

Agenda

Advancing economics in business

A Sky-high damages claim: assessing the harm from a loss of customers

Commercial litigation can require significant input from independent experts. Those experts must bring relevant experience to the courtroom, but experience does not obviate the need to base opinions on robust and clearly substantiated evidence. The recent BSkyB/EDS litigation, involving a £700m damages claim, highlights how experts can best influence outcomes

This article contains a recent example of how a well-qualified expert had an important bearing on the outcome of a major litigation case. More about that later. The main aim here is to provide an insight into how appointed experts can influence proceedings, and to highlight some key lessons that can be drawn in terms of the approach adopted.

The case concerned the impact on BSkyB's (Sky) pay-TV business of the delayed installation of a new customer relationship management (CRM) system. As well as making customers' details available to Sky's customer advisers at call centres when dealing with enquiries, the CRM system is the backbone of many forms of communication between Sky and its customers. As described in the judgment, the CRM system:¹

facilitates, governs and records all customer related transactions, such as setting up a new account, closing an account, reporting a fault, calling out an engineer or changing a package. It also allows Sky to bill and process payments from their customers.

In 2000, Sky had engaged Electronic Data Services Ltd (EDS)² to develop and install a new CRM system to replace Sky's previous system, which was reaching its capacity to deal with the number of customers that the company was gaining, and the increasing range of services being purchased by those customers. The system was due to have been installed in July 2001 at a cost of £48m. However, the contract did not go as anticipated. EDS failed not only to deliver to this timescale, but to deliver at all, and Sky eventually took the project in-house in March 2002.

In August 2004, Sky initiated proceedings against EDS in the Commercial Court, for fraudulent misrepresentations that had led to EDS being selected. Sky was claiming not only for the costs it had incurred following EDS's failure to deliver, but also for the lost

profit from customers it failed to retain as a result of not having the new system in place. The proceedings culminated in a decision issued on January 26th 2010. Following the judgment, the parties negotiated a settlement for significantly less than the original claim of around £700m.

Owing to the complexity of the issues, expert evidence was deemed necessary in the proceedings in four categories: IT, customer churn (the numbers of customers who stop buying a company's services), call avoidance (the reduction in the number of calls made by customers to call centres), and quantum (the total value of the claim).³ The focus below is on the analysis and assessment of customer churn.

Relevant experience is necessary, not sufficient

Sky's 'churn expert' had 25 years of academic and commercial experience in relation to CRM systems, in advising companies on 'how to deploy customer information, CRM systems and customer management processes in order to improve how they acquire, retain and develop customers cost-effectively so as to meet their marketing, sales and service objectives' (para 282 of the judgment).

As an economist with a focus on consumer behaviour and the functioning of markets, EDS's expert did not have the CRM experience that Sky's expert held, but had 'wide experience of analysing customer choice and [had] designed, supervised and analysed surveys of consumer choice and in particular switching decisions in broadcasting, credit cards, energy supply, mobile and fixed telephony' (para 284).

In its evidence, Sky submitted that its expert had 'much more relevant expertise to express a view on the ability of the Sky CRM system to reduce customer churn' (para 287). In the judgment, while the relevance of this experience was highlighted as enabling Sky's

expert to provide 'a valuable opinion on the effect of the CRM system on Sky's customers' (para 288), it was also found that the relevance of that experience had to be supported by the quality of the analysis on which any opinions expressed were based. In that regard, in his conclusions, the judge placed greater weight on the opinions expressed by EDS's expert, based, as they were, on the provision of 'reasons for [the expert's] predictions' and answers to the questions posed that 'were based on evidence and reliable'.

Establishing the baseline

The commercial implications of any behaviour, whether anti-competitive or failing to fulfil a commercial obligation, cannot be assessed in isolation. It is necessary to compare what has happened against a forecast of what would have happened had the issue not arisen. To establish the extent of harm suffered by Sky as a result of EDS's failure to fulfil the contract, it was therefore necessary to establish a baseline, or business as usual (BAU) scenario. As noted in Oxera's report for the European Commission on assessing damages:⁴

Calculating the damage arising from an antitrust infringement requires an assessment of what would have happened in a hypothetical scenario where the infringement had not taken place—this is commonly referred to as the 'but for' or counterfactual scenario. This is often the central stage in any damages estimation.

In determining the measures to be forecast in the BAU scenario, it is also necessary to consider the focus of the claim. In this case, the focus was on the incremental impact on the rates of churn due to the changes to the CRM system. The underlying forecasts of the actual subscriber numbers to which those churn rates were applied were therefore of secondary importance in the BAU. Since the differences between the forecasts of subscriber numbers did not have a material impact on the claim, the experts agreed to adopt the same forecast, enabling the Court to focus on those factors on which the experts disagreed.

The basis of the claim for lost profit was that the sooner the system was in place, the sooner Sky would have been able to reduce churn rates and therefore increase its subscriber base. There was a four-year lag between EDS being contracted to install the new system and its actual installation, so each customer not saved generated a loss of profit over that four-year period.

At the time of quantification, however, the actual system had only recently been implemented, so there was little evidence of the effect in practice. As a result, the entire quantification of the effects of the CRM was hypothetical.

Identifying the influential functionality

The next stage in the analysis was to identify which elements of the functionality of the CRM system could have an impact on customers' decisions to terminate their contract with Sky. There was an apparent mismatch between the issues that the IT experts and the churn experts on both sides were required to address.

For the IT experts, the issue was to determine the difference between the specification of the 'Actual CRM' system (ie, the one eventually installed by Sky) and that of the system to be installed by EDS. For example, it was important to establish whether there were additional or fewer elements in the Actual CRM than in the original specification. Any differences fed into the IT experts' estimation of the difference in cost of developing the two systems. For them, the difference between the CRM system that was in place as at 2000 (the Digital Customer Management System, DCMS) and the new system was not relevant.

For the churn experts, however, it was essential to understand not only the difference between the Actual system and the alternative CRM system that could have been installed by EDS, but also—and crucially—in what ways the new CRM system differed from the DCMS. It was these differences that affected customers' decisions to terminate their contract. The greater the differences in the contribution of the CRM system to reductions in churn, the greater the impact of the delay in installing a revised CRM system.

While it was possible to draw on the analysis of the IT experts to understand the functionality of the CRM system actually installed, and the specification of the system that Sky had commissioned from EDS, an assessment of the differences between the existing and revised systems had to be undertaken by the churn experts themselves.

However, functionality was, by itself, insufficient, and it was necessary to observe the way in which the call centre operatives used the system in practice. This part of the assessment was based on observations made during visits to Sky's call centres and offices to view the functionality of the systems and enhancements, and on statements made by customer advisers during those visits.

The main lesson from this for the use of experts was that the instructions to the IT experts were agreed significantly in advance of the instructions to the churn experts, and the read-across from one to the other was not as well incorporated as it could have been. Another key lesson was that when a paper-based assessment of a system does not suffice, on-site observations can be arranged, which can prove vital in the proceedings.

From functionality, to saveability, to saved in practice

Having developed an understanding of the differences in functionality (and usability) of the CRM systems, the churn experts faced the challenge of identifying how significant each difference in functionality was in reducing churn rates, and thus in contributing to lost profit.

The information and analysis undertaken by Sky itself, and obtained through the disclosure process, were essential for this analysis. Sky had collated and analysed significant volumes of information on the reasons for customers leaving, through both notes made by the customer advisers capturing customers' reasons, and follow-up market research. This provided a framework for assessing the reasons for churn, and the extent to which these could be addressed through changes to the CRM system.

The approach adopted by both churn experts was to identify the potential maximum target group for each element of functionality. For example, functionality that improved the customer advisers' ability to cross-sell broadband services might affect the 20% of customers who terminate their contract for value-for-money reasons. The experts then applied an adjustment to estimate what proportion of that group would be saved in practice (since no system can be entirely effective at preventing churn).

The main categories, which account for over half of the total cancellations, were:

- subscription fee issues relating directly to the price—eg, 'subscription fee is too expensive' and 'price increase';
- change in lifestyle situation—eg, moving house or going abroad;
- change in financial situation—eg, changes in employment circumstances, meaning that the customer could no longer afford to subscribe;
- content issues—'too many repeats' and 'poor quality/ too many worthless channels'.

For each of these, sub-divided into 14 categories, the drivers of churn were analysed in detail, highlighting where, in particular, customer service failings to which the CRM contributed could have been addressed by changes to the DCMS. The analysis focused on identifying the role of offers to customers in inducing them not to switch; the way in which the CRM system enabled suitable offers to be identified; and their likely impact on churn for those customers. While EDS's expert adopted a more granular categorisation to this analysis than Sky's expert, the two approaches could be mapped onto each other, enabling clear identification of where the differences in opinion arose.

One piece of evidence highlighted that extreme care should be taken when interpreting the information collated about exiting customers. This information suggested that the death of a customer was a small but significant driver of churn (and clearly one that could not be addressed by any CRM system). However, Sky's witness evidence noted that 'dead customers do apply for new subscriptions and this is referred to [as] the "Lazarus phenomenon".' (para 2056) Some supposedly 'dead' customers could therefore be prevented from churning, since they were not in fact dead, but merely used this as a reason to terminate their contract with Sky! The adjustment made by EDS's expert to the calculations to exclude dead customers from the 'saveable' category (thereby reducing the claim value) was therefore rejected by the judge.

While the judge made certain adjustments to the saveability figures presented by EDS's expert, on balance the outcome was significantly closer to the EDS expert's original figures than to the figures put forward by Sky's expert. For example, for a number of categories of churn, Sky's expert posited that almost all (96%) of the churners would be saveable as a result of the CRM system—in effect, that these categories of churn would be eliminated. The adoption of such high figures was not justified in a way that persuaded the judge that this degree of effectiveness would be likely to have been a consequence of successful implementation of the CRM. In concluding, the judge reinforced the importance of not simply bringing relevant experience to the Court, but applying that experience to generate a robust assessment 'firmly based on an analysis of the available evidence'.

Can experts change their minds?

From start to finish, experts can be involved in disputes such as that between Sky and EDS over the course of several years. During that time, a significant volume of new information may come to light, some of which may have an important bearing on statements that the experts have previously made. Sometimes, this new information will lead to different conclusions being reached, and, on occasion, it may highlight mistakes that have been made. A crucial issue is how experts should deal with such changes of opinion or corrections to their analysis.

One particular issue that arose in the Sky/EDS case related to the similarity (or otherwise) of customers who phone to cancel their subscriptions (known as 'cuscan'), and those whose service is automatically stopped by the system after non-payment (known as 'syscan'). In his first report, Sky's expert had used the information on reasons for cuscan churn, but applied those reasons to the total levels of churn (ie, including both cuscan and syscan) without examining why syscan should be treated in the same way as cuscan.

His subsequent explanations did not convince the judge, who emphasised the importance of:

ensuring that any errors, which are understandable in these complicated subjects, are made clear and the cause of the error is fully explained. (para 2133)

A further example arose in relation to understanding the functionality of the CRM and how it related to moving house. Even when it became apparent that an element of functionality that had previously been assumed to exist did not in fact have any bearing on this category of churn, Sky's expert made no corresponding downward adjustment to his estimates of the effectiveness of the CRM. This led the judge to note (para 2077): 'I found it difficult to understand how [Sky's expert] could maintain his figures when his understanding of the Sky home moving process evidently changed dramatically.'

Summary

Providing expert support to courts in complex litigation is time-consuming and requires significant focus over a long period of time. Literally millions of documents can be disclosed, and understanding of the issues (on all sides) can develop significantly over the period. At the same time, as can be seen from the level of the claim and the ultimate settlement involved in this case, the financial implications can amount to hundreds of millions of pounds.

A number of lessons can be drawn from the experience of the Sky/EDS case.

1. However relevant one's experience, opinions expressed must ultimately be supported by robust, clear and convincing analysis.
2. It is reasonable to change your mind and to correct mistakes, but the reasons for these changes must be clearly explained to avoid damage to the credibility of the evidence.
3. When different sets of experts are involved on different, albeit related, topics, and some experts' conclusions depend on the outputs of other experts, the questions relevant to one set might not address all the relevant issues. Early engagement in determining the instructions to each set of experts is therefore important.
4. When understanding that a system requires not just a paper-based assessment of the functionality, but also observation of the usage of that system, even defendants' advisers and appointed experts can request site access.

Now, about that dog ...⁵

¹ *BSkyb Ltd & Anor v HP Enterprise Services UK Ltd & Anor* (Rev 1) [2010] EWHC 86 (TCC) (January 26th 2010), para 8.

² EDS was subsequently acquired by HP Enterprise Services UK Ltd.

³ In 2007 EDS appointed Dr Helen Jenkins, Oxera Managing Director, to provide expert evidence in relation to customer churn, with Professor Merlin Stone appointed by Sky in the equivalent role.

⁴ Oxera and a multi-jurisdictional team of lawyers led by Dr Assimakis Komninos (2009), 'Quantifying Antitrust Damages: Towards Non-binding Guidance for Courts', study prepared for the European Commission Directorate General for Competition, December, p. 2.

⁵ The case document explains how Lulu, the pet dog of the barrister acting on behalf of the claimants, obtained the same MBA certificate as one of the defendants' factual witnesses, and even scored higher marks. *BSkyb v HP Ltd.*, op. cit., paras 174–96.

If you have any questions regarding the issues raised in this article, please contact the editor, Dr Gunnar Niels: tel +44 (0) 1865 253 000 or email g_niels@oxera.com

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