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**IN THE COMPETITION**  
**APPEAL TRIBUNAL**

Case No: 1381/7/7/21

Salisbury Square House  
8 Salisbury Square  
London EC4Y 8AP

Monday 29<sup>th</sup> January – Friday 22<sup>nd</sup> March 2024

Before:  
The Honourable Mr Justice Waksman

Eamonn Doran

Derek Ridyard

(Sitting as a Tribunal in England and Wales)

**BETWEEN:**

Justin Le Patourel

**Class Representative**

v

(1) BT Group PLC  
(2) British Telecommunications plc  
(Together, "BT")

**Respondent**

**A P P E A R A N C E S**

Ronit Kreisberger KC, Derek Spitz, Michael Armitage, Jack Williams and Matthew Barry (On behalf of Justin Le Patourel)

Daniel Beard KC, Sarah Love, Daisy Mackersie, Natalie Nguyen and Ali Al-Karim  
(On behalf of BT)

Jennifer MacLeod (On behalf of the Competition & Markets Authority)

Thursday, 21 March 2024

(10.30 am)

THE CHAIRMAN: Good morning. Some of you are joining us live stream on our website, so I start with the customary warning: an official recording is being made and an authorised transcript will be produced, but it is strictly prohibited for anyone else to make an unauthorised recording, whether audio or visual, of the proceedings, and breach of that provision is punishable as a contempt of court.

Yes, Mr Beard.

Closing submissions by MR BEARD (continued)

MR BEARD: Sir, thank you. I am going to pick up from where I left off yesterday. I have been looking at the law, although it was a preface to limb 1, I was covering some issues that were relevant for limb 2 as well. I was emphasising the fact that the overall test is unfairness, it needs to be proved as a whole by the Class Representative, but the question is whether prices bore no reasonable relation to economic value, and that there are different methodologies which can be used.

But if you are going to rely on a comparison of cost-plus with price, you have to be considering the actual costs with actual price, and you cannot compare other costs with actual price. You are not actually

1 testing the right thing.

2 Now, at the end you asked me whether, as a matter of  
3 law, using the 2009 RFS was wrong, and the answer to the  
4 question is yes, and the reason for that is because of  
5 the way it is being used here.

6 It is perhaps just worth remembering that back at  
7 the time of the CPO, the Class Representative was  
8 adopting a very different proposed approach. He was  
9 saying he would just compare against 2009 prices with  
10 a modification for the wholesale line rental.

11 Now, obviously I am not revisiting that sort of  
12 intertemporal comparator approach, but it was in July  
13 last year that for the first time you will recall we had  
14 reference to this 2009 RFS. There was an amendment to  
15 the pleadings and there was an annex on methodology that  
16 the Tribunal had ordered that was produced, and that was  
17 when the 2009 RFS was first relied upon.

18 Now, I will not digress into how on earth  
19 Ms Kreisberger could be saying that all along BT should  
20 have been thinking about this sort of fully allocated  
21 costs approach under the RFS terms, it just rather  
22 reinforces the unreality of what she was saying. But  
23 the point is this: what was said in July was  
24 post-disclosure, and of course that was a massive  
25 exercise, that disclosure exercise. Millions of pounds

1 were spent on gathering all the relevant documentary  
2 material, all of the unstructured data that was shipped  
3 across and so on. It was a vast exercise that was  
4 undertaken, and at that point, notwithstanding all the  
5 material that had gone across, it was said we were  
6 relying on the 2009 RFS.

7 But the position that Mr Duckworth and the Class  
8 Representative have adopted is that the 2009 RFS is not  
9 being deployed to assess what the actual indirect costs  
10 in the claim period are, it is being used effectively to  
11 create an abstracted benchmark. He was very clear when  
12 he was cross-examined on Day 15.

13 If we go to {Day15/105:1}.

14 "Question: Let me just ask the question again [this  
15 is at line 11]. You do not refer to or rely upon any  
16 actual costs incurred in the claim period in relation to  
17 indirect or common costs in your methodology, do you,  
18 Mr Duckworth?

19 "Answer: No, I do not."

20 He says it would be impossible to try and map it on  
21 to actual costs incurred.

22 Then I asked:

23 "Question: You do not seek to make any cross-check  
24 or reference to any actual costs ..."

25 "Answer: I did review the actual costs. I did

1 review the available data in great depth when making the  
2 judgment that the appropriate way to estimate the costs  
3 actually incurred in the period was to project forwards  
4 from the 2009 RFS.

5 "Question: Just to ask you the question again: you  
6 do not seek to make any cross-check or reference to  
7 actual costs in relation to your methodology, do you,  
8 Mr Duckworth?

9 "Answer: No, because I do not think the actual  
10 costs are informative."

11 So he is not taking into account the actual costs at  
12 all in any way, notwithstanding the legal.

13 THE CHAIRMAN: That is the actual costs of BT Consumer.

14 MR BEARD: Yes, yes.

15 THE CHAIRMAN: Yes.

16 MR BEARD: Absolutely. So the actual costs that are being  
17 incurred in 2015/2016 and so on that sit behind, or are  
18 to be compared with under a cost-plus analysis,  
19 the prices in 2015/2016.

20 Because that is the key thing here. The choice to  
21 use the cost-plus analysis is what takes you into the  
22 position where you need to be looking at actual costs  
23 against actual prices. We saw in relation to  
24 *United Brands* that actually there are other tests you  
25 can put forward, and indeed at the CPO stage there was

1 a different sort of methodology being proposed. But it  
2 is this absolutist approach of fixing on one  
3 methodology, taking the old costs and just uprating  
4 them, which we say is not consistent with the law.

5 Of course we understand that what is also being said  
6 now is that well, actually, you can treat these as being  
7 the actual costs. Now, of course at that point we  
8 understand that there is no bar on using pre-claim  
9 period information in order to inform you about costs  
10 during the claim period, we are not suggesting that, and  
11 that is why, as well as pointing out the legal error of  
12 approach, we also say, well, what has been done here is  
13 not an appropriate approach for ascertaining what the  
14 appropriate costs are, actual costs are, during the  
15 claim period and that using this single methodology is  
16 inappropriate. That is what I am going to come on to  
17 deal with.

18 THE CHAIRMAN: Yes, thank you.

19 MR BEARD: As I say, our position is not that there is some  
20 absolute bar to using pre-claim data, we have never  
21 suggested that, but it is how it is being used here,  
22 taking those old costs, uprating them, and then engaging  
23 in no cross-check or assessment in relation to the  
24 actual costs at all. That is the problem here.

25 Obviously we saw in the case law, indeed in the case

1           which Ms Kreisberger referred to, the *Deutsche Post*  
2           case, very rough and ready approaches to the assessment  
3           of actual costs, but it was still saying, well, let us  
4           look at the actual costs here, one way or another.

5           Anyway, I am now moving on to deal with the points  
6           in relation to the approach adopted in relation to these  
7           issues, and I picked up yesterday the point that the  
8           BT -- the case that is being put by Ms Kreisberger was  
9           somehow that what we were asking -- what we were  
10          requiring was precision, absolute precision in relation  
11          to the approach, and we are not saying that.

12          To be clear, what we are asking ourselves is the  
13          question whether the cost numbers that are being put  
14          forward by Mr Duckworth and the Class Representative are  
15          consistent with what the law requires in an excessive  
16          pricing case, including the principle of legal  
17          certainty, and are those numbers likely to be  
18          sufficiently reliable that the Class Representative can  
19          effectively prove with this plus other benchmark margin  
20          that there is no reasonable relation between the price  
21          and the economic value.

22          That is what we are saying this fails entirely to do  
23          because, and I am going to take it in a series of  
24          points.

25          The first point is that just relying on a single

1 fully allocated costs methodology is not adequate in  
2 these circumstances, particularly not one derived from  
3 costs in 2009.

4 The second is there are actually many particular  
5 problems with the use of that 2009 RFS methodology  
6 because of both the techniques of judgment that were  
7 used within it that could change, the level of common  
8 costs that exist, and indeed the changes in business and  
9 cost structure between 2009 and -- well, right through  
10 the claim period, so up to 2023. So that is going to be  
11 the second point.

12 So the first point will be about just using one  
13 methodology. The second point, I will work through  
14 a number of the issues in relation to the 2009 RFS  
15 itself.

16 I will then move to some of the criticisms of  
17 Dr Jenkins' approach, which is supposed to assist in  
18 thinking about these things. I will then deal with the  
19 rates of return, why the 10% margin, effectively, is  
20 flawed, and I will also deal with why there is good  
21 reason to prefer the 20-25% margin, and then I will pick  
22 up some points on significant and persistent.

23 THE CHAIRMAN: Thank you.

24 MR BEARD: So just picking up the first point: no one right  
25 way to measure or allocate costs. This is well



1 recognised in the case law. If we could pick it up in  
2 our closing submissions, {A/16/115}. This is  
3 paragraph 471, it should be. Yes, great, thank you.

4 I am not going to take you to all of the cases here,  
5 but I will just refer to those that are mentioned. You  
6 will see there the quote from the *Genzyme* case about:

7 "... estimates and allocations of costs will always  
8 have a degree of arbitrariness ... The actual margin to  
9 be set is not a matter of precise mathematics."

10 The *Albion Water II* case, recognising that as  
11 a matter of fact accounting technique and economic  
12 assessment will be required. That is at the beginning  
13 of paragraph 471.

14 We have also got the references to *Hydrocortisone*,  
15 the difficulties and controversial nature of some of the  
16 calculations that may be undertaken. I will not take  
17 you back, but it is quoted here, paragraph 254 in  
18 *United Brands*, which I emphasised yesterday, which is  
19 recognising that when you deal with actual costs because  
20 businesses do not produce costs allocated on a basis  
21 that may be the subject of a claim, you do have to use  
22 judgments in relation to these issues, but it is still  
23 about the actual costs. So there is not one way to deal  
24 with these things.

25 That has been recognised throughout the case law,

1 and more particularly it has been recognised in relation  
2 to recent cases concerning allegations of excessive  
3 pricing in relation to pharmaceuticals.

4 So if we go to {G/88/151}, so this is the CMA  
5 decision on remittal in relation to Phenytoin. So this  
6 is after it had been up to the Court of Appeal and  
7 remitted back.

8 I think I had already taken you to 5.17 about the  
9 lack of common practice in the pharmaceutical industry  
10 about allocating common costs, and you have heard  
11 evidence from Mr Cackett about that, how the position is  
12 the same in relation to BT.

13 5.18:

14 "There are a number of different methodologies that  
15 may be adopted when allocating common costs as part of  
16 a Cost Plus assessment. There is no overriding  
17 preferred method and different methods may be  
18 appropriate for different cases.

19 "As such, the CMA has considered the merits of  
20 various cost allocation methodologies ... based on the  
21 principles of common cost allocation identified by Oxera  
22 and the Inter-Regulatory Working Group."

23 So Oxera had done a report for the, I think it was  
24 for the OFT, or it might have been the CMA, on  
25 profitability analysis that looked at these sorts of

1 methodologies, and the Inter-Regulatory Working Group  
2 had done something similar.

3 What you see actually in this case is at 5.20 the  
4 CMA concluding that:

5 "... using an output-based cost driver -- the  
6 volumes of packs sold -- is the most appropriate [way to  
7 deal with these issues]."

8 Just to translate that across to our case,  
9 a volume-based driver is effectively a customer or  
10 a lines-based driver for allocation.

11 If we just go to the PPC's case, {G/50/27} we see  
12 there at 85, "An appropriate mark-up for the recovery of  
13 common costs".

14 So this is actually in the telecoms field, PPC, not  
15 in the pharmaceuticals field:

16 "There are a number of ways in which common costs  
17 can be allocated ... Three were considered before the  
18 Tribunal:

19 "Combinatorial tests.

20 "Fully allocated cost.

21 "Distributed stand alone cost."

22 "None of these approaches can be said to be uniquely  
23 correct or uniquely reasonable."

24 Then if we go on down to paragraph 89, {G/50/27}, so  
25 this is dealing with combinatorial tests:

1           "One way of assessing whether a particular charge  
2 for a particular product might be regarded as excessive  
3 or not, is to consider whether the price for different  
4 combinations of products lie between the LRIC and SAC of  
5 those combinations. Where all the different  
6 combinations satisfy this test, there is no  
7 over-recovery of common costs."

8           Down to 90, if we may, {G/50/28}:

9           "A problem with this approach, however, is that  
10 depending upon the size of the product portfolio of the  
11 firm, and the types of common costs, the number of  
12 combinatorial tests could be impracticably high."

13           Then if we go down to page {G/50/76}, you will see  
14 at paragraph 254, probably actually we should just go up  
15 to the preceding paragraph, 253, {G/50/75}. There was  
16 a suggestion that -- the view of one of the experts was  
17 that combinatorial tests were a waste of time.

18           Then at paragraph 254:

19           "As a general proposition, we do not agree with this.  
20 As we have described in paragraphs 89 to 90 above,  
21 combinatorial tests are one way of assessing whether or  
22 not a firm is over-recovering its common costs, and in  
23 some cases will be an entirely appropriate approach.  
24 The drawback [as we have also noted] is the number of  
25 permutations that may have to be undertaken where a firm

1 sells a large number of products/services ... In some  
2 cases -- and this is one of them -- this ... may render  
3 combinatorial testing inappropriate."

4 The point here is not that you should just leave out  
5 combinatorial tests, that you have to look at, if it is  
6 put forward, whether or not it is practicable and how  
7 one might be able to gain insight from it, because of  
8 course, to re-emphasise the point, what Dr Jenkins did  
9 with her SAC combinatorial test was try and provide some  
10 sort of insight given the fact that only one particular  
11 fully allocated cost methodology was being provided.

12 If we could go back up to page {G/50/27}.

13 MR RIDYARD: Mr Beard, sorry to interrupt, but I mean,  
14 everything you have taken to us on the pharmaceutical  
15 and then on the previous telecom case is talking about  
16 common costs.

17 MR BEARD: Yes.

18 MR RIDYARD: It would be really helpful to me at least if  
19 you could be clear when you are talking about common  
20 cost problems and the uncertainties about incremental  
21 cost.

22 MR BEARD: Right. So at the moment I am just talking about  
23 whether or not there are a range of methodologies that  
24 can be appropriate in relation to the allocation of  
25 costs generally. Obviously the differences in these

1 methodologies are particularly important in relation to  
2 common costs. I am not suggesting otherwise. The focus  
3 of these submissions is obviously in relation to  
4 indirect costs at all times because we accept that the  
5 direct costs are actual costs, of course.

6 MR RIDYARD: Yes.

7 MR BEARD: In relation to incremental and common, I am going  
8 to come on to explaining why there is good evidence of  
9 common costs here and why the assertions by Mr Parker  
10 and Mr Duckworth that there are not any common costs are  
11 not properly evidenced and are not sound.

12 MR RIDYARD: Okay.

13 MR BEARD: I will also deal with the issue that there are  
14 problems of identification of incremental costs.

15 Now, all of those problems actually exist I think in  
16 relation to all methodologies. They are particularly  
17 pronounced if you are going to use a fully allocated  
18 costs methodology and there are common costs because, as  
19 Mr Duckworth frankly recognised, fully allocated cost  
20 methodologies do not deal with those issues. They do  
21 not identify common costs separately at all.

22 MR RIDYARD: Well, there is no reason why they would not  
23 identify them separately. But I mean, we do not see in  
24 the RFS a split between incremental costs and common  
25 costs which clearly is an interesting issue.

1 MR BEARD: No.

2 MR RIDYARD: As regards incremental costs, the RFS did go  
3 through an exercise of cost causality, and, again, we do  
4 not know the details but we do know it happened --

5 MR BEARD: Yes.

6 MR RIDYARD: -- and Dr Jenkins made some comments about that  
7 as a matter of principle saying -- I think she said if  
8 it had been up to date, she would have been quite happy  
9 with ...

10 MR BEARD: What she actually said if it was up to date, so  
11 if there had been a fully allocated costs model that  
12 applied in 2015 or 2022, then she certainly said that  
13 was relevant material that you would take into account.  
14 She did not say that was the basis on which you would  
15 then carry out any allocation, because that would be  
16 contrary -- and her statements were not to this  
17 effect -- but that would be contrary to the point that  
18 she had re-emphasised, that a fully allocated costs  
19 model would lose you the flexibility in relation to  
20 these issues.

21 MR RIDYARD: It loses flexibility in relation to common  
22 costs, but if it is the -- if it is accurately  
23 identified causality for the incremental costs then you  
24 do not -- are you saying you also have wriggle room  
25 there as well?

1 MR BEARD: No -- well, the only issue in relation to the  
2 incremental costs is actually, as we saw when we were  
3 looking at the 2009 RFS, there is quite a lot of  
4 judgment that is actually involved in how you carry out  
5 the cost causality assessment. So to that extent  
6 I think it goes to the point you were raising already,  
7 which is there can be uncertainties in relation to  
8 incremental costs even within a fully allocated costs  
9 model, but that -- when you talk about that as wriggle  
10 room, obviously that means there would need to be some  
11 sort of flexibility if you were using that as the --  
12 determine as to the incremental.

13 In theory, if you can perfectly identify all cost  
14 causality, then, yes, there would not be wriggle room in  
15 relation to incremental costs, but in the real world you  
16 cannot do that.

17 One of the points we make about the difficulty of  
18 identifying incremental costs and carrying it forward is  
19 that in the 2009 RFS, as we saw, you had to carry out  
20 some very specific and detailed activity based costing  
21 exercises in order to do these things, and you were  
22 taking a judgment to carry out that activity based  
23 costing exercise, how it was done, and using that as  
24 your costs causality. One of the points we make is if  
25 you could have taken a different approach to cost



1           causality, used a different method of activity based  
2           costing, and indeed year-on-year come out with different  
3           numbers, you just cannot translate those incremental  
4           cost assessments forward. It is one of the fundamental  
5           problems with the RFS.

6           MR RIDYARD: Yes, I can see, and your case is it creates  
7           a bit of uncertainty there that -- and it might be done  
8           differently and so forth. I understand that.

9           MR BEARD: Yes.

10          MR RIDYARD: But I just want to re-emphasise it is  
11          a different nature of issue as regards ... That question  
12          about whether the causality was done perfectly and  
13          whether you would agree with it is one issue, but the  
14          question of the common costs is a different order of  
15          magnitude.

16          MR BEARD: Oh, completely. I am sorry, I am not trying  
17          to -- I hope I am clear that the uncertainties in  
18          relation to incremental costs that arise are different  
19          because they go to what the cost causality assessment  
20          was, and also of course what the actual incremental  
21          costs were over time, because you are making an  
22          assumption in Mr Duckworth's approach that even taking  
23          the activity based costing methodology that you use for  
24          some particular category of incremental cost, even if  
25          you kept that completely the same, and you concurred

1           that that was the only way that you could assess  
2           causality in relation to that particular incremental  
3           cost, actually the incremental costs could change  
4           substantially over time as the nature of the business  
5           changes, and that is not something that you can possibly  
6           factor in.

7           I mean, you ended up with Mr Duckworth coming up  
8           with these: well, efficiencies will always drive it  
9           down-type story. That does not tell you anything, as  
10          I will come on to, in relation to this.

11          So there are just a series of flaws. All I am doing  
12          at this point is saying, look, when you are thinking  
13          about this reasonable relationship, just picking one  
14          methodology is extraordinarily dangerous. It is  
15          particularly dangerous when you pick a methodology which  
16          does not allow any flexibility, a fully allocated costs  
17          methodology, and, frankly, if you do it by reference to  
18          costs that were in 2009, and you are trying to use that  
19          as a proxy for 2015 through to 2022, you are not getting  
20          close to providing the probative evidence you need to  
21          show these points.

22          MR RIDYARD: Well, we do not know how close you are getting,  
23          do we?

24          MR BEARD: Well, that may well be the answer, sir.

25          MR RIDYARD: If, as the Class Representative says, the

1 common costs are vanishingly small, and they say all  
2 these problems about common costs do not need to worry  
3 us too much, and therefore your only wriggle room would  
4 be on whether the cost causality was wrong or  
5 inappropriate in the 2009, but if the common costs are  
6 big, then I can see we have got a game on our hands.

7 MR BEARD: Two things. Yes, in relation to the common  
8 costs, that is absolutely true, and yes, it is also true  
9 that you have the difficulties with the cost causality  
10 issues, that is also true. But you have also got to  
11 think about what the absolute levels of those  
12 incremental costs are as the business changes.

13 Whether you treat that as some sort of wriggle room  
14 in relation to cost causality overall, cost causality,  
15 or you say that is a further difficulty with moving from  
16 2009 to the present day in circumstances where the  
17 business is changing radically, then that is a further  
18 concern you have.

19 So I am not -- it does not matter to me whether you  
20 treat the latter problem of businesses changing and  
21 therefore the nature of the incremental costs in the  
22 business changing as part of a cost causality problem or  
23 as a further third problem here, but the key thing is  
24 you cannot just assume that businesses will have  
25 incremental costs on the same basis in 2009 as in 2015

1           and 2022 that are only changing by CPI.

2       THE CHAIRMAN:  If I could just ...

3       MR BEARD:  Yes, please.

4       THE CHAIRMAN:  But if you wanted to make the case that  
5           actually it is inappropriate to do CPI because there are  
6           all these changes in the way that business operates  
7           which has an impact on incremental costs, where is the  
8           evidence from BT on all of this?

9       MR BEARD:  In relation to?

10      THE CHAIRMAN:  To say: look, by the time we got to 2011 we  
11           were doing this, we were doing that, that has  
12           a difference on incremental costs because of da-de-da.  
13           Where is the evidence from BT on that?

14      MR BEARD:  I do not think it lies with BT to provide  
15           evidence of the changes in incremental costs.  What we  
16           are asking ourselves is: is the assumption that  
17           businesses do not change other than by reference to CPI  
18           a sound basis on which to proceed in these  
19           circumstances, and we say that is plainly not the case  
20           in circumstances where you have a business that is  
21           moving from being voice focused into providing  
22           broadband, into the investments in relation to a whole  
23           range of other products and developing its business  
24           overall.

25           We tested a number of these points.  The particulars

1 of these points, for instance, in relation to new  
2 billing systems, in relation to onshoring, that related  
3 only to the voice issues, and we did not -- we are not  
4 even debating further the broader issues within  
5 BT Consumer which is obviously what is the subject of  
6 the 2009 RFS, but of course the costs within BT Consumer  
7 are changing radically across the period.

8 In those circumstances, for BT to be told: well you  
9 have to show what are the changes in incremental costs  
10 in order to disprove the idea that CPI from 2009 is the  
11 best way of gauging your costs is again reversing the  
12 burden. They have to show that actually that is the  
13 sensible way in which you ascertain what the incremental  
14 costs are during the claim period.

15 THE CHAIRMAN: Yes, but the difficulty with that argument is  
16 that all the relevant data on this lies with BT. The  
17 Class Representative cannot know the finer points. Now,  
18 I quite understand one of your limbs might be: this  
19 whole thing is wrong, this whole RFS is not, which is  
20 not actually what Dr Jenkins said, it is the updating  
21 problem, and I recognise that is what you are addressing  
22 at the moment. She did not just say it would be  
23 relevant material, she actually said there would not be  
24 a problem with it, because I asked her the question.

25 But getting back to this point. I can understand

1           you will have to assess a sort of overarching argument  
2           that the whole concept of upgrading, however you do it,  
3           is just entirely wrong, and you have made your point  
4           about the law and actual data. But if we were not with  
5           you on that submission, a very viable alternative, it  
6           would seem to me, for BT is to say -- you say they have  
7           assumed, they have assumed that this is a business that  
8           is not changing, and they have assumed -- you keep  
9           saying it -- the incremental costs could be very  
10          different.

11           I still do not understand why you do not go the  
12          further step. It is all very well speculating that the  
13          incremental costs might be different, but actually you  
14          are in a position to say: and they were different  
15          because ...

16          MR BEARD: Let us pause there.

17          THE CHAIRMAN: That is the difficulty I have at the moment  
18          and I would like to be disabused of the notion.

19          MR BEARD: Let us take it at the very simplest level. You  
20          say BT has the information. The whole idea of the  
21          massive disclosure exercise that was undertaken was that  
22          the parties have the relevant material including a vast  
23          unstructured dataset in order to be able to carry out  
24          whatever analysis they have, what they want to do in  
25          relation to it.

1           Now, that dataset that has been provided through  
2 disclosure is the same for BT as it is for the Class  
3 Representative. To turn around and say, well, BT should  
4 have taken that data and provided more detailed  
5 breakdowns in relation to incremental costs would not be  
6 the right way of looking at these issues.

7           In relation to the nature and changes in the  
8 business, we have provided very extensive evidence in  
9 relation to that. There is not some sort of cohort of  
10 data we have that tells us how this incremental cost  
11 material -- or this cost material is to be treated as  
12 incremental or not. We would have to do the same sort  
13 of exercise that the Class Representative would have to  
14 do in relation to it.

15       THE CHAIRMAN: I will just round off here, because it is an  
16 overarching point and I have got what you have said so  
17 far. I quite accept that if the argument is there  
18 should be something in disclosure which is a nice  
19 discrete document showing these things, no one is  
20 suggesting that, and obviously if it was, then the Class  
21 Representative says: what I am actually talking about is  
22 witness evidence. I am actually talking about somebody  
23 in the know who deals with the economics of all of this  
24 stuff who at least at a high level ... There must be  
25 somebody there who has some broad picture about that

1           which the CR cannot possibly know, and they might then  
2           be the ones who say, now let us do a little bit of work  
3           here, and you put in a witness statement about all of  
4           this.

5           That is at the moment, not necessarily a critical  
6           point, but at the moment that is what I find difficult,  
7           and I am not attracted at the moment to the proposition  
8           that that is simply a reversal of the burden of proof.

9           MR BEARD: Understood. Well, I think in these circumstances  
10          what you have was, I think I inadvertently promoted him  
11          yesterday, but you had the Director of Finance here who  
12          dealt with these sorts of -- who deals with financial  
13          issues. No questions were asked of him in relation to  
14          these sorts of matters. If the Class Representative had  
15          concerns about this, then cross-examination of the  
16          Director of Finance in relation to these issues would  
17          obviously have been a perfectly sensible course.

18          As I recall, no questions were asked in relation to  
19          these matters of him. Indeed, it was clear from the way  
20          in which questions were asked of Mr Cackett that  
21          actually, in relation for instance to unit economics,  
22          there had not properly been an understanding on the part  
23          of the Class Representative what his evidence was going  
24          to in relation to large parts.

25          The fact that the Class Representative asked no



1 questions of a witness who is clearly competent in  
2 relation to financial matters again is not a matter that  
3 we can solve here. To say that we then have to put in  
4 witness evidence spelling out changes in incremental  
5 costs when the fundamental proposition is: you, oh Class  
6 Representative, have moved to this cost-plus  
7 methodology. You have said that actually CPI is the way  
8 forward, notwithstanding all of the data you have got.  
9 In the face of evidence about the changes in the nature  
10 of the business that has been provided, to assume that  
11 that is the way forward is not robust.

12 Of course, I am making all of these submissions  
13 subject both to the points about cost causality overall  
14 and also to common costs which I am coming back to.

15 THE CHAIRMAN: Of course. I did not want to take you out of  
16 your -- but thank you for that.

17 MR BEARD: I think the other thing to emphasise of course is  
18 that what Dr Jenkins was doing by carrying out the  
19 SAC combi and DSAC exercises was actually trying to  
20 carry out an exercise which assisted the Tribunal with  
21 having some sort of insight overall into these issues,  
22 but I of course understand that one of the contentions  
23 that was put forward is there is no material common  
24 costs here, and we say that just is not valid at all, at  
25 which point the exercises being carried out by

1 Dr Jenkins are overall of assistance to the Tribunal.

2 So I just want to pick up one document just in  
3 relation to cost allocation methodologies, if I may. If  
4 we could go to {E/45.3/1}.

5 This is Ofcom's review of cost orientation. So you  
6 will recall that there were various cost orientation  
7 conditions at different times that were subject to  
8 litigation, but Ofcom carried out a consultation and an  
9 assessment of points on cost orientation.

10 If we just go over the page, down to page 4,  
11 paragraph 1.3. {E/45.3/4}:

12 "In light of our experience of the effectiveness of  
13 these price remedies ..."

14 So this is charge controls and cost orientation  
15 obligations.

16 "... and in particular cost orientation obligations,  
17 we have considered afresh in general terms the way in  
18 which we might use them in future. This document  
19 focusses on the cost orientation obligations we impose  
20 in SMP conditions in fixed telecommunications, as there  
21 are no cost orientation SMP obligations in place in  
22 mobile markets."

23 So here Ofcom are thinking about how to carry out  
24 cost orientation exercises when there might be SMP,  
25 significant market power, in the markets.

1           If we just go down to 30, {E/45.3/30}, at  
2 paragraph 3.15 you will see there a broad discussion of  
3 what they mean by cost. They are looking at DSAC, so  
4 distributed standalone alone cost, and distributed long  
5 running incremental cost, and comparing those to fully  
6 allocated cost. It is describing the concepts there at  
7 the various paragraphs.

8           If we just scroll down the page, you will see the  
9 description of those two concepts. Then if we go over  
10 the page, {E/45.3/31}, we will see -- you see at 3.21:

11           "Because of the existence of significant common  
12 costs, the SMP operator will only recover costs overall  
13 if at least some of its charges are above LRIC.  
14 However, there may be many different ways of attributing  
15 these common costs to different services, none of which  
16 may be uniquely correct or uniquely reasonable.

17           "The concept of SAC has its originals in theory of  
18 contestable markets."

19           Then there is a description of how standalone costs  
20 analysis is put in place.

21           It makes clear at the bottom:

22           "A price above [standalone costs] could therefore  
23 only be sustained if there were barriers to entry. In  
24 the multi-product context, a price (significantly and  
25 persistently) above SAC might therefore be regarded as

1           overcharging."

2           So this is full standalone costs even in  
3 a multi-product scenario is being talked about.

4           Then if we go down to page {E/45.3/34}, so further  
5 discussion of the DSAC and LRIC.

6           Then fully allocated costs. You see at 3.37:

7           "[Fully allocated costs] is an accounting concept  
8 designed to ensure that all of a firm's relevant costs  
9 (both incremental and common) are attributed to its  
10 activities. If a firm set all its charges equal to FAC  
11 for each unit, all things being equal, it would be  
12 expected to recover (but not over-recover) all of its  
13 costs, including all of its common costs. These costs  
14 typically also include an allowance for a return on  
15 capital which is measured at the firm's cost of capital.

16           "There are numerous methods for generating FAC  
17 estimates, although typically firms use some form of  
18 activity based costing. This form of analysis involves  
19 allocating all costs (both incremental and common) to  
20 individual activities ... Other approaches can involve  
21 simply allocating common costs to services in line with  
22 the incremental or variable costs incurred. BT's  
23 approach to calculating FAC is therefore only one  
24 approach. Other methods may also be reasonable and  
25 could produce different views of BT's rate of return on

1 individual services."

2 Then if we go down to page {E/45.3/35}. This is all  
3 under the heading about the relationship between the  
4 different measures. At 3.42, just at the bottom:

5 "Here we consider the merits of using 'pure' FAC as  
6 a cost standard in setting a cost orientation obligation  
7 before considering other FAC-based alternatives.

8 "Setting a condition limiting all prices to 'pure'  
9 FAC will usually be too rigid to allow the bounded  
10 flexibility we consider desirable. Where the provision  
11 of services is characterised by high fixed common costs  
12 which have to be recovered through charges, efficient  
13 recovery of total costs will require prices to be set  
14 taking account of the responsiveness of demand to  
15 changes in price."

16 Now, we understand of course that here the concern  
17 is there must be common costs, otherwise there is not an  
18 issue in relation to the principles of over-recovery and  
19 I am going to come back to that issue very shortly  
20 because what the Class Representative relies on are  
21 three points.

22 First, saying there are no or very low common costs  
23 and that is a very central theme.

24 THE CHAIRMAN: Yes.

25 MR BEARD: The second argument is that there is effectively

1           only one way that costs should be recovered under the  
2           workable competition and that is effectively the  
3           Professor Bliss type argument. Then the third point is  
4           about cost causality, which is once you are using FAC  
5           and cost causality there is one answer.

6           We have already touched on the response to the  
7           second -- the third of those points. The second about  
8           the use of the benchmark giving no flexibility and there  
9           should only be one workable method of competition is  
10          wrong.

11          So let us go back to the point about common costs.  
12          Just to pick it up, we have annex 3 to the closing  
13          submissions, so this is {IR-A/16/255}. You have the  
14          expanded version of the table that Dr Jenkins had  
15          prepared in relation to limb 1 hot tub, and what you  
16          will recall there is that this table just has the  
17          baseline and low common costs scenarios that she  
18          calculated but also the TSO cross-check analysis in  
19          relation to it.

20          I think you can see that. So you have the total  
21          revenue and total costs at the top, and then you have  
22          got indirect costs SG&A and D&A, and then you have got  
23          the baseline assessment of common costs and the various  
24          costs divided out, incremental and common, and then you  
25          have got the low, and then you have got the TSO

1 cross-check.

2 Just to be clear, those are the total amounts of  
3 common cost that Dr Jenkins is finding across  
4 BT Consumer. It is not the amount that her SAC combi  
5 benchmark calculates should be recovered from SFV  
6 services. That is a different criteria.

7 MR RIDYARD: Sorry, these are common costs that are common  
8 across everything that BT Consumer sells?

9 MR BEARD: Yes, these are BT Consumer costs, yes.

10 MR RIDYARD: But those common costs, they are common costs  
11 across the whole range of things in BT Consumer?

12 MR BEARD: Yes.

13 MR RIDYARD: As opposed to costs that are common between,  
14 say, voice and broadband alone?

15 MR BEARD: Yes, these are overall.

16 MR RIDYARD: The whole thing.

17 MR BEARD: I am going to come to the annex. I think it is  
18 useful, given this focus on the common costs issue,  
19 I think it is useful to go to the annex in relation to  
20 these issues.

21 I will come back, if I may, because I have got the  
22 responses to the questions, sir, that you were asking  
23 the other day, the four questions about direct costs.

24 MR RIDYARD: Okay, yes.

25 MR BEARD: Let us just focus on the common cost analysis

1 that we have got in relation to these issues.

2 Now, obviously Ms Kreisberger tried to suggest that  
3 Dr Jenkins was heaping inordinate levels of common cost  
4 here, and this was implausible. There has been a sort  
5 of inflation of the claims from sort of 300 million to  
6 500 million to 700 million, but those numbers are not  
7 reflecting actually what has been done by Dr Jenkins in  
8 looking at the way in which one should assess common  
9 costs or may assess common costs.

10 Because what you are asking is: is it right that  
11 Mr Duckworth's assertion that even though he cannot  
12 identify any common costs in the 2009 RFS, and, as he  
13 said, he has not made any attempt to identify levels of  
14 common costs, apart from those cross-references to SSE  
15 and Post Office, which obviously I will be coming back  
16 to, other than that, it is an assertion that there are  
17 no material common costs here.

18 We say that is just not good enough. It is  
19 particularly not good enough when Dr Jenkins has  
20 actually looked at these things in some detail.

21 Just to remind you, Dr Jenkins was not  
22 cross-examined at all in relation to limb 1. Now, of  
23 course there was a hot tub in relation to limb 1, and of  
24 course the terms of the PTR say quite properly you do  
25 not have to put all of your case in cross-examination



1           subsequently to a witness. But when this has become the  
2           absolute core of the position that the Class  
3           Representative is taking, you cannot shelter behind that  
4           and simply make assertions about the witness' evidence  
5           without testing it with them.

6           I am now going to go to Annex 7 to Dr Jenkins' first  
7           report. So this is {OR-E/25/1}.

8           Sorry, whilst we have still got it on the screen, it  
9           is worth bearing in mind what we are talking about here  
10          in terms of the common costs as share of total costs for  
11          a consumer are between 6 and 10%, without straying into  
12          the confidential elements.

13          THE CHAIRMAN: Sorry, which line of percentage?

14          MR BEARD: I am looking at the low and the TSO cross-check  
15          and the baseline.

16          THE CHAIRMAN: You are looking -- yes, you are starting with  
17          the low, that is where you get the 6% from.

18          MR BEARD: Yes.

19          THE CHAIRMAN: Thank you.

20          MR BEARD: TSO cross-check itself is 6-10%, and you will see  
21          the baseline and those figures goes up to 13%.

22          THE CHAIRMAN: Yes.

23          MR BEARD: So you are looking at low percentages overall of  
24          the total costs of BT Consumer being treated as common.  
25          So it is not that the outcome of this process is some

1 enormous percentage of total costs being treated as  
2 common, it is actually a low percentage of total costs  
3 that is being treated as common here.

4 We will see how Dr Jenkins does it if we go to  
5 Annex A 7. {OR-E/25/1}. If we pick it up at page 100.  
6 {OR-E/25/100}. You will see there this Annex A7 is all  
7 about the estimation of BT Consumer common costs.  
8 Therefore, this is why I say if you are making this the  
9 core of your case that there is nothing here, you should  
10 have challenged this.

11 We are in *Brown v Dunn* territory. We referred to  
12 this in our opening. If you are making assertions about  
13 key elements of a case you need to test them.

14 You will see at A7.1:

15 "As set out in section 6D.2, BT does not allocate  
16 SG&A and D&A costs across its divisions or specific  
17 products. Instead the BT P&L data presents one SG&A and  
18 D&A cost charge across all of BT Consumer for each year.  
19 While I could assume for the purposes of implementing  
20 the SAC combinatorial approach that this means that all  
21 SG&A and D&A costs are common costs, as I set out in  
22 paragraph 6.125, I consider that, from an economic  
23 perspective, some share of these costs is likely to be  
24 incremental to the provision of individual services, and  
25 only the remaining share should be treated as common."

1           So you are talking about the service general and  
2           administration and depreciation and amortisation costs.  
3           So service general and administration. The reason why  
4           she says you might start off with a prior which says  
5           service general and administration might well be seen as  
6           common across BT Consumer, and similarly with the  
7           depreciation and amortisation. But she says no, that is  
8           not what I am going to do here.

9           What she then does at A7.2:

10           "From an economic perspective, these common costs  
11           would be the SG&A and D&A costs that remain unallocated  
12           after identifying the proportion of SG&A and D&A costs  
13           that can be directly attributed as incremental to  
14           individual services. For example, if BT Consumer was in  
15           fact only selling one service then it would scale back  
16           some of its operations which are currently configured to  
17           supply the full range of services including bundles of  
18           fixed voice, ... Sport [and so on]. In other words,  
19           some of the reported SG&A and D&A costs would likely be  
20           reduced if BT were to stop providing any given  
21           service ..."

22           Sorry, my fault, selling, general and  
23           administration.

24           "Only those costs that remain after identifying all  
25           of the incremental costs associated with the relevant

1 services should be considered common and treated as  
2 common costs in the SAC combi ..."

3 She is identifying the common costs for the purposes  
4 of the exercise she is undertaking, but she is still  
5 carrying out an attempt to identify the common costs  
6 within these categories.

7 You will see at A7.3:

8 "Based on the data available to me I consider the  
9 extent to which each SG&A and D&A cost item could be  
10 considered common or incremental ... I explain the  
11 information available to me... I then set out the  
12 exercise I have conducted to estimate a plausible range  
13 for the share of each cost item that could be considered  
14 common ... I then set out what that means in aggregate  
15 for ... SG&A and D&A and consider that to be common each  
16 year."

17 Then look at baseline, low and high estimates.

18 She then describes the data available, and this is  
19 exactly the data the Class Representative has as well.  
20 This is no different. This is disclosed data. You see  
21 a breakdown of the SG&A and charges, a further breakdown  
22 of fixed recharges and recharges, and a breakdown of  
23 D&A.

24 Then:

25 "To supplement the above data, in particular where

1           there is limited or no description of what the  
2           particular SG&A cost item relates to, I have sought to  
3           guide my assessment by reference to an exercise  
4           conducted by Ofcom in 2015 in which it set out its  
5           approach to determining BT's VULA margins... Ofcom  
6           wanted to allocate a proportion of BT's SG&A costs to  
7           the fibre portfolio cost stack to determine the correct  
8           retail margin ..."

9           So the fact that VULA was to do -- the VULA exercise  
10          was to do with something different from Ofcom's point of  
11          view does not affect what Dr Jenkins is taking from this  
12          analysis.

13          She explains that in A7.7:

14          "[Although it was] aimed at fully allocating all  
15          SG&A costs ... I consider the information contained in  
16          Ofcom's decision still provides useful guidance for  
17          determining whether the cost categories ... are likely  
18          to include common costs. This is because in its  
19          review ... Ofcom provided its view of which SG&A costs  
20          could be considered 'short run variable' ... or 'long  
21          run variable/fixed' ..."

22          So Ofcom, obviously completely aside from this  
23          litigation, was looking at the different heads of cost  
24          and categorising them as a short run variable or long  
25          run variable and fixed, and she set out the table.

1           You see at A7.8:

2           "Whilst I do not interpret Ofcom's categorisation of  
3           SRV as meaning that a particular cost item has no common  
4           costs or that a cost item classified as LRVF is 100%  
5           common, it is likely that a cost that has been labeled  
6           [short run variable] will have a lower proportion of  
7           common costs than an item that has been labelled [long  
8           run variable and fixed]. For example, 'total labour  
9           costs -- management', is labelled by Ofcom as SRV.  
10          However, this cost item includes the staff costs of  
11          BT Consumer's management functions and is therefore  
12          highly likely that this cost item will have some costs  
13          that are common since they are overhead activities which  
14          cannot be directly allocated to a single product. As  
15          such, these costs cannot be considered to have no common  
16          costs. Therefore, while I use Ofcom's categorisation to  
17          inform my classification ... I use it as a guide only."

18          Obviously we heard from Mr Cackett about labour and  
19          how -- he referred to labour as being semi-fixed, so  
20          there would be some people that would be attributable,  
21          for instance, to sport, but not all of them.

22          Then you see A7B which is "Application of my  
23          approach to SG&A and D&A costs", and she looks at the  
24          common cost classification categories. So this is how  
25          she sets percentages, what low, low to medium, medium,

1 medium to high and high means in the three scenarios,  
2 because this is effectively what the three scenarios  
3 are. In other words, the low scenario is one where, if  
4 you got low common costs in a category, you only take 5%  
5 of those costs as being common. The baseline is 20%,  
6 the high is 35%. You can just think about that in  
7 relation to the labour costs that we were just talking  
8 about. So she is applying sensitivities in relation to  
9 these aspects.

10 Now, she then explains further how she has done  
11 these things, but actually it is three pages over I want  
12 to go to, which is a table which is landscape and  
13 therefore we will need to flip it round. {OR-E/25/108}.

14 This is Table A7.2 and this table goes on for some  
15 pages, because what it does is it works through every  
16 cost category that is within SG&A and D&A in order to  
17 explain how it is that Dr Jenkins has allocated those  
18 costs to the various zero, low, low medium, medium high  
19 categories for percentages, because those are then fed  
20 into the three different sensitivities at low baseline  
21 and high.

22 So if we take the total SG&A pay including  
23 commissions, that is what is "Label in financial  
24 disclosure". Then we have got "BT description of cost  
25 line", "SG&A pay cost". "My mapping of cost item to

1 Ofcom category", and she is looking at a number of the  
2 specific categories there. She is then identifying the  
3 size of the cost item by average, and then she is saying  
4 what it is -- how she categories these costs. She says  
5 in relation to these total SG&A pay costs, I am actually  
6 going to say that there is a low amount of common costs  
7 here. You will see there is then reasoning on the  
8 right-hand side of why she has attributed a low figure.

9 So what she is doing is she is taking the Ofcom  
10 classification which, as I said, for these labour costs,  
11 was short run variable.

12 THE CHAIRMAN: Just to interrupt, I just wanted ... on the  
13 first column, "Label in financial disclosure", that is  
14 the financial disclosure to Ofcom or is it some other  
15 financial disclosure? Just in the first column,  
16 "Label".

17 MR BEARD: Yes.

18 THE CHAIRMAN: Because this is the descriptor.

19 MR BEARD: Yes.

20 THE CHAIRMAN: It is to Ofcom.

21 MR BEARD: It is here.

22 THE CHAIRMAN: It is this case.

23 MR BEARD: Yes, it is this disclosure.

24 THE CHAIRMAN: Yes.

25 MR BEARD: Because this is just the -- as I said, the whole



1 disclosure set was provided.

2 THE CHAIRMAN: Yes. Thanks.

3 MR BEARD: For the uninitiated, this feels like a very  
4 conservative estimate, because you would think there  
5 might be quite a lot of general management functions and  
6 so on, but that does not matter. The question is, is  
7 this a sensible way of trying to identify whether or not  
8 there are common costs in this category?

9 None of this has been challenged, this analysis.  
10 There have been various points where it has been said,  
11 well, you used judgments, as if judgments are inherently  
12 inappropriate, and that of course is a point that the  
13 Class Representative can make. But in relation to the  
14 particular assessments, how these have been specifically  
15 assessed, we have not heard a specific challenge in  
16 relation to those.

17 More than that, what this illustrates is that there  
18 is a large cohort of data that was provided by way of  
19 disclosure that Mr Duckworth and Mr Parker have simply  
20 not sought to interrogate in order to make any  
21 assessment in relation to the level of common costs.  
22 They simply throw their hands up and say, well, we  
23 cannot do it in the 2009 RFS. We might have asked you  
24 for millions of pounds worth of disclosure that you  
25 provided to us, extracted from your systems across the

1 whole claim period, but we are not going to touch it.  
2 Instead, we will turn up and say, there are no common  
3 costs, let us go and look at SSE and the Post Office.

4 So you see the reasoning why that categorisation has  
5 been taken by Dr Jenkins.

6 Then if we just go over the page, {OR-E/25/109} you  
7 will see you have got "Sub Contract Cost Offshore", so  
8 this is offshore subcontractors, and this is identified  
9 as no common costs. So this is labour that is  
10 subcontracted and that is all treated as non-common  
11 because it is treated as something which can be brought  
12 in and out.

13 Then if we keep going over the page, you see  
14 {OR-E/25/110} "Marketing and Sales". So we had evidence  
15 from Mr Cackett who talked about how it was that in his  
16 view actually any marketing had a brand impact, and  
17 so on, a branding impact more generally, and to that  
18 extent one would see those sort of costs as being  
19 common.

20 But if you look at marketing and sales, you will see  
21 you have got retention, non-campaign, acquisition,  
22 platform marketing spend, and then actually this is  
23 categorised as low to medium in terms of the common  
24 costs. Again, you have got reasoning for it.

25 Then actually you have got some ironies here,

1           because if we go over the page again, {OR-E/25/111},  
2           although it is a relatively small amount, but at the  
3           bottom of the page you have got "R&D", and it says "R&D,  
4           development (short run variable)", and this is allocated  
5           as no common costs. In fact, Mr Duckworth in his reply  
6           report at paragraph 5.15, just for your notes, that is  
7           {E/7/33}, he said that he recognised that product  
8           development could be treated as common.

9           So if we just turn that up. {E/7/33}. Here we see,  
10          so this is Mr Duckworth talking about Dr Jenkins'  
11          approach. If we go to 5.15. If we just blow that up so  
12          we can read it more easily:

13          "Implicit in this statement is that Dr Jenkins  
14          assumes that the costs she identifies as fixed (i.e. not  
15          incremental) are common to all products ... she does not  
16          consider the existence of fixed costs within BT Consumer  
17          which are not common to BT SFV services. Examples of  
18          these costs will include:

19          "Product development costs which relate to the  
20          provision of broadband services, television services  
21          ..."

22          And so on.

23          She is effectively just taking those out.

24          MR RIDYARD: Sorry, I think you have just misunderstood this  
25          evidence.

1 MR BEARD: Sorry?

2 MR RIDYARD: You have just misunderstood this point.

3 MR BEARD: No, I put it wrongly to begin with.

4 MR RIDYARD: No, sorry, Mr Beard, but this is not helping  
5 you because Mr Duckworth here is saying these are things  
6 which are common between various bits of BT Consumer but  
7 not SFV services.

8 MR BEARD: Yes, he is. He is, but they are being taken  
9 out --

10 MR RIDYARD: So he is saying these would not be common  
11 costs.

12 MR BEARD: I understand. I misspoke when I referred to 5.15  
13 initially but the point I am making is actually that  
14 Dr Jenkins has taken these out. They are not common  
15 costs in her analysis, the development costs that we are  
16 referring to here.

17 MR RIDYARD: She agrees with Mr Duckworth here.

18 MR BEARD: She is effectively concurring with ... So  
19 I accept that I misspoke, but the point is still valid.  
20 The point is that Dr Jenkins is actually taking out  
21 material that should not be treated as common through  
22 her assessment and actually it is consistent with  
23 Mr Duckworth and I was being unfair when I first  
24 referred to it.  
25 In any event, you see there is an explanation there

1 because she is saying, well, I will expect R&D  
2 development costs to be related to particular products.

3 Then you see that she works her way through all of  
4 the various cost heads giving these ratings and giving  
5 these reasons.

6 Then there is a further table at A7.3 that deals  
7 with the SG&A costs during the 2019 through to 2022  
8 period. I think it is separated out because of the  
9 different labelling and because of the confidentiality  
10 but the same exercise is undertaken. That is at  
11 {E/25/115}. No, it is the next page. {E/25/116},  
12 I apologise.

13 So that is the same approach to analysis then being  
14 carried out and you can see just on that page that in  
15 relation to general marketing the heading is low but  
16 where group brand is identified that would be a high  
17 categorisation of common costs because it is dealing  
18 with brand more generally.

19 Then if we go on two pages, {E/25/118}, you see the  
20 heading at the bottom there is -- she moves on to deal  
21 with the D&A costs. She works her way through, if we go  
22 over the page, a similar exercise in relation to the D&A  
23 costs. {E/25/119}.

24 So if we then go on to page {E/25/122} you then see  
25 the results of this exercise whereby she carries out the

1 calculation using those assessments in order to consider  
2 whether within selling, general, administration D&A that  
3 you have got a certain proportion of the SG&A costs that  
4 would be deemed to be common costs using the assessments  
5 that she has reasoned through in relation to the  
6 categories and then with the three sensitives, baseline,  
7 low and high. She has done that through SG&A and D&A.

8 Then over the page, {E/25/123}, there is the  
9 combination of the two.

10 THE CHAIRMAN: Yes.

11 MR BEARD: So what Dr Jenkins did was she took the cohort of  
12 data and actually carried out a qualitative analysis in  
13 order to come up with the figures that she did. It was  
14 not some kind of arbitrary assessment. It was using the  
15 disclosed data in order to do these things. It  
16 obviously involved judgment but she provided the reasons  
17 for her judgments in relation to all of these issues  
18 and, as we say, had taken into account the way in which  
19 Ofcom had looked at the different cost categories in  
20 terms of its categorisation.

21 If we just go to IR-E/18-- sorry, I should go to  
22 {F/783/174} first of all. Because not only did  
23 Dr Jenkins carry out this exercise in order to make an  
24 assessment of what within those categories that you  
25 might start off thinking were common costs should be

1 allocated as common costs and then quantify them, she  
2 then went and carried out a cross-check by reference to  
3 what is referred to as technology service and operations  
4 which is the TSO costs.

5 So there is confidential material here but if we  
6 just pick it up at the top of the page:

7 "TSO can be thought of as the 'back office of BT'  
8 which provides support and services to all the 'market  
9 facing units'..."BT has provided the following list of  
10 responsibilities ..."

11 So it is a wide-ranging common back office function.

12 You see down at 6.200:

13 "There are three broad categories of TSO costs ...

14 "Direct: these include volume-based trades-specific  
15 contracts.

16 "Indirect: these are set at the start of the year  
17 and costs are recovered from the [market facing units]  
18 based on best known cost drivers.

19 "Fixed: these are costs that cannot be directly or  
20 indirectly attributed to a [market facing unit] and are  
21 mainly related to BT wide activities or in support of  
22 TSO activities. They include accommodation and energy  
23 and TSO overheads."

24 So she is then looking at what Ofcom actually put in  
25 that fixed category, so she took the TSO that is

1 described here, leaving aside the direct and indirect.  
2 She is looking at the fixed category.

3 If we go to annex 3 of Dr Jenkins' second report, so  
4 that is {IR-E/18/242}. There she describes how it was  
5 that the TSO material was categorised by Ofcom in VULA.

6 You see at A3.3:

7 "Data supplied by BT during Ofcom's VULA margin  
8 investigation shows that approximately 75% of all TSO  
9 costs can be classified as TSO fixed ... applying [this  
10 figure] to the cost categories identified above, and  
11 assuming that no other SG&A or D&A contains common costs  
12 ..."

13 So it is offering a very, very conservative  
14 approach. It is saying: I am just taking this TSO  
15 subset. I am taking the approach that Ofcom adopted in  
16 relation to fixed costs and looking at what those are,  
17 and these are subsets of the SG&A and D&A costs. I am  
18 not attributing any other common costs, and then I am  
19 testing what that comes out of -- out at.

20 If we go over to page {IR-E/18/243}, this is where  
21 you see the calculations she has carried out using the  
22 TSO fixed costs. What this shows is that actually  
23 taking those very conservative estimates, so assuming  
24 there are no other common costs but the TSO fixed costs,  
25 you actually come out very close to the low sensitivity



1 in her overall allocation approach that we have just  
2 seen in Annex A7.

3 In other words, she has taken the source of the  
4 Ofcom material and the data, 75% of the TSO costs,  
5 looked at it and said, look, this looks like my low  
6 estimate; and since that was the conservative approach  
7 in the TSO it makes sense, as a cross-check, for her low  
8 sensitivity.

9 What it might well do is suggest that actually the  
10 baseline or higher is the actual common cost because the  
11 TSO approach is so conservative. But what it does do is  
12 it vindicates the idea that Dr Jenkins' approach is not  
13 being arbitrary in the way that she is looking at common  
14 costs. It is providing reinforcement with the idea that  
15 there are substantial common costs here. This is  
16 against, as I say, an assertion that there are not  
17 common costs.

18 Now, there are a couple of criticisms that have been  
19 levelled at this TSO cross-check.

20 THE CHAIRMAN: Before we get there, I think we just need to  
21 take a break.

22 MR BEARD: Sorry.

23 THE CHAIRMAN: That is fine.

24 (11.45 am)

25 (A short break)

1 (12.04 pm)

2 THE CHAIRMAN: Yes.

3 MR BEARD: So without apology, I was working through the  
4 Annex 7 and Annex 3 material slowly. Because going back  
5 to the point Mr Ridyard raised, obviously one of the  
6 challenges is if there are no common costs why are we  
7 agonising about any of this? The analysis clearly shows  
8 there are common costs, and that cross-checks involving  
9 the TSO are emphatic support for that.

10 I took you to the VULA material, and just for your  
11 reference, in another matter involving superfast  
12 broadband, just for your notes, this is at {C/343/179}  
13 is where the section starts, and the paragraph is A2.75  
14 on page 194 -- A2.17, I am so sorry, on 179, and  
15 paragraph 2.75. I am sorry, this is in another Ofcom  
16 report. The only reason I am taking you to it is  
17 because it confirms again TSO as fixed costs.

18 THE CHAIRMAN: Yes.

19 MR BEARD: I am sorry, the scale of TSO fixed. Ms Love  
20 absolutely correctly corrects me. So that is A2.17.

21 Then if you go down to page {C/343/194}, at A2.75  
22 you will see, if we go down the page -- down to the  
23 bottom and then over the page {C/343/195}, this is  
24 confirming the TSO fixed costs.

25 MR RIDYARD: It does not say anything about them being

1 common costs, does it? Or does it?

2 MR BEARD: "... unable to identify a direct or indirect cost  
3 driver within a specific MFU ..."

4 If you go back up to A2.17, so that is {C/343/179},  
5 do you see there:

6 "We therefore consider that most of the shared costs  
7 which BT identifies as directly or indirectly  
8 attributable to BT Consumer will be ...The main category  
9 of costs which we have treated as 'fixed and common' are  
10 those which would be expected to remain invariant if BT  
11 were no longer to have the BT Consumer business."

12 Then the analysis continues, and that part I have  
13 taken you to is talking about the TSO within that  
14 categorisation. You are completely right that A2.75  
15 itself does not say in terms fixed and common. To some  
16 extent, this is an additional reinforcement in relation  
17 to the cross-check that has been undertaken.

18 So the point is that Mr Duckworth and Mr Parker had  
19 all this data and made no attempt at all to look at any  
20 of this categorisation. It is obvious that you could  
21 make sensible assumptions. There may be a range of  
22 reasonable assumptions and assessments you can make in  
23 relation to these matters, but saying there are no or no  
24 material common costs is not one you can do on the face  
25 of that material. That is reinforced by the

1 conservative TSO cross-check that has been carried out.

2 As I say, there are a couple of criticisms of that  
3 TSO cross-check that were levelled. The first was that  
4 somehow it contradicted Mr Cackett's evidence. This,  
5 I have to say, I found quite difficult, because  
6 Mr Cackett accepted that, for instance, if you  
7 introduced BT Sport into a suite of products offered by  
8 BT Consumer, that would require additional head office  
9 staff to manage, so those staff would be incremental.  
10 No issue about that.

11 He did not accept that all head office costs varied.  
12 He did not say anything about the proportion of head  
13 office costs that are incremental, in fact he was not  
14 asked about that. In fact, what he made clear was that  
15 there are common costs.

16 If we could go to {Day8/176:1} of the transcript.  
17 If we could just go up -- I am sorry, back to  
18 {Day8/175:17}.

19 So this is the discussion of marketing that Mr Spitz  
20 was putting and it says:

21 "Question: So you have an advertising campaign that  
22 is devoted towards promoting BT Sport and you say the  
23 cost of that advertising campaign is a common cost with  
24 SFV services --

25 "Answer: I think it certainly can be, yes.

1           "Question: You would say that is because of the  
2 halo effect?

3           "Answer: Absolutely.

4           So any advertising that is related to BT is a common  
5 cost with SFV services that is your evidence?

6           "Answer: Yes, but I think to different extents,  
7 right? I think there are some things that you think of  
8 are sort of more direct and some things that are more  
9 common, but I think, in general, I think advertising is  
10 something that is in service of the entire base, and  
11 whilst we are talking about different things at  
12 different times of year, it is really about creating  
13 a sort of brand feeling across BT as a brand, rather  
14 than, you know, just specifically for the product that  
15 it can talk about."

16           Just pausing there. That is direct evidence under  
17 cross-examination about there being common costs in  
18 relation to marketing and advertising, yet this is being  
19 dismissed. There is not a proper basis for that. What  
20 we saw in relation to Dr Jenkins' approach was not that  
21 she had put marketing and advertising as having a high  
22 component of common costs, she was putting it down at  
23 medium and low levels.

24           "Question: Let us talk briefly about product  
25 management. There will be costs directed towards

1 dealing with management of particular products, would  
2 there not, such as provision of television?

3 "Answer: Mm-hm.

4 "Question: There would be costs directed towards  
5 dealing with the management of broadband access, would  
6 there not?

7 "Answer: Mm-hm.

8 "Question: These costs are not common to all  
9 products and services, are they?

10 "Answer: I think generically product management is  
11 a common cost albeit there will be components that  
12 relate to TV, Voice, etc, etc.

13 "Question: Well, yes, if it is a question of  
14 labels, if it is the definition, management costs, at  
15 that level, perhaps. But at the disaggregated level of  
16 the management of the provision of television, your  
17 evidence is that that is a cost for SFV services, is it?

18 "Answer: No, no, I am saying product management,  
19 which was the category of job that you just referenced,  
20 is a common cost, and there are people who do product  
21 management across a variety of products. Clearly people  
22 who are TV product managers is not a common cost with  
23 SFV, but clearly there will be people who, in terms of  
24 fixed line services, who will be a common cost for SFV."

25 Again, it is suggesting clearly there are common

1 costs in relation to management, and I go back to  
2 Dr Jenkins' analysis. She was not saying that in  
3 relation to labour costs it is a high component of  
4 common costs. She actually set it as low.

5 "Question: If you then turn to paragraph 30 of your  
6 witness statement again {D/6/7}, you say there:

7 "'These indirect costs are recorded at Consumer  
8 level as they are not directly attributable to any  
9 particular division or type of product and are common to  
10 all products and services.'

11 "That is what you say. I want to suggest to you  
12 that the suggestion in this sentence in your statement,  
13 namely that indirect costs are common to all products  
14 and services, is not as precisely expressed as it could  
15 have been, yes?

16 "Answer: I mean, I think -- in general I think  
17 there are common costs that do not relate to one  
18 particular product, but of course there will be  
19 individuals within that who do relate to those things.

20 "Question: Because what you intended to convey here  
21 is simply that there are indirect costs relating to all  
22 products, not that every single cost incurred is common  
23 to all products, correct?

24 "Answer: Yes.

25 "Question: That is why I suggested to you that your

1 statement in your witness statement was not as clearly  
2 expressed as it might have been. That is what you  
3 intended to convey, what I have just suggested?

4 "Answer: I mean, I intended to convey, for example,  
5 that the cost of the finance team is a common cost, that  
6 the cost of product management is a common cost, and,  
7 you know, we can allocate them how we like, but roughly  
8 it is a common cost. That is what I was intending to  
9 convey and that is what I believe to be true."

10 So you have direct testimony saying there are -- but  
11 there are common costs in relation to a series of  
12 important categories of activity.

13 As it is, the assessments taken by Dr Jenkins in  
14 relation to those categories of activity that we saw in  
15 the table are actually more conservative in many ways  
16 than the assertions made by Mr Cackett under  
17 cross-examination.

18 But what this means is that the idea that the Class  
19 Representative can come along and say, there is not any  
20 basis for suggesting that there are any material common  
21 costs here, is just unfounded on the evidence. It is  
22 unfounded.

23 The only other criticism that was levelled was by  
24 reference to a document, {F/505/1}, where Ms Kreisberger  
25 asserted that this document records that BT applied



1 a significant downweighting for TSO costs in relation to  
2 SFV services of 20%.

3 Now, the reference she has I think is at page 18.  
4 I have lost the page reference, I apologise. Page  
5 {F/505/8}.

6 So you will recall this. This was a document that  
7 had been picked up by Ms Blight during the course of her  
8 evidence and it was in fact shown to Mr Cackett in  
9 re-examination. He was not cross-examined on it. It  
10 was shown in re-examination because he, as you recall,  
11 said, "I think Ms Blight indicated an example of unit  
12 economics".

13 As I understand it, what is being suggested is that  
14 there is a line in there under "SG&A", further down,  
15 which is "TSO Direct, Indirect and Fixed Costs", and  
16 there is an allocation of TSO direct and indirect costs  
17 that is falling across time and somehow that is to be  
18 taken as a downweighting for SFV services that is not  
19 consistent with this cross-check.

20 I mean, as soon as one begins to articulate this you  
21 see it is just a hopeless point. It was not  
22 cross-examined on. It is not clear what is going on in  
23 relation to that line at all. What it does not do is  
24 provide any substantive criticism of the approach  
25 adopted by Dr Jenkins to take TSO fixed costs which have

1           been identified by Ofcom as fixed and use them as the  
2           cross-check to see whether or not there were substantial  
3           common costs here in this business. There is just  
4           nothing there.

5           As we will come on to, Mr Duckworth was very ready  
6           to grab figures in relation to cost transformations and  
7           so on, but it is remarkable that he was not willing to  
8           engage in any data analysis in relation to any common  
9           cost assessment on the basis of this vast disclosure  
10          exercise that the Class Representative itself insisted  
11          on.

12          Of course, what we actually heard in written  
13          evidence and in the hot tub was those references to SSE  
14          and the Post Office as supposedly evidence of a lack of  
15          common costs, but those were completely hopeless as  
16          offering some kind of basis for saying there are not  
17          substantial common costs when set against the assessment  
18          that has actually been undertaken on the basis of the  
19          data, the financial data has been disclosed.

20          First of all, it was very striking so much weight  
21          was being placed on these documents from SSE and the  
22          Post Office, albeit that there appears to have been no  
23          attempt to investigate with the third parties how they  
24          had actually compiled those documents, let alone having  
25          evidence from them whereby we could actually interrogate

1           how they carried out the analysis there. To be fair to  
2           Mr Duckworth, he accepted that he did not understand  
3           what was going on in these tables. He accepted that he  
4           had misunderstood, when he gave his evidence initially,  
5           how the various cost categories, for instance, the  
6           Post Office had put forward, how they were actually  
7           calculated. He said "I admit I am not completely  
8           certain on how the Post Office has labelled costs here".

9           More particularly, given the nature of these  
10          businesses, the Post Office obviously having  
11          a significant Post Office network infrastructure, and  
12          SSE having an energy infrastructure, what we had no idea  
13          about is the extent to which those figures were in fact  
14          recharged allocations of common costs to these  
15          particular parts of the businesses. We just do not know  
16          that. Mr Duckworth fairly did not assert that he knew  
17          that. But the problem then is it is not telling you  
18          anything as a comparator, and more than that, trying to  
19          look at other businesses and say, well, that tells you  
20          that you cannot have common costs here, because these  
21          businesses' total costs are much lower. That does not  
22          actually tell you anything about whether or not BT has  
23          common costs given the structure of its business.

24         MR RIDYARD: It might do, might it not? I take your point  
25          about SSE and the Post Office, I mean, those are

1           complicated. But for the ... I cannot remember the name  
2           of the small standalone telecom company.

3       MR BEARD: Phone Co-op. Yes, I will come to that.

4       MR RIDYARD: Okay.

5       MR BEARD: Obviously Phone Co-op was not relied upon by  
6           Mr Duckworth or Mr Parker as being important in the  
7           hot tub, but it became very important in oral closings.  
8           There were not references to SSE and the Post Office.  
9           Ms Kreisberger has moved away from those two examples to  
10          the Phone Co-op. It was cited by Mr Duckworth in his  
11          report in relation to EBIT margins, in fact. It was not  
12          cited in relation to any of these cost issues.

13                 She took us to it on Tuesday for the first time, so,  
14                 again, it is somewhat unfortunate we are going there in  
15                 closing. We went to their Section 135 response to  
16                 Ofcom, so again we have got this problem that they put  
17                 in this material and we have got no proper opportunity  
18                 to interrogate it.

19                 The submission on Day 25 was: if the Phone Co-op  
20                 could operate and compete at this scale, it shows that  
21                 Dr Jenkins' allocations of large amounts of fixed and  
22                 common costs are not plausible. But I have already  
23                 dealt with how the assertions of 400 million and  
24                 700 million and so on, they are just not actually what  
25                 we are seeing in Dr Jenkins' table. They are all

1           hyperbole.

2           MR RIDYARD:  Sorry, can you remind me, how much common cost  
3           is there in money terms?

4           MR BEARD:  Well, if we go to Annex 3 to the closings we have  
5           obviously got those figures that I took you to at the  
6           outset.  So this is {A/16/254}.

7           MR RIDYARD:  We had those percentages, the 6-10% --

8           MR BEARD:  Yes, I am sorry, the numbers are above as well.

9           MR RIDYARD:  Right, yes.

10          MR BEARD:  Apologies, I was focusing -- but yes is the  
11          answer.

12          MR RIDYARD:  They are still big numbers.  I mean ...

13          MR BEARD:  Sorry, it is 255, apologies.  {A/16/255}.

14          MR RIDYARD:  Yes, the test though or the challenge is if  
15          these are truly common costs then they need to be  
16          incurred by BT even if it was just a standalone SFV  
17          provider.

18          MR BEARD:  Yes.

19          MR RIDYARD:  So I think the claim from the CRs, I think it  
20          is worth just exploring it.

21          MR BEARD:  Yes, sure.

22          MR RIDYARD:  If that is true that you need to incur those  
23          costs just in order to have an SFV business, how do you  
24          explain the existence of a much smaller operator who is  
25          also standalone, who is literally a standalone SFV -- or

1 not -- a standalone voice, a telecom provider, retailer,  
2 how do you explain their costs are so much smaller?

3 MR BEARD: I think the key here may be if the Phone Co-op  
4 could operate and compete at this scale. Because if we  
5 actually go to {IR-C/139/1} and just look at the bottom  
6 right-hand corner.

7 MR RIDYARD: Yes. Obviously it is much smaller, yes.

8 MR BEARD: It is much smaller and it did not exist for very  
9 long.

10 MR RIDYARD: Yes.

11 MR BEARD: So it is interesting what conceptually "operate  
12 and compete at this scale" means. "At this scale" is  
13 minuscule and "could operate" is profoundly transient.

14 The suggestion is that you needed to have all of  
15 these common costs even to open the door to the  
16 business. We do not know anything about what  
17 Phone Co-op did or tried to do here, but you cannot --  
18 on the basis of someone coming along with an absolutely  
19 tiny number of standalone fixed voice, where actually it  
20 looks like what they were focusing on was broadband,  
21 what they were actually doing, how they were doing it  
22 and whether there is any relevant comparator here at  
23 all.

24 So I mean, this is exactly the same sort of problem  
25 that we end up with in relation to how do you account

1 for comparisons between entirely different businesses?  
2 We just do not know what Phone Co-op was doing here but  
3 whatever it was it did not work.

4 It is just worth picking up, in our closings, so  
5 {A/16/124}, paragraph 501 at the top of the page. There  
6 is just a quote from Mr Matthew. (Pause).

7 So throwing this -- the two that were actually  
8 relied upon, having collapsed because the data was  
9 utterly hopeless, in closing this minnow is then thrown  
10 out as being somehow probative. It does not take the  
11 Class Representative anywhere in the face of the clear,  
12 transparent, systematic approach that has been adopted  
13 to the available financial data.

14 As I say, it is not that Dr Jenkins is just  
15 obsessing with: it has to be the high level. She has  
16 carried out sensitivities, she has explained how she has  
17 done these things, and she has done it by reference to  
18 what has also been done by Ofcom. To turn around and  
19 say: you can just forget about all of that and just  
20 assume there is nothing here, that is not proof of zero  
21 common costs. Therefore, it is far away from saying  
22 that one could ignore all the problems of allocation of  
23 common costs and the problems of flexibility that you  
24 end up with in a FAC mechanism, and that is including in  
25 relation to the situation that we will come on to in

1 relation to other aspects of the problems with the 2009  
2 RFS entirely.

3 But I think we started the discussion today with the  
4 distinction between direct, incremental and common. The  
5 question was posed: is there evidence of common costs?  
6 Actually the question is: has the Class Representative  
7 shown that there are not material common costs? They  
8 have not done that, and actually Dr Jenkins' analysis  
9 shows that there are, and that is reinforced by the  
10 factual evidence provided by Mr Cackett. He does not  
11 cut across it at all.

12 Just for your notes, in case you are further  
13 interested in the Phone Co-op, Ms Love very helpfully  
14 indicates that {IR-C/142.1/1}, there is other material  
15 that was submitted by the Phone Co-op to Ofcom  
16 showing -- it is neatly illustrated on that first page,  
17 the market shares of Phone Co-op that has just popped  
18 up. That is not a mistake. You will not find them on  
19 there. You can scroll down and [redacted].

20 I apologise, I think that may be need to be excised  
21 from the transcript.

22 So there are -- there is good evidence of  
23 substantial common costs, and in those circumstances all  
24 the points I was making about the problems of FAC  
25 methodology are substantial, and they actually exist in



1 relation to any FAC methodology.

2 Sir, I recognise that there was an exchange about  
3 the possibility of an up to date FAC methodology, and  
4 I just wanted to go back to that. There was an exchange  
5 with Dr Jenkins. You asked a question about it, if you  
6 recall. I just wanted to go back to that, if I may.

7 It is {Day14/31:19}. So this is, sir, you asking  
8 one more thing while we are on the subject of the RFS.

9 Then if we go over the page, {Day14/32:1}, you will  
10 see the question you asked and then Dr Jenkins' answer.

11 (Pause)

12 Did you see what she was saying was "a relevant  
13 piece of information", yes, and then Dr Jenkins further.

14 THE CHAIRMAN: Yes.

15 MR BEARD: If we go over the page again, {Day14/33:1}.

16 THE CHAIRMAN: Yes, I was thinking of the bit in the middle  
17 there, that is right.

18 MR BEARD: I just think it is important to put it in  
19 context, if I may. Because Dr Jenkins was not saying  
20 suddenly an up-to-date FAC is the answer, she was  
21 saying: I would consider it if I had the actual costs  
22 information.

23 Mr Matthew then intervenes at the bottom of the  
24 page, and if we could just skip on to page {Day14/37:1}.

25 THE CHAIRMAN: Sorry ...

1 MR BEARD: Sorry, back to 33 again. {Day14/33:1}

2 THE CHAIRMAN: I think the bit that I was in particular  
3 recalling was the end there that said:

4 "THE CHAIRMAN: ... nuances here ... there may still  
5 be other things that you would look at, but your real  
6 objection to the 2009 [RFS] as a building [block] is  
7 effectively it is out of date."

8 That is what I was thinking of.

9 MR BEARD: Yes, that is what we anticipated, and Mr Matthew  
10 then comes in.

11 If we could just then go on to page {Day14/37:1},  
12 because I think it is important, I was just going to add  
13 after Mr Matthew's interjection, you see at line 12?

14 THE CHAIRMAN: Yes.

15 MR BEARD: So I completely understand what you were saying,  
16 sir, but I think there is a danger that because of the  
17 way Mr Matthew intervened as Dr Jenkins was saying:

18 "That is ..."

19 Actually that the answer got spread across several  
20 pages.

21 THE CHAIRMAN: Yes, yes.

22 MR BEARD: I just thought it was important.

23 THE CHAIRMAN: No, no, thank you for reminding me of that.

24 Thank you.

25 MR BEARD: Before I go on to deal with -- so one of the

1 central propositions was: had the Class Representative  
2 made out negligible common costs? The answer is no.  
3 That effectively I think disposes of the position on  
4 their reliance on 2009 RFS.

5 I am going to come back to some further problems  
6 with the 2009 RFS in just a moment. But before I do,  
7 I wondered whether it was sensible to go back to the  
8 four questions that Mr Ridyard asked, because although  
9 they are not on common costs as calculated in that  
10 exercise, I think they raised other issues on common  
11 costs in relation to economies of scope and scale and  
12 so on, so I thought it was perhaps just sensible to pick  
13 them up at this point.

14 I have got notes of the questions so I hope I am  
15 capturing these correctly. The first was: do these  
16 economies of scope, so this is scope economies between  
17 bundles and SFV, arise from common costs between supply,  
18 voice and broadband to the same customer? The answer to  
19 that is yes. The fact that they are direct synergies  
20 does not change how you characterise these things.

21 We actually touched on it in paragraph 516 and  
22 explained the position in more detail at  
23 paragraph 640-646 in our closing submissions, and the  
24 reference for that is {A/16/159}.

25 Indeed, when I was going back at the outset

1           yesterday to the general history, I think it was one of  
2           the things we picked up right at the outset, about how  
3           synergies were driving the way the market worked.  
4           Obviously those synergies in relation to the particular  
5           pipe are not the only synergies, you can provide  
6           multiple products over that single wholesale input, and  
7           obviously the issue goes beyond direct costs as well in  
8           relation to this, but the question was in relation to  
9           that.

10          MR RIDYARD: The direct costs are quite big, are they not?

11           They are -- you know, the direct cost is, I do not know  
12           whether it is £7 or £8 a month, £80-odd a year, so they  
13           are quite ... If there were important synergies there  
14           then this could be quite a big part of the story.

15           It seemed a bit unexplained why you have not made  
16           more of this point and I would like to understand that  
17           really.

18          MR BEARD: Why we have not made more --

19          MR RIDYARD: Yes.

20          MR BEARD: -- of the fact that the ... Well, maybe it is  
21           a failure on the part of our presentation, but I think  
22           our account has been that you do need to look at the  
23           market across both elements because obviously you do  
24           have those synergies, that is what we were highlighting  
25           in our history, and those synergies drive in part the

1 way in which particularly our competitors set the prices  
2 in relation to the way in which the market works, and,  
3 as Dr Jenkins explained, it is thinking about the  
4 interaction between bundles and SFV in that broader  
5 market, taking into account how our competitors are  
6 dealing with these things, that is important.

7 The reason I emphasise our competitors is because of  
8 course we were buying two separate items, and so it is  
9 not that we are saying that we specifically had that  
10 synergy that you are identifying. There were perhaps  
11 other synergies there, but we did not have that same  
12 synergy. But that then drives price in the shape of the  
13 way in which competitive interactions occur in relation  
14 to the market.

15 Of course that is precisely why, when you are  
16 thinking about the pricing, you do think about  
17 the pricing of the line rental and this component in  
18 relation to which there are synergies in the same way  
19 across SFV and broadband, and then you are thinking  
20 about the increments in relation to the price that is  
21 being set by competitors in relation to these issues.

22 That is all part of the story that is being put  
23 forward here and it goes to the market definition  
24 account.

25 Now, in relation to limb 1, if the question is

1           should we be treating those as common costs and  
2           identifying those as common costs such that in these  
3           circumstances you would then say, well, those common  
4           costs are ones that have to be allocated and, in those  
5           circumstances, that is another component further, beyond  
6           the sorts of common costs that we are identifying in  
7           relation to SG&A and D&A.

8           I think the reason that we do not necessarily think  
9           in those terms is because we have to take two, or have  
10          had to take two products in relation to these. So for  
11          us to --

12         MR RIDYARD: You are saying BT does not enjoy that synergy  
13          even if TalkTalk does?

14         MR BEARD: It does not enjoy that particular synergy because  
15          it has not taken the LLU product, it has always taken  
16          the two products. I think that was common ground, that  
17          it has taken two products.

18          So BT cannot say we get that simple synergy, but  
19          what we do say is that because of the way that our  
20          competitors take those synergies, that shapes the way in  
21          which the market operates and we have to operate in that  
22          market. When I say "market", I mean unashamedly  
23          covering voice and broadband here, because that is what  
24          is going on.

25         MR RIDYARD: Well, it is the bundle -- that is a comment

1           about the bundle market, is it not?

2       MR BEARD:   Yes, it is.

3       MR RIDYARD:  They started bundling before BT did.

4       MR BEARD:  Yes, they did.  Absolutely.  That is the reason

5           why I think technically why we could not put forward

6           that as a specific common cost because it would not be

7           right for us to treat it as such.

8       MR RIDYARD:  I see.

9       MR BEARD:  So if our story is failing in relation to the

10           broader story, I am sorry, but we have been attempting

11           to explain, and Dr Jenkins has attempted to explain, how

12           it is that one has to think about the broader dynamics

13           of the market, including the way in which competitors

14           with those synergy benefits operate and essentially can

15           take our customers price.

16       MR RIDYARD:  Your bundle customers from you.  How does any

17           of that affect the voice only contracts?

18       MR BEARD:  Sorry?

19       MR RIDYARD:  How does it affect the voice only contracts?

20       MR BEARD:  In terms of the pricing of voice only contracts?

21       MR RIDYARD:  Yes.

22       MR BEARD:  Well, I do not think -- we are not saying that

23           the price that is set by competitors for bundles has

24           some sort of direct one-to-one impact on the way in

25           which (inaudible) works.  We have never said that.  This

1 was the bundle pricing fallacy, supposedly. We have  
2 never done that. What we say is that obviously, as the  
3 evidence showed, when carrying out our strategy in  
4 relation to ensuring that we did not lose customers,  
5 what we wanted to make sure was that we had a small  
6 increment moving from line rental to bundle, and at the  
7 same time that we were able effectively to recover all  
8 of the relevant costs in relation to the services that  
9 we were providing.

10 Those were the factors that we were taking into  
11 account when we were setting our prices, both for line  
12 rental and calls, because all of the evidence was we set  
13 line rentals across voice and we set calls across voice  
14 and that is the overall strategy we are following.

15 So what our competitors are doing in relation to  
16 bundles which include a voice component affects the way  
17 in which we then have to set our strategy across all of  
18 that. So it is because of the concern in relation to  
19 the switching to -- SFV switching to bundles and those  
20 prices affecting the overall story. I mean, there is  
21 nothing different there. What these synergies tell you  
22 is essentially how competitors are positioning  
23 themselves, which is what we have to face, and how we  
24 have to take that into account in our pricing in  
25 relation to all of this.



1           The second question was actually about observed  
2 bundle discounts in the market. Does it reflect the  
3 importance and size of those synergies? The answer to  
4 that is yes, and it goes back to the points I was just  
5 making, that effectively those synergies, we are seeing  
6 that pricing structure from those that provide bundles  
7 using -- effectively using LLU rather than WLR.

8 MR RIDYARD: Right, but just to explore that a little bit.

9           In the CR's very helpful response to my questions they  
10 make the point that there is -- I think they accept  
11 there is a synergy here, it is less costly to supply  
12 voice and broadband together than to supply voice and  
13 broadband separately, but they say the price premium  
14 that we observe in applying the two elements standalone  
15 is more than the cost disadvantage.

16           So there is a cost reflective and valid, if you  
17 like, bundle discount, but then there is a further fee  
18 for voice prices -- well, just the fact the voice  
19 margins are much higher than the bundle margins  
20 indicates there is also some demand-based price  
21 discrimination going on.

22           So the gap you see between the bundle and the  
23 standalone options is partly because it is just less  
24 efficient to supply the two separately. That is  
25 the synergy point.

1 MR BEARD: Yes.

2 MR RIDYARD: There is an additional factor which is, in  
3 their case, the market power factor, which is the  
4 premium, the extra margin over and above the efficiency  
5 disadvantage, as it were, of supplying the individual  
6 products.

7 MR BEARD: Sorry, this is in relation to question 2, and  
8 this is taking account all synergies or just the direct  
9 synergies? Because obviously you will have other  
10 synergies that will apply in relation to this.

11 MR RIDYARD: Possibly, yes.

12 MR BEARD: So I think it is dangerous just to be taking a  
13 single synergy. Obviously I am not deprecating the  
14 identification of it --

15 MR RIDYARD: That is fair.

16 MR BEARD: -- but I do not think you can move from one to  
17 the other. The fact that there is a difference there  
18 means you have to carry out a more significant analysis.

19 So the question you pose is obviously valid, but the  
20 idea that you then see some sort of gap, and you  
21 contribute all the gap to some sort of market power  
22 without exploring what else might be going on there  
23 is -- again, it is presuming the conclusion, and you  
24 would have to look at a whole range of factors that  
25 concern other synergies, and the way in which strategy

1 was operating in relation to those synergies, before you  
2 could reach any conclusion in relation to it. Again, it  
3 is grabbing at a number and trying to reach a conclusion  
4 from it.

5 So I am not sure, with respect, actually how helpful  
6 that is, because I think you have got to tell a broader  
7 story in relation to these things.

8 It seems we are into telling a broader story; we are  
9 back into the discussions we were having about costs  
10 more generally --

11 MR RIDYARD: Yes.

12 MR BEARD: -- and there is just a danger that although we  
13 are focusing on this particular cost item, actually we  
14 are immediately losing sight of others at that point.

15 So I am not sure you can read what they are trying  
16 to read into it in relation to question 2. But  
17 obviously we are not suggesting that the synergies that  
18 you are referring to do not have an impact on the way in  
19 which pricing operates. I think I have made clear that  
20 we do.

21 The third question was whether the incentive to  
22 price in this way, to have pricing structure that  
23 incentivised customers to take up bundles was the same  
24 for all retailers who provide voice and broadband and if  
25 so it reflected cost efficiencies and whether that is

1 a matter of concern in relation to excessive pricing.

2 To some extent I have already answered that question  
3 in the account I gave in relation to the points on the  
4 first question. So obviously yes, is the answer, it  
5 does change the way in which pricing is going to operate  
6 in relation to this market.

7 MR RIDYARD: I think you suggested that BT got less out of  
8 this synergy than other people because of the way it  
9 bought --

10 MR BEARD: Yes, BT does but I was trying to be fair, it  
11 does -- BT -- your question was why did we not make more  
12 of it? It is because we were buying two separate  
13 products and therefore you cannot tell that same story.  
14 The question is does that have an impact on the way in  
15 which the market pricing works and the way in which  
16 incentives work, and the answer to that is absolutely  
17 yes, because of the way the competitors are pricing  
18 because they can benefit from these synergies. So that  
19 is how it works in relation to this.

20 I mean, we know that BT was still trying to compete  
21 for customers both for SFV customers, and it did  
22 actually succeed in bringing in SFV customers, but more  
23 particularly bundle customers. It was not just  
24 a question of ensuring it got recapture from its own  
25 customer base. It wanted to do other things and

1           therefore it is going to have to be cognisant of  
2           the pricing that is out there from its rivals and  
3           therefore that has a significant impact on the way in  
4           which all of this works. I suppose you can talk about  
5           that as an indirect effect of those synergies rather  
6           than us being able to rely on them directly.

7           The fourth question is: are these synergies any less  
8           important if they arise from direct costs? Obviously  
9           no, it does not make any difference for these purposes.  
10          We have explained. We understand how those work and the  
11          fact that they arise from direct costs does not stop  
12          them being common costs in synergies for these purposes.  
13          Indeed all businesses will try and explore synergies.  
14          I think at one point we saw some evidence about how BT  
15          positively tries to identify synergies that it can, but  
16          it cannot always do that.

17       MR RIDYARD: Thanks.

18       MR BEARD: So with that, I am going to move on to some of  
19          the further problems with the 2009 RFS, so this is aside  
20          from the common costs issue that we have spent some time  
21          on this morning. I am just highlighting some of the key  
22          points about why it is there are significant changes in  
23          the overall position between 2009 and 2015 and indeed  
24          2023.

25          The first of these we have already highlighted in

1           our -- on a number of occasions and we pick it up at  
2           {A/16/125} in our closings.

3           THE CHAIRMAN: Which paragraph, please?

4           MR BEARD: 509/510.

5           THE CHAIRMAN: Yes.

6           MR BEARD: So this is about -- we have just been talking  
7           about economies of scope. We are now talking to some  
8           extent about economies of scale. So we are talking  
9           about the huge shift in numbers overall of residential  
10          fixed voice lines from 2009 when there were almost  
11          14.5 million to 9.5 million and falling. So that is  
12          a vast change. So obviously Ms Kreisberger's first  
13          point is, well, that does not matter because there are  
14          not any fixed and common costs here, everything is  
15          incremental or direct. We say well, no, actually for  
16          the reasons we have already given, that is fundamentally  
17          wrong.

18          THE CHAIRMAN: I was going to ask you about this. If you  
19          can just run through the argument here in 509.

20          MR BEARD: The argument in 509 is effectively that when you  
21          are talking about fixed and common costs and how they  
22          are going to be shared across the voice base,  
23          essentially the number of voice lines that you are  
24          sharing across is vastly smaller and therefore the level  
25          of costs that is going to be attributable per customer

1 is far larger. I mean, it really is not a very  
2 sophisticated point, but it is nonetheless an important  
3 one because what it is illustrating is the vast  
4 difference between considering these issues in 2009 and  
5 considering them now.

6 MR RIDYARD: There was a chart which sticks in my mind which  
7 looked at the different RFS results across the number of  
8 years, 2009 --

9 MR BEARD: Yes.

10 MR RIDYARD: -- and across those years there was also a big  
11 change in the volume of BT's business and there is  
12 not -- I am not saying there are not any fixed cost  
13 effects but there was certainly no neat pattern from  
14 those dots on that chart which would --

15 MR BEARD: That is a perfectly fair point. If we go over to  
16 paragraph 535 which I think is {A/16/131}, you are  
17 obviously right, sir, we cannot say any different. But  
18 that does not detract from the point. These are --

19 MR RIDYARD: I know other things are going on as well. We  
20 are not carrying out --

21 MR BEARD: So if you focus on this chart this illustrates  
22 one of the fundamental problems with the case that is  
23 being put by the Class Representative about taking a  
24 2009 snapshot and illustrates very neatly the problems  
25 here because in each of these years you have got an RFS

1 allocation going on because these were all years when BT  
2 was under regulation.

3 So when we say you cannot rely on the 2009 going  
4 forward I mean equally you could not rely on the 2009  
5 going backwards so if you were to deflate the 2009 by  
6 CPI you get completely different numbers from the ones  
7 that the RFS has in those other years actually created.  
8 It is just a poignant illustration of the fundamental  
9 problem we are trying to rely on a single snapshot.

10 We recognise there were changes in the methodologies  
11 that were used in the RFS, we recognise that the  
12 activity based costing assessment would change, we  
13 recognise that there were all sorts of things going on  
14 in the market that would change. Those are our points  
15 as to why it is you cannot rely on the 2009 RFS.

16 Now, I completely understand that, sir, you said,  
17 well, look, this is not spelling out some kind of  
18 economy of scale effect in terms of the way in which  
19 costs are allocated.

20 MR RIDYARD: Yes.

21 MR BEARD: Completely true. It is obviously not doing that.

22 But that does not say this. What we are saying is if  
23 everything else that they are asserting about  
24 a continuity of approach worked, then you would have  
25 a significant economy of scale effect. Actually what



1           this illustrates is that is the least, potentially the  
2           least of their problems with using the 2009 RFS.

3           Sir, there was a distinctly quizzical look.

4       THE CHAIRMAN: I was just going to go back to 509 that is  
5           all. That is where we started. I follow the point if  
6           there is a lower number of customers and you still have  
7           fixed costs you have less customers to spread them over.

8       MR BEARD: That is all it is. Therefore, when you are  
9           asking yourself, what are the costs in 2015 or 2022 as  
10          compared with 2009, the methodology being put forward  
11          does not accommodate that economy of scale impact. All  
12          it does is it has its little CPI change. It does not do  
13          anything in relation to economies of scale at all.

14          What we are saying is conceptually if you are saying  
15          use the 2009 RFS, that is a stable cost metric, we are  
16          just pointing out that on a really basic level that is  
17          not true arithmetically because of the economies of  
18          scale problem.

19          Mr Ridyard is then saying, but hang on a second, you  
20          do not get a clear economy of scale effect when you even  
21          had the RFS over preceding periods, for which I have to  
22          say, yes, that is obviously true from the 5.4 diagram we  
23          were just going to. But that does not help the Class  
24          Representative. It positively damages their case  
25          because what it is showing is that year-on-year the RFS

1 is producing wildly different numbers.

2 So why is it, why is it that if you could not rely  
3 on the 2009 RFS deflated backwards to get to other  
4 points, when there is an RFS, and nothing else is  
5 changing, so yes, bits within the RFS change. We will  
6 come on to that. Why on earth would you think that you  
7 can run it a decade forward and consider that that is  
8 a stable basis on which to assess costs?

9 I am more than happy to lose on economies of scale  
10 but if the reason I am losing on economies of scale is  
11 because actually the changes in the RFS pattern are so  
12 radical that you cannot pick that up, it does not matter  
13 to me.

14 MR RIDYARD: But it would be -- I mean, there is not  
15 a particularly clear story on -- I understand in  
16 principle if you have got literally a fixed cost which  
17 cannot change from one year to the next and you have  
18 fewer consumers, then you are going to have a higher  
19 cost per consumer. But beyond that there is not really  
20 anything concrete on economies of scale.

21 MR BEARD: No.

22 MR RIDYARD: I certainly take your point about the chart  
23 because it does jump around.

24 MR BEARD: No, I am not trying to put anything more  
25 sophisticated in relation to economies of scale. What

1 I am saying is look, what has been put by the other side  
2 is not fit for showing that these represent the actual  
3 costs during the claim period if that is what they are  
4 actually doing with this methodology. I am just making  
5 a very, very basic point about the economies of scale  
6 but I was going to come on to, but obviously we have  
7 jumped ahead to this, the point at 5.4 says, look, even  
8 if you are doing the RFS you get completely different  
9 outcomes. On what basis can you suggest the jumping of  
10 a decade forward using CPI you can somehow say, oh no,  
11 that is the best measure of actual costs, or more  
12 exactly, that that is a measure of actual costs that is  
13 such that I can rely on it to say that there is no  
14 reasonable relationship between the costs and the prices  
15 when I take into account the margin?

16 THE CHAIRMAN: Yes.

17 MR BEARD: Just to be clear, the 511 illustration takes into  
18 account illustrate both the economies of scale and scope  
19 issues in how those are calculated but I am not sure  
20 that we need to work through that in any great detail,  
21 but it just illustrates the problem that is created  
22 here.

23 THE CHAIRMAN: Yes.

24 MR BEARD: The second point that Ms Kreisberger tried to  
25 rely upon in relation to this was actually a comment

1 from the 2009 RFS itself. This is at {E/13/818}. This  
2 is review of retail markets from 2009. It is saying:

3 "Retail operating costs have also decreased as a  
4 result of the fall in numbers of connections and  
5 rentals. A strong focus on cost control has driven down  
6 the SG&A costs for these markets."

7 So I think what she is saying is well, you cannot  
8 assume a scale effect here because actually this is  
9 indicating that costs have fallen.

10 THE CHAIRMAN: Yes.

11 MR BEARD: But I mean, it is a very odd thing to rely on,  
12 particularly at this stage in proceedings.

13 "Retail operating costs have also decreased as a  
14 result of the fall in numbers of connections and  
15 rentals."

16 That is covering direct costs of course, that  
17 statement. It just follows the operating costs are  
18 going to fall in those circumstances.

19 THE CHAIRMAN: No, but it says -- the second line I thought  
20 does --

21 MR BEARD: I completely understand that:

22 "A strong focus on cost control has driven down the  
23 SG&A costs for these markets."

24 THE CHAIRMAN: Yes.

25 MR BEARD: But then you have got to assume that you know

1           that the reduction in SG&A costs outweighs the impact of  
2           the economies of scale problem and they just do not have  
3           any parameters for that at all. This is 08/09 and we  
4           have just seen the table about the fluctuations in costs  
5           and so on between 08 and 09.

6           MR RIDYARD: So the reference to retail operating costs is  
7           the aggregate costs here?

8           MR BEARD: Yes, that is what we understand it to be, but of  
9           course it has only been tested, this is the first time  
10          it has been relied upon.

11          But I mean, even if you have got that between 2008  
12          and 2009 you have the problem of whether it is  
13          outweighing because this is what is Ms Kreisberger is  
14          saying. She can assert that if there is an economies of  
15          scale issue this statement is telling you that it is  
16          outweighed. Well, you cannot do that. It does not tell  
17          you about the situation going forward.

18          The third point she made was about an argument that  
19          the fixed and common costs should be spread across all  
20          voice lines rather than Dr Jenkins' who was carrying out  
21          an analysis who spread common costs across all lines  
22          within BT Consumer. But we do not really understand how  
23          that impacts on an economies of scale argument overall.

24          We do not think it is right to begin with as the  
25          illustrative example we have provided set out, and

1 I think it may have been Mr Ridyard who observed that  
2 there is no answer because there is an issue of  
3 principle. We know the lines were falling and the issue  
4 is could there still be common costs between bundles and  
5 SFV and could those unit costs be effectively rising  
6 because of lower economies of scale? So I do not think  
7 it provides any answer.

8 THE CHAIRMAN: Is that a convenient moment, Mr Beard?

9 MR BEARD: Yes, sure.

10 THE CHAIRMAN: Thank you. 2 o'clock then, please.

11 (1.00 pm)

12 (Luncheon Adjournment)

13 (2.00 pm)

14 THE CHAIRMAN: Yes, Mr Beard.

15 MR BEARD: So we left off just before the short adjournment  
16 discussing I think {A/16/131} with Figure 5.4, and I am  
17 in the section dealing with why it is that,  
18 notwithstanding everything else, you just cannot rely on  
19 the 2009 snapshot as giving you a sensible appraisal of  
20 indirect costs for 2015 and 2023.

21 In many ways -- I will go on and deal with it in  
22 more detail, but this diagram captures the problem very  
23 emphatically. You can ignore effectively the number of  
24 voice fixed lines which is dealing with some of the  
25 economies of scale issues and the changes in scale over

1 time and how it does not correlate.

2 Just look at the levels that oscillate. Now,  
3 Mr Duckworth, when this was put to him, very fairly  
4 said, "Do not dispute any of the numbers. Different  
5 things may have been going on in relation to the RFS  
6 calculation". But if that is true, if that is true,  
7 what -- that tells you is that actually there is a vast  
8 amount more flexibility in the RFS calculation than is  
9 being suggested by the Class Representative and, if it  
10 is not, then what it is suggesting is you do not have  
11 any coherent basis to suggest that you can read the  
12 2009 -- 2008/2009 indirect costs levels forward, CPI  
13 notwithstanding.

14 This encapsulates the problem. These are all  
15 indirect cost calculations using an RFS.

16 Now, we know the RFS changed each year, we know that  
17 it did, but --

18 THE CHAIRMAN: You mean the figures.

19 MR BEARD: Sorry, I mean some of the modalities as well. We  
20 recognise there were modalities changed, so we  
21 understand that. But if it is right that the change  
22 between 2007/2008 and 2008/2009 can be over £100 million  
23 worth of costs, which is what is going on, what you are  
24 seeing is either the fact that indirect costs are in  
25 fact changing, or the manner in which you can identify

1 indirect costs is very, very much more flexible than  
2 this simple notion of cost causality, that somehow there  
3 is a magical way of doing these things.

4 Now, if it can vary by £100 million between 07/08  
5 and 08/09 for either of those reasons, on what possible  
6 basis do you then take the 2009 figure and just roll it  
7 forward more than a decade just using CPI? You cannot  
8 have any confidence in those numbers.

9 Effectively, those numbers are capturing all the  
10 possible permutations of change year-on-year within the  
11 RFS. Of course, this is entirely to one side of the  
12 fact that the RFS does not capture -- does not deal with  
13 the issue in relation to common costs that we were  
14 discussing earlier where, as we have set out, there  
15 clearly are substantial common costs.

16 So you have unreliable data for the purposes of  
17 extrapolation. It is not that each year it is  
18 unreliable. We are not suggesting that for a moment.  
19 There is nothing that BT did wrong or Ofcom was  
20 criticising BT for in any one year. But the idea that  
21 you can take this and just draw it forward from that one  
22 point, which is what we are talking about, and say that  
23 shows what the level of costs should be, or are in the  
24 alternative version, in 2015, 16, 17, 18, 19, 20, 21,  
25 22, up to last year, it is just not a proper basis to do



1           this.

2           So it might be the ways in which these things were  
3           done. In which case, if you can flex the RFS to that  
4           extent, then actually what it means, going back to the  
5           point that Mr Ridyard was identifying earlier, are there  
6           difficulties with actually identifying incremental  
7           costs, indirect costs, well, there may be a whole range  
8           of issues that arise here.

9           THE CHAIRMAN: Just on that point, and I am afraid I do want  
10          to return to what we were talking about earlier on  
11          because this is another aspect to it, but as  
12          I understand it, the state of disclosure was we got the  
13          RFS as themselves, we have the method statements for  
14          each year, the big document, and then you have the  
15          figures which we looked at, at least in the context of  
16          2009.

17          MR BEARD: Yes, you have a huge amount of background  
18          documentary material, yes.

19          THE CHAIRMAN: Although I do not think -- obviously the  
20          background documentary material was not particularly  
21          helpful because it did not show, for example, the  
22          allocation of incremental costs or common costs.

23          MR BEARD: No, what it shows is a vast range of different  
24          drivers for different cost heads and so on. But you are  
25          completely right, it does not say incremental costs.

1 THE CHAIRMAN: Yes, but again what we did not have was  
2 anything from any witness from BT saying: I can tell you  
3 what is going on in these years because I was there or  
4 somebody else was there, and explaining what these  
5 differences were.

6 MR BEARD: I am sorry, I am not sure I understand what it is  
7 that a BT witness, even if there was someone involved in  
8 the RFS in 2009, or back to 2004, I mean, those  
9 exercises are not trying to identify incremental and  
10 common costs, because that is not what Ofcom wants. So  
11 you would have to engage in some huge ex post  
12 reconsideration.

13 THE CHAIRMAN: It is just that you made the point here there  
14 must have been -- we do not know, but there must have  
15 been -- you said either the incremental costs, or  
16 perhaps you meant the indirect costs were different, or  
17 they treated them in a different way, as it were, giving  
18 some thought -- giving some ideas as to why there may  
19 have been these differences.

20 MR BEARD: Yes.

21 THE CHAIRMAN: But there is probably someone who knows why  
22 there were differences.

23 MR BEARD: There may well be. But the point that we are  
24 identifying is the Class Representative comes along and  
25 says: 2009 RFS, this is what we rely upon and this is

1           what we can roll forward with. The point we are making  
2           is you just cannot do that. Because the RFS from the  
3           year before had £100 million greater indirect costs.  
4           Now, quite why it was that that would be the case does  
5           not matter for these purposes. The question is can you  
6           have confidence in what the Class Representative is  
7           presenting to you as the baseline? The answer is you  
8           cannot. You absolutely cannot.

9           MR RIDYARD: Just to unpick these numbers in the chart.

10           I mean, it is possible that the methodology for the cost  
11           causation could have been completely unchanged in these  
12           years and it just reflects different numbers that were  
13           fed into the sausage machine, or it could be that the  
14           rules changed and you are saying we do not know which of  
15           those two explanations --

16           MR BEARD: Sorry, we do know that there was a re-- there was  
17           a recalibration of the rules every year. We know that  
18           it was reviewed, and I went to that when I was  
19           cross-examining Mr Duckworth.

20           The point I am making is how much is due to  
21           recalibration of the rules, or you can have a situation  
22           where the rules are recalibrated and that changes the  
23           indirect costs output. You can have the rules stay the  
24           same but the activity base costings methodologies change  
25           and that changes the output. Or the activities change

1 under the activities based costings and that changes the  
2 output.

3 Now, trying to attribute that in relation to this  
4 massively complicated exercise would be enormous if you  
5 could find anyone to do it. We say there is not any  
6 reason why that should be required because that is not  
7 what has been done here by the Class Representative. It  
8 chose to pick 2009, that is the mast to which it has  
9 pinned its colours, and the point I am making is I do  
10 not have to identify which of those possible  
11 permutations create the difficulty here. There is an  
12 insuperable problem for the Class Representative just in  
13 relation to this basic indirect costs number.

14 Just to stress, obviously all the methodologies, and  
15 so on, they were published. We did not go through all  
16 of the rules changes, they are all complicated matters.

17 THE CHAIRMAN: Yes.

18 MR BEARD: But it does not lie with BT to be explaining  
19 these differences. We have the data, we have the  
20 outputs, and the point we are making is: you picked 2009  
21 and that is not a sound basis.

22 Now, what I do want to deal with is just one or two  
23 slightly more granular points that we picked up because,  
24 as I say, I think this provides you effectively with ...  
25 I was going to say sufficient doubt. I mean, it is

1 clear that you cannot rely on the 2009 material in  
2 relation to it. But obviously we know, as we were  
3 setting out, that there have been big structural changes  
4 in the business and the decisions and so on that have  
5 been taken by BT post-2009, and we explored some of the  
6 particular changes in cross-examination and were given  
7 evidence by Mr Cackett.

8 You will recall that we looked at things like the  
9 marketing analysis in relation to the RFS 2009 where  
10 there was a campaign based, activity based costing  
11 analysis that had been used, and we explored with  
12 Mr Duckworth how the different campaigns in different  
13 years could radically change how, even if you kept the  
14 RFS rules the same, the activity cost, the base costing  
15 survey terms the same, but you changed your branding  
16 strategy or your marketing strategy, actually what would  
17 be attributed could be vastly different costs.

18 We talked about computer and billing systems, for  
19 example, whereby we know that new billing systems, new  
20 IT systems were put in place. Obviously in the RFS the  
21 broad summary was that they tried to carry out  
22 allocations by reference to where the project was  
23 delivering benefits. Obviously that makes sense. But  
24 that does not tell you when you have got a billing  
25 system that is working across all sorts of products.

1           Now, Ms Kreisberger tried to deal with this on  
2           Tuesday by saying, well, look, if the billing system was  
3           really to enable you to compete more effectively in  
4           relation to bundles you have to attribute all the costs  
5           to the billing system.

6           I am not sure that would even be Mr Duckworth's  
7           analysis in relation to that. Indeed, I do not think  
8           that was what he said in relation to these issues when  
9           issues about the billing system were put to him,  
10          because --

11         THE CHAIRMAN: Sorry, you meant what Ms Kreisberger was  
12          saying, that if it is there to enable you to compete  
13          more effectively in relation to bundles, you have to  
14          attribute all the costs to the bundles, not the billing  
15          system.

16         MR BEARD: Yes, I apologise. I have misspoken.

17         THE CHAIRMAN: No, I just wanted to check --

18         MR BEARD: That was exactly it, yes.

19                 So, yes, we deal with it in our closing submissions  
20                 at 131, just above where we are {A/16/131}.

21                 To be fair to Mr Duckworth, he recognises that there  
22                 are judgments that are required to be brought to bear.  
23                 He does not say that it would be the triggering event  
24                 which caused the expenditure which would be cost  
25                 causality, and indeed that does not make any sense,

1 because you would end up with a situation where the  
2 moment some particular project tipped you over into  
3 upgrading all your IT, you then attribute all your costs  
4 to that tipping point project, and that would not  
5 possibly be right if actually the project was operating  
6 in relation to a whole range of products.

7 That is not Mr Duckworth's point. Ms Kreisberger is  
8 at odds with her own expert on that.

9 But the same was true, if you recall, in relation to  
10 real estate portfolio. I am not taking this  
11 arbitrarily, you will recall these were some of the  
12 headings we looked at that were identified in the 2009  
13 RFS. Obviously the real estate portfolio could  
14 radically alter, and of course the way in which you  
15 explored the costings -- the cost allocations of your  
16 real estate portfolio might change as well.

17 So you might have changes in the RFS rules, you  
18 might have changes in the cost methodology that  
19 allocated costs by reference to real estate, and you  
20 might have changes in relation to real estate. All of  
21 these things mean that in relation to the costs in 2009,  
22 you cannot assume that they are just -- they are staying  
23 the same save for a CPI uptick, particularly in the  
24 context, as I explored at the outset, where you are  
25 thinking about this wholesale change in the way that the

1 whole business sector works from 2006 through 2009  
2 onwards.

3 So we say all of these structural changes radically  
4 undermine the way in which you can even rely on the 2009  
5 RFS in relation to indirect costs, leaving aside the  
6 common costs issue specifically, and you just do not  
7 have a proper basis for dealing with these issues.

8 It is worth picking up in our closings at 141, so  
9 that is {A/16/141}, just at (d), Dr Jenkins'  
10 observations about the billing systems as well that we  
11 have quoted there.

12 So the short point is there is no reason to think  
13 that the actual indirect costs in 2023, 2020, 2015 are  
14 going to be anywhere close to the actual indirect costs  
15 in 2009, and that is quite apart from the point I made  
16 earlier. So there is no reason to think that the  
17 proportions of these costs are somehow not involving any  
18 material common costs, or indeed that the proportions of  
19 common to incremental costs have remained the same from  
20 2009 throughout. CPI does not solve any of those  
21 problems.

22 The Class Representative picked a singular metric,  
23 the 2009 RFS. It is not in any way good, probative  
24 value.

25 I should say I have emphasised already that in



1 relation to the RFS, and Mr Duckworth accepted this,  
2 there were judgments involved at every stage even in  
3 relation to what is referred to as cost causality, the  
4 methods -- the methodologies changing, the attributions  
5 changing.

6 The fact that Dr Jenkins says, well, yes, I am  
7 willing to accept that for 2009 the RFS is a good proxy  
8 for a LRIC+ metric, which is what she did, is in no way  
9 surprising, because BT was trying to do what Ofcom  
10 wanted it to do under the rules. The question is  
11 whether or not that is a sufficient basis for what we  
12 are engaged in now.

13 Also, and I will not go back to the point, is why  
14 even if you had a 2020 RFS, you would have an input  
15 there that would be relevant for your consideration, but  
16 because you could have so many different judgments, when  
17 you are asking yourself about whether or not that is the  
18 only measure that you should use in relation to these  
19 issues, even leaving aside the common costs point, you  
20 do have a range of other judgments, but obviously the  
21 common costs point is critical there.

22 The repetition of the idea that uprating by CPI is  
23 somehow conservative or generous, it does not improve by  
24 repetition, it does not deal with any of these  
25 fundamental problems at all.

1           Ms Kreisberger seemed to be running an argument that  
2 she could justify a story that indirect costs have  
3 reduced over time. Now, we do not understand how she  
4 can possibly do that without working through particular  
5 categories of indirect costs. We do not understand how  
6 she deals with the changes between, say, 2004 and 2009  
7 in relation to the RFS where they go up and down.

8           She had four points, I think, yesterday. She said  
9 economic theory dictates that productivity gains tend to  
10 lead to costs reducing in real terms. As a basic  
11 isolated proposition, I am not sure anyone necessarily  
12 disagrees with that. But it really does not provide any  
13 good answer in relation to what a company is actually  
14 investing in, how it is incurring its costs, what it is  
15 doing in relation to a range of services. All  
16 companies, all rational companies at all times will be  
17 seeking to have productivity gains. That does not mean  
18 that we see an infinite pattern of cost reduction. It  
19 is no basis for any proof whatsoever.

20           We have touched on issues of economies of scale in  
21 relation to it.

22           The next point she raised also was the costs  
23 transformation programme. Now, it was interesting that  
24 when Mr Duckworth wanted to burrow through the  
25 disclosure and actually look at some data, he could find

1 it for a cost transformation programme, but  
2 Ms Kreisberger referred in particular to Table 18 of the  
3 Duckworth first report. That is at {IR-E/6/73}.

4 But the problem with this is these are reported cost  
5 transformations overall, and what this does not do is  
6 actually deal with the relevant SG&A and D&A costs or  
7 the particular costs heads that we actually have in the  
8 vast amount of data that was the subject of disclosure,  
9 and what we actually see is that costs have increased  
10 during 2012-2016.

11 In particular, if we look at {E/18/132}, and then if  
12 we go over the page, {E/18/133}, you will see that  
13 Dr Jenkins is explaining how, whatever was occurring  
14 with those cost transformation numbers, when you look at  
15 the overall costs they are going up.

16 Of course when she was looking at costs, and  
17 particularly looking at common costs, she engaged in the  
18 radical experiment of looking at the actual cost data  
19 that had been disclosed.

20 Then I think the next point that Ms Kreisberger  
21 referred to was Mr Cackett's evidence, where Mr Cackett  
22 was referred to a plan for efficiencies. Mr Cackett  
23 obviously and sensibly accepted of course BT constantly  
24 tries to drive efficiencies in relation to its business  
25 and reduce costs, but he did not accept that they

1           actually achieved the targets. But more particularly,  
2           even if they were achieved, the targets, or some of  
3           them, that does not tell you overall what is happening  
4           in relation to the cost base of the company. You can  
5           drive down particular costs through efficiencies, but  
6           you may be investing, developing new business lines, you  
7           might be investing in new publicity. You might be doing  
8           it more efficiently, but that does not mean that you are  
9           actually spending less because you may adopt a new  
10          strategy.

11           If you are adopting a new strategy you might  
12          actually be achieving, for example, in relation to  
13          marketing, better response rates in relation to  
14          marketing, but you are actually spending a lot more.  
15          You may have driven an efficiency there overall, but  
16          that does not mean you are necessarily going to reduce  
17          your costs because you have adopted a different  
18          strategy.

19          MR RIDYARD: Your costs per customer would surely fall if --

20          MR BEARD: Your costs per customer if you were operating  
21          more efficiently will fall. That is absolutely true.

22          It will depend on what strategic changes you are making  
23          in relation to these.

24          MR RIDYARD: Just jumping back to the increase in BT's  
25          overall SG&A that we saw in Dr Jenkins' report. I think

1 the point made about that would seem to be plausible, at  
2 least, by Ms Kreisberger, was there was no reason why  
3 the standalone costs of a hypothetical SFV provider  
4 would increase. So those increases in SG&A were most  
5 likely explicable by the fact that BT went into TV more  
6 or did other exotic things, it was nothing to do with  
7 SFV.

8 MR BEARD: It might be, or it might be the structure of the  
9 business that is delivering the SFV services might be  
10 different. It is difficult at that point to delineate,  
11 because you end up having a discussion about the extent  
12 of common costs potentially there. So if you are having  
13 a discussion about the extent of the common costs, then  
14 obviously you are in the same territory as we were in  
15 previously in relation to these issues.

16 It is also true that the dynamics of running an SFV  
17 business will be changing in the context of you selling  
18 and competing against bundle providers as well, so you  
19 have got other dynamics there that you are dealing with.

20 One has to be slightly careful, because of course BT  
21 was not in the business of selling any bundles prior to  
22 2009 and so things do change, and you have got a range  
23 of considerations that you have got to take into  
24 account, but you cannot just assume that the thing is  
25 stable.

1           But even if you were adopting some kind of  
2           conservative estimate in relation to that, you are not  
3           solving the overall issue that you have here, which is  
4           you have a benchmark cost metric which is not reliable.  
5           What is being said here is you cannot assume that that  
6           cost transformation figure that is being relied on by  
7           Mr Duckworth in relation to total cost transformation is  
8           somehow being specifically fed through into SFV, and  
9           even if you were to take a more conservative approach as  
10          to how one thought about SG&A for standalone SFV  
11          service, that does not solve the issue in relation to  
12          the supposed incentive -- efficiency story that is  
13          supposedly being evidenced by those total costs in  
14          relation to transformation back in 2010/2012.

15                 So I think even if you were to adopt that, I am not  
16                 sure that is solving the issue which this is engaging  
17                 in.

18         MR RIDYARD:   But Mr Duckworth does not make any -- he  
19                 characterises his approach as quite conservative,  
20                 because he does not -- he does not assume that BT would  
21                 make -- he does not factor in a productivity  
22                 improvement, does he?

23         MR BEARD:    No, that is true.

24         MR RIDYARD:   He says: let us assume that BT's productivity  
25                 does not get any better since 2009.

1 MR BEARD: I understand all that. But that alone, in terms  
2 of the assumptions, I am not disputing can be seen as  
3 having a degree of conservatism in relation to it, but  
4 unfortunately that is in the context of so many other  
5 issues in relation to the metric that he is using, but  
6 that particular change does not work.

7 The problem with it is even if you are taking that  
8 into account, what you are not doing, then, is dealing  
9 with, for example, the economy of scale problem that we  
10 were dealing with earlier, because he then has to say,  
11 well, actually I have made that assumption that there is  
12 no efficiency gain and actually I outweigh that.

13 MR RIDYARD: Yes, I follow all that, yes.

14 MR BEARD: So we say that in relation to the four arguments  
15 that seem to be suggesting that indirect costs have  
16 reduced over time, because that is the positive case  
17 that Ms Kreisberger put forward, that is not sound, and  
18 none of those reasons work.

19 So the outturn we have here is that in relation to  
20 the cost benchmark that is put forward, we have the  
21 fundamental problems of it being FAC only, out of date,  
22 working on the basis of no material common costs which  
23 is not a tenable evidential position to adopt, given the  
24 work of Dr Jenkins and the lack of contrary evidence  
25 from the Class Representative, in particular the

1 weakness of the material in relation to SSE, Post Office  
2 and indeed the Phone Co-op at the last minute. In those  
3 circumstances, the common costs and methodology problems  
4 are fundamental. In addition, we have clear evidence  
5 that there are fundamental problems with the assessment  
6 of indirect costs in relation to the RFS, never mind  
7 trying to break out the common costs, and that is  
8 illustrated by Figure 5.4, and in those circumstances,  
9 it cannot possibly be a proper basis for any excessive  
10 pricing finding.

11 In addition, of course, we have from the case law  
12 a range of statements suggesting that actually using  
13 different methodologies, apart from a fully allocated  
14 cost methodology, is appropriate in considering  
15 excessive pricing cases, and that is precisely what  
16 Dr Jenkins has sought to undertake in carrying out her  
17 SAC combi analysis, also running a DSAC analysis in  
18 parallel as a cross-check, and also taking actual costs  
19 and looking at a fully allocated cost metric as  
20 a further cross-check here to illustrate how the  
21 translation of the figures from 2009 that Mr Duckworth  
22 wishes to rely upon, and the Class Representative  
23 insists on, is flawed.

24 Now, Dr Jenkins does not pretend that the SAC combi  
25 is some kind of perfect assessment, and of course that



1 is entirely consistent with all we saw in relation to  
2 *United Brands* and all of the other case law. But we  
3 have set out in the annex how it works, I think it is  
4 explained in our written submissions, and obviously  
5 Dr Jenkins provided evidence on why it was she had  
6 chosen the particular sets of combinations, why it was  
7 appropriate to limit them, why those concerns that were  
8 expressed in relation to PPCs did not apply here and it  
9 was a workable methodology.

10 Nonetheless, the Class Representative says it is  
11 flawed. The first reason is that it provides an upper  
12 bound approach. In other words, it is suggesting that  
13 somehow it is allowing too much liberality in relation  
14 to particularly common cost recovery and that these are  
15 observations that are made in literature or by the  
16 experts or in case law, but actually what we have seen  
17 from the case law is that SAC combi, if it can be  
18 worked, is actually a useful tool, and that in other  
19 cases DSAC and indeed SAC standalone costs alone have  
20 been used as parameters in relation to what is  
21 permissible.

22 Of course Dr Jenkins recognises that in  
23 a multi-product firm you are -- just using SAC would  
24 likely allow an over-recovery of common costs, and that  
25 is why she is using these other methodologies.

1 MR RIDYARD: In a multi-product firm? I mean, this whole  
2 discussion only takes place in a multi-product firm,  
3 does it not?

4 MR BEARD: Yes, that is why she does not put forward SAC.  
5 Sorry, I was stating the simple and obvious. It is no  
6 part of her report that she relies on the standalone  
7 costs. But that is why, because we understand the  
8 literature and thinking that says in a multi-product  
9 firm you do not do that.

10 The upper bound approach criticism, that is -- it is  
11 not a fair and proper criticism of the SAC combinatorial  
12 approach. The reason it is designed as it is is to  
13 allow the flexibility that a business should have. That  
14 will mean because there is some flexibility there that  
15 the outcomes may well be higher in terms of permissible  
16 prices than may be in relation to certain fully  
17 allocated costs methodologies.

18 It is not actually a given, it will depend on the  
19 metrics, but it is understood that that may work. The  
20 reason it is not a given for a particular product may  
21 depend on the criteria you are using for the FAC  
22 allocation.

23 I will deal with the margin issue separately, but in  
24 the claimant's written submissions there are two broad  
25 points that say -- that are prayed in aid saying that

1 SAC combi is far too generous. The first is that it is  
2 supposedly setting entry-incentivising prices and in  
3 doing so ... setting entry-incentivising prices, and in  
4 those circumstances the case law says that that is not  
5 a permissible approach.

6 Now, it is a bad point for two reasons. The whole  
7 point of the combinatorial testing, and the  
8 identification of a binding constraint so you look at  
9 the lowest possible permissible headroom for sharing  
10 common cost, is to move away from a pure standalone cost  
11 benchmark, which would be potentially  
12 entry-incentivising, but there is also a point here on  
13 the law.

14 If we could just go to {G/95/1}. This is the  
15 *Liothyronine* case. If we just pick it up at page  
16 {G/95/7} at paragraph 2.

17 So what we are dealing with here is a situation of  
18 *Liothyronine* tablets, which are tablets for a thyroid  
19 condition, being sold in 2007 at around £4.05 a pack.  
20 By January 2009 they are up at £20-odd, and then  
21 by August 2012 nearly £46, and they ended up heading  
22 towards £250 a pack. So the cost to the NHS rose around  
23 from £600,000 to £30 million despite demand being  
24 stable.

25 If we go to page {G/95/52} at 145, so this was an

1 excessive pricing case:

2 "As noted above, in the Decision, the CMA split the  
3 total costs incurred in the supply of *Liothyronine*  
4 tablets into direct costs, indirect costs and reasonable  
5 rate of return, giving rise to a cost-plus calculation  
6 ranging [because they did a range assessment here] from  
7 £2.08 [up to about] £9.87 ... during the Infringement  
8 Period, with an average of 4.94."

9 So they carried out a broad and flexible approach of  
10 using a range.

11 Then at page {G/95/100}, you will see under the  
12 heading "Entry-Incentivising Prices":

13 "The second comparator put forward by Hg and Cinven  
14 for the purpose of assessing whether Advanz's prices of  
15 *Liothyronine* tablets were fair when compared to  
16 competing products was the prices which incentivised  
17 entry attempts by other suppliers of *Liothyronine*  
18 tablets ..."

19 You see at the bottom there:

20 "They relied on the price of £45.52 as the relevant  
21 Entry-Incentivising Price on the basis that this was  
22 the price prevailing in 2012 when Morningside began its  
23 entry efforts."

24 So what was being argued here was: look, you may  
25 have a range of cost-plus benchmarks running up to about

1           £10, but Hg and Cinven were coming along and saying,  
2           well, actually entry was only triggered when prices were  
3           at £45, so more than a little bit above the top end of  
4           the cost-plus range, and they are saying that was  
5           reasonable because you would want to incentivise entry.

6           But this was a whole different story beyond  
7           a cost-plus story. This was saying: do not worry about  
8           cost-plus. You can have a 3/400% margin above  
9           cost-plus, and that is still a legitimate price because  
10          it is entry-incentivising. This is before you get into  
11          any limb 2.

12          What the Tribunal said is no, no, no. On the basis  
13          here of carrying out a cost-plus assessment in line with  
14          *United Brands*, you take that range, and then you can  
15          have a discussion about limb 2 and other matters, but  
16          you do not suggest that any price above that, which is  
17          the moment at which someone enters, is the benchmark  
18          price that you should use. That was what was being  
19          talked about as entry-incentivising prices.

20          MR RIDYARD: So at what point do you decide that the -- you  
21          look at the entry -- you can look at the entry -- at  
22          the price that would encourage or sustain entry, and so  
23          you are saying here that when you did that exercise in  
24          the *Liothyronine* case it was just too high, and  
25          therefore --

1 MR BEARD: I think --

2 MR RIDYARD: -- because it was too high. My question is: at  
3 what point do you decide that is too high? You say it  
4 is in this case, in the *Lio* case, but you are saying it  
5 is not in the current case, or ...?

6 MR BEARD: We are not in the territory of discussing  
7 entry-incentivising prices separately as a margin above  
8 cost-plus. What we are saying is you should carry out  
9 a sensible cost-plus assessment and that SAC combi  
10 enables you to do that. What is being said in relation  
11 to *Liothyronine* is never mind carrying out a cost-plus  
12 assessment, the moment at which someone comes in is the  
13 moment at which you pick the price and say: that is the  
14 entry-incentivising price, and conceptually, therefore,  
15 you should work back from that.

16 So essentially it is saying you can push aside the  
17 cost-plus analysis and use the point of entry. That is  
18 why there is this reference to the point when  
19 Morningside began entry.

20 So the point I am making is that actually the  
21 language of entry-incentivising prices that was  
22 developed in the case law is very, very different. It  
23 is effectively divorced from a cost-plus analysis  
24 entirely.

25 So you might say that a SAC measure would be

1 entry-incentivising in relation to the position here  
2 because it would mean a standalone operator could  
3 undoubtedly enter, but we recognise that that as  
4 a calculation for a multi-product firm is too high. So  
5 we are not in the territory, ever, of just relying on  
6 some kind of external freestanding entry-incentivising  
7 price in this exercise.

8 MR RIDYARD: Right.

9 MR BEARD: So the point we are making is not we are relying  
10 on entry-incentivising prices, it is that reference to  
11 entry-incentivising prices is not a criticism of  
12 SAC combi because they are differently defined here.

13 The second criticism that is made in relation to it  
14 is there is no range of competitive benchmarks needed  
15 because the market drives prices down towards LRIC+,  
16 that is Mr Parker's essential theory here, and therefore  
17 any SAC combi methodology is just essentially not  
18 complying with his strict theory of how markets should  
19 pan out in relation to competition.

20 I think this lapses into two problems. One is it  
21 does not deal with the dynamics of workable competition,  
22 and second of all, it does not remotely deal with issues  
23 of common cost. So those criticisms of SAC combi are  
24 not valid, and those are the two criticisms levelled at  
25 the Class Representative's submissions, at 400 and 401.

1           I think the second reason that is put forward in the  
2 Class Representative's submissions are at 402 and 404,  
3 saying that SAC combi is entirely unworkable. There is  
4 a temptation to respond, well, it is a funny sort of  
5 unworkable when it has been worked, but it is a more  
6 sophisticated criticism than that in the sense that what  
7 is being criticised is how the combinations have been  
8 identified.

9           But there is nothing in any of the case law to  
10 suggest that the way in which Dr Jenkins' combinations  
11 which we have set out in Annex 2 to our submissions are  
12 adequate, or that combinatorial testing using those is  
13 inadequate.

14           These are points that we have addressed in our  
15 submissions at paragraphs 548, 551. That is {A/16/134}.  
16 Dr Jenkins dealt with these issues in the joint experts'  
17 statement. Just for your notes, that is  
18 {OR-E/49/140-142}.

19           She also explained her approach to the combinations  
20 on Day 14. If we could just go to {Day14/11:1}. She  
21 explains there how it is she engaged in identifying the  
22 combinations.

23           "Answer: ... why I do think these are the right  
24 ones for the Tribunal to consider when we are thinking  
25 about appropriate flexibility ..."



1                   If we go over the page, you will see what  
2 she says there:

3                   "So the nature of the combinations, the question you  
4 ask each time when you look at a combination is: imagine  
5 that this is BT as a standalone provider ... they are a  
6 standalone provider of SFV ... But then what you are  
7 thinking is: are there some -- have they over-recovered  
8 their common cost when we think about them being  
9 a standalone provider ...

10                  "When we calculate the standalone cost of one of  
11 these other combinations, the way we do it is we take  
12 the incremental costs of the services ..."

13                  She explains there how she goes about it.

14                  If we go down and over the page, {Day14/13:1}, if we  
15 pick it up at line 21:

16                  "Answer: So then the question you ask is: should  
17 I have split out bundles so that it looked at dual play,  
18 triple play, dual play with sport, triple play with  
19 support, all of those elements? The reason I did not do  
20 that is because actually what we are thinking about here  
21 is we are -- in a sense, we are not worried about what  
22 is going on in the bundles market, right, we are  
23 thinking that that is a competitive part of the vista,  
24 the competitive arena that we are looking at, and the  
25 strategy that BT implemented, they were not thinking,

1 oh, I want to set up a standalone sports business,  
2 right. I do not want to be a sports retailer ... I want  
3 to be a successful retailer of bundles of services, and  
4 in the competition for that I need to enhance my  
5 offering, which is currently mostly voice and broadband  
6 ..."

7 So she is giving the account of why it is she chose  
8 the bundle combinations that she did, and you can see  
9 the criticism that she is dealing with:

10 "Answer: ... okay, well, then that ..."

11 What is said against her is:

12 "... that masks the fact that sport for  
13 some part of its time was a loss leader, in  
14 a sense that losses were being made, but there  
15 is not a commercial sense in which BT was  
16 seeking to offer sport on its own. It was  
17 doing that in order to attract and retain  
18 bundle customers ..."

19 That sets the reasoning, it is that strategic  
20 position that sets the reasoning as to why it is she  
21 proceeds in this way.

22 We know that that is also how BT was actually  
23 thinking about these things. If we could just call up  
24 {F/846/1}. This was a document I tried to put to  
25 Mr Parker and Mr Duckworth. They had not looked at it

1 but it is the "2011 Board Strategy Day" paper.

2 If we go on to page {F/846/18}. This was just  
3 before BT actually ended up in the market buying  
4 Champions League football, and you can see precisely  
5 what Dr Jenkins was talking about being exhibited as BT  
6 strategy here.

7 We deal with this in more detail in our -- this  
8 issue in more detail in our closing submissions, just  
9 for your notes, at {A/16/137}, and that is paragraphs  
10 560-563.

11 So I have dealt with the first two reasons for  
12 criticising the SAC combi. The third is the allegation  
13 that the allocation of common costs is not grounded in  
14 any empirical data and is not an informed judgment.  
15 Well, I am not going to rehearse what I went through  
16 earlier in relation to Annex 7. That is just not true.  
17 It was grounded in empirical data. It was grounded in  
18 empirical data, the financial data, it was grounded in  
19 an analysis of what Ofcom had identified, and it was  
20 then cross-checked against the TSO cross-check.

21 MR RIDYARD: Sorry, can we just jump back to BT Sport,  
22 because it is really, really crucial to the calculations  
23 on SAC combi, and it is also the main criticism that  
24 I think the CR has of the way the SAC combi was  
25 implemented by Dr Jenkins.

1 MR BEARD: Sure.

2 MR RIDYARD: Because what is going on here is BT Sport is  
3 clearly making a negative contribution to --

4 MR BEARD: Initially so, yes.

5 MR RIDYARD: In its own right. So if you put it into the --  
6 if you say it is an integral part of the bundle  
7 business, as Dr Jenkins does, then it reduces the  
8 profits of the bundle business, and therefore that is  
9 making less of a contribution which gives you more  
10 headroom for SFV.

11 MR BEARD: Yes, that is true.

12 MR RIDYARD: So it is truly crucial -- BT Sport losses are  
13 an absolutely crucial part of Dr Jenkins' story, and the  
14 CR are saying they think one of the combinations you  
15 should think about it is where BT Sport was not integral  
16 to the bundle. That is essentially their criticism.

17 I am not taking a view on this, but I am just saying  
18 I think it is really important we just explore it for  
19 a second, because they say, well, BT Sport was sold as  
20 a standalone product as well, and therefore there should  
21 be a combination in which BT Sport is not seen as  
22 integral to the bundles, and if you do that, then  
23 obviously BT Sport's losses are observed for what they  
24 are, and therefore they get -- if you look at the  
25 bundles without BT Sport, for example, then you would

1 get a much higher contribution there to --

2 MR BEARD: You get much higher headroom.

3 MR RIDYARD: No, you get a higher contribution to common  
4 costs and therefore get much lower headroom on the SFV.

5 MR BEARD: Yes, sorry, that is absolutely right. Sorry,  
6 what you end up doing is, in the bundles that you left  
7 behind where you do not have the losses from BT Sport,  
8 you get more headroom on those as well as on SFV. That  
9 is the point I was trying --

10 THE CHAIRMAN: Yes, and therefore you get much less headroom  
11 on SFV, do you not? Is that right?

12 MR BEARD: I am not sure that necessarily is right, because  
13 I am not sure it goes serially. I do not think you  
14 essentially attribute all headroom to the bundle first.  
15 What you are trying to ascertain is the level of overall  
16 headroom in relation to the set of combinations -- the  
17 bundle combination -- the combination of services that  
18 you are carrying out in relation to a particular issue.  
19 So it is not just residual headroom, so you do not take  
20 them in order when you do the calculation, I do not  
21 think.

22 MR RIDYARD: Okay.

23 MR BEARD: But leave that to one side, I am not disputing  
24 the basic proposition that if you take out a loss-making  
25 component from one of the services which is within

1 a combination, you are lifting the headroom across that  
2 combination, I think we can leave it like that, and  
3 since part of that combination is obviously SFV I am not  
4 demurring to that extent.

5 MR RIDYARD: Yes.

6 MR BEARD: The reason I do put it that way is because the  
7 SAC combi is identifying that headroom, and then the  
8 question of how you actually allocate the further costs  
9 within that headroom is the separate, further point,  
10 which I think is what is sometimes referred to as the  
11 lines issue, and so on, how can you actually attribute  
12 matters within the headroom. But leave that to one  
13 side, it is completely accepted that that will be the  
14 outcome.

15 But that is why Dr Jenkins is looking at what is the  
16 strategy that BT is following here? Is it trying to be  
17 a sport -- a standalone sports broadcaster, or is it  
18 trying to follow a strategy --

19 MR RIDYARD: Yes. No, I understand that.

20 MR BEARD: -- and that is the reason I went to that  
21 particular document. Because what is striking about it  
22 is that it is at precisely the time when BT is thinking  
23 about: what do I do? It is in 2010/2011, going forward.  
24 You have been able to do bundles for a year or so. You  
25 are facing players out in the market like Virgin, like

1 Sky. You are thinking, what do I do to compete here  
2 when the core of my business historically has been  
3 telephony? I have got broadband but I need people to  
4 come in.

5 MR RIDYARD: You want some context. I understand the story  
6 entirely, but I am just saying -- and one of the central  
7 questions in the case, in a way, is how much flexibility  
8 should BT have in recovering common costs from SFV? In  
9 terms of this approach, the SAC combi approach, one of  
10 the crucial variables in that calculation is going to be  
11 how you treat the losses of BT Sport.

12 MR BEARD: I am not demurring from the maths, essentially,  
13 but I am providing the answer --

14 MR RIDYARD: Yes.

15 MR BEARD: -- on the basis of evidence as to what it was  
16 that BT was trying to do.

17 Just for your note -- actually, no, let us go to it.  
18 {F/782/1}. So this is the fixed access market reviews,  
19 so this is about VULA. You may recall this, that  
20 Mr Matthew highlighted it at page {F/782/3}.

21 A1.1, I can read it out:

22 "... summarises the evidence on BT's motivation for  
23 investing in BT Sport. This shows that this investment  
24 was to support its broadband business and, in  
25 particular, to increase customer acquisition and

1           retention on superfast broadband packages."

2           I will not read out 1.2 and 1.3.

3       MR RIDYARD: Yes.

4       MR BEARD: So I do not cavil at the issue you are raising  
5           here, but these are the answers as to why that is the  
6           right way of doing it, and Dr Jenkins was not just  
7           imagining that this was the way forward, she was looking  
8           at what was being said about how this was done.

9       MR RIDYARD: To be clear, I am not raising this because  
10          I disagree with what you are saying necessarily, it is  
11          just because I think it is ever so important that we  
12          have as much oxygen on this as is possible.

13      MR BEARD: No, I completely see the point, which is why  
14          I was going to those pieces of evidence and not just  
15          leaving it as assertion. But you have actually got --  
16          we have not gone through all the BT material that refers  
17          to sport and how they were thinking about sport and how  
18          they dealt with sport alongside bundles, and so on, but  
19          it is true that BT did end up selling sport as  
20          a freestanding product, but the whole drive for it was,  
21          as is explained, confirmed by Ofcom, and is evidenced by  
22          the material that we have seen.

23          So as I say, the story that is told is that over  
24          time more and more BT Sport was sold without fixed  
25          voice, but that is not initially the story. You recall



1           that it is something that grows. But there is also  
2           a concern with this assertion that we have not -- that  
3           was raised in the course of exchanges on this whereby it  
4           was clarified with Mr Parker after the hot tub that in  
5           fact the statistics he gives in relation to the numbers  
6           of standalone BT Sport are not actually capturing  
7           standalone BT Sport, what they are capturing is BT Sport  
8           without a fixed line, but that could be BT Sport with  
9           other TV or with broadband. In other words, you are  
10          looking at other bundle combinations.

11        THE CHAIRMAN: Sorry, just one moment, please. (Pause).

12           This is Mr Parker's statistics.

13        MR BEARD: Yes.

14        THE CHAIRMAN: About numbers of standalone sport.

15        MR BEARD: Yes.

16        THE CHAIRMAN: And ...

17        MR BEARD: We are not denying that the number of sport  
18           packages without fixed line increased over time. We are  
19           not denying that for a moment. But the point we are  
20           making is, first of all, that is not a good reason to  
21           carry out SAC combi differently because of the strategic  
22           intentions, even though there was sale of sport without  
23           fixed line subsequently, but what is important is that  
24           because there was over time more take up of people  
25           taking packages without any fixed line, you can end up

1 with broadband and sport together, and so it is not  
2 really standalone.

3 THE CHAIRMAN: It is not really standalone, that is the  
4 point.

5 MR BEARD: That is the simple point.

6 THE CHAIRMAN: Just a moment.

7 MR RIDYARD: Even if it was truly standalone sales of  
8 BT Sport, would that change anything? Would that change  
9 anything very much? Let us say it made a number of  
10 BT Sport standalone sales to consumers, how does that --

11 MR BEARD: We do not think that matters -- we do not think  
12 that changes the way in which you should do it. I am  
13 just pointing out there is a further issue here, that  
14 what is being said by --

15 MR RIDYARD: No, I understand that point. I just wanted  
16 to --

17 THE CHAIRMAN: The reason why you say: even if it is the  
18 case, and there is an argument about it.

19 MR BEARD: Yes.

20 THE CHAIRMAN: That there is lots of BT standalone sales,  
21 genuine standalone sales, you say it does not make any  
22 difference, it is still legitimate to include it within  
23 the relevant combinations, but that depends on an  
24 argument about what BT's strategy was in terms of  
25 marketing sport.

1 MR BEARD: Well, yes.

2 THE CHAIRMAN: Or using it as a vehicle to bring in bundles,  
3 that kind of thing.

4 MR BEARD: Because what you are doing is you are  
5 investing -- you are spending to obtain and acquire  
6 customers that you would otherwise be losing, or you  
7 might be able to get from other people, but in relation  
8 to voice and broadband, primarily, which is what your  
9 strategy was.

10 So the driver of your investment is capturing that,  
11 so why are you incurring these costs? That is the  
12 question. It is not quite to do with the marketing, it  
13 is what is the purpose of --

14 THE CHAIRMAN: The underlying purpose of having it.

15 MR BEARD: Sorry --

16 THE CHAIRMAN: No, no. Just a moment. Let me just ...

17 MR RIDYARD: That is useful.

18 THE CHAIRMAN: Yes. Let me just write that down. (Pause).

19 Yes, thanks.

20 MR BEARD: I think that deals with actually a number of the  
21 other reasons because, as Mr Ridyard rightly says, it is  
22 one of the points that the Class Representative was  
23 recycling as criticism.

24 Can I just pick up the so-called number of lines  
25 error. So if -- it is probably easiest done if we go to

1           our skeleton at {A/13/51}.

2           THE CHAIRMAN: You mean your opening?

3           MR BEARD: Yes, I do actually mean my opening, yes.

4           THE CHAIRMAN: Just a minute.

5           MR BEARD: Sorry, because we actually dealt with this issue  
6           there. Number of lines fallacy, because this was  
7           a complaint that has been made a couple of times. The  
8           final complaint is the SAC combi benchmark.

9           "          She has erred by dividing the difference between  
10           the level of revenue required to be earned by  
11           a particular combination to earn a margin on its SAC  
12           equal to the benchmark level of return and the actual  
13           revenue earned by the relevant combination across all  
14           fixed voice lines."

15           This suggests that somehow Dr Jenkins has used  
16           the wrong denominator and made a basic error in  
17           calculation. What this boils down to is essentially if  
18           there is headroom for the recovery of common costs  
19           through the SAC, the particular combination, then you  
20           are wrong to be thinking about those common costs being  
21           spread across all of the products within the  
22           combination. You should load it all on to SFV. That is  
23           what the criticism is.

24           We say that is not legitimate. It is perfectly  
25           sensible in these circumstances to look at the way in

1           which those costs would be recovered across the  
2           combination in question.

3           But I just do want to highlight the last two  
4           sentences:

5           "Under her baseline scenario [and this is also true  
6           of the low scenario] for all years under all  
7           combinations tested, there is positive headroom. In  
8           other words, Dr Jenkins finds no evidence of BT's SFV  
9           services prices being excessive, and this finding does  
10          not depend on which number of lines is used to derive  
11          a benchmark price ..."

12          In other words, this is a theoretical problem that  
13          only applies when you are using the high sensitivity in  
14          relation to the SAC -- in relation to common costs  
15          allocation.

16        THE CHAIRMAN: You mean because if you allocated it in  
17          a different way so it was all -- this headroom was all  
18          allocated to SFV, or is it voice, as opposed to the --

19        MR BEARD: It will be SFV because the combi is taking the  
20          increment as SFV, yes.

21        THE CHAIRMAN: Even if you did that, it would not actually  
22          make any difference to the --

23        MR BEARD: Yes, so -- effectively what she is saying is that  
24          in relation to the baseline and low cases, all of the  
25          combinations pass, effectively. In other words,

1 the prices being charged are ones where you are enabled  
2 to recover the -- none of the situations involve  
3 a problem whereby you are effectively needing to collect  
4 a significant amount of common cost from SFV alone,  
5 effectively.

6 THE CHAIRMAN: But I thought the criticism was that if you  
7 put those costs, the costs delta or whatever expression  
8 you want, the common costs that need to be covered, you  
9 did not allocate that across all the products within the  
10 combination, but you did do it in relation to SFV only,  
11 for sure you would get a higher competitive benchmark,  
12 but it would be way higher, so high that it would be  
13 absurd. That I think was the criticism.

14 MR BEARD: Yes, that is the argument but the point is --

15 THE CHAIRMAN: It is not about that you do not meet -- it is  
16 not about that it now means your actual price is below  
17 or above the benchmark. It is just that the effective  
18 common costs figure becomes huge, absurdly huge.

19 I think that is what the argument is if I have got it  
20 right.

21 MR BEARD: I think under all of these combinations you have  
22 got positive headroom across the combination, meaning  
23 you are not having to allocate significant common costs  
24 in relation to SFV. So this issue just does not arise  
25 in those circumstances because you have got overall

1 positive headroom.

2 THE CHAIRMAN: Is that the point you were just making  
3 a minute ago when you said look at the last sentence of  
4 this thing?

5 MR BEARD: Yes.

6 THE CHAIRMAN: I thought --

7 MR RIDYARD: I do not really think this addresses the point  
8 which is, it is an odd one this, is it not, because the  
9 criticism that Mr Parker is making is if Dr Jenkins had  
10 taken a more, what he thinks is a more purest approach  
11 to the combi thing, she would have got these super high  
12 allowable prices and that would somehow have been  
13 embarrassing and therefore should not be presented in  
14 that way and therefore -- so what she is -- if Mr Parker  
15 is right that she has departed from the sort of purest  
16 application of the combi, she has done something which  
17 is more conservative because she has -- all this is  
18 about how you -- what common costs are you permitted to  
19 recover on a particular bit of business.

20 MR BEARD: Yes.

21 MR RIDYARD: If it is a fact slug of business then any given  
22 amount of common cost is going to be less per unit but  
23 if it is a very, very thin slug of business, and  
24 Mr Parker is saying that if you take a very, very small  
25 amount of -- a very small segment of any multi-product

1 business and, say, a given amount of common cost could  
2 be recovered from that small amount of business, you are  
3 bound to get a very high ceiling and he says it is  
4 absurdly high.

5 I do not actually know why, at what point you would  
6 say this was absurdly high or reasonably high.

7 MR BEARD: Obviously the way in which Dr Jenkins has done it  
8 does not involve coming up with absurdly high numbers.

9 MR RIDYARD: But that is the criticism, is it not? The  
10 criticism is that she should have done it in the purest  
11 way and if she had done it it would have shown up how  
12 silly the result was.

13 THE CHAIRMAN: If I can just add something. I think this is  
14 important because we see the point that you have been  
15 making about the various analytical problems as you  
16 express it of RFS. We see all of that. But there is  
17 a kind of end result thing here as well because you  
18 have -- I do not know what the ultimate thing is but I  
19 think it is something like the common costs of the  
20 consumer business as a whole, 50% of them are loaded on  
21 to this section of Consumer which is SFV which only  
22 represents 17%, something like that, anyway. One of  
23 your arguments against that, well that does not matter  
24 because this is all about allowing the company  
25 flexibility as to how it -- I follow that. But there



1 are these points about the level, the sort of ultimate  
2 levels that are reached here, whether they simply look  
3 plausible or not, and I think that was the point that  
4 was being driven by Mr Parker is that if you apply the  
5 combi test in a pure way you are driven to a result  
6 which appears to show absurdly high common costs for  
7 SFV.

8 MR BEARD: Yes.

9 THE CHAIRMAN: The answer to that might be so what? If that  
10 is what it is, that is life, but Dr Jenkins was trying  
11 to give an answer to that and I was not quite sure that  
12 I understood what her answer was.

13 MR BEARD: If we go to the answer I think which is at  
14 {Day14/44:1}. Essentially I think what we need to be  
15 clear about is when you are identifying headroom it is  
16 how do you allocate that headroom is the question.  
17 Mr Parker is saying, oh well, you should effectively  
18 allocate any costs within that headroom to SFV and you  
19 always have to do that, and Dr Jenkins says, what the  
20 SAC combi is doing is identifying the headroom. It is  
21 not telling you then how you apply the costs, the common  
22 costs. What she is saying is, at that point you do  
23 engage in further consideration of how the business  
24 actually works.

25 If we pick it up at 44, line -- well, Mr Ridyard's

1 question and then Dr Jenkins:

2 "Yes, I just think it is very hard to think how one  
3 would implement that."

4 This is the very, very high price ceiling so this is  
5 the extreme version.

6 "So you are thinking of a standalone business which  
7 is supplying voice on a standalone [basis] and voice in  
8 a bundle, so you have to somehow fully separate these  
9 customer bases. That is why I have not done it that  
10 way. I have said whatever price you would set in that  
11 way to recover common costs, you have to think about  
12 that being the same price to these two types of  
13 customers. There is no way to hermitically seal across  
14 these two groups so you need to have a price for the  
15 voice services that are being supplied there and what  
16 the common cost allocation would be to that, whether it  
17 is sold standalone or in a bundle. I think that is the  
18 right way to think about allocating common costs in that  
19 combination."

20 THE CHAIRMAN: Let me just read on. It is useful just to  
21 read on, remind ourselves.

22 MR BEARD: Please. (Pause).

23 THE CHAIRMAN: Could we perhaps just go over the next page,  
24 page {Day14/46:1}. (Pause). Right, I see that he goes  
25 on to something else.

1 MR BEARD: Yes. But essentially he is saying when you have  
2 identified this headroom do not think about the way in  
3 which actually the business works in relation to these  
4 combinations even though you are testing these actual  
5 combinations. Dr Jenkins is saying, no, you should  
6 actually think about the way that these combinations and  
7 the way in which the business deals with these  
8 combinations work for the purposes of carrying out that  
9 cost allocation. That does end up with, as you put it,  
10 a more conservative approach in relation to it but it is  
11 not carrying out a completely abstract analysis in  
12 relation to it all. That is completely right, and that  
13 is what Dr Jenkins says is the right way of considering  
14 how you allocate headroom when you are dealing with  
15 these integrated products.

16 After all, you make a series of calls about what it  
17 is that you are putting within these different  
18 combinations for precisely the sorts of reasons we were  
19 canvassing about sports, so you are looking at the  
20 realities of the situation here. What she is saying is  
21 you take those realities to build the SAC combi model  
22 and you are also when you are identifying the headroom  
23 take those realities into account when you are dealing  
24 with the cost allocation.

25 THE CHAIRMAN: Just to crystallise this point and then we

1 will take a break. When she does her combi tests over  
2 whatever it is, 25 combinations pre-18 and 24 afterwards  
3 and whatever it is and then she ends up with whatever is  
4 going to be the lowest common cost that has to be  
5 attributed which I think is £22.84 or something like  
6 that and then that goes in as the common cost bit of the  
7 calculation of the cost benchmark, that 22.84 is  
8 actually, so far as SFV is concerned, is actually just  
9 one part of the common costs bit that is within the  
10 headroom that has to be allocated. Have I got that  
11 right?

12 MR BEARD: Yes, that is right.

13 MR RIDYARD: Sorry, can I just ask one question before we  
14 break which I am not expecting you to answer straight  
15 off but that is why you have the break.

16 Could we get a schedule or could you point us to  
17 where the data is which says what proportion of total  
18 common costs are being allocated to SFV in each claim  
19 period a year and how that compares to the proportion of  
20 SFV customers versus all voice customers in that year.

21 MR BEARD: Just so I am clear. Can we just go to Annex 3.

22 I just want to be clear what it is that is being asked  
23 for. If we go to Annex 3 which I think is 255.

24 {A/16/255} perhaps. I just want to be clear,

25 Mr Ridyard, are you asking whether or not we could

1           insert another row which rather than talking just about  
2           common costs overall is talking about common costs  
3           allocated to SFV effectively?

4     MR RIDYARD: Under the baseline, if you like, of the  
5           SAC combi, yes.

6     MR BEARD: Okay. I think the answer is probably yes, we  
7           probably can do that. I do not know how fast we can do  
8           that but I will make enquiries over the short break.

9     MR RIDYARD: Yes, thank you.

10    THE CHAIRMAN: Thank you very much.

11    (3.16 pm)

12                                   (A short break)

13    (3.32 pm)

14    THE CHAIRMAN: Yes.

15    MR BEARD: So to answer the question, yes is the answer, and  
16           we can provide it overnight so that it is available  
17           tomorrow morning.

18           That then takes me to some bad news which is I do  
19           not think I am going to finish today, so I will need  
20           a bit of time tomorrow morning. Obviously I will not  
21           take very long, and obviously Ms Kreisberger may want to  
22           have a reply.

23    THE CHAIRMAN: I rather suspect she might.

24    MS KREISBERGER: Yes, sir.

25    MR BEARD: I did not want to impose.

1 THE CHAIRMAN: If we can just look at actual timings for  
2 a moment, just to pause here. I know it is always  
3 difficult. But as we stand now, how much longer do you  
4 think you have got?

5 MR BEARD: I think I am going to need until 4.30 and then an  
6 hour tomorrow morning, if the Tribunal can bear with me.  
7 Then obviously that would actually -- if Ms Kreisberger  
8 then has an hour reply, that will actually be equal  
9 time.

10 THE CHAIRMAN: I think she may need more or want more.

11 MS KREISBERGER: Yes.

12 THE CHAIRMAN: To be perfectly honest, if we are going to be  
13 here tomorrow, I am not saying we are going to sit until  
14 4.30 tomorrow, but I do not think we will be too  
15 prescriptive about the reply as long as it is within  
16 reasonable bounds.

17 But then let us give you until 4.30 today, and then  
18 you have your hour tomorrow starting at 10.30.

19 MR BEARD: Perfect, thank you.

20 THE CHAIRMAN: Okay. Thank you. Right.

21 MR BEARD: So apart from answering that question, there  
22 was -- I did actually just want to go back to --  
23 because -- {A/13}, it was the paragraph in relation  
24 to ... {A/13/52}.

25 So I was going through (h), and I was going to come

1 on to (i) there, and I did not quite make it in the  
2 discussion.

3 The point made in (i) is the point we were then  
4 discussing, about how the headroom is allocated, and why  
5 it is that one uses the actual operation of business.

6 What is pointed out here is that actually that would  
7 be a symmetrical approach, whether or not it was  
8 headroom or negative headroom.

9 But it was really just 317 I wanted to pick up.  
10 Footnote 317, I am sorry. I will not take you through  
11 to the document but you get the reference there.

12 This is actually dealing with negative headroom, so  
13 this is dealing with a situation where Ofcom have  
14 carried out a cost allocation methodology, or are  
15 considering the application of a cost allocation  
16 methodology:

17 "Failure of a combinatorial test indicates that  
18 common costs have been over-recovered from the bundle of  
19 services in the combination."

20 The crucial point which we say is important here is:

21 "It does not of itself indicate which services were  
22 specifically responsible for the over-recovery or the  
23 extent of overcharging on each service. It could be  
24 that one service was over-priced or that some or all of  
25 the services in the combination were over-priced."

1           So that is in the context of negative headroom.

2           Where you have got positive headroom, which is what  
3 we are talking about, we say the same sort of question  
4 then arises. In other words, SAC combinatorial is not  
5 telling you, then, how you carry out that headroom  
6 allocation, which is why you then do consider the wider  
7 practical evidence, which is what Dr Jenkins does.

8           In other words, what Ofcom is saying is you do not  
9 adopt some kind of purist approach whereby you would, in  
10 the Ofcom analysis, just attach all of the negative  
11 headroom to the particular increment that you were  
12 focused upon.

13           So we are not saying that Ofcom is some sort of  
14 absolute authority in relation to it, but we are  
15 explaining why this is not some particularly exotic way  
16 of dealing with things. It is actually one that has  
17 been applied by the regulator when looking at these  
18 sorts of combinatorial tests.

19           So just taking a step back, we have explained why it  
20 is that the 2009 FAC RFS analysis is not a good basis  
21 for the Class Representative's case. Yes, Dr Jenkins  
22 has explained and operated a SAC combinatorial test here  
23 in order to assist the Tribunal in seeing how it is that  
24 a more flexible recovery of common cost approach can  
25 provide useful information and insight here, and that is



1           what it is doing. It is not for BT to prove the  
2           negative, going back to the points I have made on  
3           a number of occasions.

4           But it is also worth noting, of course, that she  
5           does carry out other cross-checks in relation to these  
6           issues.

7           First of all, we have got the distributed standalone  
8           costs methodology. Ms Kreisberger broadly addressed  
9           DSAC yesterday by reference just to her written  
10          closings, and just dealing with the points there  
11          briefly.

12          The first point she makes in her closings at  
13          paragraph 440 is that the DSAC cross-check relies on  
14          many of the same inputs and the assumptions of the  
15          SAC combi, therefore suffers from the same flaws.

16          Well, a lot of those criticisms are about the  
17          identification of the common costs and the cost analysis  
18          that is being carried out, and I have taken you through  
19          those points and I am not going to repeat them, but they  
20          are not good criticisms of DSAC either.

21          The second point is that Dr Jenkins is said to have  
22          relied on an arbitrary restriction of the relevant  
23          groupings to consider. Just to pick that up, could we  
24          go to {OR-E/49/149}.

25          So you will see there, as we go down, down to

1 page 150 {OR-E/49/150}, the second bullet in particular:

2 "There is nothing arbitrary about my selection of  
3 the increment to estimate distributed standalone costs.  
4 The case relates to the claim that certain SFV services  
5 are excessively priced but not others. It is therefore  
6 reasonable to view the broad increment as all SFV  
7 services including those related to SFV services which  
8 are not part of the claim."

9 There she is referring to the fact that Home Phone  
10 Saver and BT Basic are not included in the claim, but  
11 she is saying: but that still makes sense to take the  
12 increments as being all of them for the purposes of the  
13 distributed standalone cost assessment.

14 So we say there is nothing arbitrary or wrong about  
15 this approach in relation to the basic increment that  
16 she is using for identifying standalone costs and then  
17 the distribution of them.

18 We know that Mr Parker has done a sensitivity here  
19 that adds in bundles, but by doing that what he ends up  
20 doing is effectively just carrying out a form of fully  
21 allocated cost assessment and that is not, therefore, an  
22 informative cross-check.

23 The third point that is made in the Class  
24 Representative's submissions at 443 is that in the case  
25 law and Ofcom's past decisional practice, DSAC might

1 well have been okay to assess compliance with ex ante  
2 conditions, but somehow it is not okay for ex post  
3 competition assessment.

4 We have addressed this in our written closings.  
5 {A/16/134}. This is paragraphs 548 to 551 in our  
6 closings. With respect to Mr Duckworth, his reading of  
7 the case law as suggesting that, in relation to the  
8 consideration within the decisions and then appeals of  
9 DSAC, and why DSAC was a legitimate way of carrying out  
10 the costs allocation assessment, his suggestion was that  
11 somehow there was an overall price cap in place, and  
12 therefore all of the comments that were made in all of  
13 the case law and all of the decisions should be read as  
14 somehow qualified by that. But we just do not see that  
15 in the material at all.

16 If we go to page 138 in our closings, {A/16/138}.

17 Sorry, I think I may have given you the wrong reference.

18 It is 564, the DSAC cross-check.

19 THE CHAIRMAN: Just a second, please. (Pause). Yes.

20 MR BEARD: So with respect to Mr Duckworth, the approval  
21 being indicated in the judgments and decisions in the  
22 telecoms sector that DSAC is a useful cross-check in  
23 relation to particularly cost orientation which has some  
24 similarities to excessive pricing, that it is somehow  
25 qualified, just does not stack up as an account. If one

1 goes over the page at 565(b) {A/16/139} and 566, those  
2 are matters dealt with.

3 We also raise there the fact that although he talks  
4 about there being a regulatory overall price cap, in  
5 relation to the position of BT Consumer more generally,  
6 of course, when you are thinking about distributed  
7 standalone costs, there are actually constraints in  
8 relation to what he would accept are the dynamics of  
9 competition in relation to products that you are  
10 considering.

11 But the main point is his legal observation, such as  
12 it was, is just not valid. DSAC does provide a useful  
13 and important cross-check which has been used in the  
14 telecoms field and should not be ignored here.

15 The other cross-checks that Dr Jenkins explored were  
16 using a fully allocated costs modelling for actual  
17 costs. Ms Kreisberger suggests that there have been  
18 recantation and withdrawal in relation to the position  
19 in relation to the cross-checks, particularly on revenue  
20 and EPMU.

21 With respect, there is no surprise, there is no  
22 recantation, there is nothing of that sort. Dr Jenkins,  
23 unlike Mr Parker and Mr Duckworth, but like the  
24 decision-makers such as the CMA, and of course in the  
25 other cases, has realised that there is no one

1 particular way of doing these things and it is relevant  
2 to explore alternative methodologies.

3 Now, she does not recant in any way the points she  
4 makes about the limitations of fully allocated costs  
5 methodologies in the context of excessive pricing cases,  
6 but she did explore a range of potential drivers in  
7 relation to the operation of the fully allocated costs  
8 model, and she did it obviously in relation to the  
9 actual and contemporaneous costs during the relevant  
10 claim period.

11 Now, in relation to the different drivers that she  
12 looked at, obviously the claimant's experts have  
13 deprecated the use of equi-proportional mark-up, and one  
14 understands that it is not a good basis for allocating  
15 indirect costs in relation to this business, because you  
16 cannot assume that indirect costs are in direct  
17 proportion to -- are in proportion to the direct costs  
18 of the business. We understand that.

19 It was something that was sensible to explore and  
20 provide to the Tribunal as indicative. In fact, what  
21 that does is because it is plainly not a sensible way of  
22 allocating costs and would be hugely restrictive, what  
23 it actually does is provide a further sense check  
24 against the output of Mr Duckworth's analysis, because  
25 Mr Duckworth's analysis, based on 2009, coincidentally

1 looks like a contemporaneous EPMU analysis, but what  
2 that is showing is that the output of Mr Duckworth's  
3 analysis is effectively using the equivalent of  
4 a straitjacketing of BT in relation to accounts  
5 methodology which is plainly inadequate, and that is  
6 actually what Dr Jenkins says about this.

7 In the joint experts' statement she makes clear at  
8 7.1.19 that the coincidence of Mr Duckworth's FAC  
9 EPMU -- methodology with FAC EPMU demonstrates the  
10 inadequacy of Mr Duckworth's benchmark to determine  
11 whether SFV services were excessively priced.

12 That is instructive. Effectively, what  
13 Mr Duckworth's benchmark does is come up with an  
14 approach that results in, far from entry-incentivising  
15 prices, as we saw with the Post Office, they are  
16 actually lower than the commitments prices which were,  
17 as we saw, exit-incentivising.

18 So we say FAC EPMU, it is useful to see it, but  
19 actually it tells you more about the weakness of  
20 Mr Duckworth's analysis than anything else.

21 In relation to revenue, obviously Dr Jenkins  
22 understands the concerns that when you are considering  
23 an excessive pricing case, if you allocate costs by  
24 reference to revenue there is always a risk of  
25 a circularity. Obviously we say the circularity does

1 not arise here but we understand that concern.

2 But the third cross-check is of assistance, just as  
3 DSAC is, and that is to carry out a fully allocated  
4 costs methodology using customers or volume as the  
5 driver, which is effectively what you are doing by doing  
6 it by line.

7 Now, as I say, this is not saying that using fully  
8 allocated costs by any driver, including customers, is  
9 the right way of doing things, but she does recognise  
10 that it is useful to provide a cross-check as to where  
11 we are in thinking about these issues as an assistance  
12 to the Tribunal in circumstances where, again, it is not  
13 for Dr Jenkins to be proving these issues.

14 What we see illustrated when we look at these  
15 different cross-checks is actually a degree of  
16 clustering that may be informative for the Tribunal. If  
17 we go to our closing submissions at {A/16/144} -- sorry,  
18 can we go to the IR version, just for clarity  
19 {IR-A/16/144}.

20 So what we see there is the blue line at the bottom  
21 is the SFV -- this is the summary of cost-plus  
22 benchmarks compared to SFV services ARPU, so it is  
23 dealing with ARPU, and the flat blue line at the bottom  
24 is Mr Duckworth's methodology.

25 Then what we see are the different colours. So the

1 black solid line is SAC combi and using a 25% margin.  
2 I will come back to that in a moment. The dotted black  
3 line is SAC combi using 20%. Then we have DSAC, 25 and  
4 20%. Then we have FAC customers using those margins.  
5 Then we have the SFV services ARPU itself is the red  
6 line.

7 THE CHAIRMAN: Yes.

8 MR BEARD: So what we are doing is looking at a range of  
9 different methodologies and comparing them against the  
10 ARPU figures. So in those circumstances, we do say it  
11 is of assistance to the Tribunal in understanding how  
12 these different methodologies, each of which have been  
13 recognised, in particular SAC combi and DSAC, in the  
14 telecoms regulatory environment in relation to cost  
15 orientation matters, when one is thinking whether or not  
16 the Class Representative, or Mr Duckworth, has made out  
17 its case that that blue line is effectively good  
18 evidence of no reasonable connection, no reasonable  
19 relation between price and economic value, that single  
20 benchmark, for all of the reasons I have articulated, is  
21 not sound.

22 If we could just turn back a couple of pages to  
23 {IR-A/16/141}, we just there note, although Mr Duckworth  
24 does not accept customers as a driver, he does seem to  
25 think that where you have fixed costs of serving voice



1 customers that are not causally related to any single  
2 line, allocated by customers could be a reasonable way  
3 of allocating them.

4 So, far from saying FAC customers is some sort of  
5 perfect reflection of what is driving each and every  
6 indirect cost, Dr Jenkins and BT are just using it as  
7 a reasonable cross-check to test what the probative  
8 value is on the benchmark that the Class Representative  
9 is putting forward.

10 THE CHAIRMAN: If you modified the common costs bit of the  
11 competitive benchmark that you have just -- the various  
12 benchmarks, but let us concentrate on the combi one,  
13 that you have shown in the table, would that -- or if  
14 you halved it, for example, just taking an arbitrary  
15 deduction, would that bring the competitive benchmark  
16 then under ARPU?

17 MR BEARD: My maths is not good enough to ...

18 THE CHAIRMAN: Perhaps someone can tell me. I am only doing  
19 that -- I am only saying that because you may say, well,  
20 that is just an inevitable feature, that on Dr Jenkins'  
21 analysis, for the most part, perhaps not at the very  
22 beginning, the ARPU is actually under the competitive  
23 benchmark. It seems a bit odd. Unless you are saying  
24 the answer to that is, well, if in the event they could  
25 not contribute to their common costs in this way, that

1           is just what happens.

2           MR BEARD: No, it is a reflection of, in relation to the  
3           combinatorial benchmark, recognising a degree of  
4           flexibility in the way that you operate. But the  
5           question -- that is all -- SAC combi is providing that  
6           flexibility. So it is not in any way surprising that  
7           you end up with an ARPU that is below a SAC combi. I do  
8           not think that would be in any way surprising.

9           In relation to modification of common costs, I can  
10          explore these things. But I think just as a note here,  
11          I do not want to sound like a completely stuck record,  
12          but you have a situation where the claimant comes  
13          forward with its benchmark. What we are trying to do is  
14          say, look, there are well recognised ways of testing  
15          these things. We are offering ways to test these things  
16          which go beyond the criticisms we have about the  
17          assumptions on common costs being non-existent, which  
18          effectively undermine that benchmark, and the points  
19          I have made about the indirect costs allocation within  
20          it, even leaving aside that, and then we are going  
21          further.

22          Yes, obviously one can monkey with particular  
23          parameters, but in circumstances where a rational  
24          exercise has been undertaken, and that what you have  
25          there is a sensible set of sensitivities being

1           undertaken, the idea that one just arbitrarily draws  
2           a 50% cut through is problematic.

3       THE CHAIRMAN:  What I was trying to get at, and I am not  
4           asking you to produce the table, because I think I could  
5           work it out from the graph.  All I was trying to get at  
6           is although, on those lines, the ARPU is under the  
7           competitive benchmark, it could well be at or above the  
8           competitive benchmark a bit if you reduce the common  
9           costs element.  It would be odd if those results started  
10          then to hit your incremental costs, for example, as  
11          well, because then somebody might think well that is  
12          uneconomic, and that clearly --

13       MR BEARD:  Yes, I --

14       THE CHAIRMAN:  That is really all I was saying there.

15       MR BEARD:  Yes.  I do not know whether it is useful just to  
16          go to {IR-E/17/236}.  This is Table 6.10 in Dr Jenkins'  
17          first report which is obviously taking into account the  
18          low common cost scenario.  Because of course the reason  
19          I referred to sensitivities is because she did do that,  
20          so she has got a high baseline and low.  That is why  
21          I am concerned about the idea of cutting further --

22       THE CHAIRMAN:  No, I can see that.  That is helpful,  
23          thank you.

24                 Yes.  Right.

25       MR BEARD:  As I say, one needs to make sure that one is

1 dealing with this through the proper legal framework,  
2 and then, when we deal with it through the economic  
3 framework, we see fundamental flaws with that approach,  
4 and, indeed, a hugely limited and singular approach  
5 being adopted by the Class Representative in relation to  
6 these matters by dint of the fact that well over  
7 a decade ago now BT happened to be regulated and was  
8 subject to particular regulatory financial statement  
9 obligations.

10 Now, I want to just move on then to deal with issues  
11 on the margin, if I may, unless there are other  
12 particular questions in relation to the approach to  
13 costs.

14 I think you have the headline objections to their  
15 proposed 10% which converts to 11.1 margin on costs. It  
16 is taking a return from, effectively, a bygone era.  
17 I know that Mr Duckworth and Ms Kreisberger say, well,  
18 there are a range of cross-checks that we used, but  
19 actually it is just picking the number from 2006 during  
20 a period of regulation.

21 She said there were eight data points to support  
22 that plus. The first is the margins from 2004-2006, but  
23 that really does not assist her, because picking  
24 regulated margins is not a relevant indicator for these  
25 purposes.

1           The second reason given is the margins of other UK  
2 telecoms operators, but, with respect, this is  
3 a remarkably small selection that is being taken.

4           If we go to {IR-A/15/159}, we are talking about six  
5 companies on this plot. Yes, so there are five on here.  
6 There is the Post Office, but of course Sky is excluded.  
7 One of the others is the Phone Co-op, which is that  
8 small blue line that appears and rapidly disappears.  
9 Mr Duckworth and Mr Parker says it does not matter about  
10 the lack of data in relation to the Phone Co-op, it is  
11 all about the quality of the comparators, and that what  
12 he is trying to find are very close comparators to BT.

13           I find that a difficult submission to understand in  
14 the context of the Phone Co-op. It really cannot  
15 seriously be put forward as providing similar services  
16 based on a similar cost structure which is what is being  
17 said.

18           The same is actually true of the Post Office which  
19 is referred to above. We know that from all of the  
20 problems that we encountered when we tested the data  
21 Mr Duckworth was relying upon in relation to the  
22 Post Office.

23           In relation to Sky, it is being excluded because  
24 apparently it is a pay TV operator. Well, it certainly  
25 is a pay TV operator, but it is also obviously

1 a significant competitor in relation to voice and  
2 telephony, and if you are going to carry out that sort  
3 of analysis. I mean, Utility Warehouse is principally  
4 a utilities business but that stays in.

5 Ms Kreisberger says, well, including Virgin Media is  
6 a generous comparator because it is higher capital  
7 intensity. But it is insightful that capital intensity  
8 is being referred to as the relevant parameter of  
9 comparison, because if that is what you are doing, what  
10 you should do is look at comparators by reference to  
11 capital intensity, and at that point you should be  
12 looking at the far larger cohort of comparators that  
13 Dr Jenkins refers to that were defined on the basis of  
14 capital intensity, a huge dataset by comparison, and  
15 a huge dataset that does not involve this kind of  
16 selective picking of a tiny comparator set.

17 Then we have TalkTalk, which Mr Parker said of  
18 Mr Duckworth's data points.

19 "I would probably place most weight on TalkTalk and  
20 the Post Office in relation to the closest comparators  
21 you have in terms of the question we are really trying  
22 to explore, which is BT SFV services. TalkTalk there,  
23 not perfect, because it also does broadband and  
24 dual play as well."

25 I am not sure, when he said that, that Mr Parker was

1 necessarily conscious of the fact that TalkTalk has not  
2 sold voice only services to new customers since 2014.

3 So the selectivity is just not justifiable on the  
4 facts at all, and actually we are miles away from the  
5 sort of situation where you can say, never mind I have  
6 got only five data points for a comparison, but they are  
7 really, really good data points. They are not. They  
8 are extraordinarily poor and obviously highly partially  
9 selective, and if the criterion really is capital  
10 intensity, you should be looking elsewhere at the much  
11 broader dataset.

12 The third reason that Ms Kreisberger prays in aid is  
13 effectively Ofcom material, but as we saw yesterday when  
14 we looked at this material, or, rather, when  
15 Ms Kreisberger was going through it, this material does  
16 not assist Ms Kreisberger in the slightest. In fact,  
17 what it does, it indicates what the problems with  
18 Ms Kreisberger's approach are. This is Figure A5.14  
19 which is {IR-A/16/146}. If we can just blow that up.

20 So what this actually shows, insofar as she can pray  
21 in aid Ofcom material, and she does, is actually that  
22 20-25% as a margin for BT is what Ofcom considers to be  
23 consistent with promoting competition. This is not  
24 entry-incentivising pricing in the language of  
25 *Liothyronine*. What this is contemplating is if we drop

1 the prices for SFV services by £5 or £7, the margins we  
2 expect BT to hold will be between 20 and 25%. In the  
3 end, they went for £7 in relation to VOCs. Obviously  
4 they did not do anything in relation to the pricing on  
5 SPCs, at which point actually what they are recognising  
6 is that BT's margins will be well above that.

7 So insofar as Ofcom is saying anything, it was quite  
8 surprising for Ms Kreisberger to seek to rely on this,  
9 because it tells you exactly the opposite of what she is  
10 suggesting. It is not suggesting 10% is appropriate as  
11 a margin for BT, it is actually suggesting 20% is the  
12 minimum and you would expect it to be higher, and that  
13 actually, in relation to SPCs, Ofcom were recognising  
14 that these margins would be much, much higher, and that  
15 was not something that gave rise to a particular concern  
16 in relation to margins.

17 MR RIDYARD: Mr Beard, is this saying that BT's margins  
18 should be higher than smaller competitors because BT is  
19 bigger than them and that is just the way of the world,  
20 or is it saying BT's margin on SFV should be higher than  
21 its margin -- should be allowed to be higher than its  
22 margin on bundles or phone business more generally?

23 MR BEARD: I am not sure I know the answer to that question.  
24 I mean, what it is saying is that in relation to SFV,  
25 Ofcom is recognising that, for SFV services, BT having



1           those sorts of margins is not something that concerns  
2           Ofcom.  Indeed, Ofcom is making clear there in relation  
3           to the 7% adjustment -- the £7 adjustment, I am sorry,  
4           which is obviously what was done, that it is expecting  
5           that BT's SFV margins would be 20%.

6           But I am not sure I can answer the causative  
7           question in relation to these issues, or necessarily  
8           that for this part of the analysis the distinction is  
9           necessarily critical.

10          MR RIDYARD:  I suppose the other way of asking sort of  
11           I guess what is the same question is: should we worry,  
12           if we decide to say that BT should be charging lower  
13           prices on SFV, and the consequence of that is that  
14           no one else can live with them on SFV, is that something  
15           that should worry us, or is it just saying, well, this  
16           SFV business just happens to be a natural monopoly, and  
17           in natural monopolies you do regulate the dominant firm  
18           to a price which is fair and reasonable, but it would  
19           not be a price that anyone else could live with?

20          MR BEARD:  I think there are a number of points to unpack  
21           there.  I mean, the idea that you can see SFV services  
22           as a natural monopoly is quite a bold conception of SFV  
23           services to start with.  I mean, it is obviously  
24           understandable that in certain circumstances you may  
25           regulate a natural monopoly in circumstances where you

1 effectively cannot see the prospect of any competition  
2 or entry, but obviously that was not and is not the case  
3 in relation to SFV services. I mean, the Post Office is  
4 effectively the poster child of that, because in those  
5 circumstances it did enter, and it is only when you  
6 impose the £7 commitments that it realises that it  
7 cannot compete and cannot stay in the market.

8 MR RIDYARD: We are only having this conversation about this  
9 topic in a world where there is a narrow market  
10 definition and BT is dominant in it, or none of this  
11 would be very interesting, so ...

12 MR BEARD: That is obviously true. Sorry, I was taking  
13 issue with the idea of natural monopoly, because  
14 obviously the predicate of what you were saying was  
15 there is no possibility here, and therefore, in those  
16 circumstances, what you want is effectively full  
17 regulation, because you are not going to have a second  
18 water company-type situation, that is what you are  
19 contemplating, and therefore you drive the regulatory  
20 price down, because there is not any concern about  
21 anything else.

22 MR RIDYARD: That is what the CR is contemplating, is it  
23 not?

24 MR BEARD: Yes, it is. It is essentially saying we should  
25 use ex post competition law to continue a regulatory

1 environment that was specifically dropped by Ofcom and  
2 was not reinstalled.

3 MR RIDYARD: Because competition does not work in this ...

4 MR BEARD: That is what it is saying. That is absolutely.  
5 But I mean, the radical nature of that is actually an  
6 indictment of part of the problem with the Class  
7 Representative's case, that the idea that 10% is  
8 appropriate is indicated by what price reduction that  
9 would involve and therefore what consequence that would  
10 have for other CPs here. It would have to be this  
11 Tribunal saying, yes: no, that is exactly right. We are  
12 going to set a margin that essentially means you cannot  
13 ever have people properly competing here.

14 The radical nature of that conclusion, in  
15 circumstances where in 2018 Ofcom, even using its  
16 ex ante powers, so it is only setting prices going  
17 forward, and it is looking at a particular set of  
18 concerns it has about what it perceived to be a subset  
19 of vulnerable consumers at that time, and saying, we  
20 want to do something here, and BT saying, okay, we will  
21 do a deal with you in relation to that, and saying, no,  
22 no, no, we can do that backwards across the whole  
23 period, not only in relation to those VOCs but SPCs, and  
24 we can set it to the margin that means that no one could  
25 ever really compete for any of those people. It is just

1 not a coherent approach to how you should sensibly adopt  
2 a relevant margin assessment here.

3 Certainly this does not support the 10%. If what we  
4 are talking about is what are the conditions of workable  
5 competition, which is the hypothesis we are thinking  
6 about, insofar as you rely on this at all, it is telling  
7 you that in relation to -- consistent with promoting  
8 competition, not just letting competition be, but  
9 actually promoting competition, then 20-25% is within  
10 the range of what is being talked about here.

11 So it does not assist. It does indicate the radical  
12 nature of what it is that the Class Representative is  
13 seeking to do here through its claim, that I agree with,  
14 but it does not support the idea that it is not good  
15 evidence to support a 10% margin for conditions of  
16 workable competition.

17 There are a couple of references in ...

18 Ms Love points out, if we go to the provisional  
19 conclusions themselves at {C/1/100} and we go down to  
20 8.21. I am going to leave aside the irony that of  
21 course when certification was applied for, it was the  
22 2009 prices that was said to be the competitive  
23 benchmark. Obviously the world has changed in the Class  
24 Representative's case.

25 If one reads here:

1            "In 2009, we assessed BT's profitability using  
2            [return on sales] and have used the same approach for  
3            this assessment. Our assessment of [return on sales] in  
4            2009 suggests a margin for BT of [circa] 20% is  
5            consistent with emerging competition. If a similar  
6            margin was applied today, BT's monthly line rental would  
7            be ... approximately ..."

8            I am not sure if that is confidential.

9            If we just go back up to 8.20, you will see:

10           "At that time [so this is in 2009] BT was struggling  
11           to remain its market share and despite the removal of  
12           retail price controls in 2006 did not appear to have the  
13           commercial freedom to raise retail prices. Accordingly,  
14           the level of profitability that BT achieved on retail  
15           services at that time provides us with a starting point  
16           for the level of profitability that we believe is  
17           consistent with a market that is sufficiently  
18           competitive not to require regulation."

19           So when we take these things together, it is just  
20           very difficult to understand how any of this Ofcom  
21           material remotely assists in relation to this.

22           I think it is just worth stepping back to page  
23           {C/1/99}, because there is a reference to 5-10%. It is  
24           actually at paragraph 8.14. I think Ms Kreisberger has  
25           prayed this in aid. But of course what we see is

1 a cross-reference there to section A5.86, and for that  
2 we have to go to {C/2/30}.

3 Those are just all the regulatory entities. Then it  
4 refers to Figure A5.14 below:

5 "We have estimated how BT's profitability from SFV  
6 services would be affected based on different line  
7 rental prices from BT. We have shown a range of  
8 adjustments that could be made to BT's line rental that  
9 would result in similar EBIT margins to those we have  
10 discussed above."

11 But none of that is suggesting that those regulated  
12 margins are ones that should be applied there. Indeed,  
13 to the contrary, the paragraphs I have just taken you to  
14 indicate something completely different, as indeed does  
15 the analysis in Figure A5.14. There is certainly no  
16 proper justification for a 5-10% margin being applicable  
17 to here.

18 MR RIDYARD: So is it your view that in a competitive  
19 situation, BT should be allowed to have higher margins  
20 than it had to earn when it was regulated?

21 MR BEARD: Yes.

22 THE CHAIRMAN: Just a moment. (Pause).

23 MR BEARD: Indeed, that is precisely what Ofcom, in those  
24 paragraphs I was referring to at page 100 was saying at  
25 8.20 and 8.21.

1           So as I say, in fact the fourth point that  
2           Ms Kreisberger relied upon was regulation of network  
3           industries, and we say different risk profiles,  
4           different issues applied there, regulatory returns.  
5           That is not what this Tribunal is here to do. It is not  
6           here to sit as a regulator. I am not going to go back  
7           through Mr Matthew's evidence in relation to that, but  
8           I think that is of assistance in relation to these  
9           points.

10           In contrast, obviously we have Dr Jenkins'  
11           benchmarking exercise where actually what you have is  
12           a much fuller and clearer account of a large dataset, in  
13           fact, two large datasets, against which assessments of  
14           the rate of return can be made.

15           We pick those up in our closings at 148, so that is  
16           {A/16/148}. The criticisms levelled at these datasets  
17           are that there are vertically integrated telecoms  
18           companies in there, companies from different sectors,  
19           even different capital intensity controls, but we say  
20           that these comparators obviously provide you with a much  
21           better overall comparison about what a reasonable range  
22           of margins would be.

23           Going back to the test that we are thinking about, a  
24           reasonable relationship between economic value and  
25           price, it is this sort of comparison which is rich in

1 data that is relevant, that is helpful, in carrying out  
2 this sort of assessment.

3 Ms Kreisberger ends up resorting to trying to pick  
4 the extreme end of a Y intercept of a graph that  
5 I showed you in order to try and justify her approach.

6 If we go to {OR-E/49/267}. So this is the plot that  
7 Dr Jenkins provided: a very large dataset relationship  
8 between EBIT margin and capital intensity. She is not  
9 showing, as she said, she is not showing a very strong  
10 relationship but in her closings on Tuesday  
11 Ms Kreisberger actually ended up saying that you should  
12 focus on the point of Y intercept at that line at being  
13 about 9.5% as being a relevant and instructive data  
14 point. I mean, a more transparent attempt to pick the  
15 data you want without regards to the broader picture  
16 could not be clearer.

17 What instead we see from Dr Jenkins' approach is  
18 that the overall comparators that she undertakes do  
19 provide you with a range of margins and the criticism is  
20 levelled that one should not be looking at the upper end  
21 of the distribution in relation to her comparators.

22 Now, Dr Jenkins explains that when you are thinking  
23 about reasonable relationships, as we are doing here, it  
24 is perfectly right, both in relation to prices and in  
25 relation to margins, to be thinking about that overall



1 spread and that one of the things you will be thinking  
2 about is where are the parameters of reasonableness in  
3 relation to a margin.

4 She says well, 90%, the 90th percentile is  
5 a reasonable bound here in circumstances where you are  
6 dealing with a very large dataset. Obviously the  
7 90th percentile will represent companies who do provide  
8 benefits to their customers. They do have some sort of  
9 economic value I suppose. That is undoubtedly true.

10 But that is perhaps jumping ahead and taking into  
11 account limb 2 considerations in relation to the margins  
12 in limb 1, but she says that is a reasonable way of  
13 looking at these matters.

14 Indeed, even if you go down to the 75th percentile  
15 you are still around 20% in her calculations. If you  
16 start going down to the mid point, to the 50th  
17 percentile you are ending up saying that anything above  
18 the 50th percentile is essentially not in margin terms  
19 part of a reasonable relationship between price and  
20 economic value and that cannot be the right approach.

21 THE CHAIRMAN: Sorry, if you go to the 50th percentile?

22 MR BEARD: Yes, because you are picking the average at that  
23 point.

24 THE CHAIRMAN: Yes.

25 MR BEARD: What you are doing at that point is you are in

1 the context of assessing the reasonableness of the  
2 margin when you are considering reasonable relationship  
3 between price and economic value, you are essentially  
4 saying that all of those margins above the average are  
5 ones that contribute to an unreasonable relationship  
6 between price and economic value and that just cannot be  
7 right.

8 THE CHAIRMAN: Just a moment. (Pause). Yes.

9 MR BEARD: Because, as I say, that is the way in which one  
10 has to frame the legal test.

11 Now, I think there may be one or two small points --  
12 I do not actually know if I need to go back to them --  
13 in relation to margins and it may be useful to turn  
14 briefly to one of the other plots, but I did want to  
15 deal with just one issue on this where Ms Kreisberger  
16 suggested that it was contrary to law to do anything but  
17 take the average and that it was contrary to law to use  
18 the 75th or 90th percentile.

19 That is just not a tenable submission. She did it  
20 in the context of her submissions in Aspen. But nothing  
21 in the Aspen decision remotely suggests you are bound to  
22 use the average, the median average for either pricing  
23 or margins or a combination of the two.

24 As Mr Ridyard observed, what in effect one is doing  
25 by picking higher percentiles is recognising that around

1 an average there will be a range of prices and margins  
2 that are reasonable and that if what you are trying to  
3 do is ask yourself whether or not there is a reasonable  
4 relationship between price and economic value, taking  
5 that spread into account is important.

6 I understand that Ms Kreisberger's case, and she  
7 relies on *Aspen* to do this, is to say, oh well you take  
8 it into account in the significant and persistent part  
9 of the test. But quite apart from the fact that that  
10 somewhat contradicts her account which says, well  
11 significant and persistent is a tiny appreciability  
12 margin so we do not understand how those two things fit  
13 together, you are actually generating a huge degree of  
14 uncertainty because what you are saying is you should be  
15 picking these lower average margins, people should be  
16 working on the basis of those and then you should try  
17 and work out what goes into significant and persistent.  
18 That is not the right approach in terms of the legal  
19 test. You should be asking yourself: where do you set  
20 your benchmark, your cost-plus benchmark having regard  
21 to the reasonableness test, the reasonable relation test  
22 that we are talking about in relation to *United Brands*  
23 and a reasonable relation test is going to take into  
24 account dispersions in price, is going to take into  
25 account dispersion in margin or at least it should.

1           It is obviously perfectly sensible for the very end  
2           of a spread of a large dataset to be excluded but you  
3           want to be very cautious before you are bringing it too  
4           far back towards the average because effectively you are  
5           saying in relation to extant businesses in workably  
6           competitive markets, they are charging at prices or  
7           margins that are not reasonably related to economic  
8           value, and that is not a parameter that should be used  
9           by this Tribunal or indeed any regulator if it were  
10          faced with these matters in relation to an investigative  
11          case, and that is not what we see in any of the case  
12          law.

13           I think now might be a convenient moment and I will  
14          curtail matters so that we deal with matters within the  
15          hour tomorrow.

16        MS KREISBERGER: Could I just confirm one thing, that  
17           Mr Beard will be circulating the costs data Mr Ridyard  
18           asked for tonight so we will have an opportunity to have  
19           a look at that before tomorrow morning.

20        THE CHAIRMAN: I was not sure he was saying when that could  
21           be done.

22        MR BEARD: I did not actually say, but those that said that  
23           they could do it did also say that they could do it  
24           tonight.

25        MS KREISBERGER: I would be very grateful.

1 MR BEARD: So you could have the benefit of it tomorrow,  
2 yes.

3 THE CHAIRMAN: That is very helpful, thank you. Good, 10.30  
4 tomorrow.

5 (4.32 pm)

6 (The hearing adjourned until Friday, 22 March at 10.30 am)

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