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IN THE COMPETITION
APPEAL TRIBUNAL

Case Nos. 1151/3/3/10
1168/3/3/10
1169/3/3/10

Victoria House,
Bloomsbury Place,
London WC1A 2EB

11 April 2011

Before:

MARCUS SMITH QC
(Chairman)

PETER CLAYTON
PROFESSOR PAUL STONEMAN

Sitting as a Tribunal in England and Wales

BETWEEN:

BRITISH TELECOMMUNICATIONS PLC
EVERYTHING EVERYWHERE LIMITED

Appellants

– v –

OFFICE OF COMMUNICATIONS

Respondent

EVERYTHING EVERYWHERE LIMITED
VODAFONE LIMITED
TELEFONICA O2 UK LIMITED
HUTCHISON 3G UK LIMITED

Interveners (Case 1151)

BRITISH TELECOMMUNICATIONS PLC
EVERYTHING EVERYWHERE LIMITED
VODAFONE LIMITED
TELEFONICA O2 UK LIMITED
HUTCHISON 3G UK LIMITED
OPAL TELECOM LTD
CABLE & WIRELESS UK

Interveners
(Cases 1168 and 1169)

HEARING DAY FIVE

APPEARANCES

Mr. Graham Read QC, Miss Sarah Lee and Mr. Richard Eshwege (instructed by BT Legal) appeared for the Appellant.

Miss Kassie Smith and Mr. Philip Woolfe (instructed by Regulatory Counsel, Everything Everywhere Limited) appeared for Everything Everywhere Limited

Mr. Javan Herberg QC and Mr. Mark Vinall (instructed by the Office of Communications) appeared for the Respondent.

Mr. Tim Ward QC (instructed by Herbert Smith LLP) appeared for the Intervener Vodafone Limited.

Mr. Robert O'Donoghue (instructed by Telefónica O2 Limited) appeared for the Intervener Telefónica O2 Limited.

The Intervener Cable & Wireless UK was represented by internal counsel.

The Intervener Hutchison 3G UK Limited was represented by internal counsel.

The Opal Telecom Ltd did not attend and was not represented.

1 MR. HERBERG: So we now come to Ofcom's witnesses. Before I call the first witness can I
2 just deal with a couple of timing, housekeeping matters? You invited the parties to consider
3 timings of witnesses as a salutary discipline as to where we are going. We have just put our
4 heads together with the first witnesses and we have not so far encountered any insuperable
5 timing problems by people's estimates if they are kept to. Would it help to give you a quick
6 indication – we have not reduced it to written form or produced a full timetable, but I can
7 certainly give you an indication as to the parties' bids in relation to Mr. Myers and Mr.
8 Pratt.

9 THE CHAIRMAN: That would be very helpful.

10 MR. HERBERG: Sir, in relation to Mr. Myers, who will be Ofcom's first witness I will be a
11 short amount of time in chief, 10 to 15 minutes maximum. Then Miss Smith will cross-
12 examine first and will be up to one and a half hours. Mr. O'Donoghue for O2 – 15 minutes.
13 Mr. Ward for Vodafone – very short, and Mr. Read for BT estimates two hours. It is
14 unlikely there will be much by way of re-examination but I cannot estimate at this stage. So
15 if that were kept to we would hope to be within a day and for Mr. Pratt to be able to start
16 this afternoon. We certainly think Mr. Myers will be the great majority of the day.

17 THE CHAIRMAN: Yes, I would be surprised if that were not the case, I must say.

18 MR. HERBERG: Indeed, but either way we think that could be accommodated – even if he were
19 the entire day – because the bids for Mr. Pratt are Mr. Read estimates being up to one and a
20 half hours for BT and none of the MNOs propose to cross-examine.

21 THE CHAIRMAN: That is very helpful, Mr. Herberg, thank you very much.

22 MR. HERBERG: Then we move to Dr. Maldoom and Professor Dobbs, and for Dr. Maldoom I
23 estimate being some two hours, Everything Everywhere, Miss Smith estimates being up to
24 an hour, Vodafone up to 30 minutes, O2 – Mr. O'Donoghue – up to 15 minutes. Several of
25 those are contingent on what has been asked before so they may be shorter. Once again he
26 might be completed, we would hope tomorrow (12th) with Mr. Pratt overspill there or
27 thereabouts. Then Professor Dobbs I estimate being only an hour because I am not covering
28 substantial parts of the statement. Mr. O'Donoghue will go first for the MNOs, and
29 estimates being one and a half to two hours, Everything Everywhere up to 30 minutes, and
30 Vodafone thirty minute to an hour. So Professor Dobbs, on those estimates, clearly will be
31 the best part of a day if not a full day, but that may not be unexpected.

32 Sir, we have not yet done that same exercise with Professor Valletti and Mr. Walker but I
33 think in a way those cover the trickiest, potentially longest witnesses and part of the

1 timetable with most constriction, indeed, we think there may be some flexibility on 14th and
2 15th if we are slightly longer than those estimates.

3 THE CHAIRMAN: We are grateful to you, Mr. Herberg, and indeed to all the parties for those
4 indications, that is extremely helpful

5 MR. HERBERG: The other point I wanted to mention before I call my witnesses is in relation to
6 my examination-in-chief, in respect of all of my witnesses there have been reports
7 submitted by other parties, particularly by BT, subsequent to their statements. What I am
8 not proposing to do is to take my witnesses through each and every point where they might
9 disagree, that would be a laborious process – most of those points I am sure will be put by
10 Mr. Read in any event in due course. What I was proposing to do in chief was just to
11 highlight a few of the most salient points where there is disagreement, or where there is
12 something new to come out of it and really shortly just to pick a few matters and leave
13 everything else to those cross-examining on the basis of course that that means I am not
14 putting every single difference or every single disagreement to my own witnesses, but I am
15 sure no one is going to take a point on that.

16 THE CHAIRMAN: I am sure no one will take that point, and I am quite sure your witnesses will
17 be able to deal with such points as they wish in cross-examination and we will be more than
18 willing to give them every latitude to do so in that way.

19 MR. HERBERG: Sir, I am grateful. On that basis can I call Mr. Myers, please?

20 Mr. GEOFFREY RICHARD PLATT MYERS, Sworn

21 Examined by Mr. HERBERG

22 Q Mr. Myers, can you identify from the wall of volumes to your left bundle C2, and if you
23 could turn to tab 27 in that bundle, there should be a document headed your first witness
24 statement. Could you turn to p.43 within that statement there should be a page – I do not
25 know whether your copy is signed.

26 A It has my name but not a signature.

27 Q You will be shown a copy with your signature. Is that your signature?

28 A It is.

29 Q Does that statement contain the evidence which you wish to give to the Tribunal?

30 A Yes, it does.

31 Q And that statement was made in the 080 appeal – am I right?

32 A That's correct.

33 Q If you could just go to the next tab, tab 28, please, this is headed second witness, again of
34 you, and in that statement can you turn to p.106, please. Is there a signature on that page?

1 A No.

2 Q Again, I think you can be shown a copy with a signature. Is that your signature?

3 A That's my signature?

4 A Yes.

5 Q Does that statement contain the evidence which you wish to give to the Tribunal?

6 A Subject to a few clarifications in one specific section.

7 Q Would you like to deal with that now and tell the Tribunal about the clarifications you wish
8 to make?

9 A This is in the section that starts on p.77, para.250. My clarifications are essentially about
10 the treatment of service providers with this and the few subsequent pages, and my
11 clarifications are about ensuring consistency with the rest of my statement and indeed the
12 final determination. In para.250(a) I referred to "distributional consequences between
13 originators, terminators and service providers; and then again the first sentence of 251
14 refers to those three types of hire. Of course, service providers are different from
15 originators and terminators, service providers being defined as consumers under the Act,
16 whereas originators and terminators are not. So really those paragraphs should not refer to
17 service providers.

18 Q In other words, the statement that Ofcom was not concerned about the distributional
19 consequences does not apply to service providers?

20 A That's correct.

21 Q Yes.

22 Q Then on the next page in para.253(b), it refers to distributional effects including one set of
23 consumers gaining at the expense of another set of consumers. Then in the first sentence of
24 the next paragraph, 254, it says that the second category of distributional effects between
25 consumers was not important in the context of the disputes. In fact, what I had in mind in
26 253(b) was one set of callers gaining at the expense of another set of callers, and that
27 category of distributional effects was not important in the context of the disputes. Of
28 course, "consumers" includes service providers, and in fact the distributional effects
29 between callers and service providers is, in fact, quite important in terms of the indirect
30 effect, the greater weight that Ofcom placed on callers over service providers through
31 indirect effect. The final point is a few pages further on near the bottom of p.83, footnote
32 194. This is referring to the indirect effect as shown in figure 8, but in fact the footnote,
33 unlike the figure, actually only refers to the indirect effect on callers, and does not refer to
34 the indirect effect on service providers, whereas the line for the indirect effect in figure 8

1 includes both the indirect effect on service providers and callers with the suitable relative
2 weighting of those two.

3 Q So the amendment that you would make to footnote 194 were you writing it now would be
4 to add a reference to service providers – is that right?

5 A That’s right, I would make clear that the first sentence in that footnote which ends “so there
6 might be no positive indirect effect”, that relates to the indirect effect on callers; and then
7 make clear actually that the diagram includes both the indirect effect on callers and on
8 service providers.

9 Q Thank you. Mr. Myers, subject to those points, is this second statement the evidence that
10 you wish to give to the Tribunal?

11 A Yes, it is.

12 Q Can I first ask you, Mr. Myers, in view of some of the doubts expressed by Dr. Maldoom
13 most recently in his seventh statement, I want to ask you a few questions about the potential
14 effects of a reduction in MNO 080 prices and whether and, if so, how they were taken into
15 account by Ofcom in its decision. This is very much by way of, as it were, summary of
16 your position. It might be helpful to have open in that second statement your table 6, which
17 is at p.74. Can I ask you, first, in relation to what has been referred to as the “volume
18 effect” – in other words, the potential for a reduction in 08 prices to stimulate 08 call
19 volumes – was that a matter which was taken into account by Ofcom in its welfare analysis,
20 and, if so, how?

21 A Yes, it was, and this relates in some sense to the first three columns in this – sorry, the first
22 three rows in this table. These are all the effects that are triggered by a reduction in the
23 0845/0870 call price. The first two rows show the increase in the volume of those calls in
24 response to lower prices; and the second row refers to the potential alleviation or partial
25 alleviation of the market failure, what has come to be called the “brand enhancement”
26 feature last week. If the gap for consumers between what they think prices are and what
27 prices actually are, which is rather large at the moment, is reduced, or if they become more
28 confident about making calls to these numbers, and the evidence here is they are not
29 currently confident, then a reduced price could increase confidence, increase their
30 awareness of prices and also lead to a magnification of the volume increase. So that is what
31 is reflected in that second row. Then the third effect is an effect, as it were, that arises as a
32 consequence of an increase in volume, which is the service providers experience that
33 increase in volume and that might encourage them to increase the quality or availability of
34 the 08 services. That is the third row in this table.

1 Q And is that row what has been sometimes referred as the “brand quality”, increased demand
2 caused by an improvement in quality?

3 A Well, the brand quality *per se* is the second row, but a consequence of the increase in brand
4 quality is captured in the third row.

5 Q How were those effects taken into account in the final determination?

6 A As the table shows, they were taken account of through the direct effect – either through the
7 direct effect, as it were, in itself without the externalities or through the greater weight on
8 the direct effect reflecting the potential alleviation of the externalities and the market
9 failure.

10 Q Can I ask you then about the indirect effect, some factors, and again I am asking you about
11 whether they were taken into account in the final determination and, if so, how. Firstly, did
12 Ofcom take account of revenues received by BT in increased termination charges to the
13 extent that they were not passed on to service providers?

14 A No, those were not counted as benefits.

15 Q Did you take into account revenues received by service providers from BT by way of pass-
16 through, to the extent retained by them and not expended in ways benefiting 08 callers?

17 A Sir, those were counted as benefits but with a lesser weight than the benefits to callers
18 themselves. Although that effect is not shown – since we have got table 6 up, perhaps it is
19 worth just explaining that table 6 is showing the beneficial or detrimental effects on the
20 economic efficiency. That is, as it were, things that increased the size of the cake. If the
21 pass through to service providers merely is merely retained by service providers as profit, it
22 is not clear that there is an improvement in economic efficiency. That is why table 6 does
23 not show the indirect effect on service providers, but I think, as we have seen from, for
24 example, the summary table 9.1 in the final determination, where it refers to the indirect
25 effect it refers to both the indirect effect on service providers as well as callers.

26 Q Can I ask you then about the indirect effect on service provider customers through improved
27 quality or services or the like. Was that taken into account?

28 A Yes, the indirect effect on callers was taken into account and that is shown in the fourth row
29 in this table. The potential response of service providers to higher revenue share or lower
30 hosting prices, if that leads them to increase the quality or availability of the 08 services,
31 then that is a benefit to callers which is taken into account through the indirect effect on
32 callers.

1 Q Then, last of all, we have benefits to BT customers, benefits, money or improved service to
2 BT customers, through greater termination charges received by BT, sometimes called the
3 “fixed tariff package effect”.

4 A So, the fixed tariff package effect, if it were to occur, would be of benefit to consumers,
5 would not be a benefit to mobile customers or indeed necessarily callers to these — or
6 consumers in their role of calling these numbers. But, it would still be a benefit to
7 consumers. So, in terms of the framework that Ofcom used, yes, those things were included
8 as potential benefits. It is just that Ofcom had some doubts that this effect was actually
9 relevant or of much significance in terms of creating a benefit.

10 Q And, perhaps finally, first of all, in this taxonomy, Mr. Myers, I do not think I need to take
11 you to it, Dr. Maldoon in his seventh statement at para.22 when he dealt with Ofcom’s
12 definition of consumer welfare, he said that he was unclear whether Ofcom intends
13 consumer surplus to be its sole consideration or whether consumer surplus should simply
14 receive greater weight than profits. Can you clarify for Dr. Maldoon Ofcom’s approach
15 with regard to the profits of MNOs or TCPs such as BT?

16 A Sir, the profits to MNOs or TCPs were not counted as either benefits or detriments.

17 Q Now, dealing with a few other short points, can I ask you, first of all, to go in your second
18 statement to figure 8, which is on p.82. This is a figure about which there has already been
19 some debate in opening. Can I ask you, simply, what was the purpose of including figure 8
20 in your report?

21 A The purpose was essentially as I set out, so this figure appeared in a section headed,
22 “Summary of key conclusions — comparison between Ofcom and Maldoon 5” and, as I say
23 in para.264:

24 “For ease of comparison with Maldoon 5, at figure 8 below I set out an illustrative
25 summary of Ofcom’s conclusions”.

26 So that was the purpose. It was to try and bring out and make clearer, the nature of the
27 differences between the points set out in Maldoon 5 and in Ofcom’s final determination.

28 Q And, what inferences can be drawn about Ofcom’s assessment of the relevant sizes of the
29 different effects, direct effect, indirect effect, mobile tariff package effect?

30 A Sorry, just to start in answering that question just to refer in particular to the indirect effect
31 on this diagram, because it is the shape of the indirect effect in this diagram which is
32 materially different from the corresponding diagram, I believe it is right near the end of the
33 Maldoon 5 statement, because that showed a significant positive indirect effect at 12.5ppm.
34 And this was the question that, in my view, the difference was a difference of labelling, that

1 in Maldoon 5, effects which were categorised under the indirect effect were captured by
2 Ofcom under the direct effect. So, the point that this diagram is essentially bringing out is
3 that at 12.5ppm the indirect effect is zero. That is because the indirect effect is triggered by
4 an increase in the termination rate, and at 12.5, or as we have established, slightly below
5 12.5ppm, there would be no increase in termination rates. But, in terms of 12.5ppm the
6 only thing this diagram is saying is simply that the direct effect exceeds the mobile tariff
7 package effect, the direct effect, including the greater weight on it, exceeds the mobile tariff
8 package effect and that is simply a diagrammatic representation of a point that is made
9 elsewhere, both in my initial statement and in the final determination. And then at the
10 current price the diagram is illustrating that the mobile tariff package effect in Ofcom's
11 view, exceeded the indirect effect, taking account of the relative weighting of the indirect
12 effect on callers and service providers. And that is shown in terms just towards the bottom
13 of that diagram, "Overall effect", "Negative net effect at current price and above". So, there
14 is a positive net benefit of 12.5ppm, a negative net benefit, or a detriment, at current price,
15 and in between it is uncertain. It could go either way. So, again, it is merely illustrating the
16 direction of overall effects by showing some of the relativities at key points at key prices in
17 this figure 8 diagram.

18 Q Now, Mr. Myers, can I ask you about another matter with which Dr. Maldoon says he does
19 not fully understand what you are referring to? Can I ask you to take bundle C1 which
20 contains Dr. Maldoon's witness statements, and go to tab.14 in that bundle which contains
21 his recent seventh statement and, within Maldoon 7, to go to para.136-137 on p.51. In
22 para.136 he is dealing with a statement which he says you have made. You have not
23 disputed the smallness of any price increase caused to other mobile services by decreasing
24 the price of 0845/0870 calls. In response you have pointed to the relatively large volumes
25 of such services, and there is a quote there. And he says then at para.137:

26 "It is not clear what Mr. Myers means by the volume of 'other mobile services'
27 given these are heterogeneous".

28 Now, can you assist Dr. Maldoon with his understanding as to what you meant in referring
29 to other mobile services here?

30 A Yes. So, the quote he is responding to, or my comment he is responding to, is that more
31 than, that the volumes of other mobile services is more than 90 times larger than the volume
32 of mobile originated 0845/0870 calls. So, that point is, I think, precisely explained in
33 para.324 of my second witness statement on p.98. Other mobile services include mobile
34 voice call minutes which, I think, can be directly compared in terms of call minutes to the

1 volume of mobile originated calls to BT's 08 numbers. Other mobile services would also
2 include things like subscriptions, for example, which obviously, number of subscriptions
3 which cannot be compared directly to the volume of call minutes. So, in para.324 I say that
4 there are 118 billion mobile voice call minutes in 2009, and it is that number, and the source
5 is given in the footnote, which is compared to the 1.3 million minutes of mobile originated
6 calls. So, it is a comparison of call minutes.

7 Q Thank you. Then, just picking up where we were in Dr. Maldoon's statement, para.138, he
8 criticises you for describing an increase in the price of other mobile services as an "adverse
9 effect", whereas he is saying that correcting over-consumption is beneficial. If you would
10 just read through para. 139. My question to you on that paragraph is: do you accept that his
11 criticism is justified?

12 A So we need to distinguish here between two types of effect or, if you like if I can put it in
13 terms of over consumption, the over consumption point is a point inherently about the
14 structure of prices. It is saying that in terms of the structure of prices the prices of 08 calls
15 are too high and, as a consequence of that, the price of other services is too low. That is a
16 point about structure, so if that structure price is improved, i.e. the 08 call prices go down as
17 the price of other mobile services go up that is a benefit, that is a reduction in what one
18 might call 'relative over consumption' because it is improving the structure of prices from
19 the point of view of welfare or benefits to consumers.

20 However, if one simply has an increase in the price of other mobile services without a
21 corresponding reduction in the price of 08 calls then that is simply a price increase, that is
22 not a change in the tariff rebalancing, that is merely an increase in one element of the
23 package, so that is a detriment to consumers because they are paying higher prices. So this
24 really goes to the distinction, which I think is most clearly brought out if we consider the
25 comparison between the full reduction scenario, and the no reduction scenario.

26 In the full reduction scenario there is no increase in termination rates and the effect for
27 mobile consumers is a rebalancing of prices. That rebalancing is likely to be beneficial
28 because it alleviates the relative over consumption. But in the no reduction scenario we do
29 not have rebalancing, there is no reduction in the 08 price. The effect on mobile consumers
30 is they pay a higher price for other mobile services, so they simply experience an increase in
31 prices and that is detrimental because it does not arise in the context of tariff rebalancing.

32 PROFESSOR STONEMAN: Could you go back a little bit on that? The rebalancing, this is part
33 of the mobile tariff package effect, and there are two mobile tariff package effects. One is
34 in reaction to increased costs that the MNOs might face because of an increase in BT's

1 profits, and the other one is a mobile tariff package effect that results as 08 prices fall,
2 because 08 prices fall the mobile operators try to change other prices in order to
3 compensate. Now, if we just think about the second one of those, we will forget the first
4 one for the moment.

5 The second one, I thought the argument here was that you take the mobile tariff package
6 effect resulting from the reduction in 08 prices as a negative in the benefit calculation
7 whereas Maldoom here is arguing it is in fact a positive because those prices are too low
8 from a welfare point of view, because there is excessive cross-subsidisation. So let us take
9 a very simple example, basically what the mobile network operators might do is to increase
10 the price of handsets, so instead of subsidising the price of handsets the loss of revenue that
11 comes from lower 08 prices means there is less subsidisation of handset prices, but at the
12 moment handset prices are too low from a social point of view they ought to be higher, and
13 therefore the increase in price is not a cost in fact, it is a benefit to society?

14 A So I would say that the net effect of the tariff rebalancing with some prices going up and
15 others going down is positive – likely to be positive – because you are improving the
16 structure of prices. But that is the combination of a positive effect through the price
17 reduction and a smaller negative effect through the price increase on handsets or other
18 mobile services, but the net effect is positive. If one simply experienced the price increase
19 without a corresponding price decrease then that would not be positive that would be
20 negative.

21 Q I am sure he can argue for himself later on that the price increase here could well I think in
22 this argument by Maldoom be taken to be socially desirable and not socially harmful?

23 A But my view is that is not correct because the benefit arises from an improved structure of
24 prices. If one simply has a price increase then it does not seem to me that that is a benefit.
25 It requires the reduction in 08 prices that offsets the increase in handset prices for it to be
26 overall beneficial.

27 Q I am sure he can answer for himself when he gets here.

28 MR. HERBERG: Let me ask you one more question on that; this may be a matter on which you
29 will be cross-examined, but just to elucidate your position. Is your answer that the increase
30 in prices looked at on its own without the associated decrease in 08 prices, the increase in
31 prices by what Mr. Read's diagram called "W" – the additional revenues on other calls as a
32 result of the waterbed effect relating to "A" as he put it – is your view that that is on its own
33 not a benefit, a position which you hold absolutely as a matter of theory or is it relating to

1 the prices in this case? In other words, could there be a price at which it would be an
2 advantage on its own for the price to go up, or is it based on this case?

3 A So there could be, if the price was so low that it was below the marginal cost of the services,
4 then a price increase, because the price was below cost in the marginal cost sense, might
5 well be beneficial on its own. But absent that, the price, as I think would certainly be the
6 case here, because whilst there may be a cross-subsidy from 08s to other mobile prices in
7 terms of the size of the volume, as I was discussing before the volume of other mobile
8 services, that subsidy is relatively small. So you really would not expect that subsidy to be
9 so large that it would take the price of other mobile services below marginal cost, and once
10 the price is above marginal cost then an increase in that price on its own is a negative effect,
11 but in the context of rebalancing it is more than offset by a positive benefit from price
12 reductions.

13 Q My penultimate question, Mr. Myers, if I can ask you to turn back in Dr. Maldoom's second
14 statement, which I think you still have open, to para. 18 on p.7, please? At para. 18 Dr.
15 Maldoom is relying on the NGCS review and, in particular, the statement about the £500
16 million per annum of the detriment associated with current pricing. It might be helpful if
17 you could just have open the relevant passage in the NGCS review, which is in bundle 13
18 on your left hand side, I hope, it will be at tab 3.1 in that bundle, and p.192 within the
19 review. Dr. Maldoom is making the point that the detriment associated with current pricing
20 of 08 calls is likely to be large, in the order of £500 million per annum or more for NTS
21 calls, which is roughly one quarter of that total NTS market revenue. You will see the table
22 A2.22 on p.192 gives an aggregate for all OCPs of 563 million consumer welfare gains, and
23 mobile OCPs on the right hand side 66 million.

24 Do you agree with Dr. Maldoom that it is reasonable to take the figure of around about £500
25 million as being a fair estimate of the detriment caused by the pre-NCCN pricing of mobile
26 calls?

27 A No, I do not think that is reasonable for mobile originated mobile calls. Table A2.22 here
28 shows an estimate of the detriment, this arises from consumers believing prices are much
29 higher than they really are and, as you can see, the estimate has built up from fixed
30 originated calls, fixed OCP columns, and mobile originated calls, mobile OCP. So one
31 might say that the £66 million relating to mobile originated calls would be the more relevant
32 number. However, it is a little more complicated than that because as I think it is the
33 paragraph immediately below this table points out that it is possible that higher prices on
34 mobile originated calls could have adverse effects on consumers' confidence, or their

1 perceptions of price on fixed originated calls as well, and indeed there is potential vice-
2 versa. So £66 million may not be the correct number for mobile originated calls, the
3 detriment caused by high prices of mobile originated calls, but it seems to me that it is a
4 much better starting point for that analysis than £563 million. I think there are also some
5 further very important points to make clear about this number and what it is and indeed
6 what it is not. So what it is is an order of magnitude quantification of one of the detriments,
7 this difference between perceived and actual prices. It is not, in fact, an estimate of the
8 likely benefit of any policy proposal either set out in this document or indeed what one
9 might expect the effect of the NCCNs to be. This is showing the detriment caused by any
10 difference between actual prices and perceived prices. Given the nature of telecoms
11 services and what we know, for example, about perceptions of geographic calls is that there
12 is still some misperception of pricing geographic calls. Even the most effective remedy, I
13 don't think we would expect to remove all of this detriment. In fact, it might remove
14 significantly less than this full amount. We'd still expect at the end of any remedy, the
15 likely benefit of any remedy would reduce the gap between perceived and actual price, but
16 not entirely remove it.

17 I think, furthermore, it is important to bear in mind the nature of this market failure, this
18 lack of price awareness. This is quite deeply entrenched on the non-geographic number
19 ranges, and it is particularly so on 0845 and 0870. There has been persistent and quite
20 deeply entrenched misperception of pricing by consumers on these number ranges, and
21 indeed a lack of consumer confidence. That, if you like, is reflected in Ofcom's proposals,
22 because Ofcom's proposals in this document, which obviously are for consultation going
23 forward, it is not actually to retain 0845 and 0970 as geographically rated non-geographic
24 calls, but instead to use the 03 number range to perform function. The reasons for that are
25 because these number ranges, 0845 and 0870, are quite tainted in the minds of the
26 consumers, and furthermore it is quite a confusing message. 0845 is intended to be linked
27 to geographic, the price of geographic calls, but 0844, which is only different at the fourth
28 digit, does not have that link. It has a different regime; and similarly for 0870 compared to
29 0871. So even for a very effective remedy I think it would be difficult to change
30 consumers' perceptions of prices for 0845 and 0870, and indeed, particularly perhaps, to
31 improve consumers' confidence.

32 So the consequence of all that I think is that the NCCNs, which do not directly address
33 consumers' perception of prices or directly address consumer address, they might address
34 them indirectly, but they do not address them directly, is that the benefit that they might

1 cause – how much of this detriment they might remove, could actually be a relatively small
2 proportion of even the 66 million. I think it would be very difficult to know or to be
3 comfortable that it would have a major impact in alleviating anything like the £500 million
4 for the whole market shown in this table.

5 Q Finally, Mr. Myers, can I ask you about one point that Professor Dobbs makes in his
6 evidence. Could you turn back in bundle C1 to tab 7, which contains Professor Dobbs’
7 seventh report, and within that report go to p.12/13, where he is dealing with what he says is
8 “Ofcom’s partial welfare perspective”. He asserts at para.37 that if we are taking a partial
9 welfare perspective then,

10 “For consistency ... Ofcom must then take the position that *all* producer
11 surplus should be ignored.”

12 He complains at para.38 that that is not what Ofcom has done:

13 “In the assessment of impacts, Ofcom has not made any material allowance for
14 the fact that a significant part of 08s revenues arise from calls from businesses –
15 as opposed to retail customers.”

16 He complains at the end of that paragraph:

17 “If producer surplus is to be ignored, then any costs or benefits to such
18 businesses, to be consistent, should also be disregarded.”

19 Then you see further at para.40 he says:

20 “The fact that benefits to MNO business customers are treated by Ofcom
21 largely symmetrically (i.e. £1 for £1) with those to MNO retail customers
22 suggests that Ofcom is effectively or implicitly taking a ‘total welfare’
23 perspective ...”

24 which is his approach. Do you accept this criticism of Professor Dobbs?

25 A No, I don’t agree with it.

26 Q Can you explain to the Tribunal why?

27 A It may be helpful if we, first of all, deal with profits accruing to originators and terminators
28 as they are not consumers under the Communications Act, and that is why Ofcom, in
29 assessing benefits to consumers, did not take account of that type of producer surplus. The
30 next question is between service providers and business customers of mobile operators. I
31 think there are two distinctions there. One is that the business customers are callers. They
32 are the consumers of these 08 services, whereas the service providers are the suppliers of
33 these 08 services. They are consumers of hosting services and defined as consumers under

1 the Act, but they are not the consumers of these 08 services. That is callers, and those
2 callers include business customers.

3 Second of all, through the indirect effect there is a conflict between the interests of callers
4 and service providers, as I was explaining earlier. If the indirect effect on service providers
5 is larger then the benefit does not flow through to callers if it is taken by service providers
6 in their increased profits. So there is a conflict there between callers and service providers,
7 whereas in terms of business customers versus residential customers, there does not appear
8 to be any such conflicts. They both benefit from the direct effect, and if there is a positive
9 indirect effect for them they both benefit from that, and indeed as would service providers.
10 So through the direct effect you don't have the same conflict of interest that arises in terms
11 of the indirect effect. So it's the distinction between callers and the question of conflict
12 between interests that distinguishes service providers from business customers.

13 MR. HERBERG: Thank you, Mr. Myers. I think, if you would wait there, there is a queue of
14 people wanting to ask you questions.

15 THE CHAIRMAN: Yes, Miss Smith.

16 Cross-examined by Miss SMITH

17 Q Mr. Myers, I have got the honour of being the first in the queue. Good morning.

18 A Good morning.

19 Q Could I ask you, first, a question just arising out of the evidence in chief which you gave to
20 Mr. Herberg, and if you have still got it open I would like to look with you at the table in
21 the Simplifying Non-Geographic Numbers Consultation Paper, which is tab 13. Can we
22 look at that table A2.22, you gave very helpful evidence to the effect that the NCCNs do not
23 directly address consumer confidence and they could, in fact, address only a relatively small
24 proportion of this £66 million, I think you said to Mr. Herberg.

25 A That's likely, yes.

26 Q You were concerned about consumer confidence in the number ranges which is effectively
27 consumer confusion about the prices to be charged on those number ranges – is that correct?

28 A Essentially. It is perhaps a little bit more than just the misperception of price. It is just that
29 actually consumers not only have incorrect perceptions of price, but they also don't trust
30 these numbers. They think something suspicious is going on on these numbers, because
31 there are other adverse effects on consumers that can arise, such as fraud or bill shock,
32 anxiety from getting a bill that is larger than expected.

33 Q What, in Ofcom's view, consumers should understand when they look at these number
34 ranges is that the 080 numbers are zero rated, they are free to callers, the 0845 are

1 equivalent to the local geographic rate for calls, and 0870 are equivalent to national
2 geographic rates – is that correct?

3 A That would be the policy preference, as it were, the desirable state of affairs, but of course
4 that isn't the way everyone sets their prices at the moment.

5 Q Absolutely not. That is your policy preference, so it is the confusion arising from the fact
6 that these numbers for certain calls from certain operators are not priced at prices that
7 causes the confusion that you are concerned with?

8 A That's certainly a major part of the cause, yes.

9 Q You will also be aware that at its very best, although of course it is strongly challenged,
10 BT's evidence in this case is that the NCCNs in issue will have incentivised price drops on
11 080 calls to below 8.5 ppm. Let us concentrate on 080 calls. They are not incentivised and
12 there is no evidence from BT to suggest that the NCCNs will incentivise call prices to drop
13 to zero for 080 numbers, is there?

14 A That's my understanding, yes.

15 Q And at its very best the evidence from BT is that NCCNs 985 and 986 will incentivise price
16 reductions on 0845 and 0870 calls to below 12.5 ppm. That is their evidence?

17 A Yes.

18 Q There is no evidence that the NCCNs will incentivise a fall to the equivalent local
19 geographic rates or national geographic rates, is there?

20 A That's right. And indeed the policy preference is that 0845 and 0870 should be priced in the
21 same way as geographic calls, ie, whenever geographic calls are included in a bundle, so
22 should 0845 or 0870. So, it is more than simply a comparison at average price levels, it is
23 actually within the same package. Within each tariff package there is identical treatment of
24 0845 and 0870 calls with calls to geographic numbers.

25 Q What I want you to focus on is what, at its very best, BT's evidence says the effect of the
26 NCCNs will be on call prices to these numbers; and I think you have agreed with me that
27 they do not, even at its very best, suggest that this evidence will incentivise a reduction to
28 zero for 080 or to the geographic rates for 0845 and 0870. You would agree with me on
29 that.

30 A Yes, that's right. I think the assessment Ofcom made was that it was likely, if there were
31 these price reductions, it would be likely to move closer to the policy preference. But,
32 I agree, it wouldn't achieve them.

33 Q So we are now concerned, do you say this table is about the detriment caused substantially,
34 about the detriment caused by consumer confusion over the prices for these number ranges?

1 And is there not, at the very least, the potential for further confusion even if the NCCNs
2 incentivise the price reductions that BT says they will incentivise? Because they do not
3 incentivise price reductions to the levels in line with Ofcom's policy preference, or set out
4 in Ofcom's policy preference. So there is a potential, in fact, you said, is unlikely to have
5 anything but a small impact on this figure for detriment. The potential that it has no impact
6 at all, because it is not reducing confusion to reduce the numbers down to 12.5ppm if the
7 brand for these numbers is that they are at the equivalent local and national geographic
8 rates. Would you agree?

9 A I think there is a wide range of possibilities that could arise. It could have no effect.
10 I suppose it is possible, but perhaps not that likely, they might even increase the confusion,
11 probably since, if we are talking about a scenario of reducing prices, it might be more likely
12 that it may have little impact. Or it is, I mean, one cannot necessarily rule out the
13 possibility it might have a more significant impact. It is just that because the problems with
14 the particular number range they are talking about, well, particularly 0845 and 0870, are
15 quite deeply entrenched. A large impact might be not that — it is not clear that that is
16 necessarily that likely.

17 Q Thank you, Mr. Myers. I would like to move back, then, to some different points arising
18 out of EE's case. I would like to ask you some questions, first, on EE's case on Ofcom's
19 policy preference, and particularly the regulatory obligations that are imposed on the non
20 geographic number ranges by Ofcom. I am not going to put all of these regulatory
21 obligations to you. It is clear from the faces of documents in which they appear what they
22 mean, and a question of what they mean is set out in the evidence, and also a matter for the
23 Tribunal on the face of the documents. But, I do want to ask you one or two questions
24 about the NTS formula that has been raised by BT's witnesses. And you have been in court
25 and you have heard the discussions about the NTS formula. Is that correct, Mr. Myers?

26 A Yes, I have.

27 Q Yes. You can put away bundle 13 if that assists. Can I ask you, in your witness statement,
28 to turn to para.100, which is on p.33. In para.100 and following you address NTS
29 regulation, and you refer to the regime being put in place from 1996. And you say Oftel's
30 reasoning, at the top of para.101:

31 "Oftel's reasoning was to promote investment and innovation by moving the
32 surplus in the call price to the terminating end".

33 And, as you explain subsequently in paras.102-103 of your witness statement, that only in
34 fact happened for BT originated calls. That is correct, is it not?

1 A My understanding is that in 1996 the formula applied both to BT originated calls and to BT
2 terminated calls. I think I cover that in para.104.

3 Q Yes, I wanted to take you to that, if I may. At para.104 you make it clear that:

4 “Where BT was the TCP, the Deemed Retail Price [under the formula] was the
5 actual retail price charged by the OCP including discounts, unless it was higher
6 than BT’s actual retail price, in which case it was set equal to BT’s actual retail
7 price. So [and this is the important point] the OCP retained the cost of origination
8 ... plus a additional amount (of P-D) if its actual retail price was higher than
9 BT’s”.

10 So, the originating communications provider would keep the difference between their actual
11 retail price and BT’s deemed retail price as well as the costs of origination. You make that
12 clear in para.104.

13 A That’s right.

14 Q That is right. In para.107 of your witness statement you say that:

15 “The NTS formula is the regulation that is still in place for BT-originated calls to
16 many non-geographic numbers through the NTS Condition”.

17 And that is what we have heard described in proceedings as the “NTS call origination
18 condition”. Is that correct?

19 A That’s correct.

20 Q And you would agree again that this only applies to BT originated calls as a result of BT’s
21 SMP designation?

22 A Yes.

23 Q And, since 2009, it has not applied to 0870 calls, is that correct?

24 A That’s correct.

25 Q In para.108 you say:

26 “As regards NTS calls originated by other OCPs, when BT is the TCP, BT has
27 generally applied the NTS formula and set the same termination charges as it pays
28 to other TCPs on BT-originated NTS calls”.

29 It is also the case, is it not, that since the 0870 determination which took effect on 1st August
30 2009, BT has charged cost based termination charges for 0870 calls to other OCPs as well
31 as paying those costs based termination charges itself?

32 A Yes, that’s correct for 0870.

33 Q At para.109 you say, the last sentence:

1 “Put simply, the regulatory approach to non-geographic numbers has generally
2 been to set cost-based charges for *origination*, whereas for alls to geographic and
3 mobile numbers it has generally been to set cost-based charges for *termination*”.

4 And can I suggest to you that perhaps over-simplifies the position because it is only BT’s
5 origination charges that have been set at a costs-based level, is it not?

6 A Yes, I would agree with that. This was trying to make, as it were, a broad brush comment
7 about, sort of, high level differences, but I agree that the costs-based origination applying to
8 other communications providers was not done in the 1996 determination because, as we
9 have covered, if their price exceeded BT’s price, they got to keep the difference. What I am
10 not sure about is precisely what happened in subsequent determinations since 1996, and
11 whether that changed the picture at all.

12 Q But in 2004, I think it was, it was the first year in which the NTS call origination condition
13 was applied.

14 A That’s right. So, I guess my previous comment was really referring to the situation between
15 1996 and I think 2004. Since 2004 the imposition of the NTS condition has been about
16 where there is SMP – excuse me, there has been an SMP condition and obviously that has
17 only applied to operators who have significant market power in wholesale call origination
18 and, as far as I am aware, that has only been BT since 2003, since the market, the SMP
19 regime was introduced, so there has not been regulation of the retention of the origination
20 by other OCPs since 2003 as far as I am aware.

21 Q You make it clear, and perhaps I will ask you just to flick back to paras. 33 and 34 of your
22 witness statement, you make it clear, and perhaps you could agree this statement that there
23 is no regulatory obligation on mobile operators as to the retail prices they can charge for the
24 numbers at issue in this case, that is 080, 0845 and 0870?

25 A Sorry, could you repeat the question?

26 Q There are no regulatory controls on the prices that mobile operators can charge for callers of
27 the 08 numbers at issue in this case?

28 A So they are not obliged to set ----

29 Q There are no controls on the retail charges that they can make to those callers?

30 A That’s correct.

31 Q Paragraph 29 you make the point that this linkage between the geographic numbers and the
32 actual prices for 0845, 0870 numbers was under strain, and the last sentence you say:

33 “Therefore, Oftel set out a policy preference on the pricing of 0845/0870 calls
34 rather than an enforceable condition.”

1 I just want to focus on your use of the word “therefore”. I suggest to you that Ofcom did
2 not set any enforceable conditions on mobile operators on the pricing of 0845/0870 calls
3 because it did not and does not have the legal powers to do so in the absence of any SMP
4 finding, do you agree with that, at the time of the determinations?

5 A Perhaps I can just make one thing clear, which is the nature of my role in the determination.
6 The analysis of Ofcom’s policy preference, the articulation of that policy preference was set
7 out in s.2 of each of the 080 and 0845 determinations. That was not a section of the
8 determination that I had responsibility for, so I am not fully familiar with all aspects of the
9 policy preference and how it arose, and how it tracks back to precisely the preceding
10 documents. Clearly I did, in my witness statements and I am absolutely happy to assist the
11 Tribunal in terms of teasing out the economic underpinnings of the policy preference and
12 the implications of that policy preference for both the analytical framework – the three
13 principles etc – that Ofcom used and the application of those principles to the disputes.
14 With that context I think what I would say is I am not sure I can assist the Tribunal
15 definitively to say why it was that Ofcom did not impose any obligations on MNOs - well I
16 think perhaps I should leave it at that.

17 THE CHAIRMAN: I think, Miss Smith ----

18 MISS SMITH: Yes, I understand that caveat entirely. It is simply that you do actually, with
19 respect, Mr. Myers, have a whole section in your witness statement setting out NTS
20 regulations and the regulatory position?

21 A So this section here is simply summarising the relevant section of the final determination as
22 is indicated by the footnote giving the precise references from where those statements came.

23 THE CHAIRMAN: Miss Smith, I will only say what I have said in connection with other
24 witnesses, at the end of the day what the rules say is it is really a matter for us.

25 MISS SMITH: Of course. (To the witness): What I think you have made clear in your evidence
26 to the Tribunal is that in your understanding the policy preference is simply that, a
27 preference rather than any sort of regulatory obligation that is imposed on the mobile
28 operator?

29 A Yes, that is my understanding.

30 Q What I hope you will be able to assist us with is the impact of Ofcom’s policy preference in
31 these determinations. If I can ask you in that regard to look at para. 36 of your witness
32 statement. You say:

33 “In other circumstances, i.e. in the absence of such a policy preference, Ofcom
34 does not have a stated preference on the balance of MNOs’ retail prices between

1 the different services that they offer, which is a matter to be determined in
2 competition in the retail mobile market. The policy preference, however, led to a
3 departure from this general view.”

4 You would agree that that statement in summary, normally you would leave these prices to
5 be determined by competition but the policy preference led to Ofcom taking a different
6 approach in this case, is a statement that is repeated in your statement for 080 numbers?

7 A Yes.

8 Q And also is repeated at a number of points in the determinations, both determinations for
9 0845/0870 and 080 numbers?

10 A Yes.

11 Q And you would agree, therefore, that the stated purpose of Ofcom’s policy preference was
12 to prevent the mobile operators’ retail prices being set by competition?

13 A Sorry, could you repeat the question, please?

14 Q You say that, normally Ofcom does not have stated preference on the balance of mobile
15 retail prices, which is a matter to be determined by competition in the retail mobile market,
16 so normally prices would be determined by competition, that is what you are saying, is it
17 not?

18 A Yes.

19 Q But the policy preference led to a departure from this general view, the effect of the policy
20 preference was to intervene to prevent the normal situation where the prices would be
21 determined by competition. That is what you are saying, is it not?

22 A Well something close to that, I think. The effect of the policy preference was to say that a
23 tariff rebalancing of the sort we were talking about earlier would be overall beneficial. In
24 the absence of policy preference which reflects externalities or market failures, it is unclear
25 that a tariff rebalancing would necessarily be desirable and usually in the absence of a
26 market failure one would generally take the approach that competition is best placed to
27 determine the structural pricing.

28 Q A simple question really, you are saying there, are you not, that normally you would allow
29 prices to be set by competition – I am not trying to suggest any more to you than this –
30 normally Ofcom would allow the prices to be set by competition but the policy preference
31 and all that lies behind it led Ofcom to intervene and depart from the general view that
32 prices should be set by competition?

33 A It is the word “intervene” that I think I am having slight difficulty with because of course
34 Ofcom concluded that these NCCNs were not fair and reasonable, and so I would agree that

1 the policy preference led Ofcom to regard tariff rebalancing as a net benefit to consumers,
2 but I am not sure I would necessarily agree with the characterisation of intervening.

3 Q Well let us consider then, if we may, the impact of the policy preference in a little more
4 detail, and just as a very simple proposition you would agree, I hope, with the proposition
5 that the policy preference led Ofcom to place greater weight on the direct effect than on the
6 MTPE?

7 A That is correct.

8 Q If I could ask you to turn to para. 61 in your statement? Here in para. 61, you will recall,
9 you are illustrating the balance between the direct and mobile tariff package effects using a
10 reference case, and that reference case has three simplifying assumptions: 100 per cent
11 waterbed effect, no change in the volume of services when prices change, and equal weight
12 on the direct and MPTE mobile tariff package effects. Before I explore the impact of
13 subparagraph (c) can you just confirm to me, looking at each of those variables, para. 61(a),
14 would you agree that Ofcom did not in this case quantify exactly what the waterbed effect
15 would be?

16 A That's correct.

17 Q And although you thought it was unlikely to be 100 per cent, you concluded that it was
18 likely to be significant?

19 A That's right.

20 Q As regards subparagraph (b) would you also agree that Ofcom did not quantify the actual
21 effect on volumes when prices change?

22 A Yes, that's correct.

23 Q And also importantly you were unable to conclude from the evidence presented to you by
24 BT what the magnitude of the direct effect would actually be, and what the extent of any
25 retail price reduction would be although you thought the direction was likely to be a
26 reduction in retail prices?

27 A That's correct.

28 Q And each of those variables, just to take those three that I have talked about affect the
29 balance between the direct effect, the indirect effect and the mobile tariff package effect, is
30 that correct?

31 A Yes.

32 Q Going back to the reference case, and I would like to look at the impact of the policy
33 preference on the simplifying assumptions of the reference case. You set out what would
34 happen before you apply a greater weight to the direct effect, and you set out in the

1 reference case what the result would be in a full reduction scenario, a partial reduction
2 scenario and no reduction scenario – that is correct?

3 A Yes, that's correct.

4 Q In 62?

5 A Yes.

6 Q In the case of a no reduction or partial reduction in 0845/0870 prices there is a negative
7 overall impact on consumers under this reference case. That is perhaps sub-para.(a) and
8 (c)?

9 A Well, this discussion is dealing with the interactions or the relativities of the direct and
10 mobile tariff pack effect. It doesn't bring in the indirect effect, and it is the relativeness of
11 the direct and indirect effect which determine the overall conclusion in the no reduction
12 scenario.

13 Q I am asking you at the moment simply what I hoped I had made clear, that we are dealing
14 here, as you say, with the balance between direct effect and mobile tariff package effect,
15 and looking at that balance for the moment, in the no reduction scenario and the partial
16 reduction scenario, on your simplifying reference case there is an negative overall impact on
17 consumers in the case of no reduction or partial reduction in 0845 and 0870 prices. That is
18 correct, is it not?

19 A That's correct, yes.

20 Q In the full reduction scenario, which you deal with at 62(b), a reduction in 0845/0870 prices
21 to less than 12.5 ppm – that is the full reduction scenario – is that right?

22 A Yes, that's correct.

23 Q In that scenario the benefits to mobile consumers, the direct effect, is fully balanced by the
24 higher prices they face on other mobile services, the MTPE. On this reference case the
25 effects cancel each other out – is that correct?

26 A Yes.

27 Q The effect of Ofcom's policy preference is described in para.63(c) of your statement on the
28 next page. You place relatively more weight on the direct effect than the mobile tariff
29 package effect, and the effect of that is that termination charges would be held to be fair and
30 reasonable in this full reduction scenario, even though otherwise, apart from that greater
31 weight that is placed on the direct effect, the effect on consumer benefits would be neutral?

32 A The reference case is just that. It is making some simplifying assumptions which are not
33 realistic in order to provide assistance in understanding what happens in the case of realistic

1 assumptions. So whilst it is correct that in the reference case in the full reduction scenarios
2 it is neutral, that's merely a reference point as opposed to meaning anything more than that.

3 Q To make it clear, Mr. Myers, you will understand that Everything Everywhere's appeal
4 challenges the methodology applied by Ofcom in this case, the structure of the methodology
5 that is applied. So it is important for the purposes of EE's appeal that, okay, in this case we
6 may have come out with one answer, but the methodology that is applied is what is
7 important for EE's appeal. It was made very clear by your counsel, and you will have heard
8 it, that Ofcom's view is that the principle of ladder pricing has been held by Ofcom not to
9 be objectionable in principle, and I think you would agree that in future, when ladder
10 pricing charging structures are referred to Ofcom, you would be applying this same
11 methodology – is that correct – this same three principles methodology?

12 A Subject to the Tribunal's judgment obviously.

13 Q Absolutely, that is the intention behind the determinations. So what we are concerned with
14 is the structure of the methodology and how it works, which is why you may say that this is
15 just a reference case, but for our purposes what is important is how the structure works and
16 the relative weighting of the various different elements within your methodology. I think
17 you agreed with me that the policy preference, as set out in para.63(c), means that the direct
18 effect is given greater weight than the MTPE and termination charges could be held to be
19 fair and reasonable even though, on your reference case, there would be neutral effect on
20 consumer benefit – is that right?

21 A That's correct.

22 Q It also appears from what you say in 63(c) that even in the partial reduction scenario the
23 policy preference may be afforded much more weight and the direct effect could outweigh
24 the MTPE even though otherwise there would be a net consumer detriment as a result?

25 A That's correct, yes, it's possible.

26 Q So the effect of this, let us see if you agree, is that even though otherwise, on this reference
27 case applying this methodology, consumer benefits may be equal or slightly weighed
28 against the termination charge, the impact of the policy preference and the greater weight
29 that it gives to the direct effect could be that Ofcom could nevertheless allow termination
30 charges as fair and reasonable – do you agree with that?

31 A Well, I'm not sure I would agree with that characterisation, because the greater weight on
32 the direct effect reflects other types of benefits to consumers through alleviating the market
33 failures, as we discussed earlier, improving consumers' perceptions, potentially improving
34 consumers' confidence and potentially generating greater volumes of calls which service

1 providers might respond to by increasing quality, so the greater weight is a reflection of
2 other types of benefit that would feed through that would be triggered by a reduction, or
3 could be triggered by a reduction in 080 prices.

4 Q There are a number of elements I think you have said that feed into this greater weight that
5 is given to the direct effect, but it would be fair to say that you have never quantified to any
6 extent what proportion of this greater weight is provided for by the policy preference, by
7 other externalities that you have identified, by consumer confusion, the other elements that
8 you are identifying. You simply say that greater weight will be given to the direct effect
9 due to all these other different elements, but you have never, in fact, set out what proportion
10 of that greater weight is accounted for by each of the various other points that you make –
11 for example, the increase in volumes you say is another thing that is fed into the greater
12 weight to the direct effect.

13 A Just to clarify, the policy preference reflects all of these different effects. I set that out in a
14 later section in my witness statement, going back to the documents about what the
15 economic underpinnings of that was. It is not a question of splitting between the policy
16 preference and other factors, the policy preference covers all of those, but in relation to the
17 underlying factors, if you like, the first three rows in table 6 that we talked about at the start
18 of my evidence, I agree that there has been no distinct quantification of how much relates to
19 each of those three.

20 Q Before we leave this part of your witness statement, on that issue can I look at what I would
21 characterise as another departure from the reference case, and that is in para.63(b) of your
22 witness statement. You say in para.63(b):

23 “If the volume of mobile services adjusts in response to price changes, the
24 required size of the Direct effect for a net benefit could be larger or smaller,
25 depending on which services are relatively more price sensitive. If 0845/0870
26 demand is less sensitive (as suggested by the evidence from the MNOs), the
27 Direct effect would need to be larger for a positive net benefit.”

28 If we can just unpack that, what I think you are saying is that demand for 0845/0870 calls
29 may be less price sensitive than the demand for other mobile services – that is the first
30 point?

31 A Yes, it looking at that possibility.

32 Q If that were the situation then an increase in the prices for other mobile services which are
33 more price sensitive may lead to a greater proportional decrease in the volumes consumed
34 of those services – is that correct?

1 A That's correct.

2 Q So you are saying that in that situation if demand for 0845/0870 calls is less price sensitive
3 than demand for other mobile services, the direct effect, which relates only to the prices of
4 0845/0870 calls, would need to be larger for a positive net benefit for consumers to take
5 into account those different price sensitives?

6 A That's correct.

7 Q You also fairly confirm in that paragraph that the evidence that you were given during the
8 disputes, that Ofcom was given during the disputes, from the mobile operators was that
9 demand for 0845/0870 calls was less price sensitive than demand for other mobile services.

10 A Yes, I agree. Such evidence as there was, what the MNO suggested.

11 Q And you have been in court over the last few days. You have seen, and I can take you to it
12 if necessary, various annexes to Ofcom's simplifying non-geographic numbers consultation
13 paper which set out the results of consumer surveys, saying consumers would rather that
14 prices for 08 calls stay the same, that they would rather that those prices stay the same, and
15 prices for other calls remain unchanged. They do not want lower prices for 08 calls if the
16 effect of that would be higher prices for other mobile services. Would you agree with that?

17 A I don't completely agree with that, or at least not the interpretation. So, I would actually
18 quite like to go to the NGCS document.

19 Q We had some problems finding where it is.

20 A Yes.

21 Q I think it has been put in behind the skeleton from Vodafone in core bundle B2, so it will be
22 at the front, next to you, on the left. Vodafone's skeleton is right at the back, tab.23, and the
23 evidence that is being referred to is in the annexe to the NGCS review. Research document
24 pp.22-24.

25 A It was actually the NGCS review itself that I wanted to go to, bundle 13.

26 Q Yes, the review itself, it is in bundle 13, tab.3.1.

27 A Yes, so, I agree that the way reported the survey is what the answers by consumers were,
28 but Ofcom took a different view on the interpretation of that evidence from the
29 interpretation you have just put to me. And there are two places where that is referred to,
30 so, it is footnote 598 on p.332. In the middle of that footnote it says:

31 "As discussed in Annex 6 [in fact it is not Annex 6, it should be cross-referring to
32 para.A7.75 which I will turn to in a second] there are reasons for treating the result
33 with some caution since the qualitative [result] suggests that respondents may
34 have believed that overall telephony costs would increase".

1 Q Perhaps you could read, though, the sentence at the very end of that.

2 A Yes indeed:

3 “Nonetheless, these survey results do not provide support for significant
4 rebalancing of retail prices”.

5 And then, as I say, I believe the cross reference to that footnote should be to para.A7.75,
6 and the relevant part of that is on p.357, it is the last bullet point in that paragraph, which
7 says:

8 “These survey responses suggest that the majority of consumers are against a
9 rebalancing of retail prices, which points towards allowing a higher origination
10 payment. However, we have placed relatively little weight upon these survey
11 responses. This is because the qualitative responses suggest that some
12 respondents believed that the increase in the price of other telephony services
13 would outweigh the reduction in the price of 080 calls. In other words, responses
14 may have been shaped by a view that overall prices would increase. Insofar as
15 this is the case, respondents were not commenting on the likely outcome of zero
16 rating 080 calls, since the tariff package effect will be no large than the decrease in
17 OCPs’ profits on 080 calls”.

18 So, the point that is being made there is that this is obviously quite a difficult question to
19 ask consumers because it is a hypothetical, it is a relatively complicated hypothetical as
20 well. Prices change. These prices go down. These other ones go up. And the qualitative
21 evidence referred to, the qualitative responses, as I understand it, suggest that at least some
22 consumers did not answer the question as it was intended, ie, “Your bill stays the same.
23 Which do you prefer?” Some of them thought, “Well, I don’t make these calls very often,
24 so surely my bill will go up”, and these qualitative responses suggested that they were
25 answering the question on that basis. So, that is why, whilst Ofcom clearly accepted that
26 that was the evidence and what the survey responses said, why Ofcom did not place, as it
27 says, placed relatively little weight upon these survey responses. Now, clearly, this is a
28 matter, this is a consultation document. I wouldn’t be surprised if this was a matter that
29 would require further consideration by Ofcom in the light of the responses it has received to
30 this document.

31 Q You have made the first point I was going to make to you, that it is a consultation
32 document, and no doubt there will be submissions made on this point by the mobile
33 operators. But you would agree, simply, that on their face, as Ofcom have said in footnote
34 598:

1 “These survey results do not provide support for significant rebalancing of retail
2 prices”.

3 A Yes. I agree.

4 Q On the basis that consumers are less price sensitive when it comes to the prices for 08 calls
5 than they are for the prices of other mobile services. That is the basis upon which this
6 survey evidence proceeded.

7 A Well, the point in relation to consumers’ responses being about responsiveness to price
8 changes — I’m not certain, I think that may require looking at the evidence itself. But,
9 I accept that these survey responses do not provide support for such rebalancing. I think the
10 question, issue, is — to what extent do they provide evidence against the tariff rebalancing.

11 Q And what is set out in the sections of the report that you took us to is Ofcom’s interpretation
12 of those survey results, is that right?

13 A Yes, that’s correct.

14 Q And you have already agreed with me that, on their face, they do not provide support for the
15 tariff rebalancing, and that this is a matter which is out for consultation and consultation
16 would include Ofcom’s interpretation of those survey results.

17 A Yes, I would agree.

18 THE CHAIRMAN: Could I just ask you a follow up on that? In a world without constant
19 elasticity demand curves, is responsiveness likely to be influenced by the current level of
20 prices for these calls?

21 A Yes, I think that’s quite likely. I mean, it’s often generally the case, generally held to be the
22 case, that the higher the price, the more sensitive the demand. So, the price level is likely to
23 affect the elasticity, but I’m not sure there was any specific evidence on that in this case.

24 Q I was thinking, in fact, that currently prices are so high that very few people have any
25 experience of these calls, or have made alternative arrangements for making them.

26 A Quite.

27 Q And therefore will not really see much gain from reduction in the prices of these calls in
28 their packages because they do not make such calls.

29 A I can see that’s another possibility, yes.

30 MISS SMITH: Just on that point from Professor Stoneman, they may not make such calls, or
31 they may make those calls from fixed line rather than from mobiles.

32 A That’s a possibility as well, yes.

1 Q If I could just go back to your witness statement. Perhaps that might be a good time for a
2 short break, I am going to continue with questioning on this point but I think this is a good
3 time to break.

4 THE CHAIRMAN: Yes, five minutes.

5 (Short break)

6 MISS SMITH: If I could take you back then, Mr. Myers, to para. 63(c) of your statement, you
7 there recognise that evidence from MNOs was submitted to the effect that demand was less
8 price sensitive on 0845/0970 calls, as you confirmed?

9 A Yes.

10 Q And I suggest to you that on its face and in response to very clear questions the survey
11 evidence that was attached to the Simplifying Non-Geographic Numbers Consultation Paper
12 supported that evidence that was submitted by the mobile operators. Do you agree with
13 that?

14 A Well I am not sure one can necessarily infer price sensitivity into the consumer responses, I
15 think I already said I am not sure on that point.

16 Q Ofcom had no evidence in front of it in this determination, it certainly did not put it in the
17 determination as to the relative price elasticities of the 0845/0870 calls versus other
18 mobile ----

19 A That's correct.

20 Q But you recognised in para. 63(b) the danger, or the possibility that if demand is left price
21 sensitive on 0845/0870 calls the direct effect would need to be larger for a positive net
22 benefit?

23 A That's correct.

24 Q And in such a situation you would agree that normally in order to assess net consumer
25 benefit where there is a suggestion of difference in price elasticities you would want to look
26 at both price changes and volume changes in order to assess overall net consumer benefit?

27 A Yes.

28 Q And that if there were differences in elasticities you recognise the potential that any
29 reductions in volume resulting from an increase in prices for other mobile services could be
30 proportionately greater than any increase in volumes resulting from a decrease in prices of
31 0845/0870 calls. You recognise that possibility in light of what you say in para. 63(b)?

32 A Yes, that's right, the complicating factor may be the relative sizes of the different price
33 changes.

1 Q But none of this was, in fact, quantified by Ofcom in this determination, but there is this
2 danger or this possibility that you have recognised in 63(b). If I could ask you to look at
3 para. 88 of your witness statement you address the question of volumes. Paragraph 88(a)
4 you say effectively call volumes to 0845/0870 numbers may increase in response to a
5 decrease in those prices, that is what you are referring to in 88(a)?

6 A Yes.

7 Q In 88(b) you recognise the possibility that there may be a reduction in the volumes of other
8 mobile services in response to increases in the prices of those other mobile services. That is
9 correct, is it not?

10 A Yes.

11 Q I think we have also agreed that those volume effects may be proportionately greater if
12 consumers are more price sensitive to the prices of other mobile services than they are to the
13 prices of 0845/0870 calls. Do you agree with that?

14 A Yes.

15 Q I think you have given evidence to this effect, the potential increase in 0845/0870 call
16 volumes in response to the decrease in prices for those services is factored into your
17 methodology by the greater weight to that you give to the direct effect, that is correct, is it
18 not?

19 A Could you just repeat the question, please?

20 Q 88(a), the volume response that you recognise in 88(a), which is an increase in volumes of
21 0845/0870 call volumes in response to a decrease in the prices for those calls is factored
22 into your methodology by means of the greater weight that you give to the direct effect, that
23 is right – one of the factors?

24 A So the increase in volume reflects, at least conceptually as we have discussed earlier these
25 words separately qualified, reflects two effects, these are the first two rows in table 6 in my
26 witness statement, i.e. what one would normally expect as an increase in volume in
27 response to a price reduction without any externality or market failure and the potential
28 magnification of any price increase due to alleviating that market failure.

29 Q Yes, I will ask you the question again – I think it is a pretty simple one – the potential
30 volume increase in 0845/0870 call volumes in response to lower prices for those calls is
31 given weight in your methodology by the greater weight you give to the direct effect. I
32 think you have just agreed with me on that?

1 A I think I was saying there are two types of volume increase. One is reflected through the
2 greater weight, but there is potential for a volume increase even absent the greater weight or
3 the externalities.

4 Q The potential reduction in volumes that you recognise in para. 88(b) is given no weighting
5 in your three principles methodology, no additional weight is given to the MPTE in
6 response to that potential reduction in volumes?

7 A I would not agree with that, it is included within the mobile tariff package effect.

8 Q I am sorry, I will make myself clearer. We have said that, or you have agreed with me that
9 the volume effects, the reduction in volumes resulting from increased prices on other mobile
10 services maybe proportionately greater than the increase in the volumes resulting from
11 reduction in prices for 0845 calls because the consumers may be more price sensitive in
12 respect of other mobile services. So the volume effect may be proportionately greater when
13 you are looking at the impact of the change in prices on other mobile services than the
14 increase in volume for 0845 calls. But no additional weight has been given to the
15 possibility that the reduction in volumes may be proportionately greater because of lower
16 higher customer price sensitivity on those numbers?

17 A I don't think one would expect to reflect that through additional weight. As I said, it is
18 reflected within the mobile tariff package effect, just as the direct effect reflects potential
19 for volume increases before one brings in the alleviation of market failures.

20 Q Let us put it perhaps in the jargon, you say there is an externality in this case because
21 mobile operators set prices for 0845 calls without reference to the preferences that service
22 providers have, there is that externality that the prices are high?

23 A That is one of the sources of market failure, yes.

24 Q And there is also a potential externality that terminating operator BT could set termination
25 charges with no reference to the impact that might have on the prices of other mobile
26 services because they have no interest, there is no direct link between the terminating
27 provider and the retail prices charged for other mobile services. That is a possible
28 externality that might also ----

29 A But it is not an externality of the same type. The point is that the market failure arising
30 from the lack of price awareness and what is called in the Simplifying Non-Geographic
31 Numbers Consultation "vertical" and "horizontal" externalities, these are things that if
32 alleviated would lead to a magnification of a volume effect through, as has been described
33 last week a brand enhancement effect or improving consumer confidence. So the greater
34 weight reflects the potential for that effect to occur. The externality being referred to here is

1 simply that terminating providers do not directly care about the impact they have on mobile
2 operators or necessarily mobile customers. I can see how one could describe that as an
3 externality, but it does not seem to me that it is one that would lead to a magnification of a
4 volume effect that should be reflected through ----

5 Q Would you agree that there may be a magnification in volume effect caused by greater price
6 sensitivity of consumers for other mobile services?

7 A Yes, if I might clarify – that potential for greater price sensitivity does not need to be
8 reflected through changing the weight on the different effects because it is included within
9 those different effects, within the mobile tariff package effect and within the direct effect.

10 Q No, the volume differences are included in the mobile tariff package effect, any
11 magnification of those volume effects caused by greater price sensitivity cannot be included
12 in the mobile tariff package effect, you have not carried out any analysis of the greater
13 price sensitivity that there might be for other mobile services versus 0845 calls?

14 A There is a mechanism for magnification to arise, magnification volumes arise from lower
15 08 call prices which is improving consumer confidence, brand enhancement, improving
16 perception of calls, that is the potential mechanism that could lead to a magnification of
17 volume effect. I do not see, and I have not had described to me a similar mechanism as
18 regards the mobile tariff package effect that would lead to a magnification in that sense in
19 terms of the mobile tariff package effect.

20 Q Let me put it like this: if Ofcom was trying to consider what would be an optimal price
21 across the platform for these services, the 0845 calls, it would need to take into account all
22 sorts of externalities, including the externality you have given resulting from reduced
23 customer price awareness on 0845 calls. You would also, I suggest, need to take into
24 account the magnification and volume effects that may be caused by greater price
25 sensitivity for certain services compared with the 0845 services?

26 A I think I have already answered that, I am not sure that that externality is the same type as
27 the vertical and horizontal externalities and the lack of consumer price awareness. It is a
28 different nature, it is not one that directly comes about as between TCPs and mobile
29 operators. As I say, you have not suggested to me a mechanism by which one would have a
30 magnification of the mobile tariff package effect, due to this effect.

31 Q The problem is that in your three principles, we have various different principles weighed
32 against each other, and we are told that greater weight is given to certain principles as
33 opposed to other principles, but nothing is quantified. You say volumes may change and
34 the change in those volumes may be magnified by different issues such as consumer

1 awareness on 0845 calls. You have also agreed that there may be a magnification in
2 volume effects caused by greater price sensitivity for other mobile services. And all those
3 factors in your view need to be weighed against each other; but you have not carried out
4 any analysis of what the volume, the actual effects on volumes might be as a result of
5 different prices for the other mobile services and the 0845/0870 services, have you?

6 A Yes, I agree there has not been quantification of those things. Ofcom's conclusion was
7 based on, you know, reasoning related to the likely direction of the different effects. So, in
8 para.63, we are discussing here 63B, which might suggest the direct effect would be larger
9 for positive net benefit, 63A and 63C go in the other direction, and it was those that Ofcom
10 took into account in concluding that in the full reduction case there was likely to be an
11 overall benefit to consumers.

12 Q There has been no quantification of the actual volume effects that might be caused by the
13 greater price sensitivity for other mobile services. Would you agree with that?

14 A I agree.

15 Q And in fact the focus of Ofcom's reasoning in this case has been on just the one type of
16 externality, the externality caused by the higher 0845/0870 calls. Would you agree with
17 that?

18 A Sorry, the focus in the determination, did you say?

19 Q In the methodology that you have applied in the determination.

20 A So, the determination took into account the policy preference. And the policy preference
21 reflected what is now described as more than one, I mean, vertical and horizontal
22 externalities and lack of consumer price awareness. The teasing out of those different
23 effects has been done, as it were, in terms of under-pinning the policy preference, has been
24 done subsequent to the final determination, and is explored in much greater detail in the
25 simplifying non-geographic numbers document.

26 Q What is driving the determination is Ofcom's policy preference, I suggest.

27 A Yes. Yes, that's correct.

28 Q And so that means that the weight, very vaguely, that you put on certain externalities that
29 are consistent with the policy preference is what gives you the answer at the end of the day,
30 at the end of the methodology. It is the policy preference that drives the answer.

31 A Or is the answer in the full reduction scenario, yes.

32 Q You may have taken account of, you say, in very vague terms, although we cannot see it
33 I have to say, cannot see it on the face of the methodology, that the volume effects that may
34 be caused by greater price sensitivity, other services other than 0845 numbers, but I suggest

1 to you that the magnification of those volume effects caused by greater price sensitivity
2 does not feature in your methodology as any externality that you give greater weight to, in
3 balancing against the externality which is your policy preference.

4 A As I say, I think I have already answered that. I do not necessarily accept the magnification
5 point in the absence of a mechanism to create that magnification in terms of the way that
6 word magnification has been used here. It's a different type of externality, as I said before,
7 and one that necessarily leads to the market failure of the same character as the vertical and
8 horizontal externalities.

9 Q But if you were carrying out a full and a proper analysis, a full cost benefit analysis to work
10 out an optimal price across this two-sided market, this price platform, you would want to
11 take into account all of those externalities and costs and benefits, and would have to carry
12 out a much more complicated assessment than the one you have set out in the three
13 principles. Would you agree with that?

14 A If one was trying to derive the optimal price through a quantification exercise, yes, I agree.
15 But I have to say that I think that would be a fearsomely difficult exercise to undertake, and
16 I do not believe that that is necessarily what would be done, even in a much longer policy
17 review, because quantification is only of assistance if it's going to actually, if you can
18 derive results that are sufficiently reliable to make it worthwhile undertaking that
19 quantification exercise.

20 Q So, you would agree with me that an exercise, a quantification exercise that produced an
21 optimal price taking into account all of these costs and benefits and externalities such as the
22 greater price sensitivity to other mobile services would be a fearsomely difficult exercise for
23 Ofcom to undertake.

24 A In the sense that, if what one was trying to do was derive a model and then quantify all of
25 the assumptions and all of the effects within that model in order that the model, that that
26 quantification exercise gave you what you thought was the optimal price, yes, I agree that
27 would be fearsomely difficult.

28 THE CHAIRMAN: Miss Smith, I am sorry to interrupt, the premise of your question is that there
29 is an optimal price. What are you defining as an optimal price?

30 MISS SMITH: I am not sure whether I can tell you what that would be. What I am suggesting is
31 that there are a number of different externalities in this market that arise by the rebalancing
32 of the different prices, and that one of those has formed the major preoccupation of Ofcom,
33 the externality resulting from higher prices for 0845 calls. But I suggested to the witness
34 other externalities such as a greater price sensitivity on other mobile services did not form a

1 part of his methodology, and — if he was going to carry out an assessment across the board
2 of all of those externalities, and all of the costs and benefits resulting from a rebalancing of
3 the price my point is simply, as he accepts — that that would be a much more complicated
4 exercise than the one that is being carried out in the present case. That takes me to my next
5 line of reasoning, which is the cost orientation point.

6 THE CHAIRMAN: Before you go there, could I present an example, perhaps, of the point that is
7 worrying you. We have two cases here, one on 0800, one on 0845. Would you be able to
8 argue, for example, if the rebalancing on the 0800 as a result of the determination led to
9 higher prices for 0845, we are just shifting from one set of externalities to another set of
10 externalities, and we would have to trade one off against the other. Now, this has rather
11 important distinctions about whether we can ever separate the decisions on the two cases.
12 But, that would be an example where you would be having different sets of externalities,
13 that there are externalities on the prices that are adjusted upwards in order to — because of
14 the mobile tariff package effect.

15 A Yes, I agree. I mean, there is that potential for a change in the price on one service to have
16 an impact on prices of other services where both of those are the 08 services we are talking
17 about, whether that is —

18 Q And particularly they both have externalities.

19 A Yes.

20 Q That is the point that was being made.

21 A Yes, well, I accept that. But I understood the questions being put to me were in relation to
22 the mobile tariff package effect which is not about these prices, it is about the prices of
23 other mobile services.

24 Q When we are talking about 0800, 0845, what was part of the mobile tariff package; when
25 we are talking about 0845, the 0800 is part of the mobile tariff package. So, as separate
26 cases, they are there.

27 A I take your point in terms of, if you like, at the level of principle. I think, looking at the
28 evidence that the mobile operators gave about how they, whether they would expect to, how
29 they choose to set their packages, it is suggested it might be more likely they change other
30 prices than the 08 prices. But it may be that they can speak to that question, rather than me.

31 MISS SMITH: The purpose of this line of reasoning is simply, I hope, that the point that was
32 made by Professor Stoneman, that all these potential externalities mean that it is a
33 fearsomely difficult task to set wholesale termination charges by reference to the impact
34 that they might have on other prices across the platform. And we say in that situation a

1 much better approach, and the approach that Ofcom should have taken, is to concentrate
2 simply on the wholesale charge by reference to the costs of the wholesale termination, and
3 to address what was really worrying them, the policy preference and the impact on retail
4 prices for 0845 and 0870 calls in that market, in the retail market, which they are now doing
5 in the simplifying non-geographic numbers review. That is the, in a nutshell, the purpose of
6 this questioning. And it then takes me to, if I may, unless there are any other questions on
7 that point, sir, takes me to my questions on cost orientation. I hope you understand that
8 EE's case is that BT's costs of termination should have been at the very least a starting
9 point for Ofcom's analysis of the termination charges set out in the NCCNs, and Ofcom
10 erred in not taking those costs into account in determining whether the charges were fair
11 and reasonable. We do not make a positive case for the purposes of this appeal that the
12 charges should necessarily have been limited to the termination costs. I will, if I may, take
13 you to earlier in your witness statement, paras.11 through to 15, where you address
14 Mr. Muysert's evidence on cost orientation. I hope it is a fair summary of your evidence in
15 those paragraphs. You say there are two differences in essence between non-geographic
16 calls and geographic calls which justify a departure from cost orientation for BT's
17 termination charges, and that is, first, the role that non-geographic call charges may play as
18 providing a revenue share; and secondly, the model of competition – that is the market
19 failures and externalities – that Ofcom says exist on NTS calls but not on geographic calls.
20 Is that a fair summary?

21 A That isn't quite how I would put it. I think the starting point was that mobile operators on
22 these 08 calls was charging higher prices as a consequence of the market failures, higher
23 prices than Ofcom's policy preference, and if you like there's a starting point. Given that
24 starting point, there are two potential types of benefit which Ofcom looked at in order to
25 reach a conclusion. Of course, it is worth bearing in mind that Ofcom reached that EE is
26 suggesting it should have reached but the issue was about different reasoning. Those two
27 possibilities are, first of all, that the wholesale charges might create an incentive to reduce
28 those 08 prices and that could be a benefit, but that would need to be weighed against
29 potential negative effects; and secondly, let's say there wasn't a reduction in the 08 prices
30 but through the increase in termination rates that would result from the wholesale charges,
31 there was potential for that to lead to an increased revenue share which could benefit
32 consumers. Those two points relate respectively to the full reduction case and the no
33 reduction case, and then of course in the partial reduction case that's the most complicated
34 because it includes both those sets of effects going on.

1 Q What I am trying to get to the bottom of is why, instead of doing what it had done in, for
2 example, the 0870 determination and the recent 030 determination, instead of starting
3 effectively, to put it crudely, with the costs of termination and then assessing a fair charge
4 by reference to those costs of termination, in this case Ofcom effectively started at the other
5 end, looked at the prices proposed by BT and looked at what their effect would be in the
6 market generally, a very different approach. I want to get to the bottom of why you took
7 that approach. With respect, you say there are two possible roles that the charges could
8 play, a reduction in prices or revenue share. I want to look at each of those.

9 A May I comment that the reason of the difference from those other determinations is what I
10 said was the starting point here – i.e. that the mobile operators were charging higher prices
11 than Ofcom considered desirable for these types of calls. In the case of the 03
12 determination that was not the case, the MNOs' prices were in line with geographic call
13 prices, and in the case of 0870, BT was the originating provider in that case and BT's clear
14 intention was to align, to set, 0870 prices in the same way as geographic prices. That is at
15 the heart of the reasons for the difference in approach.

16 Q At the heart of the reasons for the difference in the approach from the 0870 determination
17 and the 030 determination is that – let us start at the beginning. You talk a lot in your
18 witness statement about a two sided market. Can we just look at para.25 of your witness
19 statement on the two sided market. You describe there that, basically, there are customers
20 at each end of the call. That is your definition of a “two sided market”. Would you agree
21 that in the 0870 determination and in the 030 determination you were also dealing with two
22 sided markets where there were customers on each end of the call.

23 A Yes.

24 Q In the 0870 determination and the 030 determination, as you have said, Ofcom set cost
25 based termination charges for calls to those non-geographic number ranges – is that right?

26 A Yes, that's correct.

27 Q So the fact that Ofcom is dealing with a two sided market, that fact in itself does not justify
28 a departure from cost based termination charges?

29 A Yes, I agree.

30 Q So what is driving a departure from the cost based termination charge is a concern about the
31 retail prices, the externality, the high retail prices that originating call providers set without
32 reference to the detriment that such prices might cause to service providers. That is what is
33 driving the departure from the cost oriented approach in the present case?

1 A So it's the high prices of that which I think you are describing has come to be called the
2 vertical externality. That was one potential source of that, it is not the only one. It is one
3 source of that in addition to lack of consumer price awareness and the horizontal
4 externalities.

5 Q In the 0870 determination there is still a lack of consumer awareness to the price of 0870
6 calls?

7 A Yes.

8 Q But that did not mean that you took a departure from a cost oriented termination charge in
9 that case?

10 A No, I think, as we have established, the reason is ----

11 Q It is the vertical externality?

12 A Well, the reason is not so much any externality, although that may be the reason why we
13 have a different starting point, but the reason for the difference is the different starting
14 point. In the 0870 determination the OCP was charging, or was intending to charge, prices
15 in the same way as geographic prices, whereas here the mobile operators were charging, as
16 we understood it, prices above that level. So that is the reason for the difference.

17 Q The whole point – and it may be that we are at cross-purposes here – is that you say there
18 was a different approach, which I accept. That is the whole point of this aspect of our
19 appeal. There was this different starting point. What I am trying to get down to was what
20 were the reasons for this different starting point. We say there should have been the same
21 starting point for the costs of termination. You say, “No, no, we were more concerned in
22 this case about retail prices so we started at the other end”. That is what I am trying to get
23 down to.

24 THE CHAIRMAN: Miss Smith, I think, to be fair to the witness, he is not actually saying that.
25 What he is saying is that in this case there is a factor which was not present in the other
26 cases, namely that the intention appeared to be in this case to price not in line with the
27 policy that Ofcom had, whereas in the other cases there was an intention to price in line, and
28 so in those cases the policy preference simply did not arise.

29 A That's right, and the two potential sources of benefit which Ofcom investigated through its
30 three principles and applying them, as I have said, was either that the 08 prices might come
31 down and that that might be beneficial. As you say, sir, that would not arise in the case of
32 0870 or 03 because the prices were already at the desired level; and the second case was
33 that higher termination rates could be a benefit through increased revenue share. In a case
34 where one does not have a wholesale termination rates schedule one would expect higher

1 termination charges typically, if it was set in a simple way, to provide an incentive to raise
2 08 prices. So it would be likely to take you away from the policy preference. Again, in that
3 context, the potential benefit of an increased revenue share just would not seem to be a
4 desirable, even potentially terribly desirable, effect.

5 MISS SMITH: So you agree there are two things driving this, or two aspects here: there is the
6 potential revenue share if the prices do not drop, or if the prices do not drop enough, and
7 then there is the potential for the incentive to reduce the prices in line with the policy
8 preference. Those are the two factors.

9 A Those were the two potential types of benefit that Ofcom investigated.

10 Q Let us leave to one side for the moment, if we may, the revenue share. I will come back to
11 that. Can I look at the point you make about externalities, the high retail prices for
12 0845/0870 calls. You have identified in the Simplifying Non-Geographic Numbers a
13 vertical externality which is the actual level of the calls, and a horizontal externality, the
14 impact of the high prices on consumers' perceptions of the brand. Is that right, there is the
15 vertical and horizontal externality?

16 A Yes, the three bands of lack of consumer awareness. Those are regarded as three inter-
17 related sources of market failure.

18 Q And you would agree, I think, that all of those problems are problems that appear on the
19 retail side of the market?

20 A Yes, those do manifest themselves on the retail side of the market.

21 Q And absent those problems on the retail side of the market, Ofcom has set wholesale prices
22 by reference to cost, that is in the 0870 determination and the 030 determination?

23 A Yes.

24 Q So let us look at those externalities then. Would you also agree that in assessing whether
25 BT's proposed termination charges would address the externalities that you identify it
26 would be relevant to consider first whether the externalities are extensive, or whether they
27 in fact may be internalised by participants in the market, and secondly, whether the
28 proposed charges are an efficient and effective way to address the externalities? Do you
29 want me to repeat those two points?

30 A Yes, I agree.

31 Q So let us look, if we may, first at the possibility of the externalities being internalised in this
32 market and start with your vertical externality, that is a problem with retail prices. Would
33 you agree that that vertical externality may also appear in vertical supply chains, it is not
34 necessarily a problem – or only a problem – that one confronts in two-sided markets? So to

1 give you an example, I think it is an example actually that you give in the Simplifying Non-
2 Geographic Numbers Review, I can take you to it (footnote 237), what is known as “double
3 marginalisation” or “double mark-up” where a retailer of a particular good imposes an
4 excessive mark-up on the wholesale price ignoring the impact of that decision on the
5 volume of sales by the upstream supplier is a similar externality?

6 A Well there are some similarities, yes.

7 Q And one way in which that externality may be internalised would be for the consumer of the
8 particular good to bypass the retailer in the middle, cut out the middleman, and contract
9 directly with the upstream supplier?

10 A It is one way, yes.

11 Q And similarly the externality on NTS calls may be internalised by service providers
12 contracting directly with the originating call providers, the mobile operators?

13 A There is that possibility, yes.

14 Q If they were really concerned about the very high retail prices charged by the mobile
15 operators it is open, of course, to the service providers to contract directly with the mobile
16 operators as to the retail prices that might be charged?

17 A I agree there is that possibility, but I would suggest that there are two types of potential
18 significant barrier to that occurring, at least on a sufficiently widespread scale to lead to
19 complete or substantial internalisation of the vertical leg sales. First, there is the question
20 of transactions costs. Service providers would need to negotiate with all of the relevant
21 originating providers, so all of the relevant mobile operators and, indeed, to have the effect
22 in terms of all mobile originated calls would need to negotiate with mobile virtual network
23 operators in addition. So that is one potential type of barrier. The other is, of course, in
24 terms of when they are negotiating with mobile operators they may have relatively little
25 bargaining power, particularly if they are a smaller service provider, and so the mobile
26 operators, even if they are willing to negotiate, might suggest a rather higher price than is
27 necessary solely to internalise the externality. So I think those are the two types of barrier
28 that a service provider would face.

29 For large service providers, and we have seen this on 080 – I am not sure we have seen it on
30 other number ranges – we have seen it for example in relation to government, in relation to
31 some public services, we have seen that the Department for Works and Pensions has,
32 relatively recently at least, undertaken such negotiation, and of course it is a relatively large
33 service provider so whilst there might still be disparity in bargaining power, it still has a
34 certain degree of bargaining power.

1 We have also seen it in relation to some very specific commercial providers. I think the
2 evidence in the 080 determination refers to breakdown cover providers, and some reverse
3 call charge operators, but it is a relatively small number of service providers, and I guess
4 their commercial model makes it worthwhile for them to engage in those negotiations to pay
5 the charges that the mobile operator suggests.

6 Other service providers, I think it is quite likely that these transaction costs and disparity in
7 bargaining power would be a significant deterrent to engaging in this kind of contracting
8 directly with the originating providers.

9 Q I do not want to cut you off, Mr. Myers, but we do have a limited amount of time in dealing
10 with these questions, so if I could ask you to look at the second witness statement of Miss
11 Durie, which is at tab 32 of core bundle C2. You helpfully recognised that for 080
12 numbers, for example, T-Mobile and Orange, and other mobile operators have entered into
13 arrangements to allow customers to access certain 080 numbers for no charge. Paragraph
14 21 of Miss Durie's statement on p.6 she refers to the Helplines Association, voluntary
15 arrangements being made with some individual charities, and the arrangement with DWP
16 and then over the page similar arrangements with other public bodies in the past on an *ad*
17 *hoc* basis, and two commercial operators offering reverse charging services.

18 In that case service providers have contracted directly with mobile operators, and have
19 overcome the two potential barriers that you suggest – the cost of needing to negotiate with
20 five mobile operators and that they may have relatively little bargaining power. One way
21 in which they can increase that bargaining power is, as the Helplines Association has done,
22 is to negotiate on behalf of a very large number of smaller charities and to negotiate with
23 the MNOs in order to get the zero rated calls, and perhaps you could look at the 080
24 determination, which is in core bundle A, p. 94, annex 2. Do you see there the list on pp.94
25 through to 96 of charities using zero-rated 080 numbers under the auspices of the Helpline
26 Association, so they have found ways to overcome these two potential barriers that you
27 identify – the cost of negotiating with mobile operators and the bargaining power issue – by
28 joining together, and where it matters to them ensuring that the calls to their numbers will
29 be zero-rated. Would you agree with that?

30 A Yes, I agree there are arrangements for zero-rating. I think the question is the extent to
31 which these arrangements would read across to commercial service providers because, as I
32 understand it, this is a non-commercial arrangement in the sense that there is no payment
33 being made by the charities, and the mobile operators I believe describe their reason for

1 agreeing to zero-rate these calls is to do with corporate responsibility. I am not sure they
2 would necessarily take that approach in relation to all 080 service providers.

3 Q Mr. Myers, you agreed in response to my question that when assessing whether BT's
4 proposed termination charges will address the externalities that you identify, the first point
5 it will be relevant to consider is whether the externalities are extensive, and whether they
6 may in fact be internalised by participants in the market and I am putting to you that there
7 was clear evidence that where service providers cared about the zero-rating of their 080
8 numbers in this situation they were able to and they did enter into direct arrangements with
9 OCPs. You would agree with that?

10 A I would not entirely agree with that. I would agree that there is clearly some evidence of
11 some service providers directly contracting with OCPs in order to zero-rate calls. I do not
12 think one could necessarily say that these are the only SP's that care sufficiently about zero
13 pricing of 080 calls, and this is an issue that I think is covered in a bit more detail in the
14 non-geographic policy document. I am not sure I am in a position to say precisely what is
15 being said there, but I would observe that Ofcom's analysis for consultation, as we
16 previously covered, is that it is suggesting the policy proposal it is suggesting consulting on
17 is that all operators should be required to charge zero price for 080 calls, and that is based in
18 part on Ofcom's analysis that the vertical externality is not fully or sufficiently internalised
19 by these contracting arrangements because of the barriers that I referred to earlier.

20 Q If the externality was substantial you might have expected service providers to have entered
21 into direct arrangements with the OCPs, the possibility is open to them, there are ways of
22 overcoming the two potential barriers that you have identified so if the externality was
23 substantial you could have expected more service providers to enter into direct
24 arrangements with OCPs?

25 A Well that depends on the scale of the barriers and how easy or difficult it is to overcome
26 them. I am not sure one can necessarily infer that from the absence – I mean the absence of
27 service providers engaging in these negotiations or these agreements is also consistent with
28 the barriers being quite large.

29 MISS SMITH: It also depends, does it not, on who has these 080 numbers, and for what purposes
30 they are using them. There are charities, but at the risk of real jury advocacy, you will see
31 that on the water bottle that is in front of everyone, Nestlé's consumer services helpline is
32 an 0800 number, and they have not entered into an agreement that that number should be
33 zero rated, but if it really mattered to them that that number was zero rated, it would be open

1 to Nestlé to enter into an agreement with the MNOs in order to internalise that externality,
2 would it not?

3 A It would be open to them, but they face the barriers of costs of negotiation and the fact that
4 they would be likely to have a relative disparity, be at a relative disadvantage in
5 negotiations, with large mobile operators about the price that mobile operators would
6 suggest being paid in order to zero rate those calls.

7 Q Well, the costs for someone like Nestlé of entering into those sort of negotiations, is
8 something admittedly that needs to be considered in determining whether or not the
9 externality is substantial; but you did not consider how substantial the externality might be.

10 A In the final determination, I think as I explained earlier, Ofcom relied on the policy
11 preference and the previous documents that established that policy preference. The
12 question of the type of investigation you are talking about is relevant to Ofcom's ongoing
13 simplifying non-geographic numbers consultation, and is being looked at within that
14 context.

15 Q Yes. Well, I think you have made the point. Ofcom did not in this case consider the extent
16 or significance of the externality in the determinations. You would agree with that?

17 A It took as given, I think it would be fair to say, Ofcom took as given, the policy preference,
18 Ofcom's policy preference on the pricing, and that reflects some of these externalities, but
19 within the determination itself, it did not seek to unpick or look into the effects underlying
20 the establishment of that policy preference.

21 Q And in fact that is now a task that you are carrying out in your simplifying non-geographic
22 numbers review.

23 A That's correct.

24 Q So, let us turn to the second point as to whether BT's termination charges, which is what we
25 are concerned with in this case, are an effective and efficient approach to address the
26 externalities. Can I ask you to go back to your second witness statement which is at tab.28,
27 para.225, p.69. In para.225, at the end of the introduction part of that paragraph:

28 "There is a significant risk that NCCNs 985 and 986 are an ineffective an
29 inefficient approach to address the externalities",

30 and so you explain there in sub-paragraphs (a) and (b) why there is that significant risk that
31 they are both an ineffective and inefficient approach to address the externalities.

32 A Yes, that's right.

1 Q You would therefore agree that a better approach to dealing with these externalities is by
2 means of direct regulation in the retail market such as that proposed in the simplifying non-
3 geographic numbers consultation.

4 A So, given a free choice of the full range of policy options, yes, I would agree with you. My
5 understanding is that that was not the question Ofcom faced in the dispute.

6 Q You say, at para.351, if I can take you to that paragraph, p.104, the same point, which is
7 that:

8 “The termination charge schedules represent an inferior approach compared to
9 Ofcom’s favoured options of tariff rebundling and maximum retail price”.

10 It is the same point. And then you make the point — I am sorry, you should perhaps have
11 gone back to para.161, p.50.

12 A Yes.

13 Q You make the point I think you have just made in oral evidence:

14 “Ofcom faced a different and much narrower question of whether [the rates] are
15 fair and reasonable As already explained, this means that the relevant
16 analytical question for the Disputes is not to identify the best approach to address
17 the market failures from a wide range of options, as that is more appropriately
18 addressed in policy reviews and may involve options that are simply not available
19 in the context of dispute resolution. Instead, the relevant question is whether BT’s
20 adjustment to wholesale interconnection rates ... would lead to benefits or
21 detriments for consumers and competition”.

22 Well, with respect, that last paragraph does not really follow. The relevant question is
23 whether the wholesale interconnection rates were fair and reasonable, as you identify at the
24 beginning of that paragraph. That is the relevant question that Ofcom was concerned with
25 in this case — (the last sentence, I am sorry).

26 A So, what I was seeking to do in this paragraph was to explain my understanding of the
27 relevant economic question, and the relevant question incorporates, obviously,
28 understanding of the statute and Ofcom’s legal duties, and I am not here to give expert
29 advice on that.

30 Q But, that question is only the relevant question, I would suggest, if Ofcom has already
31 decided that it should pursue the policy option through the setting of wholesale
32 interconnection rates.

33 A Yes, I think that’s right because, as I said, the starting point was that prices exceeded the
34 level desired in the policy preference, and the question being considered and articulated

1 here is whether or not BT's NCCNs would lead to an improvement relative to that policy
2 preference.

3 Q It would have been an alternative open to Ofcom to determine whether the wholesale
4 interconnection rates were fair and reasonable by reference to, say, the whole sale costs of
5 termination and to accept, in line with your evidence, that the retail market externalities
6 would be better addressed in an assessment, an analysis and a market review of the retail
7 market, would it not?

8 A Well, I'm not sure that's an economic question. That seems to be precisely what Ofcom
9 should and should not take into account —

10 Q I am asking you these questions, Mr. Myers, because you expressed views as to what would
11 have been the better policy approach to dealing with these retail market failures in paras.5,
12 351 and others of your witness statement. But, we will leave that point.

13 A Well, I think we have already covered it. I am happy just to confirm that, given a full
14 choice of options, my view is in line with Ofcom's consultation, so it's not a final Ofcom
15 view, but the proposal is not to use wholesale termination charges in order to induce
16 improved price in the retail market, but to take actions that address that more directly in the
17 retail market, and as regards what the relevant question is in the dispute, as I think
18 I explained, what I was trying to set out was my understanding of the relevant economic
19 question.

20 Q Sir, it may be that the remainder of my cross-examination can be cut down quite
21 substantially. Would it be possible to rise now, then I can put a blue line through the
22 questions that I do not need to put to Mr. Myers and can concentrate just on the questions
23 that I do after the luncheon adjournment?

24 THE CHAIRMAN: Very well, we will rise now and resume at five to two.

25 (Adjourned for a short time)

26 THE CHAIRMAN: Miss Smith.

27 MISS SMITH: Mr. Myers, could you turn to para.120 in your second witness statement, which is
28 on p.40. I want to ask you one or two questions on what you say about the model of
29 competition for NTS calls. You say in para.120:

30 "... the model of competition for 0845/0870 calls has focused on promoting
31 competition among TCPs and SPs at the terminating end."

32 You say in para.121:

33 "The fundamental regulatory concerns in 0845/0870 calls have been;

34 a. BT's SMP in wholesale call origination ... and

1 b. Retail pricing by all OCPs ...”

2 Would you agree that at a technical level once the non-geographic number has been

3 translated, termination of geographic calls and NTS calls is exactly the same?

4 A Yes, that’s my understanding.

5 Q Therefore, there is potentially the same termination bottleneck problem for non-geographic

6 calls as for geographic calls. In effect, the caller cannot choose the communications

7 provider that terminates their call?

8 A I wouldn’t accept that as an inference from a technical similarity between two types of

9 termination.

10 Q Would you accept that there is the same termination bottleneck problem for non-geographic

11 calls as geographic calls? In neither situation can the caller choose the TCP that terminates

12 their call?

13 A I wouldn’t accept that there’s the same termination bottleneck question. The caller may not

14 be able to choose the TCP, but there are some reasons why the analysis of market definition

15 and market power is different as between termination of geographic and non-geographic

16 calls and ----

17 Q I would like to ask you, if I may, about those.

18 THE CHAIRMAN: I am sorry, Miss Smith, let him finish.

19 MISS SMITH: I am sorry.

20 A And that’s reflected in Ofcom’s previous analysis where it has come to a view on market

21 definition and market power. Perhaps market definition is more informative for this

22 question. In the terms of geographic calls, Ofcom has concluded that every terminating

23 provider is in a separate market for termination of geographic calls on its own network.

24 Ofcom has not reached that same conclusion in the NCCN 500 Competition Act case.

25 Ofcom concluded there was a single market across termination of all TCPs – i.e. not a

26 bottleneck for each individual TCP. Previous to that, in a market review that was never

27 completed, so it was merely a consultation document, I think that was in 2004, Ofcom also

28 proposed a single market for termination of non-geographic calls, not a separate market for

29 termination on each terminating network.

30 Q In fact, I was about to take you to those. In the NTS market review in 2004 you would

31 agree that Ofcom proposed finding that BT had significant market power in that market, the

32 market for NTS call termination in the UK, but the review was suspended because of a

33 complaint by Cable & Wireless?

34 A That is correct.

1 Q Then in the NCCN 500 determination Ofcom found that BT was dominant in the market for
2 NTS call termination and hosting in the UK for the period being considered by that
3 determination?

4 A Yes.

5 Q In the current determinations you would agree that Ofcom explicitly stated that it did not
6 find BT to be dominant, nor did it find BT not to be dominant. It effectively reached no
7 conclusion on dominance?

8 A That's correct.

9 Q But you would agree against the background of the previous findings of dominance and
10 SMP there was at the very least a risk that BT had market power in terminating NTS calls?

11 A Yes, I would accept that there was a risk. I think there had been evidence of some change
12 in circumstances since the NCCN 500 conclusion had been reached. I agree that there was
13 a risk.

14 Q Can I just, on a slightly different matter, go back to your witness statement at para.119(a).
15 You say:

16 "in assessing the appropriate level of regulated termination charges,
17 consideration has also been given to network and call externalities ..."

18 In (a) you talk about network providing:

19 "... the rationale for a departure from cost based prices for mobile termination
20 in the form of a surcharge on termination charges, but the network externality
21 surcharge is no longer included since the CC's Determination of January 2009."

22 You describe, and I will not take you to it, the network externalities that were considered in
23 that case in para.147, different externalities obviously in that case than from this present
24 case?

25 A Yes.

26 Q Could I take you to 149 of your witness statement. In 149 and 150 you explain that the
27 network externality surcharge was removed in 2009 because by then the Competition
28 Commission concluded that the network externalities had been sufficiently internalised by
29 mentions – that is effectively what you say in 149 – and that the network externality
30 surcharge was ineffective and inefficient for addressing the externalities in the case. That is
31 what you say at para.150?

32 A Yes.

33 Q I just want to briefly explore with you what the network externality surcharge was before it
34 was removed, as you give it as an example of a departure from cost based termination

1 pricing. Perhaps I could ask you just to go to CAT bundle 19, tab – that is a wrong
2 reference, and I will come back to this, but you might be able to agree with me without
3 reference to the bundle. The network externality surcharge was a mark-up on termination
4 charges based on cost?

5 A No, I wouldn't agree with that.

6 Q I will come back to that, if I may, by reference to the bundle and ----

7 A I was just going to say, which may assist, that my answer and your question reflect a very
8 longstanding disagreement between Ofcom and the mobile operators about whether or not
9 customer acquisition costs are relevant to the costs of termination. In the mobile operators'
10 view they are relevant, and that I think is reflected in Mr. Muysert's evidence suggesting
11 that this is not a departure from cost based termination. In my view and in Ofcom's view,
12 those costs are not relevant to termination and that is why I said that I regard it as a
13 departure from cost based termination.

14 Q I will come back to that point, if I may, and we will look at the actual description of it given
15 by the Competition Commission in 2003 as soon as I manage to find the reference. Could
16 we move to para.38 of your statement, and I would like to ask you some questions about
17 revenue sharing. In para.38 you say:

18 "... there are two distinct roles of the TCP's termination charge for 0845/0870
19 calls [could play]:

- 20 a. To enable the TCP to recover its costs; and
- 21 b. To provide a source of revenue to share with SPs."

22 I will just make that clear, when we are talking about revenue share it is a revenue share at
23 that level of the market between the terminating communications provider and the service
24 provider, not only revenue of share between the originating communications provider and
25 the TCP. You are talking there about the source of revenue to share with the service
26 providers, the SPs.

27 A The way I would describe it is that the purpose of revenue share is revenue share between
28 the service provider and the originating provider, but the way that works through the value
29 chain is via termination charges and the terminating provider sharing what it has obtained
30 from the originating provider with the service provider.

31 Q So whether or not there is any revenue share depends upon the terminating provider passing
32 on revenue to the service provider?

33 A Yes.

1 Q And that, in turn, may depend on the level of competition between terminating providers as
2 to whether or not there is a pass on?

3 A That is correct.

4 Q Can I put this to you: if, in line with your policy preference or Ofcom's policy preference,
5 the price of 08 calls are aligned with the price of geographic calls, would you agree that in
6 that situation there is no provision for revenue share?

7 A Yes, in the case of 0870. In the case of 0845 there is some allowance in the current
8 arrangements for a relatively small amount of revenue share compared to other number
9 ranges that co-exists with the policy preference and indeed BT's practice typically in the
10 past of charging 0845 prices at local call prices.

11 Q Before we go to the detail of that, are you saying that on the basis of the current – we will
12 come back to that. Would you agree that the policy preference is the primary objective for
13 Ofcom and the desire to encourage revenue sharing is only a second order objective for
14 Ofcom if the policy preference is not achieved, the drop in prices is not achieved?

15 A Yes, I would agree that the circumstances where consideration of revenue sharing may be
16 necessary is where there is departure from the policy preference.

17 Q If I can return to your analysis in para.38 and following of your second statement, in para.40
18 you say:

19 “... Ofcom explained that in appropriate circumstances, the termination charge
20 can be consciously set above the TCP's efficient costs to facilitate revenue
21 sharing ...”

22 In para.43 you say:

23 “To the extent that revenue share is considered reasonable, the appropriate
24 comparison of costs and prices is between the termination cost and the net
25 termination charge, not the gross termination charge.”

26 I will come to that comparison in a moment, if I may, but I just want to ask you about that
27 caveat. You would agree, as a matter of principle, that in certain circumstances revenue
28 sharing may not be appropriate – if, for example, it is at such a level that service providers
29 use 0845 numbers in order to obtain revenue share when they might not otherwise use those
30 numbers, and it is used for gaming or for arbitrage purposes, or encourages routing of calls
31 in an inefficient way?

32 A Yes, I would agree that those are possible examples. I would also say that in the final
33 determination Ofcom in effect concluded that revenue share was not desirable on 0870 in
34 the relevant circumstances, and the increased revenue sharing was not desirable on 0845,

1 and that can be seen in terms of Ofcom's conclusion in the no reduction case, because it is
2 only the revenue share issue that arises in that case.

3 Q Paragraph 43 you make the point proceeding on the assumption that revenue sharing is
4 considered reasonable or is appropriate, in those circumstances you say that the appropriate
5 comparison is between the termination cost and the net termination charge. In para. 42(b)
6 just before that, you explain the net termination charge – the gross charge less any revenue
7 share paid to the SP. So the comparison there you are saying is an appropriate comparison
8 to the extent that revenue sharing is considered reasonable, is the comparison between
9 termination costs and the termination charge minus the revenue share?

10 A Yes.

11 Q Put another way, the appropriate comparison would be between the termination charge on
12 one hand, and the costs plus an allowance for revenue share on the other hand?

13 A Yes.

14 Q Now, as you indicate in para. 39 of your witness statement, Ofcom accepted that the most
15 suitable benchmark or proxy for the efficient costs of termination of 0845 and 0870 calls
16 would be the termination rates set in the 0870 determination?

17 A Yes, for the costs determination, yes.

18 Q Those termination rates are set at a cost oriented level so that is the proxy you use for the
19 costs of termination?

20 A Yes.

21 Q If I can ask you to turn to p.110 of your witness statement you say:

22 “... the termination charges for 0845 calls *before* BT introduced NCCN 985 – and
23 the charges on the bottom tier of that NCCN – are not cost-based. They are
24 significantly above the cost of termination because they include an element for
25 revenue sharing (estimated at 0.4ppm to 2.1ppm) depending on the time of day or
26 the day of the week.”

27 So effectively there you are saying there is the element for revenue sharing you estimate as
28 between 0.4ppm and 2.1ppm?

29 A Yes.

30 Q You can see from your footnote 104 that this is just a calculation of the difference between
31 the 0870 cost based termination charge, which you take as a proxy for termination cost on
32 the one hand, and the 0845 termination charge on the other, that is how you arrive at the
33 figures of “between 0.4 and 2.1”?

34 A That's correct.

1 Q You would agree, would you, that Ofcom did not consider in the determination of whether
2 this element of between 0.4ppm and 2.1ppm was set at a level appropriate to reflect either
3 actual or potential revenue sharing on 0845 numbers?

4 A Yes, I agree that question was not addressed.

5 Q In this case, what you describe as “The revenue share” is by definition simply the excess
6 over cost? By definition it is simply the difference between the charge of the lowest tier
7 and the cost?

8 A Yes, that is right.

9 Q So can we then consider how Ofcom address these points in the 08450/0870 determination?
10 That is in vol. B1 of the core bundle, and it is at tab 1. Can I ask you to turn to para.4.44
11 which is on p.47. I am not going to read it out, can I ask you to read to yourself – and the
12 Tribunal as well – paras. 4.44 through to 4.47? I am sure you are very familiar with it, Mr.
13 Myers??

14 A (After a pause) Yes.

15 Q I have taken you to those paragraphs because in para. 34 of Ofcom’s skeleton in this case
16 and in the opening of Mr. Herberg, it is said that Ofcom considered and identified BT’s
17 costs in these paragraphs of the determination. But in a nutshell what was simply done in
18 these paragraphs of the determination was to say that if a comparison is to be carried out it
19 should be carried out – a comparison between the net termination charge and the
20 termination cost, essentially the point we have just been discussing. That is what is said in
21 those paragraphs, is it not?

22 A And that the appropriate costs of termination are those set out in the 0870 determination.

23 Q The 0870 termination acts as a proxy for costs of termination?

24 A It is a bit more than that, it was – it did reflect the analysis of costs in that determination.

25 Q Absolutely. There was no analysis carried out in the decision as to whether or not the
26 difference which we have seen is between 0.4ppm and 2.1ppm, I think you have agreed
27 with me that that was either an appropriate or required level of revenue share?

28 A Yes, that is right. In my witness statement, and I cannot recall whether it is put quite the
29 same way in the determination, is the relevant question on revenue sharing was whether or
30 not it should be, as it were, reintroduced on 0870 and whether on 0845 it should exceed the
31 existing level, that was the question that Ofcom addressed in the final determination.

32 Q And you would agree that Ofcom’s view is that for 0870 revenue share should not be
33 reintroduced?

1 A That was in effect the conclusion that Ofcom reached as reflected in, for example, its
2 conclusion that in the no reduction case there was likely to be a negative effect on
3 consumers overall.

4 Q The revenue share figures of 0.4ppm, 2.1ppm are simply those that result from 0845 prices
5 at the lowest, 0845 termination charges at the lowest tier, so no increase in termination
6 charge?

7 A That's right.

8 Q Ofcom never considered that at the higher levels of the termination charge how much
9 revenue share there might be or whether or not that would be appropriate in the present case
10 to enable those sorts of levels of revenue share?

11 A Yes, that was considered and in a sense that was a revenue share question that Ofcom
12 addressed, whether or not the revenue share that might arise above the bottom tier on each
13 of the NCCNs would be beneficial or detrimental to consumers, and the conclusion was that
14 revenue share on its own was more likely to be detrimental.

15 Q Just to finish off this point, in the skeleton argument Ofcom also relies upon footnote 533 to
16 para.5.211 of annex 3 to the 0845/0870 determination, that is on p.238. You see the
17 paragraph to which that footnote is appended at para. 5.211 of annex 3 **?

18 A Yes.

19 Q It says:
20 "BT has estimated that the charging mechanism imposed will improve revenue by
21 up to X per annum which suggests there are potentially significant and direct
22 benefits to be realised, but will this revenue necessarily be passed on to SPs and so
23 lead to consumer benefits by the indirect effect"

24 So that is a point we have already discussed, that whether or not it is actually passed on
25 depends on the extent of competition between TCPs.

26 A Yes.

27 Q ** "And (see footnote 533) if the revenue is passed on it would imply increased
28 outpayments, revenue share or other costs of hosting, such that the net termination
29 charge would be relatively close to the cost of termination".

30 So, you are simply saying there that if there was an increased revenue share, the net
31 termination charge would be closer to the cost of termination. By definition it must be the
32 case.

1 A Yes, but I think it is saying a little bit more than that, that if there is a significant extent of
2 revenue share, the higher termination charges are largely passed on to service providers,
3 then the net termination charge would be close to the cost of termination.

4 Q If I could ask you just look, now, at Ofcom's assessment of BT's rationale for the NCCNs,
5 the same document, paras.4.117 and 4.118, this is on p.60. We have seen there, and I do not
6 need to read it out, 4.117 to 4.118, no contemporaneous evidence that they were designed to
7 reduce retail prices, no contemporaneous evidence that they would necessarily pass on the
8 higher charges to SPs,

9 "The contemporaneous evidence is consistent with BT seeking to obtain revenue
10 from OCPs ... to increase its profits".

11 And, in para.7.118, perhaps I could ask you just to turn to that, p.102, you make it clear
12 there, you refer back to the paragraphs that we have looked at, paras.4.45-4.47:

13 "Whilst we accept it is not clear that there has been an increase in the costs to BT
14 for providing 0845/0870 call termination to the extent the revenue share is
15 considered reasonable [the same words] the appropriate comparison is",

16 and you set out what the appropriate comparison is. But you would agree that there was no
17 suggestion by BT, and obviously no finding by Ofcom, that the NCCNs were justified by
18 any increase in BT's costs of termination.

19 A That's right.

20 Q Or, take it one step further, that the ladder of wholesale termination charges bore, or could,
21 in fact, bear any relation to BT's costs of termination.

22 A Yes.

23 Q In the 080 determination, I think it was accepted for Ofcom in opening, Ofcom did not
24 consider BT's costs of termination at all, not even in the way of carrying out this
25 comparison that it had done in the 0845/0870 determination.

26 A Yes, I think that's my recollection.

27 Q I can take you to it, if you want, but I think it is explicitly set out in para.5.71 of the 080
28 determination, that Ofcom made the point that it was not relevant to consider explicitly
29 BT's costs of termination, and Ofcom did not in fact do that, as accepted by your counsel in
30 opening.

31 THE CHAIRMAN: Could I just put a question in there that is related to this? To what extent is it
32 the case that the treatment you give to any additions to BT's profits in your summing up of
33 the different effects — in other words, you calculate any increase in BT's profits has a zero

1 welfare impact — to what extent is that the same as saying that you are considering that
2 BT's prices should be related to their costs?

3 A Well, I think I can see there is a relationship there. What it is saying is that since the, if the
4 question we are exploring is whether revenue share is desirable, it is only going to be
5 desirable if it is passed on to service providers, and indeed —

6 Q Put the revenue share to one side, the question is, the starting point of EE is that BT's prices
7 should be cost related, that is the issue. Now, if BT's prices are not cost related and they
8 increase their prices, then their profits must be going up. Now, if you then give that a zero
9 weight in your welfare calculation, that is the same as saying you do not value, or society
10 does not value, this increase in the profits of BT.

11 A Yes.

12 Q And therefore it does not value any increase in BT prices above costs.

13 A Any increase in BT's profits, because —

14 Q Resulting from prices above costs.

15 A Resulting from price above costs, but to the extent it is passed on to service providers and
16 service providers respond by improving services, that might have been a benefit.

17 Q Yes, and the fact that you give full weight to the costs involved in the MTPE, which is the
18 other side of it, I cannot really see a lot of difference between the weighting you have given
19 to the different elements in the impact and the EE requirement, or suggestion, that BT prices
20 should be cost related.

21 A Well, as I think as I said, it seems to me that Ofcom reached the conclusion that revenue
22 sharing, departure from cost based pricing for the purpose of revenue sharing, was not
23 desirable. The question that leaves is whether a departure from cost based termination
24 prices for the purpose of providing incentive to reduce 08 prices is desirable.

25 Q No, I am talking about the desire to change the 08 prices in order to increase BT's profits.

26 A Yes, and that arises from, well, at least through the termination charge, it arises from higher
27 termination charges.

28 Q Yes.

29 A So, I think I agree with you that in effect there is, in my view very little difference between
30 what Ofcom concluded and what EE is arguing for.

31 Q That was the point I was trying to get to. EE may disagree, but —

32 A Yes.

33 Q Right. Thank you.

1 MISS SMITH: I would just like to finish off these questions on the 080 determination, and then
2 go back to the document which I have now found. But, in the 080 dispute, you would agree
3 that immediately prior to the introduction of NCCN 956 BT made no charge to OCPs for
4 termination of 080 calls.

5 A Yes.

6 Q And in fact, up to November 2008, BT had paid OCPs an origination charge of 0.5ppm.

7 A Yes, or thereabouts.

8 Q And you also would agree, would you, that generally SPs pay a service charge to TCPs,
9 including BT, for 080 calls?

10 A Generally, that's my understanding, yes.

11 Q And so you would also agree that in those circs obviously NCCN 956 cannot be justified by
12 any increase in BT's termination costs.

13 A It wasn't justified by an increase in termination costs, yes.

14 Q In fact, it could not bear any relation to BT's costs of termination, the ladder pricing, the
15 structure set out in that NCCN.

16 A Well, you've got the similar point that if there was revenue share, in other words, if it
17 changed the payment arrangements, if there were high termination charges being levied and
18 it was passed on to service providers, that would change the nature or the type of payments
19 and the level of payments between terminating providers and service providers, and it might
20 potentially — depending on whether the effect was large enough — could even reverse the
21 direction of those payments, ie rather than service providers paying the terminating
22 provider, potentially it could go the other way.

23 Q At each step of the ladder there is an increase in revenue available to BT through the
24 increased termination charge, and that increased revenue available to BT may or may not be
25 available for revenue share.

26 A Yes.

27 Q That is the position. So there is no increase in cost as you go up the ladder of determination

28 A I agree there is no increase in BT's cost of termination, yes.

29 Q And, if I could just take you back to, we have found now, thankfully, it was not 19, it
30 was 20, bundle 20, tab.9. I think it probably does appear in other places as well, but this is
31 just on the network externality surcharge point. Can I just put the suggestion to you. If you
32 look at para.1.6 of the Competition Commission's determination at p.4, there is a
33 description of the network externality surcharge about half way through that paragraph:

1 “We concluded that the call termination charges of the MNOs were well in
2 excess of a ‘fair charge’, this being based on the LRIC ...”

3 long running incremental costs of call termination –

4 “... (including fixed and common network costs) and a mark up for relevant
5 non-network costs. We also concluded that there should be a small mark up for
6 the network externality, a justified addition to the fair charge because the caller
7 benefits from having a large, accessible pool of people to call and be called by
8 ...”

9 So we have there an assessment of what the fair charge would be if based on the
10 incremental costs of call termination and a mark up for relevant non-network costs with the
11 externality surcharge. So on the basis of that we simply say that what the network
12 externality surcharge was was a surcharge, a mark up, on termination charges that were,
13 themselves, based on cost?

14 A That’s not my understanding of the appropriate characterisation. What the Competition
15 Commission concluded was that the fair charge should be based on the incremental costs of
16 termination plus two mark ups. The first mark up was a mark up for relevant non-network
17 costs. That did reflect costs that were relevant to termination. The second mark up, what is
18 called here a small mark up for the network externality was in addition, on top of that, and
19 in my view that does not reflect the costs of termination. That reflects, as described here,
20 the demand benefits flowing from the network costs allowed.

21 Q I think there is actually not much between us. What you have just said, and what I think is
22 the case, is that there was a calculation of costs plus a mark up for additional non-network
23 costs, so two costs related elements, and a surcharge on top of that for the network
24 externalities. So you start with costs, you add a mark up for additional costs and you put on
25 top of it a surcharge that reflects the value of the externality. That was what was done in
26 this case?

27 A That’s correct.

28 Q Very different from the approach that Ofcom took in the present case which was effectively
29 to start at the other end, to look at the proposed charges and to consider whether or not they
30 would lead to the impacts on other charges, retail charges, that were desired by Ofcom in
31 the present case?

32 A It was different, but that reflects the very different type of potential benefit in play.

33 Q What – sorry.

1 A Here, in the case of the Competition Commission, it was a network externality effect, which
2 the Competition Commission quantified as to what the surcharge should be to contribute to
3 the network externality. In the case of the disputes, the nature of the potential benefit that
4 Ofcom was exploring was revenue sharing, and revenue sharing, the question of what is the
5 correct level of revenue sharing is not one that I think can straightforwardly be answered
6 because there is such a variety of potential services provided by service providers on these
7 number ranges. It is not like you can say, "Well, these numbers are used for this type of
8 service, a relevant cost for this type of service is this, and therefore that's what the revenue
9 share should be". It tends to be the other way round. What is the maximum allowance that
10 can be made for revenue sharing given the prices being charged by the originating
11 providers, and therefore what does that imply for the level of revenue share available on this
12 number range. Then of course service providers have the ability to choose between number
13 ranges if they want increased revenue share beyond that, for example. So I would say it
14 was a very different type of question that is being addressed, and for that reason a different
15 type of approach was adopted.

16 Q You agree, I think, that the Competition Commission started there from the cost of
17 termination and then adjusted those to take account of the network externality. I think we
18 are agreed on that?

19 A Yes, we are agreed.

20 Q Ofcom did not in this case, the present case of the disputes, start with cost and make an
21 adjustment, for example, that would reflect what it saw as the value or the quantum of the
22 vertical retail externality that is identified in the present case?

23 A But that's going to a different point. That is not going to the revenue sharing point. That is
24 going to the potential for the NCCNs to incentivise price reductions in 08 call prices, and
25 that is the way in which the NCCNs have the potential to contribute towards alleviating
26 those externalities.

27 Q I think you have already agreed with me that what Ofcom did not do in the present case is to
28 start with cost and then to put on a surcharge, for example, to reflect the revenue sharing
29 that it said did exist or should exist in the present case?

30 A Yes, Ofcom did not do that, and, as I said before, Ofcom concluded that revenue sharing
31 was not desirable, in effect.

32 MISS SMITH: Thank you, sir, I have no further questions.

33 THE CHAIRMAN: Thank you, Miss Smith. Mr. O'Donoghue?

34 Cross-examined by Mr. O'DONOGHUE

1 Q Sir, I am conscious of the time, I will take a small number of minutes. Mr. Myers, I only
2 have a few questions for you and I hope this friendly fire is not too unpleasant. Mr. Myers,
3 can you turn to para.31 of your statement.

4 A Yes.

5 Q Would you mind reading that out, please?

6 A The entire paragraph?

7 Q Yes, please.

8 A "In 2005-2006 Ofcom conducted a detailed review of Number Translation
9 Services, including 0845 and 0870. The conclusions of this review included
10 actions to improve the linkage to geographic prices for 0870 calls (see
11 paragraph 33 below). The review also indicated that Ofcom would be likely to
12 make similar changes to 0845 once dial-up internet traffic declined. This delay
13 for 0845 recognised that repairing the linkage to geographic prices for 0845
14 calls would force dial-up Internet Service Providers and some other 0845 users
15 to migrate to other number ranges at considerable cost. The delayed review of
16 0845 is now being considered within the ongoing NGCS review."

17 Q We agreed at the time there was a concern that the preference in respect of 0845 came at
18 what you call a considerable cost, or potentially did.

19 A I think this paragraph, as I understand it, is referring to what happened in 0870, which was
20 the removal of support for revenue share. So it's the removal of support for revenue share
21 on 0845 that might force dial-up ISPs and some other 0845 users to migrate to other number
22 ranges. It is not, in my understanding, the policy preference itself which is that the prices
23 should be charged in the same way as geographic call prices.

24 Q We agree that the point I am making is that Ofcom was adopting a wait and see approach, if
25 I can call that, for 0845?

26 A Well, yes, but in relation to, as I understand it, revenue share on 0845.

27 Q And that is part of the consideration which remains ongoing for the NGCS review?

28 A Yes.

29 Q It is fair to say, is it not, that there was a degree of ambiguity or contingency at that point in
30 connection with 0845?

31 A Well, it depends what aspect of 0845 you are referring to. In relation to revenue share the
32 view was taken that that needed to be considered further at a future date.

33 Q Because of the costs perceived at that time?

34 A Yes.

1 Q Would a reasonable reader looking at this costs at the time not conclude that there was a
2 degree of weighing and balancing to be done in connection with 0845?

3 A In relation to revenue share on 0845, yes.

4 Q Thank you. Mr. Myers, could you briefly turn to the final determination in 0845, which is
5 in B1, tab 1. It is para.2.44. Again, would you mind reading that, please?

6 A Paragraph 244:
7 "Ofcom supported the maintenance of the pricing link by identifying that the
8 primary purpose of the link is not to provide transparency for consumers; rather
9 it is to protect consumers' interests by maintaining reasonable retail prices for
10 all 0845 and 0870 calls from all OCPs."
11 So the concern as set out in the final determination was to maintain reasonable retail prices,
12 that is what that says?

13 A In relation to less, which of the documents being referred to, is it the 2004 document?

14 Q Well can we go back to the contemporaneous document, please, just very briefly? It is in
15 bundle 24, tab 11.9, and it is at para. 4.104. Have you found that, Mr. Myers?

16 A Yes.

17 Q Would you mind reading that, please?

18 A Yes.
19 "In Ofcom's view, the pre-announcement option should not be regarded as a
20 'loophole' as the main aim of restoring the geographic link is to improve price
21 transparency, not to bring down the price of calls. The relevant question is
22 whether the pre-announcement option would achieve the desired level of
23 transparency or not."

24 Q So that says the opposite to what you read out in the final determination, does it not? In the
25 final determination the main purpose was said to be regulating retail prices. In the
26 contemporaneous document it is said to be price transparency.

27 A Yes, well, I think as I said earlier, I didn't work on this document and I wasn't responsible
28 for s.2 of the determination and I note that the paragraphs referenced in the footnotes to
29 para. 2.44 in the final determination are different paragraphs than the one you have taken
30 me to, so ----

31 MR. HERBERG: This is a different document and I am concerned the witness is being misled.
32 This document, I do not think is the document being referred to in the footnote of the final
33 determination?

34 A Yes, it appears to be a 2006 document.

1 MR. HERBERG: It is a 2006 document, the reference in the footnote is to a 2004 document.

2 MR. O'DONOGHUE: Sir, Mr. Herberg is right, this is simply a continuation of the same set of
3 policy documents, and what I am trying to put to the witness is the ultimate conclusion,
4 which is the 2006 document. I was not suggesting for a minute that there is an exact read
5 across?

6 MR. HERBERG: I certainly had the impression from Mr. O'Donoghue's question – and I think
7 the witness may have done – that he was being taken to the document in the footnote?

8 A That was the impression I had, yes.

9 MR. HERBERG: Well it has certainly been exploded now! (Laughter)

10 MR. O'DONOGHUE: Would you accept, Mr. Myers, that there is a 'tension' – if I can call it
11 that – between what is set out in this 2006 document, and the explanation of Ofcom's policy
12 as set out in the final determination?

13 A I can see that there is a difference between the 2004 document and the 2006 document.

14 Q And again, do you think a reasonable reader looking at the two documents would detect a
15 degree of ambiguity in the document purports, if I can call it that?

16 A Well I think that would require a greater reading and understanding of both of these
17 documents than I have, so I am not sure I can give an opinion on that, because clearly the
18 context of all of these comments does matter as well as specific comments and specific
19 paragraphs.

20 Q The penultimate question, Mr. Myers, I appreciate you are not familiar with the details of
21 the policy preference at various stages, but you understand that the regulatory obligations
22 that my client was subject to at the time, and to date related to things like free call
23 announcements, general transparency under condition 14.2 and things of that kind. It has
24 not been suggested by Ofcom that my client is in breach of any regulatory obligation as I
25 understand it?

26 A I think that's correct.

27 Q On foot of these regulatory obligations my client has invested substantial sums in marketing
28 materials to comply with transparency objectives, things like that. Again, is that something
29 you are broadly aware of?

30 A I haven't been aware of that previously.

31 Q You would accept ----

32 A I don't dispute the fact, I just haven't been previously aware of it.

33 Q My question, Mr. Myers, is this, in circumstances where there is a relevant regulatory
34 obligation, e.g. setting out transparency, and an MNO in good faith complies with that

1 obligation, do you think it is then fair *ex post* that Ofcom can come along and say: “We
2 expect you to do something more than, or different to the regulatory obligation that you
3 understood you had to comply with”? Do you think there is any ambiguity there?

4 A I am not sure that precisely turns on an economic question, that seems to go to the question
5 of the nature of the policy preference and how it was established previously, and therefore
6 what all OCPs, including the MNOs could and should have understood from it.

7 Q The point, Mr. Myers, is my client – my instructions are – that they have acted in good faith
8 in marketing materials to comply with this transparency obligation and then from their
9 perspective in the final determination for the first time they are told that potentially they
10 need to do something quite different, and there may need to be retail price controls
11 depending on what the evidence shows. Do you detect a ‘tension’ – if I can call it that –
12 between the regulatory obligations and the extent of any policy preference?

13 A Well I understand Ofcom’s view of that is that it had always been clear that the policy
14 preference, that the desired pricing of 0845 and 0870 calls that they should be linked to
15 geographic call prices, and if that is right – as I say, it is not something that I had
16 responsibility for in the determination – but if that is right then I would expect that also to
17 be relevant to what MNOs would take into account.

18 Q One final question, Mr. Myers, is it fair to say that until the final determinations Ofcom had
19 not in any integrated fashion considered the full consequences of its policy preference in
20 terms of the direct effect, mobile tariff package effect, this was the first time an integrated
21 economic assessment was performed?

22 A Yes, well I think that would depend on exactly what was covered and not covered
23 particularly perhaps in the 2005/2006 documents. Certainly it included – I mean it did not
24 use the labels of “direct” and “indirect” mobile tariff package effects, but I know it covered
25 at least many of those features – whether it covered them all I am not sure.

26 Q Is it therefore not a danger that Ofcom did not understand the full effects of what its
27 preference might lead to in terms of adverse effects on other mobile prices for example?

28 A I think Ofcom took a view in these various NTS policy documents of the effects of different
29 levels of prices and different types of regulation, so I would say, at least on my reading of
30 those documents, those take into account relevant considerations. My point previously in
31 my answer to the previous question was I am not sure whether it took account of precisely
32 all of the same ones – it certainly did not use the same labels as has been done in the final
33 determination.

1 Q Do you think it is sensible that Ofcom could hold a preference where there may be unknown
2 costs associated with that preference?

3 A Again, I think that goes to the question of precisely on what basis the policy preference was
4 established and what it did and did not take into account, on which I think I have already
5 said that I did not read those documents for this purpose and I didn't work on those previous
6 reviews, so I don't believe I can assist the Tribunal on that particular point.

7 MR. O'DONOGHUE: I have no further questions.

8 THE CHAIRMAN: Thank you very much, Mr. O'Donoghue. Mr. Ward.

9 MR. WARD: Sir, I have no additional questions.

10 THE CHAIRMAN: Mr. Read?

11 Cross-examined by Mr. READ

12 MR. READ: Mr. Myers, you have probably got quite a few bundles open there at the moment.

13 Can I ask you to keep your witness statement bundle open. Can I also, if you have it still
14 there, keep bundle B1 to hand, which is the 0845 on the final determination. And there is
15 one further bundle I would like you also to have to hand to save time, and that is CAT
16 bundle 13 DF1 which is the bundle that contains the simplifying non-geographic numbers.
17 Can I also ask whether, and I suspect you probably will not, whether you have actually got
18 to hand a copy of the diagram that I introduced in opening, the flow of funds diagram.

19 A Yes, I have.

20 Q Thank you very much indeed. Can I also make the point, Mr. Myers, that I am not going to
21 challenge you on every point that BT says they do not agree with you, because otherwise
22 we would be here all week, and I get into trouble with the Tribunal and we would not finish
23 this case on time. So, I am go to try and keep my cross-examination of you to a number of
24 what I hope are salient points. Can I, first, ask you to look at the CAT bundle 13, which is
25 the simplifying non-geographic numbers bundle. It is at tab.3.1 there and it is your exhibit,
26 your second witness statement. Can I ask you, first of all, just to look at para.114, which is
27 on p.6. And there Ofcom deal with the position with companies effectively providing
28 services by means of a call, that:

29 "High charges mean lower volumes of calls (hence fewer customer calls to a
30 business) and potentially less revenue and, as a consequence, reduced incentives
31 to provide new or innovative services".

32 And here we are talking about the service providers, are we not?

33 A Yes.

1 Q Yes, now the corollary of high charges meaning lower volumes is that, if you alleviate the
2 higher charges, then it is likely that you will actually increase the volume of calls. That is
3 the obvious corollary of what is actually said in that statement.

4 A Yes.

5 Q Yes. And, likewise, if, just as you have less revenue prevents innovation or new services,
6 obviously if you have more revenue flowing into the service providers, that does allow
7 innovation and new services to be provided.

8 A Well it can do, yes.

9 Q Yes. Well, would you agree with this, would you accept that innovation in fact is quite, or
10 rather, investment within the telecoms industry is quite crucial for the purposes of
11 innovation and the like?

12 A Yes.

13 Q Because without having some form of money flowing in and investment taking place, in the
14 telecoms market in particular, given the relatively high start up costs and all the other
15 issues, it is likely to suppress innovation if you do not get money going into investment.

16 A Yes, that is right.

17 Q And, can I ask you, then, to look just very briefly at — I am sorry, I have lost the reference,
18 the thread, but I will put it round another way — would you agree that the fact that the
19 MNOs may be highly competitive in the retail market does not prevent a serious market
20 failure taking place?

21 A Yes, I agree.

22 Q Yes. And it is quite possible for the MNOs to set prices too high even in a competitive
23 market.

24 A Yes, indeed. Indeed Ofcom's view of that is what is happening.

25 Q Yes, and I think you actually say that in your statement as well. And one of the problems is
26 that there is effectively an after-market going on here, that retail customers tend on the
27 whole to buy their mobile packages on the basis of a certain set of services, and the 08
28 numbers are not within the customer's line when they are actually purchasing the overall
29 mobile package service, and that is what creates effectively the after-market. Would you
30 agree with that?

31 A Yes, so, in terms of customer's subscription choices between one mobile network or
32 another, prices of non-geographic calls seem to play a relatively little role in that and, really,
33 the choice seems to be made on the basis of other prices and features.

1 Q Yes. I think Professor Valletti in his report uses the examples of printers and toner
2 cartridges, and that people would tend to buy the printer on the basis of the cost of the
3 printer, and the after-market of the toner charges is not really taken into account. So, even
4 if you have a very competitive market in the printer sales, it still means you may get high
5 prices in toner for the printers, toner cartridges for the printers.

6 A Yes, that's possible.

7 Q And that is the classic illustration of an after-market.

8 A Yes.

9 Q Now, you were asked some questions by Miss Smith about whether or not, if there was an
10 externality going on, whether it could be internalised through the service providers who
11 really cared about zero rating or lower geographic calls being effectively able to cut deals
12 directly with the MNOs. You were asked about that. And you were taken to, I think it was
13 three examples, two of them were voluntary, made voluntary, and the other, I think it was
14 the Department of Work and Pensions. Do you recall that? You were taken to Miss Durie's
15 statement where they listed —

16 A Yes, I think there were a small number of commercial service providers as well.

17 Q That is specific to 080 calls, is it not?

18 A That's my understanding, yes.

19 Q And, just looking, focusing for a moment, on the Department of Work and Pensions, that
20 instance, I am sorry, I am going to ask you get another bundle out, just for the moment, but
21 do not put any of the present ones away. Could you just look at bundle C1. Can I ask you
22 just to go to Mr. Kilburn's evidence, his first statement which is at tab.17 in that bundle. At
23 para.31 he sets out his understanding of what actually happened with the Department of
24 Work and Pensions, and in para.31 he makes the point that this arose out of criticisms from
25 MPs about socially disadvantaged members of society, and in para.32 he then sets out
26 ultimately the permanent secretary instigated direct discussions with the MNOs to
27 determine a way of providing calls truly free to the caller. I do not know how much
28 knowledge you specifically have about that, but there is nothing in there that you would
29 want to contradict at all, that this effectively was a decision taken as a result of political
30 consternation going on about vulnerable people being charged large amounts of money to
31 ring the Department of Work and Pensions.

32 A Sir, I wasn't previously aware prior to reading this witness statement, of some of the
33 background.

34 Q I see.

1 A But I have no reason to disagree.

2 Q Yes, I see. Okay. Well, can I then ask you a little bit about this consumer detriment figure
3 that we looked at, simplifying — put C1 away by all means. Can I go back to simplifying
4 non-geographic numbers, which is at bundle 13 and at tab.3.1. Can I ask you to go to the
5 table dealing with the consumer detriment, and to look, first at para.A2.221, and this is the
6 section, is it not, that is dealing with the potential magnitude of current consumer detriment?

7 A Yes.

8 Q You see that?

9 A Yes.

10 Q If we go over the page to table A2.20 on p.188, this sets out the three primary detriments
11 that you list there, incorrect perceptions, meaning of non-geographic numbering ranges
12 undermined, box 2, consumers face high prices. Then 4, as a consequence of 1 to 3 the
13 volume of NGCs received by SPs is reduced; and 5, as a consequence of 1 to 3 vulnerable
14 citizens face increased costs. So those are the five types of detriment that Ofcom had in
15 mind when it was doing this analysis, but it effectively limited its investigation to detriment
16 one?

17 A Yes, and that's because detriment is at least easier to quantify to come up with an order of
18 magnitude quantification than the other effects, but I agree the list of five is all potential
19 detriment.

20 Q We, in fact, see that from para.A2.26, which starts at the bottom of the page.

21 A Yes, that's right.

22 Q Can I ask you to then look at para.A2.32, and the point is made there that it only provides an
23 illustration. For example, it is likely to under-estimation because it implicitly assumes that
24 the actual prices are optimal for consumers because of the presence of externalities and the
25 lack of consumers' price awareness they may be too high. So you have only focused on one
26 element of the detriment but you – I say “you”, Ofcom – recognises that that is likely to be
27 an under-estimation.

28 A Yes.

29 Q So when we come to the figure in table A2.22, which is on p.192, that figure, if anything, is
30 likely to be quite an under-estimation?

31 A Yes.

32 Q The other point that I want to be very clear about in respect of this table is that the detriment
33 that is actually being split between fixed OCPs and mobile OCPs is looking at the
34 consequences of the detriment? It is looking at the financial consequences to customers of

1 fixed OCPs and mobile OCPs, at the consequences of that detriment – in other words, how
2 it effectively distorts call patterns and distorts the volume of calls, etc, etc, and therefore the
3 effects it actually has on the customers of the fixed OCPs and the mobile OCPs?

4 A Yes, I think that's right. In terms of a diagram on p.189, that diagram is showing the
5 difference between perceived and actual price, and if all of that difference at the perceived
6 price, consumers are at point B on that demand curve. If they correctly perceive the actual
7 price much lower they would be at point A. Essentially, the detriment calculation here is
8 looking at that area of call deadweight loss.

9 Q The starting point for this, just so that we are absolutely clear about what is going on here,
10 you effectively take the price over-estimation effect and then you apply it to the respective
11 figures for the OCPs and the MNOs' existing call patterns. In other words, you multiply it
12 up effectively?

13 A That's correct, yes.

14 Q The consequence of that is if, as we know, the fixed OCPs in fact have the majority of 08
15 calls then it inevitably means that they effectively get grossed up higher as a result of this?

16 A Yes, that's right.

17 Q It goes back to the point I am making, which is that here you are not doing any specific
18 analysis of whether the detriment to the OCPs' customers has been caused by the fixed
19 OCPs, and likewise you are not doing any analysis of whether the detriment to the mobile
20 OCPs' customers has been caused by the mobile OCPs?

21 A Yes, I would agree. That is covered in A2.237, and I think I made that point earlier.

22 Q To be fair to you, you did, but I just wanted to take that one stage further, which is if the
23 major reason for the perception of customers to be dissuaded from making calls because of
24 their perception that prices were high, then the party that has effectively created that
25 problem is the one responsible for this consumer detriment?

26 A Yes, on the basis of the "or if" statements, I agree.

27 Q Although this tells you the detriment that has been effectively caused, what it does not
28 actually do is divide up who is responsible for that cause?

29 A Yes, that is correct.

30 Q So, for example, if – and I am going to put it in the hypothetical – if the majority of the
31 problem has been caused by the MNOs having high prices and therefore causing bill shock
32 and everything else to customers, if that is the position they are the ones who are likely to
33 be most responsible for the 500 plus million detriment?

34 A That's correct.

1 Q Thank you. Can I ask you now to turn very briefly to p.188, which deals with the summary
2 of detriments. I took you to this document slightly earlier. As we can see from box 5, one
3 of the key problems that is caused by high 08X is that vulnerable citizens may face
4 increased costs, uncertainty and difficulty in gaining access to socially important services,
5 and indeed we touched on that when you read Mr. Kilburn's statement about the
6 Department of Work and Pensions and the problems that that was causing.

7 A Yes.

8 Q Just so that we are absolutely clear, where did Ofcom take that important factor into account
9 when it was dealing with the final determination?

10 A The importance of the factor there is between number ranges. In 080 it was, I think, a
11 further factor supporting a greater weight on the direct effect, because there were socially
12 important services being delivered over 080. In the case of 0845 there was a similar
13 mechanism to take account of this effect to the extent it was relevant. I think the view
14 Ofcom took was that whilst it was not irrelevant, if I might say, to 0845 it was a less
15 relevant consideration, 0845/0870, than for 080, but in both cases it was reflected through
16 the greater weight on the direct effect.

17 Q So it is effectively a further factor that is loaded in, if you like, to the policy preference and
18 the weighting that you give between the direct effect and the MTPE?

19 A Yes, I think that is a fair characterisation.

20 Q Can I, finally, ask you a question about the time frame for the implementation of
21 Simplifying Non-Geographic Numbers. I think there was some indication within the
22 document itself that there may be a determination by May but it is right, is it not, that
23 actually the time frame for that has slipped back until at least September – is that right?

24 A That's my understanding, yes.

25 Q Even once the final document comes out in September, it is right to say also that it is going
26 to take some time to implement whatever recommendations Ofcom comes out with?

27 A I think implementation dates may vary between different aspects of the proposals. Some
28 may be implemented sooner than others. Frankly, I think that's a consideration that Ofcom
29 hasn't reached a final view on, and it will be covered in the statement.

30 Q I suppose the only point I am making to you, Mr. Myers, is that, come September, if
31 Ofcom's final document is published in September, it is not going to be, bang, immediately
32 taking effect, it will take some time to implement. I fully agree with you that it may
33 actually vary between certain issues, but it is still going to take time to implement?

1 A There will be some implementation time. I think there are some parts of those proposals
2 that are much more relevant to 080 and 0845/0870 and I am not sure exactly whether those
3 will be implemented sooner than other parts of the proposals, but yes, there is some
4 question of implementation time

5 Q And it is up in the air?

6 A It is up in the air, yes.

7 Q Can I ask you now to turn to the 0845 final determination, and what I want to do at this
8 stage is simply effectively set the scene for how Ofcom in its final determination actually
9 reached its conclusions. Can I ask you then – and I am looking at Principle 2 at the
10 moment, just so you are absolutely clear what I am talking about – if we go to para. 9.16,
11 which is on p.166. In para. 9.16 we have there the overview of how Ofcom actually
12 assessed matters, and so we have the “Direct, Indirect and Mobile tariff package effects on
13 retail consumers of mobile-originated 0845/0870 calls ...” and then “(b) the Indirect effect
14 on NTS service providers.” You then looked separately afterwards at the competitive
15 effects. So in other words, in carrying out your consumer analysis you looked at (a) and
16 (b)?

17 A Yes.

18 Q For the indirect effect as regards retail consumers – I am going to call them “retail
19 consumers” because it is what they have been called in 9.16(a) – but on that focus you
20 focused solely on callers to the 0845/0870 numbers, that is right, is it not?

21 A Yes.

22 Q And so if you take my diagram, and we go to the left hand side of the diagram, Ofcom did
23 not at any stage in their process of reaching its conclusions on direct, indirect and mobile
24 tariff package effects in 9.16(a) they did not actually consider in any major way box 4 on
25 the left of my diagram?

26 A Well, yes, that was considered. That was what came to be called the “mobile tariff
27 package” ----

28 Q The fixed tariff package?

29 A Excuse me, thank you for the correction, the fixed tariff package effect. I agree that is not
30 reflected in this summary, but that is addressed in, I think, s.7 of the final determination.

31 Q Because if we look at 9.27 we see what actually happened with the indirect effect and how
32 you assessed it. As you rightly say, it is not there, that box 4 is not there in the overall
33 conclusions on the indirect effect, it is on p.167 I think in your version?

34 A Mmm.

1 Q We see the analysis on the indirect effect and there is not specifically any reference to the
2 fixed tariff package effect within that section?

3 A I agree it is not covered in s.9, it is covered in s.7.

4 Q It is covered in s.7, yes. The reason why it is not covered in s.9 is because you did not
5 actually put a great deal of weight upon it?

6 A Ofcom concluded – I am sorry, I am just looking for ----

7 Q If you go to para. 7.46 I think is where you start dealing with the matter, which is p.88 I
8 think in your bundle?

9 A I think it is at the end of para.7.53:

10 “But the lack of a clear incentive unlike either the indirect effect of the Mobile
11 tariff package effect, suggests that there is greater doubt about the significance of
12 the Fixed tariff package effect to this dispute.”

13 Q The point I am putting to you is that it did not weigh very strongly at all in your
14 considerations and we see that when we come to the conclusions because it is not actually
15 mentioned there?

16 A Yes, because Ofcom did not think it was a very significant effect.

17 Q At the moment I am simply trying to set out what really gets the primary focus of Ofcom.

18 A But I think we need to distinguish between what is within the framework of effects that are
19 relevant, and the fixed tariff package effect falls within that set of relevant effects if it is
20 present. So Ofcom’s reason for not placing much weight on the fixed tariff package effect
21 was because it thought it was not a very significant effect given the lack of a clear incentive
22 for it to arise, compared to other effects. But if it had been more significant it would have
23 weighed more heavily.

24 Q Now, if we then go back to para.9.16(b) it is clear that you assessed the indirect effect on
25 NTS service providers – this is what it says – Ofcom says it approached, and it also
26 considered the indirect effect on retail consumers. Do you agree with that? One is in (a) and
27 one is in (b)?

28 A Yes.

29 Q What we do not have in any of the assessment at this stage is any suggestion that one of
30 them had significant weight over the other, so in other words the indirect effects on calls to
31 mobile originated 0845 and 0870 callers somewhere had a primary focus over and above the
32 indirect effects on NTS service providers?

33 A I agree.

1 Q And that is actually missing from the whole of this conclusion section, is it not? There is
2 nothing that says in terms: “we are going to give a greater weighting to” ----

3 A I agree. I think it is in my witness statement that it is not explicit in the final determination.

4 Q No, thank you. Finally, another point I want to be clear about because if you go back to
5 9.16 it talks about “the direct, indirect and mobile package effects on retail consumers of
6 mobile originated 0845/0870 calls” but in essence Ofcom went further than that, because it
7 was not just considering the position of 0845/0870 callers it was in fact looking at –
8 certainly when you come to the mobile tariff package effect, the effect on all MNO callers?

9 A Yes, I agree. I agree that 9.16(a) doesn’t necessarily bring that out but that is correct. Also,
10 another point on this is that it is not through the direct and indirect effect, there is potential
11 for benefits to arise for retail consumers or fixed originated 0845/0870 calls, and the point
12 is that if so provided through either the direct effects, through the brand enhancement effect
13 or through the indirect effect on callers, if they would increase the quality of 0845/0870
14 services it is very likely that that would apply to fixed callers as well as mobile callers and I
15 agree that that is implicit again within Ofcom’s analysis but it is not articulated here.

16 Q We are going to move along a lot quicker because that was my next question and you have
17 answered it. Can I turn to this question of the brand enhancement which on my flow of
18 funds diagram is at box K, just so we know what we are talking about. Now, if I have
19 understood you correctly, Mr. Myers, you say that Ofcom never took this into account in the
20 indirect effect?

21 A Can I just clarify which box are you ----

22 Q Box K, sorry, it is the one down at the bottom. It is what I think has been described, or has
23 certainly become known as the ‘brand enhancement’ issue, that if you improve 0870 or
24 0845 and 0800 numbers, then it is likely to cause an increase in demand which of course is
25 going to spread itself throughout the telecommunications chain, it is going to benefit service
26 providers, it may also benefit BT, and it may well even benefit the MNOs - yes?

27 A Yes. I think your question was that that is reflected through the direct effect not the indirect
28 effect and I agree.

29 Q The starting point is that you are saying that Ofcom never took this into account in the
30 indirect effect because, as I think you have just answered, you say it was taken into account
31 in the preference that was given to the direct effect?

32 A That’s correct, yes.

33 Q In fact, I do not think we need to turn it up but your figure 8 in your witness statement
34 actually makes the point very clearly because, as I think you said earlier on today, at the

1 intersect on 12.5 ppm the indirect effect is zero, which demonstrates that the brand
2 enhancement is not being taken into account at that stage?

3 A Yes, it's reflected in figure 8, it also explicitly stated in table 6 in my witness statement.

4 Q I think you would accept, would you not, that this was not entirely made clear in the 0845
5 final determination?

6 A Yes. I have an annex of my witness statement dealing with that point, annex 1.

7 Q Yes, and indeed if we go to your witness statement and can we look at p.66. I should be
8 clear for the transcript, this is your second statement which is at C2, tab 28, and if we go to
9 p.66, at the bottom of the page there is a footnote, footnote 173. You accept the point there
10 that:

11 "Whilst there is no explicit reference to SPs in the description of the Direct
12 effect at Final Determination, the effect on the SPs is part of the analysis
13 underpinning Ofcom's policy preference, as discussed at paragraphs 212 to
14 214."

15 Again, I think you would accept that it is not clear from the final determination exactly
16 where this brand enhancement is being taken into account?

17 A I'm not sure I'd quite accept that. I think the greater weight on the direct effect reflected
18 Ofcom's policy preference. So all of the effects that are related to the policy preference
19 being furthered, i.e. lower 08 call prices, would be reflected through that greater weight. I
20 think we need to remember that in the final determination Ofcom took the policy
21 preferences given and referred to that, took account of the implications. The kind of
22 analysis and the greater granularity of effects underlying the policy preference that has
23 occurred subsequently was exactly that, it was subsequent. So the greater granularity of
24 effects, including the brand enhancement as well as other effects, isn't present in the final
25 determination, but all of those effects are implicit or covered by the reasons, the rationale,
26 for the policy preference, as I think I set out in this witness statement.

27 Q I think you used it, albeit in a different context earlier on, that there has been a "teasing out"
28 of various things as this process has gone along?

29 A Yes, I would accept that.

30 THE CHAIRMAN: Mr. Read, would that be an appropriate moment?

31 MR. READ: Sir, can I just before we rise, move on to something linked to this but not directly.

32 Can I say that I said two hours, I hope to be two hours, but I am not obviously going to
33 finish in two hours unless the Tribunal is prepared to sit later tonight, or I am quite happy to
34 recommence with the witness in the morning, but I am in the hands of the Tribunal on that.

1 THE CHAIRMAN: We will discuss that when we rise.

2 (Short break)

3 THE CHAIRMAN: Mr. Read, you can have a few minutes past 4.30 today, but I am afraid not
4 much more than that, say 4.35.

5 MR. READ: That is helpful. (To the witness) Can I ask you, Mr. Myers, to take volume A of
6 the core bundle, which I hope is on your left. I was asking you about your contention that
7 my box K, the brand enhancement effect, was not included in the indirect effect. That is
8 what I was asking you before the break. Can I ask you to now look at the 0800 final
9 determination and go to p.33 in tab 1 of bundle A. If we look at para.4.9 it says:

10 “The factors that influence the attractiveness to an SP of offering 080 service
11 are referred to in the following discussion as indirect effects. This is because
12 the may affect the volume of 080 calls made and the quality of services
13 provided by 080 SPs, ultimately increasing or reducing the benefits to
14 consumers from 080 numbers.”

15 If one looks at footnote 71:

16 “There is also a direct effect on 080 SPs as a change in retail prices will affect
17 call volumes to the services. This is considered as part of the ‘Indirect effect’
18 discussed below.”

19 Do you see that?

20 A Yes.

21 Q So would you accept that it was quite clear from the 0800 final determination that the brand
22 enhancement demand effect in box K was actually being considered as part of the indirect
23 effect?

24 A Of course I accept that that is what it says in section 4. There is similar wording, at least in
25 terms of para.4.9. The words in para.4.9 are mirrored in the 0845 determination, I think at
26 para.4.24. As I explained in annex 1 of my witness statement there, that wasn’t actually
27 what Ofcom did. What I am turning my mind to now is just recalling exactly what analysis
28 Ofcom did on the indirect effect and whether that did including volume effect or not. I
29 suspect that Ofcom, in practice, took a similar approach as it did in 0845, which was to look
30 at the effect of higher termination rates, i.e. the revenue share point rather than the volume
31 effect. Certainly that’s what Ofcom did in 0845.

32 Q I think it is likely, Mr. Myers, that we are going to go over with you as a witness today, and
33 obviously if there is anything you feel in the 0800 final determination that you say corrects
34 or in any way nuances that para.4.9 and that footnote 71 obviously feel free to come back if

1 there is something further that you feel in the 0800 determination will assist to understand
2 Ofcom's position in that determination. We already know, and I have taken you to this
3 earlier on, that there was, in effect, no explicit reference to the SPs being linked to the direct
4 effect when the direct effect was being defined in the 0845 final determination. We do not
5 see it in the section I took you to earlier, section 9, the conclusion section, and indeed we
6 see it expressly in your statement where you accept at footnote 173 that, in fact, it was never
7 defined ---- I took you to that earlier on, p.66 of your statement, footnote 173, where you
8 accept in terms there is no explicit ----

9 A Yes.

10 Q So there is no direct linkage of the SPs with the direct effect, and what we seem to have,
11 certainly from the 0800, is a suggestion that, in fact, this brand enhancement effect was
12 being included within the indirect effect – you see the point?

13 A Yes.

14 Q The point I am really putting to you is this: given that, where exactly does Ofcom say in
15 terms, “Look, whatever we have said previously, we are actually going to include
16 categorically the brand enhancement effect” – that was not the word that was used at the
17 time – “we are going to include that box K in our preference for the direct effect rather than
18 in the indirect effect”. Where exactly does it make it crystal clear that that is what it is
19 doing in the 0845 final determination?

20 A I don't think the final determination does make it crystal clear, which is one of the reasons I
21 address the point in my witness statement. I am making the point that this brand
22 enhancement effect is triggered by a reduction in 08 prices, that is what occurs in
23 accordance with or moving prices closer to the policy preference, and therefore it is implied
24 by the policy preference, it underpins the policy preference, and is captured through the
25 greater weight on the direct effect. I accept it is not explicitly stated in the final
26 determination.

27 Q Thank you. You would accept, would you not, that this actual effect, the demand effect, the
28 box K, is actually quite an important point in terms of the weighting process that you have
29 to go through in any welfare analysis?

30 A In principle, it could be important. Quite important it is may depend on the extent to which
31 any particular proposal – in this case the NCCNs actually do effectively alleviate the market
32 failure, but, yes, in principle, it could be important.

33 Q If one goes back to the Simplifying Non-Geographic Numbers, and I know there can be a
34 debate about the 500 million and to what it relates and who exactly caused it and the like, it

1 is quite big figures we are actually talking about in the context of 0800 and 0845 and 0870
2 calls, is it not? Potentially it is a very large figure. Do you want me to take you back to
3 that?

4 A No, I am very familiar with the figure. The point I was going to make, it is a distinction I
5 drew earlier today, and it is of critical distinction in this context, is the distinction between
6 the detriment and the likely benefit arising from any particular proposal intended to
7 alleviate the multi-failure or the detriment. That's such an important difference. We see
8 that from the Simplifying Non-Geographic Numbers document. Of course, one of the
9 options that that document consider was what it called "variable termination charges", i.e.
10 termination charges linked to retail prices. So the same document that includes this very
11 large detriment figure also considers the extent to which the tiered termination charge is
12 linked to retail prices would alleviate market failures – in other words, the extent of the
13 likely benefit we might expect from it. It might be helpful to turn to Ofcom's view for
14 consultation on that point.

15 Q This is CAT bundle 13, tab 3.1, Mr. Myers, is it not, we are looking at Simplifying Non-
16 Geographic Numbers.

17 A The most relevant paragraphs, I think, are in the conclusion, or the preliminary views on
18 variable termination rates, at the p.269, the top of p.270, paras.A4.95 and A4.96. The last
19 sentence of A4.95 says:

20 "Therefore the outcome is uncertain and dependent upon these factors, meaning
21 it may not reflect the preferences of SPs, TCPs, OCPs or consumers and may
22 fail to address the market failures identified (i.e. lack of price awareness,
23 vertical and horizontal externalities)."

24 Yes, this is important part of the detriment is suppressed demand. That is the way I
25 characterised it in table 6 of my second witness statement. The relevant question for the
26 disputes is not the size of the detriment in itself, but the extent to which the likely benefit of
27 the NCCNs, the extent which they would alleviate the market failures effectively, and I
28 think I commented earlier that at the heart of these market failures is lack of consumer
29 awareness, lack of consumer confidence. So for a remedy or a proposal to be effective it is
30 going to need to improve those things and trying to achieve those things through
31 termination charges has the potential to do it but it does do it rather more indirectly and that
32 is one of the reasons why Ofcom in this policy document for consultation is proposing
33 much more direct methods to try and address those market failures, than variable
34 termination charges.

1 Q Let us just take this a stage at a time because it is quite an important point. You are
2 accepting that on any view this demand effect was not very clearly spelled out in certainly
3 the 080 FD and also in the 0845 FD. Exactly where it came into the equation was not
4 absolutely made clear cut in the course of the discussions in the determinations. You agree
5 with that?

6 A Yes.

7 Q One of the problems with not spelling out exactly how it gets taken into account is that of
8 course the risk is it gets lost in the counting, you would agree with that?

9 A Well I do not think that occurred in this case because the policy preference reflects – one of
10 the key reasons for the policy preference is because it would achieve better outcomes, it
11 would alleviate the market failure, alleviate the suppressed demand, so I think it is clearly
12 implicit within the policy preference.

13 Q Can I ask you to take the 0845 final determination and go to para. 5.32 which, on my copy
14 is at p.43 but it may be on an earlier page in your one, do you have that to hand?

15 A Yes.

16 Q This is where you introduce, is it not, the different weighting between the direct and the
17 mobile tariff package effects in the course of this final determination?

18 A Yes.

19 Q And I think that when one looks at it one cannot find there any explicit reference to where
20 exactly in this equation the demand effect is likely to fit in?

21 A I think I have already covered that, it clearly relates this to the policy preference, and
22 therefore if you want to unpick – or “unpack” might be a more appropriate word – unpack
23 exactly what effects are covered within that policy preference you would need to go back to
24 the prior Ofcom policy documents, which comment on the policy preference that I went
25 back to in order to establish my analysis of the economic underpinnings of the policy
26 preference in paras. 212 to 214 in my second witness statement.

27 Q So this is the section that you agreed I think earlier on, you did not actually write in the final
28 determination?

29 A Sorry, the articulation of the policy preference I did not write. What I am describing in 212
30 to 214, which is the economic underpinnings of that policy preference from I think it is
31 primarily the 2005 and 2006 documents.

32 Q Sorry, you made a reference to 212 I think it was, was it?

33 A Yes.

34 Q That is para.212 in your witness statement?

1 A Yes.

2 Q I see, so that is what you say the policy preference encapsulates, yes?

3 A Yes.

4 Q You accept that you were not the one responsible for writing the discussion as to policy
5 preferences in the final determination, the s.2 parts?

6 A That's right.

7 Q And you accept that there is nothing explicit here within the policy preference that says:
8 "And it takes into account the demand effect" – I am looking at paras. 4.31 to 4.33?

9 A I accept that, I think I have already accepted that. It does not unpack any of the effects that
10 are implicit within the policy preference.

11 Q You see, you have been cross-examined at quite some length this morning and, in fact, you
12 started off by actually having to make a further correction to your statement as to how all of
13 this stacked up, and then you were cross-examined at some length by Miss Smith about
14 where we find the weightings in various things. Would you agree the final determination is
15 less than transparent in the way it actually deals with these problems and these issues and
16 where they all fit into the analysis?

17 A Well it was an unusually complicated analysis that was being conducted in a document and
18 investigation that was conducted at considerable pace in accordance with Ofcom's duties to
19 resolve disputes rapidly, so I accept that not everything in this document is perfect.

20 Q But of course this was not actually the first time you had had to look at it because you had
21 already had to look at the problem in the context of the 080 dispute, had you not?

22 A I think people have referred to a 'journey' – there was a substantial increase in both the
23 weight of material and the granularity and complexity of the analysis in 0845 compared to
24 080.

25 Q Anyway whatever the position was or was not at the time ----

26 A Sorry, a further point is I do not recall the granularity of effects that were, I think, first
27 described in Maldoom 5 of the different type of effects and drawing out the volume effects
28 compared to the price signal effect, eco-system effect, etc. I don't recall that coming up
29 during the dispute itself. Unpacking this greater granularity and effects has been explored
30 subsequent to the disputes and the determination.

31 Q You would accept that that is a matter of record because everything is in writing, is it not, as
32 to who said what when, and so on and so forth?

33 A Yes, I was just commenting on ...

1 Q Yes, I understand the point, but I am not going to take time going back over the documents
2 now in order to deal with that point now. Whatever there is, is in the written documents.

3 THE CHAIRMAN: Exactly, Mr. Read, we do not need to go further.

4 PROFESSOR STONEMAN: Except I might say that when we sit down it might be useful if the
5 witness could produce something equivalent to this, that explains the granularity that you
6 now have in the witness documents. Is that possible?

7 A Yes, that's possible.

8 PROFESSOR STONEMAN: It is a useful document. A. I have certainly learned about
9 textbooks doing it, I can say that.

10 THE CHAIRMAN: It might be helpful if you could produce an equivalent to Mr. Read's
11 document. A. Is that before the end of the hearing?

12 THE CHAIRMAN: Before the end of the hearing, you certainly do not want to be under pressure
13 while you are giving evidence. A. Essentially it would just be a slight expansion I think
14 of Mr. Read's diagram.

15 PROFESSOR STONEMAN: (No microphone): Yes, but that has expansions

16 MR. READ: Before we leave this subject, whatever may or may not have been the position at the
17 time of the 0800 and the 0845 final determinations, as you yourself have accepted, you now
18 do not place a great deal of weight on this particular factor – that is right, is it not, Mr.
19 Myers? I am talking about the demand effect?

20 A Demand effect – sorry, are you asking me – sorry, I ----

21 Q I interrupted you while you were writing something down, do you want to ----

22 A I just want to clarify, are you asking me what the view was at the time of the final
23 determination or what the view is now in the context of the policy review

24 Q Perhaps I could ask you to just look at your statement? This is probably the easiest place to
25 pick it up. Can I ask you to look at para. 239 which is at p.73 of your statement.
26 Effectively you say: “The nature of the response by the callers to a reduction in MNOs’
27 0845/0970 call prices is quite uncertain”, and then you go through the material there.
28 “Therefore there will only be volume response to the reduction in 0845/0870
29 prices to the extent that consumers recognise that 0845/0870 prices are lower or
30 their confidence in 0845/0870 calls is favourably altered. Such effects are not
31 guaranteed and there may be no increase in call volumes if consumer confidence
32 or perceptions of 0845/0870 prices are not improved.”

33 Then at 240:

1 “Despite this important caveat, for the purpose of the discussion below, which is
2 the comparison between the analysis and the Final Determination, and in
3 Maldoom 5, I assume that there is an increase in volume in response to reductions
4 in 0845/0870 call prices.”

5 And then you go on with your table 6. So the whole of your table 6 is predicated on an
6 assumption, is it not?

7 A Yes. I just want to clarify – this is the analysis which reflects the further consideration in
8 the Simplifying Non-Geographic Numbers document. At the time of the final determination
9 and reflected in the final determination was just simply a degree of uncertainty about
10 exactly how much greater weight should be placed on the direct effect.

11 Q We see in reality the extensions to your consideration of this in fact in table 6, particularly
12 the breaking out in the second column of various effects and effectively the blue columns
13 on the other side talking about the direct effect greater weight, that is where they have
14 effectively been introduced, is it not, into the policy preference?

15 A That is when they are reflected within the policy preference, yes.

16 Q There is one final point I should have taken you to while we are talking about this. Can I
17 ask you to go back to para.4.33 in the final determination, on p.43?

18 A Yes.

19 Q If one concentrates on that paragraph one sees the discussion about the policy preference
20 and the relevant considerations and effectively giving relatively greater weight than any
21 pass-through to other retail prices.

22 “This does not mean that the Mobile tariff package effect is irrelevant. As we
23 show in Section 5 it plays an important role in our analysis”

24 Then that final sentence:

25 “But if the direct effect and the Mobile tariff package effects are in different
26 directions and of equal size, the relatively greater weight on the Direct effect
27 means that it should determine our judgment on the direction of the overall
28 effect.”

29 You see there that what is being said is if they are equal the greater weight we place on the
30 direct effect means it effectively overweighs the mobile tariff package effect. You see the
31 way it is put?

32 A Yes.

33 Q Now what I would suggest to you is that that actually makes it look like it is a tie breaker
34 does it not, that if you end up with equal size, one tips the other?

1 A Well that would be an incorrect characterisation. I accept that is consistent with a tie-
2 breaker interpretation but Ofcom did not take a tie-breaker approach and this is also
3 completely consistent with what Ofcom did, which is to put the greater weight on the direct
4 effect as effectively increasing, magnifying the size of the direct effect. In that context this
5 comment would also be correct and I think to my mind it is quite clear in Ofcom's
6 summary, table 9.1 and the text below it that it refers to "if the direct effect is sufficiently
7 large then the overall effect is positive", and in para. 9.30 – perhaps it is worth turning to
8 para. 9.30:

9 "As set out above, there is uncertainty about the sizes of each of the Direct,
10 Indirect and Mobile tariff package effects. However, as shown in Table 9.1, the
11 overall effect on consumers depend on the relative sizes of these offsetting effects
12 (even though we place more weight on the direct effect than the Mobile tariff
13 package effect because of our policy preference for 0845/0870 prices to be aligned
14 with geographic call prices)."

15 So I would say from my own knowledge that Ofcom did not treat the greater weight as a tie-
16 breaker effect, it was treated as increasing the size of the direct effect, which is using the
17 size of the direct effect, if you like, before the greater weight that would be needed for the
18 overall effect to be positive.

19 Q I appreciate that that may be your understanding but the problem is, of course, that parties
20 receiving Ofcom determinations and decisions have to go on what is in the decision and the
21 determination, do they not?

22 A Well they do, but I would say that the document never says that the greater weight is being
23 treated as a tie-breaker.

24 Q I will come back to table 9.1 in a minute and what that actually means, but if I can ask you
25 to go back in the document to p.91, para. 7.62. So 4.33 is not the only time we see this
26 phrase used. In 7.62:

27 "We also agree that if the Direct effect on consumers was positive and equal in size
28 to the negative Mobile tariff package effect, it would be appropriate to conclude
29 that there are overall benefits to consumers from these two effects."

30 A I think it is phrased this way because this is the simple case within which one can conclude
31 on the overall effect of the greater weight. It is not suggesting that the greater weight is
32 only relevant in these circumstances, but in these particular circumstances the greater
33 weight allows a clear overall conclusion to be reached.

34 MR. HERBERG: (No microphone) I think we should read the next sentence.

1 MR. READ: Yes.
2 “This is because we place more weight on the direct effect than on the mobile tariff
3 package effect, i.e. in these circumstances ...”
4 Which presumably is referring back to the previous sentence:
5 “... we have a clear policy preference for a pricing structure that involves lower
6 0845/0870 call prices.”
7 You see, I am putting the point to you, Mr. Myers, that there it looks as though it is a tie-
8 break situation, does it not, that it is equal size, if they are equal size one wins out over the
9 other?
10 A This comment is consistent both with a tie breaker and with the approach that Ofcom
11 actually took which was that the greater weight magnified the direct effect, and people can
12 make up their own minds about the clarity of the document, but as I say in my mind, when I
13 was working on this document, it was always clear that the greater weight magnified the
14 size of the direct effect, and it was not simply reduced to a tie-breaker role.
15 Q Would you accept, certainly with the benefit of hindsight, that those paragraphs could have
16 been phrased better?
17 A Well I accept that it could have added: “But the greater weight is not reduced simply to a
18 tie-breaker role”, but it seems to me that there is a particular inference that is being made
19 from those paragraphs that it is only a tie-breaker role, which I don’t think the document,
20 looked at as a whole, really suggests.
21 Q I have drawn the battle lines, and it is a question of construction rather than anything else,
22 so I will leave it there, I think, for that particular point. Can I now move on to your focus
23 on the MNO customers, because I think you fully accept, do you not, in your witness
24 statement that if equal weight is given to the service providers as it is to the MNO
25 customers, and by ‘MNO customers’ we mean all MNO customers, then it is likely that the
26 effect will be that the NCCNs are consumer beneficial?
27 A Well I think as we discussed earlier, it goes wider than MNO customers, because fixed line
28 customers may also benefit from increased service quality. But yes, it was the difference in
29 weight between callers and indeed consumers of other mobile services compared to service
30 providers; that was significant in Ofcom’s conclusion most clearly perhaps in the no
31 reduction scenario.
32 Q I am not going to go back to which customers were actually discussed in the determination
33 because we have already obviously looked at that. The point I am putting to you is that if
34 the SPs had equal weight with the mobile customers, the MNOs’ customers, then you accept

1 in terms that it would be that the NCCNs would be customer beneficial. Let me take you to
2 your statement ----

3 A I think that is – yes, that would be helpful, thank you.

4 Q Let me just take you to your statement, because if we go to para. 397, p.117. It says in
5 terms:

6 “If Ofcom had placed equal weight on the benefits to SPs as to callers under the
7 Indirect effect, then Ofcom would not have concluded that a negative overall effect
8 on consumers was more likely, given that the potential scales of the Mobile tariff
9 package and indirect effects were similar.”

10 So this is discussing, the quotation is discussing the no reduction scenario?

11 A That’s right. I think the likelihood is it would be found most likely to be neutral.

12 Q Yes, and in that no reduction scenario, of course, there is no other, if you like, weighing
13 effect between the price reduction and the MTPE -----

14 A I accept that changing the position on the no reduction scenario would have affected the
15 analysis of the overall conclusion.

16 Q The point is that it comes down, does it not, to how Ofcom treated the service providers vis-
17 à-vis the MNO companies? It is the focus that it actually gave to them? Correct?

18 A The greater weight on callers compared to service providers, yes.

19 Q If you look at my diagram and you look to the left hand side, it accepts that if you
20 concentrated on box 5 that would probably outweigh the mobile tariff package effect if SPs
21 were treated the same, but Ofcom has in effect only concentrated on the box 6 category?

22 A Well it took account of both boxes 5 and 6 but placed less weight on box 5.

23 Q Yes, well box 7, I think, that is where the money is split up.?

24 A Box 7, yes.

25 Q So we are agreed as to the basis it was actually done. Now I want to turn and explore the
26 justification for this, because essentially it comes down to this: you say service providers
27 are not end users in the normal economic sense of the phrase “end users”? That is
28 essentially what you are saying?

29 A If I might just look at exactly what I said.

30 Q It is para. 398 if you want to look at your witness statement?

31 A Thank you. I think I said: “... they are not the end-users of 0845/0870 services.” The point
32 is that service providers are suppliers of 0845/0870 services, the callers are the users of
33 those services.

1 Q But surely the NTS number system is there precisely because the service provider is
2 choosing a service. It wants to have a service to which people can actually send their calls
3 in. That is what is happening, is it not? That is what the whole NTS system is about?

4 A No, I don't agree. The whole purpose of the NTS system is to improve the benefit to
5 callers. An important feature of how that can be achieved takes account of the important
6 role that service providers play in potentially increasing the quality of services, but I would
7 say the overall aim is to improve the quality of services to callers, and service providers are
8 an important part of the way to achieve that, not an end in itself.

9 Q But you see in what sense are they not actually users of a telecommunications service,
10 because ----

11 A Excuse me, I said they are not the end users of 0845/0870 services, they are consumers and
12 users of posting services. They in fact supply, are one of the suppliers of 0845/0870
13 services. The use telecommunications services, but I do not think that is the point I made.

14 Q But I am interested, Mr. Myers, in understanding precisely why it is – we can all see where
15 everyone fits in on the telecommunications chain in this – what I am interested in hearing
16 from you is why you draw this distinction between end users of the service as opposed to
17 the service providers who themselves are obtaining a service owning the number, and
18 actually wanting in effect to carry out a benefit within the telecommunications system?

19 A They are consumers of wholesale services – ‘wholesale’ in perhaps the broadest sense of the
20 word – but they are not consumers of the retail services of the calls and the services
21 provided through the calls. That is the distinction.

22 Q Let us just consider this because we had the helpful example of Nestlé earlier on marked on
23 the back of the bottle, I do not know if you had the opportunity to see the freefone number
24 on the back of it? But let us just take Nestlé because they are going to be at one end
25 customers of the mobile network operators, are they not? It would be very unlikely that a
26 large organisation like Nestlé would not actually have some form of arrangement with the
27 MNOs – yes? Would you accept that as a general hypothesis?

28 A Yes.

29 Q At the other end there they are, they have owned a number, they have selected it in order to
30 have a service and yet effectively you say that when they are at the MNO chain, their views
31 get stronger weight, the focus is stronger, but when they are at the SP chain they are given
32 less weight. Now, what is the logic in that?

1 A The logic in that is going back to the fundamental purpose of the NTS regime from the start,
2 so I give an overview of that in para. 101 of my second witness statement, and essentially in
3 the last sentence:

4 “In other words, Oftel took the view that the best way to promote benefits to
5 consumers in the use of what are now 080, 0845 and 0870 numbers and premium
6 rate services was to limit the OCP to cost recover and promote competition at the
7 terminating end to compete away any excess in the call price over cost, leading to
8 an improved range and quality of services for consumers.”

9 So if we look at your flow of fund diagrams if the money sticks in box 7 it is retained by
10 service providers, then it is not going into box 6, which is the benefit to, what is written
11 here, SP customers or callers in improved quality and services. If all that is achieved is that
12 SPs make lots of money that is not in itself providing the improved range and quality of
13 services for consumers, for callers. It is box 6 that actually captures that effect, the effect of
14 benefiting consumers through investment, innovation and the improved quality of services.

15 Q The justification for this, as I understand it, is that you effectively label the SPs, the box 7
16 on my diagram, as being a producer surplus and you suggest that the benefits to the
17 consumers is a consumer surplus at the other end of the chain – you would not agree with
18 that, would you?

19 A I do give those labels, but I would not say that is the justification, except to the extent it
20 reflects what I have already said is the distinction between callers and service providers, not
21 as consumers of the 08 services, but as suppliers of them.

22 Q Can I ask you this question: would you accept that there is no distinction drawn in any of
23 the legal material that you know of – the reason I am asking you this is because you advert
24 to some of the legal material but there is no distinction drawn between the benefits you have
25 to give to an end user and the benefits you have to give to a user somewhere else in the
26 system if they are the ones certainly who are using it, and consuming it – a service from
27 another telecommunications CP?

28 A My understanding is the definition of “consumers” under the Communications Act includes
29 service providers as well as callers beyond that I am not sure I am in a position to comment.

30 Q It was in the statement and I have asked the question and I think I have the answer that it is
31 a matter of law, so we will take it no further on that.

32 MR. READ: Sir, can you just give me a moment. (After a pause): Let us just take this a stage
33 further, because I have given the example of Nestlé being at one end of the equation and
34 Nestlé being at the other end of the equation as a hypothetical example (for the benefit of

1 the transcript). Why, then, do you say that the interests of Nestlé should actually be
2 different in comparison, I am sorry, I will rephrase the question, I have not put the question
3 correctly. Your analysis treats Nestlé as a customer of the MNO in the same way as it treats
4 any “residential customer” if I can use that phrase. You accept that analysis.

5 A Yes.

6 Q What is the point, what is the underlying logic, that a big business that can get bit discounts
7 and therefore any benefits to them by reduction in prices effectively they get the better of,
8 because of the discount that they are already getting, why should their benefit be accorded
9 the same weight as the residential consumer?

10 A Sir, I think I have already covered this, I am sorry, I can’t remember, earlier today.
11 Essentially I think there are two distinctions; first of all to use an example of Nestlé, they
12 are playing different roles. When they are a caller they are playing a different role from
13 when they are a service provider. When they are a caller they are consuming the services;
14 when they are a service provider they are one of the suppliers of those services; and,
15 secondly, there is the question of conflict. I think I explained this earlier today, so that in
16 the context of the indirect effect, if we look only at residential consumers compared to
17 service providers, there is a conflict between their interests through the indirect effect,
18 essentially, whether the money ends up in Box 7 or whether the money flows through via
19 Box 6 to improve services for callers. Whereas comparing business customers with
20 residential customers, I do not think we see the same conflict. They both either benefit from
21 the direct effect or the indirect effect, but it is not that one is benefiting at the expense of the
22 other.

23 Q Where, exactly, in the final determinations do we see any of that?

24 A The issue, this issue of business customers relative to service providers was, as far as I am
25 aware, not raised and not discussed in the final determination.

26 Q Well, I think I have probably put the point. No doubt my witnesses will have something to
27 add to that when they are in the witness box. Can I now move on to look at the mobile tariff
28 package effect. Now, do you accept that effectively, the MTPE can be viewed as consisting
29 of two boxes, which I marked down there as “W” and “X”.

30 A Yes, it is a helpful way to characterise it.

31 Q Thank you. Now, if prices do not fall, the MTPE consists entirely of box X, because prices
32 stay the same, there is no box A. Box B effectively is a large termination payment, and that
33 is offset by a waterbed effect which is contained in box X. Leave over, for the moment how
34 big or small the waterbed effect is.

1 A Yes.

2 Q But that is the position when prices stay the same.

3 A Yes, so in the no reduction scenario, the mobile tariff package effect reflects box X.

4 Q Likewise, if prices fall all the way to 12.49ppm, we know that effectively box A is the only
5 box because there is no termination payment going across, and therefore the waterbed effect
6 is entirely box W.

7 A Yes.

8 Q And if prices fall partially, there is both going to be a fall in revenue in box A, and
9 termination payments, box B, which will be met by boxes W and X and the MTPE.

10 A Yes.

11 Q Yes, we are agreed on that. Now, I want for the moment to ignore the first two instances of
12 prices staying the same or falling to the 12.49ppm bracket, and I want therefore to look at
13 the last scenario I put which is the partial fall in prices. Now, I want to go back and see
14 what is actually happening here, because you are saying that when you come to weigh up
15 the position, you look at box B, the termination payment across, and you weigh that against
16 boxes W and X. Is that what you are saying?

17 A No, that's not what I'm saying. What I'm saying is that we know that the, from the no
18 reduction case, I mean, I think it is actually rather helpful to deal, first of all, with the no
19 reduction and the full reduction case, because in the no reduction case the relevant effects
20 on B and the effects that triggers compared to X, and Ofcom found that that was likely to be
21 detrimental to consumers. In the full reduction case we are dealing with A and the effect
22 that triggers compared to W, and Ofcom found that that was likely to be beneficial. So, that
23 comparing A and W is the tariff rebalancing effect, essentially, and comparing B and X is
24 the effect of high termination points, so in the partial reduction case where both those sets
25 of effects are present, we have one set of effects which is negative for consumers, and one
26 set of effects which is positive, and that is essentially why Ofcom said, "Well, the overall
27 effect is uncertain and depends on the relative magnitudes of all of the effects". Can I just
28 ask you to go to your witness statement at p.57. Perhaps I should start on p.56, because
29 here you are criticising Professor Dobbs' analysis, and at para.181 you say his argument is
30 flawed. And then you set out that it is, that indirect effect is only offset and negative only in
31 a special case where the direct effect is zero. But if one goes over the page, and then you
32 set out what you say was the issue of the indirect effect. But, if we go to D, you say, fourth:

1 “Outside of the special case, ie in the case of more relevance to disputes when the
2 direct effect is positive the size of the negative mobile tariff package effect is
3 expected significantly to exceed the size of the positive indirect effect”.

4 Do you see that?

5 A Yes.

6 Q So, what you are saying there is that box A is present because it is a partial fall in prices.
7 And then you are saying that box B is expected to be outweighed by the mobile tariff
8 package effect. That is what you are saying in that paragraph, is it not?

9 A Sorry, could you repeat the —

10 Q Yes, okay. We are looking at the partial fall in prices. You are predicating in 1A-1D that
11 although the direct effect is positive, the size of the negative mobile tariff package effect is
12 expected significantly to exceed the size of the positive indirect effect. So, in other words,
13 any benefit from box B is outweighed by the mobile tariff package effect. That is what you
14 are saying.

15 A So, I was responding to a point that Professor Dobbs made, or at least how I understood the
16 point Professor Dobbs was making which was saying that we can tell that the mobile tariff
17 package effect and the indirect effect cancel each other out – are “mutually cancelling” is, I
18 think, the quotation that I put at the end of para.180. So I was responding to a comparison
19 simply between the mobile tariff package effect and the indirect effect.

20 Q Which part of the mobile tariff package effect were you taking into account when you made
21 that assertion?

22 A In 181(d) I am including both aspects of the mobile tariff package effect.

23 Q So you are including W and X against box B?

24 A Sorry, I am comparing W and X against the indirect effect, which is boxes or part of box 6
25 and box 7, I think. It’s a very specific point that was being made, which was all we need is
26 the direct effect to be positive because the indirect effect of the mobile tariff package effect
27 cancel each other out. My point was that that is not correct, and I understood that
28 Professor Dobbs had accepted the point. That is not correct because in the partial or indeed
29 in the full reduction scenario the mobile tariff package effect exceeds the indirect effect and
30 therefore what is relevant is the size of the direct effect, not just the fact that it is positive.
31 This comment is taking account of both aspects of the mobile tariff package effect because
32 that was the context within which I was addressing the point that was made.

33 Q Let us move on to para.193. There you talk about the mobile tariff package effect again,
34 and you say that there are two sources of the MNOs’ loss of profit, firstly the increase in

1 termination rates, which is effectively box B on my diagram, and the mobile tariff package
2 effect is box X. Then the reduction in the MNOs' prices 0845/0870 calls, which is box A,
3 and the mobile tariff package effect to which it relates is box W. Then you say:

4 "The Indirect effect does not generally offset the Mobile tariff package effect,
5 except in a special case. In essence, this is because only the first of these two
6 sources of the MNOs' loss of profit – an increase in termination rates – yields a
7 matching gain in profit to the TCP. The second source of the MNOs' loss in
8 profit – a reduction in prices for 0845/0870 calls – is not matched by an increase
9 in termination charges or profit per minute to the TCP. This is set out in the
10 Final Determination ... But this fundamental point does not seem to be
11 recognised in Dobbs 6."

12 A Yes, so this second effect, the reduction in prices of 0845/0870 calls, that needs to be
13 compared with the direct effect. Then, as I said in the partial reduction case, we have the
14 balance of B and X being, in Ofcom's view, being negative, and the balance of A and W
15 being positive, and so it could go either way in the partial reduction case.

16 Q Could you just give me a moment. Can we just return to the flow of funds diagram and take
17 this a stage at a time. If we look at box A and box W – in other words, the decrease in call
18 revenues against the increase in the MTPE that is caused as a result of that – if you just
19 concentrate on those two elements you are always going to get a positive?

20 A Yes, it's likely to positive. That was Ofcom's view and that's shown in the full reduction
21 scenario.

22 Q If you just concentrate on A and W there is always going to be a positive in favour of box
23 A, is there not, because the direct effect has greater weight than the MTPE?

24 A I had a discussion earlier today with Miss Smith about – there were three effects which are
25 potentially relevant. The waterbed may be less, it is likely to be less than 100 per cent;
26 there is the greater weight on the direct effect. Those two effects suggest that the net
27 balance of A and W is positive. There's one effect which could be in the other direction,
28 which is this relative elasticity point, potentially the demand for other mobile services is
29 more elastic – more price elastic, more price sensitive, than the demand for 08 calls, and
30 that has the potential to go in the other direction. I am not disputing that Ofcom concluded
31 that the likely effect, and based its conclusion that the likely effect in the full reduction
32 scenario was positive. I am just accepting that there is at least a possibility that it could go
33 the other way.

1 Q I am looking now at the final determination and what Ofcom is actually saying in the final
2 determination. Ofcom is saying quite clearly in the final determination that the direct effect
3 is given greater weight than the mobile tariff package effect. Do you agree with that?

4 A Yes, I am not sure that there's really much disagreement.

5 Q Therefore, let me put my question just so that we are clear about it: if prices fall, box A is
6 always going to outweigh the effect of box W. That is logical, is it not?

7 A I'm sorry, I've just explained that there are three effects, two of which go in the direction of
8 the A, or the implications of A being larger than W, one of which may go the other way.

9 Q Where is that mentioned in the final determination?

10 A Well, it's mentioned in the discussion of the reference case that Miss Smith took me to
11 earlier, where the reference case makes three simplifying assumptions, the waterbed effect
12 being 100 per cent, there being no volume change and there being no greater weight on the
13 direct effect, and then a discussion of the relaxation of those three assumptions makes
14 precisely this point, that discussion brings out this point that two of those effects are
15 suggesting that the overall effect is beneficial and one other effect may go in the other
16 direction. As I say, I am not disputing that Ofcom concluded that the overall effect on
17 consumers in the full reduction was positive, or likely to be positive. I can't recall precisely
18 how it was framed.

19 Q The reference cases, when they are set out, are dealing with three assumptions, as you
20 rightly say, one of which is the waterbed is 100 per cent, and one of which is that the direct
21 and the MTP effects are given equal weight. If you take away that assumption about the
22 direct effect and the mobile tariff package effect having equal weight, so that the direct
23 effect has more weight than the MTPE, it is thereafter inevitable, I put to you, that box A is
24 going to be greater than box W. It is going to outweigh box W?

25 A That seems to be the same question, which I have already answered, which is if there was
26 no effect in other direction then I agree about that that inevitability that there was at least
27 the potential for an effect in the other direction. As I say, I am not trying to rewrite what
28 Ofcom said, Ofcom concluded in the full reduction case that there was likely to be a
29 positive benefit to consumers. That does reflect the interplay between three effects, one of
30 which is in the different direction to the other two.

31 Q Of course, the problem with all of this is that we are talking in abstracts of A, B and W and
32 X, and of course ultimately it comes down to the precise scenario, the pricing scenarios, as
33 to how you actually look at the respective weights between the respective boxes. Do you
34 agree with that? Let me give you an example ----

1 A I am not quite sure I followed your question.

2 Q Let me give you an example to flush it out. The assumption in that flow of funds diagram is
3 that current price levels are at 25 ppm. I am just taking that as an example. Let us just say
4 that, and let us say that the prices fell from 25 ppm to 17.49 ppm – yes?

5 A Yes.

6 Q That means that consumers will benefit by 7.51 ppm. That represents the price drop – yes?

7 A 7.51 ppm, yes.

8 Q Also there is going to be a termination payment, and that termination payment is going to be
9 2 ppm, because that is what the ladder actually says. If you assume a reference case of 100
10 per cent waterbed, and I will come back to the waterbed in a little while, but just assume it
11 is 100 per cent, the MTPE overall will be 9.51 ppm because it will be the aggregation of the
12 2 ppm termination charge and the 7.51 ppm drop in price. Do you see that?

13 A Well, I don't think that quite works, because we've got different volumes as between the
14 mobile tariff package effect and the direct effect.

15 Q When you say "different volumes" ----

16 A You expressed the numbers in terms of pence per minute. If we are measuring the mobile
17 tariff package effect by the volume of mobile originated calls to BT, then I agree, we have
18 got the same type of volume reflecting both the 2 ppm and the 7.51 ppm, but the mobile
19 tariff package effect is usually expressed in terms of the price increase caused for the
20 volume of other mobile services, and that volume is very different from the volume of
21 mobile originated calls.

22 Q All that is going to happen is that if you say there is a mobile tariff package effect of 9.51
23 ppm, which is the calculation that I have just done, when it comes to be implemented it will
24 be spread across a large number of services ----

25 A Yes.

26 Q -- and it will be actually considerably less than 9.5 ppm. It is actually more likely to be a
27 decimal point of a pence somewhere in the equation?

28 A On average across all other mobile services that may be the case. Quite how large any
29 specific price changes would be would depend on which prices were increased and by how
30 much. It may not be that all the prices are changed. It may be just some of those prices of
31 other mobile services are changed.

32 Q The point I am trying to put to you, Mr. Myers, is just take this example. In that instance,
33 i.e. a drop to 17.49 ppm, one can see that there is a considerable positive direct effect, there

1 is a 2 ppm termination payment, and the waterbed effect is going to be strongly outweighed
2 by the very positive direct effect?

3 A No, I'm sorry, I don't accept that. Looking at it in pence per minute terms may be
4 obscuring – I mean the point of the reference case, in fact, is to bring out that before we
5 bring in the greater weight on the direct effect, before we bring in the waterbed effect and
6 before we bring in the elasticity effects. The value of these two things in the full reduction
7 case is in fact the same in terms of £million. So the reason why we might conclude that the
8 net effect of those two was either positive or negative would depend on deviations from
9 those simplifying assumptions, i.e. that the ones that would suggest the direct effect is larger
10 would be the waterbed effect being less than 100 per cent, and the greater weight being
11 placed on the direct effect and, as we discussed, there is potentially a third effect which
12 could go in the other direction.

13 Q So you are suggesting that a 17.49 ppm may not be welfare beneficial overall?

14 A Sorry, if you are asking me purely a question about tariff rebalancing then I agree that tariff
15 rebalancing is likely to be welfare beneficial, but in the partial reduction case, which I think
16 is the 17.49ppm case, we also have higher termination charges and the effect of high
17 termination charges is likely to be negative for consumers, so we have these two sets of
18 effects present in this case, one of which is likely to be positive, the other of which is likely
19 to be negative, and so the overall effect of both sets of effects could go either way.

20 Q So what it comes down to is that whatever happens in terms of partial reduction it can never
21 satisfy Ofcom's welfare analysis because of the emphasis you are putting on the
22 uncertainties as to volume effects on the MTPE?

23 A I think Ofcom in the partial reduction scenario said it was uncertain, it could go either way;
24 that was as far as, I think, Ofcom was able to get. To get further one would need to start
25 putting quantifications to these effects. If one could reliably put quantification to some of
26 these effects then we might be able to refine the partial reduction case and establish that if it
27 fell to this level it would be more likely to be positive than negative, but Ofcom did not feel
28 able to do that quantification because it did not think it had reliable evidence from which
29 quantify these effects, some of which I think, as we discussed earlier, could be extremely
30 difficult to quantify.

31 MR. READ: Sir, I do not know whether that is a convenient moment.

32 THE CHAIRMAN: I think that is, yes. Mr. Myers, you will know from past experience that you
33 are in purdah until tomorrow morning. Do not talk about this to anyone else. Mr. Read,
34 one point: I do not expect an answer now but I just flag it for closing, you made a number

1 of points in opening and you made them quite properly to Mr. Myers in the course of your
2 cross-examination, regarding uncertainties or ambiguities in the final determinations. My
3 question to you and, as I say, I do not expect an answer to it now, is this: suppose Ofcom
4 has in its analysis done the right thing – whatever that may be – but has simply expressed it
5 badly in the final determination why does that matter? Is not what is important what Ofcom
6 has done rather than how it has expressed what it has done? I will leave that with you as
7 something which is puzzling me slightly.

8 MR. READ: Yes.

9 THE CHAIRMAN: But, as I say, I do not expect an answer now.

10 MR. READ: Well I am not going to answer it at 25 to 5.

11 THE CHAIRMAN: Very wise, if I may say so.

12 MR. HERBERG: Sir, might I just ask through the Tribunal Mr. Read how long he thinks he
13 might be tomorrow with this witness?

14 MR. READ: I think I will be an hour if the Tribunal could sit at 10 that might be helpful. I think
15 the reality is, sir, that this witness will probably end up having taken the majority of the
16 time, and I may actually be able to be quicker with Mr. Pratt as a result.

17 THE CHAIRMAN: We will sit at 10.30 tomorrow, and we will see what we can do if necessary
18 later on in the week with a view to extension of hours should that prove to be necessary and
19 we fail to catch up, but 10.30 tomorrow morning.

20 (Adjourned until 10.30 a.m. on Tuesday, 12th April 2011)

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