

This Transcript has not been proof read or corrected. It is a working tool for the Tribunal for use in preparing its judgment. It will be placed on the Tribunal Website for readers to see how matters were conducted at the public hearing of these proceedings and is not to be relied on or cited in the context of any other proceedings. The Tribunal's judgment in this matter will be the final and definitive record.

IN THE COMPETITION
APPEAL TRIBUNAL

Case No. 1146/3/3/09

Victoria House,
Bloomsbury Place,
London WC1A 2EB

22nd October 2010

Before:

MARCUS SMITH QC
(Chairman)

PROFESSOR PETER GRINYER
RICHARD PROSSER OBE

Sitting as a Tribunal in England and Wales

BETWEEN:

BRITISH TELECOMMUNICATIONS plc

Appellant

– and –

OFFICE OF COMMUNICATION

Respondent

– and –

(1) CABLE AND WIRELESS UK
(2) VIRGIN MEDIA LIMITED
(3) GLOBAL CROSSING (UK) TELECOMMUNICATIONS LIMITED
(4) VERIZON UK LIMITED
(5) COLT TECHNOLOGY SERVICES

Interveners

*Transcribed from tape by Beverley F. Nunnery & Co.
Official Shorthand Writers and Tape Transcribers
Quality House, Quality Court, Chancery Lane, London WC2A 1HP
Tel: 020 7831 5627 Fax: 020 7831 7737
(info@beverleynunnery.com)*

HEARING
(Partial Private Circuits)
DAY THREE

APPEARANCES

Mr. Graham Read QC, Mr. J. O’Flaherty and Mr. Ben Lynch (instructed by BT Legal) appeared for the Appellant.

Mr. Pushpinder Saini QC, Mr. James Segan and Mr. Hanif Mussa (instructed by the Office of Communications) appeared for the Respondent.

Miss Dinah Rose QC and Mr. Tristan Jones (instructed by Olswang) appeared for the Interveners, Cable & Wireless UK, Virgin Media Limited, Global Crossing (UK) Telecommunications Ltd, Verizon UK Limited and COLT Technology Services (the “Altnets”).

1 MR. READ: Sir, can I call my next witness, Mr. Morden?

2 Mr. JOHN MORDEN, Sworn

3 Examined by Mr. READ

4 Q You are John Morden, a BT employee, that is right?

5 A I am, yes.

6 Q Mr. Morden, you have a series of files along there and, as I said yesterday, and I hope
7 everyone has taken it on board, if at any point you need any help in finding any document
8 within those bundles do say so and efforts will be made to point you in the right direction.
9 Can I ask you then to take the bundle referred to as core bundle 1, at tab 15 and there is a
10 statement there that goes all the way through to p.426 and at p.426 there is a signature, is
11 that your signature?

12 A It is, yes.

13 Q And is this your statement and evidence in the case?

14 A It is, yes.

15 Q And you adopt it as your evidence in the case, do you?

16 A Yes.

17 Q I want to ask you one further question arising out of something that was said on the first day
18 of the hearing, were you in court on the first day of the hearing?

19 A I was.

20 Q The Chairman asked me:

21 "It would be helpful to have clearly articulated what BT thought it was aiming for
22 when setting prices in terms of its SMP condition because clearly everyone knew
23 there was a condition to comply with, there is now a debate as to what that
24 condition entails, but clearly BT ought to have had a view at the time of setting the
25 prices what its cost orientation was. It would be very helpful to know with some
26 precision what BT was aiming for in its prices."

27 Now have you anything to say on that?

28 A Only for the prices. I joined BT wholesale with the purpose of launching PPCs. My aim in
29 pricing, as with the products, was to sell as many PPCs as I could to my customers, to the
30 Altnets, so price was obviously a big element in that. It was a competitive market, I had
31 hoped to sell as much as I could, so I had to meet a number of different perspectives in
32 pricing. I had to cover my costs, and I also did not want to price too high, because that
33 would have discouraged take up of my product, and I wanted to launch it, I wanted it to be
34 successful. In terms of a precise target for cost orientation I did not have a figure, where I

1 knew that beyond this figure I would not be cost oriented any longer, but I had no intention
2 of raising prices and I felt that Ofcom and Oftel before them had examined the prices on a
3 number of occasions. We had put in a lot of data models' analysis to try and show that we
4 were cost oriented, and they had taken no action either to reduce the price or to inform me
5 that any of the decisions or assumptions we had made were wrong. So I felt that providing I
6 didn't raise the price, which I had no intention of doing it, was at a cost orientated level and
7 would remain so. I believe cost orientation is fairly imprecise, so I never had the precise
8 number that I was aiming at.

9 Q Did you at any stage consider further the pricing that you were actually setting prices?

10 A I always considered the pricing. I always considered it in terms of my compliance with cost
11 orientation and also the impact on my customers.

12 Q So did you adopt any methodology at all for dealing with how you would actually view it
13 vis-à-vis cost orientation?

14 A As I say in my witness statement, the sort of thing that we did on a regular basis was to look
15 at the output and management accounts. That's how I judge my product, because the
16 management accounts show precisely how much revenue volumes of products that I was
17 selling and gave me some indication of cost. So I could look at those accounts on a
18 monthly basis to see whether the costs that I was expecting or the efficiency improvements
19 that I was hoping for were coming through, and if there was anything unexpected in it. So
20 that would give me an idea of the return overall that I was making on the PPC product,
21 because I had to cover the costs. I had no intention of increasing the price beyond that. I
22 did have to make it so that BT wanted to provide the PPCs.

23 Q Were there any other factors at all that you took into account apart from the management
24 accounts?

25 A Well, all of the information. It seems practically every since I've managed the product
26 there was some investigation and some complaint about cost orientation or market reviews
27 or some aspect on which we were providing data to Oftel and then Ofcom to say, "If you
28 look at it this way, this shows that we're not making excessive returns; if you look at it this
29 way we think this is within the bounds allowed for cost orientation, we're on liability
30 recovering the costs that we're allowed to do". So there was always something going on
31 where we are demonstrating our cost orientation in some description or another. I know
32 there's a lot of weight given to DSAC now. This just wasn't a factor at the time. DSAC
33 was not much help to me in coming up with a pricing proposition. Not only was it six
34 months after the year in question, it was volatile and unpredictable. So last year's DSAC

1 was no predictor of this year's DSAC. It could vary by 100 per cent over the year, so I
2 couldn't halve my price one year and then double it again the next year. So, other than an
3 indicator, I gave no weight to DSAC, because it didn't help. It told me that my trunk
4 pricing was high, my terminating pricing was low, but I already knew that. That was a
5 consequence of the structure I inherited from Oftel and Ofcom. They had policy reasons for
6 their particular split, I believe. So, in terms of a precise measure for cost orientation, DSAC
7 was little more use than an indicator.

8 MR. READ: Thank you, Mr. Morden, if you would like to wait there, you will be asked some
9 more questions.

10 Cross-examined by Mr. SAINI

11 MR. SAINI: Good morning, Mr. Morden. Sir, I am going to go straight to a document which is
12 confidential, and it is one of those documents which I do not believe that I can effectively
13 cross-examine on without reading parts of it. Therefore, I was going to respectfully suggest
14 that the Tribunal go into private session just for this short part of the cross-examination.

15 THE CHAIRMAN: Very well, shall we do that. Would it assist if we rose for two minutes, or
16 shall we just ask people to leave?

17 MR. SAINI: Unless there is anyone here who is a stranger – I do not know if there is anyone who
18 is outside the confidentiality ring. If there are I am afraid they will have to leave.

19 MR. READ: Perhaps it would be sensible, sir, if you just rose for two minutes.

20 THE CHAIRMAN: We will rise for two minutes.

21 (Short break)

22 (For proceedings in Private, see separate transcript)

23 MR. SAINI: Let us have a look, please, at BT3, para. C.31. If you want to remind yourself if you
24 could perhaps read para. C 28 and following up to the conclusion, if you read those two
25 paragraphs and the four paragraphs on the next page?

26 A (After a pause): Yes.

27 Q Would you agree with me that a fair summary of that is that Ofcom was simply unsatisfied
28 with the data you had presented and because of the nature of that data it would could not
29 form any reliable conclusions?

30 A I would summarise it as saying that they were not convinced with the data split between the
31 two and their conclusion was that in supplying PPC terminating segment services overall
32 BT was making sufficient return.

1 Q They are saying for terminating segments, they are not including trunk. They are saying
2 they are not going to bid so that you are under recovering effectively on terminating. That
3 is what they are saying, are they not?

4 A They are not convinced but they do not have the evidence to show we are not.

5 Q You also said just before the very short adjournment we had that you had understood that it
6 was the communications providers who were making complaints to Ofcom that you were
7 overcharging or not acting in a cost oriented way on trunk and it was not really Ofcom's
8 views, do you remember that? I may have misunderstood what you were saying?

9 A That prompted Ofcom, yes.

10 Q Would you agree with me that in the LLMR statement on repeated occasions Ofcom
11 expressed the view that BT was pricing on its trunk segments at a level over and above that
12 which would be expected in a competitive market?

13 A Yes.

14 Q So it was not just a view of the communications providers, it was also a view of Ofcom ?

15 A There is a difference between a competitive market and cost orientation. A competitive
16 market can be a price down at incremental cost.

17 Q Perhaps I could help you, if you stay in that same bundle, please, and go back into the
18 LLMR statement, which is the immediately preceding document, and if you would please
19 look at p.340 and if you would like to read B108 down to B112?

20 A (After a pause) Yes.

21 Q There Ofcom itself based on BT's own data is expressing the view that you appear to be
22 applying excessive charges, is that correct?

23 A This is a test for BT to have significant market power.

24 Q But one of the factors that they are considering in deciding whether you have to give market
25 power is the level of your charges, is that correct?

26 A Yes.

27 Q And they are deciding here that the level of the charges appear to be, and I say "appear to
28 be" because of what is at B112, too high?

29 A That is what it is saying, they appear to be too high.

30 Q If we could just leave this document for the moment, would it be fair to say that as at the
31 conclusion of the 2004 LLMR process, both the review and the price control applied to
32 terminating segments, which we have looked at, there was a major warning to BT that both
33 Ofcom and the communications providers considered BT's trunk prices to be excessive?

1 A No, I don't see that this is a major warning, this type of conclusion has been persistent since
2 2001. Ofcom has made these type of claims, they have never taken any action.

3 Q Let us put aside the question of what action was taken, would you agree with me there was
4 at least a warning?

5 A It is a warning, we always review our prices, we would have liked some clearer guidance.

6 Q We will come back to that, I will let you have your say on that, but let me just ask you a
7 question about the warning. There was a clear warning, was there not?

8 A No, I do not think so. This is not unusual.

9 Q You do not think so?

10 A No.

11 Q You do not agree with me that it was a sufficiently clear warning that you went into print, or
12 rather an individual within your team went into print in the wholesale pricing paper to alert
13 other members of BT that there was a concern about trunk charges?

14 A No, the events are unrelated. The pricing paper was to request permission to reduce the
15 price of 155 to avoid the danger of cost orientation charges.

16 Q Therefore, someone had suggested to you surely, by a process of logic, that trunk prices
17 were not cost oriented?

18 A They would not be on 155 if we had persisted with the current price.

19 Q Would you also agree that Ofcom had made it clear in the LLMR paper, having observed
20 your excessive prices, that if they received a complaint they would act on it?

21 A Where do they say that?

22 Q If I can just identify a paragraph for you. I am sorry, I have just lost my reference.
23 MISS ROSE: 8.58.

24 MR. SAINI: I am grateful to Miss Rose, 8.58, if you are in the same document?

25 A This just says if they get any evidence based complaints they will investigate it.

26 Q That is all I was going to suggest to you. Having explained in the very preceding
27 paragraphs their concerns in relation to trunk?

28 A And did they get such an evidence based complaint?

29 Q Well I think that is why we are all here!

30 A 2005 presumably is the first.

31 Q If you could perhaps put that to one side for the moment, this bundle, please. And if I can
32 return to what you said in chief this morning, that is the additional answers that you gave to
33 Mr. Read. As I understand it, you accept that the DLRIC floor and the DSAC ceiling are
34 first order tests of costs orientation.

1 A I am advised that's the case, yes.

2 Q Okay. You had no idea about that.

3 A No.

4 Q Do you find it surprising that, given that you are the person in charge of PPCs, that you did
5 not know about that yourself?

6 A No, I was aware that we publish floors and ceilings in our accounts.

7 Q Right. But you are the person who is deciding the prices, but within BT no-one tells you
8 that you are meant to be trying to keep within these parameters.

9 A Because we had no clear guidance that was the case.

10 Q Let us take it from BT's own document, please. If you please go to bundle ADB4, and if
11 you please go to divider 6 in that bundle, which BT's primary accounting documents from
12 2005, so this is not an Ofcom publication, it is a BT publication.

13 A Yes.

14 Q And if you please go to p.55 of that document, and if one goes to the bottom of that page,
15 this is dealing with DLRIC. You may have read this already, but I will read it anyway.
16 This is dealing with the core increment and I think we are all agreed that PPCs are in the
17 core increment. You are familiar with that, are you not?

18 A Indeed.

19 Q "Combinatorial tests have not been specified in the case of the core increment.
20 Instead, the recovery of intra-core fixed common costs has been prescribed by
21 Ofcom for the use of DLRICs in determining costs laws. This restricts price
22 inflexibility by setting a price floor for components in excess of actual LRICs.
23 Ofcom uses its restriction in order to avoid complex combinatorial tests".
24 Perhaps you can keep your finger in there for the moment and jump, please, a few pages
25 ahead to p.58, para.101. And we have a similar text there which I will read, if you would
26 like me to, in relation to DSACs. Would you just perhaps like to read it to yourself.

27 A Sorry, which paragraph?

28 Q Page 58, para.5.3.5, just the first two paragraphs, please.

29 A Okay. Okay.

30 Q So, you see there again, BT's wording that:
31 "DSACs reduce price inflexibility by lowering the maximum price that can be
32 charged".

1 Now, as I understand your evidence, you as the person within BT that was dealing with PPC
2 pricing, no-one drew these facts to your attention, these points to your attention. Is that
3 right?

4 A This document is an explanatory note to the accounts. It is meant to explain what is in our
5 published accounts. It is re-issued every year. The accounts are drawn up in conjunction
6 with Ofcom. This is just trying to explain the numbers that are published. It's not in any
7 way an acceptance by BT that this is the way we should price. This does not say here, for
8 example, that this is a first order test. This explains the number and why it's in the
9 document.

10 Q Let us take it in stages, please, Mr Morden, these are not merely explanatory notes to
11 accounts, these are BT's primary accounting documents, are they not?

12 A They're explanatory notes to the accounts. That's what they do. They explain what's in the
13 accounts.

14 Q And we disagree that they are primary accounting documents?

15 A Then you're attaching a significance to it that I'm not aware of.

16 Q That's what you call them, please. Please go back to the start of this tab.

17 A That's what they're called.

18 Q "Primary accounting documents".

19 A Yes. But they are there to explain what's in the regulated accounts.

20 Q Okay. In these documents, BT itself says Ofcom has prescribed these floors and ceilings,
21 does it not?

22 A Yes. Yes, it does.

23 Q Okay.

24 A That's why those numbers are there.

25 Q Okay, so is it BT's position that, although you put this in your primary accounting
26 documents, you are openly accepting that BT has prescribed these floors and ceilings, as far
27 as you are concerned they were meaningless?

28 A They were indicative only.

29 Q Indicative of what?

30 A These are describing BT's accounting separation accounts. That's the purpose of this
31 document, is to describe why the numbers are in those accounts.

32 Q Okay.

33 A The whole accounts are indicative. They're meant – these are unaudited numbers that we're
34 talking about.

1 Q Can you just tell me, what do they indicate, then? If you fail in these floor and ceiling tests,
2 which you accept have been prescribed by Ofcom, what do they indicate to you?

3 A At – now, with the knowledge I have now, they would indicate that other tests have to be
4 done.

5 Q And, please just restrict yourself to your own knowledge, and I want to know what you
6 knew, as the person who was pricing what you knew about the importance of DLRIC and
7 DSAC.

8 A Well, I think as I described earlier, these were not particularly helpful to me as product
9 manager.

10 Q Well, let us just -----

11 A Because I could not use them, them being six months after the year end, and the
12 unpredictability and the volatility meant that I could not track them using market pricing.
13 So to me, from my own knowledge, these was of very limited use.

14 Q With respect, that was not my question, which is -----

15 A Sorry.

16 Q -- did you know about the existence of these measures as published in your primary
17 accounting documents in your day to day role as the product manager?

18 A Ever since 2001, we have put floors and ceilings in the accounts.

19 Q But there has never been any doubt in BT's mind that Ofcom regarded these floors and
20 ceilings as important.

21 A Important, yes.

22 Q Thank you very much. Now, how was it, then, given that BT itself knew that these were the
23 floors and ceilings prescribed by Ofcom? How was it that BT then went about complying
24 with these Ofcom requirements?

25 A As I said earlier, these are indicative documents, they are no use to me as product manager,
26 to pricing, because I cannot predict where they're going to be.

27 Q So, how do you decide that you are going to comply with the cost orientation obligation?

28 A Largely it comes down to, or largely I was using, rate of return. Remember, I had no
29 intention of pushing prices up. So my concern was to make sure that I was covering my
30 costs.

31 Q Would it be fair to say that, as far as you were concerned, as long as the rate of return for
32 PPC as a whole, that is aggregating trunk and terminating was all right, you were happy?

33 A Yes. Okay.

34 Q So, it would be fair to say that your approach was to aggregate.

1 A Yes, it would be.

2 Q Okay. Were you aware that, when BT published these figures of DSAC and DLRIC, it
3 itself described these as a first order test of cost orientation?

4 A In which year?

5 Q In -- I can show you a document -- in 2007.

6 A I'm aware now that this -----

7 Q I do not want to test you on things you do not know about but -- so, just to clarify, would it
8 be the case that those who are doing the accounting within BT, in other words, those who
9 prepare the regulatory financial statements and who are no doubt responsible for the
10 primary accounting documents, do not speak to you within the PPC product management
11 team?

12 A No, I mean, the regulatory accounting function was working closely with me. They were
13 the principal architects of the letter that I sent in August 2005.

14 Q Would you agree with me that BT would have sufficient information internally, in its
15 management accounts, to be able to ascertain whether it was likely to exceed DSAC by the
16 end of the year?

17 A No, because I could not predict where DSAC was going to be at the end of the year.

18 Q But you would agree with me that at the end of one year, when you substantially exceeded
19 DSAC, which we know was the position on many occasions.

20 A Yes.

21 Q It was necessary for BT to take steps to bring its costs into line so that, its prices into line, so
22 that DSAC would not be exceeded in future.

23 A As I say, you could not predict where DSAC was going to be the following year. The steps
24 I took was to ensure that my rate of return for PPCs as a whole was not excessive.

25 Q Yes, so does that just come back to your point that, as far as you were concerned, as long as
26 you aggregated the products, and you had the right rate of return, you did not really care
27 about the individual prices?

28 A I think that's probably right, yes.

29 Q Okay. And you were aware from the start, certainly from 2004 onwards, that as far as trunk
30 was concerned, there was a separate cost orientation obligation?

31 A Yes.

32 Q But you were not concerned about complying with that separate cost orientation obligation.

33 A I didn't see compliance with DSAC particularly as the only arbiter of cost orientation.

34 Q But it was an arbiter.

1 A It was an indicator that prices were high. But I knew that already.

2 Q Can I ask you one further question please, Mr Morden, which is that you suggest in your
3 statement that when you sell a product you sell a PPC and you are not particularly
4 concerned about the trunk or the terminating aspects. You see that? Is it not the case that
5 when a customer comes to you, you provide them with software to allow them to calculate
6 the price of a PPC and that is divided as between trunk and terminating.

7 A There is a pricing tool that allows customers to price up PPCs.

8 Q And just to help you, perhaps, I can – if you are in the same bundle there is a document
9 which perhaps I can – also the Tribunal may not have seen this before, but everyone can
10 perhaps look at it now, which I think refers to this tool which is – there is a document at
11 tab.2 which is the July 2010 PPC Partial Private Circuits portfolio. Can you describe to us
12 what that document is?

13 A This is the latest version of, this is the handbook that goes with partial private circuits to
14 help our customers understand the product.

15 Q Okay. And if you please go to p.26 of that document, and 4.3.3, we see:
16 “BT Wholesale on-line PPC pricing tool enables Communication Providers to
17 obtain Trunk and Terminating distances and indicative pricing quotations for Partial
18 Private Circuits”.

19 A Yes.

20 Q That mentions 64 Kbit/s to 155Mbit/s. What do you do for the others?

21 A They’re not required, I believe.

22 Q Sorry, they’re not -----?

23 A 64 is not regulated any longer. That’s the only other one we do.

24 Q Sorry, 2Mbit, you are quite right.

25 A It’s within the range, 64 to 155.

26 Q Okay, so, would you accept, then, would you accept that when a communication provider
27 makes a decision as to making a purchasing order with BT, the distinct price of terminating
28 segments and trunk segments are very important to them.

29 A The purpose of this tool is so that they can quote to their businesses, based upon the likely
30 cost of the PPC. So, if they’re preparing a quote for business, they need to know their input
31 costs. This allows them to put in an A-end and a B-end at point of handover at a customer
32 premises and to find out what the cost of that PPC is. In order to do that, clearly, for that
33 particular PPC you need to establish how many of those main link kilometres will be
34 charged at trunk, how many will be charged at terminating. Add the two together and any

1 other piece of equipment. That gives you the overall price. That's what this tool is
2 intended to do. It's a simple piece of software.

3 Q But, let us put aside the tool for the moment. You would agree with me that when someone
4 is going to make a decision, the amount of trunk they need to buy and the cost of trunk is an
5 important factor.

6 A The cost of the PPC is an important factor.

7 Q But let us just deal with trunk. The amount of trunk you need to buy and the cost of trunk is
8 an important factor, is it not?

9 A The amount of trunk in a PPC is an important factor in the price of that PPC.

10 Q Thank you very much.

11 THE CHAIRMAN: Mr Morden, just one question. You said that you looked at the rate of return
12 for PPCs as a whole in terms of assessing pricing.

13 A Yes.

14 Q But, presumably you could have calculated rate of return separately for the trunk and
15 terminating parts of the PPC circuit?

16 A The difficulty is separating of costs. As you see through the history, the difficulty is
17 extracting the cost for trunk, extracting the cost for terminating, because the way we
18 actually provide a PPC is very different from the way that is illustrated in these diagrams.
19 We pointed this out at the start, Oftel made the assumption that we would provide a PPC in
20 the same way we would provide a telephone call. A local exchange goes to a trunk
21 exchange, another trunk exchange. We don't provide it in any way like that. The amount
22 of trunk and term in a PPC is loosely bound at best to the underlying costs of provision. It's
23 decided by a formula that comes out that Oftel and Ofcom, sorry Oftel, decided the formula.
24 So you'd have to try and take this formula and then map that on to the actual network
25 provision to try and establish what costs go to which part. So it is difficult to try and say
26 how much ROCE you make on one area and how much ROCE you make on another,
27 because the costs are so intertwined. So, no, I couldn't extract the ROCE in any meaningful
28 way. Consequently I looked at the overall end to end PPC. Indeed, that is the product that
29 people buy from me. They say, "I want a connection between there and there", and the
30 formula then tells them how much of that is priced at trunk and how much is priced at
31 terminating. I then give it to my engineering department and they route it in the most cost
32 efficient way. The difficulty is matching the two up.

33 MR. SAINI: Sir, may I just ask a follow up question in relation to that, which is that I find your
34 answer rather puzzling, Mr. Morden, because BT has had no difficulty at all in the course of

1 this case and in the course of the LLMR Review in putting forward figures to Ofcom
2 indicating its very low rate of return on terminating. Unless I am missing something, by a
3 process of deduction you could work out what your rate of return is on trunk, could you not,
4 surely?

5 A It depends on the allocation of cost.

6 Q It is certainly possible, is it not, because it was possible for terminating?

7 A You can make broad assumptions.

8 Q And those assumptions were made for terminating showing a very low rate of return, were
9 they not?

10 A Yes.

11 Q So equally, one could make assumptions and obtain a rate for trunk, could one not?

12 A You could make assumptions and do that, yes, absolutely.

13 Q There is no doubt, and I do not think we disagree about this, and Mr. Budd has made it
14 clear, that throughout the history, certainly of this case and going back to 2004, BT has had
15 no difficulty in putting forward what its rate of return is on terminating. That is correct, is it
16 not?

17 A No, it's always had difficulty. As you pointed out earlier, Ofcom was not happy with a
18 model we used to try and provide this split. So it's always had difficulty, it's always had to
19 make assumptions. It depends upon what level of accuracy you want. You can make
20 assumptions, you can divide the costs.

21 Q Thank you very much.

22 THE CHAIRMAN: Mr. Read?

23 Re-examined by Mr. READ

24 Q I have got three matters I want to ask you in re-examination, one of which unfortunately
25 relates to the letter in the confidentiality ring. Perhaps I can leave that until last.

26 THE CHAIRMAN: Let us do that, Mr. Read.

27 MR. READ: Can I ask you, first of all, about what you were being referred to in additional
28 bundle 4 at tab 2. I just want to be clear, because this is a July 2010 document. Would the
29 Product Handbook have been in exactly the same terms throughout, or is there any chance
30 of changes?

31 A There would have been changes every time something changes in the product, yes.

32 Q You were asked a series of questions about how exactly you were considering pricing.
33 Sir, I think I am going to have to ask for the confidentiality ring to operate now, because I
34 may have to refer back to that document.

1 THE CHAIRMAN: We will rise for two minutes.

2 (Short break)

3 (For proceedings in Private, see separate transcript)

4 Mr. EDWARD SEFTON PIGOTT, Sworn

5 Examined by Mr. READ

6 Q You are Edward Sefton Pigott, an employee of BT, that is right , is it not?

7 A That's right.

8 Q Again, as I said to the other witnesses, if you have any problems finding any of the
9 documents in the bundles then please say so and attempts will be made to find the right
10 document for you. Can I ask you to take core bundle 1, and go first of all to tab 16, p.427.
11 If you have that, then please go to p.451, that is your signature, is it?

12 A Yes, it is.

13 Q Do you adopt this statement as your evidence?

14 A Yes, I do.

15 Q At tab 17 there is a second witness statement at p.466, and at p.475 is that your signature?

16 A Yes.

17 Q And do you adopt this witness statement as your evidence?

18 A Yes, I do.

19 Q You have been in court for the last two days, I think. Is there anything that you have heard
20 during the course of the hearing that you would like to comment on?

21 MR. SAINI: I object to that question. If Mr. Read wants to put a specific non-leading question
22 he can do that. He should certainly not be allowed to let the witness have free rein
23 effectively to comment from the witness box.

24 THE CHAIRMAN: I agree. Mr. Read, can you be a little more focused?

25 MR. READ: I was trying to deal with it as quickly but I will ask it in the form of questions. (To
26 the witness): There has been discussion during the course of the last two days about fixed
27 and variable proportions and how trunk is sold. In that context do you have any views,
28 particularly vis-à-vis the 1997 guidelines as to how they operated?

29 A Yes, if we go back to 1997 the guidelines related to the provision of network charge control
30 services for voice, and there we have a number of components which get combined together
31 to form voice services. If we look at the individual components, very often they are
32 combined together in different proportions to form services. So, for example, if you look at
33 our local to tandem conveyance segment, that is the conveyance of traffic from a BT main
34 switch or tandem switch to the local switch layer. The amount of transmission that is

1 consumed depends on the nature of the switch to which the service is being provided. In
2 some cases you have a tandem switch in the same building, it is a local switch, in which
3 case no transmission is consumed at all, but in other areas the tandem switch will be in a
4 building that is some distance away, perhaps up to 50 kms away and in that case the tandem
5 switch, the local to tandem conveyance segment will consume 50 kms of transmission.
6 Now, there may be some confusion in Mr. Myers' statement that the components are always
7 combined together in fixed proportions because we adopt in the pricing an average price
8 which takes together all of the costs of the local to tandem conveyance across the network,
9 and divides that by the total number of minutes. So what you have is very much a situation
10 of the amount of the component that is used is dependent on the distance that that traffic
11 travels from one part of the network to another – rather like in PPCs where you have the
12 PPC distance related element of the main link dependent on the length of the circuit.

13 MR. READ: Thank you, Mr. Pigott. You will be asked some more questions.

14 Cross-examined by Mr. SAINI

15 Q Mr. Pigott, I would like to ask you questions on three areas and I am glad to see that in
16 respect of your first statement at least there is a large measure of agreement between
17 yourself and Mr. Myers on many points, but I just want to make sure that I have correctly
18 understood what is agreed and not agreed. The first area is what is agreed in relation to
19 DSAC. I believe it is agreed that the floors and ceilings to be applied are DLRIC and
20 DSAC, that is correct?

21 A Well I am not sure that is quite correct. It depends on which services you are looking at. If
22 you are looking at the network charge control services, for which the '97 guidelines apply,
23 then that is indeed correct to say that the DLRIC and DSAC apply to those services.
24 However, the cost orientation obligation that was imposed on private circuits when they
25 were introduced is quite different and, certainly, if you look at the 2001 determination and,
26 indeed, the Phase 1 determination, the cost orientation obligation there is set out in very
27 different terms, particularly for services which were prospectively competitive, such as the
28 trunk services.

29 Q May I just clarify that I am not really interested in the historical position for the purposes of
30 this question, and you have set that out very clearly. What I am interested in here and now
31 as far as DLRIC and DSAC are concerned, concerning the core increment, I believe we are
32 agreed that those are the relevant measures?

33 A Those are a first order test ----

34 Q That is all I wanted to establish.

1 A ---- DSAC and DLRIC is a first order test for assessing the floor and ceiling for a service.

2 Q Can I ask you next, please, in relation to combinatorial tests. You refer in your witness
3 statement to combinatorial tests having been undertaken on two previous occasions as far as
4 you are aware. First, in relation to operator assistance and directory inquiries, and secondly
5 in relation to I believe it is international calls. You recall that?

6 A Yes.

7 Q And you also will know that Mr. Myers does not comment on what you say in relation to
8 operator assistance and directory inquiries because he says there is insufficient information
9 in your witness statement to comment on that but he does make comments in relation to
10 international calls, and I would like to ask you about those comments, please. If you would
11 please take out vol, CB 2 at p.583, Mr. Myers' witness statement. You will see at para.352
12 various points that are made between (a) to (e) concerning matters which were not relevant
13 to international calls in 1998. I would like to take you through these in turn to see what the
14 level of dispute is in respect of these matters, because – and I will be corrected if I am
15 wrong – I do not believe that you respond to this in your second statement. Is that correct?

16 A Sorry, which part are you referring to?

17 Q Paragraph 352, I just want to go through that because I do not believe you responded to that
18 in your second statement.

19 A Okay.

20 Q What Mr. Myers has done at 352 between (a) and (e) is explained why the combinatorial
21 that was undertaken for international calls in 1998 did not feature or give cause for concern
22 in respect of the particular problems he identifies at (a), (b), (c), (d) and (e). Would you like
23 to read those, and perhaps you could identify for me if it is the case that you disagree with
24 any of those points between (a) and (e). We can take them in turn but perhaps you would
25 like to just read them and then comment.

26 A (After a pause) Okay, the first thing I would say about that is ----

27 Q Perhaps you can just identify for us which are the ones you are talking about so that we can
28 be clear.

29 A Okay. If we take the first, 352(a), combinatorial tests did not span charge controlled and
30 non-charge controlled services, the purpose of the combinatorial test is to identify whether
31 or not a set of services taken together, where there are common costs in the provision of that
32 set of services in combination, have a total aggregate revenue in excess of the stand alone
33 costs of the services when taken in aggregate. That is a principle that bears no relation to

1 whether a service is charge controlled or not charge controlled. It is a principle that is set
2 out in contestable market theory.

3 Q I do not really want to know about contestable market theory, I just want to know what the
4 disagreement is on points of fact. As I understand it, the point of fact in 352(a), you may
5 disagree with why it is relevant, but in terms of its factual accuracy you do not disagree?

6 A There were some routes on those international services which were subject to a price cap,
7 and there are other routes which were fully competitive. So I think it depends whether you
8 consider a charge cap to be a price control or not.

9 Q Let us assume that we are using them interchangeably, then there is no disagreement there,
10 is there?

11 A So you're saying that something which has a price cap is not charge controlled?

12 Q I am just simply trying to establish whether or not you disagree. It sounds like all you are
13 disagreeing with is the use of the words "charge control"?

14 A Well, it may not be relevant, because a combinatorial test itself, in principle, whether or not
15 something is charge controlled or not charge controlled, that's not the principle of a
16 combinatorial test.

17 Q With respect, Mr. Pigott, you are going back to your previous point which may be very
18 interesting, but all I am interested in at the moment is whether or not there is any factual
19 disagreement and, subject to terminology, there does not seem to be a disagreement with
20 (a)?

21 A If you're saying, were the combinatorial tests for international calls spanning services which
22 were subject to a price cap, and those which were subject to no price control, then, yes, I
23 would agree with you.

24 Q Thank you. Let us look at the second one. Is that correct as a matter of fact?

25 A Well, again, I would suggest that there were some international routes which were fully
26 competitive, and there were other routes which were not fully competitive. If all the routes
27 were fully competitive there would have been no need to have anything in LRIC in our
28 regulatory statements, because it is only services where there is a need to have some sort of
29 cost orientation ----

30 Q Please bear with me, and let us put aside the relevance of the points that he is making
31 because that is a matter for submission. I just want to identify if there is a factual dispute.
32 On the first line:

33 "The combinatorial tests for International Calls did not span competitive markets
34 and markets in which BT had market power."

1 Is that right or wrong to the best of your knowledge?

2 A Well, it comes back to what you mean by “competitive markets” and what you mean by
3 “markets where BT has market power”. If you are saying that routes where BT has a price
4 cap, a ceiling, where it cannot change the prices above a certain level, and that has been
5 imposed because the route is not considered to be as competitive as those services which
6 have completely de-regulated. I don’t think I can say that this is true.

7 Q So you disagree with that one, do you?

8 A I disagree with that, because the different routes have different levels of competition.

9 Q We will see what Mr. Myers has to say about that. Let us look at (c). Is Mr. Myers’
10 understanding there correct, that as far as international calls were concerned the
11 methodology for the combinatorials was established in advance of it being applied to assess
12 charges – is that correct?

13 A Well, it’s true that we had a – the combinatorial tests for international calls were really quite
14 complex. They were set out in what we termed at the time a LRIC cube, where there were
15 different levels of common costs on different international cables. So there are different
16 layers of common costs and levels of combinatorial tests that needed to be considered,
17 because going back to the earlier point I made the purpose of the combinatorial test was to
18 establish whether the services taken in aggregate has sufficient cost to ensure that the
19 aggregate revenue across those services sharing the common costs were not exceeded.

20 Q Can I take it, Mr. Pigott – I am sorry to interrupt you, but it may be that we can cut this
21 short – as I understand it, if you look at (c) and (d) together, the methodology for
22 international calls was agreed upon before it was applied; and secondly, the methodology
23 for international calls was commented upon by industry and agreed by Oftel. I understand
24 that those two points are agreed?

25 A That’s true, but it’s also the case for the LRIC methodology that we have had for network
26 charge controls. That was also subject to consultation and agreement.

27 Q What about (e), do you disagree with that?

28 A I am not quite sure what the point here is that is being made. Could you clarify what you
29 mean?

30 Q Let us see what it says. Mr. Myers has said:
31 “Since my understanding is that there were not large common costs between the
32 International Network and other broad increments ...”
33 Let us just stop with that statement, first of all, before we go on to the rest of it. Do you
34 disagree or agree with that? If you do not know, then please just say you do not know.

1 A I think it depends on how you what “not large” means. The common costs in the
2 international cable were probably a larger proportion of the common costs. It is not true to
3 say that there are not common costs between the international network increment and
4 everything else.

5 Q Let us leave that for the moment. Can I just ask you: you say quite a lot in your statement,
6 as does Mr. Budd, about combinatorial tests, whose responsibility was it in your view or
7 BT’s view to do the combinatorial tests to establish cost orientation?

8 A Well, the combinatorial tests – let me try and think about this – the combinatorial tests that
9 would be conducted can, in fact, be conducted by using data from BT’s incremental costing
10 pool, and the team that runs that within BT is the Regulatory Finance Team. The way in
11 which the combinatorial tests can be constructed, in essence you already have a
12 combinatorial test set out in the regulatory statements because the DSAC values you have in
13 the statements show the distribution of the combinatorial test for the whole of the core
14 network.

15 Q You say in your statement, and perhaps I can remind you of this, at para.59 of your first
16 statement, which is in the core bundle at p.448. This is where you describe the
17 combinatorial tests we have just been looking at for the other examples. Do you have
18 para.59, Mr. Pigott?

19 A Yes, I have that.

20 Q You say:
21 “... I find it very difficult to understand how it can be said that proper
22 combinatorial testing, should it be necessary, cannot be done in a 4 month time
23 frame. Certainly, it should be possible within a 9 month or 15 month time frame.”
24 I infer from that that you are indicating that you considered it was for Ofcom to do the
25 combinatorial tests, and you are saying, “They had 15 months to do it”?

26 A If you look at the evidence on this, the combinatorial test is a second order test. The first
27 order test would be whether the prices of our services are outside of the DSAC range. I
28 don’t think it was until the draft determination that BT realised how Ofcom was going to
29 assess a DSAC at such a granular level as it did in its draft determination.

30 Q Let us just go back to my question and please focus on it. I do not want to stop you saying
31 what you want to say, but is it the position of BT that it was Ofcom’s responsibility to do
32 the combinatorial tests to establish cost orientation or not?

33 A Well, no, but BT did provide combinatorial tests to Ofcom.

34 Q So it was BT’s responsibility?

1 A I think ultimately BT has the information with which to conduct the combinatorial tests, so,
2 yes, it has to be BT that does the tests. So yes, the answer to your question is “yes”.

3 Q I have noticed that you provided all of the data that Mr. Budd used in his statement, the
4 tables – is that correct?

5 A The tables of rates of return, yes.

6 Q I will not ask you any questions about that, save for asking you about one particular matter,
7 which is that you said at the start of your evidence that you accept that DSAC was a first
8 order test. Would it be fair for me to summarise BT’s position as follows, and tell me if you
9 disagree with this: BT’s position is that DSAC is a first order test, but DSAC has to be
10 applied on an aggregated basis – in other words, you aggregate trunk and terminating?

11 A No, that’s not the position. You look at the service that has been sold.

12 Q That is, in BT’s position, a trunk and terminating service which makes up a PPC?

13 A In terms of PPCs, yes.

14 Q So it is the case that throughout the course of the regulatory period following 2004, BT
15 considered it was acting in cost oriented because it was aggregating trunk and terminating
16 costs?

17 A Well, I think you have to look at the services actually sold and bought by the customers
18 when you are assessing a DSAC, and that is particularly important because DSAC is
19 combined from the sum of the different component parts that make up the service. Because
20 the DSAC has that property it means that when you look at the DSAC of the end service
21 you can satisfy yourself that the total SAC of the core network is satisfied, provided that the
22 DSAC of all of the services that have been sold is also met.

23 Q I think that is a “yes” ultimately to my question, but we will see what it looks like on the
24 transcript. Can I ask you this question: you were well aware within BT that Ofcom and
25 indeed the communications providers regarded trunk segments – is that correct?

26 A Sorry, can you repeat the question?

27 Q Were you not well aware within BT that both Ofcom and the communications providers
28 regarded the trunk segment originally as a separate service?

29 A No, it was considered to be a separate market in terms of how one construed the market
30 review. If you look at the Phase one determination it sets out different cost orientation
31 requirements for the trunk to the terminating on account of the different level of competition
32 that was available in that market.

33 Q You would accept, would you not, that BT in its wholesale catalogue was required to
34 publish details concerning wholesale segment services as a separate service?

1 A We published a separate price on the price list, but that would be the case of anyone who
2 sells components that are made up into a larger service. We have to do that, otherwise the
3 price of the service can't be identified. It goes without saying that if you have got a service
4 that is made up of different bits, and those bits are used in variable proportions, you have
5 got to provide the means to calculate the price of the end service, and that is what we do in
6 the price lists.

7 Q Did you ever consider – or you may have considered now – Condition H3? Are you
8 familiar with what Condition H3 says?

9 A This is what we have been discussing over the last two days.

10 Q You are familiar with its terms? I can show you them if you would like to remind yourself?

11 A It uses the term “appropriate” in terms of the mark-up for common costs.

12 Q Do you accept that Condition H3 applies to trunk services separately?

13 A Well Condition H3 applies to network access.

14 Q Perhaps you could just tell me a “yes” or “no”? I do not mind if you are going to say “no”,
15 but it sounds to me like you do not accept it applies to trunk services?

16 A I do not know myself how network access is going to be construed in terms of each of the
17 different component parts of a private circuit because you have the same wording repeated
18 in a number of the different Conditions, one for each market that Ofcom is looking at and it
19 uses the same words in each case, does it not?

20 Q With respect, Mr. Pigott, you are Head of Portfolio analysis at BT Wholesale, is it part of
21 your job to know and understand which Conditions apply to items within the wholesale
22 market?

23 A Yes, I think.

24 Q So are you telling us that you really do not know whether Condition H3 applies to trunk
25 segments?

26 A Condition H3 applies to the trunk market, yes.

27 Q Thank you very much.

28 MISS ROSE: I have no questions.

29 Re-examined by Mr. READ

30 Q Can I just ask you a couple of questions in re-examination? First, you were asked a series
31 of questions about Mr. Myers' statement, and in particular para. 352. I want to be clear
32 what you actually are saying so there is no issue about interpreting the transcript on a later
33 occasion. In respect of 352(a) was there any form of price cap imposed in the international
34 calls' market?

1 A There were safeguard caps applied to some routes.

2 Q And how were those safeguard caps imposed?

3 A As I understand it there was a list of routes where BT had less freedom than other routes
4 before the routes were finally disaggregated. It is a long time ago since we had these
5 international routes regulated.

6 Q Mr. Myers is saying there that the combinatorial test for international calls did not span
7 charge controlled and non-charge controlled services. Do you accept that or not?

8 A I accept it to the extent that if he means “charge controlled” in an RPI minus X type charge
9 control.

10 Q Yes?

11 A But you could argue that an RPI minus 0 cap is some form of a charge control, so I don’t
12 think I accept that, because if the international call routes had all been competitive there
13 would have been no need for any control at all.

14 Q In (b) it says: “The combinatorial tests for international calls did not span competitive
15 markets and markets in which BT had market power.” Do you accept that?

16 A It comes back to the question about whether you consider prospectively competitive
17 markets to include those markets where BT has market power. So I think the answer to that
18 is I do not accept that.

19 Q You were asked a series of questions about whose responsibility it was to produce
20 combinatorial tests and we know obviously that BT did produce some combinatorial tests
21 after the draft determination. Was there any reason prior to the draft determination why BT
22 did not produce any combinatorial tests?

23 A I think that the reasoning behind that is that the history behind the regulation of trunk and
24 the cost orientation for terminating is really quite different. In 2001 and onwards the cost
25 orientation obligation for trunk services was that they should be subject to a true LRIC to
26 true SAC ceiling subject to combinatorials, and that the terminating segments to be subject
27 to cost orientation which said LRIC plus some recovery of fixed common costs. This is set
28 out at the start of the Phase 1 determination. I think when you are looking at the stand alone
29 cost of any increment in BT’s service it is pretty obvious that the stand alone cost of one
30 service in isolation is going to be pretty high. That is inevitable from the economics of
31 networks. So the true stand alone cost – you probably would not even need to look at that
32 because it would be so high compared to the average cost on an FAC basis or, indeed, on
33 the DSAC basis. So we expect the SACs to be much higher than DSACS. The other thing
34 that would suggest that the prices overall were cost oriented is when you look at things in

1 the whole the level of return for PPCs as a whole does not appear unusual. Really, you
2 would only start to look at that if you thought there was a significant problem. So if you
3 look at things on a circuit by circuit analysis, which is the thing that the operators are
4 actually buying that does not give the overall DSAC of each PPC does not give rise to
5 significant cause for concern. So I think it is the case that BT thought it was cost oriented,
6 and is quite surprised that Ofcom is taking a particular granular approach to DSAC now,
7 because it is quite different to how the cost orientation imposition on trunk services was
8 framed in 2002.

9 MR. READ: Yes, thank you, Mr. Pigott. Does the Tribunal have any questions arising out of
10 that?

11 THE CHAIRMAN: No, we do not, thank you very much.

12 MR. READ: Thank you very much. That is Mr. Pigott's evidence.

13 (The witness withdrew)

14 MR. READ: In the short adjournment I was handed a document by my learned friends, and I
15 want a proper opportunity to consider it because it relates to the next witness. To be
16 entirely fair to Ofcom it is not them who has given it to me, it was the Altnets, but I do want
17 an opportunity to try and take in what this document is actually saying. Can I ask for 15
18 minutes to consider it?

19 THE CHAIRMAN: Yes, by all means. This is the breakdown of PPC's purchase prices?

20 MR. READ: Yes, it may all be very straightforward when I have actually had an opportunity to
21 look at it, but what I need is an opportunity to look at it.

22 THE CHAIRMAN: We also seem to have an Annual Review and Notice of Meeting 2006.

23 MR. READ: Yes, again I have not had an opportunity to look at that.

24 THE CHAIRMAN: You can look at both then. Will 15 minutes be sufficient.

25 MR. READ: Well can we say 20 to be on the safe side.

26 THE CHAIRMAN: We will rise for 20 minutes in that case.

27 (Short break)

28 MR. READ: Sir, thank you for the short adjournment. Can I call Mr. Tickel?

29 THE CHAIRMAN: Yes, Mr. Read.

30 Mr. JAMES LEE TICKEL, Affirmed

31 Examined by Mr. READ

32 Q You are James Lee Tickel, and an employee of British Telecommunications.

33 A I am.

1 Q Can I ask you to take the bundles, and you have heard, presumably, what I have said about
2 if you have any problems with the bundles, say so.

3 A Sure.

4 Q Can I ask you to look at core bundle 1, and if I can ask you to go to tab.13, there is a
5 statement at p.387 which has a signature.

6 A Yes.

7 Q Is that your signature?

8 A It is.

9 Q And do you adopt that as your evidence?

10 A I do.

11 Q And, at tab.14, there is a second witness statement and again, if one goes to p.407, is that
12 your signature?

13 A Yes it is.

14 Q And, again, with the respective annexes, does that constitute your evidence as well?

15 A It does, yes.

16 Q Thank you, Mr Tickel, just wait there.

17 Cross-examined by Miss ROSE

18 Q Mr. Tickel, can we just turn to your first witness statement?

19 A Yes.

20 Q At para.8 and continuing, you make a number of comments about the need for regulation to
21 allow efficient cost recovery and a fair return on investments. Do you see that?

22 A I do, yes.

23 Q And your comments are based on the figures given by Mr Budd in his witness statement, is
24 that right?

25 A That's correct.

26 Q And the assumption that you make here, that:
27 "The final determination has resulted in BT not being allowed a fair return on the
28 required investments"
29 is also based on Mr Budd's figures, is it not?

30 A That's correct.

31 Q Can we now turn to your second statement. You address the questions of economic harm
32 that would be likely to arise from an over-charge on the Trunk segments. If you can go to
33 para.7.

34 A Yes.

1 Q Paragraphs 7-15, you discuss the demand for Trunk segments from communications
2 providers, do you see that?

3 A Yes, seen it.

4 Q And, as I understand your evidence in this section, what you are saying is that the
5 communications providers all have extensive networks so they do not need Trunk to
6 provide them with core transmission capacity. It is what you call “the middle mile”, in
7 other words relatively short lengths of Trunk. Is that right?

8 A I think that’s the distinction we’re trying to draw in the terminology, yes.

9 Q Yes. And you rely upon that in the subsequent sections of this statement to argue that
10 arguments about the economic harm in terms of competition or impact on consumers have
11 been, as you put it “diluted” because you are talking about relatively small amounts of
12 Trunk, is that right?

13 A Relatively small amount of Trunk, that are also purchased along with the terminating
14 sectors, yes. But there I think I’m trying to draw the distinction between is, particularly in
15 the context of some of the comments made in the final determination, that we are talking
16 about access connectivity demand and that needs to bear in mind the scope of that demand,
17 which was for terminating segments plus some Trunk beyond the Tier 1 nodes during the
18 period we’re talking about.

19 Q Now, you rely in relation to that, on a map that you exhibit to your witness statement. That
20 is at Vol.BT4 of the documents bundle, and it is exhibit JT2.

21 A Yes, I have that.

22 Q “Alternative core network infra-structures. These relate to all other CPs”.

23 A They, I think, as the footnote beneath says, it’s based on internal analysis based on publicly
24 available maps where they’re produced in a -----

25 Q From different operators.

26 A Yes.

27 Q It is rather difficult to tell from that map who has got what network, is it not?

28 A Sure. It is.

29 Q Do you have a bundle called “ADB4”?

30 A Yes, I do.

31 Q I am hoping that, if you go to the back of ADB4 (I beg your pardon, it is ADB3).

32 A Okay.

33 Q If you go to the back of ADB3, do you see a series of tabs starting with tab.1? Right at the
34 back, tabs 1-6.

1 A I'm sorry, I'm not sure I do, ADB3?
2 Q ADB3.
3 A At the back, as opposed to the front?
4 Q We will provide you with a copy. (Documents handed) These are individual maps of the
5 networks of individual communications providers. So, the first tab, you have got
6 Cable & Wireless. The red lines represent their network.
7 A Sure.
8 Q Then behind the next tab you have Colt's network.
9 A Yes.
10 Q Colt's network is very much more significantly restricted than Cable & Wireless is, is it
11 not?
12 A Yes.
13 Q It does not extend at all into Wales, correct?
14 A That's correct, yes.
15 Q Or south-west England?
16 A Correct.
17 Q Or East Anglia?
18 A Yes.
19 Q Or Scotland.
20 A No. But I'd make the comment it links their metro areas that they've got their local access
21 network.
22 Q Yes.
23 A Yes, that's correct, yes.
24 Q But, not in any sense an extensive national network.
25 A It links their core business hub to where I presume their customers are.
26 Q Yes, but it's very significantly different from Cable & Wireless's.
27 Q It's smaller than Cable & Wireless's, yes.
28 Q Very significantly.
29 A It's smaller. I mean, I don't, I think a geographic scope alone is never going to tell you the
30 whole story. It depends what you are talking about.
31 Q I agree, it is not the whole story, but it is the starting point, is it not?
32 A Agreed.
33 Q And then the next one, we have Global Crossing. Then we have, at tab.4, Thus – now, of
34 course, part of Cable & Wireless.

1 A Yes.

2 Q But originally a separate operator. And again, looking at Thus, we can see no coverage in
3 the south west of England, yes?

4 A Yes, agreed.

5 Q And no coverage in East Anglia.

6 A Agreed.

7 Q And then Verizon, tab.5.

8 A Okay.

9 Q Again, nothing in Wales.

10 A Yes.

11 Q And, finally, Virgin. And Virgin have a somewhat different situation, do they not, because
12 they inherited what were cable TV local franchises, is that correct?

13 A That's my understanding, yes.

14 Q And so what we see on the Virgin map is dark grey areas which are areas where they have
15 extensive local networks.

16 A Okay.

17 Q Then linked by main routes, yes?

18 A Okay.

19 Q Now, you gave some figures for the relative purchases of Trunk and terminating segments
20 which are at exhibit JT1 to your witness statement, again, in bundle BT4.

21 A Yes, I have that.

22 Q And what we have on this page, the first page of JT1, is a list of communication providers'
23 names, so we have got Cable & Wireless, Colt, Energis, Global Crossing, Kingston, Thus,
24 Virgin, Worldcom (that is now Verizon is it not?)

25 A Yes.

26 Q And other CPs. Then we see the total number of PPCs purchased by each operator.

27 A Yes.

28 Q And the total number of PPCs without Trunk and with Trunk purchased by each operator.

29 A Correct.

30 Q Now, just pausing there for a moment, there are significant differences, are there not, as
31 between individual operators as to the number or proportion of circuits that they purchase
32 with or without Trunk.

33 A There are differences, yes.

34 Q You should have this page, have you got this page, let us just turn it up.

1 A I did see it before. Thank you.

2 Q We have done an analysis based on these figures.

3 A Yes.

4 Q And if you look at the third column on this page, you see for each operator the percentage
5 of PPCs with Trunk segments, do you see that?

6 A Yes, see that.

7 Q So, for Cable & Wireless 33 per cent.

8 A Yes.

9 Q So, two-thirds of Cable & Wireless's purchased PPCs are without Trunk.

10 A That's right, yes.

11 Q By contrast -----

12 A Sorry, are with Trunk.

13 Q No, two-thirds are without Trunk.

14 A Sorry, yes, it's me. Yes.

15 Q I am so sorry, this is confidential as between, I am so sorry. It is confusing because the
16 original document is not marked "confidential", but I understand it is confidential as
17 between CPs. So, if we could just pause one moment while people leave. I do not think we
18 actually need to rise.

19 (For Proceedings in Private, see separate transcript)

20 (After the short adjournment)

21 MR. SAINI: Sir, I have no questions.

22 THE CHAIRMAN: I am grateful, Mr. Saini. I was just going to say before you started, I
23 understand from the Shorthand Writers that we were still in private session, but I think that
24 should cease now. Mr. Read?

25 Re-examined by Mr. READ

26 Q Sir, we are now in open session, and I have just got a few questions in re-examination,
27 Mr. Tickel. Could you look at the Annual Review and Notice of Meeting 2006 that you
28 were referred to.

29 A I have that, yes.

30 Q In particular you were taken to p.5 of that document.

31 A Yes.

32 Q You were asked about BT Global Services. Is BT Global Services the only BT internal
33 purchaser of PPCs?

34 A No, BT Retail will also purchase PPCs through its Business Division.

1 Q I see, and is there a substantial difference between the two of them or not?

2 A I don't have that information available. I think the majority are through Global Services.

3 Q Just looking at the figures that you were taken to regarding BT Global Services and BT

4 Wholesale, because you were asked a question about operating profit against revenue and

5 the percentages relating to that. The capital expenditure we see for BT Wholesale is £2,000

6 million, whereas it is £702 and £605 million for BT Global Services.

7 A Yes.

8 Q What does that suggest to you about the reasons why there is a difference in any of the

9 figures there?

10 A The majority of capital expenditure would be at the wholesale level in running the network.

11 Q Just so we are clear about it, when it has got capital expenditure in those accounts, is it

12 talking about the actual capital invested or is it talking about capital expenditure within the

13 year?

14 A I believe that's capital expenditure within the year.

15 Q If you were looking, for example, at return on capital expenditure, what would that be based

16 on, the investment of capital within the year or what?

17 A Based on the investment overall and providing the services.

18 Q The only point I am really asking is, you look at the capital expenditure figure, you see

19 there is a difference, but that does not actually reflect necessarily what the business has

20 actually overall expended in terms of capital?

21 A No, I think that's right. That's correct.

22 Q Perhaps I ought to ask you a final question about these accounts. Were you actually at BT

23 when these accounts were ----

24 A No, it was shortly before I joined. I was at Ofcom at the time.

25 Q You were at Ofcom?

26 A Yes.

27 Q Thank you. Do you have any questions?

28 THE CHAIRMAN: No, thank you very much, Mr. Tickel.

29 (The witness withdrew)

30 MR. READ: Sir, before Mr. Saini gets to his feet in order to introduce his next witness, can I

31 make BT's position entirely clear about the cross-examination. Obviously there was an

32 agreed timetable which indicated that Mr. Myers was going to be appearing next week,

33 rather than today.

34 THE CHAIRMAN: Yes, today.

1 MR. READ: We, in fact, have organised things on that basis. For example, Professor Yarrow has
2 not been available over the last couple of days, and it was only yesterday that I found out
3 for the first time that there was a chance that Mr. Myers might even be called today, let
4 alone actually be expected to be completed within the day. I hope I made it clear yesterday
5 that, in fact, I could not complete the cross-examination without having a break over the
6 weekend. Mr. Saini has indicated that he is happy for Mr. Myers to start, and I suspect I
7 have probably got about an hour, an hour's worth of cross-examination, but at that point I
8 am going to have to ask for it to be adjourned so that I can then take fuller instructions from
9 others behind me on what else needs to be cross-examined on.

10 THE CHAIRMAN: Very well. Let us proceed on that basis then. I would not like to waste the
11 whole afternoon obviously. I am sorry, Miss Rose?

12 MISS ROSE: Sir, we are very troubled to hear that from BT. These proceedings are extremely
13 expensive for the interveners, and of course for everybody else who is here as well. I am
14 told that our daily costs of being here are in the region of £15,000 a day. I simply do not
15 understand why it is being suggested that we need to rise early today because Mr. Read says
16 that he only has an hour's worth of cross-examination. It was clear yesterday that we were
17 likely to be starting Mr. Myers at two o'clock. My concern is that we waste, effectively,
18 two hours this afternoon, almost half a day, that is going to have a knock-on effect at the
19 end of the hearing, and increase our costs very significantly. In my submission, that is not
20 an appropriate way forward. He should be ready to use the time that the court has made
21 available.

22 THE CHAIRMAN: As I see it, we are talking about a stop at around half past three to four
23 o'clock – is that right, Mr. Read?

24 MR. READ: Probably about half past three, round about then, yes.

25 THE CHAIRMAN: I would be keen to cover as much ground as we can.

26 MR. READ: I will certainly try to, sir, but obviously there are certain points that I am going to
27 run up against where I do want to actually get some proper instructions. I think, with the
28 greatest respect to Miss Rose, it really is a false premise to say that, when they have agreed
29 a timetable which has been handed to the court, somehow they are losing money as a result.
30 I also make the point, sir, that if you cast your mind back to February of this year when we
31 had the case management hearing, it actually had to be fixed around availability and it was
32 my availability that was the serious problem. If you recall, I had work already, and it was
33 fixed on that basis. Then to suggest that I have to take the "double-whammy", if you like,

1 of being expected to go against a timetable that has been agreed up until yesterday, in my
2 respectful submission, is straining things a bit.

3 THE CHAIRMAN: I am just concerned that we do not have a further gap. Am I right in thinking
4 that Mr. Myers is likely to be finished in the course of Monday, and that we will finish the
5 CP evidence in the course of Monday?

6 MR. READ: I would anticipate that Mr. Myers will be finished well before lunchtime on
7 Monday. I do not know whether you wish to start at ten o'clock, but I do not anticipate that
8 I will have more than about an hour's worth of cross-examination to put to him on Monday
9 morning.

10 MISS ROSE: Sir, if he is saying that he only has in total two and a half hours of cross-
11 examination of Mr. Myers, in my submission, it is strongly in the public interest that that
12 should take place this afternoon. The effect otherwise is that Mr. Myers has to go all
13 weekend in purdah with the cross-examination hanging over him. What we are now being
14 told is that it is only a two and a half hour cross-examination. It is absolutely extraordinary.
15 The suggestion that this was an agreed timetable, with respect, sir, you have it, what it says
16 is that it is indicative and subject to change. Rule one for any barrister going into any
17 hearing is that you prepare the hearing before it starts and not half way through.

18 THE CHAIRMAN: Miss Rose, my question, before we get on to that, I take it that we will be
19 ready to start the experts, if they are ready, on Tuesday morning prompt, if we can finish the
20 factual evidence on Monday. Is that likely to be the position?

21 MR. READ: We had anticipated, given that there seems to have been this radical shift in the
22 amount of time that is taken on BT's witnesses, that if need be we can have Professor
23 Yarrow available to start on Monday. In other words, I am not asking for any break
24 between the end of the factual witnesses and the expert witnesses, we can go straight into
25 the expert witnesses.

26 THE CHAIRMAN: There is some force, I think, in what Miss Rose says, but nevertheless we
27 will give you your break after an hour and a half, and we will resume at ten o'clock on
28 Monday. If we can press on to the experts on Monday then so much the better.
29 Before, however, Mr. Saini calls Mr. Myers, I did have two points of housekeeping. First of
30 all, can we find homes for the two documents that Miss Rose has handed.
31 More importantly, on the table that you handed up, Miss Rose, I anticipate there might be
32 questions of confidentiality there.

33 MISS ROSE: Yes, those figures are confidential ----

34 THE CHAIRMAN: Because they are based on confidential information.

1 MISS ROSE: Yes, as between the communications providers. They are not confidential to
2 Ofcom or BT.

3 THE CHAIRMAN: I understand. Would it be too much trouble to have a further version which
4 had that clearly labelled so that when I am drafting things up I will know exactly what is
5 confidential and what is not?

6 MISS ROSE: Yes.

7 THE CHAIRMAN: I am very grateful.

8 MR. READ: Sir, I do not think it needs to trouble us now, but can I just mention one thing on
9 that table, which is that I think the fourth column in from the right should actually read
10 “Trunk segments at or under 20 kilometres”, because that was the break in Mr. Tickel’s
11 table.

12 THE CHAIRMAN: Thank you, Mr. Read. Yes, Mr. Saini?

13 MR. SAINI: I am going to call Mr. Myers.

14 Mr. GEOFFREY RICHARD PLATT MYERS, Sworn
15 Examined by Mr. SAINI

16 Q Mr. Myers, I hope you have in front of you the core bundle, volume 2.

17 A Yes.

18 Q Could you please go in that to p.476.

19 A Yes, I have it.

20 Q If you can go to p.588, which hopefully is the end of the statement – do you see that?

21 A Yes.

22 Q Is that your witness statement?

23 A It is, yes.

24 Q Is this your evidence to the Tribunal in these proceedings?

25 A That is correct.

26 Q May I ask you a question, please, just to provide a figure in relation to one of the questions
27 the Chairman at the end of yesterday. Can you please go p.524, para.124. I believe that the
28 Chairman’s question was that if one ignores 124(a) completely, imagine 124(a) is not there
29 at all, and one were re-working the figures at what is (b), the percentages at the end change,
30 and the first percentage is confidential, but I think I can say to the Tribunal that it is the
31 same percentage as that at the end of 124(a). The second percentage is one that you have
32 calculated, as I understand it. Can you tell us what that percentage is, it is not a confidential
33 percentage?

34 A It is 10.4 per cent.

1 Q Sir, what I was going to propose is, just so that there is no doubt, that we produce another
2 version of para.124 with those percentages in them and hand that up so that there is no
3 confusion.

4 THE CHAIRMAN: That would be very helpful, Mr. Saini, thank you.

5 MR. SAINI: Would you stay there, Mr. Myers, Mr. Read will have some questions for you.

6 MR. READ: Can I make clear, first, what I do not find is, in effect, this witness being re-
7 examined by cross-examination, and in those circumstances I certainly would suggest that it
8 would be, particularly as they are supporting Ofcom, appropriate, if Miss Rose has any
9 questions of this witness, that she should ask them at this stage rather than at the end of my
10 cross-examination. That is my proposition.

11 THE CHAIRMAN: Miss Rose, that seems sensible, do you have any questions now?

12 MISS ROSE: I have no questions.

13 Cross-examined by Mr. READ

14 Q Can I start by asking you some general points about DSAC and see what we can agree and
15 disagree. The first point is that you accept, do you not, that a charge can be cost oriented
16 even though it is well in excess of the DSAC ceiling?

17 A Yes, that's possible, yes.

18 Q Indeed, I think it is actually accepted in the final determination. The second point with
19 which I think you agree is that you can pass all the DSAC tests below the DSAC ceiling and
20 still be significantly over-recovering costs?

21 A Yes, that is possible.

22 Q Indeed, that is the very reason why, in the final determination, you introduced as one of the
23 so-called secondary tests an investigation into whether or not charges below the DSAC
24 ceiling might still be non-cost orientated?

25 A Yes, that's correct.

26 Q You did not do that in the draft determination though, did you?

27 A I don't recall.

28 Q You did it, did you not, in direct response to the point that BT was putting to you that
29 charges above and below DSAC could be either cost orientated above or non-cost orientated
30 below?

31 A My recollection is that this particular point was in response to points made by the CPs, who
32 were suggesting that prices below DSAC might still represent overcharging.

1 Q One of the stated reasons you give, and if you need to look at it it is at para.18(b) of your
2 witness statement, p.488 in the core bundle, is that you need to strike a regulatory balance
3 through providing enough pricing flexibility to recover its costs and then:
4 “... ensuring that this flexibility is sufficiently bounded to prevent the regulated
5 firm from exploiting its market power to set anti-competitive, exploitative or
6 otherwise unreasonable charges.”
7 Yes?
8 A Yes, that’s correct.
9 Q Is it not a problem with using DSAC ceilings as your test for that, that you may actually
10 have a price that is cost orientated even though it is significantly above the DSAC ceiling?
11 A That is why the DSAC test is not determinative on its own, and why it’s a first order test.
12 Q Yes, but you use it, do you not, in the sense of being a very significant consideration?
13 A Yes, a very significant consideration, yes.
14 Q You use it to assume overcharging when you come on to consider economic effects?
15 A No, I wouldn’t accept that. The issue there is the counterfactual that is being identified in
16 the analysis of economic harm, and what the determination did was to, first of all, use
17 DSAC as a counterfactual and look at the analysis on that basis, because DSAC was the
18 first order test. It went on also to consider whether there were other counterfactuals which
19 would be either also appropriate or more appropriate, and Ofcom concluded in the
20 determination that those alternative counterfactuals were not appropriate. Essentially they
21 involved aggregation of terminating and trunk segments.
22 Q I may have got it wrong, but yesterday I thought that Mr. Saini was saying, in terms that, in
23 fact, there is no harm, no problem, with looking at economic harm, or the potential for
24 economic harm, on the assumption that prices are being overcharged because you have
25 already failed the first order DSAC test?
26 A Yes, I think I have just covered that. That is why it is a relevant counterfactual to look at in
27 assessing harm, given that the first order test of DSAC is specified in the Guidelines as
28 identifying an effective first order test for the likelihood of anti-competitive or exploitative
29 charging.
30 Q The point is this, Mr. Myers, is it not, that when you come to assess economic harm, you are
31 assuming that, having failed the DSAC test, there is likely to be overcharging. Therefore,
32 you look at the economic harm that flows from it, or could flow from it?

1 A I agree that there is a – in fact, I believe the way I put it in my witness statement was
2 economic harm will normally follow from price above DSAC, but it won't follow in every
3 single case.

4 Q No, but you are pre-supposing, are you not, in making your assessment of economic harm,
5 that having failed the DSAC test there is overcharging taking place?

6 A No, what is established is that there is, if you like, a *prima facie* case, that there is a case to
7 answer. It doesn't definitively establishing that overcharging has occurred.

8 Q If you then at that stage assume that overcharging is taking place, in order to consider
9 whether or not there is economic harm likely to result, is it not the end result of that process
10 that you have assumed one of the things, one of the pieces of evidence, that is necessary for
11 considering whether there has been overcharging in the first place?

12 A Excuse me? Overcharging was not assumed. As I have already explained, DSAC was one
13 of the counterfactuals considered, but analysis was given of alternative counterfactuals. So
14 there is no assumption that overcharging has occurred, because that is the ultimate
15 conclusion of the analysis following the assessment of economic harm.

16 Q Maybe we will come back to that in a moment. You would accept this proposition, would
17 you not, that you can never exclude that the prices above DSAC may still be cost
18 orientated?

19 A Yes, I agree.

20 Q Let me ask you a further point about DSAC before I move on. You would agree, would you
21 not, that the distribution of costs used for calculating the DSAC ceiling is effectively based
22 on only one combinatorial?

23 A I think that's like comparing apples and pears. It is certainly true that DSAC derives from
24 the stand alone costs of the broad increment, which, in this case, is the Core increment, and
25 then the costs are distributed amongst the services within that increment. Since DSAC is an
26 alternative to combinatorial tests, as I say, you can't do a direct comparison.

27 Q No, but you have taken one combinatorial test in order to achieve your distribution of costs,
28 have you not, when you come to calculate the DSAC ceilings?

29 A You've taken the stand alone costs of the Core network, which is one combinatorial test. So
30 that is part of the derivation of DSAC.

31 Q You do not do any other combinatorial in the process of DSAC because effectively you
32 have divided the costs up?

33 A That's correct, it's an alternative to combinatorials.

1 Q When you do your calculations for reaching the DSAC ceilings it is done on incurred costs,
2 is it not?

3 A DSAC reflects incurred costs, yes, certainly in this case, and that's what one would
4 normally expect, given the information coming from BT.

5 Q You say in several places in your witness statement and it is in the final determination as
6 well – and if you want to have look at the passages then I will take you to them – that SAC,
7 the actual true SAC, if I can call it that, is a much higher figure than the DSAC. We know
8 that little table at the end of the final determination that shows that. Do you want to have a
9 look at it? As with all the other witnesses, Mr. Myers, if at any stage you want to be taken
10 to a document, please say so and we will try and do our best to take you there.

11 A Thank you.

12 Q Let us go to core bundle 2 and have a look at the table. It is at p.1011, and it is figure
13 A11.4.

14 A Yes, I have it.

15 Q You have the convergence there. The reason why that is significant, for example, in the
16 case of trunk, is because of the extent of the shared costs. What that diagram is actually
17 telling you is that because you have very large common costs at the granular end, the stand
18 alone ceiling is going to be much higher as a result – yes?

19 A Yes, that's correct.

20 Q What this diagram, and the effect that has been indicated there, is really showing is that
21 there is a vast overlap of common costs when you get down to the granular level, or a vast
22 element of shared costs when you get down to the granular level?

23 A Yes, that is the case for trunk services.

24 Q So because it is shared common costs, if BT's efficiency is improving across the board, then
25 it follows from that that the efficiency is being focused on all those shared common costs?

26 A Sorry? If BT's efficiency was improving across the board?

27 Q Let me take it a stage at a time. You do not disagree, do you, with what Mr. Budd said in
28 his witness statement about the fact that BT's efficiency considerably improved in the
29 period between 2004 and 2008?

30 A Could I have a look at that?

31 Q Yes, certainly. If you take core bundle 1, and you go to tab 10, p.307, you will see a
32 heading "Efficiency". Then he sets out the NERA analysis that was done for BT in that
33 period, and in para.8 he sets out the analysis that was done for the purposes of the

1 2008/2009 review. Then he concludes by actually quoting part of the final determination
2 there – yes?

3 A Yes.

4 Q We might quibble over the use of the words “relatively efficient” in the final determination
5 there, because BT says it is “significantly”, but there is no disputing there that BT’s
6 efficiency has improved considerably in that period?

7 A In the services covered by the efficiency study, yes.

8 Q Which are basically services that share an awful lot of the common costs that are shared
9 with trunk, are they not?

10 A I don’t – it depends on the scope of their efficiency study, which, just factually, I’m not sure
11 exactly what the scope is.

12 Q Let us assume for the moment that it covers this particular area, and let us assume also that
13 there are others. In fact, we know, do we not, from the final determination that there are
14 significant shared common costs in respect of trunk?

15 A Yes.

16 Q Because they are shared common costs, they are not solely focused on the trunk element
17 itself. That must mean that those fixed common costs over that period have become more
18 and more efficient, because that is what the study is telling you?

19 A Yes, I think there is an important distinction which I covered in my witness statement.
20 Perhaps I could find that reference.

21 Q Is this where you are dealing with combinatorial testing or ----

22 A There are two types of efficiency when it comes to stand alone costs. There is – I would
23 prefer to find the reference.

24 Q It is a long statement, Mr. Myers.

25 THE CHAIRMAN: Take your time, Mr. Myers.

26 MR. READ: I will try and find it for you if I can find where exactly it is.

27 A My response starts at para.311, p.573. When we are talking about efficient stand alone
28 costs, because stand alone costs are the costs of a hypothetical single product entrant, there
29 are questions – excuse me, it isn’t actually quite that paragraph, I do apologise. There is a
30 distinction between BT as a multi-product company supplying many, in fact a very large
31 number of services, operating at a level of improving its level of efficiency, compared to
32 what you might call a “least cost stand alone operator”, so it is quite possible for the
33 efficient stand alone cost, which reflects a single product firm to be below the efficient costs
34 of a multi-product firm, because a stand alone operator of a single product might design

1 their network, for example, in a totally different way than BT has for good, and quite
2 possibly very efficient, reasons which reflect BT being a multi-product firm. This was the
3 point that I understand was being made in the determination, that is not just a question of
4 BT's performance relative to these kind of efficiency studies, it is also the question about
5 whether or not, for a stand alone operator, that would identify the least cost stand alone
6 operator.

7 Q I understand why you are introducing it at this point because you are specifically dealing
8 with combinatorial testing, are you not? We see, if you go back over the page at 572, at the
9 top of para.303, "Ofcom's concerns about SAC/combinatorial tests". Do you see that?

10 A I see the heading, yes.

11 Q I understand the concern in putting that context. What I am asking you is a broader
12 question, which is if the reason why there is such a divergence between SAC, DSAC,
13 DLRIC and true LRIC, it is because of the very reason that you have a very large amount of
14 fixed costs having to be effectively divided at the granular level?

15 A Well, there are significant common costs. Fixed cost is perhaps slightly different. There
16 are significant common costs, i.e. significant economies of scope in the production of
17 multiple services. Whether those common costs are as large as BT has suggested is
18 something that has not been – at least, Ofcom did not accept that those common costs were
19 as large as BT had estimated.

20 Q I see. Perhaps you can look at the final determination, which is in volume 2, so hopefully it
21 will be in the same volume as your witness statement. Can I ask you to look at p.131,
22 para.7.124. Can you see that?

23 A Yes.

24 Q Then over the page we a confidential breakdown?

25 A Yes.

26 Q Indeed, it is one of the criticisms you make about BT's combinatorial testing, is it not, that
27 there are such a wide range of fixed common costs?

28 A I am not disputing that there are very significant common costs. My point was simply
29 whether they are quite as large as is set out in these confidential tables on p.928 is a
30 question of contention and ----

31 Q I see, but on any view, even if ----

32 A But I accept that there are very significant common costs involved here, yes.

33 Q It is right, is it not, that there is no other telecoms regulator in Europe who uses distributed
34 stand alone costs ceilings?

1 A I am not aware of how other regulators in other countries address this question of the
2 balance between flexibility to a regulated firm versus protection to the detriment of
3 consumers and competition. Actually I am not aware of whether other regulators provide
4 greater or more limited flexibility than DSAC provides.

5 Q That was my next question. As far as you are aware, no other regulator has ever used
6 DSAC as a test before?

7 A I don't have knowledge of that point, no.

8 Q You would not disagree, for example, with Professor Yarrow's observations on that point?

9 A Which observations?

10 Q That there are no other regulators who use the DSAC test?

11 A I'm not able to comment, I don't know.

12 Q It is fair to say, is it not, that other telecoms regulators in Europe are caught by exactly the
13 same regulation? All the national regulatory authorities have exactly the same regulatory
14 tasks and obligations, because it is all laid down by the Common Regulatory Framework, is
15 it not?

16 A That is correct, yes.

17 Q So each and every one of those national regulatory authorities has to consider its approach
18 to cost orientation?

19 A Yes.

20 Q And you do not know of any of them that actually uses the DSAC ceiling?

21 A I think I've already answered that, I don't have knowledge ----

22 THE CHAIRMAN: ---- I think that is the answer, Mr. Read.

23 MR. READ: Would you accept that there are plenty of other regulators who use stand alone costs
24 and combinatorial tests in order to check on cost orientation?

25 A Again, this is a point on which I don't have knowledge. I am not able to comment.

26 Q Sorry, you are not able to comment on the fact that other regulators use ----

27 A I have not seen documents setting out the application of combinatorial tests by other
28 regulators. I'm not saying they don't exist, I'm just saying I don't have knowledge of them.

29 Q Can you take bundle DF3, tab 3. You will see that it is an extract of "Toward Competition
30 in Local Telephony", and it is by William Baumol and Gregory Sidak, and this copy
31 actually comes from Ofcom's Knowledge Centre – yes?

32 A Yes.

33 Q So it is a document that Ofcom have produced – yes?

34 A Well, it's a document that's in Ofcom's library.

1 Q Would you go to p.80, it says:
2 "Regulators can accomplish this by requiring the complainant to proffer some
3 preliminary evidence ... The regulated firm can then be required in turn to provide
4 the regulator with stand alone cost figures for the combination of products ...
5 Concern over estimation of stand alone cost figures can ascribed to unfamiliarity
6 with the concept. Despite the Interstate Commerce Commission rate cases in
7 which in which railroads and shippers have used stand alone costs for nearly a
8 decade, relatively little has been done along those lines before other regulatory
9 agencies, particularly in telecommunications."
10 So we know there, do we not, that other regulators, in this case the rail regulators, are using
11 stand alone costs and combinatorial testing in the States?
12 A Sorry, I didn't see a reference to combinatorial tests. Is there one? It certainly refers to
13 stand alone costs.
14 Q I do not want to spend long on this document because we may have to come back to it later
15 on, but it is very much set out in the context of stand alone costs and combinatorial testing.
16 For example, if you go back to p.77, "Stand alone Cost and the Combinatorial Cost Tests" –
17 do you see that heading?
18 A Yes. My understanding of this paper is that it presents that theory and then identifies –
19 there is a heading on p.80, "Shortcuts and Approximations", and the passage you read out
20 was under that heading. As I understand it, this section recognises that applying
21 combinatorial tests in practice is very difficult.
22 Q We may have to come back to that in a little while. You would also accept, would you not,
23 that no academic or independent economist as far as you are aware has ever used this DSAC
24 ceiling test himself?
25 A I'm not aware of any reference to it in the literature, no.
26 Q Can I just ask you to go back to para.4 of your witness statement, p.479, please, core bundle
27 2. You set out there that you were the primary author of the relevant section of the Network
28 Charge Control Guidelines in 1997, and you also indicate at para.3 that you had
29 responsibility for overseeing Ofcom's economic analysis during the investigation – yes?
30 A Yes.
31 Q We know – and I will take you to them in due course – that the 1997 Guidelines are the
32 guidelines where you first begin to see the mention of these DSAC ceilings?
33 A Well, they were consultation documents leading up to those guidelines, but yes, that
34 process.

1 Q That process is crystallised by the time ----
2 A Yes.
3 Q We know that no other regulator uses this, or at least you do not know of any other
4 regulator who uses it. We know also that there is no academic or other independent
5 economist who uses it. Is it fair to say, Mr. Myers, that DSAC is really, you are the primary
6 person responsible for that test?
7 A No, that wouldn't be correct. Clearly, there were other people who at the time were
8 significantly more senior than me in Oftel, who also participated in and guided that process
9 of deciding that DSAC was a sensible first order test.
10 Q But in any event, you are one of the key people who has been involved in this development
11 over the years.
12 A Yes. Yes, that's true.
13 Q So, in a sense, this is a bit of your "baby", is it not? DSAC is the test that you have
14 developed and implemented over the years. Is that right?
15 A Well yes, I contributed to the development of DSAC as the first order test.
16 Q And so the last thing you would like to see is that test being knocked down in any way.
17 A No, that's not true. If there were sound reasons to suggest that things had moved on, that
18 there was a better way of assessing cost orientation, a better way of judging those questions,
19 then I would be perfectly open to that and don't hang on to things in the past just because
20 I was involved in them at the time.
21 Q Can I ask you at this stage about, well, let us take you, I think if we go to BT1, flag 4.
22 A Yes.
23 Q This is a draft determination. And if I take you to p.141, it is the internal numbering,
24 Annexe 13 "Economic Theory of Cost Orientation", you have indicated that you, we have
25 seen it in your statement, that you had oversight of the economic analysis, this presumably
26 is your "baby", so to speak, or you had a heavy input into writing this Annexe.
27 A Yes, that's correct, yes.
28 Q And so we see from para.13.7 onwards and 13.8, that you are setting out there the concept
29 that SAC has its origins in the theory of contestable markets, yes?
30 A Yes.
31 Q And you give a specific reference there to Baumol, yes?
32 A Baumol, Panzar ... yes.
33 Q As the basis for that. And then over the page, you are going through the issues with SAC
34 and combinatorials, and then you say, at para.A13.13, "Carrying out a significant number of

1 combinatorial tests is clearly not possible in the timescales available for Ofcom to resolve
2 this dispute”.

3 Yes?

4 A That’s what it says, yes. Yes.

5 Q Well, this is – the question I asked you earlier was that you had a significant input into this,
6 so presumably this reflects your thinking at the time, does it not?

7 A Yes.

8 Q Yes, and so that was your thinking, that you could not possibly do combinatorial testing
9 within the timeframe of a dispute resolution.

10 A To do a robust set of “significant number”, as it says, “of combinatorial tests”, yes.

11 Q Yes, “significant number of combinatorial tests”. And what I am asking you, Mr. Myers, is,
12 to what extent did you really look at contestable market theory in order to consider whether
13 combinatorial testing was possible?

14 A Because I have an understanding of contestable market theory and what it implies for the
15 nature of combinatorial tests...

16 Q So you knew the theory, but had you done any work in seeing how much, in practice, tests
17 were considered necessary by the economists who had come up with the original tests?

18 A Well, I wouldn’t claim to have complete understanding of that, but I have some
19 understanding of that question, yes.

20 Q Because, if I can just take you back -- I am sorry, I should not have let you put it away – but
21 if I can just take you back to that “Toward Competition in Local Telephony”, which was in
22 bundle DF3 at tab.3.

23 A Yes.

24 Q If I can take you back to p.80, do you have it?

25 A I have it, yes.

26 Q And we have a heading there, “Short Cuts and Approximations”.

27 A Yes.

28 Q And it sets out there (read it by all means if you wish to, the whole of that section) but we
29 say that sets out a very clear indication by the author of the theory that, in fact, you do not
30 need to do significant numbers of combinatorial tests.

31 A I commented on this in my witness statement. Let me just find the reference -- yes, it is at
32 para.227 on p.553, and my position is as set out in para.228, which is that I accept that in
33 practice it may not be necessary to conduct every single combinatorial test, but the most
34 important ones should clearly be conducted and that is consistent with this reference in

1 Baumol and Sidak which talks about aggregating into a smaller number of sets, each set
2 composed perhaps a group of products sharing common facilities, and my point is that the
3 combinatorial test should therefore be conducted for the groups of products that share the
4 most common facilities, ie which share the greatest proportion of common costs.

5 Q I understand that is what you are saying now, Mr. Myers, but what I am trying to do is to
6 see how this develops through the course of the draft determination to the final
7 determination to your witness statement. And here, at A13.13 in the draft determination,
8 which is the BT1 file, yes?

9 A Yes.

10 Q There is no discussion, is there, at all, about whether there are any short cuts to tests. You
11 just reject them out of hand because you say there is a significant number that is actually
12 going to be required and they are clearly not possible within the time frame.

13 A I don't think it rejected it out of hand, but it makes the point that if you need to do a
14 significant number of tests and the potential number of tests is extremely large, quite how
15 many tests one would need to do would depend on the nature of common costs and the
16 number of products that share those common costs.

17 Q While we have got this document open, let me just ask you to look at -----

18 A Sorry, which -----?

19 Q Sorry, the draft determination. If you wish to, you can put away DF3. And the next
20 sentence of that paragraph says:

21 "Therefore an alternative methodology that proxies this is necessary".

22 So, that is your wording at this stage, is it not?

23 A Yes. I had responsibility for this Annexe.

24 Q Now, it is not suggesting there, is it, that the DSAC test is actually a complete alternative, is
25 it? It is suggesting, because of the flow of this document, and because you called it a proxy,
26 that in fact it derives from contestable market theory.

27 A It is certainly not intending to suggest that, and I think I've said in my witness statement
28 that the word "proxies" there was imprecise, it isn't a correct description, and it doesn't
29 appear in the final determination. So, it is clear that – and it was always what Ofcom
30 understood, and I understood, that DSAC was an alternative to combinatorial tests.

31 Q Because that is not the natural flow of that Annexe, is it? The Annexe starts off by talking
32 about contestable market theory and then it goes on to talking about a proxy, being DSAC.

33 A DSAC being an alternative to combinatorial tests does follow the logical flow of this
34 Annexe, because the underlying theory which gets you to stand alone costs and

1 combinatorial tests in the first place is contestability theory; and DSACs being an
2 alternative to combinatorial tests is a practical application and a simplification of that
3 theory.

4 Q But you see, it does not say “practical application”, does it? It does not say “conscious
5 departure from textbook theory”, which is what you say in your witness statement, and it
6 does not say it is a more stringent test, does it?

7 A You may be right, I don’t know whether those words are contained in this Annexe. But, if
8 you say they do not, I am -----

9 Q But, that is what you are now saying, is it not? You are now saying it is an alternative, it is
10 a conscious departure and it is a more stringent test.

11 A Yes, I am saying that -- on the basis of prior documents, not, even if it is not explicit in this
12 document, that, in my view, was set out clearly in prior documents going back to the
13 development of the DSAC test in their extended consultation process leading up to the
14 network charge controls and the guidelines in 1997. And on the point of greater stringency,
15 that point was made in the 2004 Leased Line Market Review specifically in relation to the
16 imposition of the cost orientation obligation in Trunk markets.

17 Q Sorry – it says in terms, does it, in the Leased Line Market Review that DSAC is a more
18 stringent test that has been introduced.

19 A I don’t recall whether it says that, but what it says is that cost orientation is intended to be a
20 more stringent test than competition rules.

21 Q The Leased Lines Market Review says nothing about the 1997 and the 2001 Guidelines,
22 does it?

23 A It doesn’t refer to those Guidelines, no.

24 Q No. And it says nothing about DSAC ceilings being a more stringent test, a conscious
25 departure from contestable market theory, or anything like that.

26 A I would have to review the whole of that document to say, but you may be right.

27 Q I do not want to give you homework, but if you feel I have put the question wrongly over
28 the weekend, Mr. Myers, then feel free, please, to come back on Monday and tell me.

29 A I’m not sure it would have been necessary to do so because those points had already been
30 established in developing DSAC much earlier.

31 Q So, where had they been established?

32 A In the development of the DSAC tests, in the documents and as “crystallised” as you put it,
33 in the 1997 Guidelines.

1 Q I want to be clear, Mr. Myers, as to which documents you say this is established in? Are
2 you talking solely about the 1997 and the 2001 Guidelines?

3 A Which point are you asking me on?

4 Q You say, I have been asking you questions, just so you understand where I am going, I have
5 been asking you questions about nowhere in that Annexe 13 of the draft determination or, as
6 far as we can see, in the Leased Lines Market Review is there any reference at all to DSAC
7 ceilings being a conscious departure from contestable market theory, being a more stringent
8 test or an alternative to it. There is nothing explicit in Annexe 13 or the Leased Lines
9 Market Review that says that, is there?

10 A In the Leased Lines Market Review, no, maybe not. My point was that those points, the
11 substance of those points, had already been established in the 1997 Guidelines and in the
12 discussion of the development of the test leading up to those guidelines.

13 Q I think probably we are agreed on this, that what you are relying upon for saying that it was
14 clear that DSAC was going to be a more stringent test, is the 1997 Guidelines and the 2001
15 Guidelines, is that right?

16 A No, I mean, you already pointed me to the diagram on p.146 in this Annexe 13 which shows
17 that DSAC is lower than stand-alone cost. That clearly implies it's a more stringent test.

18 Q Remind me, do we have a diagram like that in the NCC Guidelines in 1997 or 2001?

19 A There were diagrams. Different diagrams. There were diagrams explaining the difference
20 between DSAC and SAC and identifying that DSAC is clearly lower than stand-alone cost,
21 it is a different diagram from this one.

22 Q Can I ask you this – you would agree that one of the most important things a regulator
23 should do is to be transparent, consistent, and set out very clearly how it will approach the
24 application of any regulatory obligations.

25 A Yes, that would be good practice, yes.

26 Q So, we would anticipate from that, would we not, that you would follow in the final
27 determination precisely what the 1997 guidelines and the 2001 guidelines indicate as being
28 the likely testing.

29 A Or any departures would be justified, yes.

30 Q Well, you say any departures -----

31 A Well, they are guidelines, so there may in any specific case, be reasons to depart from the
32 guidelines. I am not -----

33 Q But -----

34 A (Sorry, if I might finish) I am not suggesting that that applied in this case.

1 Q Yes, I see. Well, let us have a look at the 1997 guidelines, shall we? They are in file BT3,
2 and they are at tab.12.1. Do you have that?

3 A I do, yes.

4 Q As you say, this was the crystallisation of a process that had gone on for one or two years
5 previously.

6 A About two years as I recall, yes.

7 Q Now, it is talking specifically about network charge control arrangements in the context of
8 the PSTN network, is it not?

9 A Yes.

10 Q And we know already, well, let me ask you the question -- it is right to say, is it not, that in
11 the lead up to all of this, all the PSTN prices were already price capped because of,
12 effectively, the rate of return regulation?

13 A Well, it was actually far more prescriptive than a price cap. There was an annual
14 determination of every single interconnection price by Oftel. But they were regulated, yes.

15 Q The point being that one could pretty safely assume that these prices were cost orientated
16 because Oftel had been regulating them so carefully.

17 A No, that's not quite correct, because they had been regulated on the basis of historical costs
18 and fully allocated costs, and one of the things that was changed in 1997 with the
19 introduction of the network charge controls was a change to forward-looking costing which,
20 the accounting aspect of that, reflected the move from historical cost accounting to current
21 cost accounting; and there was also a change from fully allocated cost to incremental cost
22 plus a mark-up. So, there was material change in the understanding of the appropriate cost
23 base in 1997.

24 Q I understand that the basis of accounting effectively changed in that, went from a historical
25 cost basis to a proper prospective cost accounting looking system. But, you are not saying,
26 are you, that it is likely that in fact the cost would be seriously out of kilter from a cost
27 orientation obligation, even though you had had that accounting change?

28 A So, my recollection is there was a significant reduction in charges for inter-connection
29 services with the introduction of the network charge controls. I don't quite recall how
30 much, but there was a change in charges.

31 Q I do not think a huge amount may turn on it ultimately in that case, so perhaps we will just
32 leave that point for the moment. Can we go to chapter 3, then, which deals with the setting
33 of the charges. Now, we see from 3.4 that,

1 “The starting charge in each safeguard cap will be the interim charge for the service
2 in question determined by the Director General for 1997/8 and disaggregated where
3 appropriate” -----

4 A Sorry -----?

5 Q This is chapter 3, have you got it? Paragraph 3.4, down the bottom of the page.

6 A Thank you, yes.

7 Q I am simply making the point there that that paragraph is actually illustrating what we have
8 really just been discussing.

9 A That is for the safeguard caps, yes. I was talking about the change in prices, yes, I recall
10 more precisely now, yes, the change in prices was for the services in the baskets. Yes, you
11 are correct that the pre-existing charge was used as a starting charge for the safeguard caps.

12 Q At para.3.5 we see:

13 “Condition 13.4 of BT’s Licence requires that the charge for each of BT’s standard
14 services be reasonably derived”.

15 And,

16 “Condition 13.3 of BT’s Licence requires that interconnection must be offered on
17 terms and conditions ... which are reasonable”.

18 And then it deals with 13.3, and 13.3 in fact is the cost orientation obligation, is it not, under
19 the BT Licence as then was.

20 A As I recall, yes.

21 Q It actually says so at the start of para.3.5, does it not:

22 “Condition 13.4 of BT’s Licence requires that the charge for each of BT’s standard
23 services be reasonably derived from the forward looking incremental costs”.

24 So there is no doubt whatsoever that this paragraph is talking about cost orientation. Do
25 you agree with that?

26 A I agree.

27 Q And then it goes on to say:

28 “In the event of a complaint [I am reading about four lines down, do you see that]
29 under Condition 13.3 that a charge is not reasonable, or under Condition 13.4 to the
30 effect that a charge is not reasonably derived from the forward looking incremental
31 costs of the service, a first order test will be whether the charge in question falls
32 between its incremental cost floor and stand-alone cost ceiling”.

33 Yes?

34 A Yes.

1 Q And it is from that that you derive the suggestion that it was always obvious that DSAC, as
2 it is now interpreted by OFCOM, was consistent with that interpretation.

3 A Yes, that and some other paragraphs, but it includes this paragraph.

4 Q Yes. But that very paragraph then goes on to say:
5 “The primary focus of investigation of a complaint under Condition 13.3 or 13.4 [so
6 we know it is the cost orientation] will however be the effect or likely effect of the
7 charge on competition and on consumers”.

8 Do you see that?

9 A Yes.

10 Q And it then goes on to say how the methodology is going to be dealt with. So, how is it that
11 you say DSAC is the very significant test consideration for considering whether there is cost
12 orientation, rather than that the primary focus being upon – costs being upon the effects on
13 charge on competition and consumers?

14 A Well, the over-arching economic concern is about the effect on consumers or competition.
15 I think the relevant question we are dealing with here is precisely how that primary focus or
16 over-arching concern, should be addressed in any specific investigations which would take
17 account of the context of that matter, and to derive an analysis that was fit for purpose. The
18 context of the disputes was the application of compliance with the cost orientation
19 obligation imposed in the 2004 market review. When imposing that cost orientation
20 obligation OFCOM established the risk of adverse effects on consumers and competition.
21 OFCOM also explicitly noted that the intention was that the cost orientation obligation
22 should be more stringent than competition law. And the guidelines also identify that DSAC
23 or, as it was called “a ceiling”, provides an effective first order test. Excuse me, I am
24 reading from Annexe C, para.C.2:
25 “In investigating complaints about charges, OFCOM would not apply floors and
26 ceiling tests mechanistically. Floors and ceilings are an effective first order test for
27 the likelihood of anti-competitive or exploitative charging”.

28 So, those points seem to me to provide very important matters of context which influence
29 precisely how one would conduct an investigation consistent with an adverse effect on
30 consumers or competition being the ultimate or primary focus.

31 Q Can I ask you to look at your witness statement at this point, and go to para.95 which starts
32 on p.515.

33 A Yes. Paragraph 95.

1 Q You are talking there about *Napp* which is a case involving an analysis of anti-competitive
2 behaviour, yes?

3 A Yes.

4 Q And then you go on over the page:
5 “Second, as noted at para.34 above, ex ante regulation is intended to be more
6 stringent and restrictive on pricing behaviour than competition law. Therefore in
7 my view there should be a lesser requirement in the disputes to show the effect or
8 likely effect, ie economic harm, than for an investigation under competition law”
9 - yes?

10 A Yes.

11 Q How does that sit with para.3.5 when it says in terms, the primary focus of an investigation
12 of a complaint of non-cost orientation will, however, be the effect or likely effect of the
13 charge upon competition and consumers”.

14 A I think I have already explained that, it is my understanding of what this point about
15 primary focus is saying is that it is the over-arching, the fundamental concern, about charges
16 that are not cost orientated. But it doesn’t seem to me that this is specifying precisely how
17 one should conduct an investigation in order to establish sufficient risk or sufficient
18 evidence on this point, and that is why I think the context, as I previously explained, is very
19 important and in relation to the use of DSAC. It is identified as an effective first order test
20 for the likelihood of anti-competitive or exploitative charging, and my interpretation of that
21 is that therefore adverse effects would normally follow from a price above DSAC, even if
22 that would not arise in every situation. So, I do not see there being an inconsistency.

23 Q So, in other words, you do not see there is an inconsistency. But you accept, do you not, in
24 your witness statement, that in fact the guidelines seem inconsistent at various places. Do
25 you want me to take you to that?

26 A I believe it is para.85, is it not?

27 Q Yes.

28 A And you will note in para.86 and 87 I set out a reconciliation of that apparent difference
29 which is not a real difference because, of the role and the inferences that one can normally
30 draw from prices that fall outside of, fail to satisfy, the first order test of DSAC.

31 Q I see. So you have told us what your understanding was in the witness statement, that the
32 words “the primary focus” had to be on competition and consumers has to be contextualised
33 and read in its context, right? That is more or less what you say.

34 A Yes, that is correct.

1 Q How do you think BT are going to understand that, or any other party that is subject to an
2 SMP obligation of cost orientation.

3 Q If they see the words “the primary focus of the investigation of a complaint under cost
4 orientation obligation is the effect or the likely effect of the charge on competition to
5 consumers” are they not entitled to assume that that is how Ofcom will approach the
6 matter?

7 A I would also expect them to take account of para. C.2, that I have already read out about an
8 effective first order test for the likelihood of anticompetitive or exploitative charging being
9 provided by floors and ceilings, and the sentence on primary focus is, in fact, both before
10 and after refers to floors and ceilings. So I would expect that someone would understand
11 that these two points were quite closely related.

12 Q Paragraph 4.12. “Ofcom would generally regard a charge to be unreasonable if it is or is
13 likely to be anti-competitive or exploitative”. So again, it is bringing back to the question of
14 whether the charge is actually anti-competitive, is it not?

15 A Yes.

16 Q And anti-competitive normally means some form of investigation along competition law
17 lines?

18 A Well the very next sentence says “a first order test will be whether the charge falls within
19 cost floors and ceilings.”

20 Q Mr. Myers, I am not for a moment saying that there is not a description of a first order test
21 being ceilings, which we call DSAC ceilings. The point I am putting to you is that that may
22 be first in the sense of it happens first, but anyone reading these guidelines would assume
23 that the primary focus of any investigation, after you have gone through that first order test,
24 the primary focus is going to be on the effects on competition?

25 A Well I can only speak to my understanding, and my understanding is that the first order test
26 means far more than first than simply it is the first thing one looks at and I think that is
27 supported by – I will not repeat it again – the explanation of being an effective first order
28 test in para.C.2. I would also go back to the point I have already made that what one needs
29 to do to establish anti-competitive behaviour creating the likelihood of an adverse effect on
30 consumers and competition does very much depend on the relevant context. What one
31 would need to do in terms of an economic analysis to apply competition law, abuse of a
32 dominant position, would not in my view be the same as what one would need to do in
33 order to investigate compliance with an *ex ante* cost orientation obligation.

1 Q I think we have discussed that dispute between BT and Ofcom on that at some length. Can
2 I just ask you to look at para. C.5?

3 A Yes, I have it.

4 Q There it talks about the methodology for deriving floors and ceilings which is effectively to
5 take the single combinatorial, is it not, if I can call it like that, and then divide it up into
6 distributed stand alone ceilings for individual components?

7 A Yes.

8 Q And then look, not at the individual components, but look at the services actually being
9 provided?

10 A Yes, so the use of components is a means to an end, the DSAC test, the test for cost
11 orientation applies at the level of services and the costing system goes through derivation of
12 costs for components in order to get to costs of services.

13 Q One of your points I think you made was that all the components in this particular instance
14 are always supplied in fixed proportions?

15 A Yes. Sorry, could you point me to that, so I am precise about the point ?

16 Q I think it is in your witness statement. It may take me a moment or two to actually find the
17 reference. (After a pause) I think it is p.533, and para. 157 and there you are saying that
18 components are combined in fixed proportions to form services?

19 A Yes.

20 Q You heard what Mr. Pigott was saying earlier on today about even if you are looking at the
21 components for the purposes of the 1997 Guidelines, they were not combined in fixed
22 proportions?

23 A They were in the sense in which I meant it here. Mr. Pigott was referring to, as I understand
24 it, and I do not think there is a disagreement about this, that the usage factor reflects the
25 average routing of the service, if you like, the average use of components by any given
26 service. In reality in any particular case, on any minute of interconnection, the actual
27 routing may deviate from that average. So there is variation, if you like, on the supply side,
28 from BT's point of view in how they actually route calls. However, from the point of view
29 of the purchaser of the interconnection service it is a fixed proportion because they pay the
30 same price for an interconnection service regardless of how BT actually routes the call,
31 because they always pay according to the average usage factors.

32 Q Well we will have to have a look at the transcript and see whether that is what he said or he
33 did not say this morning, but in any event that is your answer to the issue of whether it is a
34 fixed proportion or not?

1 A Yes.

2 Q Can I take you back to the return on capital expenditure figures, which you were taken to at
3 the start of your examination which occurs in para. 124?

4 A Yes.

5 Q So we are clear, what these figures represent are the adjustment of prices down to the
6 DSAC levels and when I say “the figures” I am talking about the figures Mr. Budd has
7 produced and the figures that you have produced. They are bringing the figures back down
8 to the DSAC level, because that is the level that you, or Ofcom indicated BT should have to
9 repay?

10 A That’s correct.

11 Q Because in fact there are two different potential purposes you could have for using those
12 figures is there not? The first is to consider whether or not the repayments were reasonable
13 - yes?

14 A Yes.

15 Q But there is a further feature which is to say whether or not the original prices set at the
16 DSAC level would themselves have been reasonable?

17 A That is a different question, yes.

18 Q Yes, that is a different question, and in answering it in the final determination you did not
19 use any of the figures about the reduction down to the DSAC level for considering whether
20 there was excessive pricing in the first place?

21 A That’s correct.

22 Q The first figure that I want you to look at is in 124(a) and those two figures there in 124(a)
23 are both on the basis of you look at the period 2004 to 2009?

24 A Yes.

25 Q So the two figures in that subparagraph are for the whole period 2004 to 2009, there is no
26 issue on those figures about the exclusion of 2004/2005, that is what ----

27 A We are talking about 124(a)?

28 Q Yes?

29 A Yes, that is right.

30 Q That is what you come on to in 124(b)?

31 A That’s correct, yes.

32 Q Now, you would accept that both of those figures that you set out in that paragraph are
33 below BT’s weighted average cost of capital - yes?

34 A Yes.

1 Q So what that is telling you is that if you reduce the prices to DSAC for the entire period that
2 was being considered by the dispute, BT would actually have recovered less than its
3 weighted average cost of capital?

4 A Across terminating and trunk segments, yes.

5 Q Yes, for PPCs.

6 A Can I clarify, the appropriate measure of profitability depends on the question that is being
7 assessed, so what question is being assessed here? If I might just finish, because it is clear,
8 I hope it is clear, the point I make in para. 124 relates to the question of Ofcom's use of this
9 figure which was in the context of repayments and, as you put it, the fairness question.

10 Q That is why I asked this question; that is why I started all of this by saying there were two
11 different elements to it. But if you are looking at the first element, i.e. not the question
12 about the repayments and whether or not that was right to make that level of repayment, but
13 if you are looking at the question of whether prices from 2004 to 2009 at the DSAC level
14 would have allowed BT on all PPCs to have earned its weighted average cost of capital, the
15 answer is "no"?

16 A I am sorry, I do not regard that as the right question, because I think as I say in para. (b) you
17 should exclude 2004/5 for the purposes of assessing the fairness question. But if I take the
18 premise of your question, which is if one were to include 2004/5 – sorry you were referring
19 to both figures, so yes, the [x] – I mean BT's cost of capital ----

20 Q If you do not actually specifically refer to the figures ----

21 A I do apologise. The latter figure is slightly below the cost of capital, it is close to it but it is
22 slightly below, and the previous figure is obviously somewhat below.

23 Q You see, you can have an argument about how much weight you want to place upon this,
24 but you actually excluded totally from any consideration whether there has been excessive
25 pricing, have you not? Ofcom in the final determination does not consider it appropriate to
26 use these figures to gauge whether the price is excessive. It uses them for the question of
27 the repayments, but gauging whether the price is excessive you deliberately ignore it?

28 A Yes, for reasons set out in the determination it is not a relevant measure, since we are
29 dealing with the question of overcharging on trunk segments.

30 Q It is a piece of evidence, is it not?

31 A It is not a relevant piece of evidence to the question of overcharging on trunk segments.

32 Q And it is not a relevant piece of evidence because of the primacy you are putting on the
33 DSAC test, is it not? This is what it comes down to?

1 A No, it is an entirely different question. The relevant question is one of aggregation, not
2 DSAC. These figures do not reflect DSAC they reflect fully allocated costs.

3 Q Let me try and put it to you again, Mr. Myers, so that you are clear about the question and it
4 is on the transcript. What I am putting to you is that you take out of any consideration BT's
5 actual return on capital expenditure for the purposes of gauging whether there is excessive
6 pricing?

7 A If I can be precise in answering your question, Ofcom took into account BT's rate of return
8 on the services – on the service – on a disaggregated basis, and I set out those figures, for
9 example in table 3 in my witness statement. These numbers are aggregated numbers across
10 both terminating segments and trunk segments. Those were not considered by Ofcom and
11 nor do I consider them to be relevant to the question of overcharging on 2Mbit/s trunk
12 services.

13 Q So the fact that BT is actually under recovering on all PPCs is a factor that Ofcom
14 completely disregards, is it not?

15 A Ofcom in fact looked into the question of why that was and whether that implied that
16 anything different should be done, and the reason why that was, I think as has already been
17 discussed today, the rate of return on 2Mbit/s trunk segments was extremely high. The rate
18 of return on terminating segments was relatively low. So the source of any under recovery
19 relative to the cost of capital plainly therefore derives from the terminating segment of
20 services which were regulated in a separate market under separate controls terminating
21 segment price caps.

22 Q I think I have probably made my points to you on this, Mr. Myers. Can we move on to
23 para. 124(b), and here you adjust the figure yet further by taking any repayments to BT out
24 of the equation, do you not?

25 A Paragraph (b) excludes 2004/5, the point you are referring to is dealt with in para. (a).

26 Q Yes, sorry, my fault. Let me just ask a final question then while we are on para.124(a).
27 Why do you exclude the effects on BT's retail, its downstream divisions, because as we
28 have heard today it is Retail and Global?

29 A As I said before, the context of these numbers, and my comment on these numbers related
30 to, as is set out in para.123, in the context of Ofcom's consideration of whether it was
31 reasonable to direct BT to repay the overcharging, and I agree with you – I think you
32 characterised that as a fairness question and I agree with that. I think that was part of some
33 kind of fairness assessment. But the question being assessed is the effect of the
34 determination. The determination did not require a transfer payment between one part of

1 BT and another part of BT in terms of the repayment, and that is why, for the purpose of
2 that question, illuminating that analytical question why I consider that it was appropriate to
3 exclude the hypothetical repayments from one part of BT to another part of BT which
4 would merely shuffle money around BT.

5 Q So it is implicit within that answer that for the purposes of assessing whether there was
6 overcharging in the first place you excluded any consideration of the effects on BT's retail
7 downstream business. For the purposes of the repayments you say: "It is a paper
8 transaction so we do not take it into account", but you would also accept that if you are
9 looking at whether or not what is a price that is cost orientated you must surely have to look
10 at the effect on BT's position as well as the effect on the CP's position?

11 A No, I would not accept that that is necessarily the case, and I think in the serious harm that
12 Ofcom identified and investigated in the determination, the effects on downstream prices
13 was in relation to CPs, the effects on downstream competition was competition among CPs.
14 One of the key reasons why I do not think it is necessary to identify BT as part of that is that
15 if I go back to when the cost orientation obligation was imposed in 2004 that established
16 there was a risk of adverse effects to consumers and competition from BT setting excessive
17 prices in this market, and therefore I think it was reasonable therefore to focus on the effect
18 on CPs.

19 Q The effects of Ofcom's determination is to say that BT should have set its prices for
20 2Mbit/s trunk services at DSAC ceiling levels. That is right, is it not?

21 A That is right.

22 Q If BT had not set its own prices at those DSAC levels for its downstream business, it would
23 have been discriminating?

24 A We are now dealing, it seems to me, with a different analytical question, at least in my
25 mind, from the question simply of the repayment and fairness, we are now dealing with the
26 question of overcharging, and if I might turn to table 3 in my witness statement (p.504). For
27 2Mbit/s trunk. This sets out the rates of return on 2Mbit/s trunk earned by BT – or would
28 have been earned by BT on different bases. So the first three columns labelled (i), (ii) and
29 (iii), deal with internal/external sales taken together, and (i) is at the prices charged by BT,
30 and (ii) is, I believe, the question you put to me in terms of both internal/external prices
31 have been set equal to DSAC.

32 (i) is in bold because those were the numbers as I recall used by Ofcom, yes, it says that in
33 the source, that row (i) was reported in table 7.3 of the Determination.

1 The lower rows, (iv), (v) and (vi) show what the position would be if one looked only at
2 external sales. So we can see that if we compare, say, (i) and (iv) or (ii) and (iv) that in
3 most years these numbers are identical and row (ii) and row (v) is, I believe, identical in
4 every year. The “all year” number is very, very slightly different because of different
5 weighting across the years. Also, essentially it does not make a difference in terms of the
6 percentage rate of return, whether one looked at internal, external together, or external on its
7 own, in terms of bringing prices down to DSAC. The only material differences between
8 rows (i) and (iv) in 2004/5 – and that is because actually in that year BT set a different
9 price, there was a different price as between internal sales and external sales. So to assess
10 the question in the determination: “which was the price of external sales?” actually it would
11 be misleading to look at the return on internal and external together, it would be appropriate
12 to look at it on an external basis only, and in terms of the comparison between price and
13 DSAC that is what Ofcom did.

14 Q You are only looking at price and DSAC there, are you not?

15 A Well rows (i) and (iv) look at the prices charged by BT, rows (ii) and (v) look at prices
16 equal to DSAC.

17 Q But the point is you are looking at DSAC, for trunk – yes?

18 A For 2Mbit/s trunk, that’s correct.

19 Q What you are excluding from the equation is any consideration of what is happening on all
20 PPCs?

21 A Yes.

22 Q That is your disaggregation on that?

23 A Yes, that is right it excludes terminating segments.

24 Q So here you are accepting it is possible to look at external revenues only, is that right?

25 A Well, as I say, it does depend on the precise question that is being analysed.

26 Q But you accept that it is a sensible analysis to look at external sales only - yes? Because that
27 is what you have actually done in this table?

28 A Well, I am sorry, you are not giving me a context for what analytical question, but for some
29 purposes, yes, that would be an appropriate thing to do.

30 Q So does it come down to this, Mr. Myers, for the purposes of looking at 2Mbit/s trunk
31 segments, it is acceptable to look at external sales only, but for the purposes of looking at all
32 PPCs as a whole you do not bother looking at the ROCE, just at the external sales. Is that
33 what you are saying?

1 A That is not what I am saying. What I am saying is for the purposes of the 2Mbit/s trunk
2 assessment, in terms of the price versus DSAC comparison, Ofcom looked specifically at
3 the external price compared to the DSAC relevant to external sales. In terms of BT's rate of
4 return on 2Mbit/s trunk, then actually the figures that Ofcom used in the determination
5 were, in fact, the ones in row (i), which look at internal and external sales combined.

6 Q I will leave that point for the moment. Can I ask you about what was said yesterday? Do
7 you agree with what your counsel said yesterday, that there was a balancing exercise being
8 conducted in 2004 as to the various regulatory restraints being put upon the terminating
9 segments, and the trunk segments, and that effectively a tight restraint was being put on the
10 terminating segments?

11 A I am not quite sure what you mean by "balancing", perhaps you could just explain what you
12 mean by balancing.

13 Q I think the way it was being put was that Ofcom had to perform in the course of the 2004
14 Leased Lines Market Review an exercise in deciding how tight a restraint should actually be
15 put on the respective markets?

16 A My understanding of what Ofcom did was that it looked at each market separately, so there
17 was not a balancing as between trunk and terminating segments, the terminating segment
18 price caps were set by reference to the assessment of terminating segment costs, and the
19 analysis of market definition, SMP and appropriate remedies for trunk segments was
20 assessed by reference to trunk segment issues.

21 Q Perhaps I can try and make this go a bit faster. You accept, do you not, that in respect of
22 terminating segments an RPI minus X price cap was placed on the prices?

23 A For low and high bandwidth, yes, that's right.

24 Q And for trunk a less strict obligation was being placed on BT because it was only cost
25 orientation, that is how I understood Ofcom were actually putting it?

26 A Yes, that's correct. There was no price cap on trunk segments.

27 Q Yes, and we know for terminating segments, certainly for the low bandwidths, that price
28 cap was RPI minus 4 per cent?

29 A I don't recall the number.

30 Q If we look perhaps at additional bundle 2, tab 4, p.7, there is an Ofcom value of X for the
31 PPC charge control 2002, 2008, 2009. It has the basket, it has "Point of Connection end
32 and third party end equipment charges" Then "Low bandwidth connection and rental and
33 maintenance charges" and "High bandwidth". With 2 Mbit we are looking certainly at low
34 bandwidth connections, are we not?

1 A Yes, that's my understanding, yes.

2 Q So the value of X, we know from that, is 4 per cent?

3 A Four per cent for low bandwidth terminating segments, yes.

4 Q We also know that BT's prices for trunk drop by 18.8 per cent in real terms over the period?

5 A Yes.

6 Q It is in Mr. Morden's statement. I will take you to it if you want to see it, but it has not been
7 challenged.

8 A No, I don't challenge that point.

9 Q If you take a four year period and you actually work out what that is in terms of an RPI
10 minus X figure, it is about 4.5 per cent, is it not?

11 A I would need to do the calculation. I can't do that in my head, but I have no reason to
12 disbelieve you.

13 Q I have a suspicion I may stop in about two or three minutes, so by all means take as long as
14 you want over that calculation. Let us assume that I am right on that and when you have
15 done your calculation it is right, it means that the constraint put itself under was effectively
16 RPI minus 4.5 per cent – yes?

17 A On that presumption, yes.

18 Q Then if you take into account the fact that it had to repay 42.5 per cent of its revenues, and
19 again I would ask you to do this calculation – I am talking about the figure after Ofcom's
20 repayments are taken into account – yes?

21 A Yes.

22 Q That comes out to a figure of RPI minus 17 per cent. What I am suggesting to you,
23 Mr. Myers, is that the effects of the final determination is put a much, much tighter
24 constraint on BT's pricing than, in fact, it actually got on the terminating segments itself?

25 A I think that's a very incomplete picture. What you have directed me to is questions of price
26 changes over time. The question of the tightness of the cap does not just depend on that. It
27 depends on the price relative to cost and the profitability earned. We were looking before at
28 table 3, which shows that BT's rate of return on 2 Mbit trunk segments was, at the prices
29 charged by BT in the years of overcharging, more than 100 per cent rate of return compared
30 to a cost of capital of about 12 per cent and after repayments of the order of 50 per cent or
31 more on average. So by that measure of types of caps, as it were, if we use caps in the sense
32 in which it has been put to me, the interpretation of cost orientation for trunk was very
33 dramatically looser, much more allowance for BT to earn profitability on trunk segments

1 than they did under the – or were predicted to do, and in fact did, under the terminating
2 segment price caps.

3 Q The trouble with all of this, Mr. Myers, if I can put it like this, is that you keep dismissing
4 every single piece of information that comes out, every single piece of evidence. So you
5 dismiss the ROCE on all PPCs for the entire period, you dismiss combinatorial testing, you
6 dismiss international benchmarking, you dismiss efficiency, and so on and so forth, because
7 it all comes back in the end to the primacy you are putting on that DSAC pass/fail test?

8 A No, I don't accept that characterisation at all. I am considering each of these points and
9 each of these pieces of evidence on their merits, judging the extent to which they provide
10 relevant or informative information for the purpose of the analytical question being
11 assessed. In the case of each of the items of the evidence that you refer to, Ofcom in the
12 determination set out specific detailed reasons in most cases for how it took into account
13 and the weight it placed on each of those pieces of evidence. I certainly disagree that either
14 Ofcom or I have dismissed that information out of hand.

15 MR. READ: Sir, I think that might be a convenient moment if that is acceptable to the Tribunal.

16 THE CHAIRMAN: Very well. Mr. Saini, you had something?

17 MR. SAINI: Sir, I just wanted to indicate that I am assuming that whichever of the expert
18 witnesses that is being called, either Professor Yarrow or Dr. Decker, will be available for
19 cross-examination on Monday. I am not sure Mr. Read is going to take with the
20 communication provider witnesses, but I will certainly be ready to cross-examine on
21 Monday.

22 THE CHAIRMAN: Yes, I am assuming they will be ready.

23 MR. READ: I thought I had already made that clear, that we were having them available and
24 ready for Monday lunchtime.

25 MISS ROSE: Sir, there is a question mark over whether or not Mr. Read wishes to cross-examine
26 Mr. Robinson. He indicated that he might wish him to attend, but he might not. I have
27 been told by Mr. Robinson that he has a personal difficulty with being here on Monday. If
28 my learned friend does want him to attend, can he indicate now and he can be interposed on
29 Tuesday. I would be grateful to have certainty on that question now.

30 MR. READ: Sir, perhaps if I can have ten minutes I will inform my learned friend and she will
31 actually ----

32 THE CHAIRMAN: Can you ensure that Miss Rose knows the position.

33 MISS ROSE: I am told Mr. Robinson is here now, so, in fact, if my learned friend does wish to
34 cross-examine him I would suggest that the most efficient way of dealing with it would be

1 for him to be called to give evidence now and then he will not have to come next week. He
2 has a close relative who is in hospital, that is the situation.

3 THE CHAIRMAN: I understand, Miss Rose. I think that would be putting undue stress on the
4 timetable that has been arranged. I would rather he was here next week if that can possibly
5 be achieved, but obviously, given those difficulties, we will be as flexible to ensure that he
6 can come at a time convenient for him if he is needed.

7 Mr. Myers, I did have three points for you really: first of all, just the standard warning, over
8 the weekend you are in purdah, as it were, and you must not talk about the case to anyone.

9 There were two points subject to that. First of all, Mr. Read, you did put a number of
10 requests for calculations to Mr. Myers. I do not know if you are very clear as to what you
11 were being asked to do?

12 A I would appreciate perhaps seeing the basis of the calculation of the numbers that Mr. Read
13 identified, and then that will certainly assist me in understanding exactly what was done.

14 THE CHAIRMAN: If you want Mr. Myers to take that further I think he needs to be told clearly
15 what it is.

16 MR. READ: Sir, we will make sure that is done. In fact, we may even be able to supply him with
17 the calculations and see whether he agrees with them or not. That is only in respect of the
18 last point I have been asking about. I do not think there was anything else. The only other
19 point I put to him was whether or not there was any reference to DSAC and the 1997
20 Guidelines in the 2004 Leased Line Market Review. I said if he wanted to re-read that
21 document over the weekend to confirm that there was something that he wanted to rely on,
22 then that is fine. If it is, in fact, as I suspect it will be, accepted by Ofcom that there is no
23 specific point, in which he does not need to have to do it.

24 A The 2004 Leased Line Market Review does not use the specific phrase DSAC, but it does
25 use the evidence on DSAC in part of the assessment of excess pricing and profitability
26 when assessing BT's SMP in the trunk market. So DSAC was used in the 2004 Market
27 Review in the trunk market. It was referred to, I believe, as the SAC ceiling in that
28 document.

29 Q That was not obviously the point I was putting to the witness. It was a different point as to
30 whether there was any explicit reference to DSAC ceilings being the first order test of cost
31 orientation. I think the transcript will show. To be fair to Mr. Myers, it is absolutely right
32 that there is the reference, and we have all seen that in opening at annex B. I just wanted to
33 be sure that he was not referring to anything else. If it is accepted by Ofcom that that is the
34 position then he is released from his homework for the weekend.

1 THE CHAIRMAN: Yes, that would have been an onerous homework, and in any event I am not
2 sure how far it is necessarily right for a witness to have to trawl through documents when
3 references can be given to the court for the court to consider.

4 With that in mind, looking at para.17 of Mr. Myers' statement where he refers to DSAC as
5 being an alternative to implementation of full-blown combinatorial tests and knowingly and
6 appropriately a more stringent test, if that is a matter that is discussed in the history of these
7 matters it would be helpful to have references to that, but I am not asking Mr. Myers to do
8 it. That is something that I think Ofcom can do.

9 Unless there is anything else, we will resume at ten o'clock on Monday.

10 (Adjourned until 10 a.m. on Monday, 25th October 2010)

11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31