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IN THE COMPETITION
APPEAL TRIBUNAL

Case Nos. 1238/3/3/15

Victoria House,
Bloomsbury Place,
London WC1A 2EB

10 December 2015

Before:

ANDREW LENON QC
(Chairman)
WILLIAM ALLAN
PROFESSOR COLIN MAYER

(Sitting as a Tribunal in England and Wales)

BETWEEN:

BRITISH TELECOMMUNICATIONS PLC

Appellant

- and -

OFFICE OF COMMUNICATIONS

Respondent

- and -

SKY UK LIMITED
TALKTALK TELECOM GROUP PLC

Interveners

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HEARING - DAY TWO

APPEARANCES

Mr. Rhodri Thompson QC, Mr. Nicholas Gibson (instructed by BT Legal) appeared on behalf of the Appellant (British Telecommunications Plc).

Mr. Josh Holmes and Mr. Tristan Jones (instructed by Ofcom) appeared on behalf of the Respondent.

1
2 (10.30 am)

3 MR. THOMPSON: Good morning sir, today is BT's witnesses' day in the sun. I think we have
4 longer available but I think Mr. Holmes indicated he may be able to get through all four
5 witnesses today, so we will see how that goes.

6 In terms of batting order I was simply going to take them in the order as they appear in the
7 bundles, so Mr. Petter, then Mr. Tickel and Mr. Murray, followed by Mr. Bishop.

8 Before Mr. Petter comes up, there is one issue which I think is probably apparent from the
9 face of his statement and from some remarks I think I made at the CMC.

10 Given the prospective nature of this whole exercise, this is a highly sensitive commercial
11 issue for BT, and I think there are four categories of highly confidential issue. First of all,
12 anything that might relate to the BT share price; secondly, anything that might relate to BT's
13 bidding strategy for sports rights; thirdly, anything that might relate to BT's pricing strategy,
14 and fourthly, and in that relation, anything that relates to the question of how much
15 headroom there is under the current condition in terms of the margin.

16 All those four issues are potentially highly sensitive in what is a very aggressively
17 competitive retail market. I am hopeful, and I have spoken about this to Mr. Holmes, it
18 won't be necessary to duck in and out of confidential hearing, but I am not aware of who is
19 present in the Tribunal today and whether or not some or all of them are part of the
20 confidentiality ring, but I'm simply flagging it and I have said to Mr. Petter that he shouldn't
21 feel constrained if he feels concerned about anything from that perspective, and I hope that
22 is in order, that if necessary, we can make appropriate arrangements for a confidential part
23 of the hearing.

24 But I thought I should raise that at the start.

25 THE CHAIRMAN: Thank you, that is understood.

26 MR. THOMPSON: I am grateful. With that preamble, I call Mr. Petter.

27 MR. ALLAN: Can I just clarify, when you talk about pricing strategy, are you talking about the
28 details of that strategy or would that include the way in which pricing strategy is formed
29 within the group as a whole?

30 MR. THOMPSON: I would think I would leave that to Mr. Petter to explain, but I think it is
31 probably the more detailed questions; I think he is very well able to articulate his concerns
32 if they arise.

33 MR. ALLAN: Thank you.

34 MR. THOMPSON: If I can call Mr. Petter.

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MR. JOHN PETTER (affirmed)

Examination-in-chief by MR. THOMPSON

MR. THOMPSON: Good morning, Mr. Petter. You should have a bundle in front of you, which has a number of witness statements in it. If you could open it at tabs 1 and 2, and open in particular tab 1.

On the second page you can see the name; can you confirm that those details are correct in terms of who you are and the address from which you work?

A. That is correct.

Q. Can I take you to the end of the statement. Page 36. Is that your signature?

A. That is my signature.

Q. Have you had an opportunity read this statement recently?

A. Yes, I have.

Q. Can you confirm that this is your evidence in the matter?

A. I can confirm that.

Q. Are there any corrections you wish to make to it?

A. No, there are not.

MR. THOMPSON: I am grateful. Mr. Holmes has some questions for you and possibly the tribunal, so I will now sit down. Thank you very much.

Cross-examination by MR. HOLMES

MR. HOLMES: Good morning Mr. Petter, you are the Chief Executive of BT Consumer division.

A. Yes.

Q. That is the downstream division of BT group that supplies residential broadband services to consumers, among other things?

A. That's correct.

Q. For that purpose, you use the VULA product, GEA, to use the BT name for it, that is supplied by BT's Openreach division, the upstream access services division?

A. That's correct.

Q. Openreach and BT Consumer are separate trading units within BT Group but are not separate companies?

A. That's correct.

Q. You are a member of BT Group's operating committee?

A. That is right.

1 Q. BT Group has invested substantially in upgrading its network to fibre, in order to enable
2 superfast broadband services for consumers?
3 For the transcript you have to say "yes" --
4 A. That's right, yes, absolutely, yes.
5 Q. This is a significant strategic commitment?
6 A. Yes.
7 Q. It has involved enormous investment?
8 A. That is true.
9 Q. It was a decision that was made at board level --
10 A. Yes.
11 Q. -- involving billions of pounds and it has taken a number of years to realise?
12 A. That is right.
13 Q. BT Group took a decision to prioritise the sale of retail fibre broadband by BT Consumer in
14 the interests of recovering its investment?
15 A. That is right.
16 Q. And BT Consumer did this partly -- it prioritised the sale of retail fibre partly by marketing?
17 A. That is right.
18 Q. And partly by offering favourable pricing terms to consumers by comparison with its standard
19 broadband offer?
20 A. What do you mean by "favourable"?
21 Q. Terms that are attractive to consumers in terms of the differential between the standard
22 broadband and the superfast broadband price?
23 A. I slightly disagree with what you have said in that case, because it was always the attention
24 that the VULA product should be priced at a premium to standard broadband, and so what
25 we actually did at the time of the launch was to create a new sub-brand called BT Infinity
26 and to give it a different brand image and to market it quite differently to standard
27 broadband, in part to justify that premium.
28 Q. Understood, that is very helpful, thank you.
29 A. Yes.
30 Q. At the wholesale level, Openreach is motivated by the same strategic imperative to recover
31 investment in the fibre broadband network?
32 A. The incentives for the different operating divisions are to some degree separate, albeit they
33 come together at the group level, because the costs of the VULA product are charged to the
34 consumer P&L at the same price they are charged to other service providers, and the

1 operating divisions are separately reported to the City, and those costs figure in
2 the regulatory tests, so the Openreach prices figure in the context of the regulatory test that
3 the consumer division is subject to.

4 Q. But to repeat my question: Openreach is motivated by the same strategic imperative as BT
5 Consumer to prioritise the sale of fibre broadband services, albeit the wholesale products?

6 A. The incentives to some degree coincide but they are not exactly the same, because the big
7 investment is clearly made by Openreach. The consumer division has to maximise its
8 profits, and it is motivated through achieving sales to the maximum number of households.
9 But the particular product that is sold to consumer households for the consumer division is
10 less important than the profit that we make.

11 Q. But Openreach also seeks to maximise returns on BT's investment in upgrading the copper
12 access network to fibre by selling GEA, the wholesale fibre input?

13 A. They do.

14 Q. Thank you. Partly, BT Consumer has been engaged in upgrading existing customers from
15 standard broadband to superfast broadband?

16 A. That is correct.

17 Q. But partly also you have been winning new customers from other communications providers?

18 A. That is true. About half of our sales of fibre are sales from encouraging our existing
19 customers to migrate from copper to fibre. Therefore, the figures that were quoted in terms
20 of BT consumers' share of VULA is less representative of competition and more
21 representative of the migration strategies. BT Consumer has had a very proactive migration
22 strategy, going to existing standard broadband customers encouraging them to migrate.

23 Q. Sorry, just to return to the question. Was I correct in understanding that you said about half of
24 connections are upgrades of existing BT customers from standard to superfast broadband,
25 and about half are acquisitions of customers from other communications providers?

26 A. Historically it has been slightly -- it has been slightly more from existing customers and now it
27 is probably slightly less than half from existing customers.

28 Q. So the trend has been towards acquiring more consumers from competing communications
29 providers and away from upgrading your existing stock of customers?

30 A. No, that is not really true, actually. The numbers change from quarter to quarter, so
31 sometimes you would see more migrations from existing customers, sometimes there will
32 be a greater proportion from new customers. If there is a trend there, it would be a very
33 gradual one, because the proportions are still fairly evenly matched, actually.

34 Q. Fairly evenly matched. Very good. Just looking at paragraph 20 of your statement, which is

1 at tab 1 of the bundle that you should have in front of you, have I correctly understood that
2 the evidence here is that those proportions that are shown in the confidential red boxes are
3 the upgraded customers, and that the balance, the other part of the percentage, are those that
4 were acquired from other communication providers?

5 A. Yes, that is true. But I think just to set this in context, I think to really understand this you
6 have to look at the total share of the broadband net additions, the broadband market growth
7 in a quarter, and the counterpoint to the fact that quite a high proportion of our customers
8 going on to VULA are from our copper customer base is that our copper customer base has
9 been shrinking over this time actually, so in the last quarter, our copper customer base
10 shrunk by [Confidential] net additions. The net of all this has to be the success of the total
11 broadband business both copper and fibre.

12 And there are two points that I would like to make on this. The first is that the big winner
13 over the five years that the VULA product has been in existence in terms of broadband
14 market growth has not been BT; it has actually been Sky. Sky has grown their broadband
15 base roughly 50 per cent faster than BT. In the last quarter, so this is quarter 2, Sky's
16 broadband net additions as reported were 133,000, and those for BT are 82,000. So to truly
17 understand the competitive dynamic, you have to look at the combination of the two.

18 Q. So just to put the point that you were just making in graphical form, if you could turn to tab 12
19 of this bundle, page 15. This is the witness statement of Mr. Matthew. Are you
20 familiar -- have you seen this document?

21 A. Yes, I have.

22 Q. If you could turn to page 15. This shows -- ah, I see you are faced with a black box.
23 Unfortunately, you have a non-confidential version.

24 A. Yes.

25 Q. It has been explained to me that some of those retail shares are ones that you are not entitled to
26 see, but in terms of -- yes, I think it would be difficult to make this point without revealing
27 confidential material, so I shall move on.

28 Turning to regulation of BT, BT is subject to various regulatory requirements besides the
29 VULA margin condition.

30 A. That is right.

31 Q. There are, among other things, the BT undertakings?

32 A. Yes.

33 Q. These were given in 2005 to address competition concerns that Ofcom had at the time?

34 A. Yes.

1 Q. Specifically, Ofcom was concerned that BT had the ability and incentive to discriminate
2 against its downstream competitors by supplying inferior wholesale products or by delaying
3 wholesale product development and improvement?

4 A. That is right.

5 Q. So just looking for a moment at the quotation from Ofcom given at paragraph 22 of your
6 statement, you quote this paragraph, that Ofcom's notice under section 155(1) of the
7 Enterprise Act contains a description of the purpose and effect of the undertaking. You set
8 that out and at the end there is a reference to the undertakings constraining BT's ability and
9 removing its incentives, the incentives of its component divisions, to engage in the types of
10 conduct identified, which have the effect of restricting competition.

11 We can look at what types of conduct Ofcom had in mind if that would be helpful, but
12 I understand from your previous answer that you accept that when this refers to the
13 effectiveness of the undertakings in constraining BT's ability and removing its incentives to
14 engage in particular conduct, it is referring there to discrimination in the provision of
15 wholesale inputs?

16 A. Can I just read the quote again?

17 Q. Yes, of course. Take your time. (Pause)

18 A. Yes, discrimination, that is a fair characterisation.

19 MR. THOMPSON: Sir, I think it might be fair -- because he appears to be referring to types of
20 competition but doesn't actually say what types they are from the quotation.

21 MR. HOLMES: I am very happy to take the witness -- I had understood that the witness was
22 familiar with the concerns that were expressed in the 2005 document, but if you think it
23 would assist, shall we perhaps open that document?

24 I think it is in hearing bundle IV. This was one of the soft copy BT documents, which is
25 why it's not included in any of the original bundles. At tab 2. Do you have that?

26 A. Not yet.

27 Q. Sorry. Take your time.

28 A. Yes.

29 Q. So as you confirmed in your previous answer, you can see in the final sentence of
30 paragraph 1.4 on page 2 of the document in the executive summary that:

31 "Ofcom believes that the combination of upstream market power and vertical
32 integration provides BT with both the ability and the incentive to discriminate
33 against its downstream competitors who are also its wholesale customers."

34 That, I think, was the basis for your agreement that the concern being addressed was

1 discriminatory practice; is that correct?

2 MR. THOMPSON: I don't want to keep hopping up and down, but I think it would be fair to find
3 where the quote is that you are dealing with.

4 MR. HOLMES: I am so sorry. Do you see the passage I was referring to?

5 A. I have found the quote.

6 Q. It is in paragraph 1.4, if the note wasn't clear, the final sentence at the foot of page 2 of the
7 document.

8 MR. THOMPSON: The quote in the statement.

9 MR. HOLMES: The quotation --

10 MR. THOMPSON: In Mr. Petter's statement.

11 MR. HOLMES: -- in the notice. I was referring to his previous answer to the question I put about
12 the quotation that he has included at paragraph 22 of his witness statement.

13 MR. THOMPSON: I may be misunderstanding. I was saying the context for the statement which
14 appears in quotations, but I'm not sure whether you have given him that reference?

15 MR. HOLMES: I am so sorry, you want me to show you where in the notice this quotation
16 appears?

17 MR. THOMPSON: Yes.

18 THE CHAIRMAN: Yes.

19 MR. THOMPSON: I was thinking, both for the Tribunal and for Mr. Petter, it would be helpful
20 to have the context for that statement.

21 MR. HOLMES: I understand, yes. Let me return to you on that. We will come back to that in
22 a moment.

23 A. I should like to correct something that I said previously to the panel if I may, actually, and that
24 is to your point around as to whether there is a trend for the proportion of fibre customers
25 and those additions, the trend over time more towards new customers and away from
26 existing customers. I would like to correct myself that in fact there is a trend in that
27 direction. It is not a very pronounced trend, it is really quite a modest difference, but there
28 is a trend so I would like to correct that answer if I may.

29 Q. That was helpful. But while you were giving that clarification I think I have found the answer
30 that Mr. Thompson was asking me to give.

31 If you could turn to paragraph 5.17 in the document that is in front of you, there is no
32 reference given in the witness statement, but I believe the passage that you were quoting is
33 the one at 5.17 of this document:

34 "The purpose and effect of the undertakings ..."

1 A. Right. Could you repeat the question, please. I'm not quite sure what I am being asked.
2 Q. I was showing you the context --
3 A. Yes.
4 Q. Where the quotation which appears in your witness statement is to be found in this document,
5 because BT's counsel was concerned that you should see that.
6 A. Thank you.
7 Q. Returning to paragraph 1.4 in the executive summary, my question was, it is correct, isn't it, as
8 is clear from paragraph 1.4, that the concern that Ofcom regarded the undertakings as
9 addressing in the quoted passage in your statement relates to discrimination, as you have
10 already agreed, and that is clear from the final sentence which appears in paragraph 1.4 in
11 the executive summary?
12 A. I think it is reasonable to infer what you have said, because the penultimate paragraph does
13 refer to discrimination, and then the last paragraph talks about a suspicion that BT may have
14 been involved in conduct that had the effect of restricting competition.
15 Q. Yes.
16 A. I am not a regulatory expert --
17 Q. No I understand --
18 A. I certainly didn't play any kind of role in the formulation of the undertakings in 2005, so I am
19 taking this at face value.
20 Q. Understood, yes. For the Tribunal's reference, section 4 of this document sets out the various
21 features of the market and the types of conduct, the discriminatory behaviour which it was
22 considered that BT had the incentives to engage in. Reluctance to supply any wholesale
23 product on page 12, supply of an inferior wholesale product, on page 30 resultant delays in
24 introducing new products and resolving problems, and over the page, response to supply of
25 upstream products deters investment by competitors.
26 So the concern, I think you would agree, based on that, but with the caveat that you have
27 given, that the quotation that you have given at paragraph 22 of your statement concerns
28 Ofcom's confidence that the undertakings addressed a concern about discrimination?
29 A. That sounds correct.
30 Q. Thank you.
31 Margin squeeze is to do with the retail margin, the difference between the price of the
32 wholesale input and the retail price of the finished product, and not with discrimination in
33 the provision of wholesale inputs; that is correct, isn't it?
34 MR. THOMPSON: Sir, I must object to that. Mr. Holmes himself took you to a document

1 yesterday and it is not really a matter for Mr. Petter to opine on matters of competition law.

2 THE CHAIRMAN: Mr. Holmes, what do you say?

3 MR. HOLMES: I am happy to move on -- if it is a matter for submission, I am happy to deal with
4 it in that way.

5 Obligations. In paragraph 23 you refer to obligations not to discriminate and to offer
6 wholesale inputs on an equivalent basis as features of the undertakings?

7 A. That's correct.

8 Q. At paragraph 24, you refer to the financial reporting requirements on Openreach and those are
9 included at their published equivalence of inputs prices; do you see that?

10 A. I am just reading it.

11 Q. Yes. These are your words.

12 A. Yes, it covers several topics, but the point that paragraph 24 is making is that the published
13 EOI prices from Openreach are the same prices that appear in financial reporting and the
14 regulatory tests as well.

15 If I might qualify one point though that you said around the undertakings and margin
16 squeeze, one of the principles of the undertakings is that BT employees, especially BT
17 employees like me that are annexed to and entitled to be privy to Openreach commercial
18 information, is that there is an obligation on us to uphold the intention of the undertakings
19 to promote competition. That is a sort of key factor I am certainly very mindful of.

20 Q. We will come to that in a moment if we may, but sticking for a moment with the financial
21 reporting requirements that you refer to at the bottom of page 7 and over to page 8, your
22 point here is that these would show any discrimination at the wholesale level; is that right?

23 A. No, that is not quite the point I am making. The point I'm making is that were I to constrain
24 my retail margin, then I would still be subject to the same Openreach costs.

25 Q. Yes.

26 A. And the reported numbers that the consumer division reports to the City would be severely
27 impacted. And just to put some perspective around that, one of the key points around
28 incentives to operate on someone like me is the way the City looks at the profits as reported
29 from the different parts of BT Group. So the analysts usually comprise the valuation of the
30 BT share price based on a thing called a sum of the parts valuation; they take the
31 profitability of the different components of BT Group and attach different multiples to those
32 profits, and so one key point therefore is that the City attaches a much higher multiple to the
33 profits from BT Consumer than it does to the profits from Openreach, so the difference
34 between those multiples are they attach a 12-times multiple to the profits of BT Consumer

1 and a 7-times multiple to the profits of Openreach, and they do that as a basis for predicting
2 future profitability. And the implicit assumption that the analysts have is that profits in
3 Openreach get regulated away over time, effectively. The net of this is that were we to
4 undertake a strategy which effectively transferred profitability from BT Consumer to
5 Openreach, we would have a negative impact on the share price.

6 To put some numbers behind that, if we transferred £500 million of profit from BT
7 Consumer to Openreach, that would knock 5 per cent off our share price and therefore, the
8 fact that these numbers are reported separately and the City attaches such importance to
9 them negates the comments that have been made in some of the witness statements that
10 these charges from Openreach are, I think the phrase that's used is they're "wooden dollars".
11 They are not wooden dollars; this is very meaningful for the share price and for the
12 performance of BT Group as a whole.

13 Q. But to be clear, there is no separate share price for BT Consumer, is there? There is a share
14 price for BT Group?

15 A. There is a share price for BT Group --

16 Q. You can't buy shares in BT Consumer?

17 A. No, but the share price for BT Group is very dependent on the performance of BT Consumer
18 because of its higher multiple, and because also the City is very mindful of the fact that
19 the growth and the revenue growth for BT Group has been from BT Consumer in recent
20 times, and certainly, the future expectations for BT Consumer that the City have in their
21 models are that BT Consumer continues to grow both its volumes of fibre broadband and
22 also and especially its profitability.

23 MR. ALLAN: Sorry, Mr. Petter, could you just repeat the number you gave in your example of
24 share price impact? You said there would be a 5 per cent hit to the share price from what
25 scope --

26 A. £500 million.

27 MR. ALLAN: £500 million, thank you.

28 A. Just to put that figure in perspective, that is a big number, but then the cost of VULA in my
29 P&L at the moment is a rental cost of £348 million per year currently, and a further
30 £76 million on the migration charges and installation charges for installing customers. So
31 in total, therefore, about £350 million.

32 MR. HOLMES: To return to paragraph 24, I will come in a moment to your point about the other
33 retail cost items that are shown in the BT Consumer accounts, but the published EOI prices,
34 your point about the published EOI prices is that they would make it obvious whether there

1 was any difference in the treatment of BT and other providers; is that right? Otherwise,
2 why is it relevant that the published EOI prices would be broken out? Those are the
3 wholesale prices.

4 A. The point around EOI prices is that, yes, because those prices are the same prices it would be
5 obvious to the market were there to be a situation of the sort that you were describing.

6 Q. Yes.

7 A. I would say though that under the previous FRAND condition, and again, I'm not a regulatory
8 expert, but there was an obligation under that condition for BT to maintain models on the
9 profitability for VULA sales, and therefore that information -- and that has been available to
10 Ofcom anyway, in fact, actually. So they have that means to see it as well.

11 Q. Yes. The retail costs involve complex questions of allocation across different product lines?

12 A. I'm not sure I understand the question. Can you elaborate, please?

13 Q. So there are retail costs to BT Consumer in supplying various products at the retail level.

14 A. Yes.

15 Q. Some of those costs will be common costs and some of them will be specific to particular
16 product lines.

17 A. Do you mean common costs between BT Consumer and other parts of BT Group?

18 Q. No, just retail costs within BT Consumer.

19 A. Then that is true.

20 Q. And you would need to allocate those costs in some way?

21 A. You would.

22 Q. In determining, for example, whether a margin was sufficient to cover the retail costs of
23 particular products?

24 A. Yes, that is reasonable to infer.

25 Q. Ofcom and BT disagree in the proceedings before the Competition and Markets Authority
26 about what would be appropriate terms for determining whether or not a retail price is
27 sufficient.

28 A. I'm not sure what your question is, sorry.

29 Q. My question is that in the proceedings that -- are you familiar with the proceedings that are
30 currently underway before the Competition and Markets Authority in this appeal?

31 A. Yes, that is the second stage of this, yes; I am, yes.

32 Q. It is concurrently proceeding, it's happening now.

33 A. Yes, absolutely, I knew that.

34 Q. There is a disagreement between BT and Ofcom about how to determine the retail margin.

1 A. Yes.

2 Q. Yes. TalkTalk group complained about BT's margins in, I think it is 2013; that is correct,
3 isn't it?

4 A. Yes, I thought it was 2014, but they did complain.

5 Q. I apologise, 2014.

6 A. But they did complain anyway, yes.

7 Q. And they did so on the basis that they thought that BT's retail costs were not -- sorry, that its
8 retail margin was not sufficient to cover its retail costs?

9 A. I think that was the basis of the allegation.

10 Q. Yes. They had access to these financial reports that are published pursuant to regulatory
11 obligations.

12 A. They would have had access to market information on BT Consumer's profitability, but they
13 wouldn't have had the same access that Ofcom would have had to the models that the
14 FRAND conditions obliged us to maintain.

15 Q. No, indeed, but the financial reporting that you are referring to is published financial reporting
16 pursuant to the general obligations upon companies, public limited companies, to report
17 their performance to the City?

18 A. Yes.

19 Q. Yes, and those were available to TalkTalk?

20 A. Yes.

21 Q. They nonetheless concluded that there was -- and they would know the equivalence of inputs
22 prices?

23 A. They would.

24 Q. And they still thought that there was a margin squeeze at the retail level?

25 A. I don't recall all of the details of the TalkTalk case, but I do recall there were some very
26 wide-eyed accusations and some extremely fanciful calculations in the TalkTalk work, and
27 I can remember that when we looked at it, we were very clear very quickly that it was
28 completely without basis and that was indeed what Ofcom found, in fact, actually.

29 Q. After 18 months.

30 A. I can't remember how long it took them to make that finding, but clearly they had to do
31 an exhaustive investigation, but --

32 Q. Careful consideration of the retail margins.

33 A. I'm sure Ofcom would have been careful.

34 Q. Thank you. The other aspect of the undertakings to which you refer is the organisational and

1 governance measures to ensure that Openreach treats all communications providers
2 equivalently and that there is sufficient transparency to ensure and validate that it's doing so.

3 Is that right?

4 A. That is right.

5 Q. You refer to the requirement of the undertakings which prevent BT's employees outside
6 Openreach from directly or indirectly participating in or influencing Openreach's
7 commercial policy?

8 A. Could you give me the paragraph reference there, but yes, I would have referred to --

9 Q. Paragraph 39.

10 A. Paragraph 39, thank you.

11 Q. Sorry, forgive me, I was looking at the wrong statement, forgive me. (Pause).

12 So the correct reference is paragraph 23.1 where you refer to the functional separation
13 between Openreach and the other BT divisions required under the BT undertakings.

14 A. Right.

15 Q. You referred a moment ago, I think, in your oral evidence to the fact that there are certain
16 individuals within BT Group that can exercise -- can participate in and influence the
17 formation of strategy by Openreach. That is correct, isn't it?

18 A. There is a very narrowly defined group of people for whom that is true.

19 Q. Shall we just look at that list. So this is to be found in the undertakings, which are in
20 volume 3, part 1 of the hearing bundle. Do you have the reference? It's volume III, part 1,
21 tab 5.

22 A. Can you give me the page reference?

23 Q. Yes, of course. So within that document, if you could turn to page 19. You see the heading
24 "Access Services" under point 5? Access Services is the division now known as
25 Openreach, isn't it?

26 A. That is right.

27 Q. If you turn on to paragraph 5.38, there is a requirement there:

28 "Save as set out in section 5.41 that no employee or agent of BT who is not
29 working for access services [that's Openreach] shall either ..."

30 First of all:

31 "... directly or indirectly participate in the formulation of or making of or
32 influence or attempt to influence the commercial policy of access services
33 except through such mechanisms and processes that are also available to other
34 communications providers."

1 Do you see that?

2 A. Yes.

3 Q. That is the core of the functional separation requirement to which you were referring, the
4 protection of Openreach against influence from outside; is that right?

5 A. That is right.

6 Q. Paragraph 5.41 is over the page at page 29; do you see that?

7 A. Yes, I do.

8 Q. And 5.41.1 states that the section that we were just referring to doesn't apply to the relevant
9 individuals:

10 "... the nominated individuals ... and individuals occupying the roles and
11 functional areas ... listed in Part A of Annex 2."

12 That annex 2 is the annex to which you are referring?

13 A. Yes.

14 Q. If you turn to annex 2, that is at page 77, there is a list of the categories. So part A is the
15 relevant one for the purposes of policy?

16 A. Yes.

17 Q. There is any member of the board of directors of BT Group plc; any member of a committee
18 of the board of BT Group plc, including the BT Group Operating Committee.
19 You are a member of that committee?

20 A. That's correct.

21 Q. There is also a reference to Group Strategy. Group Strategy's role is to help maximise
22 BT Group's long-term value for shareholders, isn't it?

23 A. That's correct.

24 Q. And this involves ensuring that BT Group as a whole can sustain the competitiveness on all its
25 markets?

26 A. Yes.

27 Q. It requires the Group Strategy department to take a longer view of how markets are
28 developing and how resources are to be devoted to safeguarding BT Group's future?

29 A. I don't think it is fair to say that Group Strategy are only concerned with a long-term view --

30 Q. But they are required to take such a view, do you accept that?

31 A. They would take strategic view of the business --

32 Q. Over the longer run?

33 A. Well, it would include the longer run, but --

34 Q. Yes, I should say that the quotation --

1 A. It's an overview of the business.

2 Q. -- was a description of Group Strategy which appears on the BT website. I can provide you
3 with a copy if you like?

4 A. Okay.

5 Q. There is also, going back to the list, a reference to the Group Commercial Policy Forum. Is
6 that still in existence?

7 A. I must say I haven't heard of the Group Commercial Policy Forum, so I don't know.

8 Q. No, nor do I, that's why I was curious to know if it was something that is still featured. But
9 nonetheless we have a group then which consists of Group Strategy, members of the
10 BT Group board and members of the Operating Committee and various other categories that
11 are unclear in their scope.

12 A. I'm not sure what the question is you are asking me there. Unclear in their scope? What do
13 you mean?

14 Q. We don't know whether the Group Commercial Policy Forum now exists or what its
15 membership is?

16 A. I'm sure someone knows, but I don't.

17 Q. Understood. So, all of these people are able to influence and participate in formation of
18 strategy by Openreach of the undertakings?

19 A. They are, but it is subject to some constraints and if I may -- and this is not a document that
20 I am overly familiar with but I did notice that on page 69, paragraph 20.9, it does lay out
21 actually in that paragraph very clearly the restriction that applies to those annex 2
22 employees. It is perhaps worth reading that, because --

23 Q. Shall we turn it up; it's at page 69 as you say.

24 A. Yes, it makes very clear that those employees shouldn't abuse their positions to circumvent the
25 intention of the undertakings, and this is certainly very clear to anyone at annex 2.
26 I think secondly --

27 Q. May I just ask you --

28 A. Yes.

29 Q. -- before you carry on, where is the intention of the undertakings set out?

30 A. Again, I'm not a regulatory expert so I don't feel I am the right person to really answer that,
31 but --

32 Q. But you are a member of this group that is able to implement strategy and you are saying that
33 20.9 protects against the risk of your exercising -- limits the strategies that you are able to
34 influence; is that right?

1 A. Can I answer your question?

2 Q. Of course.

3 A. Because I think you talked to me about the intention of the undertakings and made the point to

4 me they are about discrimination. But kind of more broadly and from my memory of

5 the undertakings, their intention is to ensure the promotion of competition or the

6 maintenance of competition. I can't give you a page or paragraph reference for that, but that

7 is very widely understood by everyone in BT actually.

8 Q. Very good. So in that connection, two further points. What do you understand commercial

9 policy to mean?

10 A. It can mean a variety of things --

11 Q. In terms of the limitations on your conduct, for the purposes of the undertakings?

12 A. The limitations of our conduct, I take that to mean that we could not do anything whose

13 intention was to limit competition in the downstream markets.

14 Q. Just sticking with commercial policy, what do you understand commercial policy to mean for

15 the purposes of what can and cannot be done in influencing Openreach's policy?

16 A. I don't have a legal or regulatory definition to that --

17 Q. They use a defined term, which I should perhaps show you. It's at page 5 of this document,

18 pages 4 and 5.

19 A. Okay.

20 Q. You will see there commercial policy means:

21 "... policies and plans in relation to SMP products or in the case of section 8.6

22 relating to products and services described in section 6.1.12 and which relate to

23 any of the following in relation thereto ..."

24 Broad list, pricing, and product development and so on. But then:

25 "For the avoidance of doubt ..."

26 At the bottom there is a clarification that:

27 "... this excludes commercial policy of general application across BT which it is

28 appropriate to set centrally."

29 Do you see that?

30 A. I do see that, yes.

31 Q. And there is in this case a group perspective which you identify in your statement to maximise

32 the uptake of superfast broadband by BT Consumer? That is correct, isn't it?

33 A. No, that is not what I said earlier. I said the incentives for Openreach are to maximise the

34 performance of their investment in superfast broadband and to maximise the uptake on it --

1 Q. I was talking about --

2 A. I will just finish if I may.

3 Q. I apologise.

4 A. And the incentives on the consumer are to maximise the profits of the consumer division.

5 Q. Can we --

6 A. That was what I said.

7 Q. Can we go to your statement, which is at tab 1, paragraph 18:

8 "BT therefore concluded that taking a group perspective, its retail operations
9 should prioritise the sale of retail fibre broadband in order to make its enormous
10 investment commercially viable."

11 Do you see that?

12 A. I do see that.

13 Q. Paragraph 18.

14 A. Yes.

15 Q. So Group there was setting a commercial policy in relation to BT Consumer's activities?

16 A. Yes.

17 Q. Because of a commercial policy of general application across BT, which it is appropriate to
18 set centrally?

19 A. Yes, but I would like to qualify my answer, because at the time of my role in the consumer
20 division at this time, I was the managing director for the consumer division and I was
21 responsible for pricing and product decisions, and for business cases.

22 And the comment that is around taking a group perspective, I think what that means in this
23 context is that I was happy to absorb the costs of being the first mover, which other service
24 providers would probably have haggled and gone back to Openreach to argue about in the
25 group interests.

26 So, for example, when superfast broadband was launched there were all sorts of process
27 issues from a customer experience point of view that my team put a huge amount of time
28 and effort and money and resources into working through with Openreach, and I was happy
29 to take that group approach and go -- similarly, I was happy to spend sums of money
30 marketing superfast broadband, although the availability of it was quite small initially,
31 geographically.

32 However, and this I think is the key point, the expectation on me as the managing director
33 of the consumer division, the expectation was very much that this had to be profitable at
34 a BT Consumer level, and therefore I had to charge this at a premium to my customers, and

1 hence I formulated this new brand, BT Infinity and I created a premium pricing strategy for
2 it and sought to differentiate it from competitor offerings, standard broadband offerings, and
3 the business case comprised the premium pricing and the benefits of customers being
4 happier, and choosing to stay with us longer, and choosing to buy more products too.
5 These benefits you very much see still in our business today. So the superfast broadband
6 customers pay us on average £[Confidential] a month more than standard broadband
7 customers, and their average customer life is [Confidential] years longer than standard
8 broadband customers, and taken together -- and these mean that the migration of customers
9 from standard broadband to superfast broadband is a very profitable activity for us. That
10 was true. That was part of initial business case and that still true today.

11 MR. THOMPSON: There is some concern being expressed behind me that some of that material
12 is confidential, but perhaps we can address that at the end of Mr. Petter's ... I don't know
13 who is present in the Tribunal and whether that is of concern but there is some nodding
14 behind me that some of that material is confidential. I don't know if Mr. Petter himself is
15 worried about it.

16 THE CHAIRMAN: Presumably you are aware of which parts of your evidence are confidential,
17 Mr. Petter, and you will ...

18 A. Yes.

19 THE CHAIRMAN: You will bear in mind the need to maintain confidentiality.

20 A. I think my competitors could infer that fibre is a profitable investment for me. I probably
21 shouldn't have been so specific so as to give them the numbers, I wish I hadn't, but I --

22 MR. THOMPSON: I didn't want to curb Mr. Petter's eloquence, but sometimes he may not be
23 aware entirely that this is, as it were, speaking to the world.

24 MR. HOLMES: If Mr. Petter is content to continue in open ... if that point ...

25 MR. THOMPSON: It is being put to me that we actually don't know who in the room is actually
26 in the confidentiality ring, sitting here. So I don't know whether in fact, apart from the court
27 staff, there is any issue to be concerned about.

28 THE CHAIRMAN: I wouldn't assume everyone within the courtroom is within the
29 confidentiality ring.

30 MR. THOMPSON: Indeed. I agree. That is the reason why I rise. It doesn't sound like it is of
31 concern to Mr. Petter so I am only putting it out as a reminder perhaps to him as much as to
32 anyone else.

33 MR. HOLMES: Shall we see how we go?

34 Returning to the intent of the undertakings, you are aware that BT is required to publish

1 a Code of Practice and to give it to the individuals who are within the annex?

2 A. Yes.

3 Q. You are familiar with that Code of Practice?

4 A. Yes, I wouldn't know it as a Code of Practice. There is a training module that we have to do
5 each year to refresh our memory, so yes.

6 Q. So that you see the reference, at page 53 of the -- do you still have the undertakings to hand?

7 A. I will get them back.

8 Q. If you turn to page 53, you will see that BT is required to draw up and publish on relevant BT
9 websites a Code of Practice to be made available to all BT employees which sets out how
10 BT employees must act to ensure compliance with these undertakings, and then the
11 Code of Practice is specifically required to include guidance for BT employees in the
12 following areas, and then at (e):

13 "Those BT nominated individuals (if any) and individuals occupying roles and
14 functional areas listed annex 2 distinguishing between parts A and B."

15 So that is the annex that you referred me to and that we looked at earlier?

16 A. Yes.

17 Q. So one might expect to see, if there was a widespread understanding in BT as to the limits of
18 commercial policy based on the intent of the undertakings, a clear statement of that in the
19 Code of Practice?

20 A. I really don't feel I am the right person to answer questions on what you should and shouldn't
21 expect to see in documents concerned with the regulation effects on the business. I am not
22 a regulatory expert --

23 Q. Indeed, but you are an individual who is required to comply with the undertakings and you are
24 referring to the limits on your behaviour resulting from 20.9.

25 A. That is true, but that is quite a different point.

26 Q. If you are not familiar with the Code of Practice I won't take this further with you and we can
27 discuss it later --

28 A. I'm just not sure what the question is you are asking me.

29 MR. THOMPSON: Sir, I don't know whether, given the practice of having a short
30 break -- I don't know the answer about the Code of Practice but I suspect there are people in
31 the room who may know more about it than Mr. Petter does, so I may be able to assist the
32 Tribunal and it may be a convenient time for a break in any event.

33 THE CHAIRMAN: Indeed. Five minutes.

34 (11.35 am)

1 (A short break)

2 (11.45 am)

3 MR. HOLMES: You refer also at paragraph 32 of your statement to the constraints on BT's
4 conduct arising by reason of ex post competition law. That is right, isn't it? Do you see
5 that?

6 A. Yes.

7 Q. You note at paragraph 36 that:

8 "Sky's market power in wholesale pay-TV markets has been the subject of
9 competition investigations stretching back more than 20 years ago..."

10 That is right isn't it?

11 A. I don't recall a reference to 20 years but I certainly remember it is a long time.

12 Q. It's in the third sentence of your paragraph 36.

13 A. Right.

14 Q. Do you see that?

15 A. I do see that.

16 Q. You don't suggest, do you, that those interventions have been sufficient to address the
17 problems that you identify at the pay-TV level in Sky's provision of pay-TV services?

18 A. It's true to say I still believe there are competition problems in pay-TV. This was Ofcom's
19 conclusion itself in its recent finding on wholesale must-offer and in fact, the figures are
20 very sort of pronounced. Sky's market share of pay-TV revenues is, I think from memory,
21 around 70 per cent, and they are by far the biggest player in this sector, yes.

22 Q. And you regard regulation of Sky as limited and ineffective?

23 A. The regulatory obligations to which Sky are subject, there are very few of them. Most
24 recently the wholesale must-offer regulations to which they were subject have just recently
25 been removed so now they are subject to, to my knowledge, almost no competition
26 constraints whatsoever.

27 Q. And the WMO obligation that was removed, it was a retail minus obligation,
28 limiting -- protecting against margin squeeze; is that correct?

29 A. There was an element of pricing associated with it and that is correct, but it went further, and
30 it mandated that they had to supply a very limited set of channels, Sky Sports 1 and 2, and
31 there was no obligation to supply Sky Sports 3, Sky Sports 4, Sky Sports 5, Sky Sports
32 Formula 1, Sky Sports News, Sky News, Sky 1, Sky Arts, Sky Living.

33 Q. That is helpful, but there was a wholesale obligation of supply, or to offer, equivalent to the
34 supply of VULA which is imposed by regulation on BT?

1 A. I certainly wouldn't describe it as equivalent.

2 Q. But in each case there was a requirement to offer a particular service at the wholesale level?

3 A. There was a requirement.

4 Q. Yes. And that was then subject to retail minus price control? If you are not familiar -- by all

5 means, tell me if you are uncomfortable with the question.

6 A. I am familiar with it, but -- albeit not with a low level of detail, but saying it is retail minus is

7 a topic of controversy, in fact, because the formulation of the retail minus calculation I think

8 was a matter with which we disagreed, because from memory, it didn't impose meaningful

9 constraints on Sky, because on a reactive basis, they were still able to discount the channels

10 to their own customers down to effectively giving them away for free, and again from

11 memory, that wasn't sort of part of the retail minus calculation that was solely based on their

12 headline prices. Plus also Sky barely sells such a limited set of channels as Sky Sports 1

13 and 2; they sell bundles of the whole proposition, and therefore a retail minus formulation

14 just related to two of those channels is basically meaningless.

15 Q. You have to look at the bundles being supplied at the retail level.

16 A. Yes.

17 Q. You note in your evidence that BT Consumer seeks to trade profitably?

18 A. Yes.

19 Q. Your concern is therefore that the VULA margin condition may constrain BT's pricing more

20 than is necessary for it to be profitable? BT Consumer's pricing more than is necessary for

21 it to be profitable?

22 A. Yes, that is right, and specifically that it could make it difficult for us to make the correct

23 investment decisions.

24 If I might give some context to this comment, that the abiding trend in the marketplace is

25 for consumers to buy more of their services from a single supplier and the fastest growing

26 segment of the market is triple play. Sky has got deep advantages as the biggest pay-TV

27 player, given that they have got a 70 per cent or so market share, and for BT to compete

28 in that marketplace, it is necessary for us to make investments in content rights, and these

29 content rights in themselves can be very expensive.

30 So to illustrate that point, Sky recently, in the February 2015 Premier League auction,

31 increased the sum that they were paying for Premier League football rights from -- these are

32 market figures, I think they are known -- from about £750 million per year to

33 £1.4 billion approximately per year. So these are very significant sums that have got long

34 paybacks associated with them.

1 Sky has a huge in-built advantage, that it can monetise these rights across its large customer
2 base. There is a sense of contingent value, because consumers typically buy a package of
3 rights and if you are coming into the market as a new entrant, then if you bid for a set of
4 rights, you might get a set of rights that are in themselves worth something to you, but they
5 are worth much more if you are then successful in subsequent auctions in winning further
6 rights, but you have no certainty that you will win further rights, and in fact, the rights are
7 perishable too.

8 So -- and the typical duration of a set of rights might be three years typically, so it is very
9 hard to co-ordinate this as a new entrant such that you get that full set of contingent rights
10 that forms the basis for a strong package for consumers, and because during that time it is
11 very possible that you might lose some of the rights and an incomer might win them.

12 Therefore there are a number of obstacles and finally, quite a few of the rights owners
13 prefer to deal with someone that has scale, that they have a track record of dealing with, so
14 we found as a barrier to entry that we typically had to pay a premium to get some of the
15 players even to talk to us, and even then, some of the big sports rights holders basically
16 didn't hold auctions but just renewed their rights straight away with Sky.

17 So we have a number of barriers getting into this sector, and the costs involved are very
18 significant and there is a fair amount of risk involved for BT in getting into these sports
19 right to be competitive in pay-TV that is necessary for triple play.

20 The concern about the test is that it constrains me from making investment decisions that
21 are sensible and rational, by forcing me in fact to think about the short-term, because the
22 construct of the test applies to a particular month. That creates a difficulty for me, because
23 in a particular month after I have taken on board some costs for a new set of sports rights,
24 let's say, I have uncertainty and I certainly have a timelag as to how fast I can get consumers
25 to pay me for those extra rights, and that creates a jeopardy.

26 Furthermore, if I find myself in the position of coming in danger of failing the test and
27 economically the rational thing for me to do would be to cut my prices so as to get greater
28 scale so perhaps at some stage in the future I could then subsequently increase my prices,
29 but the test as it is constructed forces me to operate for the short-term. And to cover the
30 VULA margin in a particular month, I would have to increase my prices, even though that
31 wouldn't be the profit-maximising thing for me to do across a reasonable time period.

32 Q. So in a nutshell, the point you are making here is that BT Consumer may be required by the
33 design of the margin condition to take short-term decisions rather than taking long-term
34 commercially rational decisions about its pricing?

1 A. That is a concern. And I think there is a bit of a concern personally just in terms of the effect
2 of a lack of competition in pay-TV on the market, and just how asymmetric the regulation
3 is, because on the one hand the VULA condition applies to me and I am constrained on the
4 investments I can make in pay-TV, but the counterpoint is that Sky, although they are
5 dominant in pay-TV, and specifically pay sport, are not subject to regulation in the same
6 way.

7 So how this plays out in the marketplace, and this is what has happened most recently
8 during the course of this summer, is that Sky are able to give away VULA, to give away
9 fibre broadband free for twelve months to their customer base. And for me, that would be,
10 well, not a profitable thing to do, but they are clearly not in any way constrained from doing
11 those sorts of commercial tactics.

12 Q. Understood. And the short-term point is the one you make at paragraph 100 of your
13 statement. It encapsulates it neatly. The one-month snapshot point that I think you were
14 making?

15 A. Yes. There is another point too, in terms of the test introducing an element of uncertainty as
16 well, because most recently, in relation to the Champions League football rights -- so this is
17 a set of rights that BT won in November 2013, so before the condition had been introduced,
18 and the issue I faced there was that those rights cost about £299 million.

19 The cost applies from day one, so from 1st August in this case, but the revenues then come
20 subsequently.

21 There was a discussion with Ofcom, and this played out in the correspondence that is in the
22 court bundle, as to whether this constituted a sufficient change in circumstances for Ofcom
23 to give us additional freedoms. But I had clearly made this investment before I could be
24 satisfied that Ofcom were going to give me more freedom in terms of greater time to recoup
25 this investment, and going forward, if I wished to do the rational thing for my business to
26 make future investments, then I have no certainty as to how it will be regarded by Ofcom as
27 material change in circumstances or not.

28 So to give an example -- and this would certainly be confidential so I probably need to
29 pause at this moment ...

30 MR. HOLMES: I hesitate. I don't want to foreclose you from developing this point, to use
31 a neutral term, but this is, I suppose, more relevant really to the design of the margin
32 squeeze condition, so it may not be necessary to clear the room for this.

33 THE CHAIRMAN: That was rather my impression, that we were straying into areas of design.

34 MR. THOMPSON: Yes. I was wondering whether the matter could be given in abstract terms, if

1 Mr. Petter wishes to give this evidence, rather than naming the particular sport or whatever
2 it is that is -- I don't know what is coming.

3 I also understand that in practice, the people in the room representing parties other than
4 Ofcom and BT, I think there are representatives from Sky and TalkTalk, but the whispering
5 that is coming to me is that they are within the confidentiality ring, but ...

6 MR. HOLMES: That may provide a convenient way through if there is no one in the room who is
7 outside the confidentiality ring.

8 MR. THOMPSON: Apparently there is a student present, apparently it is a student from
9 Herbert Smith but I don't know whether that individual could be asked to leave if Mr. Petter
10 wants to say anything confidential, or whether it is not actually necessary.

11 THE CHAIRMAN: Mr. Petter, what do you say? I don't think it is necessary to get into the
12 specifics of this. Can you deal with it on more generalised basis?

13 A. Yes I can, and I will do it very briefly too, given your points on relevance.

14 So were we, for example, to wish to buy access to more channels, typically that would come
15 with some kind of fixed cost obligation called a minimum revenue guarantee, and that
16 would -- there would be a big fixed cost investment. I couldn't have certainty on the time it
17 would take me to recoup that investment; I couldn't have certainty on the degree of freedom
18 I would get from Ofcom. The test itself as currently constituted is very narrowly defined to
19 a single month and therefore I would be taking a significant risk.

20 MR. HOLMES: So in the same way that you are concerned to be able to take the long-term
21 commercially rational decision in your pricing, it might also be commercially rational in
22 the longer-term to cut your profits -- BT Consumer to cut its profits now if it would secure
23 a stronger position on retail market for the future?

24 A. Well, from a BT Group point of view, the idea of BT Consumer cutting its profits would not
25 be a commercially rational thing to do, for the reason that I explained: that if BT Consumer
26 cut its profits, that would have an extremely significant issue on the BT Group's share price.
27 So that wouldn't be a particularly wise thing to do in my view and certainly if you look at
28 the models the analysts have, the analysts don't expect BT Consumer to constrict its profits
29 and they expect BT Consumer to grow its profits, and the measure for BT Consumer,
30 success for BT Consumer for me -- I'm kind of "bonused" and "incented" -- is to grow those
31 profits because I am working to deliver against the analysts' expectations.

32 Q. But you would take a cut in profits if it was commercially rational to do so? That is your
33 point about the margin squeeze condition constraining your pricing to too great a degree,
34 isn't it?

1 A. It comes down to timescales, so the City is prepared for BT Consumer to make rational
2 investments, but they expect to see BT Consumer growing its profits. And to give
3 an example, so, the original investment that we made in Premier League football, which
4 was in 2013 for BT Consumer, despite the very significant size of that investment, which
5 was 246 million -- that is a public figure, by the way -- BT Consumer has grown its profits
6 over this period as a whole, and so those are the sorts of expectations that the City has of
7 BT Consumer, that we continue to grow our profits time on time.

8 MR. HOLMES: I am grateful.

9 I have no further questions for this witness.

10 **Re-examination by MR. THOMPSON**

11 MR. THOMPSON: Mr. Petter, you were asked about a document that appears at, I think, your
12 bundle IV, tab 2. Do you have it? It is the notice that was published in relation to
13 the undertakings.

14 A. Yes.

15 Q. I think you were taken initially just to paragraph 1.4 on page 2, which sets out a summary of
16 some suspicions that Ofcom has. Do you see that:

17 "Ofcom suspects ..."

18 A. Yes.

19 Q. But if you can also look at paragraph 1.9, you will see what Ofcom's position was in relation
20 to these undertakings; do you see that?

21 A. Yes.

22 Q. If we go into the detail, I think you were then taken to the paragraph you quote in your
23 statement at 5.17, which is at page 18. Do you see that?

24 A. Yes.

25 Q. Do you see the previous paragraph?

26 A. Yes.

27 Q. 5.16, as to what the purpose was of the undertakings?

28 A. Yes.

29 Q. Since we are on that page, can you read 5.15. (Pause) In particular, the last two sentences.

30 In fact, the last three sentences, from:

31 "For example ..."

32 A. Yes.

33 Q. I think you were invited to say that the undertakings were about discrimination, and you
34 accepted that by reference to the summary. Would you like to comment on 5.15 and

1 whether that is relevant to your answer?

2 A. Yes. I did feel that sort of -- discrimination is certainly part of the scope of the undertakings,
3 but that their intention is about competition, and that is really the point that is pulled out
4 here, that it is around ensuring that there is sufficient scope for downstream competition.

5 Q. I'm grateful. If we now look at section 4, I think Mr. Holmes very helpfully gave you the
6 headline topics and you can see under 4.1:
7 "The features giving rise ..."
8 Do you see that?
9 "... giving rise to the ability and incentive for BT to distort competition."
10 Do you see that?

11 A. In 4.1 did you say?

12 Q. I was looking at the red headline there.

13 A. Yes.

14 Q. And then there are a number of features that are set out, and I don't think we need to go to the
15 detail of them, but you might want to read through the black headline figures.

16 A. Yes.

17 Q. Then you will see under 4.13, just before 4.14, there is a series of conducts, or there is
18 reference to:
19 "Conduct which has had the effect of restricting competition ..."
20 In the markets identified; do you see that?

21 A. In 4.13 is that?

22 Q. Again, the red headline.

23 A. Right.

24 Q. "Conduct which has had the effect..."
25 Do you see that?

26 A. Yes.

27 Q. Do you see the examples; the first one is:
28 "Reluctance to supply any wholesale product."
29 Do you see that?

30 A. Yes.

31 Q. And then:
32 "Supply of an inferior wholesale product."
33 Do you see that?

34 A. Yes.

1 Q. And then:
2 "Resultant delays in introducing products and resolving problems."
3 Do you see that?
4 A. Yes.
5 Q. And then the last one is:
6 "Response to supply of upstream products deters investment by competitors."
7 Do you see that?
8 A. Yes, I do.
9 Q. And then in particular, the first bullet point under 4.24, I think it would be worth just reading
10 that. (Pause)
11 A. Yes.
12 Q. Again, does that cause you to revise any of your answers you gave by reference to the
13 summary at 1.4?
14 A. Well, it is clearly -- it is a broader point than just discrimination and that is the key thought
15 that comes out from this. It is around facilitating competition, and therefore it is around
16 ensuring that BT's downstream competitors have the ability to compete fundamentally.
17 Q. Yes. Finally, by reference to this document, I don't think you were taken to paragraph 6.1 but
18 certain points were made to you about the effectiveness of the undertakings and, in
19 particular, people in your role.
20 A. Yes.
21 Q. I was going to ask you whether that casts any light about Ofcom's assessment of these
22 undertakings as against BT's?
23 A. Yes. It clearly suggests that they view these undertakings as being sufficient to ensure
24 competition in the downstream market.
25 Q. Thank you.
26 You were asked some questions about the relationship with Sky, and you made a passing
27 reference to WMO and the withdrawal of a condition.
28 Just to confirm, I think there is an authorities bundle down at the bottom on your left?
29 A. Right.
30 Q. If you take the fifth volume and turn to tab 61.
31 A. Yes.
32 Q. You will see another of these red Ofcom documents?
33 A. Yes.
34 Q. Dated 19th November 2015, so just a couple of weeks ago.

1 A. Yes.

2 Q. Is that the document you were talking about, the decision you were talking about?

3 A. Yes.

4 Q. Thank you.

5 The only other question I have is, there was some discussion of the Code of Practice, which
6 is not actually in the papers but we have arranged for it to be produced I hope for the
7 Tribunal by lunchtime, and I think you said you weren't an expert in regulatory matters.
8 I understand the Code of Practice has arrived. It may be worth just handing it up. (Handed)
9 A copy for the witness. I don't know how many copies the Tribunal wishes to have. I have
10 been doing this job long enough so I'm not going to ask you any questions about
11 a document I have only just been given, but I don't know whether you remember the sight
12 of it, but would you accept this is the Code of Practice?

13 A. Yes I am more familiar with the version of this -- this part of the annual training course that
14 we have to do, but the content is exactly the same.

15 Q. That was the question I was going to ask you: do you have training by reference to this
16 Code of Practice?

17 A. Yes. This forms part of the mandatory training for everyone that works for BT, but especially
18 for annex 2 individuals, and it is the training module we have to do on the content of this
19 document. It was just the particular document that I hadn't -- I just wasn't quite sure what
20 was being referred to.

21 Q. Can you confirm you do undertake the training yourself?

22 A. Absolutely, yes.

23 MR. THOMPSON: Thank you.

24 Those are the questions I had. I don't know if the Tribunal has any questions?

25 THE CHAIRMAN: We don't have any questions.

26 Thank you Mr. Petter.

27 MR. THOMPSON: I take it Mr. Petter may be released? Nobody requires him to be here and I'm
28 sure is he a busy man.

29 (The witness withdrew)

30 THE CHAIRMAN: Would it be sensible to put this Code of Practice into 4.

31 MR. THOMPSON: I think probably it could go with the undertakings, or do you want a separate
32 tab?

33 THE CHAIRMAN: No, very good.

34 MR. THOMPSON: We haven't bothered with internal pagination so I think that is -- but it seems

1 to work perfectly all right.

2 With that, can I call Mr. Tickel, please.

3
4 **MR. JAMES TICKEL (affirmed)**

5 **Examination-in-chief by MR. THOMPSON**

6 MR. THOMPSON: Thank you, Mr. Tickel. You have the uncommon distinction in these
7 proceeding of having I think sworn two statements in this appeal and another statement in
8 the TalkTalk appeal. I think I can lead you to that degree.

9 Do have you bundle II in front of you?

10 A. I don't have anything in front of me. I do now, yes.

11 Q. Can you turn to tab 3 in the bundle.

12 A. Yes.

13 Q. Can you turn over and confirm that the details on page 2 are correct, in relation to your name?

14 A. They are correct.

15 Q. And address?

16 A. That's correct.

17 Q. Can you turn to the back of that statement, which is some 90 pages long, and can you confirm
18 that the signature you find there is your signature?

19 A. That is my signature.

20 Q. And that this is your statement in these proceedings?

21 A. It is.

22 Q. Do you have any corrections you wish to make to it?

23 A. No, I don't.

24 Q. Then there are some attachments at 4, which I don't think I need to get you to give evidence in
25 relation to, and then at tab 7, do you find a second statement there?

26 A. I do.

27 Q. Can you turn to the back, page 12. Do you see your signature again there?

28 A. I do.

29 Q. Is that your statement in these proceedings as well?

30 A. It is.

31 Q. Do you wish to make any corrections to that?

32 A. I don't.

33 MR. THOMPSON: Thank you, I think Mr. Holmes is likely to have some questions for you.

34 **Cross-examination by MR. HOLMES**

1 MR. HOLMES: I should now say good afternoon.

2 A. Good afternoon.

3 Q. You are the Head of the Operational Regulation and Economics for BT Group?

4 A. That's correct.

5 Q. You work at the central level of BT Group, rather than for any of the particular operational

6 divisions?

7 A. Yes, that is right. We do have regulatory functions in the lines of business, but we work

8 within the group regulatory function.

9 Q. You begin your first statement with a helpful overview of BT's provision of wholesale

10 broadband services. For the Tribunal's assistance, it might be helpful just to run through

11 that. That is at tab 3 of the bundle. Do you have that in front of you?

12 A. I do, yes.

13 Q. So at paragraph 12 we have the starting point, which is that:

14 "To compete in the supply of fixed line broadband services, [communications

15 providers] need access to a physical connection to the customer premises."

16 An obvious point.

17 A. Yes.

18 Q. Virgin Media has its own access network which runs directly to premises, doesn't it?

19 A. It does, yes.

20 Q. That covers 44 per cent of UK premises?

21 A. That was the figure at the time of this statement, I think that is generally true.

22 Q. But there are plans to extend by around a third by 2020?

23 A. Yes, they have Project Lightning, which will roll out, as it says, to further premises by 2020.

24 Q. Which might add as much as a third to their footprint?

25 A. That is my understanding, yes.

26 Q. So still less than 60 per cent coverage?

27 A. Still less, but a good share of the country will be covered by Virgin Media.

28 Q. There are also some other alternative infrastructure providers at the local level connecting

29 directly to residential premises?

30 A. Yes, that's correct.

31 Q. But those are not extensive, are they?

32 A. Not at the moment. I think they are very localised and, in truth, I think this gets us to the point

33 where BT holds SMP in the wholesale local access market, as Ofcom has found. Not

34 an issue we have disputed.

1 Q. They cover about 1 per cent of the premises, I think; does that sound right to you?

2 A. It may sound right, I honestly don't know that figure off the top of my head.

3 Q. While alternative providers could in theory now use BT's ducts, there is very low take-up of

4 that service; is that right?

5 A. That is my understanding, yes.

6 Q. And they could use that in combination with sub loop unbundling, which is the link, I think,

7 from the -- let me get this right -- the local exchange to the cabinet -- no, from the cabinet to

8 the premises?

9 A. Yes, it may be helpful just to sort of briefly talk through that network set-up. At the moment

10 we have got a copper pair that will go from the customer premises to the local exchange,

11 and many CPs utilise that; they just buy access to the physical copper pair and put their own

12 equipment in a BT exchange. And through the electronics in the home and in the exchange,

13 it becomes a standard broadband line that can reach speeds up to 24 megabits per second.

14 In rolling out fibre, and fibre to the cabinet specifically, BT has installed street cabinets

15 which themselves contain electronics, and that means that, again, the electronics in

16 the customer home and the electronics in that street cabinet can create higher speeds over

17 that copper, and then there is a fibre that goes from that street cabinet now back to the

18 exchange, and we sell that as a virtual path to other providers so they have a higher speed

19 connection from the exchange to the customer home.

20 Sub loop unbundling will effectively allow them to access that final part of the copper, so in

21 theory they could put their own electronics in the street and copy, effectively, what

22 Openreach is doing within the access network.

23 Q. But again, there is very low take up of SLU?

24 A. There is.

25 Q. In practice, communications providers wishing to provide fixed line services need to purchase

26 some form of wholesale access connectivity from BT to allow them to compete in

27 broadband provision?

28 A. Again, that is accepted following from the SMP finding that we have to provide products that

29 allow them to compete on a level playing field downstream.

30 Q. Yes, they are necessary, these wholesale --

31 A. Yes.

32 Q. And that is true for both standard broadband and superfast broadband?

33 A. We accept that, that in order to provide that full suite of services across the range of speeds

34 and to replicate what BT is doing in terms of the offering, they need access to those inputs.

1 Q. You set out the various types of access at table A1 of your statement at page 11.
2 A. Yes.
3 Q. First three, WLR -- well, SMPF and MPF are all about unbundling the local loop; that is
4 the copper element?
5 A. SMPF and MPF are about unbundling the copper, but WLR effectively is a wholesale
6 narrowband line, so it has got sort of some kit attached to it, but effectively, I see where
7 you're going.
8 Q. Yes, and BT's provision of these services is required by regulation; they are regulated
9 products?
10 A. That's right, and price controlled services.
11 Q. And SMPF and MPF are required for provision of standard broadband services?
12 A. Yes.
13 Q. Not relevant to superfast?
14 A. Well, to provide a superfast line, the customer would be buying and the CP would be buying
15 MPF and the GEA product, so the GEA is the product that enables the faster connection, the
16 faster path to be provided that the CP could utilise alongside the underlying copper, which
17 they would use to provide, for instance, narrowband call services.
18 Q. But it is the VULA which supplies the superfast --
19 A. That is correct.
20 Q. That is the next item on your table. GEA, GEA being the BT name for the regulated VULA
21 product?
22 A. Yes, "generic ethernet access".
23 Q. That is used for superfast, as you say. WBA bitstream is the next item in the table. That is
24 a downstream wholesale product produced by BT Wholesale; is that right?
25 A. That is correct.
26 Q. It can be used for either superfast or for standard?
27 A. Yes, it comes in those variants, so that is -- effectively, you are kind of working up the value
28 chain or down the value chain, depending on where you start -- if you are a CP who wants
29 to sell broadband services to consumers, you have options. I mean, that last line there,
30 end-to-end wholesale is effectively a white label-type service which any CP could provide
31 to a brand such as Tesco's, certainly in the past, and other brands to retail a broadband
32 service.
33 WBA bitstream, again, is just a service that's collected deeper in the network or further
34 away from the customer. But to utilise WLR, SMPF, MPF, GEA, you have to have

1 connectivity at the local exchange and have built out to that level.

2 Q. And both the WBA bitstream product, and the end-to-end wholesale product use VULA or
3 GEA as an input?

4 A. They would do for the relevant higher speed service, yes.

5 Q. So its pricing is therefore dependent on the price of the VULA product?

6 A. That's correct.

7 Q. The end-to-end wholesale product, as I think your answer implied, isn't one that your main CP
8 competitors would be interested in?

9 A. No.

10 Q. It's about rebranding?

11 A. That's right.

12 Q. Reselling a product?

13 A. Yes, yes, yes.

14 Q. BT does all the clever network stuff and somebody else just attaches their label and does,
15 presumably, the billing?

16 A. Mm-hmm.

17 Q. So of the products in the table, VULA is therefore the service of most interest to the main
18 competing communications providers who want to provide a superfast product?

19 A. Yes, I would agree with that, yes.

20 Q. And it's the one that BT Consumer of course uses, pursuant to the equivalence inputs
21 obligation?

22 A. That's correct, yes.

23 Q. You also describe the market context at the retail level and you note that broadband services
24 are supplied in bundles with other types of service?

25 A. Yes.

26 Q. Fixed line connections, pay television, mobile subscriptions and so on.

27 A. Yes.

28 Q. But you accept that access inputs from Openreach are still a vital enabler of competition in
29 bundles which are built around standard or superfast broadband?

30 A. Yes, I think the way I put it was they are necessary to provide a service that is based around
31 broadband, but they are not sufficient to provide the range of bundles that are currently out
32 there and which providers are supplying. Specifically when you think about triple play
33 services or you think about quad play, which would include mobile, obviously BT is not
34 providing all the required inputs or the VULA input is not affecting the ability of those

1 competitors to offer that range of services.

2 Q. While you say that the terms on which these wholesale inputs are supplied is not the sole
3 driver of success of individual communications providers, it may be one of the drivers; is
4 that right? Sorry, the reference is paragraph 60 of your statement.

5 You refer to the access services as a vital enabler of competition, the quotation -- the phrase
6 I used in my previous question in the sentence third from the bottom, and then you say in
7 the final sentence that:

8 "... the terms of supply of those access services from Openreach is by no means
9 the sole driver of the success of individual CPs in competing in the retail market
10 by offering differentiated bundled services."

11 It may be one of the drivers, is that correct?

12 A. Yes, yes, that's correct.

13 Q. Yes, indeed.

14 Let me turn now to the regulation of VULA. You note in your first witness statement that
15 the VULA wholesale price is not regulated by means of a cost plus charge control. That is
16 right, isn't it?

17 A. That's correct.

18 Q. And you say that there is an inconsistency between Ofcom's decision to regulate the VULA
19 margin, which is at issue in this case, and its decision not to impose a charge control which
20 was premised on BT's wholesale price being effectively constrained by competition from
21 standard broadband providers using LLU and from Virgin Media using its own access
22 network?

23 A. Yes, and to put that into some context, and it might be helpful at some point to turn to the
24 Fixed Access Market Review statement -- in fact, could we do that?

25 Q. By all means.

26 A. Could you point me to where it is?

27 Q. It is hearing bundle III, volume 2, tab 8.

28 A. Yes, I think this is section 12, and it may take me a short while just to find --

29 Q. We can do it by reference to the paragraphs -- I would like to look at the relevant paragraphs
30 that you refer to. But just to develop the general point, your argument is that the same logic
31 that concludes that BT faces constraints in pricing VULA at excessive levels also suggests
32 that BT faces constraints in pricing VULA at levels that are not commercially viable for
33 other communications providers. Is that right?

34 A. Yes. Absolutely. Absolutely, because I think there is certainly an acceptance -- maybe we

1 can find this section first.

2 Q. You refer to paragraphs 12.134 to 12.154.

3 A. Yes, and I think in the conclusion --

4 Q. They start at page 381.

5 A. I think it is 12.135, so it's just a different layout to a version I have of the same document.

6 I was struggling to see the relevant paragraph.

7 I think there are two -- I think it's fair to say there are two broad reasons why Ofcom did not
8 regulate the price of VULA itself. One is because they believed that there were indirect
9 constraints through the fact that at the retail level, standard broadband was a constraint on
10 the superfast broadband price, i.e. you couldn't be selling a superfast product without regard
11 to the premium that the consumer was being charged above what was already available on
12 standard broadband and, importantly, what was available on standard broadband was built
13 on regulated inputs i.e. the things we just looked at in, I think, table A .1, WLR and LLU,
14 effectively.

15 So that would have an indirect effect on the VULA price that Openreach could charge
16 because -- and the logic I am inferring, why I think that becomes inconsistent-- or my view
17 is that it becomes inconsistent with what we see when we come to the VULA margin
18 question, is the implication is that if other CPs could not buy VULA at a price that enabled
19 them to provide competitive superfast broadband inputs, then they wouldn't buy VULA, or
20 they certainly wouldn't buy it in the same volume. So that indirect constraint that is
21 acknowledged in section 12-- paragraph 12.135 as one of the reasons Ofcom did not
22 regulate the VULA price itself, then seems absent when we turn to the issue of VULA
23 margin.

24 Maybe just for completeness, I have said there were two reasons: one reason they didn't
25 regulate the VULA margin -- sorry, the VULA price was because of the belief that there
26 were indirect constraints; the second was, if you like, more a risk of regulatory failure at this
27 juncture, that there was just so much uncertainty about the way in which that price should
28 be set.

29 Q. You see those two considerations in the first two bullet points at 12.134, introducing the
30 assessment?

31 A. That's correct.

32 Q. Yes. At 12.135, I want to suggest to you that Ofcom does not here indicate that BT's
33 wholesale prices are effectively constrained by competition from standard broadband and
34 cable, but that its conclusions are more nuanced than that.

1 A. I think in the wording, I would agree they have nuanced it and certainly there was a difference
2 in the wording between this and the previous consultation statement --

3 Q. And between this and your statement --

4 A. -- but I think on balance -- sorry?

5 Q. Between this and your statement, because in your statement you refer to an effectiveness of
6 constraint and you say the price is constrained, at 28A.

7 A. I'm not quite clear what therefore Ofcom's position is.

8 Q. Let's have a look at it --

9 A. Is it that it is not constrained, because I don't read that at all.

10 Q. In the first sentence, we are considering here whether there is -- you can see from the bullet
11 point at 12.134 that what is being considered here is whether there is:
12 "... a risk of adverse effects from price distortion caused by BT's VULA pricing
13 being fixed and maintained at an excessive level if we did not regulate the level
14 of VULA prices."
15 So that is the test for finding excessive pricing when imposing a price control?

16 A. Yes. Sorry -- well, apologies but my reading of that introductory paragraph before we get to
17 the bullet points is again similar to the issues that were discussed in openings yesterday.
18 There is a recognition there could be a risk, but it seems to me the conclusion is that it is
19 believed to be mitigated to a sufficient extent by these factors that come out below, because
20 otherwise I think the conclusion you would have to draw is that it is not constrained.

21 Q. Let's have a look at what Ofcom says. At paragraph 12.135 the first sentence indicates that
22 there is some risk of adverse effects from BT's VULA pricing, given its SMP condition. Do
23 you see that?

24 A. I do, but it is a very, very general statement, i.e. when you have got SMP, therefore you are
25 not constrained in this market, therefore there is a risk. That is not quantified yet but there
26 is a risk that you might set an excess price. Let's consider the nature of that risk.
27 I mean, there's a more general point here. This seems a very different approach to the issue
28 in the VULA margin, where the risk is on balance, but --

29 Q. Indeed, but let's consider then the basis for Ofcom's conclusions. You will see in the final
30 sentence of the main paragraph of 12.135, the opening passage:
31 "... particularly during the period covered by this market review, we consider
32 that this is likely to be mitigated to some extent by the following competitive
33 constraints."
34 So there is a feeling that there are some constraints, but that those constraints will only

1 mitigate to some extent the risk of excessive pricing; do you see that?

2 A. I do.

3 Q. Taking the bullet points in turn, the first one notes that a separate superfast broadband market
4 may emerge in the future but until then, standard broadband retail price acts as a constraint.

5 A. Yes, agreed.

6 Q. The second bullet point notes that if an excessive wholesale charge for VULA results in retail
7 prices that are too high, consumers are more likely to continue to use standard broadband
8 rather than upgrade to superfast broadband --

9 A. Yes.

10 Q. -- reducing BT's VULA volumes. That is the point made in the second bullet point. But
11 a margin squeeze wouldn't necessarily lead immediately to higher retail prices, would it?
12 Turning from excessive pricing to a margin -- you are saying there is an inconsistency
13 between that finding and a finding of a risk of a margin squeeze?

14 A. In a way, though, this is where you get locked into the core issue here. You can't look in
15 isolation at one of the factors. I talk in my witness evidence about the scheme of regulation
16 and the relevance of the undertakings as well. So I would argue Openreach is setting a price
17 for GEA that is set to recover the significant investments it has made and it wants to drive
18 volumes at that price to maximise the returns and achieve payback as soon as possible.
19 So when it's then posited that a margin squeeze might sort of be, well, what sort of margin
20 squeeze could result; either a margin squeeze in that scenario is going to be Consumer just
21 taking a hit, or it's going to be the risk that Openreach departs from that strategy of selling
22 VULA at a given price trying to drive volume and increases its price because it is somehow
23 to the gain of BT Group overall, because the volumes that would have materialised on other
24 communications providers' networks will somehow materialise on BT's consumer network
25 and therefore we are better off as a result.

26 But I think so much of what is laid out here acknowledges that is not right. A Sky customer
27 taking copper might just remain a Sky copper customer if the prices aren't right for them to
28 move on Sky to the fibre, because their upgrade is perhaps an easier path. We could win
29 that customer, at the consumer level, but they could also, if they are looking out of the
30 market, decide to go to Virgin, who can offer at the moment much faster speeds, similar
31 level of content -- not quite the same but similar level of content as available on Sky.

32 It is that absence when you get to the VULA margin assessment that seems stark. There is
33 clearly a trade-off there. This won't necessarily be an exercise that would work for BT even
34 if we could, working somehow through the undertakings, which I think do constrain our

1 ability to implement such a strategy -- that it wouldn't actually pay off for BT at all. That is
2 just not explored in the evidence.

3 Q. The point I am putting to you here is that there is no necessary inconsistency between the
4 second bullet point here and the finding in relation to a constraint at the retail level, and the
5 findings of a margin squeeze. The point being that if the squeeze resulted from an increase
6 in the VULA wholesale price, retail prices might not rise. BT's downstream retail prices
7 would stay the same and competitors might absorb the increase; is that correct?

8 A. They might absorb it. I'm not really sure where that takes us. That doesn't -- that doesn't
9 sound like a margin squeeze strategy.

10 Q. They might equally increase their prices?

11 A. Can you put the question again? I'm not sure ...

12 Q. The retail competitors of BT --

13 A. Yes.

14 Q. -- when faced by an increase in the wholesale VULA price for an essential input
15 that -- basically, competitors other than Virgin might absorb the price increase, the VULA
16 price increase? That is a possibility, isn't it?

17 A. It is a possibility, yes.

18 Q. Very good. So the third bullet point considers Virgin Media and you will see there that what
19 is said is that there is some constraint, but Virgin's network coverage is smaller than BT's;
20 do you see that:

21 "... although this position is likely to change during the review period as Virgin
22 network's coverage is smaller than BT's superfast broadband network..."

23 A. Yes.

24 Q. There is also the point that a duopoly between Virgin and BT is unlikely to be sufficient for
25 effective retail competition.

26 A. Yes. Again, I mean, the stark point here of course is that we have got SMP in WLA, which
27 we have not challenged. We have an obligation to supply VULA, which we have not
28 challenged, and indeed, there was a fairness and reasonableness obligation in relation to
29 VULA, which we have not challenged, which we had always interpreted to mean we should
30 not be selling VULA on terms to competitors whereby -- effectively whereby they couldn't
31 use it, on terms that didn't allow them to compete. Because in a sense, if you did otherwise,
32 you might as well just be refusing to supply VULA.

33 So I kind of accept principles; where we are getting to is have Ofcom in their analysis
34 actually justified the imposition of what amounts to a rigid rule that we must pass every

1 month. That is the remedy that has been put in place.

2 Q. I am exploring for the moment the allegation of the inconsistency between the finding in
3 Fixed Access Market Review, which you rely on, and the VULA margin decision?

4 A. Well, it's a stark inconsistency of assessment.

5 Q. Well, you say that, but your indication that the price level is effectively constrained isn't borne
6 out by the text at 12.135:

7 "... there is some risk of adverse effects from BT's VULA pricing given its SMP
8 condition."

9 A. We are back to where the discussion was yesterday. If you want to say there is some risk,
10 I presume at some point the logic will be: we are going to assess that risk. That is why
11 I think there is an inconsistency. The assessment is wholly inadequate. You are accepting
12 there are constraints on the way in which BT would act and could act in a market in which
13 others are able to provide standard broadband, built on inputs of which there is no question
14 that the supply of those is fair, or at least consistent with the regulation that is already
15 in place. Where you have a significant other access provider in 44 per cent of the
16 country -- I mean, it seems to be downplayed as a consideration, I would say it is a pretty
17 big consideration that for 44 per cent of customers, there is a risk they might just divert
18 away from the Openreach network altogether.
19 So the real risk is, you try and strategy that is, you know, in a way it's hypothesised might
20 just be best end-to-end for BT and you get no margin on some lines. That risk exists at least
21 in 44 per cent of the country and I just don't see this then reflected when we get to the
22 VULA margin consideration in anything but very generalised ways. "This might happen;
23 that might happen".

24 Q. But we are discussing whether there is an inconsistency between Ofcom's findings in this
25 document and the VULA margin condition.

26 Can I just take you to 12.147, the conclusion on general pricing approach for VULA for this
27 market review. If you could just refresh your memory at 12.147.

28 A. Yes. (Pause)

29 Q. So you see there that they recognise a risk of excessive pricing, as we saw from 12.135, but
30 they have weighed that risk against the risks of regulatory failure and the potential impact
31 on investments, were Ofcom to regulate wholesale VULA prices using a cost base as charge
32 control at the upstream level.

33 A. Yes.

34 Q. So the concern here is to allow flexibility in wholesale pricing to ensure that investment costs

1 are covered. Some constraints, but not clear whether they are sufficient, and the concern to
2 ensure flexibility; yes?

3 A. They have balanced off a number of considerations in giving BT the freedom in how it sets
4 the upstream price in order to recover costs. I mean, this reflects what was first
5 implemented in 2010, which we think was absolutely the right approach, which is there
6 were a number of uncertainties about demand for the services that BT was investing in, for
7 the willingness to pay, ultimately, from customers. You know, you can provide them with
8 extra bandwidth but do they see the extra value in that to the level at which you might want
9 to set your price?

10 I think that fundamental belief that there was a constraint therefore from the presence of
11 existing services was central in deciding, well, on balance, we won't regulate the price.

12 I should add what is key in that is this service that BT has built by FTTC is an overlay to the
13 existing network. There are other ways we could have done it and in a small percentage of
14 areas and properties, we are doing it by fibre to the premises, just lay a new fibre and in that
15 situation the copper would go. But in a situation where you keep the copper and you try
16 and utilise it via the technology that allows you to do that, through, again, the street cabinets
17 talking to the modems in the home and enabling you to get much faster broadband down
18 that, you end up with this sort of dual running of a network which people can use to get you
19 up to 24 meg and a network that allows you to sell services above that. It seems obvious
20 there is a constraint there from people's willingness to pay. And in that context, I think, in
21 the round, good regulatory judgment.

22 That is why I say though, in stark contrast to what you then see when you turn to VULA
23 margin.

24 Q. Except it is clear as you say that Ofcom was balancing risks here. They saw a risk of
25 excessive pricing, didn't they; you see that from the first sentence of 12.148 --

26 A. They do, yes.

27 Q. May I finish. They saw a risk of excessive pricing but they thought that was outweighed by
28 the bigger risk to the promotion of efficiency and of sustainable competition if there were
29 wholesale price regulation of the NGA network.

30 A. Yes.

31 Q. So there is no necessary inconsistency between the conclusions about the sufficiency of
32 constraints in the Fixed Access Market Review, and the decision taken in relation to
33 the VULA margin.

34 A. Well, to the extent that we think -- or that -- sorry -- it's Ofcom's position that it does give

1 weight to those same constraints at the retail level when it comes to considering VULA
2 margin and what might happen and what is feasible in expecting, you know, what gains BT
3 could make? My position is I don't think they do.

4 Q. But it assessed the effectiveness of constraints in the Fixed Access Market Reviews and it
5 didn't find that there was a clean bill of health, that there was an effective constraint on the
6 pricing at the wholesale level?

7 A. Sorry, I misunderstood you. Are you saying they concluded that there was not an effective
8 constraint?

9 Q. No, they concluded that there was a risk that there was not.

10 A. Well, they concluded that there was no need on balance to regulate the wholesale price.

11 Q. Yes, and there is no necessary inconsistency between that and the regulation of the retail
12 margin.

13 A. Sorry, I find it plausible -- I mean, in truth, if this was worded in a way that said: despite
14 finding no constraint existing, we are so worried about investment incentives that we are
15 going to give BT freedom and -- you know, regulatory holidays have existed in other areas
16 where you just give BT a period of time to set whatever price it likes -- despite you not
17 believing that that is constrained in any way, that could happen.
18 That is not what I see here. The conclusion is -- okay, it's a balanced conclusion, but
19 a significant plank of that is based upon the fact that there is a constraint, there are
20 constraints at the retail level. What I am saying is inconsistent is when we come then to
21 consider VULA margin, I don't see how the same weight is given to those constraints.

22 MR. HOLMES: Let's leave that there.

23 MR. ALLAN: Mr. Holmes, sorry, I don't want to interrupt your course, but just whilst we have
24 this document out.

25 MR. HOLMES: Yes, of course, please.

26 MR. ALLAN: And if Mr. Tickel could just help us with the final sentence of paragraph 12.149
27 and just clarify for me what significance we should attach to that sentence in the context of
28 your general proposition.

29 A. That they --

30 MR. HOLMES: So sorry, sir, I missed the reference?

31 MR. ALLAN: It's the final sentence of paragraph 12.149, which says:

32 "While we are not imposing an explicit cost-based wholesale charge control ...
33 there are alternative forms..."

34 I just wonder what he makes of that?

1 A. Well, what I make of that is they then effectively, as the document goes on to do, they need to
2 turn to consider whether there might be a need to regulate the VULA margin and, if so,
3 how. But as I have stated, 2010 imposed a fair and reasonable obligation on the supply of
4 VULA, which we had interpreted -- and interpreted because it said at the time was there to
5 address a concern that you might squeeze the margin. But it was, in our view, a more
6 appropriately worded constraint on what we could do because it wasn't saying, the risk is so
7 great you must earn a defined -- defined as in a level of margin set by a formula -- a level of
8 margin on every customer you acquire in every month. It was more general than that and
9 I think its aim was to say, you shouldn't be -- Openreach -- in selling GEA, selling it on
10 terms that don't allow others to actually compete and therefore making it an un-commercial
11 product for them. So don't use the flexibility in any way to go beyond that. They didn't
12 really consider at that time what the risk was of doing that, and it seems to me quite a good,
13 because it is quite a generally expressed, backstop provision that just guards against
14 a generally expressed concern.

15 What we have actually got in this case is, despite there being a risk that frankly is never
16 quantified, we get the rigid new remedy anyway. That is the real problem we have here.

17 MR. ALLAN: Thank you.

18 MR. HOLMES: Let me turn now to the provision of VULA in practice which you cover in your
19 statement at paragraph 47 and following, beginning I think at paragraph 43 in fact.

20 A. Did you say 43?

21 Q. Yes. You are here discussing the provision of VULA by Openreach?

22 A. Yes.

23 Q. And the terms on which that is provided?

24 A. Yes.

25 Q. You say as regards price that:

26 "Openreach has the incentive to fix the price at the profit maximising level in
27 order to recoup BT's substantial investment in the fibre."

28 A. That's correct.

29 Q. You refer to two special offers to encourage the uptake of VULA products at paragraph 48.

30 Sorry, that is a wrong reference --

31 A. No, 50 is the paragraph.

32 Q. 50, yes. The first was an offer for six months in 2013 on the terms of connection and the
33 second was an offer for two months during 2012.

34 A. Yes.

1 Q. Is that correct?

2 A. That's correct, yes.

3 Q. Of course, at that time BT Consumer was the overwhelming beneficiary of those offers?

4 A. It is an EOI product, so it's provided on the same terms to all downstream providers. That

5 point was made I think in the defence and in witness evidence. I can't see that is a criticism

6 of the fact that, where there were offers, whatever offer we put out there has to be available

7 to everyone. But I do agree if the point is simply, at that time not many other CPs were

8 taking it, I think that is true.

9 Q. Those two short run offers, subject to those, the rental price of VULA hasn't changed since it

10 was launched in 2009, is that right?

11 A. No, it hasn't changed. It hasn't changed since we launched BT Sport at the retail level, it

12 hasn't changed since we changed any of our retail level bundles. Again, I see the point is

13 noted that we haven't changed the price. The price is set, we believe, to drive take-up that

14 can deliver pay back and support the ongoing investments that we have made in rolling out

15 the fibre network further and further to more and more customers. So that price hasn't

16 changed in that period.

17 But I think, if it is going to be put in that context, I would just note, well, therefore, neither

18 has anything changed in terms of what is available -- if the hypothesis is somehow BT has

19 got some strategy of taking more margin upstream and spending it downstream, you know,

20 it didn't -- nothing changed to give more margin to downstream to enable that to happen.

21 Q. But if the willingness to take superfast broadband had changed, if there was more downstream

22 demand, therefore potentially higher volumes, that would affect the pricing decision taken

23 at the wholesale level?

24 A. Sorry, there is -- I agree there is a relationship between price and volume, if that is all that is

25 being said.

26 Q. Yes, but the profit maximising price, despite changes in the market, has remained the same in

27 Openreach's assessment?

28 A. In their judgment, the price that will drive the desired level of take-up has, in their view, sort

29 of remained at the right level of pricing.

30 Q. At paragraph 51 of your statement, you show a figure to demonstrate growth in VULA lines

31 rented by other communications providers?

32 A. Yes.

33 Q. These figures are cumulative, aren't they? They show the total number of VULA lines rented

34 by each of the providers?

1 A. That's right, yes. The working system size of the GEA service, i.e. how many lines have we
2 got. I think the -- this is a confidential breakdown, but we also do publish key performance
3 indicators along with our quarterly results that would show total number of Openreach fibre
4 lines and would show the retail, so BT Consumer and Plusnet, volume of fibre lines and you
5 could work out the delta to see the overall level of this, rather than the breakdown.

6 Q. You point out that you don't -- you have chosen not to show BT's VULA volumes on this
7 figure, BT Consumer, the separate downstream division from Openreach. That is right,
8 isn't it?

9 A. That is right, because the aim of the chart is to show there is growth through non-BT.

10 Q. If they were shown, they would dwarf the other communication providers' combined volumes,
11 wouldn't they?

12 A. We have 70 per cent at the moment -- 70 per cent thereabouts, this probably goes beyond the
13 end of this graph. There may be two things to note; unsurprisingly, this graph continues
14 heading north, such that the top level is about 1.5 million now, since I submitted this
15 evidence. That net position BT has 70 per cent of installed GEA lines, other providers have
16 30 per cent. There has been a noticeable up-tick even since this ...

17 Q. But at the time that this graph relates to, just at the end of the graph, you were at 71 per cent of
18 all VULA connections?

19 A. That makes sense, yes.

20 Q. And you are now at 70 per cent --

21 A. I think it is about that. I can check it if necessary --

22 Q. So your share has remained the same?

23 A. I would probably need to refer to the actual data. It's easily identified from --

24 Q. But just taking the April 2015 point, you had about 3 million connections then, didn't you?

25 A. That would make sense to the figures we are talking about, yes.

26 Q. So more than three times the combined volume of the other providers. You also refer to
27 technical changes which have facilitated VULA installation and in particular the wires-only
28 product?

29 A. Yes.

30 Q. That is referred to at paragraph 48 of your statement. This removes the need for an engineer
31 and so lowers the cost of VULA installation. That is right, isn't it?

32 A. That is -- among other things, yes.

33 Q. Yes. This is obviously a benefit to BT Consumer as the largest purchaser of VULA?

34 A. Well, again, it's an EOI input -- and EOI service, so it's available to all. The point made in this

1 part of the witness evidence is that it was something that the other CPs were particularly
2 keen to see.

3 Again, it might be worth just having a slight walk through the technicality here. I talked
4 about upfront the technology, the fibre to the cabinet technology, we are rolling out relying
5 upon electronics in the street cabinet effectively talking to a modem in the home. At
6 launch, the modem and the street cabinet were -- the modem was an Openreach modem,
7 because of the standards we needed to develop to enable them to talk to each other. I'm not
8 a great technical expert, but I think that broadly makes sense.

9 Other CPs didn't want an Openreach modem in the home. They wanted to develop their
10 own modem. Alongside that, they were keen that, rather than have an Openreach engineer
11 have to go to the home, it could be configured without that happening and, therefore, you
12 get what is referred to as "PCP only". I am going to forget exactly what the acronym stands
13 for, but effectively that is another cabinet where an engineer would go and change over the
14 customer line, so that it now switches through the fibre cabinet and can talk to the modem.
15 So we had to develop -- or work with industry to develop standards, open standards, that
16 other manufacturers could utilise and then they could develop a wires-only solution i.e.
17 effectively a solution that was supplied without a modem and then would plug into the CP's
18 modem and they could provide the service to their customer in that way. The CPs were
19 very keen that that was the way they wanted to deliver the service for those customers, so
20 they were driving it. Of course now it's available, Consumer and others can use it.

21 Q. You accept I think that it took some time to go through this process that you have described?

22 A. There were a series of trials. I think my second witness statement goes through the timeline
23 and, as a non-technical person, it doesn't sound to me surprising that developing standards
24 in that way took that length of time.

25 Q. There was the fibre to the cabinet VULA launch in 2009?

26 A. Yes.

27 Q. Communication providers began requesting wires only in 2009 to 2010. Openreach felt able
28 to consider developing a self-install option in summer 2011. Is that right?

29 A. I think this is in my second witness statement?

30 Q. Shall we turn to it?

31 A. That would be helpful, thank you, because I won't remember these off the top of my head.
32 Okay.

33 Q. This is from paragraph 18 onwards. You see the point about 2009, the launch of fibre to the
34 cabinets. Sky's request in 2009. In summer 2011 Openreach felt it was able to consider

1 developing a self-install option because it had a sufficient understanding by that point of the
2 technology. Then a trial is running until the end of 2013, when you had an early market
3 deployment, and full launch in September 2014.

4 A. Sure. I'm not quite sure of the relevance, as I say -- this sets out the timeline but the initial
5 reason for saying we -- or Openreach developed, Openreach went through this process,
6 Openreach engaged in this process, because non-BT suppliers were keen that this option
7 was available and wanted it to be available so they could begin selling services in higher
8 volumes.

9 There were other factors, I think Mr. Murray's witness evidence goes to these, that might
10 drive the timing of when they wanted to start to really push fibre services. So it wasn't just
11 reliant on wires-only, there were a number of other factors. I think Mr. Petter referred to
12 this statistic earlier, because it is not just about the Q2 figure, but Sky's net adds through this
13 period in terms of the number of broadband customers they bring on to their network have
14 pretty much matched and often beaten BT Consumer's net adds so other CPs have
15 chosen -- that is why you see a 70 per cent/30 per cent split in VULA lines and why you see
16 the curve that starts pretty low for non-BT CPs and their consumption of VULA and their
17 sales of fibre, because they have chosen not to push it as heavily as BT Consumer has to
18 date. What we know is that is not because margin hasn't been available. That has been
19 proven by Ofcom's investigations and by what they have looked at in indicative assessment.
20 So it has not been because of an absence of margin, and they have not suffered in their
21 ability to sell broadband to their own customer base. They have -- as I say, Sky have been
22 very successful. If I look at TalkTalk, TalkTalk have increased their volumes of broadband
23 since this was launched and they have launched a TV service on the back of copper
24 broadband, almost making a virtue of the fact that their service is available at lower speeds
25 and it is a cheap package for their customers. But, at the moment and to date, it has fitted
26 with what they want to sell to their customer base. But what we have also seen is, where
27 there is a threat that those customers could churn away because they want faster speeds,
28 they are available; they are available from Sky and TalkTalk, often at prices and, certainly
29 in TalkTalk's case, at prices below BT Consumer's and I believe they are profitable and they
30 have made statements to that effect.

31 So a lot of this contextual stuff that is being put forward to somehow suggest, well, BT does
32 have it in its interests to prevent competitor -- or Openreach has it in its interests to prevent
33 competitors selling fibre I just don't think stacks up. There are choices that have been made
34 by the different retail providers, and there are choices that are made at the Openreach level

1 about the best way to set their price to drive the optimal level of volume or get that balance
2 right, shall we say, so they get pay back as soon as possible.

3 Openreach may not agree with every CP that its pricing is exactly where they want it to be
4 for commercial purposes or the product set is the right product set or indeed that they have
5 developed certain options for them, but that is normal commercial negotiation. It seems to
6 me, here, it is not and got nothing to do with the fact that Openreach is saying: here's
7 a product but, if you buy it, there is no way you can construct a commercially attractive
8 offer on it that will make you money. That would be commercially irrational for Openreach
9 to do that, because it would just lose them volume, and only some of that we might imagine
10 may go to BT Consumer, much of it will stay on copper and give them lower revenues
11 because, instead of buying LLU and GEA, they will only buy LLU from Openreach or it
12 could switch over to Virgin.

13 MR. HOLMES: Sir, I am conscious of the time. I have perhaps one or two further questions on
14 this line, if you would like, and if Mr. Tickel is happy to continue.

15 A. I would rather continue.

16 MR. HOLMES: Or we can break now.

17 MR. THOMPSON: Sir, I'm not clear whether Mr. Holmes is thinking that he will be finished
18 with Mr. Tickel shortly or ...

19 MR. HOLMES: Just on this topic.

20 THE CHAIRMAN: On this topic. In that case let's stop now.

21 (1.05 pm)

(The Luncheon adjournment)

23 (2.00 pm)

24 MR. HOLMES: Mr. Tickel, we were discussing the wires-only product before lunch.

25 A. Yes.

26 Q. And as I say, I am nearly finished on that topic.

27 You say at paragraph 8 that you regard the dispute between the BT evidence, if I can
28 describe it in that way, and the evidence of Sky regarding the history of the wires-only
29 product as not determinative in this appeal?

30 A. Sorry, paragraph 8?

31 Q. Paragraph 8 of your second statement. Sorry, do you have that? The second statement at
32 tab 7?

33 A. Okay.

34 Q. Do you have the point?

1 A. Yes, okay.

2 Q. You say that it's not determinative because the appeal is about BT's incentives to engage in
3 a price squeeze going forward?

4 A. Mm-hmm.

5 Q. With that in mind, can we turn to consider paragraph 87 of your first statement.

6 A. Is that tab 4?

7 Q. It is tab 3, at page 35.

8 A. Yes.

9 Q. You refer there to the fact that BT has not so far been found to have engaged in a margin
10 squeeze and you say that that provides strong evidence that the incentive -- the final
11 sentence:

12 "... strong evidence that the incentives on BT to impose a margin squeeze have
13 been and remain low."

14 A. Yes.

15 Q. But doesn't your point about BT's past conduct in relation to wires-only apply equally to its
16 past pricing? Isn't BT's past conduct equally not determinative in this appeal, given that
17 the concern is about the risk of a price squeeze?

18 A. Well, the relevance here is that the factors that are considered in assessing whether the risk
19 exists moving forward, I think existed looking backwards. And no evidence has been found
20 that despite that risk apparently existing, we have adopted a margin squeeze strategy.

21 Q. You say the history of the wires-only product is irrelevant because we are concerned with
22 future incentives?

23 A. No, well, first, I am responding obviously in the second witness statement to the points made
24 by Sky and to some extent also by Ofcom in dismissing the relevance of points I made in
25 the first witness statement about how by delivering wires-only, we were meeting the needs
26 of CPs and trying to drive their take-up, which was a point -- a key point in the first witness
27 statement.

28 To the extent that the second -- the responses to that were sort of challenging the
29 assumption that wires-only was a good example of Openreach behaviour, I made the
30 opening comment that I don't think the history of wires-only, and no doubt other issues, are
31 determinative of the approach that should be taken to VULA margin, but nevertheless dealt
32 with them and set out what I think is a history that shows, yes, there may have been
33 disagreements, but there were trials and ongoing activity over the two/three-year period
34 referred to there.

1 So I think there is a very specific reason to say that is not determinative in this appeal; it
2 depends what weight you attach to "determinative" anyway. I mean, in the concluding
3 comments I make at 87, I merely saying, here is another piece of evidence, another piece of
4 evidence that suggests there was a remedy in place through the period from 2010 beyond,
5 obviously, the Fixed Access Market Review statement in 2014, and until the VULA margin
6 remedy was introduced in March 2015, which seems to at least be doing its job, if indeed
7 a job needed to be done, which of course I would dispute because of the lack of ability and
8 incentives on us to even try and pursue a strategy.

9 Q. So you are referring here to the fair, reasonable and non-discriminatory obligation --

10 A. Yes.

11 Q. -- which was imposed in 2010, and you refer to that in paragraph 74 of your statement.

12 A. Yes.

13 Q. You say:

14 "The steps taken to date in addressing competition concerns about the level of
15 VULA margin are already sufficient."

16 A. Yes.

17 Q. So you have no objection to this type of regulation of the VULA margin?

18 A. Which type of regulation? The fair and reasonable?

19 Q. The fair, reasonable and non-discriminatory obligation?

20 A. We don't, because, what did it set out? It set out a framework which said, when you sell

21 VULA -- I'm at risk of probably repeating what I said before lunch: when you sell VULA,
22 make sure it's on terms that can actually be -- so it can actually be used by all downstream
23 players.

24 It is kind of reinforcing this idea of level playing field, which is what Openreach is about.

25 It's about providing a suite of access products and services that create this level playing field
26 for the downstream players who have invested up to that point of the Openreach network,
27 i.e. up to the local exchange level. It can take those inputs and we'll have effective
28 downstream competition.

29 Q. You note that Ofcom did not set out extensive guidance on how a price squeeze was to be
30 assessed when setting the FRAND condition. That is at paragraph 78 of your statement.

31 A. That is correct.

32 Q. And the fair and reasonable test is very open-ended, isn't it?

33 A. I don't know what you mean by "open-ended"; I think it's --

34 Q. It doesn't supply details about how a margin squeeze test would be applied in practice.

1 A. No, but it's typical of many, many regulatory rules we face and have faced over the years. Not
2 to unduly discriminate, not to implement unfair cross-subsidies are just some of the
3 remedies that have been in place, with the focus being, well, if there is a reason to believe
4 you may have breached it, we will look at the detail at the time and see what the effects of
5 the complained-of behaviour actually are.

6 So this kind of idea of an effects-based remedy is not a new thing at all and in fact is largely
7 viewed as a much more positive thing when contrasted with rules-based approaches which
8 can be, in general terms, very unsuitable in fast-moving markets like telecoms, which again
9 is why we are so against the VULA margin.

10 Q. It is clear from the proceedings before the Competition and Markets Authority in the present
11 appeal that Ofcom and BT disagree about when a price squeeze should be said to arise.

12 A. Yes.

13 Q. You have heard the evidence this morning of Mr. Petter that he was concerned that the price
14 squeeze would unduly restrict BT in its design because of the short-term view that he saw it
15 as taking of profitability?

16 A. Absolutely. So there are design issues with, obviously, the remedy as imposed, but I also
17 think -- and I can't recall exactly where Ofcom referenced this. There is an acceptance that
18 however we go on to define the rule, the mere fact we are trying to design a remedy that is
19 a formula that would restrict the level of margin available will mean you capture behaviour
20 that isn't actually having an effect on competition, that isn't actually preventing other
21 suppliers from purchasing VULA and constructing profitable and competitive downstream
22 services. So there is a kind of baked-in error to the test. I will -- or we referred in
23 the consultation phase to the type 1 errors this will throw up. You will stop us doing things
24 despite them being not anti-competitive, and in fact pro-competitive, where -- sport is the
25 best example of that. We invest in something to compete against Sky to construct our own
26 downstream bundle including fibre. The day one cost of it and the unit cost of it may well
27 be high, but we have a long-term business plan as to why we are doing that. We don't think
28 we should be constrained to the extent that this test inevitably, I think, goes on to constrain
29 us in the way we compete in that downstream market.

30 Now, the way I -- and we interpreted the fair and reasonable test was in contrast to that. It
31 was expressly aimed at preventing the type of behaviour that would have
32 an anti-competitive effect.

33 Q. You also refer to ex post competition law?

34 A. Yes.

1 Q. But you note that Ofcom applied a different test under ex post competition law than is
2 proposed in this case?

3 A. That is right.

4 Q. The test applied by Ofcom in the ex post context was itself not uncontroversial; indeed, you
5 say BT regarded it as conservative?

6 A. Conservative in the sense of it checked whether we were recovering costs measured in a static
7 way. Once it found that we had, it closed the case. "Conservative" as in, you know, we
8 think, even if we had failed such a test, there would have been a lot more work to do to say,
9 you know, is this having an effect on competition.

10 Q. So, if Ofcom had found that you did fail the test, there would have been a
11 likelihood -- a dispute could have arisen about the application --

12 A. It could have arisen, yes, but it didn't.

13 Q. The investigation took 18 months to reach a conclusion.

14 A. It did, although -- this point was made earlier. I think we got dates slightly wrong earlier
15 when we were discussing it. It came in in February/March 2013, the original complaint
16 from TalkTalk. There is a period where Ofcom considers whether to open an investigation,
17 and we made some submissions saying it was apparent on its face there was no basis. We
18 couldn't see the detail of the TalkTalk construct of a test they alleged we failed. So they
19 effectively built their own stack based on some of their own costs that they had. They were
20 confidential, we couldn't see it, but we -- first of all we highlighted this was inconsistent
21 with statements TalkTalk themselves were making about the profitability of fibre and the
22 fact it was profitable; they were making those comments to the City frequently.

23 We also said that our own modelling which we had showed that we were compliant. Now,
24 Ofcom didn't review that modelling at that inquiry phase, but instead opened a full
25 investigation. The very first thing we did around sort of May 2013 was send them our
26 model which showed we were compliant.

27 So finally, it took 18 months thereafter for Ofcom to scrutinise and check the data, and
28 while I think 18 months was too long, I do understand the Competition Act requires some
29 threshold that Ofcom has done their job dutifully in interrogating the way in which we have
30 treated costs, but it confirmed pretty much what we had said at the outset: there wasn't
31 a margin squeeze.

32 Q. As you note in paragraph 82, the model was interrogated by formal information requests by
33 Ofcom?

34 A. Yes.

1 MR. HOLMES: Very good, I have no further questions, thank you.

2 **Re-examination by MR. THOMPSON**

3 MR. THOMPSON: Mr. Tickel, I think I may have missed this, but it has been said behind me
4 that you were looking for a couple of references in the final statement on effects, and if it is
5 helpful to the Tribunal, I can direct the witness to those passages.

6 A. Thank you.

7 Q. I think the first is 4.46 --

8 MR. HOLMES: Speaking for myself, I didn't detect the witness requesting references, but --

9 THE CHAIRMAN: I think you can give me those references at some other time.

10 MR. THOMPSON: In that case, I think the only question I had, possibly for the Tribunal's note if
11 I just give it to you now, it's paragraphs 4.46, and 7.136.

12 You will recall being taken to the FAMR decision, section 12?

13 A. Yes.

14 Q. That is at bundle III/2, tab 8. I think you referred to the passage that begins at 12.134,
15 page 381?

16 A. Yes.

17 Q. In particular, I think Mr. Allan asked you about paragraph 12.149. Could I just ask you to
18 read and then comment on 12.136 and in particular the passage on the second page, 383,
19 starting "However" on 382 and then running through to the end, and whether that is relevant
20 to what you were saying to Mr. Holmes?

21 A. It is relevant because it's kind of accepting that there will be a constraint on the amount
22 of margin that Openreach itself can earn during the period, and obviously the whole
23 thinking behind a potential margin squeeze strategy would be that you could keep the
24 margin in the upstream business, squeeze it within the downstream business, and
25 end-to-end, be better off as a result and gain. Not only do I think that whole strategy itself
26 would fail, would likely fail given market conditions, but obviously if you are not earning
27 the margin upstream that allows -- you can't fund that sort of behaviour anyway.

28 MR. THOMPSON: That was the only question I had.

29 MR. ALLAN: Sorry, Mr. Thompson I was hunting for the reference, which ...

30 MR. THOMPSON: Sorry, it's the passage going from 382 into 383. It may assist if I just read it
31 out so it's on the transcript. It says:

32 "However, the risk of BT setting VULA prices that are higher than the
33 underlying costs is balanced against the drawbacks of regulation (which we
34 discuss in further detail below). In addition, we consider that any adverse

1 effects from VULA pricing are likely to be greater where the VULA price is
2 substantially above the underlying costs, and we consider a difference of such
3 magnitude to be unlikely during the period covered by this review given the
4 constraints on retail superfast broadband pricing set out above."

5 That passage.

6 MR. ALLAN: Thank you.

7 MR. THOMPSON: Does the Tribunal have any questions for Mr. Tickel?

8 **Questions from THE TRIBUNAL**

9 PROFESSOR MAYER: I would just like to ask one question, if I may, about your point on
10 ex ante versus ex post.

11 I was just wondering, do you see there being any advantages at all in terms of ex ante
12 setting over ex post, or do you regard it as entirely detrimental?

13 A. I don't know if there is a distinction to be drawn between the ex post competition law and
14 what I am saying about the application of the ex ante remedy of fair and reasonable, which
15 could consider effects. I think you have to balance out the risks, effectively, and set
16 a remedy that is proportionate to the risk you have identified.

17 The real advantage of an effects-based test is, obviously, where the risk is not quantified
18 and not clear and not something that is of immediate concern, then that approach seems to
19 me absolutely right, because you avoid the risk, or you should avoid the risk, of type 1
20 errors because you are giving yourself a framework within which you can consider in
21 the round, is this pricing behaviour actually affecting competition and distorting
22 competition in a detrimental way as a result of BT's upstream market power?

23 Instead what we have is a blunt instrument that has been introduced and I think that, in this
24 particular is of circumstances, is so wrong.

25 PROFESSOR MAYER: Thank you.

26 MR. THOMPSON: I don't have any questions arising from that line so I think that concludes
27 Mr. Tickel's evidence.

28 THE CHAIRMAN: Thank you, Mr. Tickel.

29 (The witness withdrew)

30 MR. THOMPSON: I now call Mr. Murray.

31
32 **MR. STUART CHARLES MURRAY (affirmed)**

33 **Examination-in-chief by MR. THOMPSON**

34 MR. THOMPSON: Good afternoon, Mr. Murray. You are welcome to sit down.

1 Do you have the bundle II in front of you?

2 A. I do.

3 Q. Can you turn to tab 5, please. Can you turn to page 2.

4 A. Yes.

5 Q. At the top can you confirm that is your name and address for these purposes?

6 A. It is.

7 Q. Can you now turn to the final page, page 30. Can you confirm that is your signature and ...

8 A. Yes, that is my signature.

9 Q. Can you confirm this is your statement?

10 A. It is my statement, yes.

11 Q. Is there anything you wish to correct in it?

12 A. Yes, there is just one small correction on page 4, paragraph 14. In the penultimate sentence

13 I refer to 25 to 50 gigabits per second, and it should just be 25 to 50 gigabits, the size of the

14 file, as opposed to the speed of the download.

15 MR. THOMPSON: I doubt that greatly change the purport of your evidence --

16 A. I very much doubt it, yes.

17 MR. THOMPSON: -- but I am grateful for that correction.

18 I think Mr. Holmes may have some questions for you.

19 **Cross-examination by MR. HOLMES**

20 MR. HOLMES: Good afternoon Mr. Murray. You currently work as Director of Regulatory

21 Affairs at BT Consumer?

22 A. I do.

23 Q. This is the division of BT that provides bundles including retail superfast broadband to

24 residential customers?

25 A. Amongst other product, yes.

26 Q. BT Consumer uses the VULA product to supply retail superfast broadband?

27 A. It does, yes.

28 Q. You moved to BT Consumer from Openreach the upstream access division that produces the

29 VULA input, where you worked until February 2015?

30 A. That's correct, yes.

31 Q. The main focus of your evidence is to describe the retail markets in which BT Consumer

32 operates?

33 A. Yes, that is the purpose.

34 Q. You are a lawyer by training, but I take it you now are involved in the business of BT and give

1 evidence accordingly?

2 A. This is the first time I have given evidence for BT, but it is now part of my role, if that is what
3 is required, and, yes, I am, if you like, a lapsed lawyer in that respect.

4 Q. I'm sure it is a relief in some ways to escape from the law of telecommunications, but there we
5 are.

6 Retail broadband products are provided in bundles with other products or services, that is
7 the point you make at paragraph 8 of your statement, which is at tab 5 of the bundle.

8 A. Yes, it is, yes.

9 Q. Customers' choices between different offers will be influenced by various factors, as you note
10 at paragraph 10. Price is one such factor?

11 A. Yes, it is.

12 Q. Speed of connection is another such factor?

13 A. Yes.

14 Q. And there are other factors as well?

15 A. Yes.

16 Q. For speeds in excess of 30 megabits per second, one needs a superfast broadband connection;
17 that is correct isn't it?

18 A. That is right. I understand broadband doesn't work at that speed, yes.

19 Q. And standard broadband using ADSL2+ technology has speeds of around 16 megabits per
20 second on average; is that right?

21 A. Yes, I think that is correct, yes.

22 Q. The speed desired by a household will depend on various factors, won't it?

23 A. It does, yes.

24 Q. One factor is the use to which the broadband will be put by people in the household?

25 A. Indeed. The more people using the broadband service, the more bandwidth they will use, and
26 therefore the greater the need for a service that will provide more speed.

27 So, for example, if people are streaming high-definition TV, if they are gaming, if they are
28 surfing web pages on the internet which have a high level of content, then yes, that will all
29 increase the need. So, if you are a house with, unfortunately, say, five teenagers, then you
30 will probably need a very fast connection in this day and age.

31 Q. You refer to live streaming of television. For standard definition that requires about
32 4 megabits per second?

33 A. Yes.

34 Q. And around 7 megabits per second to view in high-definition on a service like Netflix?

1 A. Indeed, yes, although as the quality of compression technology is improving, as the speed of
2 processors in televisions and set-top boxes improves, then that speed may come down.

3 Q. With compression?

4 A. With compression technologies.

5 Q. Yes. TV sets are now enabled with ultra high-definition technology called 4K?

6 A. Yes, indeed, some sets are, yes.

7 Q. There will be 4K programmes from 2016; is that right?

8 A. In terms of ultra high-definition, BT's broadcasting ultra high-definition football matches now.

9 Q. Yes, I knew that you had announced -- you anticipate my next question. I hadn't realised you
10 had already launched -- you have already launched then 4K sports programmes, football and
11 rugby?

12 A. For Champions League, I think, yes.

13 Q. You anticipate that 30 megabits per second will be required for 4K sport; is that correct?

14 A. That is correct, yes.

15 Q. The internet is also used for gaming, as you say, and games can be streamed live and that
16 requires high bandwidth?

17 A. I'm not sure it would need the type of bandwidth you are talking about in terms of superfast
18 broadband in order to -- in order to stream games, but certainly, the higher the quality of the
19 graphic content and the less of it which is cached on the computer or the box that you are
20 using to play it, then obviously the greater the speed of the broadband service that you
21 would need.

22 Q. The internet can also be used to download games or television programmes to view later?

23 A. Yes.

24 Q. For example, commuters might download catch-up TV before leaving the house in
25 the morning?

26 A. Yes.

27 Q. And the quicker your broadband, the less time this will take?

28 A. Indeed, yes, so -- depending on a number of factors, but in order to be able to download
29 content quickly, not only do you need a fast broadband service, as part of the linkage, the
30 flow through, you also need to make sure the person who is providing you with the service
31 has a fast service. So for example, if you are linking through to somebody who has very
32 slow servers, that will impact on the quality of the service which you are consuming.

33 Q. May I ask you just to turn to Mr. Matthew's witness statement, actually to the annex to his
34 statement, which appears at tab ... we can take it from the body of his statement at page 44.

1 So tab 12, page 44.

2 A. Sorry, paragraph?

3 Q. Paragraph (b) on that page, which is part of paragraph 96 of his statement. Do you see the

4 first quotation on that page?

5 A. Yes.

6 Q. Referring to growing -- I am slightly cautious, because although these passages aren't

7 highlighted, I suspect they may be confidential. Perhaps -- I'm sure that -- that is not the

8 case, I am being --

9 A. If it helps, I don't think there is any confidential in these paragraphs.

10 Q. Very good. So you don't disagree that, first of all, BT Consumer is able to meet the growing

11 consumer demand for faster broadband services and applications that run over them, given

12 its ability to deliver speeds of up to 76 megabits per second?

13 A. So there is the roll-out of superfast broadband at the moment. Consumer is -- BT Consumer is

14 investing to enable customers to take those products. There is a number of constraints that

15 mean not all customers are able to take services at the speed that they would like, so,

16 for example, you have some geographic areas where there are constraints; you have

17 problems for example where we have rolled out superfast broadband but there are cabinets

18 that are now full and no more customers can get on them, so we have to order cabinet or

19 upgrade that cabinet. So it's not a fully straightforward story.

20 Q. No, that is helpful, but there is nonetheless growing consumer demand; that is not

21 a proposition that you would dissent from?

22 A. There is growing consumer demand, yes.

23 Q. You also would accept, I take it, that access speed is one key factor, both to the broadband

24 experience and to customer perception of ISP performance?

25 A. It is one factor, yes. There are lots of other factors that impact on customer satisfaction when

26 it comes to utilising the services which they take over broadband.

27 Q. Another factor affecting speed is the number of devices using a broadband connection

28 simultaneously, isn't it? I think this was the point you adverted to, with the image of

29 a household with five teenaged children, all surfing at once?

30 A. Yes.

31 Q. You agree that customers are increasingly migrating to faster broadband packages to support

32 an increasing number of devices in the home?

33 A. Customers are certainly migrating; whether an individual customer is doing that in order to

34 support multiple devices, you know, quite possibly, yes.

1 Q. It will depend, yes, and there is growing consumer demand, as we have established, for faster
2 broadband services.

3 A. Yes.

4 Q. BT Group has made a major investment in the fibre infrastructure needed to provide superfast
5 broadband to premises?

6 A. It has, yes.

7 Q. So it's betting on superfast broadband as the future?

8 A. Initially I think it was a risky bet, but certainly now I think everyone is agreed it's the way
9 forward and discussions have now, to a great extent, moved on to: what is the next thing in
10 terms of ultra fast broadband?

11 Q. Indeed, BT has already announced the intention to roll out an ultra fast broadband network?

12 A. Yes, but I think not in the foreseeable future.

13 Q. And the speeds that that would support are very much higher than superfast?

14 A. Yes, so you're talking about speeds above 100.

15 Q. Yes. BT Consumer strategy has always been to promote fibre to its customers to help
16 BT Group make a return on its fibre investment?

17 A. Yes, and that's, I think, what Mr. Petter was explaining this morning.

18 Q. You make the same point, I think, at paragraph 93 of your statement?

19 A. Tab 5?

20 Q. Yes.

21 A. Yes.

22 Q. You recognise that this is a market that can change swiftly, even in the space of a year?

23 A. Yes.

24 Q. That is a point that you make at paragraph 82 of your statement.

25 A. Yes.

26 Q. Your statement covers the main players in retail broadband and your perception of their
27 different approaches?

28 A. Yes.

29 Q. There are now four main players: BT, TalkTalk, Sky and Virgin Media?

30 A. Yes, although -- well, they make up the lion's share, yes.

31 Q. And BT is the market leader with the largest share, I think, of all residential broadband
32 connections?

33 A. If you are talking in terms of all broadband connections, yes.

34 Q. Yes. They differ in their positioning, as you point out. TalkTalk, for example, doesn't place

1 the same emphasis on triple play bundles including pay television sports content?

2 A. So TalkTalk, I think, are pushing bundles as much as anybody else. They have a very
3 different target, so far as their customer base is concerned, but when it comes down to the
4 TV element of their business, I think their CEO, Dido Harding, has referred to it being
5 much more focused on children's programming, for example, as opposed to sport
6 programming.

7 Q. Yes, it was that quotation I had in mind, which is at paragraph 52 of your statement:
8 "Fundamentally we are just not in the premium sports game. The reality is if
9 you want premium sports you are not going to be a TalkTalk customer. We are
10 not the right place for you to be and we are really relaxed about that. Our most
11 frequently watched on-demand content is Peppa Pig."

12 A. Indeed, yes.

13 Q. It provides value-based offers; that is the positioning of TalkTalk within the market?

14 A. Yes, I think Ms. Harding has described themselves as sort of the Amazon of the
15 telecommunications bundled world, in terms of if people want it, they can come and buy it
16 from them, but at a price.

17 Q. Despite their different strategies, Sky and TalkTalk are now increasingly promoting
18 fibre-based superfast broadband, I think you accept?

19 A. They are, yes.

20 Q. This transition in the market partly reflects changes in consumer demand with increased
21 interest in superfast broadband?

22 A. It does, which is, I think, a feature of lots of different factors, so, for example, televisions are
23 now available in higher definition format at a lot lower cost. Those type of factors.
24 Gaming, et cetera.

25 Q. Yes. It reflects also the increased coverage of Openreach's fibre network; that is another point
26 you made?

27 A. Yes, a very important point, yes.

28 Q. And it is also dependent on the improved economics of installing fibre?

29 A. Yes, so I think by pausing, Sky and TalkTalk have essentially gained a benefit in the sense
30 that when BT were first installing, there were quite high migration charges, for example.
31 Those migration charges following the last review have now reduced considerably. So --

32 Q. They are coming into the market now in consequence?

33 A. Yes, at a lot cheaper price in terms of migrating their customers than Consumer originally had,
34 yes.

1 Q. At the end of your statement, you turn to consider developments upstream at the network
2 access level. That is beginning at paragraph 105.
3 You refer to the joint venture between CityFibre, Sky and TalkTalk to roll out a superfast
4 network in York in March 2015?
5 A. Yes.
6 Q. That is so far the only city in which this joint venture has rolled out; that is correct, isn't it?
7 A. That particular joint venture between Sky and TalkTalk and CityFibre, yes.
8 Q. Are you aware of the progress that has been made at that site?
9 A. No, and I can't give you any details, I am afraid, no.
10 Q. I hope you will have DF3 available behind you. Can you turn to tab 28. It's just an article
11 covering trials in York.
12 A. I have that.
13 Q. There's a quotation from Dido Harding, the CEO of TalkTalk, at the bottom of the page. And
14 above that there is a paragraph discussing -- perhaps we should begin in the paragraph
15 above that, the one immediately below the map, the Google map:
16 "Most of the phase 1 roll-out, which is supported by investment of
17 £5 million from each ISP and aims to cover 20,000 premises ..."
18 So that is the phase 1 roll-out:
19 "... with further investment required to do another 60,000 ..."
20 That is correct?
21 A. That is what it says, yes.
22 Q. 1,800 homes have so far been passed --
23 A. I think it says 1,800 homes.
24 Q. Indeed. So put these figures in perspective, Openreach recently passed 24 million premises,
25 the Openreach network. Is that familiar; a figure that sounds right to you?
26 A. It does sound familiar and I think this is clearly a very small trial in order to test the ability,
27 I guess, of Sky and TalkTalk to work together, first of all, and their ability to roll out a
28 physical infrastructure.
29 Q. Yes, it is a trial, an experimental point?
30 A. Yes, I think, additionally and quite importantly, psychologically it is probably also a shot
31 across Openreach's bows in terms of saying: keep the price at the right level for us,
32 otherwise we will come in and we will build our own network out.
33 Q. But that would take time to judge from the experience in York?
34 A. Indeed, yes. And indeed BT's own experience is it does take time in terms of the civil

1 infrastructure build.

2 MR. HOLMES: I am grateful, I have no further questions.

3 MR. THOMPSON: I have no questions in re-examination. I don't know if the Tribunal has any
4 questions for Mr. Murray?

5 THE CHAIRMAN: No.

6 MR. THOMPSON: So that concludes the witnesses of fact; Mr. Murray may be released.

7 (The witness withdrew)

8 MR. THOMPSON: So we have Mr. Bishop.

9

10 **MR. SIMON BISHOP (sworn)**

11 **Examination-in-chief by MR. THOMPSON**

12 MR. THOMPSON: Good afternoon, Mr. Bishop.

13 A. Good afternoon.

14 Q. Could you turn to tabs 9 and 10 of bundle II, which I hope is there.

15 A. Yes.

16 Q. I don't think there is a thing stating your name, so perhaps you could state your name and
17 address for the purposes of the Tribunal?

18 A. Simon Bishop, RBB Economics, 199 Bishopsgate, London.

19 Q. I am grateful. Have you got tabs 9 and 10 open?

20 A. Yes.

21 Q. Can you turn to the back of 9 and then the back of 10?

22 A. Yes.

23 Q. Do you see them both signed?

24 A. Yes.

25 Q. Are those your signatures?

26 A. Yes.

27 Q. You confirm this is your expert evidence in this matter?

28 A. Yes.

29 Q. Thank you. Do you have any corrections you wish to make to either statement?

30 A. I do. In the first statement, in paragraph 31, the second line says:

31 "Regulatory intervention restricts Ofcom's ability ..."

32 It should obviously read "BT's ability".

33 Q. Sorry, 31 on page 10?

34 A. Yes.

1 Q. That should read "BT", yes, that sounds like that is correct. Is there another?
2 A. Then paragraph 79(b), that should read:
3 "For these customers BT Consumer's profit would remain unchanged as BT
4 would only be able to earn the wholesale margin."
5 Q. So the second line, it should read "BT Consumer's"?
6 A. Yes.
7 Q. And the third line, "it" should read "BT"?
8 A. Correct.
9 Q. Subject to those corrections, are these your two reports?
10 A. Yes.
11 MR. THOMPSON: I think Mr. Holmes will have some questions and possibly the Tribunal.
12 Thank you.
13 **Cross-examination by MR. HOLMES**
14 MR. HOLMES: Good afternoon Mr. Bishop.
15 A. Good afternoon.
16 Q. Your instructions are set out in annex A3, paragraph 3 on page 53 of your first report.
17 A. Yes.
18 Q. So you were asked to prepare a report providing an economic critique of Ofcom's final
19 statement including a commentary on the soundness or otherwise of Ofcom's economic or
20 economic-related arguments and rationale for the decision.
21 A. Correct.
22 Q. Your firm is engaged for BT in relation to other currently pending regulatory matters; is that
23 correct?
24 A. I believe so.
25 Q. A strategic review of digital communications, for example, which concerns --
26 A. Correct.
27 Q. Have you had any involvement in that work?
28 A. No.
29 Q. Did you advise BT during the administrative process that proceeded this case?
30 A. No.
31 Q. Your conclusions of your first report are summarised in section 1, the executive summary of
32 which begins on page 3. This is another small correction of mine to suggest; I don't know if
33 it will be contentious. You say at the start of paragraph 3:
34 "The key components underpinning Ofcom's conclusions are as follows ..."

1 At paragraph 3(a) I think you are in fact summarising your overall conclusion; is that
2 correct?

3 A. Correct.

4 Q. Namely that Ofcom's assessment does not allow the conclusion that an anti-competitive
5 margin squeeze will be likely to arise?

6 A. That's correct.

7 Q. You say that Ofcom wrongly proceeds on the basis that whenever an arithmetic test is failed,
8 such that a hypothetical downstream competitor is unable to cover a level of costs, there are
9 likely to be inevitable adverse effects for end-users; that is one of the criticisms in your
10 report?

11 A. Correct.

12 Q. You are thereby distinguishing between what you call an arithmetic margin squeeze and
13 an anti-competitive margin squeeze?

14 A. That is correct.

15 Q. By an arithmetic margin squeeze, you mean a test which determines by a process of simple
16 arithmetic whether a firm's retail revenues are below some measure of retail costs, including
17 the cost of the integrated operator's wholesale input price?

18 A. Correct.

19 Q. You accept that there is a necessary arithmetic component to a margin squeeze test, I think?

20 A. Yes.

21 Q. But you say that in order to identify objectionable conduct, it is not sufficient to show
22 arithmetically that a dominant firm cannot cover its own retail costs, given the spread
23 between wholesale input price and the retail price; is that correct? Sorry, should I repeat the
24 question?

25 A. I thought you were going to go on to say something else.

26 Q. No, no. Well, there is a potential -- so in order to identify objectionable conduct, it is not
27 sufficient to show arithmetically that there is this lack of spread between wholesale input
28 price and the retail price; you also need to go on to consider whether there is a significant
29 reduction in the effectiveness of competition. That is the key distinguishing feature
30 between the anti-competitive and the arithmetic margin squeeze in your terminology?

31 A. As a former mathematician, the arithmetic margin squeeze is a necessary condition. Showing
32 adverse effect for end consumers is the sufficient condition.

33 Q. Yes. The two together provide the sufficiency, yes.

34 If there were such a reduction in the effectiveness of competition, that is to say a significant

1 reduction, there is no dispute that that would give rise to consumer harm; you accept that
2 the one would follow from the other?

3 A. Well, I think we need to be precise here. For me, a reduction in competition is synonymous
4 with showing adverse impact on end consumers.

5 Q. Yes.

6 A. I think this was a point of difference between myself and Ofcom, which is really
7 inferring -- Ofcom's view is, if we can show there is an adverse effect on competitors, we
8 will infer an adverse effect on competition, and then we will infer an adverse effect on
9 consumers.

10 I don't think that you can conflate those, harm to competitors with harm to competition.

11 Q. But do you accept, on the other hand, if I have understood your answer rightly, that the harm
12 to the competitive process, if there is a harm to competition, that that leads necessarily to
13 harm to end users?

14 A. Since in my terminology harm to end consumers and harm to competition are synonymous,
15 I would agree with you.

16 Q. Indeed, thank you. You don't say that competitors need to be excluded completely in order for
17 a reduction in the effectiveness of competition to occur?

18 A. That is correct. The sort of standard terminology in competition economics in this area, one
19 talks about foreclosure or marginalisation, and that can be partial or full.

20 Q. Yes. So for example in the -- perhaps we could have a quick look at this, the article 102
21 "Enforcement Priorities" paper. It's at tab 11 of authorities bundle 1. The sentence I would
22 ask you to review is the final sentence on page 9 of paragraph 19:

23 "In this document the term 'anti-competitive foreclosure' is used to describe
24 a situation where effective access of actual or potential competitors to supplies
25 or markets is hampered or eliminated as a result of the conduct of the dominant
26 undertaking whereby the dominant undertaking is likely to be in a position to
27 profitably increase prices to the detriment of consumers."

28 That is not a definition of foreclosure that you would dissent from; you would accept the
29 "hampering" as well as the "elimination"?

30 A. Just to be very clear, it is the hampering which leads to the position where it is profitably -- to
31 increase prices to the detriment of consumers.

32 Q. Yes.

33 A. Can I put this away?

34 Q. Yes, thank you. At paragraph 32 of your first report, you identify the elements which you say

1 Ofcom would need to demonstrate in order to justify its proposed ex ante regulatory
2 intervention. And the first -- do you have that?

3 A. Yes.

4 Q. At first, you say that Ofcom would need to demonstrate that BT would have the ability to
5 worsen the terms of VULA so as to cause an arithmetic margin squeeze. You accept I think
6 that BT would have the ability to engage in an arithmetic margin squeeze, given its
7 significant market power that it has been found to have at the wholesale level; is that
8 correct?

9 A. I think you will find that is what I say in the very next paragraph.

10 Q. Yes, indeed, very good. So the second and third things that you say that Ofcom would need to
11 show are that BT would have an incentive to engage in such pricing behaviour, and that
12 pricing behaviour would result in the marginalisation of downstream competitors to such an
13 extent that consumers are adversely affected. It is in relation to those that you say Ofcom's
14 analysis is deficient.

15 A. Correct.

16 Q. The reason why you say there is a deficiency is because you don't think Ofcom has done
17 enough to show that BT has the incentive to engage in an arithmetic margin squeeze or
18 to show that competitors would be marginalised, so a lack of analysis you are complaining
19 about, not a fault of analysis?

20 A. Correct.

21 Q. In assessing incentives and effects, you emphasise the facts of the particular market are
22 important, the specific factors of the market. You would accept also this is a swiftly
23 changing market, would you? That is the evidence that you have heard today?

24 A. That is the evidence I have heard, yes.

25 Q. You have not assessed yourself whether BT has an incentive to engage in a margin squeeze or
26 whether the effects would be anti-competitive and therefore harmful to consumers?

27 A. Well, not directly, but I think one can infer the kind of hurdle of evidence that one would like
28 to see in order to conclude that BT did have the incentive and that that incentive would lead
29 to adverse effects for end consumers. And I think here, you need to look at some of the sort
30 of key findings and facts of the industry. So number one, I think there is common
31 agreement that the downstream retail market is subject to effective competition. Number
32 two, that BT is facing a vertically integrated competitor in the provision of superfast
33 broadband in the form of Virgin.

34 Those important facts, and I think Mr. Tickel also discussed these, would have, if you like,

1 a sense of -- I would need a lot of evidence to overturn my prior that a margin squeeze
2 would not be profitable for BT.

3 Q. But just to turn to paragraph 84 of your report. You state there that the limited information
4 you have seen doesn't allow you to conclude whether there is indeed an incentive from BT
5 to engage in a margin squeeze. That remains your position?

6 A. That remains my position, subject to the comments that I have just made, yes.

7 Q. As regards the limited information that you proceeded on the basis of, you set out a summary
8 of that information for the first report at annex A3, page 53, paragraph 6.

9 A. Yes.

10 Q. The final statement, Ofcom's letter from the European Commission, the BT witness evidence,
11 a report that BT put in during the administrative process, a decision by Ofcom in relation to
12 TalkTalk's margin squeeze complaint under ex post competition powers, and other publicly
13 available documents which are referenced in the submission.

14 Were those documents provided to you by BT?

15 A. I honestly cannot remember.

16 Q. You don't recall.

17 A. No.

18 Q. Factual witness evidence has also been provided by two of BT's three main competitors, who
19 are parties in these proceedings, Sky and TalkTalk. There is a witness statement from
20 Mr. Andrew Heaney which is at tab 14 of the same bundle which contains your expert
21 report. Have you reviewed this?

22 A. Yes.

23 Q. You see at paragraph 6 that the statement is particularly directed at addressing points arising
24 out of BT's Notice of Appeal and the supporting evidence?

25 A. Yes.

26 Q. In particular of Mr. Bishop in a report from RBB. The statement contains factual evidence on
27 matters that are the subject of comment in your first report, doesn't it?

28 A. It does.

29 Q. You don't refer to any of the factual evidence provided by Mr. Heaney in your reply report, do
30 you?

31 A. No.

32 Q. You equally don't refer to the factual witness statement of Mr. Blumberg, who also considers
33 factual matters identified in your first report?

34 A. Correct.

1 Q. You were provided with these statements by BT?

2 A. I was, yes.

3 Q. Were you instructed to disregard this factual evidence in giving your expert opinion?

4 A. Absolutely not, absolutely not.

5 Q. We will come to that evidence in due course. One further housekeeping point --

6 A. Sorry, can I just -- I mean, I do make the point in my second report and I say in footnote 3:

7 "I have also not responded specifically to the points raised by TalkTalk and Sky

8 in their statements of intervention as I consider the issues raised in those

9 interventions are dealt with sufficiently in this report."

10 Q. But you don't canvass the evidence specifically when considering the matters that you have

11 raised?

12 A. No, we can discuss that.

13 Q. We can do that, yes.

14 Just turning back to the executive summary of your first report, it's at tab 9. I think -- at

15 least in my version, I don't know if it has been corrected in yours, but at paragraph 13 there

16 is a corrupted reference. The paragraph begins:

17 "In section ..."

18 Then it says -- there is a computer-generated error report, "error reference source not

19 found". It has happened to us all.

20 A. I think it applies to section 6.

21 Q. It is section 6, indeed. You explain in that section why the inappropriate level at which

22 Ofcom's regulation has been set can have adverse effects on BT and its rivals' incentives to

23 invest in future developments in wholesale and retail markets.

24 A. Mm-hmm.

25 Q. Let me now turn to area analysis of incentives, which begins specifically as regards BT's

26 incentives at page 17, paragraph 66.

27 You say that:

28 "To consider the effects of a margin squeeze on the profits of Openreach and

29 BT Consumer, it is necessary to assess the likely responses of consumers to that

30 pricing behaviour."

31 A. To both the direct competitors, so the VULA competitors, and then ultimately the end

32 consumers' responses as well.

33 Q. Yes. You identify six possible consumer responses in your first report at paragraph 79?

34 A. Sorry, can we just be very precise, and can we use the word "customer" for the downstream

1 competitors, and "consumers" for end consumers, please, just so we are very clear.

2 Q. Certainly, but in 79 --

3 A. I know, it's customers.

4 Q. Customers, I see. So you are referring here to the decision-making of the downstream rivals,

5 rather than the end consumers?

6 A. Yes.

7 Q. Very good. I don't think that affects the --

8 A. It shouldn't do, but I think it is useful to make sure we are not talking about consumers --

9 Q. No, I understand. Let's have a look at how that point is developed, and we will see if the point

10 you have just made makes a difference of substance.

11 We have prepared a table. Before any concerns are expressed, it does nothing more than to

12 take the headings at 79 and break them out so as to make easier reference to the second set

13 of A, B and C bullet points. (Handed). We can then explore the end column to see whether

14 you agree with its contents.

15 So the first of the categories is a situation which customers might choose to switch to BT's

16 superfast -- so these are responses to a price increase at the wholesale level and the choice

17 might be made to switch to BT's superfast broadband service instead. Now, customers --

18 A. Actually, yes, you are right --

19 Q. It should be consumers?

20 A. Yes.

21 Q. I am very relieved you say that, so we should perhaps substitute "consumers" then as the first

22 word in point A.

23 So one response would be for consumers to switch to BT superfast broadband service. You

24 accept, I think, that such a switch seen in isolation would be beneficial to BT?

25 A. Yes.

26 Q. And that is because BT would enjoy increased end-to-end profitability as a result of

27 the -- assuming that its retail activities were profitable before the wholesale price increase?

28 A. Yes, it would gain an additional VULA customer and it would earn additional retail margin.

29 Q. Yes.

30 A. Yes.

31 Q. Well, additional margin overall. Whether it's at the retail or the wholesale -- we are

32 envisaging here a wholesale increase.

33 A. Yes.

34 Q. The second consumer reaction you identify is that a consumer might remain with the rival?

1 A. Yes.

2 Q. Albeit paying a higher price?

3 A. Yes.

4 Q. I wasn't sure what your position was about the benefit to BT, but I think it has been clarified
5 by the amendment that you made. You would accept here as well I think that for this
6 customer --

7 A. BT benefits.

8 Q. -- BT benefits because of the higher wholesale margin?

9 A. Absolutely.

10 Q. So we can remove the question mark in the third column of the table beside point B.
11 The third category you consider is that customers might choose another bundled option and
12 you break that into three possibilities that I have listed separately on the spreadsheet. So the
13 third category is that a consumer might purchase standard broadband, and you say that
14 would be a loss to BT?

15 A. Yes.

16 Q. Fourth, the consumer could purchase superfast broadband, but from Virgin or similar, i.e.
17 another infrastructure provider. Again, loss to BT.
18 The fifth, that the consumer does not purchase broadband at all, another loss?

19 A. Yes.

20 Q. And this would be neither a standard nor a superfast purchase; they leave broadband
21 altogether as a product?

22 A. Sorry, I need to say yes, don't I.

23 Q. Before turning to the next category I want to explore these last three categories in a bit more
24 detail. So beginning with category C, the shift to standard broadband.

25 A. Yes.

26 Q. Could we look at the decision, please, which is at hearing bundle 3.1 at tab 1. Could we turn
27 to paragraph 3.55, which is on pages 29 and 30.

28 A. Yes.

29 Q. If you look at the second bullet point, there is, in a confidential section, an explanation of how
30 many of BT's new residential superfast broadband subscribers were new to BT in the third
31 quarter of 2014. Do you see that?

32 A. I do, yes.

33 Q. And the figures -- you were here for this morning's evidence; there were some figures of
34 a higher nature suggested by Mr. Petter this morning, in terms of the new to BT. You recall

1 that?

2 A. I remember you talking about it but I can't remember the exact number, to be honest.

3 Q. I don't think it is significant for the point, but in any event, the point that I wish to make by

4 reference to this bullet point is that there is already a fair amount of switching between

5 communications providers, by consumers moving to superfast broadband. Would you

6 accept that?

7 A. It says here -- I take the number as given, yes.

8 Q. Yes, indeed. You have seen from Mr. Matthew -- you have reviewed Mr. Matthew's

9 statement, of course?

10 A. Yes.

11 Q. You have seen from that that superfast broadband is growing rapidly in popularity?

12 A. I think --

13 MR. HOLMES: Let me take you to it. We can put away the decision now. Mr. Matthew's

14 statement --

15 MR. THOMPSON: Sorry, just before -- I wasn't quite sure which question was being asked or

16 answered, whether it was switching between CPs or whether it was switching between

17 products. I'm not quite sure which question Mr. Holmes was put together Mr. Bishop.

18 MR. HOLMES: The question related to the switching between communications providers.

19 MR. THOMPSON: As well as --

20 MR. HOLMES: The switching between communications providers as a result of consumers

21 moving to superfast broadband. That was the question. You don't need to modify your

22 answer?

23 A. No, that is fine.

24 Q. So if you turn within -- I'm sure you are very well familiar with this, but at page 17 there is

25 a figure --

26 A. Tab 12?

27 Q. Tab 12, yes.

28 A. Yes.

29 Q. You see there the take-up of superfast broadband?

30 A. Yes.

31 Q. Mr. Tickel's evidence is that customers are increasingly migrating to faster packages to

32 support an increasing -- I apologise, Mr. Murray's evidence which he repeated orally, is that

33 customers are increasingly migrating to faster packages to support an increasing number of

34 devices in the home?

1 A. Yes.

2 Q. Did BT advise you that it is currently planning the roll-out of an ultrafast network, or were
3 you aware of this?

4 A. I was aware of it, yes.

5 Q. So this again shows the shift towards superfast?

6 A. Okay, but just one comment here, and we talked about -- we referred -- and I don't have the
7 confidential version here, even though I am in the confidentiality ring.

8 Q. Sorry, would it help if somebody were to provide you with that?

9 A. It would.

10 Q. Do we have a spare bundle available? (Handed)

11 A. There is a lot of discussion about the evolution of the market yesterday, and some of it today
12 and I'm sure we are going to come on to it more. But an important point to make is none of
13 these market developments, I think, are the consequences of anti-competitive behaviour.
14 These are market developments which have been driven by investments that BT has made,
15 and I think even Mr. Matthew would accept, is the outcomes we are seeing are competition
16 on the merits. So when we come to talk about, as I am sure we are going to come back to,
17 about the relative importance of how end consumers would respond if there were increases
18 in VULA prices, which -- again, I think we need to be very clear: only increases in VULA
19 prices which give rise to a margin squeeze are relevant; any other increase which doesn't
20 give rise to a margin squeeze is irrelevant for our purposes. This is pro-competitive
21 information and how dispositive it is of answering the questions of how consumers are
22 going to respond is something we need to discuss.

23 Q. Indeed. To be clear, the reason why I am putting these points to you is in order to try to assess
24 the extent of the likelihood of purchasers switching to standard broadband, when confronted
25 with a price increase affecting superfast broadband.

26 A. Okay, but again, we need to be very, very careful here, because the way Mr. Holmes has just
27 put the question or the point, and I am sure he didn't do it deliberately, but is under the
28 impression that someone has already become a superfast broadband subscriber. When we
29 are looking at the margin squeeze issue, it is a sense of: I'm a subscriber, I am thinking of
30 taking up superfast broadband from TalkTalk, say. If the prices of TalkTalk were higher,
31 what would I do instead?

32 So this is not about switching down from superfast broadband, down to standard broadband.
33 It can include that, but it is not exclusive to that. And that is a fundamental mistake that
34 Mr. Heaney makes in his expert witness statement.

1 Q. His factual --

2 A. His factual --

3 Q. His factual statement, yes. If we could turn to Mr. Heaney's statement, to paragraph 29.

4 A. You will need to remind me of the tab.

5 Q. Sorry, tab 14.

6 A. Now you will need to remind me of the paragraph.

7 Q. Paragraph 29. If there are page numbers, they are too small for my eyes to ... if you could just

8 refresh your memory of that paragraph.

9 A. Yes. Paragraph 29, yes, okay.

10 Q. So this suggests that there are a number of customers for whom the difference between

11 superfast broadband and standard broadband will be very apparent, and that it may be

12 a decisive consideration when deciding what choices to make?

13 A. I'm sure that that is 100 per cent true. But also what we know from Ofcom's own analysis and

14 we also know from standard economics is what we are interested in is the number of

15 marginal consumers, and given Ofcom's definition of the relevant market, we know there

16 are a sufficient number of consumers who will compare and trade off between superfast

17 broadband and standard broadband. That is a conclusion which we draw from Ofcom's own

18 definition of the relevant market.

19 Q. If you could read paragraph 30 of Heaney.

20 A. Yes.

21 Q. This suggests, doesn't it, that those who have already upgraded, the category you referred to

22 previously, would be unlikely to respond to a price increase by reverting to standard

23 broadband. So that particular class of consumers wouldn't go down, judging from the

24 evidence he gives here.

25 This is his evidence as a businessman based on --

26 A. Yes, okay, I mean, that's --

27 Q. -- some quantitative assessment.

28 A. What is the quantitative assessment here? This is his view --

29 Q. If you look at the passage which is highlighted in yellow, the confidential passage?

30 A. Can I read the passage out?

31 Q. I don't believe you can, no.

32 A. But there is no quantitative evidence there. This is his opinion and I think there are two things

33 here. One, even if we take this as assuming that no consumer who has got to superfast

34 broadband will ever switch to something else, this doesn't alter the point that we have got

1 huge numbers of subscribers in the marketplace who are not in superfast broadband. They
2 either have no broadband or they are standard broadband, and at the end of the period,
3 I don't have the precise numbers in front of me, but when we talk about the massive take-up
4 of superfast broadband, we are still going to be left with a broadband market where
5 approximately half of those subscribers are going to be standard broadband.

6 Q. But we are weighing the costs and the benefits and we are considering consumer conduct in
7 the light of the evidence in relation to this category?

8 A. Yes, but in the light of the evidence put forward here, I have no idea whether we are talking
9 about half a million, one hundred thousand or one.

10 This is not quantitative evidence. This is a businessperson's perception and there is no way
11 I can gainsay someone who is actually in the business, but this does not allow you to
12 address a quantitative conclusion.

13 Q. I accept there is no quantification, but it does nonetheless indicate his judgement of the
14 significance of the prospect of spin down?

15 A. When you say the "significance" ...

16 Q. He says -- he explains why TalkTalk does not bother doing what is described in that
17 paragraph?

18 A. But when we talk about significance, we have to have some idea about the magnitude. He
19 says "highly unlikely". So first of all, highly unlikely. I don't know whether -- again, we
20 are going to come back on to this whole issue about what level of risk is significant or not,
21 but this says highly unlikely, so is that 5 per cent, 10 per cent, 15 per cent? Who knows.
22 Certainly Mr. Heaney doesn't know and I don't know. And how many subscribers are we
23 talking about?

24 Q. But it's the best available factual evidence that you have before you, and it is relevant material
25 at least, isn't it, to assessing the balance of costs and benefit?

26 A. No, I think this is the fundamental difference, because Ofcom are saying: we accept that when
27 we are assessing the incentives, there is a trade-off between the costs and benefits of an
28 increase in the VULA price. I think that is now common ground, but in order to make that
29 assessment, one has to have some sense of the quantification, and if you don't do any
30 quantification, then it seems to me very hard that you can then draw a conclusion that there
31 is a significant risk that BT has an incentive to engage in the margin squeeze.

32 MR. HOLMES: If I may, I will return to the issue of quantification with you subsequently.

33 THE CHAIRMAN: Shall we break there.

34 MR. HOLMES: Yes, thank you.

1 (3.15 pm)

2 (A short break)

3 (3.20 pm)

4 MR. HOLMES: So we were discussing paragraph 30 of Mr. Heaney's statement and the point
5 that I want to put to you by reference to that paragraph is that consumers who had already
6 upgraded, based on Mr. Heaney's evidence, would be more likely to look elsewhere in
7 the market to see where they could get a better deal than to leave superfast broadband
8 altogether?

9 A. I say the same. Even if we take this purely at face value, it tells us nothing about the
10 magnitude. But, you know, let's take it at face value.

11 Q. How else should we take it?

12 A. Well, just that. But as I said, it doesn't -- you can't tell me and Mr. Heaney can't tell me
13 whether we are talking about -- you know, how many people we are talking about here.

14 Q. Well, he can't tell you because he is not being cross-examined in these proceedings.

15 A. That is not my fault.

16 Q. No, indeed.

17 This category of consumers who have switched to superfast broadband will grow in
18 importance as the market transitions to superfast broadband; as more people are on
19 superfast broadband already, this group of consumers who are, as I put to you, more likely
20 to look elsewhere for another superfast offer if their existing provider's price increased, that
21 category that would be more likely to look elsewhere will increase as more consumers are
22 on superfast broadband?

23 A. From -- as I understand, if I have the figures at the top of my head, from roughly 30 per cent
24 to roughly 50 per cent.

25 Q. The fourth category in your table concerns purchases of superfast broadband from Virgin or
26 another infrastructure access provider. This is obviously an option for people with access to
27 Virgin, but as you point out, Virgin only covers 44 per cent of premises, so the number of
28 people with that option is limited, isn't it?

29 A. It is 44 per cent at the moment. I think we heard earlier that there has been extension
30 to -- again, I can't remember the precise figure, but between 60 and 70 per cent.

31 Q. To under 60 per cent I think was the evidence. A big investment has been announced. A third
32 increase on coverage of 44 per cent.

33 A. Anyway, an increase over 44; we can agree on that.

34 Q. Yes. Even for those consumers who do have that option, if they are considering switching,

1 they might go either to BT or to Virgin?

2 A. Yes.

3 Q. If --

4 A. Or to Sky.

5 Q. But we are assuming that Sky would be subject to the same margin squeeze, of course.

6 A. Right, but you are making the very big implicit assumption that the impact of a VULA price

7 increase -- and again, just to stress that if we are not talking about a margin squeeze, none of

8 this matters. So we are assuming that there is an increase in the VULA price which gives

9 rise to a margin squeeze on TalkTalk, doesn't necessarily give rise to a margin squeeze on

10 Sky, or makes Sky an ineffective competitor. So your presumption that the switching

11 would only be to Virgin or BT is not a correct one.

12 Q. We are exploring the proposition as you have developed it at paragraph 79 of your statement.

13 A. Okay, sorry, I thought we were still in the world of Mr. Heaney and paragraph 30.

14 Q. I apologise. No, we have moved on now to category D on your table, so the response to an

15 increase of price, purchasing -- the result would be to move to another provider such as

16 Virgin or similar.

17 A. Okay. Yes.

18 Q. If you could please turn to Mr. Heaney's statement again at tab 14, to paragraph 18. This is

19 confidential material, but if I could just ask you to review that quickly. (Pause)

20 A. Yes.

21 Q. So there he gives an indication of the destinations of customers moving from TalkTalk to

22 other communication providers, and you can see there as regards that provider,

23 an indication of how moving customers split between Virgin Media and BT?

24 A. Okay, but here we -- I thought we were talking about superfast broadband customers. This

25 paragraph here seems to be referring to all TalkTalk customers.

26 Q. That is true, but it is the best evidence we have about the moves that are made.

27 A. Yes, but it doesn't tell me anything about what is happening to TalkTalk superfast broadband

28 customers.

29 Q. Very well. Category E, no broadband purchase at all. So we are here countenancing

30 a situation in which a consumer who doesn't purchase broadband is considering a move to

31 superfast broadband as their first entry proposition, or --

32 A. Are you sure that's ... I think what we are saying is that you can think of this as either someone

33 who is thinking of upgrading from superfast broadband -- thinking about taking superfast

34 broadband.

1 Q. Yes.

2 A. And the VULA price increases TalkTalk's superfast broadband price, for example, and that
3 customer says: okay, I'm not taking broadband at all.

4 Q. So they are contemplating an upgrade to superfast and their response to a price increase is to
5 stop buying broadband at all?

6 A. More likely, they don't have broadband at all. They are thinking of entering the market and
7 taking up superfast broadband, and then they actually decide that they won't take up
8 a bundle including broadband. So they might say: I am thinking about taking pay-TV with
9 superfast broadband, but now the package is a bit too expensive, I will just take
10 pay-TV-TV.

11 Q. There is an attractively-priced offer in the market, BT, and they react to the price increase of
12 their provider by deciding not to take broadband at all?

13 A. Very possibly. I don't see how you can rule out that possibility on a priori grounds for the
14 example I have just given. If you have a customer who is placing a large valuation on
15 Sky Sports, and a very low valuation on superfast broadband, this switching possibility,
16 you can't rule it out.

17 Q. You can't rule it out.
18 Longer-term incentives. Let's consider for a moment the longer-term impact of the
19 scenarios that we have canvassed to date. So, for four of the five scenarios, that is to say all
20 of them except B, the rival communications provider loses volumes of superfast broadband
21 customers. That is right, isn't it?

22 A. Yes.

23 Q. Yes. Do you agree that insofar as a rival communications provider loses superfast broadband
24 volumes, its superfast broadband business will generate lower profits?

25 A. Yes.

26 Q. If the effect on its volumes overall is sufficiently pronounced, then it would be less able to
27 benefit from advantages that come from economies of scale?

28 A. Economies of scale in what, because I think you need to be very precise.

29 Q. In the broadband business.

30 A. No, but what is the source of the economies of scale?

31 Q. We can perhaps see the relevant -- some relevant economies of scale in Mr. Heaney's
32 statement, if you turn again to tab 14. Footnote 9, which is at the bottom of the page,
33 starting at paragraph 39.

34 A. You've made me realise I need to go to the opticians.

1 Q. I am relieved it is not only me. Yes. You see the proposition he puts in the paragraph 41 to
2 which the footnote relates:

3 "This reduction in scale would increase TalkTalk's average costs of operation as
4 there are economies of scale in relation to the number of subscribers in
5 operating a broadband business based on LLU."

6 A. Yes.

7 Q. And he explains what those various economies are and he explains that:

8 "All VULA customers are also LLU customers, given the manner in which
9 TalkTalk structures its network."

10 A. Yes, but I think here is important, because what Mr. Heaney is talking about, and he is quite
11 rightly concerned here, is with the overall profitability of his business.

12 Q. Yes.

13 A. And obviously with some fixed costs associated with running that business, the more
14 subscribers he has, the more profitable he is going to be, but in terms of his ability to
15 compete, TalkTalk's ability to compete for incremental superfast broadband customers, that
16 obviously depends on the incremental costs associated with winning that incremental
17 customer. As far as I know, and this is a factual question, so I'm not the right person to say
18 whether it is right or wrong, the economies of scale in TalkTalk getting an additional VULA
19 subscriber are pretty low.

20 Q. That is an assumption on your part, or is it based on --

21 A. That's just my understanding, but I can't --

22 Q. Your understanding based on instructions or ...?

23 A. Discussions with BT.

24 Q. Discussions with BT. Are those figured in evidence?

25 A. No.

26 Q. No. Very good. Mr. Heaney's, whose evidence we do have, lists various economies of scale
27 for the business as a whole. Costs of power and space, which are fixed at the exchange
28 level; a single ethernet switch per exchange; semi-fixed backhaul; MSAN fixed at one per
29 exchange, and then TalkTalk is rolling out 10-gigabyte backhaul circuits which do not
30 depend on usage.

31 A. Yes.

32 Q. There will also be other economies of scale, will there not, such as in relation to advertising?

33 A. Yes, those are all fixed costs, aren't they.

34 Q. Yes. Would you agree that, all else equal, a communications provider with fewer economies

1 of scale than it would otherwise have would be less able to use its superfast broadband
2 offerings to exert a competition constraint on BT?

3 A. No. As I just explained, what matters is all of these things go to affect the overall
4 profitability of TalkTalk's superfast broadband business. It can be big, it can be half as big,
5 twice as big. Unless you can say that the scale -- the incremental costs are varying with the
6 numbers of subscribers drastically, then that is what you need for me to say scale would
7 matter in terms of the competition.

8 Q. If a communications provider is forecasting lower profitability, would they have a lower
9 incentive to invest in superfast broadband products than they otherwise would have?

10 A. Yes, and I think this is a really important point and I think it is one which Mr. Matthew
11 makes, which is if TalkTalk are making higher returns from selling standard broadband,
12 relative to superfast broadband, well, clearly they have got incentives to push, in the short
13 run, standard broadband over superfast broadband. But that is not a competition issue; that
14 is just commercial reality.

15 Q. So that reduces the competitive constraints in superfast broadband?

16 A. Why?

17 Q. Because the main competitors in the market aren't competing vigorously for customers.

18 A. Sorry, that cannot make any sense whatsoever. Cannot make any sense whatsoever. You
19 have someone who can earn, compete, at a positive margin but chooses not to because they
20 are earning a margin greater elsewhere. That is a commercial decision. That is not
21 a competition issue.

22 I think, if we can go to Mr. Matthew's report at tab 12?

23 Q. Yes.

24 A. I think it is footnote 18. There you can see he is making the point actually from paragraph 44:

25 "In contrast, it could be argued that Sky and TalkTalk ... currently have weaker
26 incentives to drive SFBB services, as there are indications that given current
27 SFBB prices and the cost of VULA, margins are lower..."

28 It is not anti-competitive. They are earning positive margins; they are just choosing as a
29 commercial strategy to push something else, and that is up to them.

30 Q. But obviously, if their margins were squeezed they would have lower incentives?

31 A. That is true, but a lot of what you presented yesterday, Mr. Holmes, was this apparently
32 apocalyptic scenario when Sky and TalkTalk would only have together 10 per cent -- well,
33 20 per cent market share of superfast broadband, but that is just an outcome of the
34 competitive process.

- 1 Q. You mean the current trends?
- 2 A. The current trends, which is a reflection of not an anti-competitive outcome. It is the outcome
3 of vigorous competition in a dynamically changing marketplace.
- 4 Q. But if you are seeing in this shift that there are changes in the performance, the share of these
5 competitors, that increases the prospect of being able to marginalise them in
6 the marketplace through a margin squeeze, no?
- 7 A. No, I don't see that. And particularly again, I think Mr. Matthew -- I can't find it. He has the
8 figures on the share of VULA add -- so excluding Virgin upgrades to superfast broadband,
9 the share of BT VULA adds is going down over time. That's sort of telling me that there is
10 increasing competition from TalkTalk and Sky, not suddenly: oh my God, we need a leg-up.
- 11 Q. Insofar as there are positive economies of scale in this market, the fact that some consumers at
12 category A in this table will have moved to BT, therefore increasing its profitability in retail
13 superfast broadband, and potentially increasing BT's economies of scale, that is the other
14 side of the coin, isn't it?
- 15 A. But again, I think -- I hate to be precise on this. You are using the economies of scale in
16 a very loose sense. Yes, BT are going to be more profitable, but does that mean to say that
17 they are gaining such an advantage in terms of competing for the next incremental
18 subscriber? I haven't seen the evidence to say that that is the case. This is the thing. You
19 need to focus -- Ofcom needs to focus on the competitiveness of the market, not on the
20 profitability of individual providers.
- 21 Q. Taking the five behaviours together, there would be certain immediate costs and benefits for
22 BT arising from a price rise; we can agree about that, I think?
- 23 A. Yes.
- 24 Q. And then potentially a series of longer-term benefits for BT insofar as competitors were
25 marginalised; would you agree with that?
- 26 A. Well, on the presumption of your question that competitors were marginalised.
- 27 Q. Yes.
- 28 A. But if they weren't, then no. And also you are assuming that the long-term effects on BT are
29 only upside. There are also downsides.
- 30 Q. The short-term effects or long-term effects?
- 31 A. The long-term. There are losses here, and this is losses to the VULA business. If there are
32 losses in the short run, then that is likely to have an impact on the roll-out of the superfast
33 broadband network, which can also have losses associated with it.
- 34 Q. But the competitive roll-out by BT has concluded now. That was the evidence we heard.

1 They are now relying upon state subsidy for the remaining roll-out?

2 A. Well, as far as I understood, and someone can correct me, I thought that BT was also involved
3 in funding some of that state roll-out.

4 Q. That is not a matter in evidence. I will be corrected if I am wrong about that.

5 A. Also, there is -- again, an implicit assumption in this whole process is that BT wants to
6 foreclose people, rather than the alternative, which is: I am investing several billion pounds
7 in a network which has a huge upfront sum cost. It is better for me to get returns if I can
8 sell this through various distribution channels. And what I mean by distribution channels,
9 different VULA-based competitors, BT Consumer, Sky and TalkTalk. And
10 I don't think -- that sort of view of the world hasn't been taken into account at all.

11 Q. If Mr. Petter's evidence this morning were correct that increased profitability at the
12 BT Consumer level would result in a higher valuation for BT, a long run increase in the
13 profitability of BT Consumer would be advantageous to BT, have incentives to promote
14 that?

15 A. Correct.

16 Q. Very good.

17 Turning to the last category on this table, the absorption of prices from profit margin. So
18 this is the suggestion in your first report, to go back to -- sorry, I apologise, it is not in 79,
19 it's elsewhere in your report. It's the suggestion that a rival will retain customers by
20 absorbing the price increases in the VULA upstream product from its profit margin overall.

21 A. Yes.

22 Q. You would accept that this would benefit BT since it would earn a higher wholesale margin?

23 A. Yes.

24 Q. Your point at paragraph 76 of your statement is that in this scenario, there would be no
25 detriment to consumers; that is right, isn't it?

26 A. Yes.

27 Q. And you say, if you turn back to paragraph 52, that the presence of bundles will diminish the
28 likelihood that BT will be able to marginalise these retail competitors.
29 I would like to go through with you the example that you then give at paragraph 53, if
30 I may.

31 A. Yes.

32 Q. So this is a stylised example of an arithmetic margin squeeze that you would say was not
33 an anti-competitive margin squeeze; that is right, isn't it?

34 A. Mm-hmm.

1 Q. So in the example, Sky offers TV services which consumers value at £15 and which cost it
2 £5 to supply. There is therefore a £10 margin available in supplying pay-TV products.
3 The cost of providing downstream dual play offers is £5 per customer per month for both
4 BT and Sky, and by "dual play", you mean there a phone line and a broadband connection?

5 A. Correct.

6 Q. BT offers -- and that is the case for both BT and Sky, so therefore Sky is as efficient as BT in
7 this worked example?

8 A. Yes.

9 Q. BT offers VULA for the price of £10, while its downstream price for the dual play offer is
10 £14, and that gives rise to an arithmetic margin squeeze because of the difference between
11 the £14 price -- sorry, the £14 price downstream is greater -- and the wholesale price is
12 greater than the downstream efficient costs?

13 A. Yes, the margin is less than the costs of providing the services, yes.

14 Q. Yes. You say that BT would not be able to marginalise Sky and therefore to perform
15 an anti-competitive margin squeeze because if Sky sells its triple play bundles for any price
16 below £29, it will continue to obtain a profit, and that is the sum of the £15 plus the £14,
17 which is the price set by BT for the dual play offer?

18 A. Yes.

19 Q. Indeed, it could go as low as £20 if it used the entirety of the margin that is available to it for
20 TV services?

21 A. Mm-hmm.

22 Q. Can I start by understanding the scope of this issue. I understand from paragraph 57 that your
23 position is that this bundling issue arises in relation to triple play bundles, that is to say,
24 pay-TV plus phone line and broadband?

25 A. Yes.

26 Q. Would you agree that this is a minority of customers, based on the evidence?

27 A. I have seen numbers relating to Sky of about 4 million, but you can remind me.

28 Q. If we turn to Mr. Matthew's statement at paragraph 72. Just refresh your memory of that
29 paragraph. (Pause).

30 A. Yes.

31 Q. So you see there that this survey evidence indicates that only 39 per cent of consumers in
32 the survey had a pay-TV service from their broadband supplier. Then you have the Sky
33 figures, which I don't believe are confidential, that around half of their subscriber base take
34 broadband and pay-TV.

1 A. Uh-huh.

2 Q. The example also depends on the rival communications provider having a cushion arising out
3 of their own competitive advantage in some other component of the bundle. Is that right?

4 A. No, it just requires that there is a positive margin.

5 Q. But that could derive -- they could be a more efficient competitor than BT?

6 A. More efficient competitor, more attractive bundle, whatever, as long as there is a positive
7 margin in selling the bundle.

8 Q. So they could either have an efficiency advantage or they could have some competitive
9 advantage in relation to another component of a bundle? Some attractive offer for
10 consumers. Is that right?

11 A. Yes, or they could just be very good marketeers. Yes.

12 Q. You give the example of Sky TV. Before looking at the Sky example in more detail, could we
13 consider TalkTalk. Could you please turn to Mr. Heaney's statement.

14 A. Which tab, please?

15 Q. It is at tab 14. You see at the end of paragraph 8 he states his view about TalkTalk's ability to:
16 "... use any market power to cross-subsidise other powers, enabling it to set
17 higher levels of quality or lower prices than would be possible on a stand-alone
18 basis."

19 A. I think Mr. Heaney misunderstands my point. My point is simply that they are earning
20 a positive margin on a bundle. We looked at footnote 18 of Mr. Matthew's report, and
21 I can't give the numbers, but you can see that they were positive margins. So an increase in
22 the VULA price doesn't -- doesn't necessarily lead to -- could still mean that there is
23 a positive margin. It's clearly going to be a lower margin, but the fact that it's just a lower
24 margin doesn't in and of itself prove an anti-competitive effect.
25 Again, I keep coming back to the way in particular Mr. Matthew puts these issues. It is
26 almost as if any increase in the VULA price is problematic, and we can see that through his
27 discussion -- I'm not going to turn to it, but discussion in paragraph 49 of his report. He
28 doesn't talk about a margin squeeze, he just talks about an increase in the VULA price.
29 And, of course, any increase in an input cost will reduce any downstream firm's margins.
30 But so what?

31 Q. If we could just briefly look at paragraph 49 of Mr. Matthew's statement, to consider the point
32 you have just made. It's at tab 12. We will come back to Mr. Heaney's statement in
33 a moment, if we may. So tab 12, paragraph 49 I think was the paragraph you cited. This is
34 in the context of a section headed, two paragraphs above "There is a risk that BT might

1 engage in price squeeze in order to favour its downstream business". So he is not, on a fair
2 reading, talking about any increase in the price of VULA, is he?

3 A. No, I disagree. You read the second sentence -- well, read the whole of 49:

4 "The terms of supply of VULA to BT's retail competitors will influence the
5 nature and intensity of competition that BT's retail operations face. If BT sets
6 a higher VULA price ..."

7 It doesn't say "which gives rise to a margin squeeze", it just says "if BT sets a higher VULA
8 price":

9 "... that will raise the cost to competitors in supplying SFBB products."

10 I agree, but it doesn't tell you whether it's anti-competitive or not.

11 Q. Turn over again to page 26, paragraph 52. You see the reference there to "setting higher
12 VULA prices relative to its retails offers"? A more charitable reading of this ...

13 A. No, sorry, Mr. Holmes, I disagree. Again, a vertically integrated -- this is a correct statement
14 of any vertically integrated firm. When deciding -- absent regulation, which I assume that
15 is what we are assuming here, and any functional separation, any vertically integrated firm
16 will take into account these issues. But this is not anti-competitive, and this is the whole
17 sense that a lot of this is, because BT is vertically integrated and may well have advantages,
18 that is a problem. And that is what I disagree with.

19 Q. If we could return to Mr. Heaney's statement, which is at tab 14, and pick up the theme that
20 I raised with you previously about paragraph 8. Turning to paragraph 37, you see his view
21 expressed there, that:

22 "It would be unrealistic for TalkTalk to absorb any wholesale price increases if
23 BT chose to raise the wholesale price it charges for VULA for the reasons stated
24 at the start of the sentence in the confidential text."

25 And you see why in the following sentence.

26 A. I just need to -- I think we need to read this in context. So go to paragraph 34 and, again,
27 I can't read this out, but it is in the confidentiality ring, here he is not saying -- well, it just
28 says there, and the most important word, which I hope I can read out, is "relative", which is
29 on the second line of the yellow, and it comes back to the point I made earlier; TalkTalk
30 may well be finding it more profitable to push standard broadband relative to pushing
31 superfast broadband. That is just the way the world is. It is not an outcome of
32 anti-competitive behaviour on BT's part.

33 Q. No, indeed. But we are asking ourselves whether TalkTalk would be vulnerable to a margin
34 squeeze if it were to occur in terms of their exclusion from the market.

1 A. What we should be talking about is whether BT has incentives to engage in that behaviour.

2 This whole discussion which follows is predicated that BT does have that incentive, but we
3 haven't yet established that.

4 Q. If there were a softening of competition as a result of a provider like TalkTalk, one of the four,
5 leaving the -- let me put it like this: if there would be such a softening of competition at the
6 retail level as a result of a company like TalkTalk ceasing to supply packages with superfast
7 broadband, would you accept in that case that BT might have incentives?

8 A. No. No, because you -- even in your sort of highly stylised world I think it is wrong. And it is
9 wrong for the following reasons: first of all, the relevant market we are talking about here,
10 as Ofcom has defined it, is all broadband. So even if TalkTalk ceased completely to sell
11 superfast broadband, there is still going to be a competitive market. Secondly, you are
12 making an implicit presumption that effective competition in the supply of
13 standard -- superfast broadband, even way out into the future when standard broadband is
14 no longer in the same relevant market, requires four competitors to have effectively
15 competitive outcomes. No evidence. That is a total presumption. Total presumption on
16 Ofcom's part.

17 Q. You heard the evidence that TalkTalk provides value propositions in the market?

18 A. But what you are saying here is ultimately -- and, again, it comes back to all of this, if
19 TalkTalk got squeezed out of the market because its margins are too low or it decides it's
20 going to focus on a different segment of broadband because it earns higher margins, for me,
21 that is the outcome of the competitive process. For you, for Ofcom, you are saying: no,
22 we've got to give a leg-up, we've got to give a leg-up to TalkTalk to stay in the market.
23 This, again, comes back to the last leg of this whole test, which is: what is the impact on end
24 consumers? And what really worries me, as a potential consumer of superfast broadband, is
25 that the consumer is not mentioned. I tried to listen very carefully to what you had to say
26 yesterday, Mr. Holmes, when you were talking about the impact, the effects. I didn't
27 hear -- and I haven't gone through the transcript, but I didn't hear once "consumers". You
28 just talked about the impact on TalkTalk and the impact on Sky.

29 If we go to the final statement, and I think it is paragraph 750, there is even an admission
30 from Ofcom that BT retail prices may even be higher as a result of this margin squeeze test,
31 and that fills me with horror.

32 Q. But you accept that, if there were a weakening of competition, a significant weakening of
33 competition, that would produce consumer harm?

34 A. But you're -- and correct me if I am wrong, but you seem to be equating the effectiveness of

1 competition with the number of competitors, and I don't see that that is necessarily correct.

2 PROFESSOR MAYER: Could I just ask at this point, Mr. Bishop. I understand that you feel that
3 Ofcom has not provided evidence on incentives or effects. Could you just tell us what
4 evidence you feel should have been provided to substantiate that.

5 A. Excellent question. There are a lot of things -- these issues come up routinely in merger
6 settings, which is slightly different, for the reasons that Mr. Allan raised yesterday, but we
7 have essentially vertical arithmetic. It is common ground that a vertically integrated firm, if
8 it increases the price of its input, there are costs and benefits associated with that. One
9 wants to have some handle on what those costs and benefits are. You can start by looking
10 at what is happening in the marketplace today. You can also do a survey. A lot of these
11 issues which are put onto this table, we could have undertaken a survey to suggest
12 a customer who is thinking of taking up superfast broadband, what options it would have.
13 What would be the second best alternatives. We can look at the margins involved in
14 earning for each of these providers, is earning on standard broadband and superfast
15 broadband across all the various bundles. That is the kind of assessment I think Ofcom
16 should have undertaken.

17 PROFESSOR MAYER: And in relation to effects, what would the evidence be that you would be
18 looking for?

19 A. For effects I would want to be (a) showing that standard broadband was providing a weak
20 competitive constraint on the pricing of superfast broadband products, and I would also
21 want to show that the marginal costs of providers varied significantly with their subscriber
22 base. So not the fixed costs, because clearly I think we all accept that there are economies
23 of scale in that sense, but in terms of the incremental costs of being able to compete for the
24 incremental subscriber, how do those vary with subscriber base.

25 PROFESSOR MAYER: Thank you.

26 MR. HOLMES: So returning to the Sky example in paragraph 53 of your statement, we can work
27 out the profit that would be made in various circumstances. If Sky were to provide TV
28 only, it would make a profit of £10 from a customer. That is right, isn't it?

29 A. I assume that you have read my report correctly, yes.

30 Q. Yes. If Sky were to provide a triple play bundle, but with standard broadband, not superfast
31 broadband, it would similarly make a £10 profit?

32 A. Yes.

33 Q. It is only if Sky provides triple play with superfast broadband that its profit comes down to
34 £8?

1 A. Yes.

2 Q. Or lower, depending upon the extent of the arithmetic margin squeeze?

3 A. Yes.

4 Q. So you would agree I think that, in that event, in the event that it absorbed the superfast
5 broadband price increase from its margin, Sky's incentive would be stronger to
6 compete -- sorry, Sky would not have such a strong incentive to compete for superfast
7 broadband customers?

8 A. In a purely static sense, that is clearly right. But, and, again, I think there is a slight internal
9 inconsistency with Ofcom's argument, in the sense of this is apparently the crucial period of
10 transition to superfast broadband. And, if that is the case, then sometimes firms will
11 swallow the lower margins in the short run because they realise they need to get the
12 advantages that Ofcom presumes are apparent in the next couple of years. So, again, I think
13 there is a sort of tension between purely looking at the static margins and saying: oh, I earn
14 more from standard broadband today, versus the long run transition, where firms are going
15 to have to take a view about where they want to be. Again, those are commercial decisions,
16 but what is relevant in terms of whether they can compete is whether they earn positive
17 margins.

18 Q. You suggest at paragraph 52 of your second report that, in these circumstances, Sky might
19 actually seek to sell bundles including standard broadband instead of superfast broadband.
20 That is right, isn't it?

21 A. Yes.

22 Q. Would you agree that some customers that currently take triple pay from Sky or who are
23 thinking of doing that might be prepared to split the bundle and decide instead to take
24 broadband and voice from BT whilst still taking Sky's pay-TV service?

25 A. Very possibly.

26 Q. And, as in relation to the other categories, a communications provider facing lower
27 profitability would have fewer incentives to invest in superfast broadband offerings?

28 A. Relative to what?

29 Q. A situation in which a margin squeeze was not occurring.

30 A. Well, I mean -- then you have just changed the example because you threw in the words
31 "margin squeeze". Because obviously, again, a high margin or a low margin, but let's
32 assume we are talking about -- there is an alleged margin squeeze, but in my sort of world,
33 which that very stylised example is trying to put across, there isn't a margin squeeze,
34 because Sky again is earning positive margins. So if they earn higher margin, would they

1 have greater incentives? Yes. But does that mean there is an adverse effect on
2 competition? Not necessarily.

3 Q. But it does suggest that, as well as the short-term advantage to BT identified in your report,
4 there would also potentially be a long-term advantage from the reduced competitive
5 constraint on superfast broadband if that were the result?

6 A. Sorry, what was the result?

7 Q. If there were a reduced competitive constraint on superfast broadband as a result of
8 communications providers responding to lower profitability by investing less in superfast
9 broadband offerings.

10 A. I hate to be pedantic but I think you need to be here. Because investing in what? Are we
11 talking about marketing. Yes, that is one possible way of investing. So Sky decides not
12 to -- well, let me go back. The theory of harm we are worried about with margin squeeze is
13 that BT increases VULA price, squeezes the margin that TalkTalk and Sky earn, they exit
14 the market and then BT says: whoopee, we're putting up the price.
15 Sky is not going to be going away. They are still going to be offering standard broadband.
16 Probably TalkTalk as well. At that point, are they effective competitors going forward?
17 Why not? They can still get access now at the VULA price at a positive margin. They are
18 now competitors. So there is a presumption -- if you want me to say: if I assume that Sky
19 and TalkTalk are irrevocably marginalised such that their costs of competing are much,
20 much higher in the future, will there be an adverse effect on competition? I say "yes", but
21 you are not going to the question about, well, how were they marginalised over the long
22 run? And, again, it is not in the Ofcom report.

23 MR. HOLMES: Sir, in terms of timing, I am making good progress, but I have come to the end
24 of a topic and, if it were convenient, this might be a good moment to break until tomorrow.

25 THE CHAIRMAN: Very well, yes.

26 MR. THOMPSON: Sir, I think it might help both me and Mr. Bishop to have some sense of how
27 much longer we have to go. But I don't want to put Mr. Holmes on the spot, because
28 I know things have been slightly elastic already.

29 MR. HOLMES: It is always hard to judge, but I imagine I will be finished by the middle of the
30 morning.

31 MR. THOMPSON: I think that means we will certainly get through Mr. Clarkson and then we
32 may have a question whether we start with Mr. Matthew tomorrow afternoon or whether we
33 leave Mr. Matthew until Monday.

34 THE CHAIRMAN: Mr. Bishop, as a formality, you are under oath, so you shouldn't discuss your

1 evidence with anybody before we resume tomorrow.

2 (4.15 pm)

3 (The hearing adjourned until 10.30 am on
4 Friday, 11th December 2015)

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