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IN THE COMPETITION
APPEAL TRIBUNAL

Case No. 1109/6/8/09

Victoria House,
Bloomsbury Place,
London WC1A 2EB

8th 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

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

HEARING
DAY TWO

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: Good morning.

2 MR. SHARPE: Good morning. Sir, we are nearing the end, you will be pleased to hear of
3 Ground 1. Let me pick up just a loop from last night, if I may. In our submission, the
4 clearest possible example of the deficiency of the report lies in the absence of any evidence
5 or analysis that the Commission reasonably concluded that its actual remedies - not
6 theoretical ones - would succeed in reducing PPI prices by 60 percent at all or in any
7 reasonable timescale. The figure of £200 million as the total consumer detriment was
8 dependent on reaching that price reduction. That figure - 60 percent - although it is derived
9 as I showed you yesterday, from Table 1, cannot be found in the main body of the report,
10 yet the Commission now asserts that its conclusions that that price reduction would be the
11 outcome of its remedies package. I repeat that because it is so fundamental to the
12 Commission's report and our challenge to it.

13 Two other matters from last night. Sir, you may recall our brief exchange about 10.43 of
14 the report. You drew attention to the word 'risk'. We have reflected on that overnight. We
15 interpret this paragraph to mean this, and only this: the Commission accepts that there is a
16 risk that its remedies package will not generate enough changes in behaviour fully to
17 address the AEC. The word 'however' here is used to say, "It does not dismiss that risk, but
18 then goes on to state that it hopes and expects that there will be beneficial consequences".
19 But it does not go on, as I say, either to quantify those consequences or to say that they will
20 be sufficient to generate the ----

21 THE CHAIRMAN: Could you just remind me of the paragraph?

22 MR. SHARPE: 10.43.

23 THE CHAIRMAN: I remember it well.

24 MR. SHARPE: Yes. Another set of paragraphs you will remember is at 10.340. We left it last
25 night with, I suspect, a minor disagreement between us. I simply want to state that we do
26 not resile from our submissions at all. You will recall that these were the sections that
27 compared the chosen remedies with other remedies which were not chosen. Those
28 paragraphs do compare the chosen remedies with alternatives, but they fall far, far short of a
29 conclusion that the remedies which were chosen would be sufficient to eliminate the entire
30 consumer detriment in practice, such as to give rise to a 60 percent price reduction in PPI.
31 The only point of those alternative remedies would be less appropriate to do so.
32 I have already started - as I hope I will finish today, sir, by merely giving you the references
33 to the report. It was abundantly clear yesterday that the Tribunal is more than familiar with
34 the report. I hope it will be sufficient, subject to your guidance on occasions, for me simply

1 to quote the relevant paragraphs in the report and not take you to those paragraphs unless
2 you wish me to do so, or unless I may wish to do so myself because we have not seen it
3 before, or there is something of a special interest.

4 THE CHAIRMAN: I think we would like to have time to have the paragraph open in front, but
5 what we do not need is extensive citation of whole sections.

6 MR. SHARPE: Of course. That simply goes also for the defence and skeleton. Otherwise, I fear
7 I may not finish today. Therefore, in conclusion, in evaluating whether its package of
8 remedies and the POSP, in particular, was proportionate the Commission either carried out
9 the wrong comparison - that is to say, by looking at the total scale of the detriment, rather
10 than making the realistic effect of its remedies package. So, throughout, they looked at the
11 total detriment instead of looking at the effectiveness of the remedies, or, alternatively, if it
12 can be said that the Commission did consider that its remedies package would be sufficient,
13 would be a perfect remedy to eliminate all the total detriment, the Commission did not
14 acquaint itself with any relevant evidence as to the realistic effect of the POSP, or carry out
15 any relevant analysis, or any analysis at all actually, to this effect. In other words, there was
16 no evidential basis for them to have reached that conclusion, thus offending the injunctions
17 in *Tameside*, *Mahon*, and *IBA*, which I showed you yesterday. So, those are the twin prongs
18 of our case and we win on either.

19 I want to say a brief word about the timescale issue which I ventilated yesterday. So, I will
20 not dwell over-long. There was no attempt to analysis any timescale, even in broad terms, in
21 the report. I remind you - but will not take you to or cite - of the references where the
22 Commission refers to the remedies having an effect in a timely way -- or, over time. Now,
23 the Commission responds to this argument at paras. 83 to 88 of its defence (to which I will
24 not take you, but for your reference will be in CB1, Tab 9, p.370). They state by way of
25 conclusion - and I think the Tribunal will be familiar with this - We decided that the
26 package of remedies that we have set out will provide a comprehensive, reasonable and
27 practicable solution to the AEC we have identified in a timely way”.

28 That is the same timely manner to be found in a number of other, we say, conclusory
29 paragraphs in the report. I give you them: 10.373 and 10.510, for example. These are, of
30 course, in exactly the same language as was used in *Tesco*. You will recall the references
31 from *Tesco*, which I will not take you to. They suggest, I think, that the formulation means
32 the same thing to the Commission. Now, whether ‘timely manner’ or ‘over time’ is used is,
33 frankly, a matter of indifference, we say. Both terms have a common factor of telling all

1 parties in this Tribunal nothing useful about the timescale over which these remedies were
2 supposed to have their effect. So much for the report.

3 Now, can I turn to the Commission's defence? That defence - and I would like you please to
4 go to this - is at CB1, Tab 9, p.370. You will pick it up at para. 84. This is the
5 Commission's attempt to fill in the gaps in the report. We look at para. 84. We see in (a),
6 (b), (c), (d) and (e) references to the report which do no more - no more - than state when
7 the provisions of the formal are to take effect. In other words, it is a timetable for the
8 implementation of the remedies package and not when - or even if - that package would
9 have the effects claimed for it. In short, it does not meet our point at all. In fact, they
10 provided us with an answer is eloquent in itself.

11 If we turn now to para. 85, over the page at p.371, they have another attempt to deal with
12 the timescale over which the POSP will have effect on the AEC. We will take this in turn,
13 but, I think, quickly. Paragraph 85(a). They now argue that,

14 "The key drivers of change to customer behaviour generated by the POSP will
15 take effect 'straightaway'".

16 Two paragraphs from the report are cited in support. 10.43 at p.191. This, of course, is the
17 one we were just considering - the one that refers to risk. If you wish to go to it, do so. But,
18 I hope it is fresh in the mind. It says nothing at all about the timescale. A reasoned estimate
19 of when these remedies are going to have the effects claimed for them. Then also 10.99 at
20 p.207, to which I will take you, if I may CB2, p.207. We could waste time by asking you
21 to read this in full. I have no intention of doing that. I simply say that this paragraph, 10.99,
22 brought in in support of a reasoned explanation for the timescale ... does nothing of the sort.
23 It has no relevance whatsoever. I venture to say, Sir, that the only relevance to it is the fact
24 that it has the words "break in time", it is obviously the product of an enthusiastic word
25 search facility. We do not doubt that the provision of information is likely to take effect in
26 April 2010 as a matter of law, and the clear break between the sale of credit and PPI in
27 October 2010. The Commission states in the report that will be the case at para. 10.43.
28 But, as you have seen, these only provide the incentives and opportunity for consumers to
29 search, but benefits will only start to arise if ever once consumers start to respond to this
30 incentive and opportunity, and only then if they respond in sufficient numbers to bring
31 about a substantial reduction in PPI prices. As the proportionality analysis was based upon
32 a 60 per cent price reduction that is the sort of price reduction they must be considering,
33 because after all that is how they calculated the total detriment.

1 In our submission it is plain that the Commission made no findings about the report about
2 the timescale over which this would occur, they even accepted in the now familiar
3 paragraph 10.43 that there was a risk that the POSP would not generate the changes and
4 behaviour necessary fully to address the AEC over that timescale.

5 If one looks briefly at 85(b) the Commission now argues that the key drivers will take, as I
6 said, immediate effect. Four paragraphs of the report are cited. On inspection, and I am not
7 inviting you to go but simply to note if you will, 10.45, 10.81, 10.87 and 10.519, you will
8 see that none of the paragraphs support the Commission's new argument in the defence. On
9 the contrary, at para. 10.45, this is the paragraph you may remember from yesterday, and I
10 took you to it, the Commission states:

11 "By encouraging consumers to shop around after the credit sale, we considered
12 that a point-of-sale prohibition will open up the possibility for substantially greater
13 sales to be made on a stand-alone basis and would provide a stronger incentive
14 than currently exists ..."

15 So we say that far from concluding that PPI prices would drop quickly, and would have
16 immediate effect – to quote the defence, either at all or by 60 per cent required by its
17 calculation, the Commission are here recognising that all it was doing was encouraging
18 consumers to shop around, which would in turn create a stronger incentive for distributors
19 to offer keener prices and maybe spend more on advertising television and so on. But the
20 key point for us is the Commission made no findings about how effective these admonitions
21 to consumers to shop around might be, or about the timescale over which the search activity
22 might be generated, and to the extent the consumer search did increase, how much of an
23 incentive this would create for distributors to decrease PPI prices or the extent of any
24 reductions in price, let alone the time scale over which this is all going to happen.

25 If we may go quickly again to 85(c) in the defence, a similar picture if one considers the
26 incentives – the word "if" is curious, it is suggesting accurately I think that they had not
27 thought of it at the time of the report for inclusion, because none of this is in the report. On
28 any reasonable reading of the report none of this was considered or commented upon.

29 Of course, the Commission does refer, as you see, to a number of paragraphs in the report –
30 in 85 (c) you can see the reference is there to figure 10.3 at para. 10.183, para. 10.45 again,
31 para. 10.333 to 10.339 and 10.479.

32 Once again on inspection these paragraphs do not include any analysis of the timescale over
33 which any positive effects might be expected to occur contrary to the assertions now made
34 in the defence.

1 Of particular significance in para. 85(c)(ii) you see the defence states that the stand-alone
2 provision will be given a further substantial and immediate boost with the introduction of
3 the POSP, and we see a reference to 10.45.

4 10.45 of the report says nothing of the sort; on the contrary – and again this is familiar to
5 you – it states:

6 “By encouraging consumers to shop around after the credit sale, we considered
7 that a point-of-sale prohibition will open up the possibility for substantially greater
8 sales ...”

9 Therefore, far from concluding a substantial and immediate boost the claims in the report
10 are infinitely more modest measured. The rest of the paragraphs relied upon do no more
11 than discuss the effect of the remedies package and what effect it might have without any
12 consideration of the timescale.

13 The Commission also argues and tries to distinguish *Tesco*, and I will deal with this briefly,
14 this is at para. 88 of the defence, over the page, 373: The present situation is very different
15 from *Tesco* case, since in *Tesco* the competition test intrinsically could be expected to take
16 some time for the full benefits of the remedy to take effect, because it depended on the
17 decisions of supermarkets; this is contrasted with the present case

18 So in the light of this statement it appears that the Commission’s latest position, and one
19 very different from that in the report is that the full benefit of its package of remedies can
20 be expected to arise immediately or in very short order. The only problem with this is that
21 it is contrary to the report itself. The copious references of which 10.508 is an example,
22 that the benefits to customers will be there over time, the benefits will exceed the costs over
23 time, is wholly inconsistent with the Commission’s defence that there would be a
24 substantial and immediate effect. At best it is highly doubtful, and more realistically simply
25 wrong, and in our view it is certainly unsupported by any evidence at all in the report.

26 There is a further complication which I will mention, even if competition increased in
27 respect of the sale of new PPI policies this would not affect the millions of existing PPI
28 policies, those who already have them on an annual basis and have the opportunity to take
29 out a new policy. For your note the numbers of such policies will be found at CB2, table
30 2.2, that gives the number of such policies – I do not propose to take you to them, but I will
31 report it in a moment.

32 The only recommendation designed to deal with existing PPI policies is the requirement of
33 an annual statement. For existing PPI policies, however, the requirement for an annual
34 statement does not extend to existing personal loan PPI policies, which is a very large

1 group, or to existing single premium second mortgage PPI policies, another very large
2 group. Though as with much of the report, as mentioned yesterday, the data available is not
3 up to date, tables 2.1 and 2.2 of the report show that as of 2007 this would exclude over four
4 million policies, or approximately one-third of the total active PPI policies, and providing
5 over 50 per cent of PPI revenue. By any standards this is a very significant number of
6 people and policies.

7 At para. 84(d) of the defence you will see this large group is written off as small legacy of
8 single premium customers and dormant accounts. Even in relation to those policies where
9 an annual statement is provided it is unrealistic to think, and the Commission nowhere in
10 the report provides any evidence or concludes that these annual statements would lead to
11 100 per cent of customers searching around for new PPI policies to get a better deal, and go
12 to a provider other than the provider with which they have taken up underlying credit. Even
13 if this was the case, the Commission's remedy package only requires an annual statement to
14 be sent within a year of that part of the remedy package coming into force – that is to say by
15 1st October 2011. At best, therefore, in respect of existing customers, only some customers
16 will get the benefit of the Commission's remedies, and even for them only up to one year
17 after the Commission's recommendations come into force, or remedies come into force. It
18 is up to two years and eight months after the publication of the report.

19 In conclusion, as in *Tesco*, the Commission made no attempt in the report to analyse or
20 reach any findings about the timescale over which its package or the POSP could be
21 expected to remedy or mitigate the AEC, still less to achieve the 60 per cent reduction in
22 PPI prices assumed in the Commission's analysis of consumer detriment.

23 Since the Commission reached no conclusions about the timescale over which any benefits
24 from its package of remedies might arise, it took no account of this in considering the
25 proportionality of its remedy and the report is, therefore, accordingly flawed as a result of
26 the Commission's failure to take account of this relevant consideration.

27 Those are my submissions on timescale.

28 I have one further matter dealing with Ground 1, which I trailed yesterday. This was that it
29 is the Commission's failure to consider the extent of the incremental benefits, if any, that
30 would arise from the POSP. We know this is significant because the POSP is the only part
31 of the remedies that is likely to incur significant costs, or rather to have a detrimental effect
32 on sales. It has a detrimental effect on sales because of the factors I discussed yesterday,
33 the reduction in demand brought about from what I will call for shorthand "inconvenience".
34 So there is the real possibility that the inclusion of a POSP in the package of remedies

1 might, in fact, have a net negative effect on consumers brought about by the reduction in
2 demand.

3 It is not in dispute that while the Commission considered whether the addition of the POSP
4 alongside the other informational remedies would be more effective in addressing the AEC
5 than the informational remedies, they said that in terms and concluded that it would be, the
6 Commission made no attempt to consider or even quantify the extent of the incremental
7 benefits brought about the addition of the POSP; or the AEC detriments which would
8 remain if the POSP were not included. These are fundamental mistakes.

9 The question could not and did not therefore consider whether there was any net benefit at
10 all from the inclusion of this incremental remedy, and whether the additional costs of the
11 POSP was proportionate to any net benefits.

12 THE CHAIRMAN: I think you said a moment ago, Mr. Sharpe, that it was common ground that
13 the Competition Commission concluded that the POSP would make the remedies more
14 effective.

15 MR. SHARPE: In the Commission's view, and that is indeed their justification for including it,
16 they say that it would.

17 THE CHAIRMAN: I am quibbling about your "more". My recollection is that they concluded
18 that without the POSP the remedies would simply not be effective, so it is not incremental
19 in the sense of making an existing, minus the POSP package of remedies which are already
20 effective, more effective. It makes the difference of being effective and ineffective.

21 MR. SHARPE: I think orally I expressed it both ways actually.

22 THE CHAIRMAN: It might be necessary to look quite closely at that.

23 MR. SHARPE: I think we are going to deal with it more fully in Ground 2. I think the simple
24 point that I am making is this: the extra remedy, the POSP, has benefits, though it also has
25 detriments. It was incumbent upon the Commission in order to effect a proper exercise in
26 proportionality to have some assessment of what the extra benefits would be compared with
27 the detriments that its inclusion was very likely to introduce. There is no real difference
28 between the parties as to the nature and existence of those detriments brought about by
29 reduced demand.

30 It may assist if I take you to ----

31 PROFESSOR STONEMAN: Could we ask, for the benefit of the Shorthand Writers, that we
32 actually use "POSP" consistently, point of sale prohibition, instead of "PSOP"?

33 MR. SHARPE: What am I saying?

34 PROFESSOR STONEMAN: PSOP.

1 MR. SHARPE: What should I say?
2 PROFESSOR STONEMAN: POSP.
3 MR. SHARPE: I will write it down.
4 PROFESSOR STONEMAN: Point of sale prohibition.
5 MR. SHARPE: Could we go to para.10.36. 10.36 and 10.37 are, in fact, the only paragraphs in
6 the report that address the point being raised. What we have here is, as I say, the sum total
7 of the Commission's analysis. The Commission's failure to carry out this analysis can be
8 seen most strikingly in para.10.50, if you have the report.
9 Sir, did I misunderstand your question? I am instructed that I did.
10 THE CHAIRMAN: I do not know!
11 MR. SHARPE: Are you saying that absent the POSP – absent the prohibition – the remedies
12 package would be ineffective?
13 THE CHAIRMAN: Yes.
14 MR. SHARPE: No, that is not the Commission's case at all, with respect. The Commission's
15 case is that you needed ----
16 THE CHAIRMAN: I thought it was.
17 MR. SHARPE: -- the prohibition to address the point of sale advantage. Therefore, the
18 prohibition complements those existing remedies. It is certainly not saying that it is
19 essential to achieve any benefit but there will be an incremental benefit, namely countering
20 the point of sale advantage which they say the other remedies will not address.
21 THE CHAIRMAN: I would be surprised if that was common ground.
22 MR. SHARPE: I am sorry?
23 THE CHAIRMAN: I would be surprised if that was common ground. I understand that to be
24 your submission.
25 MR. SHARPE: I think it is common ground, with respect, but I will leave it to Mr. Swift to come
26 back on it. I do not think it is the Commission's case. It is not pitched so high that the
27 prohibition is essential before any benefits accrue – far from it. They say it is needed in
28 order to eliminate the point of sale advantage which the other informational remedies, they
29 say, would not address. That is the reason why they want to include it, and did not exclude
30 it, having heard a good deal of evidence that, in fact, it would lead to consumer detriment by
31 its inclusion brought about by reduced demand. In other words, no other remedy would
32 address all the ingredients of the AEC (one of which was the point of sale advantage). This,
33 I think, reinforces the point I am making so that we have to deal with the incremental
34 benefit against the incremental cost -- the incremental net benefit, bearing in mind that it is

1 going to have -- It is one of four provisions which you need to examine. We are not
2 challenging the other remedies. Nor are we challenging the AEC finding. What we are
3 doing is challenging the addition of the prohibition in the bundle of remedies because it is
4 not clear they have done any analysis to indicate that the net benefits of including the
5 prohibition outweigh ----

6 THE CHAIRMAN: I understand your submission. You are going to have to persuade me, at any
7 rate, that it is right to assume that the POSP should properly be regarded as an addition
8 merely from the fact that it is the one remedy you are challenging.

9 MR. SHARPE: It manifestly is an additional remedy to the package of remedies. It thereby
10 became part of the package of remedies. But, what was it seeking to achieve. What does the
11 Commission think they were seeking to achieve is much more to the point? I have already
12 shown you the references which say that it is there to come to the point of sale advantage. It
13 can do no other.

14 The essence of our case on this point, on this part of Ground 1, is that it was incumbent
15 upon the Commission to look at each of the remedies to see what impact it would have.
16 You will recall the injunction and the whole doctrine and application of proportionality. It
17 simply was not appropriate to add more and more remedies if the net benefit was less than
18 the cost of including them, i.e. it was disproportionate. It is no different for the prohibition.
19 It is just that that is the only one we are seeking to challenge. So, we are entitled to regard
20 the other remedies as a given and then say, "Well, now you have come to this one, can you
21 justify the addition of this one, having regard to what the law requires - namely, an
22 assessment of the net benefit that accrue from its addition against the costs of its inclusion?"
23 That is a fairly straightforward application of the doctrine of proportionality. If we were
24 challenging one of the other remedies, and had accepted the prohibition, we would be
25 making exactly the same argument in relation to that remedy.

26 The Commission's failure to carry out this analysis I think is most marked in the rather
27 familiar 10.50 of the report. You will recall the Commission considered whether the effect
28 of the prohibition would be to reduce PPI sales, the possible effect in respect of which
29 substantial evidence has been put before the Commission, which I am going to take you to
30 later. The Commission accepted that the remedy would have a negative effect on sales. We
31 see that in 10.50. But it concluded that the entire remedies package would lead to an
32 increase in PPI sales which would (and note the words) partially or fully offset that decline.
33 As a result, the Commission concluded, in the same paragraph, that the prohibition was
34 justified in the light of the scale of the detriment identified. If it is worth reinforcing, note,

1 they mean total scale of the detriment identified. That is the area which was exposed and
2 corrected in *Tesco*.

3 I will come again in a moment in Ground 2 to the fact that the Commission
4 proceeded without any proper analysis of evidence. But, for present purposes,
5 what is significant is that the Commission considered whether the adverse effect
6 on sales of the prohibition - and, after all, that was the only one that was likely to
7 have any adverse effects on sales - by way of removing -- the easiest way of
8 buying -- selling and buying PPI results in inconvenience and would potentially
9 lead to a fall in PPI sales -- whether that was offset by the positive effects on sales
10 of the remedies package as a whole.

11 No distinction is made here between the other remedies which are unlikely to reduce sales
12 and the prohibition where lower sales are accepted as a possibility by the Commission. As
13 a result the Commission concluded that the inclusion of the prohibition in the remedies
14 package was justified without knowing whether the addition of the prohibition would in fact
15 have a net positive effect on sales or not.

16 The same issue arises in relation to the other side of the coin, looking at the costs of the
17 prohibition. Although the Commission requested information from the parties to the inquiry
18 about the costs of each individual element of its remedies package, and presumably must
19 have considered that in order to arrive at the global figures we have seen of £100 million to
20 set up and £50 to £60 million ongoing -- The reference for that, again, is 10.508 of the
21 report. The Commission made no attempt to compare the costs of each element of the
22 remedies package to their incremental benefit. As a result, the Commission had no basis to
23 conclude that the costs arising from the inclusion of the prohibition in the remedies package
24 was proportionate to the benefits which would arise from its inclusion.

25 The Commission's defence to this is interesting. It is found in the defence at paras. 89 to
26 111 in CB1, Tab 9. Sir, I have no intention of taking you through my friend's defence, save
27 to draw your attention to one or two unusual features. Its essence is that it would have been
28 "conceptually wrong and impractical" to have done this exercise. We find that at para. 111.
29 We say that completely ignores the central issue of proportionality and is wrong. In relation
30 to the addition of the remedy to a package of other remedies - and the Tribunal in *Tesco*
31 held that it was necessary to know what a measure is expected to achieve before one can
32 sensibly assess whether that aim is proportionate to the adverse effects of the measure. In
33 the context of a decision whether or not to include an additional remedy in the package of
34 remedies we must know what the additional measure can be expected to achieve, i.e. the

1 incremental benefit arising from its inclusion. It is only once we can get an assessment of
2 that incremental benefit, and only once that is identified and can be determined, that the
3 incremental benefit can be examined to see whether it is proportionate to any adverse
4 effects arising from its inclusion.

5 Therefore, even if the inclusion of the additional remedy renders a package of remedies
6 more effective, it would not be proportionate to include the additional remedy if the adverse
7 effects were greater than those additional benefits. As you see here, the Commission argues
8 in the defence that it is not correct because it has a wide margin of appreciation in
9 considering issues such as the effectiveness of remedies. This misses the point. While the
10 Commission has a wide margin of appreciation in the analysis that it does carry out, it has
11 no margin of appreciation to decide whether or not to do that analysis. It has no margin
12 whatever when it comes to ignoring relevant considerations or taking into account irrelevant
13 considerations. If it were different, that would drive a coach and horses through the whole
14 judicial review. It is a very hollow remedy.

15 The Commission in this case made no attempt to determine whether the inclusion of the
16 prohibition would have a net positive or a net negative effect. Because it failed to do that, it
17 really was in no position to determine whether it was proportionate to include it.

18 There is a further oddity about the Commission's defence as well. Now, remember, they
19 said it was conceptually wrong and impracticable to do this. One sees in para. 108 that they
20 say that they did consider whether or not it should be added to the package of remedies, or
21 whether the information alone would be capable of addressing the AEC which the
22 Commission found to exist. So in para. 108 they say they did it, and in para. 111 they say
23 that it is conceptually wrong and impracticable for them to do it. Sir, those are my
24 submissions on Ground 1.

25 THE CHAIRMAN: Thank you.

26 MR. SHARPE: I will now proceed to Ground 2. This is where we say the Commission
27 concluded that the prohibition was justified without any proper evidential basis for this
28 conclusion.

29 THE CHAIRMAN: In a sense you have been chipping in bits of Ground 2 all the way through
30 your submissions on Ground 1 wherever you say "and had no evidence", it is really the
31 Ground 2 point is it not? I realise you have used the two grounds as the vehicles for
32 bringing up different aspects of the substrata, but you have referred to "no evidence" on
33 numerous occasions.

34 MR. SHARPE: I have.

1 THE CHAIRMAN: I am not trying to chase you off it ----

2 MR. SHARPE: No, not at all.

3 THE CHAIRMAN: -- just to say that I have been taking on board submissions that the Ground 1
4 stage as being relevant to Ground 2 if there are no evident submissions.

5 MR. SHARPE: Thank you, Sir, that is a comfort. You recall in our skeleton we did say there was
6 some overlap, and I think I may have remarked on it in opening. What I am going to really
7 focus on in Ground 2 is especially on one specific aspect, and this is what I have called
8 already the inconvenience factor. This is really quite a striking part of the report. You will
9 I think and hope have read Professor Yarrow's report?

10 THE CHAIRMAN: Yes.

11 MR. SHARPE: And I will give you the reference, CB1 and I am referring to para. 41. He states
12 that the prohibition is unique. I think it is obvious to all of us that it is intended to promote
13 increased consumer shopping around, but the means of doing so are very different from the
14 other remedies which provide more information, more transparency in the market websites,
15 unbundling. What it is attempting to do is not by way of making a market more efficient in
16 that sense, in the sense of creating greater information or offering any direct help to
17 consumers. What it does do is take something away, and that is how I opened; taking
18 something away namely, the ability to conclude the transaction; all the evidence suggests is
19 the most convenient way – that may be thoroughly justified, it is not a case we are
20 challenging on the merits – but that is what it is doing. It imposes costs, it takes away
21 things, it makes consumers worse off so as to change their behaviour with the ultimate aim
22 of making them better off. I think that is a fair paraphrase of how the Commission are
23 going about this.

24 The evidence received by the Commission – and I refer especially to that beginning really at
25 10.48 onward of the report, which I am not going to take you to for the moment, but the
26 majority of customers welcome the convenience of having both sets of the transaction
27 conducted together, and a move to a less convenient and desirable way of buying PPI meant
28 that the prohibition was widely expected to result in sales falling. The Commission accepts
29 this at para. 10.50, which you have seen.

30 It then follows that unless any detrimental effect arising from the reduced level of sales was
31 smaller than any positive effect arising from the prohibition it is difficult to see how the
32 prohibition would be reasonable, effective, or proportionate to impose.

33 The Commission make no effort to assess the extent of the lost sales that might arise, none
34 whatsoever, or even the increased cost to be borne by consumers in shopping around, even

1 if they do eventually take up PPI. It is extraordinary that the Commission took no account
2 of these detriments in its proportionality analysis.

3 PROFESSOR STONEMAN: Mr. Sharpe, can I just intervene there? One of the things I first
4 noted about this case is given its origins, what has happened to mis-selling, because this
5 would seem to be the area where you could actually say there is a reduction in sales but
6 these were all poor sales anyway and, given the number of complaints to the FSA over mis-
7 selling of PPI this reduction in sales is in fact a benefit and not a cost.

8 MR. SHARPE: In partial answer to that, of course, the FSA has been active in this area. I am
9 going to show you later the issues surrounding ICOBS. It was suggested that tough rules
10 which have been accepted by the industry would actually go a very long way to meeting
11 some of the detriments identified by the Commission but, as you have seen, the
12 Commission did not accept that argument and wanted to go further and superimpose this
13 remedy upon the FSA's remedies. So the Commission took the view that rules against and
14 enforcement against mis-selling would be insufficient to eliminate the detriments they
15 discovered.

16 To pick up your point, there are in the report several references, one of which I am going to
17 take you to later. The Commission is slightly schizophrenic. It recognises that PPI prices
18 they say are too high, and because they are too high they may encourage the sellers to sell
19 more because they were profitable. Then it draws the conclusion that some of these sales
20 may be over sold through mis-selling. It then also says that if prices were lower more
21 people would buy PPI. So you seem to have a concept of market distortion brought about
22 by high prices which leads to overselling – sales driving – but a distortion because the
23 prices are too high because people who would otherwise buy at a lower price are not in a
24 position to buy it. As we will see later, the Commission really stayed on the fence on this
25 one, they said that it is all ambiguous. There is plainly a distortion but the net effect is
26 ambiguous, and I will come back to this because the point is a very important one, because
27 the whole basis of the Commission's remedy is predicated upon price reductions which had
28 the effect of increased sales, whereas the welfare effects of that earlier in the report are
29 judged to be ambiguous.

30 PROFESSOR STONEMAN: I will accept that but in a sense Barclays have gone the same way in
31 that the Yarrow analysis assumed that there is no mis-selling. It also assumes that the two
32 demand curves, in order to undertake the comparisons that are made, must be based upon
33 the same preference and information sets, which is a wrong assumption given what is going

1 on with respect to the package of remedies. You may well not be able to answer that
2 yourself, but I think it is an important point of your case that perhaps you ought to explore.

3 MR. SHARPE: I take issue with the presumption of it being wrong. What Yarrow was
4 attempting to do here was impose some temporal discipline upon the nature of these
5 remedies. You will recall his demand curve at any moment in time. If there is an increase in
6 inconvenience that is tantamount to an increase in cost. A reduction in demand all other
7 prices remaining constant, credit prices, PPI prices, just a generalised shift I once learned
8 was a decrease in demand.

9 Over time, but not at that time, because that is an immediate and obvious effect, there may
10 be as a product of the process which the Commission has set in train, the possibility of
11 greater shopping around with prices falling leading to an extension of demand, albeit with
12 that demand schedule to the left. As you saw in his analysis, one has got to weigh up the
13 increase in welfare brought about by sales at the lower price which could potentially be at a
14 slightly higher volume than the decrease in demand ----

15 THE CHAIRMAN: Is that not a detriment?

16 PROFESSOR STONEMAN: That is exactly the point, you cannot compare those two demand
17 curves because they are based upon different information sets and different preferences. As
18 such, you cannot compare the welfare generated under those two circumstances as a way of
19 evaluating the impact of the package.

20 MR. SHARPE: I want to understand this perfectly. I think I understand the point that the second
21 demand curve, if it existed, would be on the assumption of *ceteris paribus*?

22 PROFESSOR STONEMAN: No.

23 MR. SHARPE: Your argument, if I understand it correctly, is that that is illegitimate because the
24 other remedies would have kicked in to improve transparency in the market and the FSA's
25 policies, which would have eliminated, if they are applied properly, and we have to assume
26 that they will be, mis-selling. Have I understood that correctly?

27 PROFESSOR STONEMAN: It may have eliminated mis-selling but basically the second demand
28 curve enables people to go away and think about it. As such, their information set will be
29 different than it would have been when they were given the quote in the bank. That is the
30 first part of it.

31 The second part of it is the other remedies will give them a total quote for the PPI which
32 they can take away and look at which they would not have had previously. The whole point
33 is that the information they have on which to make the decision and the preferences that
34 they bring to the decision will be different in the second case than the first case. In that

1 situation you cannot compare the utility or the welfare generated under the different demand
2 curves one to the other?

3 MR. SHARPE: Defending Yarrow, one can compare it if one takes the moment in time when the
4 prohibition takes effect, because at that time the other remedies had not yet had any effect.
5 Indeed, I have spent a good time this morning indicating that we have no idea how quickly
6 those remedies are going to take effect. If I take the general thrust of your demand, it is that
7 a demand curve might become more elastic, the second demand curve, if it exists.

8 PROFESSOR STONEMAN: No, I am saying that the demand curves are completely different
9 concepts in the two worlds and cannot be compared for welfare purposes. It is not for me to
10 argue this. I am asking whether your side can respond.

11 MR. SHARPE: If I have to come back on that, I will, if I may, sir. I think though that the
12 difficulty we all have, all of us, in this report is that the argument that you have articulated,
13 it may not be in Yarrow but it is certainly not in the report.

14 PROFESSOR STONEMAN: The Yarrow report is based upon that foundation.

15 MR. SHARPE: The Yarrow report is his view as to where the Commission has gone wrong – and
16 that is all it is attempting to do. What evidence have the Commission brought to bear upon
17 the welfare effect – upon the reduction in demand brought about by inconvenience? It
18 would be very easy to say that it is all nonsense because really we have a kaleidoscope of
19 effects all happening at once with the implication that the demand will not reduce and the
20 demand curve will become more elastic and therefore makes the Commission's case, which
21 I think has been made more elegantly here than it is made in the report. We are guessing.
22 The whole essence of a report is that nobody should have to guess what the Commission's
23 evidence is for these effects. These are all, certainly Yarrow, inferences that he is drawing
24 from his understanding of the report and of the use of the model. We have seen nothing in
25 the report, and certainly the model does not model this effect. It just assumes a reduction in
26 price over some indeterminate timescale.

27 PROFESSOR STONEMAN: Thank you.

28 MR. SHARPE: I will come back to it, if I may. I am sure I will be prompted to.

29 Going back to the report itself, we do not see any evidence which would sustain the absence
30 of any attention paid to the detriment in all the evidence the Commission received and
31 indeed the Commission itself accepted – and this is the importance of 10.50. The
32 Commission might inwardly take the view that there will be this kaleidoscopic effect, and it
33 will be very quick, and so forth. In 10.50 it is certainly accepting in the report that there is
34 going to be a reduction in demand. All it is saying is simply that the movement of the

1 demand curve and the preference shifts will be such as to overwhelm that. It does not even
2 say that, it says “partially”. So they are hedging their bets and their understanding. They
3 see the problem and a lot of it is based upon faith.

4 I wonder, sir, would it be a convenient moment to have that break? I am happy to carry on.

5 THE CHAIRMAN: I see no reason not to take a slightly early break to give you a chance to
6 confer before we lose sight of the point that is being raised.

7 MR. SHARPE: Indeed, thank you.

8 THE CHAIRMAN: We will come back at 11.35.

9 (Short break)

10 MR. SHARPE: We are content, I think, to rely upon the report at this stage. I think I understand
11 the point - which, if I may say, is very well made. But, we are challenging the report, and
12 the report seems to think that there will be only a partial - not necessarily a full -
13 amelioration of the sales brought about by inconvenience. That is the world we have to deal
14 with.

15 On the question of mis-selling, this is very complex. As far as Barclays is concerned, this is
16 not a report about mis-selling. There are very few findings in relation to mis-selling in the
17 report. Mis-selling is not, of course, the Commission’s problem. It is the FSA’s. Now, I
18 understand that my friend, Mr. Lasok, at the retail end of PPI will be addressing you on that.
19 No doubt the FSA will have some comments as well. But, I do not think the Commission’s
20 case is that any material element of existing PPI demand is attributable to mis-selling as
21 such. Indeed, the whole thrust of their case is that lower prices would mean an increase in
22 sales.

23 PROFESSOR STONEMAN: I am sure they can speak for themselves at the appropriate time.

24 MR. SHARPE: I hope so.

25 What we are doing here is discussing the detriment associated with the inconvenience of the
26 prohibition. The Commission deal with this at paras. 10.46 to 10.49 of the report. I am not
27 going to take you to teach of those paragraphs. I am, instead, going to paraphrase the
28 evidence. Obviously, you will want it in front of you.

29 THE CHAIRMAN: We have looked at it. Speaking for myself, I have read it several times.

30 MR. SHARPE: The evidence included, as you see, evidence from Nationwide. But, after it
31 temporarily withdrew its PPI product in August 2007, but included in its sales process a
32 discussion of PPI and a suggestion of sources of information, only 3 percent of its
33 unsecured personal loan and credit card customers had bought PPI. (That is 10.47.) We
34 estimate that the fall in Nationwide’s sales lay between 85 and 92.5 percent. You will not

1 find those figures set out in the report, but they are readily calculable from Table 2.5 of the
2 report itself to which I am not going to take you. If it is in contention no doubt I will be
3 told. We also see the evidence of surveys - up to 91 percent in one survey showing that
4 customers like the convenience of buying PPI at the same time as purchasing credit
5 (10.48(a)).

6 Then we have important evidence from HBOS of a pilot scheme in which consumers at the
7 loan point of sale were handed a telephone to discuss PPI with a specialised insurance team
8 and even that modest extra effort resulted in a halving of the take-up rates for PPI. A 50
9 percent drop. You will find that at para. 10.48(b).

10 Unless it is confidential we see at para. 10.49 behavioural research commissioned by AXA,
11 which even showed that a very small delay would significantly reduce the likelihood of the
12 consumer taking action.

13 Then we see evidence from HSBC showing that when it withdrew its personal loan PPI
14 policy and offered customers the opportunity to purchase wider protection, this led to a
15 decline in sales.

16 The Commission here actually accept at 10.49 that this could be explained by the delay
17 between purchase of the product and the consumer meeting the HSBC advisor. So, in the
18 light of this evidence it was little wonder that the Commission acknowledged at para. 10.50
19 (which you have seen) that the prohibition reduced the convenience of purchasing PPI and
20 the Commission accepted that the direct result of the prohibition would be an adverse
21 impact on sales - although the report went on to state that it had designed the remedies
22 package, as they put it, 'to reduce the risks of the substantial fall in take-up of PPI policies'
23 (10.51). I should say that if you were to turn to para. 95(d) of the defence -- I feel the report
24 needed improvement because they add the words 'significantly reduce the risk of a
25 substantial fall'. At the appropriate moment you may wish to make a suitable amendment.
26 The report therefore accepted that the prohibition might have some negative impact on
27 sales, but did not quantify it. The Commission's only analysis of the admitted adverse
28 effect on sales is at para. 10.50, which I think will now be very familiar. It said that the
29 potential reduction had been over-estimated by "some parties" and it had not made specific
30 comments explaining why one of the items of evidence elicited - and that was particularly
31 from Nationwide - and also other evidence not listed was of little use.

32 Although they set out the reasons for rejecting Nationwide's evidence, and evidence based
33 upon previous attempts to launch stand-alone products, the Commission made no comment
34 on the other evidence put before it, including HSBO's natural experiment - the one that

1 showed a 50 percent reduction, simply to state that some parties had over-estimated it. Now
2 the reference to ‘some parties’ may relate to evidence from Nationwide and previous
3 attempts which they rejected. But, it is at least likely, if that is right, that they did not reject
4 evidence from HSBOS showing the 50 percent fall. They do not really consider it at all.

5 That is surprising, given the magnitude of the drop.

6 It is clear that the Commission made no attempt to analysis or quantify the acknowledged
7 detrimental effect that the prohibition would have.

8 They do conclude that they expected that its proposals would increase competition, would
9 reduce price, would lead to an increase in PPI sales and then would result in partial or fully
10 offset a decline from the reduction. But, they do not begin to analyse what price reductions
11 are likely to take place, what level of price reductions would be necessary to offset the
12 reduction in demand. They do not begin to say how much the increase in PPI sales would
13 be and what would occur as a result of the remedy, or the package of remedies. There is no
14 analysis of the extent that any such effects might offset the decline from the reduction in
15 inconvenience.

16 On this basis the Commission concluded that the prohibition was both necessary to
17 stimulate competition so as to contribute towards remedying the AEC identified. Once
18 again, as you see, they have justified it by reference to the scale - that is to say, the total
19 scale - of the detriment identified.

20 The Commission relies very heavily on this conclusion. However, in my submission, it
21 throws into very stark relief the different approach of the parties. There is no doubt at all
22 that the Commission reached this view. The Commission says that it is sufficient and that
23 Barclays should be content with it. From Barclays’ perspective, it is not sufficient for the
24 Commission to reach such a view, it needed to have collected the relevant evidence, reached
25 a conclusion based on that evidence and then reported; in this case it did nothing of the sort.
26 No other consideration is given in the report to this important factor, the adverse impact of
27 the prohibition. Most significantly, as I flagged, in the proportionality analysis (10.477 to
28 10.514) comparing the benefits of the package against the cost no account at all is taken of
29 the adverse impact of the prohibition. So the Commission’s calculation of the detriment
30 arising from the AEC takes no account of the costs of inconvenience imposed by the
31 prohibition on consumers who continue to purchase the product. No account is taken of any
32 sales reduction due to the prohibition, or of the consumer harm associated with such
33 reduction. Fundamentally, the Commission failed to analyse or properly take this
34 detrimental effect into account.

1 To the extent that the prohibition leads to a customer who would otherwise buy PPI at a
2 particular price not in fact buying it due to increased inconvenience. The prohibition would
3 give rise to the same kind of welfare loss as existed in *Tesco* in my submission. The same
4 terminology the Tribunal latched upon in *Tesco*, “unmet demand”, I think can properly be
5 applied here without any violence.

6 It gives rise to the same type of static welfare loss that the Tribunal looked at in *Tesco* – it is
7 considered by the Commission at para. 10.494. Obviously the case turns around and around
8 and around and I am going to come back to that a little bit more in Ground 3. If the
9 Commission regarded themselves as doing a good job in assessing static welfare loss in the
10 weight of the evidence they gave, in the weight of their own acceptance of the reduction in
11 demand, it seemed essential in my respectful submission that the Commission should have
12 undertaken some analysis of the static welfare losses and factored that into their calculation.
13 They chose not to do so.

14 There is a twist to this which Professor Stoneman anticipated earlier. If I may first of all
15 refer you to para. 94, p. 375 of the defence to which I should ask you to go. Could you
16 kindly read para. 94? (After a pause) We see here in the defence at least the Commission
17 is reporting, and I will take you to it in a moment, the possibility that in the past there had
18 been overselling of over priced PPI products. Of course, overselling and so forth is not the
19 Commission’s “baby”, it is the FSA’s “baby” and had been dealt with significantly by rules
20 which came into place somewhat before the report was published, and one presumes they
21 are the right rules otherwise no doubt the FSA would not have introduced them. Either
22 way, we have here a statement that in the past there is some ambiguity.

23 PROFESSOR STONEMAN: Could I ask, is it accepted that part of the AEC is not mis-selling?

24 Is that accepted by both parties.

25 MR. SWIFT: Good morning, sir. First, may I say when I was preparing for this case I looked
26 closely at para. 94 of the defence, which was written in response to para. 7(d) of Lloyds’
27 statement of intervention and I have to say that I would put myself in the sense of Homer as
28 having nodded, but I cannot support that sentence. The ambiguity noted by the Commission
29 was quite plainly in respect of the existing position in the market place. Para. 10.493 makes
30 it abundantly clear that the Commission expected an increase in sales in a well functioning
31 market as a result of the information market and as a result of the likely reduction in price.

32 PROFESSOR STONEMAN: I do not think that answered my question.

1 MR. SWIFT: I just wanted to make that point first so there is no misunderstanding on the part of
2 Mr. Sharpe or Miss Davies, because this is a point which is being developed by Miss Davies
3 in, for example, para. 75 of her skeleton.

4 PROFESSOR STONEMAN: What about the question then? Does the Commission include mis-
5 selling as part of the consequences of the AEC, or part of the character of the AEC?

6 MR. SWIFT: It certainly does, and that is set out quite clearly at para. 5.136 of the ----

7 MR. SHARPE: To which I am about to take you, we are about to reach it.

8 MR. SWIFT: It is not agreed.

9 PROFESSOR STONEMAN: It is not agreed, thank you, that is all I wanted to know.

10 MR. SHARPE: I think I heard my friend disassociate himself from his own defence – if I can just
11 clarify that that is the case.

12 THE CHAIRMAN: I think just the last sentence of para. 94.

13 MR. SWIFT: Yes, a mistake; I confess to it.

14 MR. SHARPE: To err is human! Let us, if we may, pick it up at 5.136, and if you would kindly
15 read to 5.138. (After a pause) This is rather a curious set of statements. We find that the
16 Commission had found in the report that there was a distortion of demand for PPI, and the
17 sale of PPI could currently be higher or lower than would be the case in the competitive
18 market.

19 I am trying to make sense of it, and it is not easy, they seem to be saying that as the PPI
20 prices might be higher and profitability greater, PPI distributors might expend more effort to
21 try and sell PPI product, and this might constitute a distortion in the market. I have some
22 difficulty in understanding this as a general proposition. I doubt if it is one that is going to
23 spend very long in the business schools. If a product is profitable, you would actually rather
24 expect people to devote some effort to selling more of them. The Commission at this
25 juncture is saying, “That is a distortion in the market place”. It has alarming consequences
26 if it is upheld.

27 What they might be saying is that a proportion, albeit a proportion which has not been
28 identified at the moment, and it remains, it is just supposition and speculation, it may be that
29 because it is such a profitable product people will push them harder than they would
30 otherwise do, and people for whom they are not qualified, i.e. well off people, who really do
31 not need that extra insurance and really should not have any pressure brought to bear to sell
32 them, will, in fact, take them even though it is not necessary. I think this is what mis-selling
33 means. That constitutes mis-selling because of poor advice.

1 First of all, we do not acknowledge that any of the AECs of themselves are directed to mis-
2 selling, as such. That is not the way the Commission put their case, though it may be rather
3 different now. Remedy for mis-selling is the responsibility of the FSA. What the
4 Commission may be saying is that because there are higher prices with supernormal profit it
5 acts as an encouragement to sell more and an unspecified proportion of those may properly
6 be characterised as mis-selling owing to the extra incentive to sell the extra product. There
7 is not the slightest evidence to suggest that or the slightest evidence to suggest that the
8 Commission focused on that as an AEC.

9 Let us see what they do report here. The key paragraph is 5.138:

10 “The overall effect on demand of the upward and downward pressures is
11 ambiguous. Nevertheless [ambiguous or not] we believe that these pressures
12 resulted in a distortion of demand for PPI.”

13 It seems to us that the Commission is indeed advancing a new argument here that a
14 reduction for the prohibition would not be detrimental.

15 THE CHAIRMAN: What do you mean by “here”, in the defence or in the report or in this room?

16 MR. SHARPE: Well, all three at the moment because they are all inconsistent with each other.

17 My friend seems to be disclaiming any responsibility for his own defence.

18 THE CHAIRMAN: Yes, but is the novelty that that is not in the report?

19 MR. SHARPE: No, no.

20 THE CHAIRMAN: You said “new argument”.

21 MR. SHARPE: The argument run in the report is that the overall effect of this so-called excess of
22 higher prices, if a proportion of those higher prices generate extra sales and those extra sales
23 are mis-selling – and here I am only speculating as to how the Commission are running their
24 case and no doubt we will hear more from Mr. Swift in due course – then any reduction in
25 the sale of the PPI products will actually be welfare enhancing because those are sales that
26 should not be made at all. I think that is the essence of whatever case they are running.
27 I think the point is this, and I may be reading more into this than exists and I am trying to be
28 helpful to the Commission, because at the end of the day they say the net effect is
29 ambiguous, they just do not know.

30 It seems that the case being put by the Commission confirms that the Commission had no
31 proper basis for the conclusion that the prohibition was justified. Let me explain: the entire
32 basis for the only attempt that the Commission to quantify the extent of the consumer
33 detriment arising from the AEC – that is 4.94, the static welfare analysis – was that there
34 were static welfare implications of the current high PPI prices, so-called deadweight losses,

1 arising in part from people not buying PPI at higher prices who would have bought them at
2 lower price.

3 We can see from table 1 of appendix 10.11, and it might be useful to go to this now. I think
4 it is at p.824 (we have been to it once before). We see the benefits arise from PPI sales
5 increasing. So we have got initial protected advances, and it does not matter whether you
6 look at system or non-system remedies at this point. Let us take system remedies. Initial
7 protected advances, £340,000. Then we move that to the counter the counterfactual
8 protected advances at 474. So the whole welfare analysis on which the Commission's case
9 for total consumer detriment is based is predicated upon an increase in the value of PPI
10 sales. Indeed, the deadweight losses are only remedied to the extent that these consumers
11 purchase PPI, obviously implying an increase in sales.

12 If the Commission is now saying, at the risk of some under-statement, somewhat
13 surprisingly, that it either did not expect PPI sales to be higher after its remedies came into
14 effect or, perhaps less surprisingly, given the lack of analysis carried out, they had not got a
15 clue what was going to happen, whether sales are going to increase or not, this confirms our
16 submission that its calculation of the consumer detriment is fundamentally flawed.

17 Barclays challenge stands that the Competition Commission took no account of the
18 admitted negative effect on sales arising from the prohibition itself.

19 What does the Commission say about that? May I take you to para.119 of their defence.

20 The Commission say they did consider this issue in detail and it was taken into account in
21 the design of the remedies package – a familiar form of words, you will recall, from *Tesco*.

22 The problem with this argument is that the Commission carried out no analysis to allow it to
23 determine the extent of the problem and did not suggest that the design of its remedies

24 package would prevent sales falling due to increased inconvenience. There was therefore

25 an acknowledged material adverse effect arising from the prohibition which the

26 Commission did not evaluate or consider. You will note in para.119 that the prohibition is

27 part of a package of remedies, and you will note the words “largely” or “completely

28 counteract any loss of sale from loss of convenience”. That, of course, is in the defence.

29 The paragraphs which are quoted is the familiar one of 10.50 and 51 where the

30 Commission, in fact, stated more modestly that it expected its remedy of packages to lead to

31 an increase in sales that would partially or fully offset a decline, which you have seen

32 before. There is nothing “largely” about it all. It was an improvement on the report. The

33 point is that no findings were made that the remedies would largely offset anything. Since

34 the Commission carried out no analysis and made no findings about the extent of any offset,

1 and recognised explicitly that it could only be partial, the report accepted the possibility that
2 the loss of sales might only be offset to a limited degree, resulting in an acknowledged
3 detrimental effect which should have been considered as part of even the static welfare
4 analysis they did conduct, but they did not, and they failed to take account of it at all, and
5 especially for their proportionality analysis.

6 I have said it before, and I will submit it again, as most recently in *Tesco* - the reference is
7 to para. 50 of the *Tesco* judgment, but it is familiar law - the Commission must do what is
8 necessary to put itself in a position properly to decide the statutory questions. In our
9 submission the Commission did not put itself in a position to know whether the prohibition
10 would have a beneficial effect, or not. So, in summary, none of the Commission's
11 arguments justify its failure to analyse the detrimental effect arising from the prohibition
12 and its failure to take into account any of the detrimental effect in its proportionality
13 analysis.

14 Sir, those are my submissions on Ground 2.

15 Before I go on to Ground 3, may I correct something which I am instructed, I am told is in
16 the transcript yesterday? It is said that I remarked that the report in its treatment of
17 marginal cost found that credit prices were below marginal cost. Page 56, line 25 of the
18 transcript. I really want to make it absolutely clear if there is any ambiguity - and I am not
19 convinced there is - that we do not accept that. Our arguments are simply based upon our
20 understanding that the Commission's arguments by implication, because of their references
21 to an increase in price up to marginal cost, introduced the notion that they are already below
22 marginal cost. I think elsewhere in my submissions I drew attention to this as an
23 assumption in their modelling - not as an output in their modelling. I just wanted to make
24 absolutely clear there was no ambiguity. I am most grateful to my friend, Miss Davies, for
25 pointing it out.

26 Ground 3. We say that the Commission's analysis of (1) the extent of the consumer
27 detriment arising from the AEC, and (2) the Commission's analysis of whether the benefits
28 of its intervention would outweigh the loss of any relevant consumer benefits was flawed by
29 reason of its failure to take into account relevant considerations or by taking account of
30 irrelevant considerations. Much of this will now be familiar to you. In its skeleton
31 argument - to which I am not going to take you - the Commission argues at paras. 61 and 62
32 that our challenge is flawed because it ignores what it calls the substantial body of
33 reasoning set out in the report. However, in relation to proportionality the only relevant
34 reasoning was in relation, as I have submitted, to the total scale of the consumer detriment

1 which was assessed using Appendices 10.9 to 10.11 and the scale of the total costs.

2 Nothing else is relevant in the report to this question.

3 So, we are obliged now to look at the only analysis carried out by the Commission
4 contained in these appendices. I am going to be sparing in my recourse to these appendices
5 which I believe I am capable of describing what they say, I hope accurately, and why it is
6 wrong. I have trailed my coat a little bit on some of this by emphasising the theoretical
7 hypothetical nature of that and the complete inappropriateness of translating this high
8 theory, if you like, based upon all sorts of assumptions which we regard as hopelessly
9 unrealistic to the practical world of applying a remedy to a major industry with millions of
10 people as well as my clients and other banks - millions of people taking up PPI at a very
11 difficult time.

12 I will begin in the following way: the Commission considered first of all the extent of the
13 consumer detriment arising from the AEC. They considered whether it should modify its
14 proposed remedies in order to prevent the loss of relevant customer benefits arising from the
15 AEC. You may remember that the relevant customer benefits were essentially the lower
16 prices for credit that were associated with the higher profits for PPI. The other side of the
17 coin from 'excess profitability' of PPI was low profitability, and possibly even selling credit
18 incrementally at a loss - an extraordinary proposition.

19 They conducted a modelling exercise based upon what they call the Excel model, which is
20 explained in Appendices 10.9 and 10.11. They used the results in the model set out to
21 Appendix 10.11. In order to quantify the static deadweight losses the Commission relies
22 upon this model in Appendix 10.10. We have seen references, but the most important
23 reference is now the familiar one of 10.494, which I am not going to take you to - I think
24 you know it. This produced a static deadweight loss calculation of in excess, as they put it,
25 off £200 million. It was the quantification of this static deadweight loss alone which
26 provided the basis for the Commission to conclude that the entire consumer detriment to be
27 addressed would be greater than £200 million. It then followed that as this was greater than
28 the £100 million set-up costs and the £50 to £60 million annual costs, that it would be
29 proportionate to go forward and implement the remedy.

30 THE CHAIRMAN: You say it is the £200 million alone which led them to that positive
31 conclusion. Have I mis-read the report in thinking that it reflects a thought process that you
32 should in fact, in an ideal world, add to the remedy detriments not merely the quantifiable
33 one - the static deadweight loss - but the other unquantifiable ones: the dynamic losses and
34 the other static loss, but you cannot put a figure on them?

1 MR. SHARPE: That is not, of course, the Commission's case, sir. My friend will have to argue
2 his case properly.

3 THE CHAIRMAN: My question is: is that not a fair reflection of the thinking in the report?
4 Never mind what their cases is, is that a fair reflection?

5 MR. SHARPE: There are reference of course. Of course there are references to the so-called
6 dynamic benefits. They are not quantified. No attempt has been made to quantify them.

7 THE CHAIRMAN: Save that they are adjectivally described as 'large'.

8 MR. SHARPE: Yes. Is that evidence, I ask rhetorically?

9 THE CHAIRMAN: It is a judgment.

10 MR. SHARPE: It is a judgment call, yes. One does not expect a judgment call when one has to
11 make an assessment of the proportionality of a remedy. The essence of the exercise is the
12 ability at least to attempt. This Tribunal has insisted upon some attempt at quantification in
13 Tesco. It is not enough to say it is impossible. That was the counsel of despair you saw
14 yesterday. Nor would any Tribunal - and nor are we - insisting upon exactitude. But, we do
15 expect some attempt to say what the benefits are likely to be because if you cannot make an
16 assessment of what the benefits are likely to be, how can you begin to assess whether it is
17 proportionate or not. The Commission say that the dynamic benefits exist. They say that
18 they are large. We have seen nothing in the report to indicate or to demonstrate how a
19 reduction in PPI prices of 60 percent would take place, whether it would take place, when it
20 was going to take place. Absent any evidence at all as to the effectiveness of that process
21 and the timescale, I believe we are entitled to say that they have not discharged their
22 responsibilities under the law to provide a proportionate estimate. The estimates they do
23 provide - and on which we say they rely - are the static welfare loss calculations which
24 informed their judgment as to the balance of cost and benefit. Now, they got it wrong there
25 anyway, as you saw, because they looked only at the total consumer detriment. But, as this
26 Tribunal said in *Tesco*, that is not enough. They have got to look at the effectiveness of the
27 remedy. In our submission it cannot be sufficient to say, "Well, the effectiveness of the
28 remedy? It is going to be jolly good, it is going to be jolly effective. In fact, it is going to
29 be quite large", when, at the same time, the costs of implementation are going to be very
30 high and continuing. It was incumbent on them, in our submission, to at least offer an
31 estimate. They do not even do that. The word 'large' does not constitute a satisfactory
32 discharge of that duty.

33 Our reading of the report, and the only reason why they have introduced the static welfare
34 loss model, in my submission, is to provide a basis on which to justify the proportionality

1 argument; that is how they run it, otherwise they would not have bothered. If it is sufficient
2 to say: “In our judgment, and we are the experts here, and we have the margin of
3 appreciation, you have to trust us, but the benefits are likely to be large”, then the report
4 would have been a very short one. In my submission that cannot be right, it cannot be best
5 practice for a major competition authority to make a conclusory statement that it is large
6 and expect my clients and the rest of the industry to say: “That’s fine, we will just go ahead
7 and accept it”. Even the Commission itself recognised that that would have been an
8 insufficient basis to proceed, and that is why they introduced the static welfare loss model,
9 and that is the model I am seeking to address now; it is all I can address because there is no
10 evidence for me to challenge their conclusory adjectival statement that it was large.

11 As I said, the model used by the Commission carried out a comparison between the benefits
12 and detriments that consumers would receive in a non-remedy market, and those in a post-
13 remedy market, although for reasons which are not explained rather than modelling the
14 effect of the actual package of remedies as best they could, the Commission chose to model
15 two sets of hypothetical remedies instead.

16 Two sets of remedies: first, what they call a “system” remedy, which is assumed to be 100
17 per cent effective. The system remedy assumed here resulted in 100 per cent of consumers
18 shopping around for PPI prior to the point of sale ----

19 THE CHAIRMAN: Can you show me where that is stated in terms? I recall the 100 per cent
20 effective cost free, the three basic assumptions and I recall the paragraph in which that is
21 stated, I do not have, as it were, in the forefront of my mind the fleshing out of that.

22 MR. SHARPE: I think we will find it in appendix 9 ----

23 THE CHAIRMAN: Yes, that is where it might be, but I would like to see it in black and white.

24 MR. SHARPE: No, no, for your note I will certainly give it to you. But the important point is
25 here it is positing a system which will be 100 per cent effective ----

26 THE CHAIRMAN: That would just need to remedy the AEC, that is why I want to see what 100
27 per cent effective actually means, and it has been defined.

28 MR. SHARPE: Oh yes.

29 THE CHAIRMAN: The starting point is para. 8 in appendix 10.9, which is the one I do
30 remember, but what I am looking for is to see how it was fleshed out in the way you have
31 just described.

32 MR. SHARPE: Then we will search in vain.

33 THE CHAIRMAN: Well if it is not fleshed out why do you say “fully effective” means 100 per
34 cent ----

1 MR. SHARPE: Allow me a moment, Sir. I did not think it was in contention.

2 THE CHAIRMAN: Well it may not be, but I would still like to see where it is spelled out.

3 MR. SHARPE: If it is not we can save ourselves a bit of time. This was the basis, and there is a
4 reference in the report and we will go to it in due course; I will set my learned Junior on to
5 it.

6 THE CHAIRMAN: Do come back to it if you want, Mr. Sharpe, but “fully effective” in its
7 statutory concept means to remedy the AEC, as I understand it. So if it is to say that an
8 AEC is not remedied unless 100 per cent of consumers search that would be quite a steep
9 hurdle.

10 MR. SHARPE: Oh yes, it certainly means that. One has to understand here, Sir, do not worry
11 overly about the AEC in this context, because we are in a parallel universe. We are in a
12 parallel universe because the assumptions on which the model is based, and it is the
13 Commission’s model not mine ----

14 THE CHAIRMAN: Yes.

15 MR. SHARPE: -- is that the excess profit they have identified as existing in the sale of PPI will
16 be eliminated.

17 THE CHAIRMAN: Yes, but excess profits can be driven to zero without every single consumer
18 search.

19 MR. SHARPE: I think the model essentially is that every single consumer faced with the
20 opportunity to do so will do so.

21 THE CHAIRMAN: Well if that is the model I want to see that spelt out, but do not do it yourself,
22 Mr. Sharpe, there are people who can be trawling through to find it.

23 MR. SHARPE: We will come back to you on that, but it is certainly our assumption of the
24 Commission’s assumption, and if we are wrong no doubt the Commission will tell us – they
25 have not yet. In order to work everybody must play their part in this hypothetical ----

26 THE CHAIRMAN: Well a sufficient proportion of people must play their part for the sellers to
27 reduce the prices to a level that are not regarded as excessive.

28 MR. SHARPE: We will come back to it, Sir. The important point to bear in mind here is we are
29 in a parallel universe where certain assumptions have been made, and one of those
30 assumptions is there will be 100 per cent elimination as a result of a process of search.

31 THE CHAIRMAN: And it is a search before, as I understand it, the point of sale of the credit?

32 MR. SHARPE: Yes, that is right.

33 THE CHAIRMAN: That is how it is defined in this particular model ----

34 MR. SHARPE: That is right.

1 THE CHAIRMAN: -- though not elsewhere.

2 MR. SHARPE: So there would be, and I will call it just “shopping around” at the moment, and
3 not worry too much, prior to the point of sale with the result there would be competition for
4 the system of PPI and credit. So that is the system remedy, but the other side is the so-
5 called “non-system” remedy – again assumed to be 100 per cent effective. This did not
6 alter the extent to which consumers shopped around for PPI or credit, and instead simply
7 restricted the price of PPI directly by fiat, for example imposing a price cap. The
8 Commission admitted that its actual package of remedies would not correspond to either
9 hypothetical remedy model, but hypothesised that these were just two extremes in order to
10 evaluate what kinds of remedies would produce the most beneficial effect.

11 THE CHAIRMAN: Mr. Sharpe, could you or your team help me on one other point – I am sorry
12 to interrupt you.

13 MR. SHARPE: Not at all.

14 THE CHAIRMAN: If you look at para. 4 of appendix 10.9 on my page 803 ----

15 MR. SHARPE: These are distinct categories.

16 THE CHAIRMAN: -- your page A10.9-1.

17 MR. SHARPE: Is that the one that begins: “There are two distinct remedies ...”?

18 THE CHAIRMAN: It then says: “The clearest example of this type of remedy”, which I think is a
19 system remedy, was option 1 in the remedies notice. I just wonder if you could unpack that
20 one for me? I could not find the remedies notice in my bundle.

21 MR. SHARPE: No, we did not think it was relevant.

22 THE CHAIRMAN: And therefore I do not know what option one in the remedies notice was, and
23 I do not know what this means. Again, if your team could do it I would be most
24 grateful ----

25 MR. SHARPE: I am going to have to come back to you.

26 THE CHAIRMAN: -- because I just do not now what they are referring to as a “pure system
27 remedy”.

28 MR. SHARPE: Yes.

29 THE CHAIRMAN: Do not do it now, Mr. Sharpe, it is just a piece of information I would like to
30 have.

31 MR. SHARPE: You appreciate where the remedies ----

32 THE CHAIRMAN: I am not complaining.

33 MR. SHARPE: -- no, where the remedies notice comes in, it comes in where the Commission
34 puts out its provisional agenda and so forth.

1 THE CHAIRMAN: It is just a piece of what you might call indirect definition here that I cannot
2 follow through to its conclusion. It may be Mr. Swift knows what it is?

3 MR. SWIFT: I can give you a reference, it is in the file, and it is appendix 3 to the Commission's
4 defence, but it is not in the core bundle.

5 THE CHAIRMAN: I think I just need to be told what option 1 is, that is the easiest thing.

6 MISS DAVIES: Sir, I can do slightly better than that, option 1 was:

7 "... standard disclosure of cost to the customer of PPI and credit, and requirement
8 to provide a statement of key messages on advertising and marketing material."

9 THE CHAIRMAN: Thank you very much.

10 MR. SHARPE: In answer to your earlier question, if you go to p.806 over the page in appendix
11 10.9, and pick it up at para. 21 and 22, you will see it says:

12 "With a fully effective system remedy, consumers can observe and react to
13 secondary market prices once the remedy is in place."

14 THE CHAIRMAN: (After a pause) Yes, I have read that.

15 MR. SHARPE: We interpret 21 and 22 to mean that all customers would have the ability to do
16 that.

17 As I said, the Commission admitted that this did not correspond to any actual set of
18 remedies. So before we actually go on further and look at the spectrum of remedies, system
19 and non-system remedies, the actual remedies proposed in the report have not been
20 evaluated at all in the technical material the Commission appended to the report.

21 We must be absolutely clear, this has got nothing to do with the actual remedies that have
22 been put forward as such. The Commission used its Excel model of these two extremes for
23 a number of purposes, including evaluating what kinds of remedies would produce the most
24 beneficial results, and whether it should modify its remedy package in order to preserve the
25 relevant customer benefit of lower credit prices and, most significantly, to quantify the
26 static detriment which the Commission hoped to address.

27 You have seen our application and skeleton arguments in general terms. Many of the
28 problems that Barclays have identified make the model defective for any purpose. In our
29 submission, it is at its most unsuitable in the context of quantifying the static detriment
30 which the Commission hope to address since the hypothetical extremes in the
31 Commission's model bore so little resemblance to the real life remedy package that the
32 Commission was planning. To put it another way, the Commission's analysis ignored so
33 many relevant considerations about the actual remedy package that the result produced
34 provided no indication of the actual level of consumer detriment the Commission's

1 remedies could reasonably be expected to remedy. The consequence of that means that
2 there was no basis on which the Commission could properly conclude that its proposed
3 package of remedies would produce greater consumer benefit than the costs involved and
4 thereby be proportionate.

5 The Commission relies very heavily in its defence on the two categories of consumer
6 detriment that it identified. One of them is the dynamic effects and the other one is the
7 static adverse selection effects. The point that seems to be made is that it does not matter if
8 the Commission's quantification of the static deadweight losses were flawed since there
9 were other categories of detriment which could have made the remedies proportionate in
10 any event. The problem with this is that the Commission makes no attempt to quantify in
11 any way its static adverse selection category of benefit and simply asserted without
12 evidence or analysis that the dynamic effects would be, as you pointed out, on a very large
13 scale. As I said earlier, it does not provide any more explanation or quantification than that,
14 not even orders of magnitude.

15 I think I have made my submissions on that point earlier.

16 THE CHAIRMAN: Yes.

17 MR. SHARPE: In any event, since any proper analysis of the static deadweight losses which the
18 actual package of remedies might be able to remedy would have needed to consider the loss
19 of sales, which I have already addressed you on, due to the decreased inconvenience. A
20 proper analysis might, in fact, have led to a negative outcome making it necessary to carry
21 out a proper analysis of the static deadweight losses in any event. I cannot say, nor am I
22 submitting, that the overall effect of the reduction in demand would lead to that. I am
23 saying that it was worth an enquiry, and in not doing so the Commission failed to look at
24 something which was highly relevant leading up to their calculation. The weight of
25 evidence suggests that they were wrong to walk by it and not attempt proper analysis.
26 So before we go any further, the Commission's quantification of the static deadweight
27 losses is therefore fundamental to its conclusions on proportionality, we say, and it is the
28 defects in that analysis which render its findings on proportionality unsustainable.
29 We recognise, and I refer you to, but will not take you to, para.138 of the Tribunal's
30 judgment in *Tesco*, that many questions of judgment and appraisal will arise in the course of
31 a Commission enquiry, and that there is indeed a wide margin of appreciation which exists
32 on which the court, respectfully, should be slow to interfere with. However, the touchstone
33 in any analysis of the Commission's action is the requirement also stated in *Tesco* that the
34 Commission must do what is necessary, and I repeat it unapologetically, to put itself in a

1 position properly to decide the statutory questions. In this case and in this context the
2 statutory question was whether the actual package of remedies was proportionate or not.
3 Put simply, in evaluating a hypothetical package of remedies with entirely different features
4 from the package of remedies that was, in fact, imposed, the Commission was not, in itself,
5 in a position to determine what the effect would of the actual package of remedies and
6 whether it was proportionate or not.

7 Note, this is not an attack upon model building or modellers or even on economics. There
8 is a powerful role for models in competition proceedings and nobody would deny that.
9 When a model is so divorced by admission from the reality of a particular case and is based
10 upon assumptions which, by any standards, are so hopelessly unrealistic and which in the
11 course ignore matters which the Commission, themselves, regard as material, or at least
12 admit the presence of the adverse detrimental effects, then it was quite wrong for them to
13 have ignored the obligation to consider the evidence. They ignored it at their peril. The
14 failed to take account of a relevant consideration.

15 What does the Commission say to this? I go back to their defence, which we will find in
16 core bundle 1, tab 9, and I refer you in particular to para. 168. This is in response to the
17 submissions I have just made - failed to take account. As you see, the Commission states
18 that it chose not to (and the word they use is) 'extend' the model to take account of issues
19 such as lost PPI sales arising from the loss of convenience and the implications of the costs
20 of intervention on consumer welfare. Why? Well, the model was not developed to analyse
21 these issues.

22 I have to say, when I read this I regarded it then, and regard it now, as both a surprising and
23 fatal admission. It essentially admits our challenge. The Commission is arguing that its
24 calculation of the consumer detriment represented the consumer benefits that it expected its
25 remedies to be able to achieve. However, if factors relating to the actual remedies - and in
26 particular the large expected loss of PPI sales arising from the prohibition - were not taken
27 into account the calculation could not produce any indication of the actual level of
28 consumer benefit that the Commission could reasonably be expected to propose its remedies
29 to produce.

30 So, we have a model here which, by admission, is not fit for purpose because it has wilfully
31 ignored what we submit is an important consideration. Yet, we are expected to accept its
32 conclusions in terms of total welfare loss and its justification that they have proceeded to do
33 the proportionality exercise properly. It is now quite clear that they did not. It is equally

1 clear that they could not on the basis of this model because, as you see, it was not fit for
2 purpose.

3 Let me take some themes in turn, if I may. As I trailed, the first problem with the model is
4 that the Commission modelled theoretical remedies rather than the actual package. As you
5 saw, they modelled two types of remedy - a non-system remedy ----

6 THE CHAIRMAN: You have made that submission, and I do not think it is probably in issue.

7 MR. SHARPE: I anticipated that, but may I go on for a brief second, and if I overdo it, please
8 come back. I want to emphasise one thing: based on the assumptions that the Commission
9 has made in its model, a price cap would have called for a 60 percent reduction in PPI
10 prices. So, if I have said that and you have taken it on board, I will say no more.

11 Then we have a system remedy. This is based upon the hypothetical remedy that would
12 result in consumers engaging in search behaviour, probably in our judgment all of them
13 doing so, resulting in that 60 percent reduction in PPI. These had no basis in fact or reality.
14 These were the assumptions underlying the construction of the model. But, while they
15 modelled both kinds of remedy, it made no attempt to evaluate how close the actual package
16 of remedies would be to either of these hypothetical remedies. It did not consider whether
17 the hypothetical package of remedies would be somewhere in the middle or perhaps more
18 realistically -- Sorry. It did not consider whether the actual package -- what was actually
19 proposed would be somewhere in the middle or, perhaps more realistically, would not
20 produce any benefits of the kind indicated by either extreme of the spectrum in the
21 theoretical model. That seems a perfectly reasonable proposition to make because a real life
22 remedy would not survive on any of the assumptions that have been made, which underlie
23 the hypothetical remedy - namely, to remind you, that they were fully effective, costless,
24 and would drive the excess level of PPI profits to zero.

25 Without having considered the way in which the actual package of remedies would operate,
26 the Commission had no way of determining the extent of the benefit that would arise from
27 its actual intervention and consequently no way of knowing what proportion, if any, of the
28 £200 million consumer detriment referred to in paras. 4893 to 496 of the report would in
29 fact be remedied by the intervention.

30 We now know, not from the report but from the defence, that this £200 million figure was
31 calculated using the Commission's non-system model - that is to say, the price cap which
32 required a 60 percent reduction in PPI prices. So, the price cap is not the result of a process
33 over an indeterminate time period. The 60 percent reduction is an assumption based upon
34 costless, perfect, fully effective regulatory intervention of a sort we are used to. So, when

1 one moves from the theoretical world to the practical world, it is very difficult to engage
2 reality.

3 The Commission argues that this was a more conservative approach, and assuming that it
4 would have been a non-system model. It might be that this misses the point. The system
5 model might have been the more conservative model - whatever that may mean -- Sorry.
6 The use of the non-system model might have been the more conservative model of the two
7 hypothetical packages of remedies under consideration. But, even that would provide no
8 guidance as to the level of benefit that might realistically be achieved if the actual remedies
9 package which did not include a price cap and does not include a price cap, as you have
10 seen, would have been assessed. In other words, it is even more different. We are not in a
11 price cap world in these remedies. These remedies do not incorporate price caps. So, the
12 model is even less fit for purpose as offering a justification for its implementation as a
13 “system remedies on a package of remedies”.

14 The Commission is saying that this was an approach that it considered appropriate. They
15 are saying more than that - they are saying they are entitled, as a matter of discretion, to
16 have adopted this approach. Now, you have already heard my submissions on why that is
17 not an answer to my criticisms. If they had had the evidence and made an analysis of the
18 real world - or as much of it as could be analysed sensibly - and not drifted into the
19 hypothetical world with its assumptions which are unrealistic, and had adopted a non-
20 system remedy which, in the end, was never adopted as part of the package of remedies
21 before us, then in that situation their modelling has no relevance whatsoever and no use at
22 all in justifying their adoption of the remedies package.

23 In other words, you only have a discretion -- A true exercise of discretion and power of
24 appreciation can only take place once they have done the essential spadework and have
25 collected the necessary evidence. That is the statutory test. If they fail to collect the
26 evidence on which that assessment can be made it cannot be a proper exercise of discretion
27 to say that, “In the absence of evidence we can do what we like”. That is not the law. They
28 must have the necessary evidence to put themselves in a position to make a proper
29 assessment of the situation. It is really a very simple proposition in relation to the
30 modelling, Ground 3. The model is so divorced from anything that could have been of any
31 use at all by virtue of its assumptions - and this is my first point - I have got more that no
32 proper use could have been made of it, and therefore it was an inappropriate forum to be
33 able to form any judgment.

1 Of course, the Commission are also making the further mistake, which I have highlighted
2 much earlier in my submissions, and with which you are familiar, and I took you to it in
3 Ground 1, that the Commission is always looking at the full extent of the problem rather
4 than the benefits of its actual remedies package could realistically hope to achieve. That,
5 too, drops out of its use of this model. Not only was it not fit for purpose because it omitted
6 important factors which they should have considered, namely, the drop in demand, it was
7 also not fit for purpose because the legal test in assessing proportionality is somewhat
8 different looking at the total consumer detriment if that is important, what it should have
9 done is isolated the impact of the prohibition, and it did not purport to do that and is
10 therefore even more so not fit for purpose.

11 The Commission seeks to explain, and I emphasise not in the report but in its defence at
12 paras 173 to 175, why it was acceptable for the purpose of quantifying the consumer
13 detriment though it would be remedied by its actual package of remedies, why it was
14 acceptable to model hypothetical remedies – that is at para. 173 beginning at p.400 of tab 9
15 of core bundle 1. This is their defence of modelling hypothetical modelling.

16 The Commission argues at para. 173 that our complaint is unjustified as a result of the
17 Commission's conclusions that any realistic set of assumptions both system and non-system
18 remedies would produce a positive net consumer welfare effect.

19 This, of course, was the argument which the Tribunal rejected in *Tesco*, because there was
20 disparity of the numbers. It also ignores the difference between the hypothetical remedies
21 under consideration and its real life package of remedies which would certainly not be
22 costless and in respect of which no evidence or analysis had been obtained to show that it
23 would be fully effective to drive down PPI prices by 60 per cent. So they could have had a
24 model which says either it was going to be fully effective to achieve the 60 per cent, or they
25 could have had a model that says hopefully get a proportion of the total consumer detriment,
26 and we will assess the proportionality of that against the costs of intervention. But in the
27 end they did neither, they took a model which bore no relationship to reality based upon
28 assumptions which cannot possibly have any application to the real world and then tell us
29 that the model was not designed to do anything which, in my respectful submission, is
30 relevant for this Tribunal.

31 If we turn to 175, again this justification is drawn from the defence and is not found in the
32 report, the Commission say that this was a complicated area, and we agree, in which
33 judgment was required, and that it was impossible without making spurious assumptions
34 formally to model all of the effects of the package of remedies proposed. So it is all very

1 difficult, very complex. The Commission argues that it exercised its judgment – back to its
2 discretion – to assess the benefits of the remedies against the extent of the consumer
3 detriment, taking into account the loss of the relevant consumer benefit of lower credit
4 prices and the cost of the package of remedies.

5 Once again, remember the assumptions: fully effective, costless, and driving out all the
6 profits. The Commission should have done, but did not, make any attempt to support these
7 assumptions or evaluate how its conclusion could alter if any of these assumptions proved
8 to be false in any degree. The minute that is pointed out, and there is no evidence to sustain
9 those assumptions, they are pure assumptions, then in our submission very little if any
10 reliance can be placed on the model, but more importantly the Commission failed to have
11 regard to evidence they should have done by modelling what the effects would have been,
12 and it would not have been a difficult task respectfully to simulate alternatives, which
13 would have indicated extra cost, less than perfection, or some of the so-called excess profits
14 of PPI remaining. They certainly have the skill and expertise to do that, and the resources,
15 but they chose not to do it. They wilfully chose not to explore this issue, and therefore did
16 not consider a relevant consideration and therefore their judgment is flawed.

17 At the risk of flogging a dead horse one can easily understand why they chose not to do that
18 because at the time this was written they understood the position to be that all they had to do
19 was show the total consumer detriment, whereas *Tesco* said rightly: “No, that is not right; in
20 any proportionality exercise you must look and see the extent of the detriment you are likely
21 to ameliorate as a result of imposing your remedy.”

22 This comes on to my second point in relation to modelling. The Commission took no
23 account of the costs of the modelling. Professor Yarrow deals with this in his report and I
24 will give you the references to his report but not take you to them: paras. 83(c) and (d), and
25 I think his report is at CB1, tab 4.

26 It is explicit assumption, I will give you the reference but not take you to it, appendix 10.9
27 at para. 8, which I think you may have seen recently. The Commission assume that the
28 remedies model was costless. This was obviously a false assumption. It is a false
29 assumption very, very obviously, there is no speculation about this because the report itself
30 comes up with costs of implementation, and you heard the numbers, £100 million set up
31 cost, £50 to £60 million in annual costs, and these are costs arising directly from its
32 remedies. So, somewhat oddly, you start off with an assumption of no costs but the report
33 reports very substantial costs and continuing costs. In our view, the error is more
34 significant than this since the Commission concluded that other costs, namely, increased but

1 unquantified marketing costs. You will recall the passage that extra marketing costs and so
2 forth would be incurred if the market structure were to be created by its remedies. For your
3 reference it would be 10.44 of the report. In fact, it is more than just these costs would be
4 incurred, the Commission is relying on those marketing costs being incurred in order to
5 generate the process they think will be put into place – not merely that the costs will be
6 incurred, but it is not quite the same thing in advertising, incurred effectively – in order for
7 its remedies to have any impact on competition and hence prices. The extra costs which
8 they are assuming will be incurred are not in the modelling any more than the set up and
9 implementation costs.

10 What are the implications of this? As a result of these additional industry-wide costs, if PPI
11 prices fell so that the excess profits were zero as the Commission assumed, the new
12 equilibrium level of PPI prices would be higher than that assumed by the model. It would
13 have to incorporate the extra costs of set up and implementation, it would have to include at
14 the very least the extra marketing costs which the Commission assumes will take place. In
15 other words, the marginal cost will be higher.

16 PROFESSOR STONEMAN: I asked you yesterday to be careful of the distinction between
17 marginal cost and fixed costs, exactly for the point you have just made. You have been
18 talking about fixed costs and now you have suddenly said marginal costs will be higher.

19 MR. SHARPE: First of all, all costs will be higher, that must follow from the evidence and
20 analysis. I take it your distinction is drawn between the set up costs which will be largely
21 invariant to sales?

22 PROFESSOR STONEMAN: Yes.

23 MR. SHARPE: So we would have in any circumstance, even if marginal costs were a constant,
24 the final equilibrium price would be marginal cost and average fixed cost.

25 PROFESSOR STONEMAN: The price is equal to marginal cost, that is the competitive outcome.

26 MR. SHARPE: And then we have the operating costs of the new remedy £50 to £60 million a
27 year, they would be, let us assume, rightly, I think, marginal cost.

28 PROFESSOR STONEMAN: That is where you have to pay to be in business.

29 MR. SHARPE: The implementation costs may be related to sales.

30 PROFESSOR STONEMAN: This is not the time to go through them, this does not say which is
31 which, and what I am concerned here is for your argument you have to be extremely
32 careful.

33 MR. SHARPE: I am very grateful for that. We can talk about fixed and marginal cost, but we
34 will not find any help in the report. My simple point, and perhaps all I need to make, is that

1 there I no recognition that costs will rise, it flies in the obvious evidence in the report, which
2 is reported, namely the costs of implementation. The total costs will rise, and with
3 marketing costs and compliance costs to the extent they are related to greter volume of
4 sales, will increase marginal cost. Remember, Sir, respectfully this is an industry wide
5 solution, so assuming everybody obeys the rules, and there is no reason to think otherwise,
6 the overall level of costs would increase. So, in a competitive market, if I have understood
7 it correctly, some of those fixed costs, the average fixed costs, will be factored into a price,
8 because that will be true of everybody in the industry. I think that is right. So the
9 equilibrium price, I think, would be $P = \text{margin cost} + \text{average fixed cost}$.

10 PROFESSOR STONEMAN: I do not want to argue the detail of the model.

11 MR. SHARPE: Can I express relief!

12 I will be brief, sir, but may I just finish this section and then we will adjourn?

13 THE CHAIRMAN: Yes.

14 MR. SHARPE: The important point is this: whatever the costs, there is going to be an increase in
15 costs and the effect of that, prices will be higher than that assumed in the model, reasonably.
16 Though we will come on to it after the adjournment, we would expect fewer PPI products to
17 be sold at the higher price. As a result the model over-estimates the benefit of regulation.
18 My next point was going to be fixed costs.

19 So in summary, the Commission concluded that its remedies package was justified on the
20 basis of a level of PPI sales arising from the remedies. That was higher than would, in fact,
21 be the case as a result of its failure to take account of a material consideration, namely the
22 overall costs of the remedies package.

23 I want to address the Commission's response to this argument. It will not take long, but I
24 think, sir, unless you wish me to proceed, it might be an appropriate moment to adjourn.

25 THE CHAIRMAN: Let us look at the Commission's response after the adjournment.

26 MR. SHARPE: I should say that we are well on track to finish some time this afternoon.

27 THE CHAIRMAN: I am pleased to hear it. You might like to give a little thought over the short
28 adjournment, if you have any time, to this question: one way of looking at the way the
29 Commission did the proportionality analysis is that they looked to compare the consumer
30 detriment with the loss of what they defined in quite an extensive section of their report as
31 "relevant consumer benefits", "RCBs", and there is a passage in the report where they ask
32 themselves whether the loss of the choice of buying the product at the point of sale of the
33 credit – that is buying a PPI at the point of sale of the credit – is a relevant consumer benefit
34 and then decide that it is not. It strikes me that you may want to make some submission

1 about whether, in the analysis of proportionality, the exclusion of what you call the
2 convenience factor may result from the conclusion that the loss of that opportunity is not a
3 relevant consumer benefit, and whether that is a right or not right approach to the
4 proportionality question.

5 MR. SHARPE: Yes, very interesting. Notwithstanding the discretion that the Commission has to
6 ignore relevant considerations ----

7 THE CHAIRMAN: I am not asking you to answer now, but it strikes me that one possible
8 analysis of why one sees the particular calculation that they did goes down that route.

9 MR. SHARPE: Yes, I am very much obliged. We will look at that. Thank you.

10 THE CHAIRMAN: Two o'clock.

11 (Adjourned for a short time)

12 MR. SHARPE: Sir, before the short adjournment you set me an examination question about
13 relevant customer benefit. I would like, if I may, to address that now briefly. As I
14 understood the question, it went like this: the fact that the Commission concluded that para.
15 10.392 to 10.393 that convenience was not a relevant customer benefit, does that, should
16 that modify in any way the package of remedies in order to answer the statutory question?
17 Perhaps I can rephrase that because I am having difficulty reading my writing. I want, if I
18 may, to formalise the question to make sure I have got the right question. You raised the
19 issue of relevant customer benefit. The fact that the Commission concluded at 10.392 to 393
20 that convenience was not a relevant customer benefit -- If that is true, should the
21 Commission then seek to modify the package of remedies to take into account that finding?
22 Is that correct formulation of the question?

23 THE CHAIRMAN: Not quite. The thinking that was going through my mind was that one
24 possible analysis of the way the proportionality question was approached was that the
25 Commission looked, on the one hand, at the relevant consumer detriment, which they hoped
26 to remedy, and, on the other hand, the loss of any relevant customer benefit occasioned by
27 the imposition of the remedies. But since, in their quite lengthy analysis, the relevant
28 customer benefit issue having considered all the competing candidates they did not include
29 what you call the convenience factor - what I think is described in those submissions as the
30 loss of choice of buying your PPI at the credit point of sale factor - the question is: is it a
31 fair reading of the report that therefore it fell out of the analysis by virtue of that
32 conclusion?

33 MR. SHARPE: Fell out of the proportionality analysis? Yes. I understand. That was my
34 understanding.

1 THE CHAIRMAN: If so, is that, in your submission, a correct approach?

2 MR. SHARPE: That is the question. I suppose if that is the case, would the Commission have
3 been justified if in their ignoring of what I will call the convenience factor -- Let me point
4 out of course that that is not how the Commission run their case.

5 THE CHAIRMAN: No, but it is how you run your case.

6 PROFESSOR STONEMAN:

7 MR. SHARPE: I am running my case that proportionality is important.

8 THE CHAIRMAN: It is your case that the Commission did not include anything for that loss of
9 that convenience factor.

10 MR. SHARPE: Yes, but I am not running ----

11 THE CHAIRMAN: The proportionality analysis.

12 MR. SHARPE: Yes. But, they are not running an argument that they were entitled to do that on
13 the basis they already considered ... customer benefit. In my view, respectfully, the issue is
14 a simple one. If you are evaluating the actual benefits from a package of remedies you can
15 only look at those benefits which will accrue. So, they had to look at how PPI sales would
16 in fact increase or decrease. They are not airbrushed out of the picture by their earlier
17 dismissal of them as not constituting a relevant customer benefit. Since convenience, we
18 know - and I do not think it is contested - had a key impact on sales, in our submission they
19 had to take that into account. That was the reality of the position.

20 In short, it is not enough for them to say, "It is not a relevant customer benefit; therefore we
21 can lose it" because the quite separate issue is to assess the question of proportionality. In
22 support of that, you will recall there is a difference - a difference which is difficult to
23 understand. Whereas there is a duty to look at consumer detriment, there is a discretion to
24 take into account relevant customer benefit. It seems to me that that chimes badly with the
25 notion that having considered and rejected it, they must therefore, at their discretion, go
26 forward and ignore that issue for the purposes of proportionality. It would be very odd if
27 they could say remedies are beneficial, since it will, for example, increase sales by 50
28 percent if, in reality, sales were, on analysis, to go up by much less -- or even fall, as a
29 matter of fact. We see them as really quite distinct exercises. I am most grateful to be
30 stimulated into thinking more about the matter. It may be, Sir, that I may not have given
31 you the correct reference at 10.392, which I think is the point of sale advantage. I am going
32 to ask my learned friend to just check if for me. If so, I apologise. I will give you the right
33 one.

1 Before the short adjournment I was taking you to some submissions that the Commission's
2 hypothetical modelling took no account of costs at all, still less the costs which were
3 admitted to take place - costs of implementation. We had a very stimulating discussion
4 about exchange regarding an effect on prices of such costs increases - industry-wide costs
5 increases. I was about to take you to what the Commission says about all this. I will do
6 that very briefly. There is nothing in the report about costs. That is a fundamental point. I
7 think this is the report I think we are interested in at paras. 184 to 187 of the Commission's
8 defence at CB1, Tab 9, p.406. I hear the Commission say that Barclays is wrong to suggest
9 that, as you see, providers' costs would increase. They even go so far as to say that certain
10 categories of costs might end up falling. This is a heroic reply, given the acknowledgement
11 that costs are going to increase, to which I have already taken you many times. That is the
12 first point.

13 The second point, in relation to the defence -- I do not propose to take you to it, but I will
14 give you the reference to it in my learned friend's skeleton argument (CB3, Tab 4, para. 73,
15 p.146) -- We move from the defence's denial of any cost increases and the possibility of
16 cost decreases, to an acknowledgement that actually Barclays is right and that costs will
17 rise. For completeness,

18 "Whilst the Commission agreed with Barclays that some costs would increase
19 following the imposition of the remedies package, the Commission considered
20 that others would fall (as seems to be recognised in Barclays' skeleton in which it
21 refers to costs *changes* rather than cost increases). In particular the Commission
22 found that competition would generate dynamic benefits over time including
23 lower costs, and further, there would be a reduction in claims costs as a result of
24 the effect of reduced prices on adverse selection".

25 Paragraph 493 is a familiar one to you by now. It may not come as a surprise to you to
26 discover that on inspection para. 493 says nothing of the sort and is not support for any
27 proposition. The simple point that I want to make, and make quickly, is that there is now at
28 least in the skeleton argument an acknowledgement that the Commission was wrong in its
29 defence that costs would not increase -- some costs would not increase. They were obliged
30 to say that. But, I remark that the references given in the report do not actually sustain even
31 the Commission's current position and no analysis was done - at the risk of repetition - as to
32 the magnitude of any increases and the impact that would have upon any calculation of
33 consumer detriment and to welfare generally.

1 PROFESSOR STONEMAN: Mr. Sharpe, could you clarify something for me, please? You talk
2 about claims costs here. Is that the costs of processing claims? I am not quite certain in my
3 own mind at the moment, when we talk about prices and costs, whether we are actually
4 including underwriting costs or not. I think the report is only concerned with distribution
5 costs, if you like.

6 MR. SHARPE: May I take instructions on that. I want to give you an accurate answer, if I can.
7 Would you forgive me, we will answer that question. I am not in a position to answer it
8 now, but we will come back.

9 PROFESSOR STONEMAN: Thank you.

10 MR. SHARPE: My understanding, but I will get confirmation, is that the underwriters actually do
11 all the work and they are going to be processing claims. When a claim is made, it is they
12 who actually process it. I am sure Barclays does all the other work. Some of the costs at
13 least will be borne by underwriters, and therefore costs will rise. We will make it good, but
14 I think that is a quick answer to your question.

15 The point is an obvious one. Here we have a major issue as to where costs are. If I may put
16 it uncharitably, we have a good deal of confusion in the Commission's position. The report
17 is silent on this and it is a manifestly important issue, because it goes to how they begin to
18 calculate welfare losses. It is not how we begin to calculate them, but how they begin. In
19 short, they fail to address something which is vital. The relevant consideration, the latest of
20 the relevant considerations they should have looked at which they did not look at, and it
21 adds to the basis on which the application should prevail.

22 May I now turn to the Commission's modelling assumption that the remedies would be
23 fully effective and reduce profits to zero without any justification for this conclusion. My
24 submissions draw upon Professor Yarrow's expert report, and I will give you the paragraphs
25 but not take you to them for your note. It is paras.76 to 82 and 83(a) and 83(b) of his report,
26 which is at CB1, tab 4, 105. You have heard and seen the basis of the Commission's
27 assumption that the remedies being considered would be fully effective and will drive the
28 excess level of PPI profits to zero in each case – for your reference, appendix 10.9, para.8.
29 You have already seen the magnitude of the reductions assumed in table 1, which I took you
30 to yesterday, which is also at appendix 10.11 and reproduced in Professor Yarrow's report.
31 It is a 50 per cent price reduction. It is a matter of arithmetic.

32 The Commission carried out no analysis which would suggest that its remedies package, a
33 non-assistance remedies package, would be fully effective in eradicating the AEC that it
34 identified or the consumer detriment arising as a result. Even if more consumers began to

1 engage in such behaviour and stand-alone competitors entered the market, as the
2 Commission hopes, it would not follow from this that all suppliers of credit and PPI would
3 seek an equal contribution to their fixed costs and profits from the sale of credit and PPI.
4 The underlying assumption here is of an equality of elasticity of demand. That means the
5 intensity of demand for credit, and PPI is the same. That is an unproven assumption and
6 indeed may not have survived the relentless attack from my friend on behalf of Lloyds,
7 which no doubt she will address you on.

8 I will put it like this and no higher: if, as is highly likely, the elasticities of demand are
9 different for the two products, the profit maximising approach would still be to price the
10 two products at a level which would give an unequal contribution to fixed costs and profits.
11 There is nothing in a competitive outcome when products are sold in this way to suggest
12 that price equals margin or cost for each product. They are inter-related.

13 While PPI or credit perhaps would still cost more than the Commission assumed in its
14 hypothetical models, the bundle of PPI and credit would still possibly represent good value.
15 This would materially affect, or materially reduce, the consumer benefit which the
16 Commission calculated as arising theoretically from its proposed remedies. Inexplicably,
17 the Commission carried out no analysis and obtained no evidence to determine to what
18 extent differential margins would remain on the sale of these two products, and would
19 remain a feature of the market place. As a result of its failure to consider this possibility the
20 Commission proceeded on the basis of benefits arising from its remedies which might be,
21 once again, significantly higher than those actually obtainable.

22 The Commission's answer to this challenge, once again, and it is para.188 of the defence,
23 p.407, is very brief, and could you please read it, was to admit that the Excel model did not
24 seek to model the effects of the actual remedies package imposed, and the question of
25 effectiveness was dealt with at 10.465 to 10.479 of the report. It is all very well, but the
26 argument merely confirms that the Commission did not carry out the comparison that the
27 Tribunal held necessary in *Tesco*, since its figure of £200 million did not represent even a
28 realistic estimate of the level of consumer benefit that its actual remedies could actually be
29 expected to achieve in the real world. The wrong comparison was therefore undertaken,
30 and I will not take you to it, at para.10.508.

31 So a pattern is emerging. The answers are all in the design of the remedy and the model –
32 well, we use it, and we proclaim its use, in 4.94 – but when we start picking away at it to
33 look at the assumptions underlying it we are told, “Well, the model really was not designed
34 to do that, we did not want to extend it for that purpose”.

1 In my respectful submission, I am not making points which are trivial in terms of the
2 magnitude on prices, profitability, sales, these are all considerations which the Competition
3 Commission or all bodies should have taken into account and their failure to do so is
4 manifestly a failure to have regard to irrelevant considerations. They should have done the
5 spadework, as I put it.

6 As for the 60 per cent reduction in price that the model assumes, can we go to para.190 of
7 the defence, p.408. Again the language is very peculiar:

8 “... Barclays alleges that the Commission’s analysis depends upon no less than a
9 60% reduction in PPI prices ...”

10 It is almost as if it has come as a shock to them to discover that we can actually do some
11 arithmetic from table 1. I do not think it is in dispute – the arithmetic is not in dispute – that
12 the reduction in price is 60 per cent, so why it is an “alleged” reduction escapes me. It does
13 not seek to deny, nor can it deny, that this was what was used in the model and therefore
14 what was relied upon by the Commission to arrive at the calculation in 10.494, which
15 underlay its decision to adopt the remedy package that it did, and in particular the
16 prohibition.

17 What do the Commission say in answer to this? I will deal with this, as it were, generically.
18 It is the same paragraph, I am running them through. PPI prices were very high, a long way
19 above competitive levels – that is what they are saying. In the competitive market, we
20 would expect prices to fall dramatically from their current level. The word “dramatically”
21 of course does not appear in the report, that is an improvement on the findings in the report,
22 but it does not matter.

23 The report, as you will now easily recall, only stated that it expected prices to fall but it did
24 not, as you now know, offer any analysis of how far and when; it expected them to fall – a
25 general reduction – they made no comment about it being dramatic or otherwise. All it said
26 was it was confident that its remedies would address the competition problem and to do so
27 as you now know in a timely manner. We say that is quite simply not enough.

28 It is obviously not enough because it is not as if the Commission had applied its skill and
29 judgment in assessing the economic evidence, and said in this type of market, in the sort of
30 competition that is likely to evolve, the actual remedies package would result in a price fall
31 of 60 per cent and then provided evidence for that assumption; it did not do that at all, it just
32 says: “In a competitive market, what is the typical outcome? Price equals cost.” In other
33 words, that reduction from one price to the lower price, where price equals cost is not an

1 assessment exercise, it is an assumption. I said that yesterday and forgive me, I am going to
2 repeat it. It is not an output of the model, it is an input into the model.

3 Therefore, it was on this basis that the only number that is in the report and on which, I
4 repeat, the Commission can rely is the number for static welfare, which is what they do rely
5 on £200 million, and if it is based on such fragile evidential foundations it has no value at
6 all. There is absolutely no evidence in the report that this is a realistic indication of the
7 benefits that the Commission's remedies might achieve, and that is what is essential. I am
8 delighted to see the Commission has confidence in its numbers, and it will be nice to see on
9 what evidence it basis such confidence because I can see none.

10 My fourth point in relation to Ground 3 is this: the Commission's modelling took no
11 account of the adverse effects of its remedies' package, and for your reference it is begins at
12 para. 47 of Professor Yarrow's report. I am conscious we have actually spent quite a bit of
13 time on this, so I feel no particular need – unless you wish me to – to rehearse the ground
14 about the effect of convenience and soon.

15 But there is a factor I think extends from this and this is part of the general point which I
16 raised yesterday, that the Commission's modelling was based on out of date information.
17 This represents a further problem in the Commission's analysis. It relied very heavily on
18 financial data in 2006, as you have seen. But at the risk of understatement substantial
19 changes have taken place in the credit market and in the PPI market between the end of
20 2006 and the end of January 2009 when the Commission came to publish its report. I fully
21 accept that in every Competition Commission inquiry and report there has to be a realistic
22 cut-off date because the Commissioners have to come to an assessment on the basis of the
23 world at a particular time, and that cannot be the day before the report is published,
24 obviously.

25 Two points: first, 2006 left 2007 and 2008 to go through, and the information was not
26 merely available but was made available to the Commission for these periods. Secondly,
27 there must have been every reason to believe that the world had changed, unemployment
28 had increased, the fear of unemployment had increased, the credit market had changed, and
29 so the sheer scale of the difficulties facing the credit market and individuals – especially
30 those who would normally move toward PPI insurance, should have been known to the
31 Commission and they should have taken extra effort to bring their analysis to bear upon the
32 most up to date available data.

33 What the Commission has done is calculate its estimates of the likely benefits of the
34 proposed package of remedies on the basis of the benefits that would arise if the market in

1 2010 onwards, when the remedies will come into effect, reflects the size and profitability of
2 the market in 2006. In my submission, it is obvious that it will not; that era is over. As the
3 FSA will doubtless tell us, even if lenders were willing to repeat their mistakes perhaps at
4 their height in 2006, the FSA will do its best to try and stop them, and the size of the credit
5 market will therefore be reduced and, as a consequence, PPI as a secondary product to
6 credit has had its market reduced as well.

7 We can see this, and I am going to take you to the report at CB2, table 2.6, under para. 2.32
8 – we can take this briefly. This looks at gross written premium for 2006 and 2007, and for
9 the first half of 2008. This is based upon the shares that various underwriters have in the
10 market. The Commission have not calculated the reductions but we have. Before doing
11 that, forgive me, I think the most effective way is to look at the totals. One immediately
12 sees a significant reduction from £4.3 billion overall to £3.7 billion in 2007 and a rate if
13 annualised – and that may be a danger; treat it with caution – of about £3 million in 2008.
14 This shows a 15 per cent fall by my calculation in 2006 to 2007 and a further 19 per cent
15 fall from 2007 to 2008. That is calculated on the basis of the first six months, obviously. It
16 is nothing less than a reduction of about 31 per cent from 2006.

17 Although the Commission did not carry out a profitability analysis for 2008, and so we
18 cannot be sure for certain, it is also likely that average profitability per policy has fallen,
19 given the substantial increase in claims that has occurred with rising unemployment.

20 The Commission has therefore proceeded on the basis of a level of benefits arising from its
21 proposed package of remedies that is unlikely in fact to arise given these changes in the
22 market. What does the Commission say to this?

23 PROFESSOR STONEMAN: Excuse me, Mr. Sharpe, can we go back again? I asked you earlier
24 whether the price included the underwriting costs.

25 MR. SHARPE: Yes.

26 PROFESSOR STONEMAN: I think that is a rather important point here in that if the level of
27 claims has increased and therefore the underwriters are paying out more, that means that the
28 underwriters are making less profits. Does it necessarily mean that the distributors are
29 making less profits? It is rather important that we have this clarification as to whether the
30 price we are talking about on the market is the income earned by the distributors over and
31 above the underwriting costs that are paid or whether it includes the underwriters profits and
32 costs.

33 MR. SHARPE: I think I must take instruction because I do not want to guess, but my
34 understanding of the position is that in that type of situation the underwriters are having to

1 incur greater costs. They will then in turn charge more. That is the mechanism by which the
2 PPI prices were increased.

3 PROFESSOR STONEMAN: So the price we have been talking about, the price ... marginal cost
4 in Appendix 10-point-whatever -- Is that the price including the underwriting charge or is
5 that purely the distributor's margin on top of the underwriting? That is a crucial issue. You
6 have been talking about a 60 percent reduction and I do not know whether you are talking
7 about 60 percent reduction in the distributor's margin or a 60 percent reduction in the price
8 ... distributor's margin plus the underwriting ----

9 MR. SHARPE: No. No. I think our understanding - and, of course, it is the Commission's table -
10 throughout has been that we are just discussing the price of PPI, not margins.

11 PROFESSOR STONEMAN: So within the marginal cost is included the charge by the
12 underwriters to, for example, Barclays.

13 MR. SHARPE: Yes.

14 PROFESSOR STONEMAN: I would like to have that clarified.

15 MR. SHARPE: We will. That has been our working assumption. Of course, if the underwriters'
16 margins were constant over time it may not matter because the ratios would be the same,
17 would they not?

18 PROFESSOR STONEMAN: Yes. But the point you are trying to make at the moment is that they
19 are not.

20 MR. SHARPE: Indeed. What we are seeing here is a very significant reduction. Now, what does
21 the Commission say to this? They say, first of all, that they used the most up-to-date
22 information which was available and suitable to enable the modelling exercise to be
23 completed within the time limits. That is how they put it. I will come back to the reference
24 for that. The Commission fails, however, to explain why only the 2006 data was used, why
25 it was judged to be suitable, given the Commission obtained updated information in relation
26 to 2007 and the first half of 2008 (the skeleton).

27 The quotation I gave you, for your note, was from the defence at para. 195. That is where
28 they said they used the most up-to-date information which was available, on the one hand,
29 and suitable - pretty nearly two years before the report was signed. Now, they do not say
30 why the 2006 data was suitable given the Commission obtained updated data. The question
31 also requested forecast data in relation to the rest of 2008.

32 But, even if it were true - even if this statement is an accurate reflection that it was neither
33 available, nor suitable - the Commission should, and could, still have given consideration to
34 what proportion of the £200 million benefit they calculated on the basis of the 2006 data,

1 which would still arise if the market reduced in size by the kind of percentages which are
2 reported in the report itself. There would not, I think, have been any difficulty in producing
3 a reasonable estimate on this basis. So, notwithstanding reporting this reduction, on the one
4 hand, they went ahead to calculate the total consumer detriment on a totally different data
5 basis, i.e. cut off in 2006, with the very reasonable inference, given the 31 percent reduction
6 in the market. Once again we have a very significant over-estimate of the likely benefits of
7 intervention.

8 The next topic - and the last one in relation to Ground 3 - relates to the Commission's
9 treatment of the proper elasticity of demand. Here I draw upon Professor Yarrow's
10 evidence at paras. 65 to 75. To put it mildly, this may seem a little arcane, but the level of
11 elasticity of demand used is crucial to the level of benefits which the Commission
12 calculated would arise since the Commission's model calculates benefit and detriment
13 based upon the level of demand for PPI and credit which would arise from changes in the
14 price. So, they assume a 60 percent price reduction in the case of PPI. So, the next
15 question is: What sort of assumption can they make about an increase in sales and the ratio
16 between the percentage reduction in price and the increase in sales is the elasticity of
17 demand? In other words, in order to make an estimate, or an assumption, in the case of this
18 model as to how far sales would increase of PPI, the Commission had to calculate the
19 elasticity of demand.

20 Yarrow explains in paras. 65 to 75 of his report that once he was in a position to reverse
21 engineer (that is his word) the Competition Commission's calculations, he could identify
22 the Commission had made what appears to be a fairly elementary mistake, and calculated
23 the wrong kind of elasticity. You see, it is one thing in the market to say, "Well, we have
24 two suppliers of a product or a service and one of them reduces the price of its product.
25 What effect would that have upon that provider's sales in taking sales from somebody
26 whose price had not been reduced?" I think that is called the cross-elasticity demand.

27 That ratio is quite important.

28 But, it is a very different calculation - and it is a very different elasticity - when we look to
29 see what the effect would be on the industry as a whole if the overall level of prices in the
30 industry fall by a given percentage. There, it is not a case of substitution for people already
31 buying the product going to a cheaper supplier and switching their patronage. It is a case of
32 saying, "Well, I can't go anywhere else to buy the product. Am I going to buy the product
33 in greater volume because the overall prices have fallen?" They are really quite distinct
34 activities, quite distinct inquiries.

1 If we are talking of the reduction in the supplier's elasticity of demand, with all other
2 supplier's prices remaining constant, we are dealing here with people who, by definition,
3 are already buying the product and their only decision is, "Well, I'm going to buy it. But,
4 where can I buy it cheaper?" so that they will switch their demand. There is every reason to
5 believe intuitively, but we do not have to go into it, that that would be quite a high number -
6 the elasticity could be quite high, all things being equal. It may well be possible that some
7 people who have never bought the product may be attracted by the lower price. We cannot
8 rule that out. But, there are two effects - the substitution effect from an existing supplier and
9 the supply from somebody demanding things they would not have bought before because
10 the price was higher than they wanted to pay. So, can you see? There are two effects in
11 place.

12 If we are talking about an industry-wide demand then we are not talking about any
13 substitution between suppliers. We are talking only about the second effect, which is that,
14 "The price has fallen. Can I now afford PPI?" Now, the 60 percent price reduction which
15 the model assumes does not apply to only one supplier of PPI - it is an industry-wide
16 assumption. It would be meaningless for it to be otherwise. Therefore, the Commission
17 needed to calculate the industry-wide demand - not the demand for an individual supplier's
18 service PPI product. What the Commission actually did was to calculate an inelasticity of
19 demand which reflected what would happen if a single supplier reduced its price relative to
20 other suppliers. In other words, they took account of an irrelevant consideration when, in
21 fact, they should have taken account of a relevant consideration - namely, the industry
22 demand.

23 Commendably, if I may say so, in its response, in para. 197 of its defence, the Commission
24 does not deny that the wrong elasticity of demand figure was used and would therefore
25 appear to accept that this was the case.

26 Less commendably they attempt to downplay this as trivial but offer no evidence. The
27 simple answer is that we have not any idea how trivial this mistake has been until the proper
28 market wide elasticity demand figure is calculated. It must be said that in our judgment it is
29 certainly likely to be higher than the own price elasticity and could, in fact, be substantially
30 higher, but the key point is that they did not the exercise because they admit they got it
31 wrong and it could have an important influence upon the robustness of the model.

32 THE CHAIRMAN: Can you just, without taking us to it, give us the references to passages in the
33 evidence, for example, in Professor Yarrow's report, which, as it were, evidences that an

1 industry wide elasticity may be much lower and might therefore have a real consequence in
2 terms of the overall figures?

3 MR. SHARPE: Yes, the basic paragraphs are 65 to 70.

4 PROFESSOR STONEMAN: May I clarify that what is really needed is a measure of the industry
5 elasticity of demand in the absence of any point of sale advantage?

6 MR. SHARPE: Yes, this is, respectfully, consistent with your remarks this morning that we have
7 to look at it in the context of the overall packages. I am just the applicant here. This is an
8 acknowledged mistake. I do not know whether, and I have said I do not know, Barclays
9 does not know, this is a significant mistake or a trivial mistake as the Commission asserts.
10 It is for the Commission to show, because they are asserting that the mistake has trivial
11 consequences. Fundamentally, they did not do an exercise they should have done. They
12 made a mistake. It may well be the case that if they can demonstrate, and should have
13 demonstrated from the report, that the outcome would actually have no material difference
14 then I acknowledge that our point on this would be weaker, but they cannot because the
15 report itself does not offer any guidance because they did not acknowledge the mistake,
16 they got it wrong.

17 THE CHAIRMAN: Their point is that the approach was spelled out in advance and nobody
18 complained about it. I am just looking for where we find in paras.65 to 75 of
19 Professor Yarrow's report an opinion that, in fact, an industry wide demand elasticity would
20 be likely to be lower. I can understand the theory, I just want to see the evidence.

21 MR. SHARPE: Paragraph 74 may assist you. May I take your first point that no complaint was
22 made ----

23 THE CHAIRMAN: All that says is that it cannot – anyway, yes?

24 MR. SHARPE: No complaint was made about it because nobody could reverse engineer the
25 model until its publication. I do not think we can be blamed for doing something that was
26 impossible. It is not a good point that the Commission are making. Indeed, I have to say
27 that it is by no means clear, even today, how the Commission have gone about the
28 calculations of elasticities. You may well have seen the subsequent correspondence and the
29 supplementary witness statements where my friend Miss Davies is teasing out more and
30 more information from the Commission as to what the elasticity of demand they were
31 operating might have been. We can only reverse engineer so far. I think my fundamental
32 submission would be that that is extremely interesting and bears very heavily upon our
33 submission that there was so little evidence on which to base the key assumption of an
34 increase in sales. Respectfully, I am unsure whether it is right for Barclays to come in and

1 try and remedy the mistakes of the Commission. The appropriate thing, in my respectful
2 submission, is for the matter to be remitted for them to do it again, not just for this but for
3 all the other mistakes I have attempted to isolate.

4 THE CHAIRMAN: Except that a judicial review challenge requires a test of materiality.

5 MR. SHARPE: Indeed.

6 THE CHAIRMAN: It is incumbent upon the challenger, is it not, to show that the criticism, if
7 well made in theory, could – and I am not sure you have to say “would” – could have a
8 material consequence?

9 MR. SHARPE: “Could” would do.

10 THE CHAIRMAN: It requires or may require either some argument or some evidence?

11 MR. SHARPE: Indeed. I did not come to court with just the elasticity point.

12 THE CHAIRMAN: No, no, of course not, but I am simply flagging this one, and now is the time
13 to ask any relevant questions.

14 MR. SHARPE: Quite. It is the Commission that asserts, of course, that the effect is trivial. In
15 the ordinary way he who asserts must prove. They, of course, are in a materially better
16 position than Barclays Bank to have come to a conclusion about the industry elasticity of
17 demand.

18 THE CHAIRMAN: Is it, in fact, the case that this model only emerged for the first time at the
19 publication stage?

20 MR. SHARPE: May I take instructions, I am not sure what ----

21 THE CHAIRMAN: I think that is implicit in what you said a moment ago.

22 MR. SHARPE: It would not be a surprise if something approximating it, if not the identical
23 model, was produced when the Commission produced its provisional findings.

24 THE CHAIRMAN: But your answer to the point in the defence that nobody complained about
25 the elasticity analysis ----

26 MR. SHARPE: My understanding, Sir, was that it was ----

27 THE CHAIRMAN: -- was, “We never saw this until the report was published”.

28 MR. SHARPE: No, I did not quite say that. I said it was impossible to reverse engineer the
29 model until we have seen the report in full. If I am wrong in that I will no doubt be told, but
30 I do not think it is a good point. My understanding from Professor Yarrow’s evidence is
31 that he was not in a position to reverse engineer it until he had had greater sight of the
32 assumptions underlying the report.

33 What we have here in table 1 is a very simple notation essentially, two prices, a difference,
34 two volumes by value, a difference, and a ratio between the two, but Professor Yarrow was

1 careful to look at the model as a whole and came to the conclusion, having reverse
2 engineered it ---- My instructions are that the calculation used to produce the elasticity of
3 demand figure which is in the report – I think it is minus 1.54 (minus 1 obviously because it
4 is a slope) – was not provided to the parties during the enquiry or indeed in the report. It
5 was only after Professor Yarrow effectively reverse engineered that calculation which you
6 will find he is working at paras.68 to 72 of his report that the mistaken approach was
7 identified. In our submission, the Commission cannot properly criticise the parties for not
8 taking into account something which they did not understand existed.

9 PROFESSOR STONEMAN: Can I just raise one point on that table 1, the footnote with the star -
10 ---

11 MR. SHARPE: We are in table 1.

12 PROFESSOR STONEMAN: Yes, p.805 of the bundle, para.13. That is where the minus 1.54
13 comes from?

14 MR. SHARPE: It is.

15 THE CHAIRMAN: It is not reverse engineering, it is just stating it.

16 PROFESSOR STONEMAN: It is consistent with the numbers there.

17 MR. SHARPE: No, what Professor Yarrow did to this number constitutes a reverse engineering
18 to determine how they arrived at that figure of 1.54.

19 PROFESSOR STONEMAN: I am looking at the footnote 4. Is George Yarrow is not basically
20 reversing footnote 4? In other words he is allowing the number of people who buy PPI to
21 vary. I am not too sure how footnote 4 relates to table 1 – I was just looking at table 1 – but
22 the argument with George Yarrow that the market elasticity is greater than the firm level
23 elasticity because you changed the price, the number of people in total who will buy PPI
24 will increase.

25 MR. SHARPE: Yes.

26 PROFESSOR STONEMAN: But footnote 4 says: “provided there is no change in the proportion
27 of consumers” – I am talking about the footnote 4 in 16 and I am not quite sure how they
28 slide together?

29 MR. SHARPE: I am not sure it relates to that. I am looking for some qualification in relation to
30 table 1, we see the asterisk that relates to the profitability frontier in appendix 3.9.

31 PROFESSOR STONEMAN: I had not made that connection.

32 MR. SHARPE: 16, I am not sure 16 relates to volume, with respect. There is no longer any
33 excess profit so we have reached the price equals marginal cost. “Increase in price will lead

1 to reduction in the level of credit sales”, and I think that might be looking at the effect of
2 the remedy on PPI sales affecting the demand for the bundle of credit and PPI.

3 THE CHAIRMAN: I am sure if the Competition Commission think there is anything in it they
4 will follow it up.

5 MR. SHARPE: Sir, may I just have two moments to take instructions on this point? (After a
6 pause) If this is a matter of importance I can take you through some submissions on the
7 elasticity point, but the framework within which I am doing it is not that I regard it as part
8 of Barclays’ task to refute the assertion by the Commission that the effect is trivial. They
9 say it is trivial having admitted their mistake. Their model is based upon elasticity, which is
10 the wrong elasticity, and in my respectful submission they do not put it right.

11 As for the materiality, I think I can assist you because I think first of all – and I am in a
12 dangerous position because I have refuted - it is generally regarded that an industry
13 elasticity, because it derives from attracting more people to a particular product, would tend
14 to be somewhat lower in general terms than a cross elasticity where people are already
15 attracted to the product; in other words, the product is being sold to them.

16 THE CHAIRMAN: Well you may say so, Mr. Sharpe, that is why I was asking for evidence.

17 MR. SHARPE: Well, you are, if I may say so, very well equipped in this Panel to seek guidance
18 on that point.

19 THE CHAIRMAN: Yes, well let us see.

20 MR. SHARPE: In fact, I am looking for the Commission to justify their assertion on triviality.

21 THE CHAIRMAN: I think I have your submission that essentially the ground work for analysing
22 how the elasticity was derived was not available pre-publication.

23 MR. SHARPE: My understanding is that the ability to reverse engineer was either not available
24 or was difficult.

25 THE CHAIRMAN: I see.

26 MR. SHARPE: But the fact is it was only done after the report was published, and that is why we
27 are here.

28 THE CHAIRMAN: I am not, you understand, looking at this as a sort of ‘not pleaded during the
29 investigation’ point, but simply as to whether the fact it was not raised may give rise to a
30 prima facie inference that it is not material.

31 MR. SHARPE: I think the only truthful answer one can offer, Sir, the only one I am capable of
32 giving you is that the Commission’s reasoning quite simply was not understood. It has
33 taken the intensity of this application to understand – as I say, even now we are not entirely

1 clear where the Commission is coming from, as Miss Davies will emphasise, I am sure, as
2 to what elasticities they are adopting.

3 The figure of 1.54 itself has been discarded by the Commission.

4 THE CHAIRMAN: You will have to make up your own mind where the situation is having heard
5 Miss Davies and Mr. Swift. There is another figure for credit I think, 0.89.

6 MR. SHARPE: I wonder, Sir, if I may suggest, I do not propose to take you to this, because I
7 think we are in danger of not seeing the wood for the trees – at least I am not – but if you, at
8 your leisure, were to consider the following, and I will just give you, as it were, a minor
9 reading list, which all or some of you may wish to take advantage of. Table 1 to appendix
10 10.9 ----

11 THE CHAIRMAN: Yes, I have that.

12 MR. SHARPE: -- that is the one that provides an estimate elasticity for PPI. This derives from
13 the GFK NOP survey.

14 THE CHAIRMAN: And we have the analysis of that.

15 MR. SHARPE: And we see its source. So there is no doubt at all that the elasticity estimates rest
16 on the GFK results. If we now turn, and I am not going to take you to it, but I give it to you
17 as a reference – Appendix 3.9, para. 26. The appendix is entitled “In Home Survey Results
18 for Downstream Market Definition”, so downstream market is the PPI market. So this
19 section is concerned with estimating the cross-price effects, and that is to say switching
20 between price providers where the price of PPI increases, and so the discussion has focused
21 on the effect of that, not credit demand.

22 If one looks at para. 28, for your note, it is abundantly clear that what is being assessed is a
23 switch to another PPI provider ----

24 THE CHAIRMAN: Mr. Sharpe, that I think is not in issue, the question is whether the evidence
25 goes to its materiality. I thought your point was the defence did not challenge that this was
26 how it had been done, but said it did not matter.

27 MR. SHARPE: Well that is true. What I was leading up to was a calculation of own price
28 elasticity, and may I just simply refer you to para. 27. That arrives at a figure of minus 4.3,
29 which is a very significant figure for own price elasticity.

30 THE CHAIRMAN: We have got the homework, you say?

31 MR. SHARPE: Yes, the key point, they say it makes little difference, but we say that assertion
32 contradicts the clear reasoning in appendix 10.9 which infers significant cross-price effects
33 from the GFK survey, and I have tried to start on that, and Yarrow deals with it I think at 68
34 and 69 of his evidence.

1 The one point is we can say we know the line of direction here, that the model
2 overestimates the total increase in PPI sales that would arise from a decrease in PPI prices
3 generally. So once again the consumer benefit is overestimated. The issue then is by how
4 much? I do not think Barclays can assist the Commission. We can only point out that this
5 was an error of their making and they should have done a better job of it.

6 I now turn to Ground 4. We say in Ground 4 that the Commission's analysis of the relevant
7 markets and the extent of the competition problems which existed in the market, which the
8 Commission found to exist, were flawed by its failure to take account of relevant
9 considerations. As I said in opening, the Commission concluded that the relevant market
10 as an individual distributor's or intermediary's sales of a particular type of policy. This led
11 to the conclusion that each provider had a monopoly supplier for PPI product to its
12 customers at point of sale. The Commission concluded that while PPI sold by distributors
13 and intermediaries to their credit customers was not competitively constrained by stand-
14 alone PPI suppliers, asymmetric constraints did exist that stand-alone suppliers were
15 competitively restrained by PPI policies sold by distributors. Not an unusual situation. That
16 is how they analysed it.

17 I turn immediately to the impact of Ground 4, and why it is important. The Commission
18 contends in para. 200 of its defence, to which I am not going to take you, that the challenges
19 made in Ground 4 to the Commission's analysis of the relevant market and the problems
20 arising from that market are flawed because Barclays has failed to identify any connection
21 between its grounds of challenge and the Commission's findings in relation to AEC. This is
22 incorrect and ignores the relationship between the three relevant sections of the
23 Commission's report: Section 3, dealing with the relevant market; Section 4 - the indicators
24 of the extent of competition between PPI provider; Section 5 - factors affecting the nature
25 and extent of competition in the supply of PPI. In our submission there is a close
26 relationship between these sections, with the conclusion that the Commission reaches at the
27 end of Section 5, in relation to AEC, being the culmination of its analysis under 3, 4, and 5.
28 We hope that is not controversial.

29 Significantly, it was only as a result of the findings that the Commission made in Sections 3
30 and 4 of the report about the state of competition, which I showed you yesterday, and the
31 prejudice that this was causing consumers, that the Commission moved to analyse what
32 effects of the market caused these problems and consequently concluded that they were
33 AEC.

1 The Commission's conclusions on AEC are set out at para. 5.144 of the report. They are
2 therefore wholly dependent upon the analysis of Sections 3, 4, and 5. It might be useful if
3 we go to those paragraphs. It might be useful, Sir, if you were to read 5.144 to 5.146.
4 (After a pause) In our submission these conclusions were wholly dependent upon the
5 analyses in Sections 3, 4, and 5. In turn, the Commission's decision that certain remedies
6 were all necessary and proportionate, including the prohibition, depended upon its
7 conclusions by the AEC and consequent and detrimental effect on consumers, and therefore
8 upon the analysis of Sections 3, 4, and 5. So, as a result of this relationship, the effect of the
9 challenges made is that if successful both the analysis in question and all subsequent
10 conclusions necessarily fall together. That is why we have embarked upon the task of
11 challenging the Commission's choice of relevant market.

12 We say, first, that the Commission's choice of this unusually narrow market was the result
13 of a failure to carry out proper analysis. For the reference - but I am not going to take you
14 there - it is para. 97 of our notice of application, which is at CB1, para. 38. You see that the
15 Commission has rejected the suggestion that the relevant markets were wider than just
16 individual distributor's customers on the basis of the slip test. The details of that you will
17 have seen, I think, in Appendix 3.9, which is at CB2, p.535. I am sure it is not necessary for
18 me to explain the workings of the slip test. In this appendix the commission considered
19 whether a 5 percent increase in price would lead to a sufficient number of customers
20 switching supplier to make an increase in price unprofitable. The Commission used this
21 information from its 2008 In Home survey which had shown that depending on the type of
22 policy, between 11.3 and 21.3 percent of customers actively compared two or more PPI
23 products before taking out their policy. The Commission's results showed that if 90 percent
24 of these active comparers for PLPPI - and that, you appreciate, is the personal loan PPI -
25 would change supplier as a result of a 5 percent increase, the price increase would not be
26 profitable. If 95 percent of those active comparers for mortgage protection policy insurance
27 would change supplier as a result of a 5 percent increase, the price increase would not be
28 profitable. Thirdly, if 80 percent of those active comparers for the second mortgage, PPI
29 would change supplier as a result of a 5 percent increase in price the price increase would
30 not be profitable.

31 In this appendix the Commission stated that the analysis did not provide a definitive
32 conclusion on the scope of the relevant market. You will find a reference to that - though I
33 am not going to take you to it - at Appendix 3.9 at para. 45, p.548. Now, despite that
34 admission, the Commission concluded that a narrow market definition should be adopted on

1 the basis that it was not convinced that the level of people described in this appendix would
2 have altered their choice of product on this basis (para. 46 of that appendix). This was at
3 the level of assertion because the Commission obtained no evidence to suggest that a
4 significant number of customers who were engaged in actively comparing policies would
5 deliberately purchase a PPI policy, or credit and PPI package together, that was 5 percent
6 more expensive than an otherwise identical alternative. Unsurprisingly, it did not put
7 forward any analysis to support such irrational behaviour. Furthermore, in its analysis the
8 Commission ignored one of the key limitations that exist on increasing prices particularly
9 for the secondary market product, such as PPI, which is for the customer's not to purchase
10 any product. We are fixated, of course, on competition between PPI suppliers, but, as I
11 remarked earlier, the alternative is to self-insure – in other words, instead of paying
12 somebody to take the risk for you, you take it yourself. For millions of people that is
13 precisely what they do. It is not worth it because I do not think, in my judgment, the risk of
14 unemployment or penury is so great that I am going to pay the money out. That calculation
15 is an implicit one but if the price were lower then people would say, “Now, it has become
16 worth it, and I measure that against the risks that I had earlier assessed”.

17 What we have seen in this industry are falling PPI penetration rates.

18 May I take you now, please, to table 2.5 of the report, which is above para.2.25. One sees
19 in this table essentially the manifestation of what I have just been describing, the self-
20 insurance phenomenon, voluntary or otherwise, but one sees a universal picture of falling
21 penetration over time for each of the types of PPI product on the market place. So one sees
22 in 2002, for example, personal loans had a penetration rate, PPI, of 62 per cent. This is by
23 numbers of loans. There is a steady decline and for the first half of 2008 the market has
24 gone down from 62 per cent of people taking out loans also taking out PPI to 38 per cent.
25 The reduction is perhaps even more dramatic in first charge mortgages. One sees a
26 reduction in credit cards. Second charge mortgages, virtually just under half, and so on.
27 This is not suggestive necessarily of a captive market which can be defined in terms of
28 individual transactions because there is obviously an alternative which the Commission
29 should have explored which is represented by this. There is a potential market for PPI
30 products which would have been 100 per cent of each of these categories of product, and its
31 penetration rate was falling. It is a voluntary activity to take out insurance and people
32 decided it was not worth it. The implications of that are only that if the price of PPI
33 products is so high it would be one factor at least predisposing people to avoid PPI and not
34 buy any insurance at all. If that is right we immediately bring into question the

1 Commission's choice of relevant market as being confined simply to a particular set of
2 transactions and we immediately bring in the possibility at least of a wider market.

3 It is not my case to say that that is absolutely and undeniably correct, it is my case to say
4 that there was no evidence to suggest that this choice of relevant market could be sustained
5 in the face of data such as these here, which strongly suggests there were other factors at
6 work.

7 The Commission also rejected the wider market definition that might arise from this market
8 definition on the basis of what is known as the "cellophane fallacy". One sees this at
9 appendix 3.9, para.48, p.548 of the report. In our submission, this determination was
10 flawed for a number of reasons. The most obvious one of course is that the world has
11 moved on since 2006, but I have already made that submission.

12 More fundamentally, the Commission fell into the trap of using its findings on profitability
13 to support its narrow market definition while using its narrow market definition to justify a
14 profitability analysis that was limited to PPI alone. One can see that from para.4.83 of the
15 report, to which I am not going to take you. In the context of deciding on the correct
16 relevant market, the Commission should have looked at its wider profitability findings
17 which showed, for example, that distributors of personal loans and personal loan PPI were
18 not making excess profits on the bundle of products. You will see that (for your note) at
19 para.4.85 of the report. The Commission describes this sector as being, and I quote from
20 that paragraph, "marginally profitable" in 2006. So one immediately sees that there is a
21 strong element of circularity in the Commission's reasoning.

22 As Professor Yarrow explains in his report, and I refer to CB1, tab 4, especially paras.102 to
23 103, there is nothing unusual or surprising, at least to him as an economist, about a supplier
24 of complementary products earning a different level of return on different categories of
25 product. This is something that the Commission has frequently accepted previously – for
26 example, and I hope this will not be in contention, in its groceries report. There is nothing
27 in economic theory, to my knowledge at least, that says the supplier of complementary
28 products must earn an equal return on each product. As a consequence of finding high
29 profitability in relation to PPI, that was the only evidence that normal economic forces were
30 at work. In other words, what they were witnessing was something which actually on
31 analysis was something that was perfectly normal, if not commonplace, which had been
32 observed and accepted in the past by the Commission in other contexts. I am reverting back
33 to where I started. In that type of situation where you have differential profitability for
34 complementary goods, it was inappropriate to apply the cellophane fallacy as if they were

1 selling a single product at the point at which the elasticity demand would be unity. It is an
2 inappropriate thing to do. I do not want to trespass on questions of analysis and assessment
3 in judgment. This is a straightforward mistake, and as a result it has led to some fairly
4 significant consequences in the choice of relevant market.

5 Furthermore, the Commission failed to take into account its own evidence when identifying
6 the relevant market. I draw your attention now to the following factors which indicate that
7 a wider market definition was appropriate. I am going to take you through this by
8 reference, and I will comment. First of all, the GFK NOP 2008 survey, which I mentioned
9 a moment ago, which you will find at appendix 3.9, especially para.9. This is on consumer
10 search, and I have mentioned that it concluded that between 11.3 and 21.3 of people
11 surveyed shopped around prior to the purchase. Of these, unsurprisingly, a majority
12 searched for both products in tandem. The Commission called this amount of comparison
13 “limited”, without condescending to explain or offering any further explanation or carrying
14 out any analysis

15 – what would be an adequate level of search? If one fifth of parties buying credit and PPI
16 are searching for credit, and that is what the survey suggested, why is that limited, why is it
17 by implication insufficient, and what sort of level would have been not limited, and would
18 have been sufficient? I do not know the answer to that and I suspect neither do the
19 Commission. What the Commission should have done here was provide some assessment
20 that says: “Our experience or analysis is that prices will not change if only one-fifth seek an
21 alternative quote. It will vary from market to market. I hazard if one-fifth of people buying
22 petrol shop around petrol prices would revert to cost pretty quickly if they could. It may or
23 may not be different for PPI, but one looks in vain in the report for any justification of why
24 the Commission could confidently assert and dismiss one-fifth of this particular population
25 searching, and that being written off as limited and offering no guidance as to the extent of
26 the market.

27 The Commission provided evidence of high termination rates associated with credit product
28 settlements. That you will find at appendix 4.3. The Commission argued that evidence of
29 early settlement did not necessarily provide an insight into the extent to which consumers
30 switched credit or PPI combination. They saw very little direct evidence of the level of
31 switching the combination of PPI and credit. As they put it, the evidence they did see was
32 of limited use because it was unable to determine the extent to which this switching was
33 affected by PPI prices. The Commission concluded that in general PPI demand was

1 unresponsive to changes in PPI prices, and they therefore expected the level of switching
2 the combination of credit and PPI on the basis of PPI prices was low.

3 THE CHAIRMAN: Mr. Sharpe, we are quite well beyond the normal 'stop' point ----

4 MR. SHARPE: Oh, I beg your pardon.

5 THE CHAIRMAN: -- if you could look for one; you choose.

6 MR. SHARPE: Well, I am just about to conclude this particular section. One sees the point the
7 Commission are trying to make.

8 THE CHAIRMAN: Well I have read the paragraph.

9 MR. SHARPE: Instead of analysing the market on the basis of the evidence the Commission was
10 determining the evidential position once again on its assumptions about the market. We
11 will not find anything in the report which would justify the statement that I have just made,
12 and on which the Commission relies. That, indeed, would be a convenient moment, Sir,
13 thank you.

14 (Short break)

15 MR. SHARPE: Sir, during my submissions on relevant market ----

16 THE CHAIRMAN: I was going to say, Mr. Sharpe, insofar as you just want to remind us of what
17 your notice of application says, I think you can just ask us to re-read it.

18 MR. SHARPE: Oh!

19 THE CHAIRMAN: You were, before we broke briefly, I think getting to a stage of reading from
20 your notice of application. It is very helpful to have it read out aloud, but quite time
21 consuming.

22 MR. SHARPE: Would you allow me just another few moments indulgence, and then I will stop
23 and then happily yield to Miss Davies.

24 THE CHAIRMAN: Yes.

25 MR. SHARPE: I was referring to the Commission's failure to take account of its own evidence,
26 and the last point on that was referring to the high margins earned on PPI products as
27 indicating the responsiveness to demand for PPI prices to change was low. What is not in
28 our notice of application are our answers to the Commission's ----

29 THE CHAIRMAN: Yes.

30 MR. SHARPE: -- in the defence, and I refer you to paras. 214 and 215 of the defence. Here the
31 Commission's argument is that Barclays' challenge is irrelevant since the Commission
32 concluded in the Report at 3.149 that even if it had taken a different approach to market
33 definition it would have made no difference to its analysis of competition for the purposes
34 of the investigation. It is a somewhat surprising statement, but nevertheless. The argument

1 again ignores the conclusions reached by the Commission and the way in which the
2 Commission used the conclusions reached in s.3 of its report. I refer you to 3.144 of the
3 report. The Commission's view in the report was that the market definition and the
4 assessment of competition between providers were linked, and overlapped significantly, and
5 that is hardly surprising. So far from being independent – it would have made no difference
6 – we see here a clear admission of a linkage, and a significant linkage. So they are using
7 the Commission's findings in section 3 to bolster its conclusions in section 4, and vice-versa
8 and, if I may, I will refer you back to para. 103 of our notice of application which refers to
9 an example of this and take it no further now.

10 So the key conclusion of the Commission is that there was little competition between PPI
11 providers and the report summarises how the Commission came to this view at paras. 4.1 to
12 4.4 using those underlying findings in section 3, that is to say the factual findings which the
13 Commission relied upon as the basis for its narrow market definition that there was little
14 substitutability between policies and distributors.

15 In the same way that the Commission's findings in relation to relevant market were flawed
16 by the defects in the analysis carried out, the Commission's findings about the extent of the
17 problems in the market were consequently flawed as well.

18 The Commission also argues at para. 218 of its defence that we have mis-stated the
19 Commission's findings on market definition since its analysis of market definition extended
20 beyond the slip test analysis, which they say is the subject of our complaint. We have never
21 argued that the SSNIP test was the sole piece of analysis relied upon by the Commission.
22 But, whatever it was, it was a key piece of the analysis. It is not possible to determine what
23 view the Commission would have reached on the competitive situation in the PPI market,
24 and hence the market definition if the SSNIP test had been carried out properly. So, we do
25 not regard that as a satisfactory answer.

26 At para. 220(d) of the defence the Commission argues that Barclays' complaint that the
27 Commission relied upon is 2006 profitability analysis is flawed because the prices were too
28 high was based on all of the evidence and Section 4 of the report and not just the
29 profitability analysis. On inspection, the only analysis carried out in Section 4 about the
30 correct level of prices was the profitability analysis. So, we do not quite understand what
31 the Commission is saying. This was the only basis they could have come to have reached a
32 view about price levels. The Commission also notes that it did analyse profitability for
33 2007 and we accept that they did do so. However, given the market turmoil experienced
34 since 2007 - and, rightly or wrongly, we put 2006 and 2007 broadly together; it was only

1 towards the end of 2007 and then through to 2008 that the turmoil we are experiencing
2 started - we do not think that the 2007 figures add anything to the story. They provide little
3 guidance to the state of the market at the date of the publication, or the signing, of the
4 report.

5 Paragraph 200(e) of the defence. The Commission argues that it determined market
6 definition and profitability separately. This is incorrect. We set out in para. 103 of our
7 notice of application that in Appendix 3.9 the Commission relied upon its profitability
8 findings from Chapter 4 to make its decision on market definition and upon its market
9 definition decision in para. 4.83 of the report in deciding how it should assess profitability -
10 the circular reasoning which I alluded to earlier. It concluded that it should be assessed by
11 reference to PPI alone and not the total profitability of PPI and credit, despite the fact that
12 both products are demanded together.

13 The Commission also argues that Barclays does not explain why the absence of excess
14 profits on PPI and credit would make a difference to market definition. The point,
15 respectfully, is an obvious one: if there were no excess profits in relation on the bundle, that
16 would be consistent with suppliers having to compete on the basis of price - on the price of
17 the bundle, i.e. PPI and credit together, rather than on each component. So far from being an
18 adverse factor - the hypothesis that there are no excess prices on the bundle - that is pretty
19 good evidence that actually people are comparing the prices of the bundle and the market
20 was improperly narrowly defined. If that is right, then the relevant market would be PPI
21 and credit together. That ought not to be a surprising proposition. Nobody wants PPI
22 without credit and when people want credit they have a decision, a choice to see whether or
23 not they want to incur extra costs on PPI. They will look at the cost of the bundle as a
24 whole - not as two component parts.

25 In respect of para. 223 of the defence, this is where the Commission is responding to para.
26 104A of the notice of application. He says that it did consider how much substitution was
27 enough. You will recall my earlier points before our break. I go no further than to say that
28 this analysis was flawed for the reasons we had already set out in para. 101 of the notice of
29 application. There was no evidence of consumers going out and willingly, knowingly
30 spending more than 5 percent more on their products rather than switching to a cheaper
31 product. It indicates a sort of perversity of behaviour and irrationality on the part of
32 consumers which, at the very least requires explanation - and no explanation is forthcoming.
33 Of course, the Commission also argues in response to para. 104(b) of the notice of
34 application, in familiar terms, that all this is within its margin of appreciation in rejecting

1 the evidence of high termination rates. Well, the Commission rejected this evidence
2 without obtaining any evidence in relation to the reasons for these high termination rates,
3 and therefore had no way of knowing whether it was relevant or not.

4 In response to the notice of application at para. 104(c) - that it is not necessary for the
5 Commission to propose acceptable levels of non-price competition in order to conclude that
6 there was little competition - we say logically that it is necessary to consider what scope for
7 non-price competition exists before it is possible to determine whether a non-price
8 competition could take place below the level to be expected in a competitive market, or not.
9 So, their failure to take into account those factors, we say, vitiates their decision in relation
10 to the relevant market. So, there was no proper evidential basis for the Commission to
11 conclude that the relevant market was limited to each individual credit customer.

12 Just drawing finally to a close, the Commission's analysis took no account of changes in the
13 market. I have already addressed you on the obvious changes that have taken place and the
14 fact that the modelling took place up to the end of 2006 - that is to say, over two years old
15 by the time of the report. I have already pointed out that they had access to data much more
16 recently than that and chose to ignore it. I have already shown you the significant reduction
17 in the overall size of the ... premium. That is the accepted measure of market shares. I have
18 also shown you the reduction in penetration rates for each of the products showing a
19 consistent pattern. I guess this trend suggests that penetration rates could reasonably be
20 expected to continue to fall in the future.

21 The Commission also received extensive information from the parties showing that the level
22 of claims had risen substantially during 2007 and 2008. One sees this reported at 10.14 of
23 the report. One sees there that ABI provided evidence that their unemployment claims rose
24 by 69 percent between September 2007 and September 2008 - a pretty significant increase.
25 The Commission also received evidence from Aviva showing that in the early 1990's
26 recession - which was the comparator one might make - the average annual cost to a scheme
27 for unemployment increased by somewhere between 300 and 500 percent over the three
28 years 1989 to 1992.

29 Very significant changes which were quite simply ignored by the Commission. As you see,
30 we are using this not only for the purposes of Ground 3, but also to indicate the market was
31 much broader and much wider, and should have taken into account the range of substitutes
32 available, not least the free substitute of self-insurance. It would be miraculous, on one
33 level, if findings which might have been appropriate for 2006 could stand scrutiny in a
34 world which has rapidly changed so dramatically when the Commission had evidence that it

1 had so changed and could, by inference from previous recessions, have indicated the
2 general development. There is no argument about the fall in the overall market, no argument
3 about the fall in penetration. There is no contested argument about the increase in the costs
4 and claims record. Yet, surprisingly, the Commission, though it had the ability to do so, to
5 take them into account, proceeded on the basis that business was as usual.

6 So, their analysis of the market was essentially as if nothing had changed. As I pointed out
7 before the break, nothing would change up to the coming into force of these remedies in
8 2010 onwards.

9 The only reason given by the Commission for failing to take account of these substantial
10 market changes, which you will find at para.10.17 of the report, which is so brief that I will
11 quote it, is that it was:

12 “... not persuaded that the current economic downturn would clearly result in a
13 sufficiently different outcome from our analyses of claims profiles for single
14 premium policies and waterbed effects to warrant a change in our approach to
15 remedies.”

16 A magisterial and conclusory statement based upon no analysis whatsoever and in defiance
17 of the evidence which it was confronted with and which it reported. They do not appear to
18 have carried out any analysis to consider the sensitivity of its conclusions to the kind of
19 market changes which I have described. It had no evidence on which it could properly
20 conclude that the changes consideration result in a sufficiently different outcome to alter its
21 approach to remedies.

22 THE CHAIRMAN: I thought we were here concerned with market definition. 10.17 is about, in
23 a sense, not a wholly unrelated point, nothing is unrelated ----

24 MR. SHARPE: That is the point, they are very related. When circumstances in the market
25 change people look for substitutes, and it is appropriate then that a market which was
26 defined in one term in a particular market situation can only be defined in the context of a
27 market situation. If that situation has changed so dramatically it at least requires a further
28 enquiry to see whether the assumptions which decided the market in 2006 can stand now
29 and onward to 2010. Essentially, if the market has collapsed and shows signs of collapsing
30 further and if profitability is collapsing, is it appropriate to think of a market definition
31 under different circumstances? I do not know the answer to that, but I do know that this
32 was a factor that the Commission should properly and reasonably have addressed to see
33 whether or not there was a range of substitutes.

1 PROFESSOR STONEMAN: If I could just pick up that last point that has been made, you took
2 us a little while ago to table 2.5 in the report, p.34, which looked at PPI penetration rates by
3 volume. It goes through to 2008 with the penetration rates declining over time. I assume
4 this has taken us into the area of turmoil by 2008 so that when we get into para.2.25 the last
5 couple of lines says basically that the decline in penetration rates for reasons put to us, with
6 some slight change in how it is sold, but has “regulatory scrutiny; and negative publicity”
7 as the main driving forces – in other words, mis-selling as the main reason for the decline in
8 the market. It would seem to me that if that is the contrary viewpoint then the points you
9 are making are almost irrelevant.

10 MR. SHARPE: I understand the point, but respectfully I think the assumption is wrong. I do not
11 think the Commission or anyone is ascribing in a causal way mis-selling and saying that is
12 the reason why these sales have fallen so much. It is undoubtedly a factor that ----

13 PROFESSOR STONEMAN: That is what that sentence says.

14 MR. SHARPE: It says it is one of a number of factors, and moreover it was not found by the
15 Commission, it was reasons put to them. Here and elsewhere in the report there are a good
16 many explanations for the reduction and it is true that mis-selling and the reputation of the
17 industry is one factor, but no one, not even the Commission, has said that that is the reason
18 why penetration rates have fallen.

19 PROFESSOR STONEMAN: I am not going to argue with you.

20 MR. SHARPE: We acknowledge that it is one of a number, quite a large number, of
21 considerations which have been advanced to explain the reduction in demand, but it is not,
22 and does not claim to be, the major factor. One of the changes which the Commission were
23 invested to consider was the effect of regulatory change and whether that vitiated the need
24 for further remedies and the Commission, as you know, said it did not.

25 We have got to be careful. We talk about “advised” sales, that does not mean mis-selling or
26 non-advised sales.

27 In para.227 of the defence the Commission argues that it did take account of each of the
28 relevant pieces of information. The issue is not whether the Commission was aware of
29 these matters, the issue is whether the Commission considered whether it should, and
30 properly concluded that it could rely upon data which preceded these substantial changes.
31 If the world has changed several things happen. One, is the definition of “relevant market”
32 appropriate; and secondly, the broader question, whether or not any remedies are
33 appropriate as well. Given the extent of the changes the Commission could not properly do
34 so since it relied upon data which was two or three years old.

1 The point I anticipated a moment ago that there was no account of regulatory changes, I will
2 refer, if I may, to our paras.117 to 126 of our notice of application. The main change was
3 the FSA's introduction in January 2008, so nearly a year or so before the report came out, it
4 came into effect in, I think, early July 2008, of an updated ICOBS, Insurance Conduct of
5 Business Sourcebook, and this introduced a number of important changes which we
6 explained to you in our notice of application. The cooling off period extended, improved
7 disclosure information, and the very clear statement that when selling PPI that it was not
8 conditional, loans were not conditional on the sale – in other words, people had the ability.
9 That was already in force by the time the report was published and there was some modest
10 experience as to how it was working. That is the background in which these remedies will
11 take effect.

12 The other key change of course was the decision by some of the major lenders, whose
13 names I am not allowed to read out, to stop offering single premium PPI policies.

14 The third change was the PPI FSA website, designed to encourage and inform consumers,
15 to make them aware of their rights, and so forth.

16 All those were aimed at addressing features of the market which the Commission had
17 identified as problems. The Commission approached these changes as follows. In relation
18 to ICOBS, one sees at paras.10.12 and 13 of the report, they could not wait to see what the
19 results were. All right, July 2008 to January 2009, so a relatively brief period, but they
20 chose not to make the effort. The FSA had told it that it was "fairly convinced" that the
21 kind of information changes and disclosure requirements were unlikely significantly to
22 affect the structural problems seen in the market and that is why we have the pleasure of
23 Mr. Hoskins and Miss Demetriou no doubt to argue that point. We did not believe that the
24 measures that the measures introduced by the FSA would be nearly sufficient in themselves
25 to remedy the AEC identified.

26 If you will allow me just a moment? (After a pause) Let me conclude by looking briefly at
27 the Commission's defences to these points. At para. 230 of the defence the Commission
28 argues once again that it did take account of each of the relevant pieces of information, but
29 on analysis once again the paragraphs referred to by the Commission only confirm
30 Barclays' case. It is correct the Commission referred to each of these regulatory changes
31 and gave its reasons for concluding that they could be ignored. The Commission had
32 gathered no evidence in relation to these issues, and therefore plainly were not in a position
33 to come to any view that the changes were irrelevant.

1 In relation to the FSA's statement of intervention, this relates solely to this issue, it does not
2 err on the side of economy but I am perhaps the least qualified person to make that remark.

3 In the FSA's view, its interventions in the market would not be sufficient entirely to remove
4 the problems the Commission have identified.

5 In our submission the FSA's views are irrelevant. This is an application of the
6 Commission's report and, furthermore, the FSA's views suffer from the same problems as
7 the Commission's report, they are based upon assumptions about the effectiveness of these
8 interventions rather than upon any evidence, and certainly not on any evidence that was
9 before the Commission and which would have allowed the Commission properly to
10 conclude that the market had not been affected by these interventions.

11 In short, while it is always helpful to hear from the FSA, we are here to challenge the
12 Commission's report and, as you have seen, there are fissures – I put it no higher than that –
13 between the views of the FSA and the Commission itself.

14 Now, it will come as some relief to know that that concludes my submissions in relation to
15 our Grounds 1 to 4. We are inviting you to quash the report insofar as it relates to the
16 prohibition and the Commission's findings on market definition, and the nature and extent
17 of competition in the supply of PPI.

18 We are also inviting you to remit the matter back to the Commission with a direction to
19 reconsider and produce a new report in relation to these remedies, and give them an
20 opportunity to do it again and do it properly.

21 Over the course of my submissions a number of points were raised, a number of inquiries
22 were made. We will endeavour overnight, or a convenient moment, to seek answers and I
23 would ask at a suitable moment, if the need should arise, if I may rise again to offer those
24 answers?

25 THE CHAIRMAN: Maybe. Time may be saved if you could do it with a short note ----

26 MR. SHARPE: With pleasure.

27 THE CHAIRMAN: -- identifying the question and supplying the answer with references.

28 MR. SHARPE: No, with pleasure, that seems a very apt way of proceeding, if I may say so.

29 Those are my submissions.

30 THE CHAIRMAN: Thank you.

31 MISS DAVIES: Sir, as the Tribunal has seen Lloyds' Banking Group, which now comprises the
32 former Lloyds and HBOS, the parties making submissions to the Competition Commission
33 during the course of its investigation supports the challenge made by Barclays to the
34 Commission's assessment of the welfare effects of its proposed intervention, specifically

1 the point of sale prohibition, and therefore similarly invites this Tribunal to quash the report
2 insofar as it recommends the introduction of that prohibition and to remit the matter to the
3 Commission.

4 As you will have also seen, we make not submissions at all in relation to the separate
5 question of relevant market, and for the purposes of these proceedings can be taken as
6 neutral on that point.

7 Having heard my learned friend, Mr. Sharpe, the Tribunal is of course now well aware as
8 regards the welfare assessment Barclays challenges fall under three separate Grounds, 1 to
9 3. In our statement of intervention and skeleton we have focused on additional points
10 directly supporting, in our submission, Grounds 2 and 3, and these can broadly be described
11 as challenges to the Commission's assessment of the negative effects of intervention and its
12 modelling exercise, and I propose to do the same, of course, in my oral submissions.

13 I should say at the outset that as has been noted now, on more than one occasion, there is a
14 considerable overlap between those points and the points made by my learned friend, Mr.
15 Sharpe, in relation to Ground 1, and in particular because the Commission, in response to
16 the challenge made by my learned friend under Ground 1 claim that it decided its remedies
17 would be fully and immediately effective, such as it was appropriate to regard the scale of
18 detriment it found by using its models as representing the extent of the benefit, the
19 Commission in doing that is clearly relying on exactly the same assumptions as underlying
20 its conclusions in relation to the adverse effects of the reduction of convenience – the point
21 that is addressed by Ground 2.

22 Put another way, the very significantly reduced prices that the Commission assumes will be
23 achieved drive both the positive effect that the Commission relied on to discount the impact
24 on PPI demand for loss of convenience (para. 10.50 of the report) and was key to the view
25 that the static consumer benefits of intervention would be in excess of £200 million.

26 So insofar as we are, in our statement of intervention and skeleton, making points about the
27 assumptions that led to that conclusion they equally support Ground 1, but we are simply
28 doing them in the context of Ground 2.

29 Turning now specifically to what I was proposing to cover in my oral submissions. I was
30 broadly proposing to address three topics, which can be summarised as follows: the impact
31 for the Commission's analysis of its conclusion that the reduction in convenience brought
32 about by the point of sale prohibition would lead to a reduction in demand of PPI, albeit one
33 that the Commission thought could be partially or fully offset by increased sales brought
34 about by the reduced price of PPI that expected. On that we fully support the submissions

1 made by Mr. Sharpe, the latter view did not justify the Commission simply ignoring the
2 former with the consequence that the Commission quite simply failed to take into account a
3 relevant consideration. But there are some additional points, entirely supporting all the
4 points that Mr. Sharpe made, that we wish to make in relation to that; that is the first broad
5 area of submission.

6 The second broad area of submission is the unsupported and insufficiently reasoned
7 assumptions that led the Commission to conclude, if it did, that there would be sufficient
8 increases in demand due to lower prices to offset any reductions in demand resulting from
9 the loss of convenience. I say “if it did”, because of course the Tribunal is now very well
10 familiar with the language of para. 10.50 and the partial or full offset that we find in that
11 paragraph. But as that is now being treated by the Commission in its defence and in its
12 skeleton as meaning effectively offset. One has to look at the assumptions that support that
13 with some care and we again support Mr. Sharpe and say that is manifestly insufficiently
14 reasoned and some of the points that are made in our skeleton in relation to that have been
15 touched on by Mr. Sharpe but there are some additional points we wish to make.

16 The final area is other defects in the modelling.

17 Just to explain where I am going, 1 and 2, those broad topics, reverse the order that we
18 adopted in our skeleton, but given the approach in para. 10 of the report, I hope it is
19 convenient to do it in that order, rather than to take the order that we did take in our
20 skeleton.

21 At each stage, Sir, I am, of course, and my clients are very well aware of the need to avoid
22 duplicating what Mr. Sharpe has said and I will do everything possible to do so, but to some
23 extent, because there is an overlap obviously between all these points, at least to explain the
24 relevance of the points I am making or what is additional about it I do have to go back a
25 little over what Mr. Sharpe has said, but I will do everything I can to avoid it.

26 THE CHAIRMAN: I do not have my finger on a buzzer!

27 MISS DAVIES: “No repetition, hesitation or deviation”, I am reminded by Miss Bacon.

28 Loss of convenience – the first broad topic. As I have said, we fully support the points
29 made by Mr. Sharpe about the Commission’s failure to assess and thereby take into account
30 the consequences of a reduction in demand produced by the acknowledged reduction in
31 convenience produced by the point of sale prohibition. On this, of course, the starting point
32 must be to look at what the report actually says about the issue of lost convenience. And the
33 key conclusion, as the Tribunal is well aware, is para. 10.50 of the report.

1 That paragraph, which is at p.194 of the report – I am afraid, Sir, I have the same problem
2 as Mr. Sharpe, in that I do not have the numbering in this bundle. But, para. 10.50
3 essentially encapsulates three key conclusions. The first - and this is not at all surprising,
4 and one with which no-one in this room would disagree - is that the point of sale prohibition
5 will result in a reduction in convenience. That is the first sentence. The second is that a
6 reduction in convenience would mean, all other things being equal, some consumers being
7 deterred from purchasing PPI. To that extent there would be a decline in sales of PPI. That
8 decline had to be offset. You do not get to a process of offsetting if you have not got a
9 process of decline in the first place. The Commission, we accept, did not stop there. It also
10 considered that there would be that process of offsetting. It expected, as it says, that there
11 would be an increase in PPI sales that would partially or fully offset the decline for a
12 reduction in convenience.

13 For the purposes of the first section of my submissions, the second conclusion - that there
14 would be a reduction brought about by the reduction in convenience, reduction in PPI sales
15 - is the key conclusion. The first point we would ask the Tribunal to note in relation to that
16 conclusion is that it in itself is not a surprising conclusion. It was a conclusion that was
17 supported by the submissions made by the overwhelming majority, if not all, of the parties
18 to the Commission, including one of the original super-complainants - the Citizens Advice
19 Bureau. We quoted the relevant submission of the Citizens Advice Bureau in para. 37 of
20 our skeleton (p.77 of Bundle 3, Tab 2). What one can see is that the Citizens Advice
21 Bureau, the consumer protection body, is expressing the concern that,

22 “The proposal to prohibit distributors selling PPI at point of sale will result in
23 fewer consumers taking out credit protection while doing little [they go on] to
24 improve the cost and quality of PPI products offered to consumers”.

25 It is not a difficult conclusion to see why it is being drawn. “Intransigent means that
26 obtaining something is made more difficult at least for some the appetite for obtaining it
27 will reduce”.

28 That was the point of the behavioural study referred to by the Commission at para. 10.49 of
29 the report which related to hurdles put in the place of consumers claiming a free gift.

30 “Even if something is free it is pure up-side. If you make it more difficult for
31 someone to obtain it, the chances of them actually going and doing it are reduced”.

32 That was also the point demonstrated by the HBOS study to which the Commission refers I
33 para. 10.48(b). Mr. Sharpe has taken you to that evidence earlier today. But, the point was
34 that the simple fact of passing a consumer a telephone after the credit sale to speak to a

1 different operative led to a 50 percent fall of take-up rates. Yet, as Mr. Sharpe has pointed
2 out, the Commission did not, in these paragraphs, or elsewhere in the report, seek to
3 quantify the extent of the decline brought about by the reduction in convenience. All that we
4 can infer from the first sentence of para. 10.50 is that the Commission thought it was of a
5 lower magnitude than some parties had submitted. But, with respect to the Commission,
6 that does not really say very much because some parties had suggested there would be a
7 very dramatic reduction in demand indeed. We set out in para. 35 of our skeleton the
8 substance of some of the relevant evidence on this issue. Sir, this is not going behind the
9 report because the extracts that we refer to in this paragraph include suppliers who are
10 referred to in Footnote 25, on p.193 of the report, as parties having made to the Commission
11 the point that a high proportion of consumers would not bother to purchase PPI following
12 the credit sale as it would be significantly less convenient for them to do so. The
13 Commission, in Footnote 25, refers to the fact of the submissions, but does not actually set
14 out the substance of what was being said. In para. 35 we have picked upon that and referred
15 to the substance of what was being said.

16 At para. 35(b), p.76 of our skeleton, as the Tribunal can see, RBS (which is one of the ones
17 being referred to in Footnote 25) submitted that it expected a significant proportion of
18 consumers were very likely never to buy PPI if not given the convenience of buying there
19 and then.

20 Nationwide, the next one down - the vast majority. BBA at (f) - major reduction in
21 penetration levels. De facto, who is independent of ties to any provider - there will be a
22 dramatic plunge. My clients: we have also referred to the evidence and talked about the
23 industry going over the cliff edge. So, to say simply, as the Commission does in para.
24 10.50, that the potential reduction in PPI sales has been over-estimated by some parties
25 really does not give any handle at all on the magnitude of the effect that the Commission
26 was expecting.

27 It is, with respect again to the Commission, quite, in our submission, simply impossible to
28 read the report in the way now being suggested by the Commission in its skeleton at para.
29 80. Tab 4 of this bundle. Three lines up from the bottom we have an assertion that, "The
30 Commission did not consider that there would be a material contract in demand". That is
31 not a point that is made anywhere in the report.

32 Before turning to the way that the Commission addressed this - which is the third of their
33 conclusions, that there will be this process of offset-ing - it is in our submission important to
34 understand why a decline in PPI sales could matter. On this the starting point is to be clear

1 as to what a reduction in PPI sales due to loss of convenience means in this context. In
2 short, our understanding - and we believe this is what the Commission intended - is that it
3 means all other things being equal (I will come back to that in a moment) that at any given
4 price point consumers are to be regarded as less willing to purchase PPI than they would
5 have been if the reduction in convenience had not existed. To put into layman's terms, if
6 you make something harder to purchase and all else is equal, it has to be priced more
7 attractively if it is to be expected that the same number of people will continue to purchase
8 it. In economic terms that means, all else being equal again, that the demand curve has
9 shifted inwards.

10 In making these submissions we are coming to the point where Professor Stoneman
11 interrupted my learned friend Mr. Sharpe earlier and talked about the shifting of the demand
12 curve. I am going to address that if I may. But, the starting point of the analysis is simply
13 isolating the effect of the reduction in demand brought about by the loss of convenience and
14 then considering what other factors - and there are other factors, we accept that - that might
15 come into play.

16 Shifting the demand curve. Now, on that we have taken the liberty of, I hope, producing
17 some visual aids to help me try and explain this and to help demonstrate the point that we
18 wish to make. (Same handed) They build on the figures that are in Professor Yarrow's
19 report - the figures in the context of graphs as opposed to figures in the sense of numbers.
20 Sir, what we have here are two diagrams - Diagram A and Diagram B. If I can simply,
21 firstly, deal with Diagram A, this is intended to illustrate the effect of shifting in the demand
22 curve. I should say that these have been produced for me by Mr. Colley. What he has done
23 is to assume that because of the reduction of convenience - and it is purely an assumption -
24 the demand is reduced by 50 percent. So, one can see that, looking at Diagram A, by
25 looking at the dotted lines. At an initial price of 10 there was an original level of PPI sales
26 of 100, coming down to the bottom for the horizontal axis, but if you assume that the
27 reduction in convenience produces a 50 per cent reduction in demand your total levels of
28 sale will be reduced to 50. The numbers do not matter. It is simply illustrating the point.
29 This pivotal effect of the shift in demand curve should not be in dispute because exactly the
30 same picture that the Commission itself drew in appendix 10.9, when looking at the effects
31 of a shift in demand curve in figure 2, they got exactly this same picture. That is what
32 happens if you shift the demand curve, at the same price you get a significantly lower
33 demand.

1 That is of course not the end of the story because if the price reduces you can produce the
2 same volume of sales, albeit at the lower price, and that is illustrated on diagram B. If you
3 go down to diagram B, looking again at the horizontal and vertical dashed lines and looking
4 at the 100 price – the hundreds are hundred volume – if you go up from 100 volume you get
5 the same number of sales but a new price. Again, the numbers do not matter.

6 Conveniently, Mr. Colley has assumed the 60 per cent reduction, but it does not matter. So
7 you get the same volume of sales but at the lower price. That is the left hand straight line.
8 What this diagram then goes on to do is to attempt to encapsulate, and again this is just
9 looking at reduction in convenient, what happens if you do not shift the demand curve?
10 What does it do to your analysis? This is actually the area in pink. If you do not shift the
11 demand curve but you have a price reduction, the same price reduction, in fact the volume
12 of sales doubles. It increases to 200, because by not shifting the demand curve you have not
13 taken any factor into account of the consumer's unwillingness brought about by the
14 reduction in convenience to purchase the product at a particular price.

15 PROFESSOR STONEMAN: Could I just say something with respect to what I was trying to say
16 this morning. The shift in the demand curve in the top picture, I have no argument if that is
17 purely due to convenience, but there is another way of looking at convenience and that is to
18 say it is convenient to make an impulse buy. We have all bought impulse buys and when
19 we have got home we have looked at it and thought, "That is a rather silly thing to do". I
20 am not sure what the difference is between an impulse buy and an increase in
21 inconvenience, but if this shift in demand curve in the top picture is a matter of, "I shouldn't
22 have done that, should I", then I think the story is rather different.

23 MISS DAVIES: Professor Stoneman, we accept that and I am going to come to deal with that,
24 absolutely, because that is a point that is made by the Commission to say that you can
25 ignore the fact that there are potential consumers of PPI out there who do not buy PPI
26 because of a reduction in convenience, because in fact those are consumers who may not
27 have benefited, the product had no real value to them in any event. I am going to come to
28 deal with that.

29 THE CHAIRMAN: May I just ask a question: what is your unit of volume that runs along the
30 bottom of your two graphs? It is presumably nothing to do with price and it is presumably
31 nothing to do with number of transactions, because you may get large or small transactions.
32 How does one approach the question of volume in a way that is not corrupted by doing it on
33 the basis of price?

34 MISS DAVIES: Sir, it is simply PPI policies.

1 THE CHAIRMAN: Just the number of policies?

2 MISS DAVIES: The number of policies.

3 THE CHAIRMAN: What, on an assumption that they are for a broadly equivalent amount
4 insured before and after?

5 MISS DAVIES: Yes, effectively, that is my understanding. I will come to it in a moment, but in
6 table 1 ----

7 THE CHAIRMAN: That is where I am going.

8 MISS DAVIES: None of these graphs are perfect, no one is trying to suggest any of them are,
9 and one has to make various simplifying assumptions to represent things graphically, but it
10 is in here simply units.

11 We accept that is not the end of the story and as Professor Stoneman pointed out this
12 morning the actual picture that one is required to address is much more complex because in
13 addition to the reduction in convenience and the drop of price there is a whole informational
14 aspect associated with the package of remedies proposed by the Commission. There are, in
15 our submission, three possibilities in theory that those other factors might produce. One
16 possibility is that the information available, the additional information available, to PPI
17 consumers prompts people to buy PPI – for example, the advertising, I had in mind – who
18 would not have bought it previously before the package of remedies came in. That would,
19 if that happened, itself result in increases in demand at any given price. We accept that. So,
20 in fact, because of the informational advantages of the remedy, the area in pink on this
21 graph would, in part or possibly entirely, be achieved by the informational aspect. We
22 accept that as a matter of logic, but that is not what, in our submission, is being said by the
23 Commission in para.10.50 of the report. In para.10.50 of the report what they are talking
24 about in terms of their partial or full offset is in terms of volumes of sales and bringing the
25 sales back to the hundred, as we understand it, talking about levels of PPI sales. “Levels of
26 PPI sales”, you will see when you go into appendix 10.9, “levels of PPI sales” is a phrase
27 that is used in the context of volume. So their offset, the offset they have in mind, is to
28 bring back to 100 which necessarily will be at a lower price. They are not talking about
29 increases above that. If they were it would not be an answer in any event, in our
30 submission, because of the word “partial” that appears in para.10.50. I will come to the
31 importance of the word “partial” in para.10.50, but essentially it means that even if
32 somehow – and, in our submission, it is not possible to read 10.50 in this way – 10.50 is
33 actually talking about an increased inclination in demand, the Commission are expressly
34 recognising that it may only be partial, it may not come all the way back up to the original

1 demand curve, it may be somewhere in between. That is one possibility, an increase in
2 demand, an upward shift to the demand curve because of informational aspects.
3 There is another possibility. This partly brings me on to the point that Professor Stoneman
4 just put to me, which is in fact the additional information available prompts a reduction in
5 demand at any given price because it allows people more accurately to value the product,
6 and to decide not to buy it when it is actually of no value or benefit to them. That would
7 actually shift the demand curve the other way. Again, there is no suggestion in the report
8 that that is what the Commission thought would be happening. It is actually inconsistent
9 with the partial or full offset, but it does not give them the benefit in the pink area which we
10 submit they have taken into account by not looking at the effects on the demand curve of
11 the reduction in convenience.

12 There is a third possibility that we can probably dismiss quite likely, which is there is no
13 change in the demand curve at all. That would actually mean that the informational
14 remedies have no impact whatsoever, and that is certainly not what the Commission
15 thought, so it may be that that can be dismissed, but in theory it is there.

16 The point about all of that, however, is that the Commission did not look at any of it. They
17 did not say, "We recognise that reduction in demand will mean the demand curve shifts
18 inwards but all other things being equal, actually there are other factors which will bring it
19 out". They did not do that. They looked at it in terms of PPI sales levels and necessarily
20 the PPI sales levels that they were looking at were sales that were at lower prices – it is the
21 bottom dashed line on the graph which immediately brings with it questions for the welfare
22 analysis, but of course if you have the same volume of PPI product being sold at a lower
23 price you have an impact by reason of the waterbed effect found by the Commission on
24 credit prices, credit prices were all increased and therefore a negative welfare effect on
25 credit consumers which needs to be factored into the analysis.

26 I said a moment ago that "partial" was an important word in para. 10.50 in this context ----

27 THE CHAIRMAN: You should be looking for a moment of escape, Miss Davies, if you are just
28 starting a new subject, and it sounds as if you are ----

29 MISS DAVIES: I am.

30 THE CHAIRMAN: Let us start again at 10.30 tomorrow. What is your time estimate?

31 MISS DAVIES: I will finish at some point during the morning.

32 THE CHAIRMAN: Assuming no great change in the level of intervention from the Tribunal.

33 MISS DAVIES: I will finish before lunch time, but quite when I perhaps will reflect on
34 overnight.

1 THE CHAIRMAN: Thank you. Any homework you want us to do?

2 MISS DAVIES: No.

3 (Adjourned until 10.30 a.m. on Wednesday, 9th September 2009)

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