which I don't think is appropriate.

16 The other way of proceeding is on day one, you adopt
17 the as-efficient-competitor test. Now, to the extent
18 that that then results in entry which will be
19 productively beneficial and also have allocative
20 efficiency benefits, if the -- well, two things can
21 happen, actually. The retail price could start falling,
22 but then the -- if the -- if as you envisage the retail
23 price starts falling, Royal Mail would have to stay in
24 compliance with the as-efficient-competitor test going
25 forward until it reached a point of not being a dominant

1 company any more.

2 So at the end of year 1, when it was setting prices
3 for year 2, if the retail price has fallen, it has to
4 recalibrate its access prices to stay in compliance with
5 the AECT for the next year and so on into the future.

6 PROFESSOR ULPH: So you're saying you draw it as a kind of
7 sequential AEC assessment, reset the dials that were...

8 MR DRYDEN: Right, and companies do this. This is a reality
9 of competition policy compliance, which is there are
10 dominant companies out there who are calibrating their
11 pricing according to AEC tests, and what they're doing
12 is refreshing that analysis, you know, as frequently as
13 they revisit their pricing.

14 PROFESSOR ULPH: Okay, Mr Parker?

15 MR PARKER: I mean, I suppose the discussion we've just had
16 in some senses I agree with, which is that the AECT, as
17 presented by Mr Dryden and set up by Mr Harman, does not
18 include any allowance for allocative efficiency or of
19 any price competition benefit. It's purely focused on
20 productive efficiency. It says if you can compete
21 productively, then the -- in terms of you have LRIC
22 lower than -- your costs are lower than LRIC, then
23 you're allowed in, otherwise not.

24 There's no allowance given within the forms of
25 the test that Mr Dryden and Mr Harman are presented for

1 any kind of allocative efficiency benefit.

2 So then the question is what do you -- what do you
3 do -- what would you do. Well, one version is not to do
4 -- not to do an as-efficient-competitor test or not to
5 modify it, but just to look at: do we think competition
6 is beneficial and what do we think about the price
7 competition benefits of entry, and not really worry
8 about whether that's efficient or inefficient, but just
9 move away from that entirely. Or you could, as
10 discussed yesterday, potentially start thinking about
11 making some kind of allowance for the entrant, so you
12 can be, to a certain extent, less efficient, that would
13 be the REO approach, and we'll allow you some headroom
14 because we think that the pro competition benefits,
15 you know, outweigh -- outweigh the potential for static
16 inefficiency losses. I think we should also put
17 potential dynamic efficiency benefits in that camp as
18 well.

19 So I think either of those two approaches could be
20 a way forward. I'm not sure I have a -- it depends how
21 difficult it is to do either approach. So if it's
22 really hard to try and work out the appropriate way of
23 doing a REO, which I think might be the case here, then
24 you probably want to look at the more general
25 in-the-round assessment. If it's very clear what you

1 need to do, maybe you could do a REO.

2 PROFESSOR ULPH: It's clear that trying to allow for
3 the possibility of prices falling with extra competition
4 is just informationally much more demanding, because you
5 have to have some kind of account of how you're moving
6 down the demand curve as you lower the prices, so there
7 might be some output expansion effects as well there, so
8 it just becomes a lot more difficult to build that in.

9 MR PARKER: However you do the test, but clearly that's what
10 we're trying to do from a kind of consumer welfare
11 perspective overall.

12 MR MATTHEW: Just -- I mean, just to make an observation on
13 that. So yes, you would expect prices to be coming
14 down. One of the reasons why price cost tests are used
15 in the circumstances where they -- they are genuinely
16 very useful is the certainty they provide, and I think
17 you're absolutely right to say there is a trade-off
18 between trying to use an AEC test to sort of predict
19 the future in a sort of -- you know, a systematic way,
20 as opposed to something that you can test, evaluate and
21 sort of say, "Well, I've ticked a box".

22 So, I mean, Mr Dryden was right, you do recalibrate,
23 perhaps, and generally, when you're trying to use an
24 AECT as a bright line, one -- the use of kind of
25 self-imposed limitations to make it manageable, to take

1 a short-term view as to price v costs in the short run
2 and not try to take into account all these dynamics, but
3 that of course is a limitation of what the test is
4 actually capable of telling you. It simply doesn't tell
5 you very much about what might happen.

6 PROFESSOR ULPH: Okay, thank you.

7 Do either of my colleagues want to ask anything?

8 MR FRAZER: No, thank you.

9 PROFESSOR ULPH: Okay, I'd like to ask just one final
10 question about AEC tests, and then we'll come on to
11 product differentiation. So this question has already
12 been alluded to, I think by Mr Dryden. And the question
13 is what account should be taken of the zonal tilt as
14 well as the price differential between NPP1 and APP2,
15 when doing the AEC test?

16 So let me just make the question a little bit more
17 precise. So the question here is: how is the behaviour
18 of Whistl affected by the price differential, and in
19 conducting the AEC test, or an REO test, the analysis
20 tends to focus on the choice by Whistl to use either
21 NPP1 or APP2, but there are three price plans out there,
22 NPP1, APP2 and ZPP3, so the question is, should one take
23 account of the fact there's that third price regime in
24 looking at the choice between NPP1 and APP2? Could
25 the zonal tilt have had an effect on the choice between

1 the different price plans, and to what extent was that
2 allowed for in any of your analysis?

3 MR DRYDEN: So it wasn't allowed for in the analysis. It
4 could have an effect if arbitrage is possible and
5 the factory could only be to make the price cost test
6 pass with a greater margin, because the entrant can only
7 be in a better position, but if it has more -- if it has
8 another pricing plan available to it that it can -- that
9 it can use.

10 So when we implement the as-efficient-competitor
11 test, the question that we're asking is an entrant that
12 had the same costs as Royal Mail, could it profitably
13 have competed at every level of roll-out, given
14 the pricing under the CCNs, and so we are taking there
15 as a given the price differential, obviously, and we're
16 also taking as a given other elements of the CCN
17 package, including the zonal tilt, and the answer we're
18 getting from the tests is yes, an AEC could profitably
19 compete.

20 So the zonal tilt is reflected in the test and in
21 the -- and therefore in the level of the prices that are
22 paid. But what the test isn't doing -- but, sorry, what
23 the test is also doing is requiring the entrant to
24 choose between NPP1 and APP1, and not allowing for any
25 arbitrage, and that, as I've said already, can only make

1 the test -- result better. So we viewed it as -- we
2 viewed not modelling it as conservative and left it at
3 that.

4 PROFESSOR ULPH: Let me make it clear that in posing
5 the question, I wasn't just thinking about arbitrage.
6 That's another issue which is itself quite
7 controversial. The point that I was trying to get at
8 was, supposing you think about ZPP3 as a price plan in
9 and of itself. Now, under the contract change notices,
10 price in London came down quite a lot, and if we go back
11 to the discussion we just had, when you're thinking
12 about whether to serve a particular zone, what you're
13 thinking about is what would be my costs of delivering
14 mail in that zone versus the cost of paying the access
15 charge to Royal Mail for delivery in that zone. That's
16 one of the bits of the calculus that you would be
17 thinking about.

18 So if the access price in London comes down a lot
19 and even below the cost of Whistl, it becomes less
20 attractive to Whistl to think about serving London on
21 a zonal price plan.

22 So the question is, is that somehow locking Whistl
23 more into only thinking about the choice between NPP1
24 and APP2? Is that a potential effect that this change
25 in the price plan could have?

1 MR PARKER: I think the change in the price plan and
2 the zonal tilt comes in multiple places.

3 PROFESSOR ULPH: I agree that.

4 MR PARKER: It comes in partly if I, as Whistl, seek to
5 enter for instance in London, previously on the sort of
6 FAC equitable mark-up type approach, that was the most
7 expensive -- one of the most expensive areas for
8 Royal Mail because its LRIC was higher than in other
9 areas and therefore looked most attractive, if you could
10 come in with an offer that was less than the access
11 price in those areas, that gave the entrant headroom.

12 So there is potentially -- the main effect of
13 the zonal tilt on Whistl as I see it is not so much
14 about what's happened in London, but it's
15 the consequential effect of what's happened elsewhere,
16 because I go into London, let's suppose I entered into
17 some London areas to begin with, that means that I am --
18 I have to pay access charges on areas that are sort of
19 disproportionately non-London, and it's the access
20 charges that have gone up in price very considerably,
21 because essentially the common costs have been
22 reallocated into the rural and suburban areas that
23 I wasn't choosing to go into.

24 So that is true -- that effect is true on ZPP3, but
25 it's also true on APP2 when we start talking about the

1 surcharges, because essentially on APP2, you have to
2 meet a national zonal profile of having the right
3 proportions of mail in -- well, what are described as
4 cheap -- cheap areas -- low cost areas for Royal Mail
5 and high cost areas for Royal Mail, but they're actually
6 not anything to do with Royal Mail's cost or certainly
7 not its LRIC, it's about the prices.

8 So something that looks like what -- previously you
9 were taking mail out of Royal Mail's system where it had
10 high costs, high incremental costs. You're still doing
11 that, but the surcharges are calculated because it looks
12 like you're not -- it's not that you're taking costs
13 area out of Royal Mail and high cost, it's now you're
14 taking an area out of -- you're taking volume out of
15 Royal Mail in low price areas.

16 So, if you like, Royal Mail is penalising entrants
17 into London because it says: well, that's an area
18 I don't make much margin on, so I want to get my margin
19 back somewhere else, and I'm going to get it back in
20 the areas you're not going into.

21 So to that extent, I don't think it would be
22 described as cost reflective, and therefore -- so
23 I think you're right that the zonal tilt has material
24 implications for how -- for the profitability of an
25 entrant on a given roll-out plan. The way it comes

1 through, I think, in Mr Harman's model of Mr Dryden's
2 framework is that the surcharges have been calculated as
3 they would be under the new price plans, and those
4 surcharges get, you know, very -- very material.

5 And just a last point, Mr Dryden mentioned again
6 that the AEC has the same cost as Royal Mail, but
7 the nature of being an entrant here is if you're an
8 entrant at less than 100% scale, I -- my costs in all
9 the areas I don't serve are not Royal Mail's costs,
10 they're Royal Mail's prices. So you can't really
11 match -- anything less than 100%, you have no scope to
12 match Royal Mail's costs, because you're facing
13 Royal Mail's prices in those areas, and those are very
14 materially marked up because of the allocation of common
15 costs.

16 THE CHAIRMAN: Is the only conceivable form of realistic
17 entry -- I know we're talking historically -- in this
18 market by an existing access operator? Is that a sort
19 of assumption of all this discussion?

20 MR PARKER: I understand that to be the view. I mean,
21 that's, I think, in Ofcom's decision.

22 MR MATTHEW: As a matter of facts, as evidence and facts on
23 the market, that's the belief we had.

24 THE CHAIRMAN: So Ofcom, I mean, the stage of this process
25 began with opening up access competition, and then it

1 led to end-to-end competition. There is no existing
2 putative -- there was no existing putative 100% scale
3 entrant with existing warehouses, sorting equipment and
4 people trained for making deliveries and other -- so
5 there's no cross entry possibility that was on
6 the radar?

7 MR MATTHEW: Not that I'm aware of, no, and we --

8 THE CHAIRMAN: Not even in the big tech world?

9 MR MATTHEW: I mean, as I understand it, the possibility of
10 other people who do sort of, like, have extensive parcel
11 courier arrangements do not see extension into bulk mail
12 as a course, but slightly hazy on the history of how
13 that was worked out, but the --

14 THE CHAIRMAN: Not, this history, as hazy as I am.

15 MR MATTHEW: But the very clear position, as I understand
16 it, was Whistl was the only entrant that had entered
17 the market with the broad intention of essentially what
18 I think was the old ladder of investment, so you build
19 up a customer base and then you use that as the thing to
20 kick off. It was seen as the only plausible entrant,
21 and after it left it was seen as no -- no further one.
22 So it's not been part of the suggestion that there was
23 another entrant extending from an alternate arrangement
24 here.

25 THE CHAIRMAN: Everybody agreed on that? Mr Dryden? The

1 assumption was that that would be the sort of --

2 MR DRYDEN: I think everybody -- as far as I understand,
3 everybody is operating on the premise that entry would
4 be -- as a DDO would be via first being an AO.

5 THE CHAIRMAN: That's very helpful.

6 MR DRYDEN: May I make one remark on the discussion that
7 we've just had?

8 THE CHAIRMAN: Of course you may.

9 MR DRYDEN: So, as far as Royal Mail's zonal tilt goes,
10 which I appreciate -- which I understand did
11 significantly change the prices across the zones. Just
12 to reiterate we -- I take that -- because that's not
13 part of the allegation of inappropriate conduct, I take
14 that as just part of the factual matrix along with
15 everything else. So when I apply the
16 as-efficient-competitor test I'm asking the question
17 could an as-efficient-competitor profitably compete at
18 every level of roll-out, including taking --
19 including -- in this "as if" world including -- sorry,
20 as if the CCNs had been implemented, so therefore
21 including the zonal tilt. The answer to that question
22 is, yes; that's the first calculus. I also assume
23 the zonal tilt is there when I do the second calculus
24 and check that the entrant would have the incentive to
25 keep rolling out.

1 There is a separate question that I think some of my
2 colleagues were maybe venturing into, I'm not quite
3 sure, which is whether the zonal tilt itself was
4 inappropriate conduct, and because that isn't part of
5 the allegation, I haven't addressed it. I gave my view
6 earlier about the relevance of tram lines and such like
7 to that question of what are the limits on
8 a multi-product for a rebalancing, but because it's not
9 part of the allegation, it's -- the appropriateness or
10 otherwise of the zonal tilt is not something I've ever
11 had to look at.

12 THE CHAIRMAN: But you said you treated it as factual
13 background, so it's part of the matrix of facts that
14 informs your assessment of what is alleged to be --

15 MR DRYDEN: Precisely.

16 THE CHAIRMAN: -- bad conduct. And I take it that's
17 generally accepted too, isn't it?

18 MR PARKER: Yes.

19 THE CHAIRMAN: Right, well ...

20 PROFESSOR ULPH: That's the last question I wanted to ask
21 about the as-efficient-competitor test. Sighs of relief
22 all round.

23 I just want to ask one question about price
24 discrimination. So bearing in mind that Whistl is both
25 a customer and a competitor of Royal Mail, what form of

1 price discrimination does a price differential fall
2 under, and does that make a difference to the analysis
3 that we're conducting here?

4 Mr Dryden, do you want to ...

5 MR DRYDEN: So just to be definitionally clear to begin
6 with, in this context, at least, primary discrimination
7 is discrimination against someone who is your competitor
8 with a view to disadvantaging them in a market you
9 compete with them in.

10 Secondary discrimination is competing among
11 customers in a market in which you are not present. And
12 it's true for the reason you gave, sir, that both -- in
13 a sense we have both of these elements at play.

14 The view that I took was that this was -- should be
15 thought of as primary discrimination, because
16 the allegation is about primary discrimination. So what
17 is at the heart of this case is the exclusion of Whistl
18 as a competitor to Royal Mail in the delivery activity.
19 So my characterisation -- so while recognising that both
20 elements are present, it seemed to me that the relevant
21 bit of the characterisation was that which related to
22 the concern in this case, and that's why I said I think
23 we can think of this as primary discrimination.

24 There is a school of thought that primary
25 discrimination cases aren't really a distinct category

1 of case but are just forms of other kinds of
2 exclusionary pricing abuse like margin squeeze and etc,
3 but as I explained yesterday, I think, you know, because
4 I viewed this as a pricing conduct exclusionary type
5 case, that led me to apply an as-efficient-competitor
6 test.

7 It seems to me that if one took a different view,
8 which is that this is a hybrid of primary and secondary
9 discrimination, then that wouldn't change the conclusion
10 that an as-efficient-competitor test has some evidential
11 relevance, because it seems to me a curious notion that
12 if it's relevant to the primary discrimination
13 characterisation, it's odd that it becomes wholly
14 irrelevant at the moment it becomes a hybrid, all
15 the more so because economists generally struggle with
16 the idea that secondary discrimination is a coherent
17 kind of abuse, because it's not really clear what
18 the incentives of the dominant company are in that
19 regard. I hope that answers the question.

20 PROFESSOR ULPH: That's very helpful. Mr Parker?

21 MR PARKER: I think I would agree with Mr Dryden but
22 secondly discrimination is a very peculiar concern,
23 because if the dominant firm is not present on this
24 other market, it's not very clear what incentives would
25 be to give rise to any distortive effect. So if you

1 like, I think that's a bit of a curiosity. There are
2 occasional cases around these lines but they seem to be
3 not very material.

4 So then I think we're in a world of everything else
5 and that goes back to the discussion I think we had
6 right at the beginning as to, is there a one size fits
7 all test for all forms of exclusionary abuse, to which
8 my view, as informed by the views of Professor Salop, is
9 no, I think there are different paradigms out there,
10 different types of behaviour and you might want to deal
11 with them in a different way. So I don't find from an
12 economic perspective the primary line/secondary line
13 distinction to be very interesting.

14 PROFESSOR ULPH: Okay. Mr Matthew.

15 MR MATTHEW: I agree, I didn't -- as I said in my report,
16 I didn't see this framework as being particularly useful
17 here. Both elements do seem to be present. I suppose
18 just one observation, it's not really about
19 categorisation, but when we think of discrimination, at
20 one level, you can think of primary liners being where
21 you adopt something like selective pricing or some other
22 sort of, "I'm a dominant firm, I'm going to set low
23 prices where I face competition"; and that slightly
24 more complications arise -- what I think sometimes gets
25 referred to as a hybrid approach occur, when the very

1 people that you're foreclosing are actually the people
2 you're supplying. So it's not that you're setting
3 different prices to meet competition somewhere; it's
4 that you're setting different prices to your customers
5 because you are competing with them somewhere else in
6 the value chain or in this case back into your core
7 monopoly; and I don't think, you know, as a matter of
8 categorisation that takes you anywhere particularly.
9 It's just to observe that discrimination where you are
10 supplying your primary competitors may carry overtones
11 of being more potentially concerning than where you're
12 merely setting different prices to your customers.

13 THE CHAIRMAN: I detect a sort of general theme in what
14 you've all been saying over the last two days which is
15 we should look to the substance and not get too
16 sidetracked by trying to attach labels to particular
17 conduct in the thought that that will get us home. Is
18 that a fair summary of what you are saying?

19 MR DRYDEN: I would agree.

20 MR PARKER: I would agree.

21 THE CHAIRMAN: That's wonderful to note.

22 Tim, do you have any questions?

23 MR FRAZER: No, only to observe that Mr Dryden looks pained
24 again.

25 MR DRYDEN: Yes, sorry, sir --

1 THE CHAIRMAN: Agreement through gritted teeth.

2 MR DRYDEN: No, I agree, but at the risk of being very
3 repetitious and therefore tedious, I think labelling is
4 going on --

5 THE CHAIRMAN: Those two are not necessarily the same thing.

6 MR DRYDEN: So I agree that labelling etc is not helpful; we
7 need to look through to the substance. I think there is
8 labelling aptly in this case, which is the low pricing
9 labelling and I think that is -- I mean, that's a point
10 that I've made before.

11 THE CHAIRMAN: Okay.

12 I think Mr Matthew would probably describe it as
13 a regulatory approach rather than a label --

14 MR MATTHEW: I think I would not describe it as labelling;
15 I would describe it as rather the substantive analysis
16 that has been carried out in this case.

17 THE CHAIRMAN: I won't prolong this in case the disagreement
18 winds.

19 Now, there is an opportunity for counsel to ask
20 clarificatory questions.

21 I assume there are none so we can break for lunch.

22 MR BEARD: Sadly, there are one or two. I just wonder
23 whether it's sensible to pick this up at 2 o'clock
24 because I haven't got many, I've got about three issues,
25 but I'm just guessing that in order for each of

1 the experts to respond and I'm guessing also Mr Holmes
2 or Mr Turner may have, I don't know. I'm happy to
3 start.

4 MR HOLMES: For my part at this stage, I don't have
5 clarificatory questions. I think it has been a very
6 helpful exercise.

7 THE CHAIRMAN: Mr Turner?

8 MR TURNER: I have a few questions but they're probably not
9 clarificatory arising out of the hot tub. Better left
10 for cross-examination.

11 THE CHAIRMAN: If you can get your questions, and then we'll
12 change the format of the courtroom and you can resume
13 your customary seat on the bench in front of you which
14 will no doubt be very pleasing.

15 Clarificatory questions by MR BEARD

16 MR BEARD: So actually, the first question was just
17 a clarification going back to yesterday. Mr Dryden
18 referred to a table in his first report to the CAT,
19 which he referred to as table 1 in, I think, his fourth
20 report. So that's in the first bundle at page 142,
21 I think. And it was referred to in passing and really
22 it was just a question both for Mr Dryden and the other
23 experts as to what they see as the significance of
24 the material in that table.

25 I'm sorry, it's page 22 internal page numbering.

1 I was using the version from another bundle,
2 I apologise.

3 MR FRAZER: I think you might mean 23?

4 MR BEARD: I do, I'm sorry, Mr Frazer. I was using external
5 numbering from a different version. It's the third tab.
6 22, top right-hand, 20, bottom right-hand.

7 MR FRAZER: In that case I'm not. I'm in the wrong one.

8 THE CHAIRMAN: What about tabs?

9 MR BEARD: Tab 3 of my bundle.

10 THE CHAIRMAN: Which page?

11 MR FRAZER: It's external 22, tab 6, and internal 20.

12 THE CHAIRMAN: We are there. Success. Right, I'm there.

13 MR BEARD: Excellent.

14 THE CHAIRMAN: Finally.

15 MR DRYDEN: So what the as-efficient-competitor test is
16 doing is at each and every level of roll-out, it's
17 asking the question, given the access prices that
18 the entrant is paying Royal Mail in all the areas that
19 it hasn't ruled out, what would its cost level need to
20 be where it does roll out in order to be profitable,
21 given the retail price?

22 Shall I say that again, or is that ...

23 THE CHAIRMAN: No, we understood that.

24 MR DRYDEN: Yes, so that's the critical downstream cost in
25 the first column.

1 We then compare the cost level that the entrant has
2 to have to be profitable with Royal Mail's costs for
3 supplying those volumes, and that's given in the third
4 column. And then provided that the column A as its
5 labelled is above column B, it's telling us that
6 the costs that the entrant has to have where it has
7 rolled it out in order to be profitable are greater than
8 the costs of the Royal Mail, and therefore an
9 as-efficient-competitor could enter and in fact
10 a somewhat inefficient competitor could enter. And
11 the degree of that inefficiency is captured by the
12 difference, which we've expressed in the last two
13 columns in absolute and in proportional terms.

14 So that's telling us in the last column that in
15 the base case, it varies by level of roll-out, but the
16 entrant can have costs roughly 50 to approaching 70%
17 higher than the LRIC of the Royal Mail and still be
18 profitable given the access price it pays where it
19 hadn't rolled out and the retail price that it's
20 competing against.

21 THE CHAIRMAN: Is that understood by the other experts?

22 MR PARKER: Yes, I mean, this is basically a --

23 THE CHAIRMAN: Mr Dryden's evidence, which we have read.

24 MR PARKER: It's a table of the numbers in the charts that
25 we've seen this for the base case.

1 MR MATTHEW: That's my understanding.

2 THE CHAIRMAN: Thank you.

3 MR BEARD: The next question that also went back to
4 yesterday to a comment by Mr Dryden where he referred to
5 the Salop paper that I think Mr Parker has referred to
6 on a number of occasions, and it was said that that
7 paper is not concerned with applying an AEC test, and
8 I just wondered if the experts could briefly explain
9 what test it was that they understood Mr Salop was using
10 in that paper. I don't know whether --

11 THE CHAIRMAN: I think Mr Parker should answer that to start
12 with, because that was his point. Professor Salop,
13 who's unfortunately not here to defend himself.

14 MR PARKER: Let me just get the paper up. I mean,
15 essentially -- so the paper is broadly about the
16 circumstances in which it would make sense to carry out
17 an incremental price cost test and which -- of which
18 the AEC test is one form, because it's comparing prices
19 and costs.

20 THE CHAIRMAN: Yes, we've read the paper. Probably we
21 didn't understand it, but we've read it.

22 Any other comment on that?

23 MR DRYDEN: I disagree, sir. It's the -- there are three
24 different objective tests of abuse that are often
25 canvassed: the sacrifice test, the

1 as-efficient-competitor test and the consumer welfare
2 test. We can set aside the third. The first two,
3 the sacrifice test and the as-efficient-competitor test,
4 are both price cost tests. They are in many
5 circumstances the same, but in some circumstances
6 different. The circumstances in which they are
7 different is where the sacrifice test would indicate no
8 sacrifice on the part of the dominant company suggesting
9 the conduct is okay, but where the conduct would
10 nevertheless exclude an as-efficient-competitor, in
11 which case the as-efficient-competitor test would
12 indicate the conduct is not okay.

13 Professor Salop criticises the price cost test
14 because it -- he has in mind because it can have various
15 false negatives. The first false negative that he
16 mentions is that the test may be passed in the sense of
17 no sacrifice, but an as-efficient-competitor may
18 nevertheless be excluded, and that obviously is not
19 a false negative that can arise from the proper
20 application of an as-efficient-competitor test, because
21 by construction, that test is only satisfied if an
22 as-efficient-competitor could come in.

23 Another way to see this point is the origins of
24 the test that Professor Salop is dealing with is
25 the Brooke Group case, and if we then sort of

1 cross-refer to Professor Vickers' 2005 article, he is
2 dealing distinctly with the sacrifice test and
3 the as-efficient-competitor test under different
4 headings and under the sacrifice test he is referring to
5 Brooke Group.

6 So the short answer is there are two different
7 tests, sometimes produce the same result, sometimes
8 produce different results, but it's quite an important
9 distinction for our purposes.

10 THE CHAIRMAN: Mr Parker, do you want to come back on it?

11 MR PARKER: Only that I --

12 THE CHAIRMAN: What I took away from what you said
13 yesterday, and having read the article myself, was that
14 at the risk of lapsing into labelling again,
15 Professor Salop was talking about conduct that raises
16 rivals' costs and putting forward the idea that the AECT
17 was not helpful in that analysis. That was about as far
18 as I went. Is that right?

19 MR MATTHEW: That was the main takeaway I took.

20 Could I just make a comment, though, on this
21 specific point, because he does also talk about AEC --

22 THE CHAIRMAN: Well, just say I accept Mr Dryden's point
23 there's a lot more in the article but --

24 MR MATTHEW: There was a lot more in the point Mr Dryden
25 made. So Salop does argue that an AECT can be passed by

1 the dominant firm, and yet an AEC would actually be
2 excluded, and he does that in the way he constructs
3 the test in his article. And the gist of the intuition,
4 if I remember rightly, is he considers this a slightly
5 odd situation where it is one where you bid for an input
6 that both the dominant firm and its rival have to
7 purchase. The dominant firm bids up the price, it would
8 be a scarce resource, perhaps -- well, I think it
9 probably does need to be a scarce resource, it bids up
10 the price. It can just pass while it's got
11 the monopoly, but when the rival comes in, it splits
12 the monopoly and the duopoly and it can't pass because
13 it only gets the duopoly profit.

14 So it has echoes of some of the questions earlier
15 about what happens when a rival comes in and that
16 changes the profitability of the incumbent that might
17 look better when it's sort of evaluating the tests, when
18 it's the monopolist, not when it's not actually facing
19 a real competitor.

20 THE CHAIRMAN: Any more for clarification questions?

21 MR BEARD: One. There has been lots of talk, perhaps even
22 agreement about fuzzy lines and grey areas and so on,
23 and it's really a question for all of the experts. Do
24 you think it would have been helpful for there to have
25 been guidance given in relation to these matters?

1 THE CHAIRMAN: What, bit CAT? By Ofcom?

2 MR BEARD: By Ofcom.

3 THE CHAIRMAN: By Ofcom.

4 Well, I'm afraid, Mr Matthew, you're on the spot.

5 Would it have been helpful, with the benefit of

6 hindsight, I think is the question.

7 MR MATTHEW: If Ofcom had advised Royal Mail, don't do it?

8 MR BEARD: No, if there had been guidance in relation to

9 the proper methodology that a dominant company should

10 take when it's considering pricing practices.

11 THE CHAIRMAN: The \$64,000 question. Anybody want to try

12 that? Mr Matthew is wisely not answering, I think.

13 Have a go, Mr Dryden. It's your chance to change

14 the regulatory landscape.

15 MR DRYDEN: I'm not sure whether it's appropriate to say so

16 or not. For me, what has been more lacking has been any

17 meaningful, or in fact any interaction with Ofcom in

18 this case about the AECT at any stage. So I think we're

19 revisiting issues now that sensitivity --

20 THE CHAIRMAN: That wasn't quite the question, actually.

21 MR DRYDEN: Yes.

22 THE CHAIRMAN: So you're clarifying your evidence.

23 MR DRYDEN: I think guidance is good in that it tethers

24 people and experts so we don't have complete free form

25 and complete free-wheeling. Guidance provides

1 a reference point and it seems to me that of course
2 experts should then be free to follow the guidance and
3 explain why or depart from guidance but also explain
4 why. I think the lack of any guidance puts us in
5 a world where those tethers are lacking, and I think
6 the consequence of that is, I think, in some of these
7 discussions, we are seeing departures from what I think
8 are fairly standard principles that ordinarily I would
9 expect to be applied, but we don't have -- you know,
10 I don't have any guidance that I can refer to that,
11 which I guess is why we're going to the literature
12 and -- etc for some of these points.

13 THE CHAIRMAN: So you don't see guidance as helping
14 incumbents or dominant companies; you see guidance as
15 preventing the regulator from roaming too free from its
16 brief, is that right?

17 MR DRYDEN: No, that wasn't what I was trying to convey.
18 I think it benefits everybody. It should benefit
19 the regulator, it should benefit the dominant company,
20 it should benefit the entrant and it should benefit the
21 experts, and ultimately, it should benefit the court.

22 THE CHAIRMAN: A suitably Panglossian comment.

23 Mr Parker, views on guidance?

24 MR PARKER: I mean, clearly we're in a hypothetical world of
25 would it be better to have had some guidance. I suppose

1 we're -- the benefit of guidance, as I think
2 the question goes to, is it would have allowed
3 Royal Mail more certainty as to whether its conduct was
4 the right side of the line where the guidance would set
5 out the line. I assume that's the idea. I can see how
6 that's beneficial to Royal Mail. I think it's a matter
7 of how you trade off the kind of -- the benefits of
8 legal certainty for a dominant firm with the special
9 responsibility that the dominant firm has that's set out
10 in competition law, and that's as far as I can go.

11 THE CHAIRMAN: Well, I'm glad that nobody has said that this
12 judgment might conceivably provide guidance, but I'll
13 leave that for another day.

14 We'll come back at 2.15 and resume our normal
15 configuration. Thank you very much.

16 MR BEARD: Can I just confirm that the experts are now
17 released?

18 THE CHAIRMAN: The experts are now released from
19 the concurrent exercise and we resume normal behaviour
20 in the sequence subject to Mr Harman's availability,
21 obviously, but I think we're going to start with
22 Mr Dryden, is that right?

23 MR BEARD: Yes, I don't know how Mr Holmes wants to proceed.

24 THE CHAIRMAN: Are you able to proceed this afternoon?

25 MR HOLMES: I think we'd like to go away and consider

1 the outcome of the hot tub --

2 THE CHAIRMAN: Right.

3 MR HOLMES: -- with -- together. Whether any

4 cross-examination will be needed, I'm not at all sure

5 about. For my part, this was a very helpful exercise,

6 it's covered the ground and we don't want to lengthen

7 things unnecessarily.

8 THE CHAIRMAN: No, I keep trying to speed the timetable up,

9 but people keep saying, "Well, let's take the afternoon

10 off". That wasn't quite the intention.

11 MR HOLMES: No.

12 THE CHAIRMAN: But it's entirely up to you to decide what

13 you want to do. Do we come back at 2.15 or not?

14 MR HOLMES: Yes please. I think it would be much more

15 sensible to get this concluded today if that's okay.

16 THE CHAIRMAN: Yes, all right.

17 Mr Turner are you happy with that?

18 MR TURNER: I'm happy. I would prefer to begin tomorrow

19 morning and have time to reflect, as Mr Holmes has also

20 said, but we'll take stock over lunch.

21 THE CHAIRMAN: Okay, we'll reassemble to discuss whether

22 we're going to reassemble.

23 (1.15 pm)

24 (The short adjournment)

25 (2.15 pm)

1 MR BEARD: Mr Chairman, members of the tribunal. We are
2 still keeping our distance. It was realised that there
3 was so much paraphernalia --

4 THE CHAIRMAN: You're not referring to your colleagues, are
5 you?

6 MR BEARD: And boxes, yes.

7 Two things. We have had a discussion amongst
8 counsel. In relation to this afternoon, the intention
9 is for the cross-examination of Mr Dryden to go ahead in
10 order for that to be completed.

11 We have had contact with Mr Harman during the short
12 adjournment and -- by email, and Mr Harman is not going
13 to be in a position to attend this week, including on
14 Friday. There is a possibility that the availability of
15 Mr Harman could be substantially delayed, is
16 the potential indication, in which case we will have to
17 revisit matters.

18 We thought, rather than trying to deal with what may
19 be a potentially very difficult situation in terms of
20 timing of the hearing, it might be sensible to leave
21 matters for the moment and provide the tribunal with an
22 update on Friday when we may know better from Mr Harman
23 what the possibilities of his attendance to give
24 evidence may be.

25 In that regard, I've spoken to Mr Holmes and

1 Mr Turner about possibly taking witnesses out of order.
2 That is obviously not ideal; it would be much better if
3 Mr Harman were to go first in the proper order, and then
4 Mr Matthew and Mr Parker, as was intended.

5 Mr Holmes, for entirely understandable reasons,
6 would rather Mr Matthew did not move forward. Mr Turner
7 is content for Mr Parker to be moved forward out of
8 order. The intention therefore would be for Mr Parker
9 to be cross-examined on Friday, meaning we would not sit
10 tomorrow.

11 If that were to be acceptable to the tribunal, that
12 would be the current plan. We would then, at that time,
13 or during the course of Friday, hopefully with further
14 contact with Mr Harman, be able to discuss how
15 the remainder of the trial timetable might work out.

16 I'm sorry that isn't a full solution, but we don't know
17 properly --

18 THE CHAIRMAN: Mr Parker is not available tomorrow?

19 MR BEARD: He may be, but I would be grateful if we could
20 deal with Mr Parker on Friday, if he's available, that
21 is.

22 MR TURNER: If it's more convenient to Mr Beard.

23 MR BEARD: I may well be more than a morning with Mr Parker.

24 I doubt it, but if that were to be the case, even if we
25 started tomorrow, we wouldn't finish.

1 THE CHAIRMAN: Okay. We could finish early on Friday.

2 MR BEARD: I would anticipate we certainly will finish on
3 Friday, yes.

4 THE CHAIRMAN: I wouldn't say we're entirely within your
5 hands, but this is really for the parties to agree
6 amongst themselves and we will try and go along with it
7 to the best of our ability.

8 MR BEARD: I'm very grateful to the Tribunal, and Mr Harman
9 did ask that we convey to the Tribunal his apologies
10 that he's not available in the ordinary course. We of
11 course indicated to him --

12 THE CHAIRMAN: Well, he has our good wishes, as you know.

13 MR BEARD: Yes.

14 THE CHAIRMAN: Mr Parker is no longer in court, I don't
15 think. No. I think in my haste to get away, I forgot
16 to thank the concurrent experts for their time and
17 effort. I think it is quite a -- it's quite an
18 undertaking and we're very grateful, so I would want
19 that to be recorded.

20 MR BEARD: It was an extremely helpful exchange.

21 THE CHAIRMAN: Mr Dryden also, he may have left.

22 MR BEARD: Well, Mr Dryden is about to take --

23 THE CHAIRMAN: We're about to see even more of you. Well,
24 admire your stamina.

25 MR BEARD: So unless there are other matters, I don't know

1 whether Mr Holmes or Mr Turner want to make any
2 comments, then the next stage is simply to call
3 Mr Dryden for the next stage of the evidence.

4 THE CHAIRMAN: Right, proceed, please.

5 MR NEIL DRYDEN (sworn)

6 THE CHAIRMAN: Please make yourself comfortable. You are
7 no stranger to that box.

8 Examination-in-chief by MR BEARD

9 MR BEARD: Mr Dryden, do you have in front of you the two
10 volumes of expert evidence.

11 A. I do.

12 Q. Could you take up the first of those bundles and turn to
13 tab 6. You see a document entitled, "Response to
14 Ofcom's decision". Could you turn to internal page
15 numbering page 61 in that document, bottom right-hand
16 corner.

17 A. Yes.

18 Q. Is that your signature, Mr Dryden?

19 A. It is.

20 Q. Is this your first report in these tribunal proceedings?

21 A. That is correct.

22 Q. Is it true to the best of your knowledge and belief?

23 A. It is.

24 Q. Now, Mr Chairman, members of the tribunal, also in this
25 bundle are further reports by Mr Dryden that were

1 submitted during the course of the investigative process
2 and in relation to responses to the USO. I'm very happy
3 to take Mr Dryden to those and have them confirmed as
4 his correct copies of the report. They're in this
5 bundle, if that would be of assistance.

6 THE CHAIRMAN: Proceed as you wish.

7 MR BEARD: If you could then turn back to tab 3 of this
8 bundle, please, Mr Dryden. And then again, within that,
9 turn on to page 41, little numbering. Is that your
10 signature?

11 A. It is.

12 Q. Is this the first report you've submitted in the course
13 of these proceedings?

14 A. That is correct.

15 Q. And is it true to the best of your knowledge and belief?

16 A. It is.

17 Q. Thank you.

18 If you could then go to tab 4 in the same bundle.

19 Just for the tribunal's notes, that first report is
20 the one that's referred to as ND1 and this is now ND2.

21 You'll see a report entitled, "Assessment of
22 the relevant penalty calculations"?

23 A. Yes.

24 Q. Again, page 19, is that your signature?

25 A. It is.

- 1 Q. Is this your second report in these proceedings?
- 2 A. It is.
- 3 Q. Is that true to the best of your knowledge and belief?
- 4 A. It is.
- 5 Q. Thank you.
- 6 Then if you could go to tab 5, a document entitled,
- 7 "Supplementary report on relevant turnover
- 8 calculations", and it's internal page number 1, external
- 9 page numbering 605. Is that your signature again?
- 10 A. It is.
- 11 Q. Is this true to the best of your knowledge and belief?
- 12 A. It is.
- 13 Q. So these are the prior reports.
- 14 If you could then take up the second concurrent
- 15 evidence expert bundle, Mr Dryden, at tab 7.
- 16 A. Yes.
- 17 Q. If you could turn on to page 78 internal numbering.
- 18 A. 76?
- 19 Q. I'm so sorry, I misread, yes, 76. I apologise.
- 20 Is that your signature again?
- 21 A. It is.
- 22 Q. Is this your second report in these tribunal
- 23 proceedings?
- 24 A. That is correct.
- 25 Q. And is it true to the best of your knowledge and belief?

1 A. Yes.

2 Q. This report is referred to as ND5 for the purposes of
3 the tribunal.

4 Then finally, if we may, could we go to tab 11 in
5 this bundle.

6 A. Yes.

7 Q. And page 5 internal numbering?

8 A. Yes.

9 Q. Your signature again?

10 A. It is.

11 Q. This is your sixth report, third in these tribunal
12 proceedings, is it not, Mr Dryden?

13 A. That is correct.

14 Q. And is it true to the best of your knowledge and belief?

15 A. It is.

16 MR BEARD: I have no questions for you, Mr Dryden.

17 I believe Mr Turner may have some questions for you.

18 I'm not sure whether Mr Holmes does. No. Mr Holmes
19 doesn't have any questions for you.

20 A. Thank you.

21 THE CHAIRMAN: Mr Turner.

22 Cross-examination by MR TURNER

23 MR TURNER: So Mr Dryden, I've only got a very small number
24 of questions for you. The first question is something
25 that arose from the hot tub yesterday which was pursued

1 by Professor Ulph today. I don't know if you have
2 a copy of the transcript from yesterday, but I'll quote
3 what you said. It was early on, and you said that your
4 AEC test was:

5 "... by construction more conservative ..."

6 Than a test over the whole of bulk mail at national
7 level:

8 "... because you are checking not only can an
9 entrant that came in big bang full scale compete, but
10 you're checking that an as-efficient-competitor at every
11 level of roll-out could profitably compete."

12 Do you remember that?

13 A. I do.

14 Q. And you said your test looks at the -- and I quote
15 again:

16 "... intermediate points, which are basically
17 the SSCs which describe a roll-out path."

18 Yes?

19 A. Yes.

20 Q. Can we please open the Salop article. I don't know if
21 we've actually turned and looked at it together yet.
22 It's in the second bundle of the concurrent expert
23 evidence at tab 8.4. And go in it, using the internal
24 numbering, the article numbering, to page 392. Tell me
25 when you've got that.

1 A. I'm there.

2 Q. Now, the bottom of page 392, Professor Salop says this:

3 "Some courts and commentators have suggested that
4 foreclosure should only be considered a cognisable
5 concern if it would exclude competitor that is 'as
6 efficient' as the monopolist."

7 Yes?

8 A. Yes.

9 Q. So he's now addressing that proposition.

10 And if you drop down towards the end of that
11 paragraph, all of it is relevant and some of it was
12 covered in the hot tub yesterday, but I would like to
13 focus what he says in the last sentence on page 393 in
14 that paragraph:

15 "Even in the context of ..."

16 What he describes as "this permissive standard", and
17 passes it on the as-efficient-competitor basis:

18 "... it must be recognised that the foreclosing
19 conduct may actually prevent the entrant from achieving
20 the scale necessary to become an 'equally efficient
21 competitor.'"

22 So that's the point of departure.

23 Now, Mr Dryden, in our case, this case, I think
24 you've seen the evidence that a nascent direct delivery
25 operator, as Whistl was in 2013, would not yet have

1 achieved economies of scale; do you agree?

2 A. I agree.

3 Q. And to pursue a point that was touched on this morning
4 by the Professor, you've seen that a prospective
5 roll-out by Whistl after that point to at least 25% of
6 the country was regarded as a necessity, as a platform
7 for convincing large customers to come on board and then
8 boost conversion rates in the areas of the roll-out,
9 yes?

10 A. Could you repeat the percentage?

11 Q. 25%. Would you like to have a look at a document or two
12 referring to that?

13 A. I'm happy to take that as you put it.

14 Q. I'll show you one document, as you've raised it, before
15 we ask the question. Do you have C4A? This is
16 a document that the tribunal has already looked at
17 before. It's one of the places where that figure seems
18 to have been mentioned. In C4A, if you go to tab 32,
19 there's the PwC due diligence report that they prepared
20 for the investors.

21 And you might remember that one of the points that
22 has been canvassed so far is on page 58 in that tab. We
23 went there a couple of times, but this was the PwC
24 advice and you see it in the title at the top:

25 "At the point of 25% national coverage, TNT Post is

1 able to offer a sufficient discount to make it
2 financially attractive (and material) for customers to
3 convert ..."

4 So this is one of the places where this point was
5 made.

6 Now, in the early stages -- and I'm pursuing
7 the Professor's line -- where you have roll-out to say 5
8 SSCs, or 6, or 7, or 10, we can take it that even
9 a hypothetical new entrant will not yet be operating at
10 scale or anything close to it. Would you agree? In
11 the real world. I'm not turning to your test yet. Or
12 would you resist that?

13 A. The proposition is that at 5 or 6 or 7 or 10, it would
14 not be operating at scale or anything close to scale?

15 Q. Yes.

16 A. I'm hesitating because I don't know if 10 SSCs is
17 actually close to 25% and therefore close to scale.
18 I take the proposition that obviously if the number of
19 SSCs is small enough, they would not be operating at
20 scale.

21 Q. Right. Now, turning to your test, at every roll-out
22 level which I think your test considers, whether it's 1
23 or 2 or 5 SSCs, it only measures the possibilities for
24 an entrant who has already achieved full efficiencies,
25 who is already as efficient, who is already operating at

- 1 scale, is that right?
- 2 A. I agree.
- 3 Q. So the base case assumes the hypothetical entrant is
4 serving 100% of all the bulk mail customers in each of
5 the SSCs in your base case, is that right?
- 6 A. That is correct.
- 7 Q. Although in reality, such volumes would be impossible
8 for an entrant to achieve and probably never would
9 become possible?
- 10 A. I agree that it is unlikely that a real world entrant
11 would get to 100% market share. The test of course is
12 not trying to predict the outcome, it's trying to set an
13 efficiency condition.
- 14 Q. If the overall volumes of this hypothetical entrant was
15 at the same level that a real entrant might anticipate,
16 then the average costs would be substantially higher,
17 would you agree?
- 18 A. Of the entrant?
- 19 Q. Yes.
- 20 A. They -- they may be.
- 21 Q. They may be, or they would be?
- 22 A. Well, I don't -- I don't know about the cost structure
23 of an entrant and I don't -- because of the method
24 I adopt -- need to know about the cost structure of an
25 entrant. Obviously, if they're at less than scale or

1 they have -- or at less than the density of Royal Mail,
2 they have a scale or a density disadvantage that would
3 mean they would be higher cost. Whether they can
4 compensate that with cost advantages like lower labour
5 cost or finding some entry strategy that isn't some
6 other way low cost, I don't know, but I certainly don't
7 disagree with the proposition that you would have to
8 overcome a degree of scale and density disadvantage.

9 Q. Yes. Just to anchor this. If we go to your fifth
10 report, which is in the second bundle of concurrent
11 evidence at tab 7 and see the way you expressed it which
12 is at 205 of the bundle numbering at tab 7. Tell me
13 when you've found that.

14 A. I'm there.

15 Q. So there you said:

16 "Mail delivery is subject to large economies of
17 scale. If the overall volumes of Royal Mail were at
18 the same level as an entrant might anticipate ..."

19 Did you mean there a real entrant or an entrant in
20 the real world?

21 A. I think it can be a real world entrant, yes.

22 Q. "... then Royal Mail's average cost would be
23 substantially higher."

24 So --

25 A. Yes.

1 Q. -- that's the position.

2 And so based on what we have now discussed, return
3 to what you said at the outset of the hot tub yesterday,
4 which I quoted, and I'd suggest that within that
5 context, the AEC test is not properly described
6 as "conservative", it does not describe a roll-out path,
7 and it does not give any assurance about the real
8 ability for allowing the roll-out of a competitor who
9 hopes to grow to an efficient scale but does not yet
10 have efficient scale?

11 A. Well, it is conservative in the dimension that we were
12 discussing at the time, which was the fact that we're
13 looking at intermediate points of roll-out and not
14 the end point. So in that dimension it's more
15 conservative, clearly, than only looking at the end
16 point.

17 Counsel is quite right that it isn't allowing
18 headroom for this scenario that I think we've now
19 discussed a few times of splitting the volumes between
20 Royal Mail and the entrant, for example 50:50. That
21 would clearly involve a substantial loss of economies of
22 density. And the test is not factoring that in. But
23 I have, I think, made no claim about conservatism in
24 that respect, and I think this appropriate because once
25 we begin to factor that in, we are factoring in a regime

1 that will allow for entry that will increase total
2 industry costs and at that point, unless we've analysed
3 whether the allocative efficiency gains are going to be
4 big enough to outweigh the inefficiency, we don't know
5 whether consumer welfare will be higher or not.

6 Q. I'm not so much concerned with the splitting of volumes
7 after entry has occurred. The jumping off point for
8 this question was Salop's point where he is discussing
9 an as-efficient-competitor test, and one of the points
10 he makes about it was that under that standard,
11 the foreclosing conduct might actually prevent an
12 entrant from achieving the scale necessary to become
13 equally efficient. And viewed in that way, if you have
14 a situation of a market similar to that we have in this
15 case where it is necessary to grow and achieve scale,
16 looking at individual SSCs, whether 3 or 5 or 7, and
17 assuming that the entrant has scale at each of those
18 points, is not addressing that factor. That's
19 the proposition.

20 A. I understand, and it's, I think, correct to say that
21 it's not being addressed in the sense that no extra
22 headroom is being created. I do think that yesterday
23 I touched on this issue. The relevant point that
24 I recall making is that if we think of an entrant coming
25 in that is initially less efficient than the incumbent

1 because it has -- it lacks economies of scale or any
2 other kind of economies in the early stages but becomes
3 more efficient over time, we can think of the
4 as-efficient-competitor test that I'm using as a sort of
5 NPV test, but what my test is doing is to the extent
6 the entrant has an early phase of relative inefficiency
7 because it doesn't have scale and scope, it is requiring
8 the entrant to compensate that by being more efficient
9 in the future.

10 So, you know, the condition is that the entrant has
11 to be as efficient, whether it comes in and it is just
12 as efficient from day one and it remains as efficient or
13 whether it comes in and is less efficient and becomes
14 more efficient over time and that all discounts back to
15 being as efficient, that is essentially, in my view,
16 the kind of thing that we're agnostic about, because
17 we're just setting the condition that will bring about
18 entry if and only if it's productively efficient. How
19 the entrant profiles the achievement of that efficiency
20 is -- I can see that there are different ways of doing
21 it.

22 And it is perfectly true as Mr Turner says if
23 the entrant is initially inefficient, then it will have
24 to compensate for that in some way.

25 Q. So I'll turn to a related question. Again, this is

1 building on the facts of our case. One of the impacts
2 of this price differential structure which has been
3 introduced, it's an impact that we saw in the factual
4 evidence from Whistl, is that the price difference was
5 an impediment to an entrant growing to scale precisely
6 because it undermines customer confidence. Do you
7 recall that dimension of the evidence? It was
8 a significant feature of the Whistl evidence.

9 A. Yes, I do recall it from the -- I don't recall it from
10 these -- from the hearing itself, but I recall it in
11 general from the case.

12 Q. Perhaps we can turn up one example of that again. Do
13 you have bundle C2, or can that be handed to you.

14 Does the tribunal have bundle C2? Just make sure
15 that Mr Dryden is given the bundle with this in it.
16 It's Mr Polglass' witness statement, and in it, while
17 that's being handed to Mr Dryden, it's reading
18 paragraph 31.

19 So you see he says:

20 "After the price differential was introduced, our
21 progress on customer conversion completely stopped. We
22 had some customers who had agreed to trial our
23 end-to-end services, but they held off ..."

24 So that's a flavour of the evidence about the impact
25 of the conduct under consideration in this case, and

1 the question is, how has that been taken into account in
2 the construction of your AEC test concerning the impact
3 of the price differential?

4 A. So the short answer is that it hasn't. It seems to me
5 there are two scenarios here -- or maybe more, sorry,
6 and I'm not going to win any friends for saying there's
7 three scenarios. The first scenario is that the -- and
8 these are theoretical scenarios; I don't know which
9 apply. The first scenario is the CCNs are announced and
10 then it is assumed with certainty by all market
11 participants that they will take effect. So that is not
12 a world of uncertainty, actually, that's a world of
13 certain implementation of the CCNs, and in that world,
14 my -- application of the AECT tells us whether an
15 entrant could profitably compete and says what they
16 could.

17 Second version is the CCNs are announced and there
18 is uncertainty because there is some probability
19 attached to them actually being implemented and there's
20 some probability attached to them not being implemented.

21 So there is uncertainty, but in either of the two
22 outcomes an entrant could profitably compete, because we
23 have shown on the AECT that with the CCNs and AEC could
24 compete and without the CCNs, although I haven't looked
25 at it, presumably an AEC could profitably compete.

1 And the third scenario is whether this announcement
2 creates uncertainty because it is taken as indicative of
3 the fact that there might be future announcements of
4 entirely different changes to the prices, but that is
5 something that I think no test can factor in.

6 So in other words, my test doesn't have explicit
7 account of uncertainty, but I think it deals with
8 the relevant possibilities.

9 Q. I think, if I may say so, it's a rather more concrete
10 question. What you see there, for example in Polglass,
11 is specific evidence that the behaviour we are all
12 concerned with, which was the announcement of the price
13 differential, did lead to a stalling of the ability to
14 recruit customers. It effectively froze. Whereas, as
15 I understand it, your test, when examining the impact of
16 the behaviour, assumes on the base case and indeed on
17 the sensitivity -- in the base case 100% conversion
18 rates all the way through to test the ability to cope
19 with the behaviour, and on the sensitivity, as it were,
20 a pre-announcement conversion rate, even on that basis
21 not accounting for the evidence in the case.

22 So the question is whether the AEC test that you're
23 proposing as a sufficient basis for testing
24 the competition impact of the behaviour we're all
25 concerned with actually is dealing with all of

1 the factual dimensions of this case?

2 A. But then I think the question isn't a distinct one from
3 the previous one I was asked about how the AECT factors
4 in scale and scope. My answer, in relation to this
5 latest question, was purely focused on the uncertainty
6 element in and of itself. I've already answered
7 the issue about scale and scope.

8 Q. Well, we'll move on.

9 The last point about the construction of the test is
10 this: I would just like to be clear about
11 the characteristics of the hypothetical entrant in your
12 test. So I'm going to call this entity RM2, Royal Mail
13 2, and as I understand it, you're modelling that
14 wherever in the country RM2 enters, whether it's in five
15 SSCs in a flash, or 25 SSCs from 0 to 25 in a flash, it
16 only bears the same bulk mail delivery costs as
17 Royal Mail does. In that sense it's as efficient; is
18 that right? RM2 bears the same bulk delivery costs as
19 Royal Mail?

20 A. Correct.

21 Q. And those are incremental to the existing universal
22 service deliveries?

23 A. That is correct.

24 Q. And so to try to visualise it, that means that for
25 the hypothetical RM2 entity you could imagine a second

1 postal delivery infrastructure already in place
2 throughout the country which RM2 can plug into whenever
3 it wants to offer bulk mail delivery in a particular
4 SSC. If it goes into Edinburgh, it's got an existing
5 network there, it's equivalent to the universal service,
6 and it can plug into it and then its incremental costs
7 of bulk mail delivery are all that your model is
8 concerned with; is that right?

9 A. Not quite, because we're not imagining that the entrant
10 would be plugging into some parallel second USO
11 provider. As I have tried to explain, the
12 as-efficient-competitor test is setting a condition for
13 productively efficient entry and allowing the dominant
14 company scope to exclude productively inefficient entry.
15 How the -- and we know in fact that the CCNs allowed --
16 passed that test and did so with some headroom, so in
17 fact a degree of inefficient entry was permitted. How
18 the entrant achieves the efficiency level within
19 the level that is provided by the test is not something
20 that we are concerned about, because we are concerned
21 about setting the condition not engineering the outcome.

22 Now, it seems to me extremely unlikely that the mode
23 of entry would be a second USO provider. The reality
24 is, if there is an entrant out there, they would have
25 a substantially different business model from Royal Mail

1 in multiple respects. You know, essentially their whole
2 business model could be different.

3 So -- but again, sorry to repeat myself, the test is
4 about the condition, it's not a prediction about
5 the shape of the entrant.

6 Q. Yes, I understand that. So you're saying -- you're not
7 specifically assuming that in fact it would plug into
8 a rival second network, but what you are assuming is
9 that the level of costs that it would achieve would be
10 down at that point, however it had arrived at that
11 position?

12 A. Correct.

13 Q. So one needs to imagine that in the real world a real
14 entrant is able to -- if not to replicate that
15 arrangement but somehow to match that degree of cost
16 advantage that Royal Mail enjoys because of its
17 provision of the universal service?

18 A. Yes, so if the as-efficient-competitor test is just
19 satisfied -- in fact it was satisfied with headroom, but
20 if the as-efficient-competitor test is just satisfied,
21 if there is to be entry, the real world entrant must
22 have found a business model that allows it to achieve
23 the dominant company's level of cost or better. And if
24 it can, we should see entry, and if it can't, entry will
25 not be observed.

1 There's one wrinkle --

2 Q. Yes.

3 A. -- which is that whenever we talk about cost, it's
4 quality adjusted cost. So the entrant -- I'm sorry,
5 the dominant company might have a cost of 10, and if
6 the AECT is only just satisfied, it would allow the --
7 it would allow for a cost of 10. If the entrant has
8 a cost of 11 but has somehow found a way of providing
9 quality enhancements and etc for the customer, and
10 the customer values that quality improvement at more
11 than 1, then the entrant could profitably enter, because
12 it's quality adjusted -- in quality adjusted terms, it's
13 as efficient as the incumbent.

14 Q. So I would like to understand what you say. Abandon
15 pure theory, the theory that there would be an RM2 which
16 would have costs at the level of incremental costs of
17 Royal Mail, and think about the facts of our case in
18 order to examine the realism of that proposition.

19 In that regard, I'd like to go back to a document
20 that we looked at when Ms Whalley was being questioned.
21 So you should have it if you have the Whalley
22 cross-examination bundle to hand. I'd like to go in
23 that to tab 4, which was the Ofcom Royal Mail access
24 pricing review from December 2014. We looked at part of
25 this with Ms Whalley. If you could go in it, using

1 the internal numbering, please, to page 25.

2 A. Yes.

3 Q. So you'll recall, looking at the top of the page, that
4 I asked Ms Whalley questions about the first of several
5 points that Royal Mail had made and which Ofcom was
6 responding to on the question of cherry-picking, and
7 Royal Mail's concern that there were unfair advantages
8 than an entrant had. I'd like to turn to look at what's
9 said in paragraph A5.106 concerning one of the features
10 of entry that has been canvassed in this hearing being
11 a putative advantage that an entrant might have, an
12 entrant delivering, say, two or three days a week rather
13 than the six days a week that Royal Mail delivers for
14 the universal service.

15 Have you seen this paragraph before?

16 A. I've -- I might have read all of these reviews, but some
17 time ago. So not --

18 Q. so let's just look at A5.106 --

19 A. -- fresh in my mind.

20 Q. -- together:

21 "An entrant into bulk mail delivery is likely to
22 face incentives to offer a less frequent service than
23 Royal Mail. Doing so would enable it to consolidate
24 volumes over fewer deliveries, thereby benefiting from
25 economies of scale. The entrant advantage.

1 "We don't consider this to be an artificial cost
2 advantage because there are no regulatory requirements
3 that would prevent Royal Mail from reducing
4 the frequency of its own bulk mail delivery service in
5 response to entry. We recognise Royal Mail is very
6 unlikely to act to this freedom, because it would mean
7 giving up the significant economies of scope it
8 currently enjoys in using the same delivery network for
9 both USO and bulk mail. However, this suggests that
10 the cost advantages Royal Mail enjoys from using the USO
11 network for the delivery of bulk mail exceed the cost
12 advantages from operating a bulk mail delivery service
13 on a less frequent basis. The USO requirement is
14 therefore likely to confer a net cost advantage upon
15 Royal Mail when competing with an entrant in bulk mail
16 delivery rather than placing Royal Mail at a competitive
17 disadvantage."

18 The question arising from this, Mr Dryden, is
19 whether you would agree that there are, on the facts
20 rather than speaking as a matter of pure abstraction and
21 theory, but on the facts and what is known about this
22 market, good reasons to infer that the unique advantages
23 of being able to plug into the US network outweigh any
24 advantages a real entrant might enjoy because it can
25 provide deliveries, say, two or three times a week

1 rather than six. So my challenge is to turn from pure
2 theory and pure abstraction without any definition of
3 what we're talking about to something closer to
4 the facts of our case.

5 A. I find that -- I find that a difficult question to
6 answer, because the way that I've always looked at it is
7 we take the USO as a given and we think of the --
8 Royal Mail's -- as I think is sort of conventional, and
9 it doesn't depend on it being a USO actually, it just
10 depends on it being another service, and we look at
11 the incremental cost of bulk mail to the Royal Mail.
12 Because it's a multi-product firm, it benefits from
13 economies of scope across different services. That
14 undoubtedly confers an advantage on Royal Mail because
15 it will reduce its LRIC for bulk mail, but it is, in
16 spite of all of that, going to be productively
17 inefficient for a higher cost provider of that increment
18 to come in. And that takes us back to sort of my theory
19 of the case.

20 Q. I understand.

21 Just one last question on that. Do I gather that
22 you're not aware of any tangible reasons why one might
23 expect a real life entrant to be able to match
24 the advantages that Royal Mail derives from being able
25 to plug into the universal service network?

1 A. I don't have expectations about entrants because -- of
2 that precise nature because for the purposes of the test
3 I don't need to, and also it's inappropriate for all
4 the reasons that I've given.

5 The USO, or just more generally the fact that
6 Royal Mail is a multi-product firm and we're looking at
7 one of the product, bulk mail, and that has an
8 incremental cost that benefits from economies of scope
9 with other products, is an advantage to Royal Mail.
10 Whether that is an unassailable advantage against
11 potential real-world entrants or not is not really
12 within my expertise because I don't know -- you know,
13 it's not within my expertise to assess, out of possible
14 real world entrants, you know, what advantages they
15 might have and how they might compensate or not.

16 Q. So the answer to my question is yes? The question was,
17 you're not aware of any tangible reasons why one might
18 expect a real life entrant to be able to match that
19 advantage?

20 A. But nor am I aware of reasons that they couldn't, I just
21 -- I think the more accurate answer is I don't know.

22 Q. So my final question is a short one arising from
23 something that's said in your last report and the joint
24 statement. If you could open up the joint statement,
25 please. That's in the first concurrent evidence bundle

1 at tab 2. In it, if you could go, please, to page 7.
2 In the left-hand column, "Issue", in bold, you have 2,
3 "The AEC approach", do you see that?

4 A. I do.

5 Q. So the following subparagraphs are all concerned with
6 propositions concerning the as-efficient-competitor
7 approach.

8 If we turn over the page to 8 at the bottom, 2b, you
9 have the first -- the second sub-proposition:

10 "The approach is appropriate for identifying
11 anti-competitive foreclosure in the present case."

12 You see that?

13 A. I do.

14 Q. Then in your answer, the following columns are first
15 Mr Matthew, then yourself and Mr Parker on the right, on
16 page 9 you say in the second full paragraph, halfway
17 down the page:

18 "The reasons for adopting an AEC [test] ... include
19 that it promotes consumer welfare compared to no
20 intervention."

21 Can I check that what you mean here is that your
22 test is better for consumer welfare than having no test
23 at all?

24 A. Correct.

25 Q. In other words, no relevant competition law enforcement

1 at all?

2 A. That's correct.

3 MR TURNER: No further questions, sir.

4 THE CHAIRMAN: Thank you.

5 Re-examination by MR BEARD

6 MR BEARD: I think I've got two in re-examination. You were
7 asked a couple of questions about Mr Polglass'
8 statement, paragraph 31. Actually I'm not sure where it
9 is in your bundles. It's C2/5 for the tribunal.

10 Now, Mr Turner asked you about this paragraph and
11 about Whistl's reaction to announcement. If we weren't
12 talking about Whistl but about an AEC and the market
13 knew it was an AEC, would you expect a similar reaction
14 in terms of conversion rates?

15 A. No, because as I've explained, the announcement of
16 a price differential that reduces the headroom for
17 inefficiency but still leaves some headroom for
18 inefficiency could impede the roll-out of an excessively
19 inefficient entrant. So this is something -- this is an
20 effect that is being identified here which is an effect
21 that could bear on a less efficient entrant but is not
22 one that can bear on an as efficient entrant.

23 Q. Thank you.

24 If we could go back to where Mr Turner started with
25 the --

1 THE CHAIRMAN: Sorry, I'm not sure I understand that answer.

2 I mean, I'm sure it's my limited intellect. Are you
3 saying it wouldn't be any different because in your AEC
4 situation, conversion would be complete and automatic?

5 A. More generally, if the -- as long as the entrant is an
6 AEC in all respects, of which I think you identify one,
7 the -- under the differential, then the announcement of
8 the differential, that shouldn't create an expectation
9 of their exit, so yes.

10 THE CHAIRMAN: So this issue of cliff edges and consumer
11 confidence doesn't arise?

12 A. As long as the test is passed, it's not an issue, in my
13 opinion.

14 THE CHAIRMAN: It's not an issue because the test is passed,
15 or so long as the test is passed? Because it's passed?
16 It becomes almost a definitional matter?

17 A. I agree.

18 THE CHAIRMAN: I'm asking, not pronouncing.

19 MR BEARD: I think you had an answer.

20 Can we go back to where Mr Turner started, which was
21 with this favourite Salop article which is in concurrent
22 expert bundle volume 2. I think we're blessed with two
23 copies of it, but I think he took you to tab 4. I don't
24 think Mr Turner actually put a question to you in
25 relation to the elements he quoted. He began on 392,

1 which is in this section, "Impact on market or monopoly
2 power", and he said:

3 "Some courts and commentators have suggested that
4 foreclosure should only be considered a cognisable
5 concern if it would exclude competitor that is 'as
6 efficient' as the monopolist."

7 Am I right in understanding that that is a reference
8 to applying an AEC test, as you understand it?

9 A. In this part, yes.

10 Q. And then he went on at the bottom to say -- to quote:

11 "Even in the context of this permissive standard, it
12 must be recognised that the foreclosing conduct may
13 actually prevent the entrant from achieving the scale
14 necessary to become an 'equally efficient competitor.'"

15 Do you consider the AEC, as Professor Salop does, to
16 be a permissive standard?

17 A. No, I think it is a -- it is a standard that has a lot
18 of pedigree and has been tested in fact in many cases
19 and made its way into guidelines and etc because it is
20 a test that is seen as striking an appropriate balance
21 between intervention and non-intervention. So it is not
22 inappropriately permissive nor is it inappropriately
23 restrictive.

24 Q. So you don't agree with Professor Salop in relation to
25 this analysis?

1 A. When he simply calls it permissive, I disagree.

2 The paragraph, it seems to me, also validates the idea
3 that in the bulk, his paper is not about the
4 as-efficient-competitor test.

5 MR BEARD: I'm grateful. I don't have any further questions
6 for Mr Dryden.

7 The tribunal may do. I don't know.

8 Questions from THE TRIBUNAL

9 PROFESSOR ULPH: I'd like to ask you about a rather
10 different matter, about the net present value
11 calculations and for the benefit of the transcribers
12 I want to refer to a book by two authors, the first is
13 Dixit, and another one is Pindyck. Are you familiar
14 with that?

15 A. I am.

16 PROFESSOR ULPH: So would you recognise that in a situation
17 where investment is characterised by significant degrees
18 of sunk costs or irreversibility where there is
19 uncertainty but where there's also learning taking
20 place, so over time some of that uncertainty gets
21 resolved just by the process of learning over time, then
22 it also comes down to the rational investment strategy
23 as a cautious step-by-step approach. So you make an
24 initial investment, wait and see what the outcome of
25 some uncertainty is, and proceed to a further stage of

1 investment.

2 And moreover, the rational investment strategy is no
3 longer characterised by the net present value being
4 greater than the level of investment or by the internal
5 rate of return being greater than the cost of capital,
6 because you have to recognise that a value has to be
7 given to the option of waiting and learning. I just
8 wonder if you accept that and recognise that.

9 A. So I recognise that. Two remarks. One is, I understand
10 that the Whistl evidence which I heard was that there is
11 a degree of sunk costs.

12 I have done no measurement of the degree of sunk
13 costs. It's not in my knowledge. I would just make an
14 observation that it seems to me that while there are
15 some sunk costs, they are -- I wouldn't characterise
16 this activity as being necessarily very high in sunk
17 costs, for the reason that it is highly labour
18 intensive. So certainly there's a degree of sunk costs
19 but one could think of other network industries where
20 almost all the costs are sunk, whereas this activity of
21 delivering mail is still quite labour intensive. That
22 said, there are sunk costs.

23 The Dixit and Pindyck intuition would, if anything,
24 take me in a slightly different direction, sir, than
25 the one you're going in, which is my understanding of

1 the Dixit and Pindyck situation says even for projects
2 that are NPV negative, one might want to take the first
3 few steps in order -- and incur losses, to create
4 the option value for being able to roll out further in
5 the future if the conditions are favourable.

6 So so far, I've always been saying that the AECT has
7 to be passed at sort of each and every level of
8 roll-out. I think that the Dixit and Pindyck insight
9 would go in the direction of suggesting that's
10 conservative, in the sense that the real option approach
11 to valuation suggests a willingness to incur some early
12 losses for the benefit of revealing or creating
13 the option for future roll-out. So it doesn't seem to
14 me that it goes -- I'm clearly answering this on the --
15 you know, just as I sit here but it's not obvious to me
16 that that would go in the -- against the conclusions
17 that we've -- that I've presented so far.

18 PROFESSOR ULPH: Just two observations. First of all, I'm
19 not necessarily saying it goes in a particular
20 direction, I'm just saying that as a general rule,
21 NPV is no longer the right rule to use.

22 But secondly, the question would be, have you tested
23 whether, in the kind of circumstances we're dealing with
24 here, the rule would point in the direction that you're
25 talking about. Unless you've actually calculated

1 the option values.

2 A. So first of all I fully agree, I think, on your remark
3 about -- or at least insofar as it accepts that actually
4 it may work in the direction of suggesting the test is
5 conservative as a possibility.

6 I haven't looked -- I haven't analysed the roll-out
7 decision on a real option basis. I think the reason --
8 one of the reasons I haven't done that is on the base
9 case, the as-efficient-competitor test is passed at each
10 and every level of roll-out. So if we were looking at
11 those graphs that have a dip and there's the negative
12 zone and we're thinking about whether that constitutes
13 a fail or not, that could be another factor that would
14 go into the mix of that evaluation.

15 PROFESSOR ULPH: I agree.

16 Could I ask you about another issue. It goes back
17 to the theory of price discrimination. So one argument
18 that's been put forward is we're not seeing price
19 discrimination here, we're seeing product
20 differentiation, that somehow buying things on APP2 is
21 different from buying things on NPP1, because you don't
22 have to meet the tight requirements of NPP1. So there's
23 some advantage given to consumers of being on -- or
24 customers from being on APP2 as compared to NPP1. So
25 it's a kind of product differentiation story.

1 I think an analog I would think about would be, say,
2 time of day pricing and trains. If I'm getting a train
3 from St Andrews to Edinburgh, if I travel at one time of
4 the day, I pay one price; if I travel at another time of
5 day, I get a different price, but it's the same cost of
6 getting me from A to B, same train, and there's no
7 difference in that respect, but I might have reasons for
8 wanting to travel at one time of day vis a vis another
9 time of day.

10 So the question then is how do you go from
11 recognising that there is some difference between two
12 products to a theory that says you can justify a price
13 difference on the basis of those differences in
14 the products? What kind of evidence as an economist do
15 you think you would turn to to try to justify that price
16 differential?

17 A. I would -- my preference would be to not answer that
18 question.

19 PROFESSOR ULPH: Okay.

20 A. Because the discrimination aspect has been outside of my
21 scope since the beginning, I'm sort of cutting in at
22 this problem after that step assuming discrimination,
23 and I would be reluctant to give a short answer to
24 something that I haven't thought about sufficiently.

25 PROFESSOR ULPH: Okay, I accept that.

1 A. Thank you.

2 THE CHAIRMAN: You're telling us very politely to work it
3 out for ourselves, is that right?

4 I think that probably concludes the evidence of this
5 witness. Mr Dryden, you may stand down, you are
6 discharged. Thank you very much for your help.

7 A. Thank you.

8 (The witness withdrew)

9 THE CHAIRMAN: Right, that leaves us at the break anyway,
10 but it's going to be a permanent break, is it?

11 MR BEARD: It's a very short term measure of permanence,
12 Mr Chairman, until Friday morning.

13 THE CHAIRMAN: So we don't sit tomorrow.

14 MR BEARD: We don't sit tomorrow. We were only going to sit
15 a half day tomorrow, but if we are going to sit -- not
16 tomorrow, we are going to sit on Friday --

17 THE CHAIRMAN: Obviously if there's anything we need to know
18 in the interim, please could you ask your solicitors to
19 contact the registrars.

20 MR BEARD: We will of course do that and we will be hearing
21 from Mr Parker on Friday is the intention.

22 THE CHAIRMAN: Is everybody happy with that?

23 MR HOLMES: Very much so, sir.

24 There's one point that it might be helpful to
25 canvass now, if that's convenient, which is the written

1 closing submissions, and whether the tribunal has a view
2 about what it would find most helpful in terms of
3 the page length of the document.

4 THE CHAIRMAN: 15 pages?

5 MR HOLMES: We were anticipating for our part that
6 the tribunal might find it helpful to actually have
7 quotations from the transcript set out in the body of
8 the document, so you can review them without having to
9 cross-reference, and that tends to lead to a longer
10 document, but we understand there's also a balance to be
11 struck, and you don't want hundreds of pages.

12 We were wondering -- I should say, I haven't
13 canvassed this yet with Mr Beard or Mr Turner, so they
14 may take a different view, but we wondered if 90 pages
15 might provide a --

16 THE CHAIRMAN: 90?

17 MR HOLMES: -- middle way.

18 THE CHAIRMAN: Between 0 and 180?

19 MR HOLMES: Yes, sir, that's a very economic answer.

20 THE CHAIRMAN: I think at this stage we are inclined to let
21 you have your head. If you're willing to settle for 90,
22 I think that will suit us, but please bear in mind
23 the discussion I have had with both of you before;
24 the longer it is, the less likely it is we are to glean
25 understanding, particularly towards the end.

1 MR TURNER: We're content with 90.

2 THE CHAIRMAN: 90?

3 MR BEARD: Yes, I suppose that is ... so there will be

4 180 pages from Ofcom and Whistl and we will deal with

5 90, yes.

6 THE CHAIRMAN: Sounds terrible, doesn't it. I'm sure your

7 submission will be all that much better.

8 MR BEARD: Thank you. I'm grateful.

9 THE CHAIRMAN: Thank you. Okay. Friday morning then.

10 (3.22 pm)

11 (The hearing adjourned until 10.30 am on Friday,

12 28 June 2019)

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