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IN THE COMPETITION
APPEAL TRIBUNAL

Case No. 1109/6/8/09

Victoria House,
Bloomsbury Place,
London WC1A 2EB

7th September 2009

Before:

THE HONOURABLE MR. JUSTICE BRIGGS
(Chairman)

PROFESSOR PAUL STONEMAN
DR. VINDELYN SMITH-HILLMAN

Sitting as a Tribunal in England and Wales

BETWEEN:

BARCLAYS BANK PLC

Applicant

- v -

THE COMPETITION COMMISSION

Respondent

- and -

FINANCIAL SERVICES AUTHORITY
LLOYDS BANKING GROUP
SHOP DIRECT GROUP FINANCIAL SERVICES LTD

Interveners

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HEARING
DAY ONE

APPEARANCES

Mr. Thomas Sharpe QC and Mr. Matthew Cook (instructed by Clifford Chance LLP) appeared for the Applicant.

Mr. John Swift QC and Miss Kassie Smith and Miss Elisa Holmes (instructed by the Treasury Solicitor) appeared for the Respondent.

Mr. Mark Hoskins QC and Miss Marie Demetriou instructed by and appearing for the Intervener, The Financial Services Authority.

Miss Helen Davies QC and Miss Kelyn Bacon (instructed by Herbert Smith LLP) appeared for the Intervener, Lloyds Banking Group.

Mr. Paul Lasok QC and Mr. Tim Ward (instructed by DLA Piper) appeared for the Intervener, Shop Direct Group Financial Services Ltd.

1 THE CHAIRMAN: Yes, Mr. Sharpe?

2 MR. SHARPE: Sir, may I begin with a brief housekeeping matter please – timetable.

3 THE CHAIRMAN: Yes.

4 MR. SHARPE: Sir, I expect to be up for today and a good chunk of tomorrow. I apologise in
5 advance for that but my task I think is to try and give you as much background material as
6 well as our own submissions, but I will not be any longer, especially in front of this
7 Tribunal, than is absolutely necessary. We then anticipate that Miss Davies will follow for
8 Lloyds Bank as supporting intervener, and she thinks she is going to take two hours to half a
9 day. That takes us up to Wednesday afternoon.

10 Mr. Lasok, on behalf of Shop Direct, thinks he can be even briefer than that and thinks
11 between 30 minutes and an hour. That takes us up to about 3 o'clock or so on Wednesday.
12 I have spoken to Mr. Swift, who appears on behalf of the Commission, and quite rightly he
13 drew my attention to the fact that we are throwing him into the deep end mid-afternoon
14 having had the dubious privilege of two days of listening to me, and will perhaps need a
15 little bit of time to prepare his thoughts which, of course, will assist the Tribunal, so
16 between us we thought, subject to your approval, if we should finish the applicant's case
17 and interveners by about 3 o'clock on Wednesday, and there is no guarantee, it might be
18 later than that, you might think it sensible to adjourn to allow him overnight and, if
19 necessary, we could start a little earlier on Thursday morning.

20 THE CHAIRMAN: We will, I think, take a flexible approach to that, Mr. Sharpe, Mr. Swift, you
21 may feel you have a burning desire to say something immediately or not as the case may
22 be.

23 MR. SWIFT: Good morning, Sir, members of the Tribunal. I am very happy with Mr. Sharpe's
24 suggestion, although I was a little bit concerned about coming in to bat at 3 o'clock in the
25 afternoon with an hour of perhaps some hostile bowling. We will see how we get on; the
26 other possibility, if Mr. Sharpe finishes by close of play tomorrow – there are too many
27 cricket analogies here – Shop Direct come in for an hour on Wednesday morning, then I
28 could start on Wednesday morning, let us be flexible.

29 THE CHAIRMAN: Our anxiety, if there is one, is only to make sure that we finish this week.

30 MR. SHARPE: I would think, Sir, there is no real risk of us going over.

31 THE CHAIRMAN: Have you got an updated time estimate, Mr. Sharpe?

32 MR. SHARPE: I have and I should mention the FSA are coming on after- I am sorry, when Mr.
33 Swift rises he expects to be about half a day. So that could take us, depending on when we

1 start to no later than Thursday lunch time. Then Mr. Hoskins will proceed to finish with the
2 FSA, which he expects as I understand it to be really quite brief.

3 MR. HOSKINS: About 30 minutes.

4 MR. SHARPE: Thank you, 30 minutes. It is quite likely I shall rise again to reply, subject to
5 your wishes, but I do not anticipate that being very long, so there is a chance – I put it no
6 higher – that we will finish on Thursday evening or pretty early on Friday, so I think we are
7 well within the margins of tolerance.

8 THE CHAIRMAN: We have set aside the whole week, but it goes without saying that we can
9 make very good use of Friday even if you finish on Thursday. (Laughter)

10 MR. SHARPE: Yes, indeed, and I shall certainly be no longer than I think is absolutely
11 necessary. Experience has taught me in this Tribunal it is not necessary to say things twice
12 and if I fall from that standard I will no doubt be reminded of it.

13 There were one or two other matters which happily have dropped away, they deal with
14 admissibility of what I call the “after evidence”, Mr. Colley’s second report. A spirit of
15 harmony continues to exist ----

16 THE CHAIRMAN: Harmony or bargain as it appeared from the correspondence.

17 MR. SHARPE: Indeed, yes. So there is a mutual recognition of each other – if they have any
18 points to make about the nature of the evidence it is up to the parties to make it, there is not
19 going to be a preliminary application on admissibility.

20 THE CHAIRMAN: Yes, well it seems to us sensible that harmony has been reached, because it
21 might otherwise have entailed a rather nit-picking trawl through lengthy documents to see
22 which bits of them survived some acid test but we think that is best done, as it were, when
23 we consider our views about that matter in the round.

24 MR. SHARPE: With respect that is absolutely right, Sir.

25 THE CHAIRMAN: May I just ask you one question, in your very helpful skeleton argument you
26 promised us a reading list which I think did not materialise so far as getting to us ----

27 MR. SHARPE: Oh, I am sorry.

28 THE CHAIRMAN: No, that is quite alright, but not having had it you are perfectly entitled to ask
29 in broad terms what we have read so that you know read in the Tribunal actually is. Shall I
30 just tell you in broad terms, we have obviously read all the skeletons, we have read what I
31 suppose I ought to call “statements of case” and the expert and brief non-expert evidence,
32 and we have separately read large parts of the report; I do not think any of us would pretend
33 we have read every word of it and quite substantial tracts of it are not, I think, in issue.

34 MR. SHARPE: They are not.

1 THE CHAIRMAN: But make the assumption that we have certainly read items to which we have
2 specifically been directed, but also in the context of reading whole chapters to see how they
3 stand as a whole and you will no doubt not need to be told which chapters we have in mind
4 in particular.

5 MR. SHARPE: May I suggest, Sir, that I am planning to take you in the ordinary way actually, in
6 opening, to some extracts from the report which I think are particularly important. If I
7 overstay my welcome I hope you will indicate to say: "This is all now very clear, get on
8 with it, move on."

9 As far as the authorities, it is not a case in my respectful submission a case where there are
10 major legal issues between the parties, I think that is clear. Not just for form but because it
11 is appropriate I will be taking you to *BSkyB* briefly, I will be taking you to *Tesco*, not so
12 briefly, because *Tesco* is a very important case for us, actually apart from that and making
13 reference to the familiar cases of *Mahon* and *Tameside* and so forth, there is really not a
14 great deal more on that. My friend has introduced some more authorities, the childcare
15 ones, which I appreciate how he might be using those, but I respectfully want to wait and
16 see how he deploys his case and then I will respond briefly in reply.

17 THE CHAIRMAN: You do not need to read passages out save where the emphasis placed on
18 words is important as an aid to interpretation, and where you feel that it is necessary
19 because of the numbers of those present who do not have the materials in front of them, but
20 in general if you tell us what you want us to read.

21 MR. SHARPE: Exactly, Sir. My quotes really will fall into two categories, the lengthy ones
22 which I have no intention of reading I will, if I may, direct you to where I think you should
23 read and you will tell me when you have finished, but there are others where the quotes are
24 sufficiently short that it would be disproportionate to go off and find the reference when I
25 hope I can be relied upon faithfully to quote from the text itself, and that will be in the
26 record, and I will make sure that the record has the references so that in what I will
27 euphemistically call "your leisure" you can return to it if you want to.

28 THE CHAIRMAN: Just to make sure we are all on the same track, we are operating from a five
29 volume hearing bundle.

30 MR. SHARPE: Five volumes, that worries me.

31 THE CHAIRMAN: Well there are two authorities and three bundles, one of which consists of the
32 report and one of which consists of skeleton arguments – oh yes, I am sorry, there is a
33 supplementary authorities' bundle, that takes it up to six.

1 MR. SHARPE: That is right. We have essentially three core bundles, I will call them CB1, CB2,
2 CB3, and three authorities' bundles. There is an issue about confidentiality, which my
3 friend, Mr. Swift, has reminded me of, and I am trying to remember what it was. I think we
4 are dealing at all times with a confidentiality bundle.

5 MR. SWIFT: Yes.

6 MR. SHARPE: That is all. My understanding is that anything relevant is marked, but actually it
7 was, if I remember, very trivial, perhaps in every sense, redactions.

8 THE CHAIRMAN: Well we have seen the marking system, and we will obviously try to avoid
9 trespassing in terms of what we say into those areas and you can do it by asking us to read
10 passages without reading them out.

11 MR. SHARPE: I do not think I am actually going to direct you to anything that is remotely
12 confidential.

13 THE CHAIRMAN: Good.

14 MR. SHARPE: I think it only concerns, from memory, the sensitivities of the FSA and, as
15 always, I shall be sensitive to their sensitivities, I do not think it looms at all in our case
16 actually.

17 THE CHAIRMAN: Finally, Mr. Sharpe, we think it sensible to take short breaks mid-morning
18 and mid-afternoon. I am very happy you should choose what is most convenient to you.
19 We do not have shorthand writers who will be getting into serious problems I do not think if
20 the break is five minutes earlier or later, indeed the break is for everyone's convenience
21 rather than theirs.

22 MR. SHARPE: Thank you, I will choose a natural moment so we are not mid-sentence, and if I
23 should forget my learned Junior will prompt me.

24 Prudent people with responsibilities to their families, and worried, as millions of people are
25 today, they will lose their jobs or earn less, become sick or even die before a mortgage or
26 loan is paid off, will try to reduce the risks associated with taking out a mortgage or a loan.
27 Of course, there are those who can take out loans with no real concern. I am bound to
28 reflect that pretty well everybody in this room falls into that category. But, many on lower
29 incomes are not so fortunate. They will have to think twice before taking out a loan at all,
30 but if they do go ahead, one way of reducing the risk to themselves and their families is to
31 insure against a bad event - a bad event which would disable repayment so avoiding
32 foreclosure of their mortgage and possible homelessness or debt proceedings.

33 Payment protection insurance - PPI - fulfils that need. As the report makes clear, most
34 policies are presently sold by distributors - that is the term of art, you will recall, in the

1 report, at the point of sale, of the credit being insured. It is hardly surprising that protection
2 against default and the underlying credit are inextricably linked so that both the borrower
3 and the lender find it convenient to conclude all aspects of the transaction in one go - that is,
4 taking out the loan and taking out the insurance of that loan.

5 The Competition Commission's own survey reports the overwhelming response that the
6 convenience of the two related transactions taking place together is highly valued. I will
7 take you briefly to the GSK survey later. The report tells us that over half of PPI policies
8 are sold across the table through face-to-face contact with an advisor, with the client
9 discussing his or her needs at that time, sometimes in the course of a lengthy interview - I
10 think Lloyds provide evidence for their own in-house survey of forty minutes time, or so.
11 The Commission has decided, nevertheless, to impose an absolute prohibition on PPI
12 distributors selling PPI at the credit point of sale across the table, whether the borrower
13 wants to buy it then or not. As a result, the PPI customer has to undertake two separate
14 transactions separated by time, rather than just one. The borrower is required to wait at
15 least twenty-four hours, and even then he cannot physically cross the threshold back into the
16 bank or to the office of the lender to sit with an advisor. He or she - and it must be the
17 borrower only - must initiate the contact and must confine the contact with the lender
18 distributor to the telephone or internet. Before any sale of PPI can be made, the PPI
19 distributor must obtain confirmation that the borrower has obtained the personalised PPI
20 quote, has seen it, and later be prepared to verify it to what are called the monitoring
21 agencies that the sale was a genuinely consumer-initiated sale.

22 For everyone else, they must wait seven days from the provision of the PPI quote before the
23 other side of the credit transaction - the insurance protection - can be concluded. This, of
24 course, is the point of sale prohibition - the POSP. I apologise for the plethora of acronyms,
25 but that is par for the course, I am afraid, in all competition proceedings. It is that POSP
26 which is the primary focus of this application.

27 Just by way of introduction, let me take you to Professor Yarrow's expert evidence for two
28 short paragraphs. You will find this in CB1, Tab 4, p.82. I ought to say that Professor
29 Yarrow, in competition circles at least, and regulation circles, needs no introduction. He is
30 a seasoned observer of the regulatory scene. In fact, he is a regulator himself. He is on the
31 board of Ofgen, the energy regulator, and advises another regulator, the Civil Aviation
32 Authority. He is a don at Oxford. Among his other attributes he founded the Regulatory
33 Policy Institute, the RPI. The RPI, of course, was also co-founded with the then solicitor,
34 Peter Freeman - a name that will be familiar to you as he is now the Chairman of the

1 Competition Commission. So, his credentials are, I think, unimpeachable. He just offers
2 this very brief opening observation which I think sets the scene a little bit. I am going to
3 take it up at para. 9. We are not going to go to this report very much. I am going to use his
4 expert report as support for my submissions. Paragraph 9 reads,

5 “The stand-out feature of the report is the proposal to introduce a point of credit
6 sale prohibition (POSP) for PPI. This is the aspect of the proposals which (at least
7 compared with the other remedies proposed) the CC itself recognises involves a
8 stepped change upwards in the degree of regulatory intervention in the market”.

9 The footnote is worth considering.

10 “The news release accompanying the publication of the report acknowledges that
11 the proposed remedies represent ‘significant interventions in this market’”.

12 He also then goes on to quote para. 10.508 of the report,

13 “We acknowledge this remedies package represents a substantial change to the
14 way PPI is bought and sold and that the transitional costs for distributors of
15 implementing the packages are likely to be material. We note that the point of
16 sale prohibition, which is the most costly to implement, is at the heart of the
17 remedies package”.

18 Then briefly at 10,

19 “The proposition that point of (credit) sale of PPI, an obviously convenient and
20 low cost way of selling the product which is currently the predominant way of
21 supplying and obtaining PPI is a feature of the market that had adverse effects on
22 competition [and obviously we will be coming back to AEC in that later] is
23 strongly counter-intuitive, even to intuitions honed over the years by sustained
24 exposure to anti-trust economics. In contrast, the proposition that the prohibition
25 of a predominant convenient and low cost method for selling a product would be a
26 major restraint of trade that could be expected to have an adverse effect on
27 competition seems almost so obvious as to amount to a reasonable but rebuttable
28 presumption - that is, it would be the prohibition of the practice, not the practice
29 itself that would normally be expected to give rise to the AEC”.

30 I think it is worth just glancing at 11. I am not going to read it. You see his approach here
31 is not to analyse the POSP on the grounds of rationality. Is it barking mad? That is not his
32 task. What he is saying here is, “I have assessed the Commission’s reasoning and use of
33 evidence in order to try and understand how they get to the conclusions they have reached,
34 and to determine whether the reasoning and evidence stack up in a way that might

1 reasonably support their conclusions that the POSP can be expected to have a favourable
2 economic effect". So he is four-square behind our case. We are looking here not at the
3 rationality of the proposal, and it is a key distinction, we are looking to see how on earth did
4 the Commission arrive at the conclusions that it did on the basis of the evidence it provides
5 to support or not its conclusions.

6 Our challenge to the POSP is made on three grounds, and I am going to summarise them
7 briefly. First, we say that the Commission approached the proportionality of its proposed
8 remedies on entirely the wrong basis, a fundamental attack upon what they did, what they
9 thought they should be doing in assessing proportionality. The first part there is that they
10 were content to look only at the full scale of the problems which the Commission identified.
11 It is one thing to say in the course of a report that the total detriment arising from this AEC,
12 the adverse effect on competition, in the PPI is X million. That is an interesting statistic and
13 an interesting enquiry, no question. But when we assess the proportionality of any remedy
14 it is simply not good enough to compare the costs of implementing the remedy with the
15 overall scale of the detriment because actually we are interested in what the remedy can
16 achieve.

17 This was the fundamental mistake the Commission made, and understandably, because this
18 had been their approach since this Tribunal's judgment in *Tesco*. This report was crafted,
19 drafted, in the period late autumn leading up to November, December and January, and it
20 was published I think on 29th January 2009, and of course the *Tesco* case was argued in
21 November and judgment came out afterwards on 4th March. I will take you to *Tesco* later,
22 but it is sufficient simply to say that this Tribunal analysed the Commission's approach to
23 this assessment of proportionality, listened to the Commission's submissions that they were
24 entitled to look, as a matter of law, to the total scale of the detriment and no consider the
25 effectiveness of the remedies. It was only the effectiveness of the remedies that had to be
26 balanced against the cost of implementing those remedies, and you will know from your
27 reading that that approach was struck down by the Tribunal.

28 It is every lawyer's nightmare in a way to have advised and crafted a report where the legal
29 substratum, the approach, that the Commission have taken, has been overwhelmed or taken
30 away by this Tribunal in the *Tesco* judgment. That will be one of my primary submissions.
31 I trail that, but that is our first approach to proportionality.

32 The second point underlying that is that it is not sufficient to say what the remedy might do,
33 because even if they had got it right and understood that their remedy would achieve, they
34 say, the elimination of all the detriment, and that is a point I am going to have to argue

1 against, an essential ingredient to that calculation must be how long is it going to take. If it
2 is going to take effect immediately - by “take effect” I mean have effects to eliminate the
3 adverse effect on competition, I do not mean simply to implement the legal regime to
4 provide for it, but how long is it going to take. Plainly something that is going to take effect
5 immediately can be calculated, and the cost of implementation adjusted. Sometimes, and
6 we acknowledge, some remedies will take a long time to be implemented and be necessary.
7 Whatever the circumstances, the Commission are obliged not merely to say that it will all be
8 implemented in a timely way in time, they have actually got to sit down and make an
9 assessment of how long it is going to take before the detrimental effects you are seeking to
10 eliminate are being eliminated. Any failure to do that means you cannot do a proper
11 proportionality calculation because as each day goes by, each month or year goes by, costs
12 will add up, so you cannot do the essential cost of implementation exercise without
13 knowing how long it is going to take.

14 That is especially true in this case where £100 million or so of costs will have to be
15 incurred, as it were, up front, immediately, in the course of this order being implemented.
16 We have no idea from the report, and this is the fundamental point. If they had said, “We
17 have hard evidence”, and provided it, “that these remedies will take effect in one, two, three
18 or four years, then we can we can work back and see what the costs were”, but there is
19 nothing in the report to give any reader any indication of how long these remedies are going
20 to take, if ever they provide an effective remedy to the detriments they have identified. It is
21 a pretty fundamental position, a fundamental gap in the report, and once again and not
22 coincidentally it was exactly the error that the Commission fell into in *Tesco*. They used
23 pretty well the same language, “they will come into effect in a timely way”. Fine, that is
24 great, but, as the Tribunal said in that case, that is absolutely useless in order to make an
25 assessment of what the costs are going to be.

26 Failure on either of those grounds, in my respectful submission, means that the remedy must
27 be quashed.

28 It is clear to us, whatever the Commission may say in its defence and skeleton argument,
29 which of course were produced after the judgment in *Tesco*, the Commission evaluated
30 proportionality by reference to the full scale of the problems that existed in the PPI market
31 rather than what the remedies were designed and expected to achieve.

32 The Commission argue in their defence that this is all right since they concluded in the
33 report that the remedies package will perfectly remedy the problems they found to exist, so
34 it does not matter whether they have looked at the total scale, which we say they did,

1 because what the remedies were designed to, and would, achieve would be the complete
2 elimination of the detriments they discovered. So they may have got it wrong, and I am
3 putting a gloss on it, which I hope I am entitled to do, we may have looked at the total scale
4 of the detriment, but it does not matter because actually when the remedies get going they
5 will eliminate the total scale of the detriment so it will actually be, “What are you
6 complaining about?” We take a very dim view of that submission and I am going to take
7 you to the report to show that not only did they look at the scale of the detriment, they
8 regarded that as sufficient and the report is abundantly, in our submission, that they were
9 well aware that their remedy would not be perfect. Indeed it would be an heroic claim if
10 any Commission, any regulatory body, in the world aspired to perfection. Unfortunately,
11 anything less than the achievement of perfection here damns the report. What they should
12 have done is made a sensible and mature assessment of that proportion of the total detriment
13 they were likely to eliminate, the timescale in which it was going to be eliminated and then
14 matched that against the benefits they claimed would arise.

15 As a result of this challenge they are forced into an almost impossible situation of having to
16 justify they argued the case and created the report on a different ground than they created
17 the *Tesco* groceries report at the same time as they were defending their approach in the
18 *Tesco* case; and secondly, in any event, whatever the report may say, the remedies are
19 going to be perfect and they are going to be fairly immediate, to take effect fairly
20 immediately. None of those cases, none of those arguments, in my submission, can be
21 sustained.

22 It means I am going to have to take you through the report to the points that they rely upon.
23 Our view is that they did not make any findings of any kind which would support them.
24 As I say, that is our first attack. They just got it wrong fundamentally, and measured by the
25 standard that this Tribunal established in *Tesco* that remedy must be quashed.

26 Secondly, as I have already explained, by prohibiting the easiest and most convenient form
27 of PPI sale with an adviser, armed with all the details about the credit, the credit product
28 that is being sold, both parties are tuned to what needs to be discussed on taking up credit
29 and the terms and the ability to repay and the risks that any borrower might be running,
30 whether it be sickness or unemployment, and all that sort of thing. That is by far the most
31 convenient form of PPI sale period. Denied the possibility of doing that even for 24 hours,
32 but especially for seven days could lead and would lead to a fall in PPI product sales and
33 everyone – everyone – who gave evidence, including those who were instrumental in
34 bringing this case to the attention of the Office of Fair Trading and then the Competition

1 Commission, everyone, thought that this remedy, whatever its longer term effects may be,
2 would have short term, and possibly longer term adverse consequences on demand. It
3 would, in essence, leave that demand unmet, because this type of delay undoubtedly adds to
4 the cost and convenience of taking up PPI, at the very least people have to make two trips
5 and go through a further interview process.

6 All the evidence suggests from everybody who is in this industry, and those who comment
7 upon it, and those whose responsibility is to protect the consumer – Citizens’ Advice
8 Bureau, for example, their evidence suggests it is going to increase the cost with the result
9 that less people are going to take up product. It is not really an argument. The
10 Commission acknowledged this, and I am going to take you to para. 10.50 of the report in
11 due course (but for your note). They made no attempt, as they should have done, to
12 evaluate, even in general terms, the extent of that admitted adverse effect as they should
13 have done. But it is worse than that. When they come to make their assessment of
14 proportionality they ignore it. So when they analyse and evaluate proportionality the near
15 certainty based on the evidence of a reduction in demand, which one would have thought
16 was actually rather an important feature of the remedy, is ignored, as if it had imposed no
17 costs upon the consumer. There is a danger here of isolating costs only in relation to those
18 people who did not take it up but would have done but for the egg and spoon race of having
19 to go back. In fact, even those who did come back in seven days would have had to incur
20 some cost and time. I do not want to make too much of that point, but they are two sides of
21 the same coin. This was therefore a further ground on which their analysis of
22 proportionality was flawed.

23 Thirdly, quite closely linked to our first ground, in its analysis of proportionality, the
24 Commission modelled the effects of a hypothetical package of remedies which I suspect
25 you have seen, the assumptions of that model were that it would work, the remedies would
26 be fully effective, costless, and would drive the level of excess PPI profits down to zero in
27 each case. It is very important, in my submission, to understand that these were not outputs
28 of the model, in other words you set up the equations and the relationships, press the button
29 and then see what the predictive power of the model would be. These were assumptions
30 underlying the model itself, and from time to time it must be said the Commission is not
31 entirely clear of the distinction between an input and an output.

32 To put some bones on all of that, if I can just crystallise where we see how curious this is as
33 a way of proceeding, the assumption is that PPI prices would fall by 60 per cent. Once
34 again this is not an output of the model, it drops out of the assumptions they are using. I

1 think the way they have proceeded goes like this: the profits from PPI are X, the marginal
2 cost of PPI is Y, in a competitive market the profits would be competed away down to the
3 marginal cost, and that is slightly problematic. If that is right then the price must fall, and
4 we will calculate that, by 60 per cent. So you see it is almost a circular assumption. If there
5 is a competitive market profit will be eliminated, prices will fall and so we will assume the
6 benefits can be calculated by reference to that 60 per cent price reduction.

7 We take issue with some of that, but I am also very much aware, although it is not my task
8 here today to go into the ins and outs of the report and say "I could have done it better", I
9 could not, but those instructing me could have done it much better. That is, forgive me, not
10 a task, certainly not for me and it is not a task I would like the Tribunal to discharge. My
11 simple submission is this, this was just an assumption, it is no better than the robustness of
12 those assumptions that at all times this model cannot be seen to be an accurate reflection, or
13 even a working reflection, an adequate reflection of what I am pleased to call the reality of
14 the PPI market. It is one set of hypothetical assumptions after another. While looking at a
15 hypothetical package of remedies may well have been a suitable way of determining the full
16 scale of the problem, or at least an approximation to it existing in the PPI market. Of
17 course, prior to *Tesco* that is all they thought they had to do. It is not the correct way of
18 assessing the actual benefits that would arise from an actual package of remedies especially
19 one which virtually by admission was going to impose substantial additional costs which
20 would have, we think, unarguably substantial adverse effects on sales, and where there is no
21 evidence obtained by the Commission, or analysis carried out which suggested this actual
22 package of remedies would produce anything like a 60 per cent. fall in PPI prices, let alone
23 immediately or soon after implementation.

24 While any of these three grounds is sufficient basis in my submission for the Tribunal to
25 quash the Commission's decision to implement the POSP I think it is important to recognise
26 the close interrelationship between the three grounds. They all deal with the way in which
27 the Commission approach the benefits detriments balance and hence proportionality of the
28 POSP.

29 Each ground identifies separate problems in the analysis but the end result is the same. The
30 Commission's conclusion that the POSP was justified and proportionate is at best unsafe
31 and should be struck down. Simply to repeat, it is not Barclays' case, or the position taken
32 by Professor Yarrow, as I showed to you, that it is inherently perverse or wrong for the
33 Commission to interfere in the market, or to prohibit consumers buying PPI at the same
34 time as credit, odd that such a restriction on freedom may be.

1 I mention this simply because the Commission in its defence at I think footnote 1 to para. 4
2 – I am not going to take you to it – say in terms that actually all Professor Yarrow is doing
3 is mounting a merits claim, he is not. He is looking, as we are looking, for the evidence
4 which must sustain the Commission’s assumptions about the effectiveness of the remedy
5 and the costs of its implementation. We are well aware that on issues of methodology,
6 appraisal of the evidence, balancing judgments, the Commission has a wide margin of
7 appreciation.

8 As the Commission accepted, and I took you to the footnote of the news release, this is a
9 significant intervention which will unarguably restrict the freedom of both customers and
10 businesses and has the potential, and perhaps certainty to produce serious adverse effects by
11 inhibiting consumers who value the protection afforded by PPI obtaining the protection
12 itself. I will take you to *Tesco* later, but the more intrusive, uncertain in effect, or wide
13 reaching a proposed remedy is likely to prove, the more detailed or deeper the investigation
14 by the Commission of the factor in question must be. This is what the Tribunal referred to
15 as the double proportionality approach. In other words, yes, the Commission has a wide
16 margin of appreciation. It will, and must, inevitably come to judgment. Of course. But,
17 that judgment must be an informed judgment based upon evidence - not upon hypothetical
18 assumptions and not ignoring important evidence such as the obvious adverse effect upon
19 the take-up of PPI in the light of their remedy.

20 So, instead of undertaking that careful analysis the commission made no attempt to assess
21 the extent of the detriment arising from the remedy, nor to attempt to assess at all - as far as
22 we can see, or by reference to any of the evidence, the extent of the benefits that would arise
23 from its package of remedies as a whole.

24 That is bad enough, but actually there is a further fault in all of this. As you will have seen,
25 there is a package of remedies here. The other remedies cause Barclays no concern at all. I
26 will take you to them briefly later, but only briefly. But the POSP is an additional to those
27 remedies. What the Commission did was purport - and I think I have said enough to
28 indicate that I mean ‘purport’ - to look at the overall benefit from those remedies in total
29 and match it against the cost of implementation. Now, they got that wrong because they
30 should have looked at the effectiveness of those remedies, and they did not. They just
31 looked at the scale of the detriment. But, the only remedy that causes costs, which is
32 problematic, and which may cost more than it is ever likely to achieve in reducing benefit is
33 the POSP. So, what they should have done - and, indeed, this is a matter of general
34 principle - it is not confined to this case - is that when there are several remedies the

1 Commission is obliged to look, if you like, at the incremental benefits of the extra remedy
2 matched against the incremental costs of imposing that remedy. It is not rocket science. If
3 one remedy would have achieved the elimination of all the detriment, taking the extreme
4 example, the other remedies would be otiose. It would be disproportionate to add them to
5 the bundle of remedies because they are unnecessary. Now, we are making no claim that
6 this case is not about the other remedies - but it is about the extra POSP. What we are
7 saying is that they should have looked to see what the incremental benefit of that was; what
8 it is likely to achieve, matched against, we say, the significant cost of its introduction. They
9 did not do that. That may be part and parcel of their general world view, as it were, but all
10 they had to do was to look at the global detriment and anything that contributed to that
11 global detriment elimination would be enough. That was quite wrong. What they should
12 have looked at was to ask, "How much is it going to cost us to implement POSP against the
13 benefits that POSP might ultimately achieve?"

14 The truth is that they have no evidence in the report to justify what they did. I will make
15 that good later, of course, but as a result the Commission was hardly in a position to know
16 whether its package of remedies, and incrementally the POSP, would benefit consumers and
17 also produce the level of benefit necessary to outweigh the substantial costs of introducing
18 it. That will put out - and I think it is agreed - about £100 million to set it up, and then the
19 annual costs of between £50 and £60 million going on and on. That is quite apart from the
20 losses to consumers of the consumer welfare aspect as a result of the reduce demand which
21 should be in addition to that.

22 So, there are very significant up-front costs which are unavoidable and very significant and
23 annual costs of the POSP and the other remedies.

24 We consider that if a proper examination had been made, the detriment arising from the
25 POSP is likely to outweigh incremental benefit. We believe that, but it is not our case. It is
26 not a matter which we are asking you to determine. What the Tribunal is being asked to
27 consider is whether the Commission failed to carry out the analysis required, which it could
28 have done, to see first whether the POSP would have a positive overall effect on consumer
29 welfare and, secondly, if it did, whether there would be proportionately increased to be
30 incurred as a result of its introduction. Both calculations have to be done. What would it
31 achieve? How much would it cost to achieve that? Then it becomes a judgment about
32 whether or not it was proportionate.

33 As you have heard, as the Commission did not do the proper analysis of what the remedy
34 was designed to achieve, what would it achieve -- As they have made a mess of the costs of

1 implementing it - and we will come on to that - it follows that it is unlikely to have been a
2 proportionate judgment. It is that failure to carry out the analysis which means the
3 Commission's decision to propose and implement the POSP is a remedy that should be
4 quashed - quashed for it to be sent back to them to undertake the analysis that I am saying
5 they should have done. We do not know where we will end up as a result of that exercise.
6 We hope and believe that wiser thoughts will prevail next time around. That is a risk any
7 applicant takes in this type of proceeding. We are not coming here to ask you to make a
8 decision on that. We are asking you to go away and do it properly.
9 Of course, the last ground. We also challenge the Commission's choice of relevant market
10 is absolutely fundamental in competition cases. If you get the relevant market wrong, as
11 every student knows, a good many mistakes arise very quickly from that because you do not
12 where competition is taking place. What is it you have got to consider?

13 THE CHAIRMAN: It might depend which textbook the student had read! Some of them say it
14 does not make any difference.

15 MR. SHARPE: Not many, with respect. Most textbooks - and I am sure in the economics
16 profession there are wide divisions of honest intellectual opinion - and certainly all
17 competition cases that have been before this court and others, would place very, very strong
18 weight upon the prior exercise of determining in what market are we seeing any impact on
19 competition. If that market is narrow defined, then plainly issues of monopoly arise very
20 quickly. I remember once being in the Competition Commission many years ago and the
21 then chairman asked my client, "Well, do you think you have a monopoly?" My client, an
22 American, thought he had a sense of humour and said, "Ah, well, gee, we've got a
23 monopoly of Kellogg's Cornflakes". It was not quite the answer I expected and hoped he
24 would give. But, yes, in his own terms he did have a monopoly of Kellogg's Cornflakes,
25 but if there are dozens of other competitors to Kellogg's Cornflakes - anything from muesli,
26 to Weetabix, or a banana - in the wider market to be fed at breakfast, plainly what looked
27 like a monopoly defined on way, looks like something that is competing pretty heavily
28 across the piece. The statement is right. It is not a particularly profound statement. We
29 tried to argue that milk was a substitute for Coca-Cola at breakfast. We did not succeed.
30 That leads me on, I think, to the way the Commission have approached relevant market.
31 They say that the relevant market was confined to an individual distributor's sale of a
32 particular type of PPI policy. So, by definition, each distributor had a monopoly to supply
33 PPI to its credit customers at the point of sale. I guess what it is saying is that at that
34 moment, across the table, the prospect of going elsewhere -- the degree of substitution to a

1 freestanding supplier was low. We will examine that later. The possibility of self-
2 insurance, of course, has to be taken into account. "I don't want this. I can take the risk
3 myself." It is not easy to see why that is not a good substitute, as it is for the very
4 significance numbers of people who take out loans and do not take out insurance.
5 The way the Commission have put their case is a bit like saying that Tesco, to choose an
6 example almost at random, has a monopoly of sugar supply to people who want sugar in
7 their coffee and who buy their coffee at Tesco. Those customers do not have to buy their
8 sugar at Tesco, they can go down the high street, or whatever, and find a shop that only sells
9 sugar. It is pretty obvious that most people do not do that. In other words, Tesco has a
10 point of sale advantage in the sale of sugar to people who buy their coffee and milk and
11 anything else at Tesco. That is all very unfair on the exclusive sugar supplier. It obviously
12 puts that company at a disadvantage. However, the reality is that Tesco is meeting the
13 needs of customers who want to enjoy that convenience of being able to enjoy their coffee
14 and their sugar and their milk together. That is essentially my gloss, but it is an accurate
15 gloss, on the Commission's choice of relevant market here.

16 This has alarming consequences in almost every market. It is particularly obvious in
17 financial services where a bank, an institution, will want to sell more than one product -
18 insurance, pension, PPI, whatever. Are they to be disabled from doing so because of a
19 definition of relevant market which places them in the monopoly box from day one at that
20 moment across the table where they enjoy a "point of sale" advantage. I think one can
21 immediately see Barclays sensitivity to this issue and why it is such an important matter for
22 us to determine.

23 Like in every case, the choice of relevant market does form the basis of the Commission's
24 findings. Our case is that the Commission failed to do the appropriate analysis enabling it
25 to define the market properly. It simply ignored the evidence, even its own evidence, and
26 when it did apply the relevant concepts in the report, and I will show you, they applied them
27 inconsistently.

28 One of the issues here which I will flag is this: when you read the report you may have
29 been struck, as I was, by the careful summary of the facts - I am not going to knock the
30 Commission's expertise credentials there at all - it is surprising that the facts pretty well end
31 up in 2006. Very little new evidence relating to 2007 and virtually nothing in relation to
32 2008, even though the report was signed off on 29th January 2009. They may have taken
33 the view that nothing has happened of any interest since 2006, that world markets have been
34 stable, that the financial community is sound, that unemployment has remained unchanged

1 and fear of the future does not exist or is misplaced. They would be wrong. Not only were
2 they wrong, they were told they were wrong in the course of the enquiry. They were given
3 hard evidence of the deterioration in the number of people taking out PPI in 2008, in the
4 profitability of PPI products; and of course the other side of the coin was higher
5 unemployment, the number of people, unfortunately, who are obliged to take advantage of
6 their insurance because of increased unemployment. These data were furnished to the
7 Commission and they showed, as I said, fall in penetration rates for all types of loan. I am
8 going to give you a reference, but I am not going to take you to it. It is our application,
9 para.110, p.43.

10 All of these developments since 2006 had important changes in the dynamics of the market
11 place. The extent of some of the changes is obviously still in dispute and I will make good
12 some of Barclays factual submissions later, and perhaps gently remind the Tribunal of what
13 has been going on in the United Kingdom economy in the world of credit insurance since
14 2006.

15 What I have tried to do there is set the scene and what I would now like to do is to take you
16 briefly to the statutory position. We start in the authorities bundle, bundle 2, tab 19, p.847.
17 I believe, first, there is nothing in contention, or hardly anything in contention, between the
18 parties in relation to the statutory position, so that encourages me to move on, and I would
19 be surprised if you have not seen this before and discussed it. P section, 134, will you go to
20 it, please. You will see, and I am going to paraphrase this - it is probably best if I say what I
21 think it means, unless you particularly want to read it. So on any market investigation
22 reference the Commission is required to decide the following questions, whether any
23 relevant feature “of each relevant market prevents, restricts or distorts competition in
24 connection with the supply of any services in the United Kingdom.” That formula “prevent,
25 restrict or distort”, is a very, very familiar one. Those of us with longer memories, like Mr.
26 Swift and I, will recall the 1980 Competition Act, and even before then the Fair Trading
27 Act, and the definition of a “complex monopoly situation”, and in the European Union it is
28 the formula to look at agreements which “prevent, restrict or distort” competition under
29 Article 81, and of course it is the substance of the Chapter 1 prohibition in the Competition
30 Act.

31 Here it is being used in the Enterprise Act to say that any feature of a market, a relevant
32 market, which is administratively defined - careful to note, this is not an economic market,
33 this is a market that has been defined for the Competition Commission by the Office of Fair
34 Trading, and it is not meant to be restrictive. It draws the distinction, please, between a

1 market which confers jurisdiction on the Commission and a relevant market which we look
2 at for the purposes of analysis. They may be the same but frequently are not, and there is no
3 good reason why they should be.

4 That situation, that feature, which “prevents, restricts or distorts” competition, is defined by
5 law as an adverse effect on competition. I will call that an AEC. If the Commission
6 decides that there is an AEC then we go on to 134(4)(a) to (c), and have then got to decide
7 what action should be taken for the purposes of, and the formula is, “remedying, mitigating
8 or preventing” the AEC or any detrimental effect on customers. If you flip to 134(5) you
9 will see “detrimental effect” defined in the form of: “higher prices, lower quality, or less
10 choice of goods or service in any market in the United Kingdom” or “less innovation in
11 relation to such goods and services.”

12 It has to be shown that those detrimental effects derive from the AEC, there has, I think, to
13 be some causal relationship between the two.

14 Then the Commission has to decide whether it should recommend the taking of action by
15 others for the same purpose, so it is not exclusively in the hands of the Competition
16 Commission if it wants other people to do something, that is not the situation today. Then it
17 has to be decided what action it should take and what is to be remedied, mitigated, or
18 prevented. If we go to 134(6), you see that in deciding those questions: “...the
19 Commission shall, in particular” – so it is non-exclusive – “have regard to the need to
20 achieve as comprehensive a solution as is reasonable and practicable”. You might mentally
21 note “comprehensive” solution, because the word “comprehensive” appears especially in
22 the defence and the skeleton as an indication, though when it was seeking a comprehensive
23 solution the Commission had always intended to eliminate all the detriment it had
24 identified. In fact, it was a perfectly correct reference to the statutory duty here to achieve
25 as comprehensive a solution – and note – not at any price but as is reasonable and
26 practicable, and to what? - to the adverse effects on competition and on consumers
27 resulting from the AEC.

28 The Commission must also have regard – you will see this in 134(7)

29 THE CHAIRMAN: “May have regard”.

30 MR. SHARPE: Yes, indeed, I am being reminded on all sides. We have a duty to achieve as
31 comprehensive a solution and then the Commission may, and again “in particular”, so it is
32 non-exhaustive have regard to the effect of any action on any relevant customer benefit. If
33 you go to the next subsection, 134(8) you will see “benefits” described essentially a mirror
34 image: “a form of lower prices, higher quality or greater choice of service in any market, or

1 greater innovation”, and in particular that these benefits are unlikely to accrue without the
2 AEC.

3 So it is a statutory recognition there are two sides to every argument, that something which
4 is an AEC may have some benefit, but whereas the Commission is obliged to look at the
5 AEC and the consumer detriments, it has a discretion not to look at the relevant customer
6 benefits. The Commission did look – purport to look – at the relevant customer benefits.
7 If we go over the page to 138, the Commission has a duty, that is what it says in the
8 headnote, under a duty: “to remedy, mitigate or prevent the adverse effect on competition
9 ...” found and any resulting detrimental effects on consumers.

10 Once again the formula, comprehensive solution as is reasonably practicable, and it can do
11 so either by accepting undertakings or, as in this case, planning to make an order, and there
12 is a draft order in existence under s.161. I am simply going to mention it and then walk
13 away from it. There was some dispute or argument before the Tribunal in *Tesco* whether
14 when it says “duty” under s.138 it means “duty”. Happily, the Tribunal said that was of no
15 consequence, and it is of no consequence here.

16 If we turn to s.171(3) at 875 of the bundle, briefly at subsection 3 we see the Act required
17 the Commission to:

18 “publish general advice and information about the consideration by it of market
19 investigation references and the way in which relevant customer benefits may
20 affect the taking of enforcement action in relation to such references.”

21 The Commission has discharged this duty in the form of a guidance to how it was going to
22 approach market investigation references, and that will be found at the last tab in this
23 bundle, tab 26, and if we may pick it up at p.1369 of the bundle at para. 4.7. I should say
24 there is no disagreement between the parties – how can there be – as to the nature and
25 source of the guidance and what it contains. This is what the Commission should have
26 done, and it is common ground they should have done it; the difference is they say they did
27 it and we say they did not.

28 Would you like a moment just to go through it if you have not looked at it before, Sir? 4.7
29 up to 4.16. (After a pause) All the notes are there, the common acceptance of the duty, the
30 proportionality exercise and the express reference to time.

31 My next section is going to be a little longer, because I am going to take you to the
32 problems in the market and the report. I am just wondering, would it be convenient to break
33 for a moment?

34 THE CHAIRMAN: Yes, shall we plan to resume at about 12 minutes to?

1 MR. SHARPE: Of course, sir.

2 (Short break)

3 MR. SHARPE: I would like now to turn to the problems in the PPI market which the
4 Commission examined, and, for our purposes Grounds 1 to 3 which relate to the remedies.
5 We only need for the moment concern ourselves with the Commission's conclusions. This
6 was the background against which the remedies were proposed. I will come back to Ground
7 4 later.

8 THE CHAIRMAN: We can put the law away for a bit, can we?

9 MR. SHARPE: Yes. I would like to take you to CB2. This is the report at p.45. You see the
10 heading 'Market Definition for the Distribution of PPI'. What I would do ----

11 THE CHAIRMAN: No, not on my p.45. There are two sets of pagination at the bottom of each
12 page. (After a pause): It is p.53 of the bundle, p.45 of the report.

13 MR. SHARPE: Internal p.45.

14 THE CHAIRMAN: Generally speaking, just the paragraph numbers of the report will do the
15 trick.

16 MR. SHARPE: It is para. 3.1 onward. This deals with the Commission's analysis of the relevant
17 market. May I ask you simply to read paras. 3.1 to 3.8? (After a pause) Sir, those
18 were the Commission's conclusions on relevant market.

19 May I now take you to para. 4.1? Will you please read paras. 4.1 to 4.4? (After a
20 pause) These were the Commission's conclusions on the extent of competition
21 between PPI providers. You will note that they dovetail into the Commission's
22 finding a relevant market if there is no competition between them, then they infer
23 they were into separate relevant markets. This analysis, as they put it, is
24 consistent with that.

25 May we now go please to para. 5.1? Would you read 5.1 to 5.5? (After a pause) There is a
26 narrow focus on the POSP. You have obviously noted the reference at 5.5(d). Then, lastly
27 in this sequence, to paras. 5.144. this is beginning to answer the statutory questions about
28 features in the market giving rise to the AEC. Would you kindly read 5.144 to 5.146 on that
29 page? (After a pause) You see here the four principle features which give rise to the AEC.
30 Once again, 5.144(d) the sale of PPI at the point of sale by credit providers further restricts
31 the extent to which other providers can compete effectively. That is the point of sale
32 advantage which they judged to be a feature which is an AEC.

33 So, that is essentially the first stage in the Commission's argument. They have come to
34 these conclusions. They obviously think the market is in some difficulty.

1 Pausing there, the Commission place great stress upon these findings, perhaps abnormally
2 so. We are not contesting any of these conclusions. They are the product of assessment,
3 save for the relevant market under Grounds 1 to 3. Everything I am saying is as you have
4 heard earlier. But, they place great stress in the defence . They characterise the market as
5 dysfunctional. You will recall that in the defence. It is not a word that the Commission
6 thought it necessary to use in the report. But, who knows? Therefore, because the market is
7 ‘dysfunctional’, it requires this radical reform.

8 At one level this rather misses the point. Any AEC requires to be remedied or mitigated if
9 the Commission wants to do so. You have seen the statutory duties under which it is
10 placed. There is no specially higher duty to do that because they regard the market as
11 ‘dysfunctional’. It is an irrelevant consideration. In the context of looking at remedies -
12 and we are only dealing on Grounds 1 to 3 with remedies - the Commission could only
13 impose a package of remedies that complied with the relevant statutory tests, including in
14 particular that the remedies would benefit consumers and were reasonably practical and
15 proportionate. There is a hint in the defence and in the skeleton that because the market is so
16 dysfunctional we do not really need to approach the question of proportionality with
17 appropriate rigour. It is just so bad that almost anything would improve it. That was a
18 profound statutory mistake.

19 Our Grounds 1 to 2 are directed at the process underlying the Commission’s decision that
20 the POSP would benefit consumers and was proportionate to deal with the AEC and the
21 detrimental effects found. Whatever the effects and the problems identified, the
22 Commission was required to justify each of its proposed remedies by establishing on the
23 basis of proper evidence and analysis that they would have a proper overall effect on
24 consumer welfare. Now, since inevitably each of its remedies would also give rise to costs
25 or other detriments - and I am thinking in particular of the POSP - the Commission also
26 needed to establish the extent of their overall positive effect on consumer welfare. It is only
27 then that the Commission would be in a position to engage in any form of proportionality
28 exercise. They have got to look at the costs involved in the introduction and the adverse
29 effects that its introduction would cause - an essential pre-condition to the evaluation of
30 proportionality. I do not want to labour the point any further because you have heard it more
31 than once. They failed to carry that out. Their constant reiteration of the effect of the
32 market and the absence of competition is nothing to the point. It does not absolve them
33 from the duties they would be placed at whatever findings they made regarding the AEC.
34 Those are the relevant parts of the report leading up to the remedies.

1 Before I go on and deal with the remedies I want to address you quickly upon the relevant
2 legal standard for judicial review. I suspect this is going to be very brief. The most recent
3 and apt case for this is the *BSkyB* case before this Tribunal. That you will find in the first
4 volume of the authorities at Tab 16. This was a merger case, but I do not think it matters for
5 our purposes. I think it is common ground between my friend and myself that this is the
6 standard which should be applied by this Tribunal. May we pick it up at the bottom of
7 p.692? First, and helpfully, there is an extract, as you see, from *Wade & Forsyth*. This is
8 the ninth edition. The tenth edition has found itself in the bundle for some reason or
9 another. It is absolutely verbatim. The editors have not chosen to add to their wisdom. But,
10 it is an important extract because I think it very accurately summarises the law. I am at
11 para. 54, which carries over to p.693. You see the extract from *Wade & Forsyth*. (After a
12 pause) I draw this to your attention immediately because the argument which has been
13 deployed in the defence and skeleton, which you have seen, is that really what we are doing
14 is essentially attacking the Commission's judgment and its assessment of complex
15 economic issues, and really going to the heart of what used to be called in the old days
16 'jurisdiction' They have the expertise and it is simply inappropriate even to put the way
17 they have made those balancing judgments before the court. Now, that is actually nothing
18 to do with our case. We are very careful not to do that. What the extract from *Wade &*
19 *Forsyth* is actually doing is simply saying this: "There are limits to that indulgence (
20 because that is the indulgence he was referring to). There has got to be satisfactory
21 evidence". Now, the Commission can make its assessment, but it has got to be, as I said
22 earlier, an informed judgment based upon hard evidence. Helpfully in this extract 'no
23 evidence' does not mean a total dearth. You are entitled to look and see the evidence that
24 they have provided and then you, the Tribunal, form a view as to the adequacy, or
25 sufficiency, of that exercise. Does it stack up? That is the Tribunal drawing attention and
26 endorsing that.

27 Now may I take you to para. 56? This was the President's very carefully summary of the
28 case law. It is his understanding of the *IBA* judgment in the Court of Appeal. Normally I
29 would go to the Court of Appeal for this, but this is this Tribunal and there is nothing in
30 contention. I think his summary from A to G is a very helpful and succinct summary of the
31 law and the way in which the Tribunal should address these issues. May I ask you to read
32 please A to G? (After a pause) I should hope, Sir, that none of this is controversial, but it is
33 a useful summary of the task ahead.

1 As for proportionality, you have seen that in the guidance notes, and I am going to take you
2 more formally and at greater length to the *Tesco* judgment where proportionality was
3 affirmed, not in doubt, not in dispute in this case, but as to what it actually means in law and
4 I will take you to that in due course.

5 I have taken you up, as it were, to the point of the remedies in the report. We have dealt
6 with their conclusions. I have taken you to the law as to how you should now assess the
7 report. The sensible thing is to now go forward to the report itself again where it deals with
8 remedies. We need core bundle 2. Thanks to your very helpful indication of what you have
9 read, Sir, I am going to be guided, if I may, by you. I am going to take you to various
10 aspects of the report. If the sections are very familiar to you I hope you will say so and we
11 can move on. It is very largely going to be Chapter 10, and perhaps we can pick it up at
12 10.6. There are going to be extracts from it, so I am going to, if I may, ask you to look at
13 10.6, 7 and 8.

14 THE CHAIRMAN: (After a pause) Just up to 8 at the moment?

15 MR. SHARPE: Yes, just up to 8. So that is their basic approach, they are ticking boxes here.

16 They consider at 10.12, if you go to that, the impact of some of the background to this, the
17 ICOBS, the Insurance Conduct of Business Source Book 2008. You might find 10.12 and
18 10.13 of background interest, and would you read it, please. (After a pause) At 10.14 you
19 will see their consideration of the economic downturn, you might like to read 10.14 to
20 10.20, please. (After a pause) You will see here their approach to the economic downturn.
21 There are two points I think I would like to draw your attention to briefly. One is at 10.19,
22 we have the relevant customer benefit. I will deal with this later, but here it arrives, and this
23 is the first time we have looked at it. The relevant customer benefit here was the effect the
24 Commission found that because credit and PPI are sold together as a package, not
25 contingent on each other but people did not want insurance without the loan, where they
26 could take out the loan without the insurance, the higher profits in the sale of PPI were
27 reflected in lower profits for credit, the cost of credit. There is nothing particularly
28 surprising about that and it is a very common phenomenon. I doubt very much if Tesco
29 make the same margin on milk as they make on linguine, to choose an example at random.
30 What they both do is make a contribution to Tesco's fixed costs and the price which Tesco
31 will charge will in part be dependent upon the intensity of demand for each product.
32 What we have got here is a product which is sold together, as we know, and the profitability
33 of PPI was seen to be higher than the profitability of loans. Therefore, one of the relevant
34 customer benefits identified by the Commission was the lower charge for the credit which

1 might disappear if PPI prices fell taking away the profit which enabled lower profits to be
2 earned on the loan. All this is simply a reflection of demand for loans, loans at a more
3 competitive market, they say, than the market for PPI, and therefore, the intensity of
4 demand being different, the prices would be different.

5 The effect of some form of intervention in relation to PPI prices, directly or indirectly,
6 would have the effect of reducing the pot of money available to reduce the cost of credit.
7 The relevant customer benefit in this case at this point in time in the analysis is simply the
8 lower costs for credit. You will note here that when it suited the Commission instead of
9 saying the status quo would be maintained and it really did not very much, as you have seen
10 in the earlier references to PPI, here they are saying: “We do not actually think that the
11 scale of the relevant customer benefits, i.e. the lower credit charges, which they observed up
12 to December 06, would persist at that level in the future. That may or not be right, but
13 anyway you see how they are approaching it, they are making an analysis – one of the very
14 few times in the report they are looking forward from 2006 to the situation in 2007/2008.
15 There is also an assumption here about the profitability of PPI and future claims, which you
16 have seen, which may or may not be true, and I will come back later to how useful the
17 Commission’s analysis of the effect of the recession has been upon increased costs and
18 lower profitability.

19 Now, we can go on to para. 10.31 which deals with the remedies that the Commission has
20 decided to implement. If you look at 10.31 this, as you will see, deals with the totality of
21 the remedies not just the POSP; would you please read it. (After a pause) Moving on to
22 10.34 we see there a deeper analysis of the POSP, a description of the POSP and a very
23 helpful figure 10.1 over the page, which I will not take you through, but I found it useful in
24 understanding, as it were, the small print of what the point of sale prohibition requires, and I
25 hope I did it no injustice when I paraphrased it when I started.

26 If we go over the page, 10.36, which you should read, and 10.37 states the case for how
27 essential in their judgment the POSP is. Would you please read both those paragraphs?
28 (After a pause) 10.39 establishes the issues not without risk, the OFT and the FSA are clear
29 supporters, which should not come as a surprise, and hardly anybody else other than those
30 who had most to gain, namely the stand alone providers of PPI thought this was an
31 adequate, sensible remedy.

32 It is useful at 10.39 to go through the alleged adverse effects. (After a pause) That
33 establishes the basis on which the Commission started its assessment of the utility of the
34 point of sale prohibition. It is useful now to go on to 10.40 and read on to 10.45, please.

1 (After a pause) I drew attention earlier that the Citizen's Advice Bureau were the people
2 who started this investigation by the OFT and the subsequent market investigation and you
3 see what they have to say at the end of 10.40 and can I just draw it particularly to your
4 attention. They said that "... the growth of stand-alone policies ..." which is after all what
5 this remedy is designed to achieve, "... might be fairly small and the net effect could be to
6 shrink the market ,which would not be wholly beneficial for consumers."

7 10.41, if I may just underline it for you, if you have not already: "... this remedy will not
8 entirely remove all aspects of the incumbency advantage enjoyed by the distributors." But
9 then curiously they said they do not think it is necessary to remove all the incumbency
10 advantages of distributors "... in order effectiv4ely to remedy this aspect of the AEC."

11 They seem to be saying it is a partial remedy but they are saying that will do. They
12 nevertheless go on to say that the remedy will make a very substantial contribution to the
13 overall effectiveness but one is looking for some guide as to what that means. "Substantial
14 contribution", obviously it means large, but how large? Is it large enough to deal with all
15 the detriment that they have identified. I am obviously going to have to come back to this
16 but it is far from a ringing endorsement that we are confident this will eliminate all the
17 detriment we have discovered. This is the Commission adopting the language and approach
18 of *Tesco*.

19 Then at 10.43 which you have seen, and a fair reading of this is also an acknowledgement –
20 an honest and candid acknowledgement – that this is not going to have a complete impact
21 on the detriments that they have identified. It is the beginning of a process creating a clear
22 break between the sale of credit and PPI. It is giving them the tools they require to compare
23 policies and so on, and significantly increases incentives and the ability of consumers to
24 search for the best value policy.

25 Sir, that may all be entirely right, but that is not what they should be doing here. They
26 should be saying, "This remedy will not merely provide incentives for people to do things,
27 but they will actually do it, and not merely do it, but do it to such an extent that the
28 detriments will be eliminated".

29 10.44. You have seen market spend. Nowhere in the report will you see any quantification
30 of how much more should be spent on marketing. Now, if the whole idea is to encourage
31 transparency of comparison - and advertising plainly has a role in drawing alternative
32 competing offers to the public's attention - then plainly costs are going to increase. Fine. Is
33 there any acknowledgement that costs will increase in the report? No. When we go to the
34 model - as I am afraid under Ground 3 we are obliged to - the assumption is that costs will

1 not increase. Major internal contradiction. Important things regarding even the theoretical
2 hypothetical calculation of detriment have been inconsistently applied and important issues
3 such as increase in cost or a reduction in demand are quite simply not factored into the
4 calculation - the calculations upon which the Commission relies.

5 PROFESSOR STONEMAN: Could I just ask: When you do come to the report to look at those
6 numbers, could you make a clear distinction between marginal cost and fixed cost, please?

7 MR. SHARPE: I will try, but it is difficult because when the Commission analyses cost - as I
8 suspect may underlie the question - they talk about bringing the cost of credit up to marginal
9 cost with the implication that current prices for credit are below cost. There is no reference
10 at all to the importance of fixed cost and how prices actually might be higher than marginal
11 cost.

12 PROFESSOR STONEMAN: I would like your experts to take that into account when they advise
13 you.

14 MR. SHARPE: We shall send a signal and endeavour to answer the question, I hope.

15 This is how the Commission have approached it. They have ticked the boxes, but even
16 now, respectfully, we are seeing chinks in the reasoning, and major evidential gaps not only
17 in relation to cost, but in relation to the reduced demand, assumptions about marketing
18 expenditure which are not made good anywhere at all in the report, and assumptions about
19 consumer behaviour which may, or may not, be right. We are not here to say that they are
20 wrong. We are here to say that they might be right or wrong. But, there is not the slightest
21 evidence to suggest that the Commission sat down and began to analyse what the effects
22 would be.

23 I should add, to meet one of my friend's points, this is not just an attempt to say that they
24 should go around and measure everything to the third decimal point. That is not the law,
25 and it is certainly not our case. But, a good faith attempt to quantify magnitudes is what is
26 required here. Of course, it is exactly what the Commission purport to have done with the
27 alleged precision that you will have seen in calculating the welfare losses. They have tried
28 to do that there - we say imperfectly - but why can they not do it and apply the same
29 approach here? They did not, because they could not. But, they should have done, and any
30 analysis based upon guesswork and speculation is simply no use at all in a matter as
31 important as PPI.

32 That takes us up to the important issue of the reduced take-up of PPI if the remedy is
33 imposed - this rupture between of point of sale of credit and point of sale of PPI. That is at
34 10.46. Would you please look at 10.46 to para. 10.52. (After a pause): These paragraphs

1 constitute some of the most important paragraphs in the report. That is obvious. I am going
2 to have to come back to one or two of them later. You have seen them. I draw your
3 attention just to one short sentence in 10.50.

4 “By increasing competition and thereby reducing price we expect our remedies
5 passage to lead to an increase in PPI sales. That would [and then] partially or fully
6 offset a decline from a reduction in convenience”.

7 That is the Commission’s case - at its strongest ‘fully’; at its less strong, ‘partially’. But,
8 neither they, nor Barclays has any clue as to what proportion of that obvious and admitted
9 detrimental adverse effect is going to be cured, and when. You have seen the weight of the
10 evidence which suggested to the contrary. I am going to go back to some of that later, but
11 not too much.

12 At this point may I go back to the analysis of the higher costs of distributors at paras. 10.60
13 to 10.62? (After a pause) Paragraph 10.62 flags where the analysis of proportionality is
14 going to take place. We will deal with that in due course.

15 I want to take you to the analysis of the alternatives at 10.67. This is something I would
16 rather gloss over now, but I draw it to your attention as background. I do not particularly
17 want to hold proceedings up now. It is 10.61 to 10.71. That takes us up to the conclusion
18 of POSP at 10.72. This is important, paras.10.72 to 10.79, and may I ask you, please, to
19 read them. (After a pause) I am sure you picked up at the opening of that extract of 10.72
20 the Commission’s repetition, given the severity of the competition problems and the scale of
21 the resultant consumer detriment. We are back here to looking at the total detriment. We
22 have not yet come to any position where they are analysing what the effect of their remedy
23 to eliminate the detriment. We have some admissions, but it will not eliminate all the point
24 of sale advantage already, as you have seen.

25 Again in 10.76 they refer to “significant incentives for consumers”, which may or may not
26 be true, “to search for best value for money”, but we know nothing about what the
27 consumers are actually going to do.

28 What is clear is that they have clearly identified that there will be increased costs for
29 distributors and intermediaries. They simply say that the imposition of those costs can be
30 justified by reference to the benefit, but what is the benefit? If the Commission’s case is
31 consistent they are saying the benefit is the total elimination of all the detriment, but we
32 have no evidence of that. Therefore, we have no evidence of what element of the detriment
33 is going to be effectively remedied.

1 May we then go on to para.10.371. I will take this briefly, but this deals with alternatives,
2 and in particular price caps. Price cap in this context would be, if I can give you a sneak
3 preview, a non-system remedy. It would have been open to the Commission to have said,
4 “We are not going to engage in a process here to open up incentives for consumers, and so
5 forth, we are quite simply going to order a price cap, full stop, and this is how the
6 Commission dealt with that. You will see at 10.373 the first reference to a timetable within
7 which this is going to take place:

8 “[When] we have decided to implement [we] will address the AEC that we have
9 identified in a timely manner ...”

10 If you move the story forward a little bit, the Commission’s argument is “address” means, I
11 think, “deal effectively” with the totality of the consumer detriment the Commission
12 identified. We take issue with that. The word “address” means “address, we will deal with
13 it”, rather than “solve”.

14 The case must not descend into a semantic argument, but I think it is a measure, with
15 respect, of the desperation given that they have been caught between two judgments and
16 have to come to this Tribunal to say that when they meant they were going to deal with the
17 total detriment they meant they would deal with all the detriment, totally, effectively,
18 because that is the only thing they can say after *Tesco*. They have now got to say they are
19 going to deal with it, so words like “address”, which were put in perfectly innocently to
20 mean “deal with”, “address”, “seek in some way to arrive at a solution” have now been
21 expanded to mean, “We will not merely address, we will eliminate the consumer detriment
22 that they have discovered” – that is the essence of their argument – but also in a timely way,
23 a timely manner. They say that means they have addressed the question of timescale as
24 they were bidden to do in the guidance, and it is essential to any analysis of proportionality.
25 So the Commission has to rely on words like “timely” to indicate “now”, “immediate”,
26 “soon”. The ordinary natural meaning of the word “timely” means “appropriate”, and the
27 Commission’s intervention was “appropriate”, “timely”, it does not mean the Commission’s
28 intervention was “immediate”. It is a measure of, respectfully, the artificiality that has crept
29 into this case as a result of *Tesco* essentially having changed the legal ground rules for the
30 basis on which the Commission approached the matter.

31 There are other clues to that as well. We have seen one reference, and we will see more, to
32 the Commission saying they have dealt with something because of the design of the
33 remedy, “design”. That is exactly the way in which they argue the case in *Tesco*, the design
34 of the planning arrangements they were putting forward was going to deal with the

1 detriment. They used the same text. They would not use it if they were drafting the report
2 again now, because simple reliance upon design tells us nothing at all as to whether or not
3 the remedy would be effective. It may be a wonderful design, but that is not the issue. The
4 issue is, is it going to be effective to eliminate the detriment? And, if not, how much of the
5 detriment will it eliminate? Unless we know how much we cannot measure that against the
6 cost of implementation.

7 Let us go on to relevant customer benefits at 10.74 – I trailed this earlier. If you would go
8 straight to 288, which is 10.442. It is slightly dyslexic going through all these references I
9 am afraid. 10.442 – 10.464 is a lengthy extract, but I think I have no alternative but to take
10 you to it because it is rather important. We know that one of the benefits from PPI profits is
11 lower credit prices. The bundle of credit and PPI, credit is cheap, PPI may be more
12 expensive. They identified correctly that that was a relevant customer benefit which was
13 likely to be sacrificed if anything served to reduce PPI prices, whether it was price control
14 or the point of sale prohibition. This is the Commission’s analysis, and I am sorry would
15 you go to it and read through 10-442 to 10-464, it is three or four pages? (After a pause). I
16 am obviously going to return to one or two aspects of that, that is the Commission’s case,
17 and you will also see, as I remarked earlier, that they do not expect that benefit to last
18 indefinitely based upon their assessment – at 10-463 they are not confident that the scale of
19 the relevant benefit would persist.

20 I now turn to paras. 10.466 where the Commission deals with the rationale for
21 implementing the remedies package as a whole and would ask you just to read 10.466 to
22 10.476. (After a pause) Perhaps we could just end the morning by asking you to continue
23 reading now the section “Benefits and synergies of the remedies package” taking us up to
24 10-479. (After a pause) Thank you, Sir. I am wondering whether it would be first of all a
25 convenient moment to adjourn, and secondly, I am conscious this is not the most
26 satisfactory way of proceeding but I cannot think of any alternative, may I ask you, if you
27 should choose to do so, when we come back I am going to take you to paragraphs 10-480 to
28 10-492, that is effective lower credit cost to all credit customers, and the important
29 paragraphs are 10-493 to 10-495 and then I have to tell you there is light at the end of this
30 particular tunnel. If there is any chance at all of your glancing at those I should be grateful.
31 I am certainly going to take you to 10-493 – 10-495, but if you should have an opportunity
32 to look at it before it will speed things up.

33 THE CHAIRMAN: We will see what we can do. 2 o’clock.

34 (Adjourned for a short time)

1 THE CHAIRMAN: From what you said about light at the end of the trouble, you may be near the
2 end of this process. We have, of course, read Chapter 10 in particular, and most of us more
3 than once quite slowly and line by line. So, if there are other passage you may think you
4 can point out what the gist of it is, and take us to any particular parts you particularly rely
5 upon.

6 MR. SHARPE: We are almost at the end of the tunnel, actually. It is a long and complex report. I
7 hope I have not overstayed my welcome unduly on this.

8 THE CHAIRMAN: Not at all, no.

9 MR. SHARPE: But, as I say, I will be coming back to various extracts in the course of making
10 submissions about the four grounds. But, by then I think everything will be very familiar.
11 So, the amount of time we spend will be limited. Thank you for doing your homework. If
12 we can pick it up quickly at 493, 494 and 495. You have probably seen that these are very
13 important paragraphs. Just to reinforce the arguments here, the Commission is saying at
14 para. 493 that there is a large category of dynamic benefits which they would expect to see
15 arising from increased competition. I will come back to what they are claiming here. I will
16 simply point out that the evidential basis for these claims is very limited indeed. But, in the
17 end it may not matter because although they say they have not been able to put a value on
18 them - which is true - it is also fair to say that they are not really relying on them. What they
19 are relying on - and it is important to emphasise this - is the calculation in para. 494. In
20 other words, the reliance is exclusively upon their 'static welfare implications of the current
21 high PPI prices' - dead weight losses that stem from people who do not want to pay higher
22 prices for PPI, but would buy PPI at a lower price. Not merely a lower price, but a price
23 which was the 'competitive' price. What is the competitive price? Well, from the
24 Commission's standpoint it is where price equals marginal cost. There is an underlying
25 assumption here that costs are constant. Of course, we are not discounting in that a
26 reasonable return on capital equivalent to the cost of capital which the Commission has
27 calculated.

28 What is important is that they have used this Excel model, which is set out in Appendix
29 10.10. I am going to take you to that, more in the context of Ground 3. - I am going to
30 assume that you have had a look at it - to estimate the potential scale of the static effects on
31 consumers.

32 Even if we assume that all PPI profits are used to fund lower credit prices, and you have
33 already been exposed to the notion that there is a sort of reduction in PPI prices which may
34 then lead to an increase in credit prices -- That is the waterbed effect. So, you sit at one

1 end of the waterbed, I am told, and the other bit goes up. The assumption the Commission
2 has made is not one based on any empirical work or any survey evidence, or anything like
3 that. It is an assumption that the 'excess profits and PPI' will immediately be translated into
4 higher prices for credit. You have already read the evidence given to the Commission as to
5 the magnitude of the increases in the price of credit which would have to take effect in order
6 to maintain the level of overall profitability in PPI and credit sales.

7 The end result, from the result of their modelling, is an annual net deadweight loss in excess
8 of £200 million based upon 2006 figures. That is the figure that the Commission have
9 proceeded on to indicate the extent of the consumer detriment in this case. It is all they
10 rely upon. So, in effect, it is all I need to address. I do not have to worry about the dynamic
11 effects. So, the result of all those graphs you have seen is a figure which they calculate at
12 £200 million on the assumptions of their model. I have already given you those
13 assumptions. They are essentially based upon 100 percent effectiveness and perfection.
14 I am not going to outstay my welcome on these three paragraphs. I am going to come back
15 to them, as you have guessed, but briefly. I am certainly not going to deal with adverse
16 effects which seem to have loomed large in the Commission's thinking that when it comes
17 down to the remedies, it disappeared. I say that with some relief. So, I do not need to
18 address it.

19 The end result is a remedies package. I turn over to para. 10.507. The numbers I have
20 already given you. No argument about this: £100 million to implement and then £50 to £60
21 million per year ongoing compliance costs. No date is given, but one assumes they are
22 going to be for the foreseeable future.

23 At para. 508 they simply say, "Well, we have looked at the calculation. We know it is the
24 most costly to implement. It is at the heart of the remedies package". We know that.
25 Then they say, "Based upon the information we have seen, the ongoing costs of the
26 remedies package we are proposing would be significantly less than the annual consumer
27 detriment we found". Of course, I have already drawn your attention several times to the
28 fact that they are looking here at the total annual consumer detriment - the £200 million
29 deadweight loss. They are not looking at seeing what of that detriment all the remedies,
30 including the POSP would deal with. So, you look at the big picture but you are not
31 actually addressing what matters: What will the remedies do with it? Will it eliminate all
32 or some? Of course, faced with the position they are in, the Commission have to say, "Our
33 remedies will be wholly effective in dealing with all the detriment". If you like, there is a
34 box in this case and we are right in the middle of it now. The consumer detriment is £200

1 million - the total consumer detriment on the one hand. The sum total of all the remedies
2 will have a beneficial effect equal to or greater than £200 million. Why? Because it is 100
3 percent effective.

4 We have the conclusions on effectiveness and proportionality at 10.509 to 10.514 which
5 you have read, I am sure. I will just note it and move on.

6 That has been a somewhat lengthy introduction to my analysis which I now start for Ground
7 1. Ground 1 is simply this: the Commission failed to take into account considerations
8 which are relevant to the proportionality of the point of sale prohibition. As I have said,
9 there are two key errors. I am going to repeat them: first, the Commission failed to consider
10 the extent of the benefits that would arise from its proposed packages taken as a package;
11 secondly, they failed to consider evidence relevant to the extent of the incremental benefits
12 that would arise from the inclusion of the POSP in the package of remedies.

13 In relation to the first, I ask you simply to note para. 70 of the Commission's defence - that
14 it did in fact consider the extent of the benefits that would arise from its proposed remedies.

15 We say that is not correct. They did what they thought the law demanded at the time. On
16 that they were judged wrong. It follows that this remedy in the PPI report should go the
17 same way as the comparable remedy in the *Tesco* report. But, we also say this: that even if
18 it were correct, and even if they say they did address, in the sense of consider, evidence
19 relevant to the effectiveness of the POSP. Even if they did that there was no evidence
20 obtained by the Commission, or any analysis carried out, which would have allowed us to
21 conclude that its package of remedies would have the effects on which it based its analysis
22 of proportionality. So you see, one, they did not do it, we say, they are therefore wrong.

23 They considered the wrong measure, namely total consumer detriment, but even if they did
24 we cannot see any evidence to sustain any conclusion which they could apply in doing the
25 analysis and proportionality.

26 A key assumption in the Commission's analysis, to remind you, is that the effect of all of
27 this would be a 60 per cent reduction in PPI prices. Sometimes they use it to say, "This is
28 what is going to happen", on which there is not the slightest evidence, none at all. Another
29 analysis, which is nearer the bone, is that it was their key assumption on which their Excel
30 model and other thinking was based. I think it is beyond doubt on an honest reading of the
31 report that they started off by looking at the excess profitability of PPI in their judgment,
32 worked out what the costs were likely to be, including a reasonable return on capital
33 equivalent to the cost of capital and then factored that in and reduced the price to a level

1 which would equate with that normal level of profitability. The price would then fall to
2 marginal cost.

3 By the same token, if the water bed effect were perfect, so there was total movement down
4 and up, then there would be an increase in the price of credit equivalent to the excess profit
5 calculated of 1.4 billion on PPI - the report is sometimes somewhat vague on this – then the
6 price of credit would go up, and it seems that they are assuming that the price of credit at
7 the moment is below marginal cost, so every unit of credit sold at the moment is sold at a
8 money loss. That is the assumption. Therefore, the effect of the water bed effect would be,
9 as they put it, to increase the price of credit which everyone will have to pay – everyone, not
10 just PPI purchasers – but it will be a good thing because the price will go up to marginal
11 cost and that will be more efficient.

12 Those are the Commission's assumptions.

13 The lack of evidence point that we are making there, there is just no evidence to sustain it, is
14 something we pick up more fully in our ground 2. Ground 1 deals with the fact that in
15 asking themselves the wrong question and not making the proper comparison between the
16 effect of the remedy and the detriment, but looking only at the total consumer detriment,
17 they turn their minds to irrelevant considerations and fail to consider a relevant
18 consideration. It is a relevant consideration because this was the guidance given to the
19 Commission in its judgment in the *Tesco* case. I would like to take you to the *Tesco* case at
20 last, which you will find in authority bundle 1, near the end, tab 17. The case begins at 784
21 (in the hope that your bundle is paginated the same as mine). Before going to this, it is
22 obvious that this case is of immense importance to both sides. We say it is tolerably clear
23 that the Commission, acting on their assumption of the law, went wrong and took into
24 account irrelevant considerations. They say, notwithstanding their defence of *Tesco*
25 roughly at the same time as they were writing this report, it did not matter, they did
26 everything in conformity with the *Tesco* judgment; and moreover, that *Tesco* did not really
27 advance the case at all in relation to accepted principles of judicial review. We say that is
28 manifestly *ex post facto* reasoning.

29 It has another attraction. It is doing exactly what we are trying to do here. It is a judicial
30 review against a market investigation in this Tribunal, in this case into the supply of
31 groceries.

32 Would I be right in thinking you might have looked at this in advance of the hearing?

1 THE CHAIRMAN: It has been extensively cited. For my part, my recent reading has confined
2 itself to the citations, but I have looked at it at a somewhat earlier date. If you want to edge
3 wider, please do.

4 MR. SHARPE: By the standards of this Tribunal it is remarkably short. Can we pick it up at
5 paras.1 to 6. That gives you the background and would you like to read it. (After a pause)
6 It is an admirably comprehensive summary actually, and it means that I can skip a good
7 deal of the rest of the judgment. You have seen already what it is all about, a fear about
8 local concentration, a worry about the growing concentration of the big supermarkets, the
9 propensity, according to the Commission, of higher prices in those areas, and if not higher
10 prices, affecting the overall level of grocery prices depending upon the incidence of
11 concentration – the more areas that were concentrated the higher the price nationally would
12 be – a very powerful report in many ways.

13 I think we can go straight to para.51. Here we have the familiar statutory questions. I am
14 not suggesting you read it as attentively as you were able to do before, but you see the
15 statutory questions – what are the features, local concentration, and then you see the
16 planning regime, closing off new entry into areas, control of land. Then over the page at 52
17 you see the detrimental effects identified, poorer retail offer for consumers. You see how
18 they have calculated the detriment. They are calculating the detriment on the basis on what
19 they regarded to be excess profit arising from the greater ability to price higher than would
20 otherwise be the case. So they have not succumbed to dead weight losses and hypothetical
21 calculations, they have just done the calculation, how much more money are these
22 supermarkets making as a result of the ability to exploit local concentration, a very common
23 sense way of proceeding.

24 “The Commission estimated the nature or scale of this consumer detriment
25 indirectly using as a proxy the additional profit ...”

26 You see immediately on the one side they are looking at the total consumer detriment and
27 they have calculated it in this by excess profit.

28 Paragraph 54 takes us through the statutory process, “What are we going to do about it
29 having found an AEC?” You have seen that mirrored in the Enterprise Act itself and also in
30 the report. There is a reference to the Guidelines in 55, which need not detain you. The
31 academic excursions in 56 need not worry us at all.

32 Then we go on to para.58. Here the Commission are looking to see how they can remedy
33 this feature, so they introduce the competition test. We do not need to go into the history
34 and evidence submitted to the Commission from Mr. Freeman, but it might be useful just to

1 turn to para.63 entitled “The substance of the competition test”, and here we have in a
2 nutshell the detail of what is to be applied, namely under certain circumstances local
3 authorities should have the power to consider the local competition situation with the OFT
4 involved. The Commission was giving quite careful guidance about the parameters which
5 should be used, fascia tests and the areas within which the tests would be applied – so called
6 isochrones equal travel distance times, and so on.

7 This is all detail, but it reflects how the Commission approached these features of the AEC
8 in that case. If we turn to para.72, p.805, I think by now you can see the problem in the first
9 sentence of 72(a), the Commission reviewed. “The scale of adverse effect of the AEC” – in
10 other words, the total effect. It can earn £100 to £125 million in profits. Then (b), you
11 balance that against £6 to £8 million a year in extra costs. Put the two together, it cannot
12 have constituted a major difficulty to think that the proposed competition test was indeed
13 proportionate. They have compared the total consumer detriment, albeit a proxy for it, with
14 the costs of implementation.

15 Let me turn to the grounds of review. I am not going to ask you to dwell on the preliminary
16 observations over long, but I suspect that Mr. Swift might wish me to draw your attention to
17 paras.76 to 79 at least. I should say without any further ado we accept this. We are not
18 suggesting that the intensity of judicial review of the merits of the Commission’s decision
19 forms any part at all of our case. (After a pause) We are certainly not arguing that the
20 Competition Commission’s report should be read anything other than as a complete
21 document, and should not be analysed “as if it were a statute” which you will see at para.
22 79, quoting a case *Ex parte NHBC*, which has a particularly fond memory for me. We
23 understand that completely. We are content for the Tribunal to give the Commission a
24 generous and not restricted, or to allow it to read the report in a generous unrestrictive way.
25 We are certainly not attacking any decision based upon the public interest if such be
26 relevant in this case. You will be absolutely clear by now, Sir, that what we are doing is
27 attacking the paucity of evidence and the manifest reliance upon an improper consideration,
28 namely, the total consumer detriment.

29 We can turn over the page and have a look at the formulation of ground 1 in this case at
30 para. 84. The way it was put was that the application of the competition test would create
31 costs and would place a barrier upon the largest grocery stores in Britain from extending
32 and, in their view, meeting an existing consumer need. The effect of that, according to
33 *Tesco*, was it would have reduced capacity, artificially limited competition and deprived

1 customers of the benefits which such expansion would bring; so it was seen as a cap on
2 growth. It is expressed at the very beginning of para. 86 as “unmet demand”
3 The accusation here was the Commission failed to have regard to take into account evidence
4 as to the costs of that unmet demand on consumers.

5 I think we can now go forward, this is really to build on your understanding of this case, to
6 ground 1 at para. 111. We see there the Tribunal’s treatment of the unmet demand test. As
7 you see:

8 “... nevertheless in our view that Tesco is correct in submitting that there is a
9 significant gap in the Commission’s analysis in relation to the ‘costs’ of the
10 competition test. The Report does not fully and properly assess and take account
11 of the risk that the application of the test might have adverse effects for consumers
12 as a result of their being denied the benefit of developments which would enhance
13 their welfare, including by leaving demand ‘unmet’.”

14 We see at para. 112 the Tribunal’s acknowledgement of the Commission’s position. If you
15 will kindly read para. 112. The Commission does not seem to be denying there would be a
16 cost, what it is saying is that the risk of it is going to be dealt with by the design of the test
17 and they have taken that into account by having a slightly lower market share threshold.
18 So the same sort of reply – I think you have really seen the emphasis on design being a
19 sufficient answer to lack of evidence – was used in *Tesco* as we have seen (and will see
20 more of) in our case.

21 We can take it a little bit quicker now, and go on to para.122. Having pointed out a
22 sufficient lacuna in the evidence, and having dismissed the Commission’s answer to that
23 we have the familiar timing issue. It would: “... ‘address’ the AEC in relation to highly-
24 concentrated local markets ‘over time’ ...” and that is it. That did not impress the Tribunal,
25 paras. 120 – 123.

26 At para. 124 the Tribunal made the point that it is certainly not up to it to see how quickly
27 these remedies would take effect. The key point is somewhere a few lines up from the
28 bottom of para. 124:

29 “Tesco was not, as we understand it, contending that any such demand could only
30 ever be met by the 60 per cent incumbent ...”

31 And this is important:

32 “... rather it was submitting that, particularly in the light of certain findings in the
33 Report, it was impermissible for the Commission to assume without proper
34 investigation and consideration of the issue, that no unmet demand or other

1 welfare costs would arise because whenever the test blocked an incumbent's
2 development a rival's would fill the void without significant delay."

3 - and the Tribunal agreed with that submission. In other words, the Tribunal was looking to
4 see what is the nature of the process and what evidence is there that it is going to work, and
5 that is super-imposed upon the earlier issue of when is it going to work?

6 Paragraph 125 is also a salutary lesson. It seems that the Commission has sought to
7 substantiate the assumption by means of submissions in the course of the proceedings
8 themselves; the Tribunal said:

9 "We do not believe that this is an appropriate way of supplementing the Report's
10 consideration ..."

11 I think it is manifest and settled law that it is not open for a decision maker to find
12 alternative, different bases for a decision already made in evidence subsequently provided in
13 the course of proceedings, and that is why I am concentrating fully on the report, though
14 where necessary reverting to the defence and skeleton but not too many times.

15 Sir, you have anticipated the Tribunal's conclusion – we can pick it up at para. 127:

16 "The upshot is that the risk of welfare losses or 'economic' costs such as those to
17 which the Commission itself refers ... and which is admittedly a relevant
18 consideration for the Commission in fulfilling its statutory role ..."

19
20 It has not been properly addressed by the Commission. It could be significant. These
21 factors were not taken properly into account. In other words, it was not just enough for the
22 Commission to advert to these costs, and tick and box, and say, "Well, we have got it", and
23 that is all. They should have actually provided some reasoning and evidence, and not
24 simply relied upon the all-purpose defence of, "Well, we got the design right. So,
25 everything else will be right as well".

26 So, when we come to the exercise of proportionality, which begins at p.128, if there are
27 going to be economic costs or welfare losses, they have to be taken into account when
28 deciding on an appropriate remedy. It does not matter what heading you put them under. It
29 has got to consider them also under the proportionality of the test. In this report the
30 Commission's analysis was deficient in that respect.

31 I have gone into Ground 1 appropriately, I hope, in some detail, to give an indication of how
32 the Tribunal handled that element of the *Tesco* case.

33 Ground 2 fits perhaps more readily, even more readily, into our own case - failure to take
34 into account considerations which are relevant to the proportionality of the competition test.

1 You see the *Tesco* complaint is summarised in para. 129. It failed to make any assessment
2 of the possible benefit of the competition test. Secondly, it failed to take account of the
3 economic costs of the test. Thirdly, when they examined the proportionality of the test the
4 Commission failed to take account of the fact that its assessment for the AEC was not clear-
5 cut. So, they started off with the failure to take into account relevant adverse effects of the
6 test.

7 I hope you can immediately see the analogue here with the Commission's failure to assess
8 properly the important reduction in demand that all the evidence suggested was going to
9 take place as a result of the point of sale prohibition - that people would not, owing to
10 inconvenience and other factors - take out as many PPI contracts as they would have done
11 absent this so-called remedy.

12 Paragraph 131 captures an important truth which is highly relevant to our case. It is not in
13 dispute that the application of the proportionality principles also involves the question
14 whether and to what extent the proposed measure will be effective for its purpose. Now, a
15 measure will be considered not to be proportion if it is ineffective with respect to its aim or
16 if its costs are disproportionately large in comparison with the mischief at which it is aimed.
17 We see that much of the argument concerned the way in which the Commission was
18 required to carry out the proportionality exercise. Can we pick it up at para. 132? The
19 Commission had failed to carry out a proper cost benefit analysis, and therefore as not in a
20 position to come to a judgment under s.134. *Tesco* cited a number of sources for that. But,
21 at para. 133 *Tesco* characterises the Commission's claim that it could not quantify the
22 effectiveness of the competition test in breaking down the existing AEC as an unsustainable
23 counsel of despair. In fairness to the Commission they have not said that here. They did not
24 say it was impossible to calculate. Our argument is that they just did not calculate it, and
25 could have done. At the very least the Commission should have attempted an analysis
26 along the lines suggested by the guidance. Broad estimates, sensitivity analyses, scenarios.
27 Then, take a view as to which weight to attach to the results. Obviously they avoid
28 spurious accuracy, and so on.

29 Paragraph 135. The Commission accepts the remedies must satisfy proportionality
30 principles. Obviously. What are those principles? Here you see in the judgment the
31 factors which must be taken into account in accordance with law. The quotation at para.
32 136 - *ex parte Fedesa*. This was a case involving the application of growth hormones in
33 European beef. There was an outright ban on the application of such hormones, even
34 though all the evidence seemed to suggest that the costs of the ban - the extra costs incurred

1 by farmers in particular - vastly exceeded any benefit which would accrue from a wholesale
2 ban on growth promotion - which was essentially the application of testosterone and
3 oestrogen, and so on. The issue was: Was the game worth the candle? The precise facts
4 are not overly relevant, but you can see the quotation from *Fedesa*.

5 “By virtue of that principle, the lawfulness of the prohibition of an economic
6 activity is subject to the condition that the prohibitory measures are appropriate
7 and necessary in order to achieve the objective legitimately pursued by the
8 legislation in question; when there is a choice between several appropriate
9 measures resource must be had to the least onerous, and the disadvantages caused
10 must not be disproportionate to the aims pursued”.

11 This is the clearest statement. My friend relies upon it, and so do we. There is nothing
12 between us. Measures must be effective to achieve the legitimate aim in question. This is
13 Mr. Lasok’s hammer, if you will recall his telling skeleton. It must be no more onerous
14 than is required. It must be the least onerous of the choices. It must not produce adverse
15 effects which are disproportionate. We accept there may well be adverse effects, but they
16 must not be disproportionate.

17 We know full well that a balance has to be struck between these considerations. In
18 resolving that balance there is no dispute that the Commission does have a wide margin of
19 appreciation. At para. 139 you see how the Tribunal developed this point and passes on to
20 the limits of that wide margin. Will you read para. 139, please? (After a pause): In our
21 judgment the key points are the reference to the double proportionality principle, or
22 approach. It seems commonsensical, the greater the intervention, the greater the
23 consequences, the greater the cost, the less one can simply pass by with a superficial
24 analysis and inadequate evidence -- or superficial evidence. But, here the Tribunal also says
25 that ultimately the Commission must do what is necessary to put itself into a position
26 properly to decide the statutory question. That plainly and obviously must garner the
27 evidence which is required in order to make the balancing exercise.

28 In a nutshell, the distinction from my friend’s case is that he is saying he had all the
29 evidence and the appropriate balance is a matter of discretion. Our case is that they did not
30 have any evidence at all which would have enabled them properly to have effected the
31 balance which the law requires. In this case they should have taken into account relevant
32 considerations, which they did not; they should have examined the effectiveness of the
33 remedy, which they did not; they should have taken into account the time period within
34 which it would achieve its objective, which they did not. They also should have looked at

1 the adverse effects that may flow from the implementation of the remedy, which they did
2 not.

3 More finely, para.140, the Commission applied the proportionality test, and here is a
4 quotation from the Commission on the Commission's pleadings:

5 "Although the Commission found that the scale of the AEC is difficult to estimate,
6 its best estimate of that effect indicated that it is substantial. Balanced against that,
7 it found that the cost of applying the competition test would be relatively low and
8 the test goes no further than necessary to achieve an effective remedy. The test
9 was therefore proportionate."

10 What was the mischief that the Commission was examining here? It was the additional
11 profit earned by the larger grocery retailers owing to the weak competition. At para.142 we
12 see the nub of Tesco's case, that the Commission did not attempt to estimate the actual
13 benefits in terms of increased competition which the test would produce and instead limited
14 itself to pointing to its estimate of the aggregate annual detriment to consumers caused by
15 existing highly concentrated markets. In other words, by looking at the total detriment they
16 had misapplied the proportionality principle.

17 The analogue I hope is clear, that if you are going to do this proportionality exercise, which
18 you must, you have got to have a very clear idea what it is your remedies are seeking to
19 achieve and the likelihood of achieving them. If it is the case that the Commission was
20 content and had enough evidence to put itself into a position to say, "This remedy will
21 achieve 100 per cent success in this market", so be it. If that is their case then we will look
22 at the evidence. Instead, we see in their report nothing less than a repetition of the approach
23 they adopted in *Tesco* for very good reasons.

24 That is the undoubtedly the basis of their approach in both reports, but it was sufficient to
25 look at the total detriment and not address at all the effectiveness, still less the incremental
26 effectiveness of the point of sale prohibition. Unless you know how effective the remedy is
27 going to be, how on earth can you assess if it is proportionate relative to the costs of
28 achieving that result?

29 In this case I think we can go to para.146. We see that Tesco's position was that the
30 Commission had no attempt to estimate the competition test contribution to the achievement
31 of the elimination of the AEC and the detriments; still less did it provide an adequate
32 timetable, timescale. It had not even estimated it, even in approximate terms, or considered
33 it at all. You will see the reference, "Yes, it will happen, but it will happen over time".

1 Then would you read para.147. I am obviously pointing to the Commission’s use of the
2 word “address”, which we have already seen in the report, which the Commission relies
3 upon in this case saying “address” means “eliminate”.

4 My submission there is following directly from the President in this case, first, the word
5 “address” does not indicate whether the package of remedies including the test is expected
6 wholly to remedy the AEC in existing concentrated markets or merely to mitigate it; and if
7 the latter, by how much? You will see his remarks about “over time” tell one virtually
8 nothing about the anticipated timeframe.

9 Pretty well everything I have cited to you by way of the Tribunal’s comment and the
10 Commission’s response to Tesco could, I think, without too much violence, be translated
11 into this case. Failure to address the effect of the remedy, the failure to consider the
12 timetable in which it is going to operate, we are enormously assisted by the Tribunal in this
13 case, not only, firstly, to point the way to the requirement to ascertain what the effect of a
14 remedy would be – in other words, to address it, but in terms which are less ambiguous and
15 opaque; and secondly, always to stipulate as best the Commission can how long it is going
16 to be before their remedies are likely to take effect. Unless you know that, how on earth can
17 you do a proper proportionality exercise, both in terms of extra cost and uncertainty. I said
18 earlier, having a case directly against the approach you have taken is the lawyers’
19 nightmare, but it has come to pass in this case.

20 Before leaving the *Tesco* case, it is worth just considering one or two other aspects which I
21 think are at 150. The Tribunal not only drew attention to the absence of any guidance as to
22 the timescale or to effectiveness generally, but drew attention to the fact that it was
23 surprising because the test it implemented would, in principle, be capable of having
24 profound, widespread and indefinite effects on businesses and customers alike in the
25 grocery sector. To quote the final sentence:

26 “Yet the report does little more in this regard than record the Commission’s belief
27 that the package of remedies proposed will eventually address the AEC.”

28 At the risk of going overlong, look at para.152 to see how the Commission responded to
29 some of this. The obvious first point they make is, “There is such an enormous disparity
30 between total consumer detriment and the costs of implementation”. It was not actually in
31 contention, but that was fine, and there were other consumer detriments which they did not
32 quantify, which existed in the background. The speed of its application would of itself be
33 quite difficult to calculate because it rather depended on the supermarkets on their rate of
34 expansion, and so forth. It would have been unreasonable, the Commission argued, to

1 conclude that the benefits would not outweigh the costs. You have, as it were, to draw
2 inferences. It would be wrong to criticise the Commission for not filling in all the gaps here
3 and looking at the effect since the remedies when the numbers themselves were so great and
4 the disparity between the detriment and the costs so great; really, it would be quite wrong.
5 The Tribunal did not think much of that argument as you will see at para. 154. First, there
6 was the inadequate calculation of the economic cost involved – Tesco’s Ground 1.
7 Nobody knows what the answer to that would be, but if they had done it properly it is at
8 least possible the Commission might have been less confident in their submissions. They
9 had no way of knowing because they had not done it, and the Commission has accepted that
10 might be a good point, or at least more accurately a distinct possibility. Paragraph 155 is
11 rather technical, but para. 156:

12 “We do not consider that Mr. Roth’s first point justifies the absence of any proper
13 assessment or consideration of the effectiveness(including time scale) of the test.”

14 A pretty perfunctory, somewhat dismissive response, but nevertheless, respectfully,
15 absolutely right. If it were different then all the Commission need to do is to say that the
16 numbers are so great, the differences are so huge then we can do anything.” That is not the
17 Commission’s normal way of doing things, and they have said in this case the differences
18 are huge and there are dynamic detriments and benefits and so forth; they are not relied on,
19 they have relied upon their graphs, the dead weight loss in their theoretical model, so that is
20 what we are attacking, we do not need to attack anything else. They have said actually the
21 costs of implementation compared with that is so great. We have taken issue with that, but
22 if they want to run that argument again before this Tribunal as they might, they have a
23 pretty difficult job in the face of the Tribunal’s dismissal of its argument but if anything the
24 numbers and differences were even greater.

25 The conclusion the Tribunal reached (para. 162) was that the Commission’s approach was
26 flawed as a result of the fact that it:

27 “... based its proportionality assessment on an assumption that the whole of the
28 estimated customer detriment would be remedied by the test, in combination with
29 the other remedies.”

30 There is in the report no recognition or weighing of the now acknowledged possibility that
31 the existing AEC might not be satisfactorily remedied or mitigated for many years.

32 My friend has not made any admissions or acknowledgements that the AEC might not be
33 satisfactorily remedied, that is his privilege, but respectfully that is not his task; his task is to
34 point to passages in the Report which say that the remedies will eliminate the AEC and, as

1 there is no timescale measured, it is difficult to read into the report what timescale the
2 Commission had in mind if it had in mind any timescale.

3 As for the margin of appreciation (para. 163) we see that:

4 “Whilst the precise methodology adopted for assessing these matters, and the
5 weight to be attributed to the results of such assessments are (subject to rationality
6 or questions of law) likely to fall within the margin of appreciation of the
7 Commission ...”

8 We accept that. “... the assessments and the weighing must take place.” Our submission,
9 every simply is that they looked at the wrong matter to balance the proportionality exercise
10 – total detriment – and therefore did not make a proper assessment and weighting. So in
11 truth there was nothing properly to assess.

12 As you see at para. 165 the Tribunal was unanimous in striking down the report - an extra
13 reason, but I will no dwell on that.

14 A good report then in to PPI would have to contain evidence and conclusions as to what a
15 remedies measure is able to achieve before the Commission could sensibly have assessed
16 whether that aim is proportionate to any adverse effects of the measure in order to be able to
17 assess the proportionality of the remedy. They should have examined the extent of the
18 consumer detriment that would be remedied by all the remedies, including POSP, and they
19 should have set out what timescale they had in mind; they did neither.

20 I have said the Commission’s view is that it had this discretion, this margin of appreciation
21 in assessing this. I think its position is essentially that provided it can show it had given
22 some consideration to an issue and came to a judgment on it this is sufficient to insulate its
23 decision from legal challenge – in other words, it ticked the box and then we move on. In
24 our view it is plainly not enough to meet the legal standard required.

25 First question: did the Commission in fact gather the relevant evidence to put itself into a
26 position where it could properly consider the issue? Secondly, did it then make a decision
27 that was supported by such relevant evidence as they collected?

28 It must be common ground that if they did not in fact gather the relevant evidence, and did
29 not put themselves into a position where they could properly consider the issue, and did not
30 make a decision supported by such relevant evidence then the decision must be quashed, in
31 this case the remedies.

32 Sir, I draw on and have cited in our pleadings the well known cases of *Tameside*, *Mahon*
33 and also the Court of Appeal in *IBA* case, where all these principles are made good in rock

1 solid law. I am going to quote on short extract from *Tameside*. *Tameside* is in the bundle,
2 and I am going to quote from 1065.

3 THE CHAIRMAN: Where do we find it?

4 MR. SHARPE: I am not planning to take you to it but ----

5 THE CHAIRMAN: You might as well give us the reference.

6 MR. SHARPE: -- I will give you the reference when my learned Junior finds it for me.

7 THE CHAIRMAN: I will leave a blank!

8 MR. SHARPE: Authorities 1, tab 2, p.27, and my reference is to para. 1065 B, which will be
9 found at p.78. I suspect Lord Diplock's words will be very familiar to you, Sir, but he
10 said:

11 "... the question for the court is, did the Secretary of State ask himself the right
12 question and take reasonable steps to acquaint himself with the relevant
13 information to enable him to answer it correctly?"

14 - a simple proposition of law – House of Lords authority – and I would be very much
15 surprised if it is in contention.

16 Lord Diplock, again, in *Mahon v. Air New Zealand* we will find at Tab 3, p.90. Here my
17 quotation is from p.820G (p.102). Here, Lord Diplock simply states,

18 "An investigative decision-making 'must base his decision upon some evidence
19 that has some probative value'".

20 My last quote, simply to round this off, is Lord Justice Carnwath in the *IBA* case, which you
21 have seen, and which is found at Tab 11, p.406. Here he simply says,

22 The relevant question is whether there was adequate material to support the
23 defendant's conclusion".

24 It is basically a little puzzling to non-lawyers, if I may say that, because these are just
25 glimpses of the blinding obvious. It is save that the way administrative law developed -
26 until the *Tameside* judgment - it afforded the reviewing courts a very limited role in
27 examining a decision-maker's findings of fact. That was considered to be a matter within -
28 to use the old language - jurisdiction of the decision-maker. That was the fact finder and
29 had the expertise to find the facts. Therefore, the court recoiled in examining the decision-
30 maker's choice of fact and analysis of them. If you take a case like *Tameside*, when there
31 was no evidence to sustain the decision-making, it was taken up to the House of Lords
32 pretty much on this point - that any decision that cannot be supported by a firm evidential
33 foundation is a bad decision. It was not a separate head of review. It was under the existing
34 head of review that they failed to take into account relevant consideration - namely, facts

1 which were not there, not merely facts which were there. I hope I have expressed that
2 adequately. These are really just homely nostrums nowadays, and very, very familiar to us.
3 This is, of course, where the Commission has gone wrong. Our case is that if you have
4 asked yourself the wrong question and gone to the total detriment, it will be pure chance if
5 you have analysed the right evidence to get the right answer. Our case is very simple: first
6 of all, they did not look at the effectiveness of the POSP, either in conjunction with the
7 other remedies or incrementally, as I put it, because there is no evidence to say that they
8 did; secondly, if they say that they did, and it was going to be wholly and perfectly effective
9 as a remedy, there is no evidence to suggest that either. So, we can run it both ways. Faced
10 with - if one can ever be faced with a lacuna - a lacuna in the evidence, then we are entitled
11 to say that that is a decision-making body failing to take reasonable steps to acquaint
12 himself with the relevant information to enable him to answer, in this case, the question
13 correctly, and failed to base his decision upon some evidence that has some probative value.
14 In a nutshell, that is precisely our case. They were flying blind. We will see later many
15 other examples. We will be supported by Miss Davies and the Lloyds' evidence, but
16 numbers have just been plucked out of thin air - thin air.

17 (Short break)

18 MR. SHARPE: Sir, I think we can take things much more briskly now. I am going to take you to
19 some aspects of our Ground 1. I will remind you first of those paragraphs 10.493 and
20 10.494 which you saw before the short adjournment, and which I took you to when we
21 started.

22 THE CHAIRMAN: Do you want us to have them open?

23 MR. SHARPE: No bad thing. (Pause) Paragraph 494 is the only part of the report which
24 establishes what the total consumer detriment is, or, rather, is assumed to be. It rests upon,
25 as you see, the so-called Excel model set out in the Appendix 10.10. It is not my intention
26 to take you to that immediately, but I want to remind you that even though the Commission
27 says the losses may be substantially more, even though they may claim extra dynamic
28 benefits from their remedies, this is what we have to address. The model was used to
29 calculate the so-called deadweight loss. It was done on the basis of calculating that flowing
30 from people being offered credit at lower prices today under the existing regime than would
31 be the case if PPI profits were not being used to fund the sale of credit. So, they did it by
32 comparison between a scenario based on prices prior to the remedies coming into effect,
33 and a hypothetical scenario in which the remedies under consideration were assumed to be -
34 and here, for your note, I am quoting from Appendix 10(9) at para. 8, p.804 of CB2 -- It is

1 not necessary to go to it because I am simply going to quote that ‘the assumptions on which
2 this excess model were based -- the remedies under consideration were assumed to be ‘fully
3 effective, costless and drive the level of excess PPI profits to zero in each case’.

4 If you now will turn to p.824 of the bundle, you will see Table 1 of Appendix 10.11. None
5 of this is what I would regard as a conventional economic model which is full of
6 assumptions co-efficients, equations, R-squared, regression analysis, tests for
7 heteroscedasticity and other marvels of the modern age. All this is essentially a set of
8 assumptions. We look and see prices on Table 1. Initial PPI price is judged to be 78 pence
9 per month for an indicative £100 per month loan. That is going to fall on the assumption
10 that PPI prices fall to marginal cost to 31 pence.

11 There is no model working here because it is not that sort of economic model. This is just
12 two numbers, one of them we think accurate, 78p, because it is not difficult to calculate
13 that; but then we have a figure of 31p, a reduction of about 60 per cent. This reduction has
14 to take place for any of the Commission’s assumptions to roll forward.

15 The analysis itself, as you see, was based upon an increase in credit prices. If the profits
16 disappear from PPI, by definition or by assumption the argument is they will be recovered
17 from higher credit prices. This was the Commission’s assumption. So we see an increase
18 in credit prices, as you see, from point 4.2, initial credit price for the indicative loan per
19 £100, and that goes up, as you see, to the counterfactual credit price, 58p, an increase of
20 about 40 per cent.

21 For our purposes, it is not necessary to dive into any difference between system and non-
22 system remedies here, because the point is the same whether one is chosen or the other.

23 For whatever use that may be to you, that is the basis on which the calculation of the
24 Commission’s remedy is based. From that you get £200 million total consumer detriment.
25 I suspect my friend Miss Davies, judging by the evidence of Mr. Colley, has subjected this
26 to relentless investigation. It has incidentally teased out some quite interesting new facts
27 from the Commission underlying the relationships here. She may dwell on it a little. For
28 our purposes, for Barclays purposes, it is quite sufficient to point out that this is just an
29 assumption. It assumes a hypothetical world that none of us live in. All economic models
30 do that to some extent and it is right that they do. You have to abstract some issues because
31 the world is a rather complex place. Here the Commission was not even attempting to
32 mirror reality in the way that models, economic models, try to do. It was simply setting up
33 an almost closed system, but if you assume X then Y. So if you assume competitive forces,
34 if you assume a reduction of 60 per cent in prices, if you assume a water bed effect, then

1 eventually something approaching £200 million will emerge at the other end and constitute
2 a consumer detriment. You have got to assume that is a perfect process to be fully
3 effective, it has got to have no costs associated with it, because, after all, we live in a perfect
4 world, do we not, and it is going to be perfect in eliminating all the excess profits the
5 Commission found. It was on this hypothetical model that the Commission has based its
6 important remedy.

7 PROFESSOR STONEMAN: Can I just get you to emphasise this. I was looking at p.804, para.8.

8 “For the purposes of analysis we assume that both system and non-system
9 revenues are fully effective, are costless and drive the level of excess PPI profits to
10 zero in each case.”

11 Therefore, that is the exercise that they are undertaking. I took it then that what table 1 does
12 is to say, what is the pay off in terms of consumer benefits in that case? It is not saying,
13 “This is what will happen”. Are you saying that Barclays interprets this as a forecast?

14 MR. SHARPE: Oh, no.

15 PROFESSOR STONEMAN: I have interpreted it as what is the potential pay-off, not what is the
16 potential outcome.

17 MR. SHARPE: Our case is actually much simpler than that, with respect: is this a satisfactory
18 basis, evidential basis, to provide support for the introduction of such an intrusive remedy?
19 Can it be said with confidence that the consumer detriment which the Commission has
20 identified in the real world of its report does in fact exist. That is, if you like, our starting
21 point to this. So we move from the world of the hypothetical to the real world. It is an
22 evidential question because our case is very much evidence based. If they had provided,
23 and may well have to provide, if, with respect, you remit it back, a better assessment of this
24 – I doubt if they will do this type of analysis, they will probably want to sit down and look
25 at relationships between price and demand with more care, they will not make assumptions
26 about elasticity of demand which they make, as you have seen. They will try and firm up
27 some of the empirical bases – it will not take them long – and then they will arrive at their
28 conclusions. Instead, what they have done is make certain assumptions, perfect world, this
29 is what will happen in a perfect world.

30 I do not have any particular problem in saying that the arithmetic is right or wrong, I cannot
31 tell. What I can say is that it is utterly irrelevant for the important consideration of defining
32 whether a remedy is proportionate or not. I hope that is helpful.

33 If I may say, the thrust of our argument, and I think perhaps I have overdone it so far, is that
34 what is important here is to assess not the total detriment on the one hand – it is not an

1 irrelevant issue to see what the total detriment will be, it certainly is not and you must not
2 be confused into thinking I am saying that. What I am saying is that if you are going to put
3 forward a remedy it is absolutely mandatory – and *Tesco* tells us now that it is mandatory
4 and I hope very much you will sustain that – to actually see what is the effectiveness of
5 remedy. The total detriment could be colossal but the remedy could be useless or trivial.
6 Therefore, they have started off looking at the wrong comparator. The £200 million is
7 neither here nor there. We are not altogether sure it is strictly relevant. It is only relevant, I
8 will put it another way, to an assessment of what the total detriment would be. Our case is,
9 whatever the total detriment can be, it could be a hundred times more or a hundred times
10 less. The real issue is, what is the effectiveness of the remedy?

11 I wanted to show you that because it is an example of how the Commission have
12 approached this matter. You see it is a pretty dramatic reduction and if you are assuming a
13 costless 100 per cent effective remedy then I think the sub-text is “and in short order of 60
14 per cent”, you have got some explaining to do because that is a pretty dramatic change in
15 the market place.

16 Anticipating, did they make the correct comparison? You know my answer, no.

17 At para.61 of the Commission’s defence, which I am not going to take you to, my friend can
18 do it, there is the following quotation, because what did the Commission actually do?

19 “... the Commission concluded that the scale of the problem, i.e. the AEC and the
20 consumer detriment resulting from it, far outweighed the costs of the remedies.

21 This is not a ‘close call’, where differences at the margins could make a difference
22 to the Commission’s conclusion.”

23 That may remind you of the exchange I reported from *Tesco*. The difference is so big we
24 do not need to worry about it. Well, para.61 of the Commission’s defence seems to repeat
25 that and respectfully I ask that you endorse the Tribunal’s approach to it, which simply was
26 fairly in two lines to reject it. What it does it, it confirms that the Commission looked only
27 at the scale of the problem. That is what they are pointing to in para.61. Rather than
28 considering the extent to which the problem could be resolved by the remedies, they are
29 making the same point, as was rejected in *Tesco*. For your note, paras.152 to 156 of *Tesco*,
30 that is authorities 1, pp.833 to 834.

31 In their view plainly there was no need to consider the benefit that would arise from its
32 remedies because the problem was apparently so much larger than the cost. As I say, it was
33 a bad point in *Tesco* and it is a bad point here – it is an even worse point given the far higher
34 costs, £100 million implementation, and £50 to £60 million annual costs.

1 Of course, the Commission in general terms did consider the wider question of effectiveness
2 of whether the proposed remedies would be expected to have some beneficial effect; of
3 course they did in general terms.

4 The issue between the parties is whether the Commission went further than this general
5 overview, ticking the box if you like, and answered the question that the Tribunal in *Tesco*
6 judged to be relevant, the extent of the benefit that results from the remedies. The only
7 quantification of consumer detriment carried out by the Commission is the one I have just
8 showed you. That dealt with the full total detriment, and that turns on whether the
9 Commission properly conclude that its package of remedies would be expected completely
10 to remedy the entire AEC.

11 The Commission did not anywhere in the Report directly address the question of whether it
12 was proceeding correctly in looking at the full detriment arising from the AEC. The
13 Commission does not state that on the facts of this case it expected the full detriment arising
14 from the AEC to be the same as the detriment that it expected to be remedied. The report is
15 silent on that, and for the reasons I have given, because at the time they drafted the report
16 they did not think that was the correct test – the pre-*Tesco* test. Therefore, there is nothing
17 in the report to suggest that the Commission was not proceeding on the same basis as it
18 proceeded in *Tesco* – looking at the scale of the problem rather than the effectiveness of the
19 remedies. Against this background the Commission’s case amounts to saying that it did, in
20 fact, conclude that its remedies’ package would be 100 per cent effective, and consequently
21 (if accidentally) it carried out the correct proportionality analysis.

22 In our view that is a very poor evidential basis for such a “radical” reform as the POSP to
23 be implemented. The important point is there is nothing in the report to justify that
24 conclusion.

25 None of the paragraphs from the report relied upon by the Commission in its pleadings
26 include any evidence or analysis to the effect that the Commission proposed a package of
27 remedies which would eradicate every element of the AEC, remedy the entire consumer
28 detriment, or result in a 60 per cent reduction in price. I have already shown you examples
29 in the report, one where they admit that the remedy would not eliminate what they called
30 the “incumbency advantages.” Again, for your note that is para. 10.74 at p.201 – they said
31 it was not necessary.

32 There are other paragraphs in the report, notably 10.41 at p.191, which essentially makes
33 the same point, and I give it to you for its reference, and 10.43 on the same page, 191.

1 The admission that the incumbency advantages would persist, and 10.41 and 10.43 referring
2 to the increased incentives for such, but acknowledgement of a risk that this element of the
3 remedies package will not generate the changes in behaviour necessary fully to address the
4 AEC. Do you see that at the beginning of para. 10.43?

5 THE CHAIRMAN: Does that imply an expectation that notwithstanding the risks it nonetheless
6 will fully address the AEC and, if so, does that go any way to answering your point about
7 the imprecision of the use of the word “address”?

8 MR. SHARPE: I think not, with respect. I think it is a frank acknowledgement, I think quite
9 realistic, that, as they say elsewhere in the report, you cannot really predict the future
10 accurately, and we all acknowledge that, and there is a risk it may not work. I do not read
11 into this that it will work but there is a risk that it will not, meaning there is a presumption
12 that it might. It will enhance competition. We do not need to disagree that it may well
13 enhance competition, and we accept there is a risk the elements will not generate the
14 changes and behaviour necessary fully to address, you can only take it at face value. But it
15 is a long way from saying what they have to say. They have to say, in order to meet the
16 *Tesco* test, that the remedy they are proposing is so effective it is to eliminate the total
17 detriment. Shall I take you back to that? With respect, you are looking at me somewhat
18 quizzically. The *Tesco* test says: “Look at the remedy and see how effective it is going to
19 be. It may, hypothetically, be 50 per cent effective, so it is going to hit 50 per cent of the
20 total detriment, so when you are assessing whether the cost of implementing the remedy is
21 proportionate one can only look at 50 per cent of it is going to be remedied, and that is the
22 correct test; it is the test the Commission argued was wrong in *Tesco* and this Tribunal put
23 them right.

24 When we come to PPI we should have adopted a test which looked at the effectiveness of
25 the POSP, essentially being the only remedy that was going to cause significant costs.
26 They did not look at the effectiveness of the remedy at all – that is what I have been
27 submitting – but they have tried in an estimate which we regard as laden with imperfect
28 assumptions, the £200 million total detriment. What they failed to do is to assess whether
29 or not all of that, or just some of it, would be captured by their point of sale prohibition
30 remedy.

31 We say on any fair reading of the report, and I am trying to take you to bits and pieces of
32 the report, you cannot read into this anything other than a statement that they only thought
33 they had to measure up total detriment against the cost of the remedy. That was wrong.
34 What they should have done is look to see what the effectiveness of the remedy was. They

1 are now coming back and arguing in para. 61 of the defence, that actually the scale of the
2 problem is all they need to consider, i.e. the pre-*Tesco* test, and they now seem to be
3 arguing that actually the application of this remedy will perfectly eliminate the adverse
4 effects; that is all they have left, because there is nothing in the report that says: “We
5 considered how effective this POSP remedy would be to eliminate consumer detriment.”
6 They could have said, acknowledging what they do acknowledge, that it is going to be
7 partially successful – you remember in para. 10-50, not going to meet all the considerations,
8 there is a risk as you pointed out. They could have said “Acknowledging all these risks we
9 think we might hit, say, 80 per cent of the consumer detriment that we have identified”.
10 Then it would have been possible to have taken the costs of implementation against meeting
11 the 80 per cent target for the effectiveness of their remedy and a proper proportionality
12 exercise could have been done, because it could have been 50 per cent, it could have been
13 20 per cent, I am just hypothesising. That would have been a good proportionality exercise
14 and, if done properly, would be unimpeachable, because that is essentially what the
15 Tribunal told them to do in *Tesco*.

16 In this case what they have done is relied exclusively upon an analysis, which we do not
17 think much of, that there is going to be total consumer detriment. But, as I have said you
18 will not find in this report any recognition that their proposed remedies is going to be
19 anything other than perfect. We say that simply beggars belief and that what they should
20 have done is produce evidence either in support of that proposition on the one hand (which
21 they have not) or they should have acknowledged that it was not going to be a perfect
22 remedy and produced evidence that it would have met a proportion of the total detriment,
23 and only then could a proper proportionality exercise have been done. So, they have gone
24 comprehensively wrong. Because they have gone comprehensively wrong, it is obvious
25 they have had regard to irrelevant considerations - namely, their exclusive reliance upon
26 total detriment, and they failed to take into account relevant considerations - namely, they
27 should have generated evidence about the effectiveness of the remedies they did choose. In
28 the end they did neither. That is why we are here. We want this report, sir, to be quashed.

29 PROFESSOR STONEMAN: Mr. Sharpe, in terms of what you have just been saying, can I ask
30 you whether you recognise any distinction between a remedy which is 50 percent effective -
31 that is, it meets 50 percent of the problems arrived by the AEC - and a remedy that is 100
32 percent effective but we are only half sure it will work?

33 MR. SHARPE: With respect, that is not a fair question because the answer I would give in a
34 seminar room would be, “I do not think I can” because the balancing exercise which the

1 Commission must necessarily do is going to be a balance in a world of uncertainty. I do not
2 think I could fault an assessment which was probable-istic. The future is yet to come.
3 Nobody knows. I would say the Commission has expertise in assessing that consideration.
4 That is about as far as I can go because the real issue for me, bringing a case in law is: Did
5 they even do that? You see, for that argument to survive here we would have had to see
6 evidence - not a vague reference to the word 'risk'. We would have to see hard evidence
7 that they had addressed the probabilities of success.

8 First of all, let us establish that there is nothing in the report - no heading, or paragraph, or
9 text - which says, "We think our remedy will be effective up to this point", whether it is in
10 absolute terms or even if they said they had a very good chance of achieving these
11 objectives. If they had supplied evidence to that effect, our case would be very different.
12 But, they did not. It is no wonder they did not - because they did not think they had to.
13 They thought all they had to do was to say that, "The total detriment is so much bigger than
14 the costs of implementation, that is the proportionality exercise done". Bigger. Bigger.
15 Big gap - not as big as Tesco, but nevertheless substantial. So, it is this exclusive reliance
16 upon total detriment that damns the Commission. They failed to take into account
17 something which, if they had had the benefit of *Tesco* before rather than after, they would
18 never have crafted the report in this way. They would have gone back and said, "Now we
19 have to look and see just how effective this remedy is". Of course, it must be said - and we
20 have never hidden this - we do not think this remedy is any good, otherwise we probably
21 would not be here. But, what the Commission should have done is set out what the
22 evidence would have been to say that the probabilities were high and the costs of
23 implementation were lower, and the effectiveness would be greater. It is this lacuna - an
24 absolute gap in the evidence. We have to hunt around, as if we are playing some sort of
25 legal scrabble, in the report to try and find odd words to try redeem the Commission's
26 position. That is simply not appropriate. It would not be appropriate under any
27 circumstances. It is even less appropriate when the remedy itself is such an important one.
28 We would be falling into the problem that Mr. Justice Auld (as he then was) in the *NHBC*
29 case found: we just cannot read this as if it is a statute, with each word having particular
30 significance. We are prepared properly to look at the general thrust of the report, but we
31 need help. Where in the report - and this is not a rhetorical challenge - do we find a clearly
32 articulated statement of the evidence underlying the assumptions as to the effectiveness of
33 the remedies? There are none.

1 THE CHAIRMAN: We would expect to find it after the word 'however' in the third line of para.
2 10.443, would we?

3 MR. SHARPE: Yes.

4 THE CHAIRMAN: That introduces, one assumes, their reasoning for concluding, if they did
5 conclude, that the risk was not sufficient to lead them to a conclusion that the remedy would
6 not be fully effective. It is just a matter of language. I am trying to avoid treating it as a
7 statute. They use language for a purpose and one is entitled to interpret it. The question to
8 my mind is: If that is right, and if what follows is intended to answer the question about
9 risk, how far does it go? Does it go for the rest of that paragraph or right on to the end of
10 10.45?

11 MR. SHARPE: First of all, in a sense, what follows the 'however' point is actually a reprise of
12 the underlying argument. It is one of the features ----

13 THE CHAIRMAN: It introduces a lot of things by reference, because they have covered a lot of
14 that ground already.

15 MR. SHARPE: Yes, indeed. By the time you have got to this stage you actually do not need this
16 because what you have done is established that there is an AEC. What you need here is a
17 statement not of what the basic problem is in fundamental terms, but you need a statement
18 that says, "We think this is a very effective remedy. We will meet all the detriment for the
19 following reasons". That is not what you get. What you do get is a number of
20 speculations (as I pointed out this morning) at 10.44 -- There might be an increase in
21 advertising expenditure -- consumers might shop around -- and so on. Well, they might do
22 anything. It may be perfectly legitimate, but there is not the slightest evidence pointing to
23 the effectiveness of the remedy. What they have done - and one can easily see it - is they
24 have confused arguments which go to the need for a remedy, with a proper analysis of the
25 effectiveness of this remedy. By this stage we are all convinced that a remedy is needed -
26 let us say. We have not got a clue as to whether or not this remedy is going to achieve what
27 is claimed for it. Sir, does that meet your point? Are you still concerned about the use of
28 the word 'risk' here, indicating an acknowledgement that it might not be a perfect remedy?

29 THE CHAIRMAN: I am listening to your submissions, but I am not going to stop asking myself
30 the question for some considerable time.

31 MR. SHARPE: Sir, I am here for your benefit - not the other way round. If I can assist you, I
32 will. Just to repeat, the word 'risk' here -- It is not clear what it means. I know what the
33 word 'risk' means, but I do not think my friend can erect from this an unhelpful assertion
34 that the Commission did in fact consider the effectiveness of the remedy. We would expect

1 to see some rigour attached to that, given the double proportionality arguments which you
2 saw in *Tesco*, if nothing else. It is, to repeat, a very imperfect basis. This case cannot be
3 defended on the basis of one word. There is no risk of that at all, of course.

4 THE CHAIRMAN: We would not be here for five days if that was the case.

5 MR. SHARPE: To repeat, the essence of this is that it is straying into repeating essentially the
6 need for a remedy, but nowhere will we see any evidence, hard or otherwise, of how
7 effective that remedy would be. My answer to that is: It is obvious they did not think they
8 had to do it. We say, "Of course, it is fundamental. It is fundamental because it is
9 common-sense". You balance up what you hope to achieve against the cost of achieving
10 it. The global position of the total detriment is interesting, but not vital.

11 If I can take you to p.294, para. 10.477, again you have seen this and I will take you to it
12 very quickly. Just read this. They do not want to pass it as if it were a statute, but the
13 remedies package, what will it do? It will encourage consumers to search – good:

14 "... by removing many of the barriers to searching that we identified. In particular,
15 this remedies package will improve the transparency and comparability of price
16 information, will offer consumers a clearer understanding of the cost of PPI."

17 Here we are talking about the non-POSP remedies, as you can see;

18 "... (and hence the benefit of searching) and will remove some of the persistent
19 consumer misconceptions that previously discouraged shopping around. An
20 increase in the level of searching will contribute to the development of greater
21 price competition among PPI providers."

22 Just pausing there, that is what the other remedies will do, and they are not in contention.

23 THE CHAIRMAN: Is this about just the other remedies?

24 MR. SHARPE: Yes, I think so.

25 THE CHAIRMAN: I thought it was about all the remedies, I thought it was the whole package.

26 MR. SHARPE: It is a package of remedies, yes, but it is a package of remedies so far ----

27 THE CHAIRMAN: Correct me if I am wrong, Mr. Sharpe, but I thought that one of the effects of
28 the POSP would be to remove a misconception that you will not get your credit if you do
29 not take out insurance – I may be wrong – by separating them out.

30 MR. SHARPE: It may well have that additional effect, but I think the essential thing there would
31 be, first of all, the clear statements you cannot bundle one with the other. That is, I think,
32 unlawful. I do not think you can attribute that to the POSP. Secondly, the personal quote
33 for PPI, is detached from the quote for credit. So it will be obvious to everybody that they
34 are two separate products.

1 THE CHAIRMAN: I am really just looking at the heading. “Benefits and synergies of the
2 remedies package”, I thought was the whole shebang.

3 MR. SHARPE: It is, but what I have said so far, and I have read it out so far, I have not got
4 POSP. There are a considerable number of benefits accruing already from the non-POSP
5 remedies themselves. So we have got an increase in search activity, greater development of
6 price competition, and then in addition the package will decrease the point of sale advantage
7 and as a result will provide more opportunities for stand-alone providers to compete for PPI
8 consumers. So we will have the PPI sole providers, as it were, coming into the market with
9 their better ability, they think, to sell PPI to people who have already taken out credit the
10 week before.

11 My point in drawing this to your attention is the cautious way in which the Commission are
12 expressing it, “The remedy package will encourage consumers, it will contribute to the
13 development of greater price competition, it will decrease the point of sale advantage and
14 provide more opportunities for stand-alone providers”. This is not and should not be the
15 language of certainty. This is the language of, “This will go in the right direction, and who
16 knows, it might”, but it will only decrease the point of sale advantage, it will not eliminate
17 it.

18 Earlier you may remember their frank acceptance that the incumbents advantage will not
19 disappear.

20 We say that is quite inconsistent with an argument which is still being run that the
21 Commission were considering that they did not need to consider the effect of the remedies
22 separately because they assume that the remedies that they proposed would be successful in
23 eliminating all of the AEC. That is their case.

24 Here we have *en clear* the pretty obvious acknowledgement, rightly, that their remedy is
25 going to be less than perfect. Faced with that argument and the total absence of any
26 assessment of the individual remedies, the whole thing has become a bit of a disaster. That
27 is why we want you to order it to go back for them to do it again properly.

28 We have no doubt at all that the Commission honestly believe that matters will improve as a
29 result of the intervention. Nothing in the report at this stage says that the Commission
30 believed that the market would operate flawlessly or that PPI prices would collapse by 60
31 per cent. It is rather a lot to swallow, that a market will operate flawlessly. It is not a
32 proposition that most people would accept, especially nowadays. This is a cautious and in
33 many ways sensible assessment of a process they want to put in place which, with a bit of

1 faith, will engage market forces more carefully, it will make markets work more efficiently,
2 allow consumers greater transparency and who knows, may have beneficial results.

3 That is not the Commission's case, because in order to work out a proportionality exercise
4 they have engaged in the Excel model, they have made the assumptions they have made and
5 have provided a number which has proved, in my submission, to be relatively easy to attack
6 as being hopelessly unrealistic a basis for the total detriment which in turn reveals a
7 complete gap in assessing what proportion of that total detriment will be remedied by the
8 POSP.

9 Of course, what they could have done is they could have obtained evidence on searching
10 and switching by consumers. They had got a lot for the purposes of market definition but
11 they, themselves admit that that actually would be insufficient to assess how quickly the
12 market would work. How quickly are people who are used to going in and dealing with
13 their insurance along with their loan going to say, "In seven days I will go to someone else
14 or someone else will come to me"? How do we know anything about their shopping around
15 patterns? We do not. The Commission should have gone out and got some evidence as to
16 how much that process in which they put so much faith will operate. I am not saying that
17 faith was misguided. I am saying there is no evidence at all to justify any conclusions about
18 how that process will work, and none whatsoever to justify their initial assumption that
19 prices will collapse by 60 per cent. If they do not collapse by 60 per cent then that figure of
20 £200 million is rubbish.

21 Of course, they make no attempt to assess how costs will change over this period. Would
22 there be increased costs associated with consumers switching around? They acknowledge
23 there may be increased advertising expenditure but you will not find that factored into the
24 Excel model they produce. There is no quantification of the extra advertising spend. All
25 there is is some read-across from the advertising used in other financial products. It may or
26 may not be relevant but no argument is advanced to say that advertising proportion would
27 be relevant for a product like PPI, which historically has not been advertised in any
28 widespread way, still less on television.

29 These are questions the Commission should have addressed and did not, and they do not
30 explain why. Of course, they make no assessment of how to evaluate consumers' price
31 sensitivity in respect of PPI. Are people going to buy more PPI if the price is lower?

32 Probably, that would be reasonable behaviour if people are priced out of the market at the
33 moment. How much more? Is it going to be a dramatic change in demand or is it going to
34 be a modest change in demand? I cannot make any judgment about that from having read

1 the report more than once. We have some estimates of elasticity of demand. Professor
2 Yarrow has had some fun analysing those elasticities because they made a very profound
3 and elementary error in confusing two types of elasticity, which I will spare you for the
4 moment and perhaps return to when I deal with Ground 3. That is the fundamental issue
5 because credit and PPI come together, but PPI is very much a secondary product. It is
6 obvious that you are not going to buy insurance if you have not got the loan. Any sensible
7 person is going to wrap up the price of loan and insurance and see what it costs. That is
8 particularly true of things like mortgage interest where mortgages are protected in that way.
9 People can have a clear idea of what the monthly payments are going to be. We do not
10 know anything at all about the strategy of companies providing loans and PPI as to how to
11 optimise the costs; should they charge more for PPI and less for loans? That is what they
12 have done historically, and I indicated this morning there is nothing wrong in that, Tesco's
13 does it all the time, as I said. Insofar as that is a sensible thing for them to do, given the
14 different intensities of demand, they may well continue to do so because there is no reason
15 to believe that the intensity of demand for loans and insurances is exactly the same. It is a
16 very simple proposition.

17 PROFESSOR STONEMAN: Could I interrupt you on that one? It may well be the case sensible
18 in terms of generating greatest profits for the distributor but if the elasticity of demand for
19 PPI is particularly low because of the point of sale advantage, which is a result of the
20 monopoly that you have, then it is not welfare desirable that it should be done?

21 MR. SHARPE: No, I can only accept that, and it is also true, the other side of the coin, if the
22 price of credit is below marginal cost.

23 PROFESSOR STONEMAN: I thought we had all accepted that the credit market was
24 competitive?

25 MR. SHARPE: It was. The Commission seemed to think that prices are below marginal cost, so
26 any rebalancing on the waterbed would actually have an increasing efficiency effect as
27 essentially less loans were made, less costs incurred. This morning you asked me to think
28 about all of this analysis completely ignores contributions to fixed cost, and there seems to
29 be an implicit assumption that you will not find it in the report, but either there are no fixed
30 costs, which seems an absurd argument, or that all costs are going to remain constant at any
31 level of output, which again seems very odd – one only has to go to a bank headquarters to
32 realise it, and I say this with apologies. There are fixed costs in place so any reduction in
33 the volume of loans is bound to have a reduced contribution to fixed costs, so costs will go
34 up. So those lovely theoretical assumptions that costs remain constant over output are

1 completely wrong. It does not matter, it is a hypothetical model, but it does not have a
2 hypothetical application, it is here and going to be the basis of every bank who provides PPI
3 in the future unless this report is quashed.

4 (After a pause) My friend quite rightly reminded me of course the conclusion of all of that
5 is what I have just been saying is not rocket science and it is something the Commission
6 should have done, it would have formed a more secure evidential foundation to their
7 arguments, much better than a hypothetical model. I said earlier if they were doing it again
8 they would not start from here.

9 The key point I want to ram home over again – I am afraid at the risk of boredom – is that in
10 conducting this type of exercise what is required is a firm grasp of the evidence. They have
11 the power to demand evidence, they have the resources to generate evidence and then to
12 form judgments. What we have seen here is actually an imbalance. Plenty of evidence has
13 been collected from the one thing that would make a difference, that is to say the output of
14 the report, namely its remedies – how is the world going to change as a result of this? We
15 see nothing. We have a proposal of a model, a view of the world, how it might work,
16 absolute vagueness about the timetable it is going to work, and no willingness at all to
17 address the vital question of how effective the remedy is likely to be. They were content to
18 give us some numbers about the total detriment and even they, I am afraid, are fraught with
19 error.

20 Let me repeat, I am not asking here for certainty. I am not suggesting the Commission
21 should have quantified things to the third decimal point, but everything I have suggested
22 they did not do could have been done in terms of estimates, broad orders of magnitude –
23 that is indeed what the Tribunal indicted in *Tesco*. There was no explanation – if they had
24 said: “We could not do this because we did not have the data” one can begin to understand
25 and we would have a different sort of challenge; they did not say that, and there is no
26 evidence they did not have the data. After all, they did attempt to investigate dead weight
27 loss in their own way, and they believed quantification was important, but when it really
28 mattered in the real world, with the data present they chose not to do it. So in the end under
29 Ground 1 their case collapses on the basis of the complete absence of any realistic effect to
30 assess what the effect of their remedies would be, because only once you have done that can
31 you put it into the balance to see whether or not that remedy was proportionate.

32 Again, I turn to the Commission. What do they say about this? I refer now to para.71 of
33 their defence, and I refer you to two paragraphs – this is at tab 9, p.367. We have the
34 Commission’s statement there, which I should ask you to read, please – it is quite short.

1 (After a pause) You can see the context in which this exchange was generated: “You did
2 not look at the effectiveness of the remedies in the report.” “Oh yes we did” says para. 71,
3 now go away and look at paras. 10.477 and 10.478 in the report”. Now, let us look at what
4 the Commission says:

5 “We considered that this combination of measures, by opening up the market to
6 competition and directly addressing search and switching costs, will
7 comprehensively address the AEC that we have found, and which results in
8 consumer detriment.”

9 The stress of course on “comprehensively address” and of course we have been here before,
10 they interpret “comprehensively address” to mean “completely eliminate” the AEC they
11 have found.

12 Then when it comes to 10-478 they say:

13 “Taken together, they will have a greater effect in increasing competition than if
14 they were implemented individually ...”

15 - that is to bring in the POSP –

16 “(and we consider that this combined effect is required in order to effectively
17 address the AEC that we identified).”

18 Now they paraphrase these two paragraphs of the report at para. 12 of the defence at 347, if
19 you would please go to that? We see in para. 12 – remember this is the defence, not the
20 report:

21 “The Commission gave the fullest consideration to what the effects of its remedies
22 package, including the POSP, might be expected to be – always taking account of
23 the difficulties of prognosis when radical measures are needed to address deep
24 seated competition problems leading to severe consumer detriment. The
25 Commission concluded that the benefits of the package as a whole, and the
26 synergies as between the component parts, would be significant and would remove
27 the AEC:”

28 Then we are back to those references in support. Those references in 10-477 and 10-478
29 you have seen, and I remark that very far from proving that they consider the effectiveness
30 of the remedies and the total elimination, as is claimed in para. 12 of the defence, they are in
31 fact modest and qualified, realistic assessments of what might happen, written before the
32 benefit of *Tesco*. The defence was written very much afterwards. Neither of these two
33 paragraphs cited, or any other part of the report, can be recognised by the description the
34 Commission are making of them in para. 12, would remove the AEC. Interestingly, if that

1 were so, one would have expected something else. One would have expected a further
2 reference to some evidence. One would have expected a significant amount of evidence
3 reporting the Commission's analysis of the effectiveness of the remedy. There is no citation
4 of such evidence. That is hardly surprising because there is no evidence. As for the girder-
5 like strength placed upon the word 'address', which we have already seen, and the word
6 'effectively' and the statutory term 'comprehensively remedy' which you saw in s.134, in
7 my respectful submission, are just afterthoughts. These are a long, long, long way from an
8 assertion that the commission were analysing the effectiveness of the remedy, and, more
9 importantly, even more, constitute any evidence that they had done so. Even if they are
10 right as to what these words mean in this context, this is not evidence - this is assertion.
11 But, I am less charitable than that, I have to say. I think this is an ex-post rationalisation of
12 what these words mean. These are fairly typical words used in market investigation reports,
13 as we have seen in Tesco. 'Address'. The design of a remedy. 'Address', 'effectively',
14 'comprehensively' - these are words which are drawn from the statute. There is nothing
15 wrong in that. But, they cannot be interpreted in this context to mean, "We have addressed
16 the effectiveness of a remedy".

17 There are, unfortunately, a number of examples in the defence and skeleton argument where
18 the Commission improves upon the report - I am sure unwittingly. I know unwittingly. It is
19 one thing to say, and report, that the remedies set out in the decision represent as
20 comprehensive a solution as possible. That is what they were required to do under the Act.
21 But, we say you cannot interpret that to mean total elimination of the consumer detriment.
22 Indeed, the language of the Act, if you may recall from this morning, is not to demand a
23 comprehensive solution - it is to demand a comprehensive solution as is reasonable and
24 practicable - a very realistic qualification.

25 THE CHAIRMAN: Does the Act use 'comprehensive' at all?

26 MR. SHARPE: Yes. 134.6. Note the qualification. It is small wonder that in a report made
27 under this power in the Act that they are going to track the Act. Where does that take us?
28 It just says they have tracked the legislation. It is not evidence that the remedy would be
29 sufficient to eliminate any or all of the adverse effects.

30 If I could just take you to para. 10.51(3) which you will find at p.312 of CB2 -- If you
31 would like to read 513 and 514? (After a pause): The point I particularly want to draw
32 your attention to is 514. The Commission is saying that the use of the word
33 'comprehensively' means they fully intended to embrace a remedy which would cover all
34 the detriments that they identified in their modelling. 10.514 tracks the word

1 'comprehensively'. "It represents as comprehensive a solution to the AEC ... as is
2 reasonable and practicable". You have just seen that in the Act. There is no surprise that
3 they have repeated it here. But, the very language does not sustain the proposition that they
4 were going to eliminate all the consumer detriment they had identified. In fact, the
5 opposite. That is not what the Act requires. The Act requires to do what they can - what is
6 reasonable and practicable. That is what they mean. They mean it in terms here in the
7 report. Somehow or other, when it comes to the defence and the skeleton, words change
8 and adopt a different meaning. It does not work, with respect. They were simply tracking
9 the Act, what was required under the Act, and very properly saying, in their judgment,
10 "This is what it does". But, it does not say they were going after all the detriment - they
11 were just doing what the Act tells them to do.

12 Let me take you to the Commission's skeleton argument. This is in CB3 at Tab 4, p.130,
13 para. 26. If we pick it up at para. 25, they are referring to our Ground 1A. Remember, the
14 effect of all the remedies, not the incremental remedies. We are making the point fairly and
15 squarely - they should not have used the total consumer detriment found as a starting point.
16 They go on. Would you read, please, paras. 26 and 27? (After a pause) You see the point.
17 I have stated it more than one - the Commission's claim is that they are going to eliminate
18 all the detriment. So, we see it here, in terms, in the skeleton notwithstanding a fair reading
19 of the report, effectively addressing the totality of the competition problems, and so on.
20 Then they cite 10.510, at p.302 of CB2. This is evidence now. This is supposed to be proof
21 that they addressed the question of whether they did indeed consider the effectiveness of the
22 remedy. We are asked to read 10.510 (1) because they say it is going to address the AEC in
23 a timely manner -- So, we will address the resultant consumer detriment and therefore it is
24 not worth the price control. So, they put that as proof positive that they were considering
25 the effectiveness of the remedies.

26 Now, simply saying that the remedies passage will address the AEC in a timely manner is
27 not evidence of anything other than that the Commission said it. It is a statement of hope -
28 not evidence. It tells us nothing about what was in the mind of the Commission and still
29 less is it the evidence that is needed to demonstrate that the remedy they chose would be
30 effective to eliminate the total detriment, which is now their claim.

31 Just to repeat the point at the risk of overdoing it, no reference at all to how prices are going
32 to fall by 60 percent in a timely way - or, indeed, if ever. So, whatever para. 26 of the
33 skeleton is seeking to do, it cannot be sustained by the one reference it offers at 510. If we
34 go to para. 27 we have yet more references. I am afraid we can treat them in much the

1 similar way. If we go to 10.304 of the report at p.265 -- I recall the Commission says, "This
2 is a conclusion which the Commission reached having carried out a detailed analysis of the
3 effectiveness of each of the remedies - proposed elements of the remedies package both
4 individually and in combination with other elements".

5 On the face of it, that seems very promising. If we go to paras. 340 to 373 you will not find
6 any detailed assessment whatsoever. All this does is instead of looking at the remedies and
7 justifying them, it looks at the alternative remedies and why they were not adopted. It has
8 got nothing to do with it - and certainly does not suggest that the existing package of
9 remedies would eliminate the total detriment.

10 Perhaps I should take you to the other paragraphs at 10.466, but they tell the same story.

11 THE CHAIRMAN: Your last point is good if you only look at the headings, but it gets a bit
12 frayed at the edges if you look at the details. I am not inviting you at this late stage in the
13 day to go through all the detail, but there is a constant comparison between the proposed but
14 rejected remedies and the ones which they are actually intending to impose.

15 MR. SHARPE: Yes. But, what I was looking for was evidence of their effectiveness - not why it
16 should not have been chosen. What we expect to see in a report like this - and in future
17 reports - because we are writing for the Commission for the future as well - is hard evidence
18 of why the remedies were chosen, and not why others were not chosen. I do not think it is a
19 fair reading of what they are doing here if all they are doing is comparing what they chose
20 to do with what they might have done. What I am looking for is: Why did they choose
21 those remedies? Perhaps more finely, what is it in the remedies they have chosen which is
22 evidence of their ability to meet all the detriment that they say it would meet? There is
23 nothing there. What they should be doing is saying, "This remedy, in combination with the
24 others, is chosen because it is effective and it is effective in the following ways, and taken
25 together it would have the effect of eliminating the total consumer detriment we have
26 identified". That is not what those passages say.

27 I am quite happy to make that good. That is possibly a threat at this hour of the night.

28 THE CHAIRMAN: It is something one can address by reading the passages again.

29 MR. SHARPE: Would you, sir?

30 THE CHAIRMAN: We are going to be doing that - during hearing time.

31 MR. SHARPE: This might be a convenient moment if it suited you.

32 THE CHAIRMAN: We are up to time, Mr. Sharpe.

33 MR. SHARPE: I can say that I, too, am up to time. I am reasonably confident I shall finish
34 tomorrow afternoon. I have three other grounds to go.

1 THE CHAIRMAN: Indeed, but the first three all overlap.

2 MR. SHARPE: Yes. I will not outstay my welcome. We have covered a lot of ground today. It
3 is in the order of being a sort of common cost. We can exploit those tomorrow by not going
4 over the material which we have already been through.

5 THE CHAIRMAN: Any particular overnight homework? Simply to avoid reading lengthy
6 passages.

7 MR. SHARPE: Allow me a moment, would you, please? (Pause) I think that phase is over, you
8 will be relieved to hear. No, there is nothing specific I am going to detain you on. I am
9 going to spend a little time going backwards and forwards with the defence and skeleton to
10 illustrate, I think, the shallowness of the report on certain matters, but I think you have
11 already done that. There is nothing special.

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13 (Adjourned until 10.30 a.m. on Tuesday, 8th September, 2009)
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