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IN THE COMPETITION
APPEAL TRIBUNAL

Case No. 1109/6/8/09

Victoria House,
Bloomsbury Place,
London WC1A 2EB

9th September 2009

Before:

THE HONOURABLE MR. JUSTICE BRIGGS
(Chairman)

PROFESSOR PAUL STONEMAN
DR. VINDELYN SMITH-HILLMAN

Sitting as a Tribunal in England and Wales

BETWEEN:

BARCLAYS BANK PLC

Applicant

- v -

THE COMPETITION COMMISSION

Respondent

- and -

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

Interveners

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HEARING
DAY THREE

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: Before the case proceeds one piece of unfinished business from yesterday, I
3 suggested that we were going to come back on some of the points raised during our
4 exchanges ----

5 THE CHAIRMAN: Yes, and we invited you to do so, if you could, in writing.

6 MR. SHARPE: We have done and you should have before you a very short note, which we have
7 circulated to all and sundry. I should announce that if anyone feels they need a copy we
8 have two or three spare copies.

9 THE CHAIRMAN: Thank you. I am just looking at the headings at the moment. Thank you.
10 We will read that in our time, if that is all right, Mr. Sharpe, and if we have got any
11 questions on it we can raise them at the reply stage.

12 MISS DAVIES: Sir, when I finished yesterday I said I was coming to the word “partial” in
13 para.10.50 of the report. I am sure the language of the sentence I am referring to is very
14 familiar to the Tribunal, but it might be useful just to have it open if it has been put away
15 overnight.

16 THE CHAIRMAN: This is 10.50.

17 MISS DAVIES: Yes, Sir, p.194 of the report. It is the word “partial” in the second sentence:
18 “By increasing competition and thereby reducing price, we expect our remedies
19 package to lead to an increase in PPI sales that would partially or fully offset a
20 decline from a reduction in convenience.”

21 The first point about this that we ask the Tribunal to note is that the potential of a partial
22 offset in that sentence is presented as an outcome of equal potential to that of a full offset.
23 There is no suggestion that the latter – that is a full offset – is more likely than the former.
24 Indeed, in so far as one discern anything at all from the language, one might infer from the
25 fact that the potential for a partial offset is presented before the full offset, the writer of the
26 report thought the former was more likely than the latter, but it does not matter ----

27 THE CHAIRMAN: Construing it like a trust rather than a will.

28 MISS DAVIES: Of course one cannot construe this as a statute, I accept that entirely, but if the
29 view that was being expressed was, “We expect a full offset but there is a possibility” ----

30 THE CHAIRMAN: No, I understand that point.

31 MISS DAVIES: It does not matter in any event, because the key point is that, on any view, each
32 of the potential outcomes was considered by the Commission.
33 As a matter of language, and again I understand the point about statutes and not construing
34 it as such, but simply as a matter of language, the word “partial” is obviously a somewhat

1 vague one. Logically, it could mean anywhere on a scale of 1 to 99, somewhere in between,
2 something less than 100. Nowhere in the report does the Commission explain or seek to
3 quantify the extent of the partial offset it had in mind.

4 So we are left with a position that in this paragraph, and indeed throughout the rest of the
5 report, what the Commission is saying is that there will be some sort of offset somewhere
6 between 1 and 100. Noticeably, it does not claim an increase in excess of 100. It is not
7 saying that PPI sales in the post-intervention world will exceed the level of PPI sales in the
8 pre-intervention world, though that would be the effect of ignoring the shift in the demand
9 curve that I was talking about yesterday, as illustrated by our diagram B, but that is not what
10 is claimed. What is claimed is the partial or full offset.

11 What the Commission has done in its defence is to attempt to put some limits on the scale
12 by construing the words “partially or fully offset” to mean “largely or completely
13 counteract”, that is para.119 of the defence, or “small or non-existent”, that is para.193 of
14 the defence, but in doing that it is effectively seeking to rewrite what para.10.50 actually
15 says, because 10.50 clearly does not carry any such connotation, and nor does the report say
16 that at any other point.

17 If the Commission was really reaching a judgment to the effect that the reduction in PPI
18 sales would be effectively offset, which is what they are trying to convey by the words
19 “largely or completely counteract” or “small or non-existent”, that is a judgment that
20 obviously ought to have been set out in the report and explained, but it is not. Nor is it any
21 answer, again with respect to the Commission, for the Commission to say, as it does now in
22 the relevant paragraphs of its defence, “Well, look at para.10.51 of the report which deals
23 with the design of the remedies”, because all that 10.51 does, and again one can see this
24 from the very first sentence of 10.51, is say that the Commission had designed the remedies
25 package to reduce the risks of a substantial fall in take up for the simple reason there is no
26 take up, but what it does not do is go further and say the effect of that design is to remove
27 the possibility of a reduction. Nowhere else in the report does the Commission claim that
28 either. So the suggestion in para.48 of the Commission’s skeleton that this issue – this issue
29 being the issue of “partial offset” – had been addressed through the design of the remedy is
30 once again a significant improvement on the conclusions actually found in the report.

31 What we are left with is, which is clear from the report, that the Commission was
32 contemplating as a realistic outcome a partial offset – i.e. a partial reduction in PPI sales.
33 The question of course is what are the potential consequences for the welfare analysis of
34 such a partial offset, which I am afraid does slightly bring me back to the question of

1 shifting demand curves, and our diagrams of yesterday, but I will try and take it as quickly
2 as possible. When we were looking at the two little aids we put forward yesterday, those
3 were designed to illustrate the consequences on volumes of PPI of shifting – the first one,
4 diagram A – the demand curve by reason of the inconvenience; and the second was
5 designed to illustrate the effect of not shifting the demand curve, but nonetheless assuming
6 considerably reduced prices. In that case the area in pink indicates an area of increased
7 volume of sales that you would not have got if the demand curve had been shifted.
8 Just before I come to the effect of “partial” on this, I will pick up one point that you, Sir,
9 raised yesterday, the question of the metric of the horizontal axis. As I explained yesterday,
10 in this graph it is intended to be numbers of parties, numbers of consumers actually
11 affected. Table 1 of the report does something slightly more complex, although the effect is
12 the same, and I just wanted to explain it so that there is no confusion about this. What the
13 Commission are doing in table 1, which is setting out the results of their model ----

14 THE CHAIRMAN: You mean table 1 at the end of appendix ----

15 MISS DAVIES: Appendix 10.11 – is looking at the value of insured advances in pounds. That is
16 of the £1 million assumed credit, they assume £340,000 will be protected by PPI, which is
17 slightly more complex obviously than simply just looking at numbers of policies, but the
18 effect is the same because it is also a measure of volume of PPI. It is not a measure of ----

19 THE CHAIRMAN: I was assuming something slightly more sophisticated than merely a number
20 of policies would be used, otherwise you would make all sorts of assumptions about how
21 much insurance is taken out in respect of a particular amount of credit.

22 MISS DAVIES: Indeed, but the point I am trying to make is that for the purposes of demand
23 curves, it does not matter ----

24 THE CHAIRMAN: As long as you are not using the cost of the policy.

25 MISS DAVIES: Exactly. The Commission never did that, because of course they were not
26 looking at it from the suppliers’ perspective, they were not looking at the PPI revenue.
27 They were always looking at it from the consumers’ perspective, and therefore they were
28 measuring it, in some cases in fact by numbers of policies, in some cases by value of
29 insured advance, but it is a measure of volume of PPI.

30 THE CHAIRMAN: If you measure it by value of insured advance that presumably has a built in
31 assumption that the insurance is a complete insurance for the liability to repay the advance
32 in the stated risk events – are you, or is it simply a constant across your model? It is
33 probably the latter.

34 MISS DAVIES: I believe it simply a constant.

1 THE CHAIRMAN: It will not ever be complete probably anyway.

2 MISS DAVIES: Probably not.

3 THE CHAIRMAN: There will be a delay before it – I do not know, I do not know enough about
4 the detail.

5 MISS DAVIES: I have to confess that I do not in that respect either, but the assumption is
6 constant.

7 I should also have said yesterday that we do not understand there to be any debate about the
8 principle of shifting demand curves inwards to reflect the suggestion that a consumer is less
9 willing to buy a product at a particular point. As I tried to say yesterday, that is exactly
10 what the Commission did itself in its models in relation to a different factor, impacts on a
11 consumer's willingness to buy, i.e. there is reduced demand in credit, so they are not
12 moving through to the PPI point of sale. So there is not an issue in principle about this, as
13 we understand it.

14 THE CHAIRMAN: Is there a slight difference between the demand curves in your visual aid and
15 the ones I think that Barclays rely upon in their expert evidence, in that yours get to zero
16 sales at the same price for both demand curves, whereas I think the ones relied upon by
17 Barclays, the two curves are parallel to each other, such that you get to zero sales at a lower
18 point in the price scale? Does it matter? It may not matter.

19 MISS DAVIES: It does not matter. There is, in fact, no difference in principle. What Professor
20 Yarrow was not doing, which this diagram does, was putting values on the horizontal and
21 the vertical axes and actually looking at it by reference ----

22 THE CHAIRMAN: No, there is not a value on your vertical axis. It is just that they both meet at
23 the same point.

24 MISS DAVIES: Yes, but he also was not doing what this does, which is assuming a particular
25 reduction in demand. He was simply trying to illustrate a point. In fact, when you actually
26 put numerical values on it and assume the 50 per cent reduction in demand that this is
27 assuming, you end up with a graph that looks like **this** mathematically; both assume the
28 same elasticity of demand, there is not a difference.

29 THE CHAIRMAN: They both work for illustrating the point you are trying to make, as I
30 understand it.

31 MISS DAVIES: Exactly.

32 PROFESSOR STONEMAN: The elasticity of demand, these have different elasticities of
33 demands – this looks like constant elasticity whereas the Yarrow ones you have a changing
34 elasticity as you move down the curve.

1 MISS DAVIES: Certainly these are constant elasticity, if that is the explanation why the Yarrow
2 ones are at different angles.

3 PROFESSOR STONEMAN: (No microphone) The Yarrow ones being parallel do not have a
4 constant elasticity but any demand curve has a changing elasticity as you move down the
5 curve.

6 MISS DAVIES: I am grateful for that explanation, but it does not affect ----

7 PROFESSOR STONEMAN: I did not think it would.

8 MISS DAVIES: It does not affect the point that we are making, both can be used to illustrate this
9 point.

10 THE CHAIRMAN: Yes, I think my question was at a rather less sophisticated level.

11 MISS DAVIES: I was about to say this is a slightly more simplistic reason, the only assumption
12 that it is changing is the assumption as to the magnitude of the demand, and that is the issue
13 that is being addressed in para. 10.50 which is why we have looked at it in these graphs.

14 PROFESSOR STONEMAN: Yes.

15 MISS DAVIES: Turning specifically to the impact of the word "partial" in para. 10.50 I made the
16 point yesterday that the process that we understand para.10.50 of the report at best to be
17 reflecting is the process in fact reflected in blue on diagram B, namely to state that despite
18 decreased volumes of sales produced by the reduction in convenience, in fact, because of
19 the reduction in prices the same volume of sales would be achieved bringing back the sales
20 level to the 100 whether that is measured by the number of policies or value of insured
21 advances.

22 On that basis if you are only achieving a partial offset you are obviously not even getting
23 back to the 100 you are coming somewhere lower, and what you certainly are not doing is
24 giving yourself the ability to claim as a benefit the whole area in pink which is increased
25 volumes of PPI sales. In that scenario none of the factors we were discussing yesterday as
26 impacting on demand in the post-intervention world, that is factors that could in fact
27 increase the magnitude of demand, increased advertising, increased awareness of PPI are
28 providing an answer because even at the lower prices you are still getting lower volumes of
29 sales than you were before at a given price.

30 As I acknowledged yesterday there is a potential alternative in theory, although that is not
31 what we understand para.10.50 to be contemplating, but that is actually what the
32 Commission had in mind was that there would be upward shifts in the demand curve
33 because of those other factors bringing the demand curve back closer to the original. But,
34 even there if you are looking at a partial upward swing, as opposed to a full upward swing

1 you do not get back to the original line obviously, you get to somewhere between the two
2 diagonal lines on diagram B. Again, that obviously means that you cannot just assume in
3 your favour an increased volume of sales represented by the full amount of the pink area.
4 We submit whichever way you look at it and applying the natural meaning of the word
5 “partial”, para. 10.50 of the report is postulating as a potential outcome, and an equally
6 potential outcome, a scenario in which the Commission was not simply entitled to assume,
7 as it did, that the demand curve stays in the same position; it was not simply entitled to
8 assume in its favour the increased volume of sales represented by the pink area.

9 It also failed because of this failure to recognise this effect, to take into account the negative
10 effects of an inward shift of the demand curve which are explained by Professor Yarrow
11 and Mr. Colley in their reports, and they are twofold in principle. One, the unmet demand
12 point, which has been explained by my learned friend, Mr. Sharpe, potential consumers of
13 PPI who are put off by the reduction in convenience from buying PPI. There is a second
14 effect as well which is the impact of increased credit prices brought about by reduced
15 volumes of PPI so credit consumers will be paying a higher price. If you do not do any of
16 this process, you do not take any of that into account. I will come in a moment because
17 there are some answers being hinted at or being suggested by the Commission to that side of
18 the equation in their defence and, more particularly, in the supplement to the defence which
19 I ought to deal with.

20 But, before I do that, just before while I am on the modelling exercise and demand curves,
21 there is one other curious aspect of the Commission’s modelling work which is related to
22 this which Mr. Colley highlighted in his report and to which we have referred in our
23 statement of intervention, which is that despite the language of a partial or full offset, which
24 of course, does not suggest an overall improvement, each of the Commission’s models each
25 in fact predict very substantial increases in the penetration rates of PPI. We can see that if
26 we look at table 1 at the end of appendix 10.11 and it might be useful just to turn to that
27 now.

28 THE CHAIRMAN: Did you say “each of their models”?

29 MISS DAVIES: Each of them.

30 THE CHAIRMAN: Which models do you have in mind?

31 MISS DAVIES: I have in mind ----

32 THE CHAIRMAN: In a sense I suppose table 1 has two models.

33 MISS DAVIES: Table 1 has two models, it has the bound results which the Commission said are
34 the most extreme results for non-system remedies and system remedies. The proposition is

1 also true for the model that they have used to generate the £200 million figure. We can tell
2 that because we have finally got the assumptions that generated that model and we have
3 checked and it is also true. I do not have a table equivalent to table 1 for that model, though
4 if it would assist we can of course provide one.

5 THE CHAIRMAN: Right, if it is agreed.

6 MISS DAVIES: Looking at table 1, we could not do it until we got the supplemental defence ----

7 THE CHAIRMAN: No, I understand that.

8 MISS DAVIES: -- because we did not have the assumptions, but we have checked. Looking at
9 table 1 at appendix 10.11 and looking at the left hand column "system remedy", what we
10 see is that the first three lines are setting out existing prices for PPI credit and bundle, and
11 then counterfactual PPI credit and bundle, which are calculated by applying the assumption
12 of a 60 per cent price reduction made for this model. They then make assumptions as to the
13 volume of sales, which they do in this table by the value of protected advances, and
14 originally they have £340,000 protected advances, £660,000 unprotected, which is a
15 penetration rate of 34 per cent.

16 THE CHAIRMAN: The value here is the value to the seller, is it not?

17 MISS DAVIES: No, it is the value of credit. It is calculated by reference to the value of the loan.
18 You can see that from the last line of this section – "Initial total advances £1 million" that is
19 the value of the loans that are made.

20 THE CHAIRMAN: Yes.

21 MISS DAVIES: And so "Initial protected advances £340" is of a million pounds worth of loans,
22 a book of £1 million worth of loans, £340,000 of that has the benefit of PPI. It has nothing
23 to do with the PPI revenue. The PPI revenue is actually, you can see the price for PPI at the
24 top line 0.78, it is actually $0.78 \times 340,000$, you have to take some numbers off because they
25 have assumed, as one can see in the asterisk "prices in £'s per month for an indicative 100 x
26 12 month loan", so you have to take two noughts off it. That is probably a complication of
27 maths but this is not looking at PPI revenues, it is looking at it solely by reference to the
28 value of the loan product, and that is why it is a measure of volume rather than a measure of
29 value.

30 PROFESSOR STONEMAN: Did we manage to sort out whether that PPI price included the
31 underwriting cost or not?

32 MISS DAVIES: Sir, I have not taken any instructions on that overnight.

1 PROFESSOR STONEMAN: We left that in the air yesterday as to what the PPI price covered,
2 was it just a distribution margin or did it include the cost of the underwriting, which you
3 promised to get?

4 MR. SHARPE: In answer to that, I hoped I had answered it yesterday, it is the total; it includes
5 everything, yes.

6 PROFESSOR STONEMAN: Fine, so that the point was that when you talk about 60 per cent
7 reduction in price, given the cost of the underwriting it is assumed competitive anyway,
8 there is a much greater reduction in the margin?

9 MR. SHARPE: Exactly.

10 PROFESSOR STONEMAN: Thank you.

11 MISS DAVIES: I am grateful. If one looks to the counterfactual in terms of sales, in the system
12 remedy we have a counterfactual where the volume of sales has increased to £474,000 but
13 the volume of loans has decreased overall because instead of it being £1 million it is
14 £749,000 and also the volume of unprotected loans has decreased. That means in reality
15 that the penetration rate, the percentage of credit product that has the benefit of PPI, has
16 nearly doubled (68 would be the doubling). The same is true if one looks at the non-system
17 remedy results in the next column. There we have a percentage penetration rate of 65.4
18 compared to a previous penetration rate of 34.

19 THE CHAIRMAN: Non-system remedy would not include a POSP, would it?

20 MISS DAVIES: The non-system remedy ----

21 THE CHAIRMAN: A pure non-system remedy.

22 MISS DAVIES: Sir, as Mr. Sharpe explained yesterday, the Commission did not in fact analyse
23 where on the scale between a system and a non-system remedy POSP -- it assumed that the
24 only remedy it was consulting on was the price cap, which was a pure non-system remedy -
25 a price cap. But, a non-system remedy, as we pointed out in our skeleton -- A point of sale
26 prohibition, certainly in an initial period, could operate as a non-system remedy because at
27 the starting point you have very low consumer searching - that is the existing situation.
28 Consumers go along. They get told by their credit provider, "Well, we can't give you PPI
29 unless you come back in a week or 'phone us tomorrow". At that point the consumer is
30 given an awareness to search, but the searching that the consumer is doing then is searching
31 after the credit point of sale, which, for the purposes of this analysis and these appendices,
32 is non-system searching because what the ----

33 THE CHAIRMAN: I understand that submission. That is in your skeleton.

34 MISS DAVIES: It is not only a submission. It is actually the definition.

1 THE CHAIRMAN: I understand how you say it derives from the definition.

2 MISS DAVIES: Just to give the references, it is in appendix 10.9, paras. 4 and 5 searching after
3 the credit point of sale is treated by the Commission for these purposes as non-system
4 searching. That is the point. We are perplexed, we have to say, by what is said by the
5 Commission in the skeleton about this because the suggestion in its skeleton, somehow or
6 other, that searching after the credit point of sale is searching that has been taken account of
7 in the system remedy for these models just is completely inconsistent with the explanation
8 given by the Commission in paras. 4 and 5, appendix 10.9, of what they were doing.
9 Although my learned friends for the Commission say in their skeleton, "Oh, well, the
10 definition is almost the same", the point is that they are missing the absolutely critical part
11 of it, which is searching after the credit point of sale. It is not enough for their purposes,
12 certainly for these appendices, to say, "Oh, the point of sale prohibition might lead to more
13 searching for PPI". It has to be searching for PPI pre. the credit point of sale, bundle
14 searching to be a system remedy.

15 That said, and as I will come on to explain, what we now know - and it is not clear from the
16 report - is that for the purposes of calculating the £200 million, or the £440 million figure,
17 the Commission used its non-system remedy models. They suggest that is conservative. I
18 will come on to explain why we submit that is not conservative. But, they do say that. So,
19 in fact, that point, in effect means that in calculating the static consumer detriment, they
20 were assuming against themselves no bundle searching. They were simply assuming
21 searching post credit point of sale. That is a slight distraction.

22 I was on the point of penetration rates. One can see the doubling.

23 Now, the Commission correctly points out in its defence that these high penetration rates in
24 the post -intervention world are an output of the model - not an assumption made by the
25 Commission for the purposes of it. But, with respect, that does not affect the point I am
26 making as it still means that the net welfare benefit that the Commission says it can achieve
27 are predicted on significant increases in penetration rates. It is predicated on significant
28 increases in penetration rates.

29 Now, standing here, we cannot explain to you, I am afraid, Sir, how that fits with the quality
30 of assessment at para. 10.50. It is not explained anywhere by the Commission in the report,
31 or, for that matter, in its defence or skeleton, despite us having raised the point. It may well
32 be - and I can say no more than that because we do not have an explanation - it flows from
33 failing to take into account the shifting demand curve point that I have just been addressing
34 because one of the potential consequences of doing that - and failing to do the offset process

1 that para. 10.50 contemplates, is that you could assume increased volumes of PPI sales that
2 you are not actually going to get. But, we do not know.

3 In any event, the short point, in our submission, is that by failing to analyse in more detail
4 the impact on demand for PPI at this point of sale prohibition, and to factor into the
5 offsetting process that the Commission recognised was required to occur because of that,
6 the Commission has failed to take account of the relevant consideration. It could not just
7 assume, as it did, that because there would be some form of offsetting process, whether full
8 or partial, everything would be all right.

9 That, as I say, is a simple point. But, I do need to go on to address the downward side of the
10 equation - the extent of consumer detriment that is produced by a reduction in demand, to
11 which there are two sides.

12 PROFESSOR STONEMAN: Just before you go on from there -- I have been working on the
13 basis that for the penetration rate to go from 34 to 63.3 (in Table 1) was in fact a reflection
14 of the elasticity of demand of -1.54 on p.805.

15 MISS DAVIES: I think that is right.

16 PROFESSOR STONEMAN: So, we do know what it comes from.

17 MISS DAVIES: I am sorry. I was not trying to suggest that we do not know where it comes from
18 We do not know how it fits with the offsetting process - the full or partial offsetting process
19 that the Commission is referring to in para. 10.50. That was the only point I was trying to
20 make.

21 Actually, just before I leave Table 1, I should just make one thing clear while we are
22 looking at it. Table 1 is only dealing with personal loans because it was only for personal
23 loans that the Commission felt it was necessary to go on and look at non-system remedies in
24 detail. Table 1 does not, at the end of it, give you a total net consumer benefit or detriment.
25 What it does is it gives you a percentage figure. Right at the bottom - relative size of
26 consumer surplus gain/loss. One can see under the system remedy 32.3 percent and under
27 the non-system remedy -41.5 percent. The direction is indicated by the plus or minus. The
28 system remedy is indicating a big consumer gain. The non-system remedy is indicating a
29 big consumer loss. To put real figures on it you multiply those percentages by the excess
30 PPI profits that the Commission was contemplating. You end up with just a real terms
31 figure. Just while we are looking at it, and to explain it, the system remedy - £209 million
32 benefit; non-system remedy - £268 million loss. The reason I explain that is because I am
33 going to come in a moment to some of Mr. Colley's analysis, and he simply uses the £209

1 million and £268 million figures. I just wanted to explain where they come from while we
2 are looking at Table 1. We can put that away for a moment.

3 I am now going on to a different point which is the down-side of a shift in demand - the
4 consumer detriment. As I said a moment ago, that has two elements.

5 THE CHAIRMAN: Are you coming back to the third table - the £200 million?

6 MISS DAVIES: I am going to come back to that a bit later, if I may, when I deal with the £200
7 million. These points are much broader than the £200 million. They infect ----

8 THE CHAIRMAN: Yes, but you identified three, if you like, calculations. You have shown us
9 two of them.

10 MISS DAVIES: Yes. I certainly will be coming back to the £200 million.

11 Down-sides. Two potential detrimental effects - the unmet PPI demand and the impact of
12 increased credit prices. On the unmet PPI demand, that is the point where we go into the
13 point raised with me yesterday by Professor Stoneman of impulse buys. In essence, what it
14 is a potentially different reason to that advanced by the Commission for ignoring the
15 reduction in demand associated with the point of sale prohibition - namely, that the point of
16 sale prohibition could operate to deter those for whom PPI is an impulse buy, by which we
17 understand to mean those for whom the product is of no real value.

18 That is a point that is being trailed by the Commission in its defence, and could we just look
19 at para.19 of the Commission's defence, p.329, tab 9, bundle 1, where in the first sentence
20 they say:

21 "A decline in sales of PPI below the current level is not necessarily an adverse
22 effect in itself nor is the current level of sales a benefit."

23 That is getting, as we understand it, at the same point that Professor Stoneman was raising
24 with me yesterday. Although they do not explain it here, it may be that what they are
25 referring to is a broader category than impulse buyers, they are referring to not only those
26 who do not really need the product, but also a category for whom the product was actually
27 unsuitable for some reason - the terms excluded the cover or whatever.

28 Whichever category you are looking at, there a number of points that we would make about
29 this assertion. The first is that it is not a point advanced in the report at all as a justification
30 for failing to consider the effects of the recognised potential for a reduction in demand
31 produced by the increased inconvenience, let alone as a justification for failing to consider
32 the position where the offsetting process is only partially effective. It is just not there.

33 The second is that, in any event, it only works as a point if all the consumers who are
34 deterred from buying PPI due to the reduced convenience are the very same consumers as

1 those for whom the product was not actually beneficial in the first place. Indeed, that may
2 be why the point in para.19 is a somewhat caveated one, as one can see from the word
3 “necessarily”. If it is not the very same consumers, you have obviously got a group of
4 consumers out there for whom the product would have been of benefit but are deterred and
5 who suffer in economic terms a welfare loss.

6 If it is being suggested it is the very same group three points arise. First of all, the
7 Commission, itself, because it has not addressed it in this way, advances no reason in the
8 report for supposing that this would be the case.

9 Second, they could not actually do so because nowhere in the report has the Commission
10 purported to analyse in any detail the extent to which the current demand for PPI is
11 overstated because of the existence of such people, people who are buying a product with
12 just no benefit. The closest they get is in para.5.136 of the report, which perhaps we could
13 look at briefly, p.124 of the report. In the first two sentences they are saying:

14 “... high margins on PPI available to businesses gave them the incentive to
15 maximise the uptake of PPI ... The effect of this would be higher levels of sales
16 than might otherwise be the case and that the quality of sales would not always be
17 the paramount consideration for businesses.”

18 They are recognising the possibility of this factor, but they are not putting any
19 quantification on it, even within a broad range of reasonable values. So they do not know
20 on current market how many people are buying PPI who should not be because it is of no
21 value. Necessary, if you do not know that, you cannot say that the people who are put off
22 from buying PPI in the post-intervention world are those very same people. You just do not
23 know whether you are talking about 100 on one side and 50 on the other or vice versa, you
24 just do not know.

25 The third point we would make about this is even if, despite all those points, you could
26 somehow or other simply assume that it is the same group of people, what that, in fact,
27 means is that the consumers who are deterred from taking up PPI by the prohibition are,
28 from the suppliers’ perspective, the lowest risk group of consumers. They are the ones who
29 are never going to make a claim. In fact, that means that would in turn lead itself to a likely
30 increase in net claims costs because the profile of the consumers who are taking up PPI is
31 different in the post-intervention world. None of that is factored into the Commission’s
32 analysis either. So we say it just simply does not work.

33 In any event, there is another point, even if you were to put all that to one side and say, “Oh,
34 well, we can basically ignore unmet demand, none of that addresses the possibilities which I

1 have been explaining of assuming additional upside in terms of volume of sales, or the
2 negative welfare effect on creditors, consumers of increased prices, which is a separate
3 negative welfare effect. That negative welfare effect, just for your note, is explained by
4 Mr. Colley at para.4.11 of his report, and Professor Yarrow in paras.48-49 and 55-57, and
5 we do not understand there to be any dispute about the principle. There is none suggested.
6 In short, it is a simple, “water bed effect” means reduced PPI income, increased credit
7 prices.

8 PROFESSOR STONEMAN: Before you leave it entirely ----

9 MISS DAVIES: I was not going to, I was going to come on to marginal cost.

10 PROFESSOR STONEMAN: The convenience issue: I see the argument, but one of the things
11 that bothers me is this, and I am wondering how much it is an argument that says,
12 “Competition is bad, monopoly is good, because if you have a monopoly there is only one
13 price and therefore you do not have to spend any time searching, and therefore there is no
14 inconvenience with monopoly”. I am wondering whether that is the argument that you are
15 running, as soon as you are allowed choice people have to spend resources exercising and
16 pursuing that choice and that is a downside to having choice and therefore a downside to
17 competition as opposed to monopoly.

18 MISS DAVIES: I do not think we are running that argument. What we are trying to say is that
19 when you are looking at the net consumer welfare effect of intervention, which the
20 Commission recognised it had to do because of the water bed effect, amongst other reasons.
21 You would have to bring into play all the factors that are relevant in terms of consumer
22 welfare. We are certainly not saying that the downside in terms of unmet demand or
23 increased credit prices could not be regarded as being overcome by the upside. But it is a
24 downside against the existing counterfactual.

25 PROFESSOR STONEMAN: It is the convenience issue that I am particularly concerned by. The
26 water bed effect, we have not got to that yet. It is this convenience issue, that if you give
27 people choice then they are disadvantaged because they have to spend resources exercising
28 that choice.

29 MISS DAVIES: Another way of looking at it is that by forcing people to purchase PPI at a time
30 and a place which involves more work on their part, which is what the prohibition does, you
31 are actually, because of natural human behaviour, preventing people from purchasing a
32 product that they could actually benefit from. That is what the Citizens Advice Bureau was
33 concerned about. You are placing an obstacle in the way of people purchasing a product at

1 a time which all the consumer studies indicated they regarded it as most convenient to
2 purchase, the point of sale.

3 In fact, one of the downsides of the point of sale prohibition is that removes consumers'
4 choice. It removes the ability for the consumer simply to say there and then when they buy
5 their loan, "I want to protect my loan now, I want to go away from this office today feeling
6 comfortable that I have taken out this loan from you but it is protected, I know. It means of
7 course they can do it the next day by picking up the telephone, or a week later, by
8 contacting the credit provider themselves, going into the office and doing it, but it means
9 extra investment of time and effort on their part. Inevitably, and that is what the
10 behavioural study was showing, extra investment of time and effort means that some
11 consumers, even though the product will have benefited them, just will not do it.

12 PROFESSOR STONEMAN: Do they have to experience that delay? Can they not just walk out
13 of Lloyds into Barclays next door and say: "I have just taken out a loan with Lloyds. Now,
14 because this is a nice open market I would like to come to you at Barclays and you can give
15 me PPI now", immediately after the ----

16 MISS DAVIES: It is not the same as the strawberries and cream analogy of going to a
17 supermarket and saying: "I would like some strawberries and cream for tea" but they do not
18 have the cream and going to the next door supermarket and picking it off the shelf. You
19 can go to the next door bank, but you have then got to go through the whole interview
20 process again, discussing your ability to pay, the extent to which you are a risk and so on.
21 You cannot just pick it off the shelf, it is increased inconvenience, and that is reducing the
22 choice for the consumer. As Mr. Sharpe so eloquently put it yesterday it is making them
23 worse off in order in the event ultimately they will end up better off.

24 PROFESSOR STONEMAN: You see this is what worries me, that giving people a choice makes
25 them worse off. I find that a great contrary to competition law, that I have problems with.

26 MISS DAVIES: It is because you are reducing the choice, you are actually taking away.

27 Consumers at the moment obviously have a choice at the credit point of sale. They could at
28 that point walk away from their loan provider and go and look elsewhere around the market.
29 I accept that is not actually happening to a sufficient extent and that is what the Commission
30 was concerned about but they do have that choice at the moment, you are not actually
31 adding a choice to the range of choices that they have; what you are doing is taking away
32 one – overall you are removing an aspect of their choice, you are preventing them from
33 doing it at the point where they regard as most convenient.

1 THE CHAIRMAN: We seem to be getting back into a field, which is a point I raised with Mr.
2 Sharpe yesterday, namely that this is better categorised as a loss of consumer choice which
3 the Commission did directly address at paras. 10.391 to 10.394 in the report, because it was
4 suggested that the choice inherent to being able to buy at the point of the credit sale with an
5 RCB, and they rejected that and only identified a single RCB that they had to worry about
6 namely reduced credit prices.

7 MISS DAVIES: I would give the same answer to that that Mr. Sharpe gave yesterday, which his
8 not actually a question of a discretionary exercise under s. 134(7), the reason this is relevant
9 is you are having to assess, and the Commission accepts this, the net overall consumer
10 welfare when it comes to the proportionality exercise, and necessarily even if you are not
11 regarding increased choice as something that is a relevant consumer benefit within the
12 meaning of s.134 of the Enterprise Act, necessarily you have – because of all this issue
13 about demand curves and the effects on volumes – to take it into account at that later stage.
14 Otherwise, once you have recognised as they do, that there will be a reduction in demand
15 because of the reduction in convenience, they recognise that. If you do not factor that into
16 your analysis at the later stage you are simply, for the reasons I have been explaining,
17 ignoring a relevant factor, looking at the net consumer welfare effect.

18 Miss Bacon points out to me there is a separate point, of course, about all of this, which is
19 that all of this, the paragraphs, Sir, you are just referring me to, are predicated on the
20 assumption that there is actually an increase in consumer searching in competition and so
21 on, which I am going to come to in a minute, and the criticisms we and Barclays make
22 about that assumption.

23 I was then coming to credit, and the adverse effect on credit for consumers. Again, picking
24 up on this, even if the point about PPI consumers is counter intuitive or whatever, you
25 cannot because of the waterbed effect just ignore the effect of reduced volumes of PPI on
26 credit, and that is important because obviously the pool of credit consumers out there is
27 much bigger than the pool of PPI consumers; we have seen the current figures, 34 per cent.
28 There are 66 per cent of credit consumers who are not benefiting from PPI in the current
29 market structures, but for whom, if PPI prices come down, credit prices will go up.

30 Whatever the position on relevant credit customer benefit you cannot just ignore from the
31 analysis the effect on those credit consumers, and the Commission recognise that and that is
32 what it sought to do although it did not do it properly, we say, for the reason that I am
33 addressing.

1 The Commission, because they did not get into this level of analysis, did not go through it
2 and say “we can discount on that demand point, because we do not think that is a real
3 benefit anyway ...” for whatever reason, “... but we ought to look at the impact on credit
4 consumers anyway and see whether that is positive or negative”; they did not do that, so I
5 cannot point to any analysis in the report on this point. What I can point you to is Mr.
6 Colley, because Mr. Colley has done some work in response to the Commission raising this
7 point at para. 19 of their defence, and looking at the welfare position if you only take into
8 account credit consumers who have an increased credit price as a result of a reduction in
9 demand for PPI. I will give you the paragraph note for the moment because I am going to
10 come back to it when I have explained a little bit about his models and the work he has
11 done, but it is at paras. 38 to 41 of his report. What that does demonstrate, we submit, is
12 that just looking at this effect alone there remains with a reduction in demand for PPI the
13 potential for very significant net welfare detriment.

14 THE CHAIRMAN: Can you just give me the reference again?

15 MISS DAVIES: Second report, core bundle 1, tab 12, p.512; I will come back to it but I just
16 wanted to flag it at this point.

17 THE CHAIRMAN: What is the paragraph number of his report?

18 MISS DAVIES: Paragraphs 38 to 41. In order to explain what he has done I need to explain a
19 little bit about his first report, so I will deal with it at that point, but just to flag it now.
20 What I should at this point address is an issue that may be also lurking somewhere in the
21 Commission’s submissions, and seems to be the point they are making in the supplement to
22 defence responding to that work that Mr. Colley has done. It seems to be a suggestion that
23 an increase in credit prices is not in itself necessarily a detriment and that is a submission
24 that we understand is being made, if it is being made, on the basis that credit is currently
25 being sold below marginal cost, so increasing the price to above marginal cost is actually
26 beneficial in the welfare analysis.

27 On that, the theory of the point is expressed by the Commission in para. 10.482 of the
28 report, if we could just look at that. It is p.295 of the internal numbering. It is a paragraph
29 you were invited to read by Mr. Sharpe over lunch on day one I think. They note:

30 “... that a distortion in credit prices is not intrinsically beneficial. That credit
31 prices are low as a result of distortion in the PPI market may be considered to be a
32 benefit to some consumers; however, we noted that where credit prices are below
33 their marginal cost, this will result in inefficiency.”

1 That is the theory of the point, it is not actually reaching any conclusion about it; it is
2 simply saying that if prices are below marginal cost then there will not be a benefit. One
3 can see that that is being said in para. 10.480, one can see from the heading to this section;
4 that is being said in the context of a section of the report where the Commission is
5 considering whether to modify its remedies package to preserve the relevant credit benefit it
6 recognised in lower credit prices.

7 What it did not do in this section, or anywhere else in the report, is to go on and say: “We
8 can discount that relevant customer benefit, full stop, because credit prices are below
9 marginal cost, so actually it is not a benefit at all, it is an inefficiency.” They did not say
10 that anywhere in the report, and they did not, in fact, anywhere in the report reach any
11 conclusion as to whether credit prices are below marginal cost.

12 THE CHAIRMAN: They did conclude that it was a relevant customer benefit.

13 MISS DAVIES: They did conclude it was a relevant customer benefit, so they discounted this
14 point. The lower credit prices were a relevant customer benefit. They did not conclude that
15 credit prices were below marginal cost and for that reason there was a relevant customer
16 benefit. They simply concluded that credit prices are lower than they would otherwise be
17 and therefore there is a relevant customer benefit. They did not conclude that latter
18 conclusion because it was actually the result and that inefficiency (which is the theory that
19 they were addressing and considering in para. 10.482) -- Having not dismissed it in the
20 general, for our part we do not see how you can then say, “Oh, well, a reduction in credit
21 prices produced by a reduction in PPI demand can simply be dismissed because it is an
22 inefficiency because prices are below marginal cost”. But, it goes further than that. As I
23 have said, they did not actually reach any conclusion anyway on the extent to which credit
24 prices are below marginal cost. They made an assumption., for the purposes of their model,
25 that they were. But, it is no more than an assumption. That is now absolutely clearly
26 admitted by the Commission in their supplement to the defence that we got last week. If I
27 can just very quickly take you to that -- It is not a document which Mr. Sharpe took you to,
28 I believe. It is at the back of Tab 9 in Bundle 1, starting at p.444G, which is para. 21 of the
29 supplement. There you can see that what the Commission is doing is addressing the point
30 that Mr. Colley raised - the analysis he did - of, “Even if you only look at credit prices, there
31 is still a consumer detriment here”. They then, in para. 22, make a broad point to do with
32 increasing demand, which I have already addressed. They then go on in paras. 23 and 24 to
33 deal with the point that I am currently addressing about credit prices. They make the point
34 that, as a matter of logic, credit prices in the context of the waterbed effect are not at their

1 optimal level. I do not take any issue with that logic. We accept that logic. But, that logic
2 does not prove that credit prices are currently below marginal cost. That simply proves that
3 credit prices are depressed at present.

4 They then go on to look at the model output and market definition assumptions, in para. 24,
5 which I do not need to address. But, going over the page, to p.8, at the top of the page, they
6 say that the assumption that Mr. Colley describes as arbitrary, which is an assumption that
7 credit prices are below marginal costs, which drives the result that credit prices are below
8 cost, is simply the assumption set out in appendix 10.9.

9 “In our base case, competition for credit customers is vigorous such that firms
10 make no profits overall over the ‘system’ of PPI and credit. It follows, as a matter
11 of logic, that if there are excess profits in the secondary market, and zero profits
12 over the system, those excess profits must be negated by losses in the primary
13 market for credit. There is nothing arbitrary about this assumption”.

14 So, they are describing the logic of it. If you assume, going into the model zero profits
15 overall, the excess profit on PPI, you must be selling below cost on credit if you have got a
16 100 percent waterbed effect, but that if you have a 100 percent waterbed effect it is
17 important, but they do not make any finding about it. Nowhere in the report do they make
18 any findings about the extent to which credit prices are, or are not, below marginal cost. It
19 is driven by the assumptions that go into the model.

20 In our respectful submission, you cannot simply discount the negatively affected credit
21 consumers on the basis, “Oh, well, they’re getting a benefit they should not be getting. It is
22 inefficient”. For all those reasons you cannot simply just discount the downward side of a
23 contraction in demand for PPI.

24 What the Commission suggests in its skeleton is that it also concluded, in any event, that the
25 detriments resulting from the reduction in convenience produced by the prohibition were, in
26 any event, clearly outweighed - that is the language in para. 48 of their skeleton - from the
27 benefits resulting from the remedy.

28 Coming back to para. 10.50, that seems to be a reference to the last sentence of para. 10.50
29 in which the Commission concluded that even if there was a reduction in convenience, that
30 was necessary and justified in light of the scale of the detriment identified. Clearly
31 outweighed. Again, somewhat of an improvement. The point is that they are suggesting
32 that even if there is a decline in demand it does not matter - it is justified - because of the
33 scale of the detriment. But, on basic proportionality principles, in order to determine that
34 the detriments associated with the potential cause of action are outweighed by the benefits,

1 you obviously have to consider and analyse a world in which the detriments are felt. If you
2 are trying to say, “Well, there’s a downside here, but the upside outweighs it, and makes it
3 justified”, you actually have to look at a world in which the downside is felt”. That is what
4 the Commission did not do here. They did not anywhere, in their models, or at any other
5 point in their report, think to capture negative effects associated with the reduction in
6 demand for PPI that I have been endeavouring to describe. That is so, even in a world,
7 which, as I pointed out, was clearly recognised by the Commission as a potential, in a world
8 in which the reduction in PPI sales was not fully counter-balanced by the increase, the
9 partial reduction. They did not even look at that.

10 I am not suggesting - no more than Mr. Sharpe was - that this is an exercise in precise
11 quantification, precise mathematics. It can be done within a range of reasonable values.
12 Look at a range of reasonable values for a reduction in demand.. What are the
13 consequences if that is not completely counter-acted. But, they did not do any of that. They
14 just ignored it. Without conducting such an analysis, they were in our respectful submission
15 simply not in a position properly to claim, as they did at the end of para. 10.50, that the
16 prohibition was justified in light of the scale of the detriment that they identified. It is a
17 total failure to take into account a plainly relevant fact.

18 Sir, of course we accept that there are some material facts that are not taken into account by
19 Mr. Colley, which, if they were taken into account, would have such a small impact on the
20 eventual outcome if, on a judicial review, the Tribunal can effectively brush them aside.
21 But, that is not this case - not by any stretch of the imagination. Because the Commission
22 did not look at potential scales, potential ranges, again I cannot show you anything in their
23 report which says, if you had actually taken this into account, “This is the extent”. But, just
24 to address this point, Mr. Colley has done a little bit of work on it which I simply just
25 wanted to show you. It is in his first report at Tab 7 of the first bundle, starting at para. 4.7,
26 4.8 and 4.9 on p.185 of the bundle. That is where Mr. Colley is explaining the logic of the
27 point which I have been developing. What I wanted to show you is at para. 4.10 and 4.11.
28 He then does some calculations using the Commission’s bound results, which are the Table
29 1, appendix 10.11 results, making all the assumptions the same as the Commission, apart
30 from an assumption as to impact on PPI demand. You can see he has modelled three - 30
31 percent, 50 percent, 70 percent reduction in demand. You can see the results over the page
32 in Table 1. He uses the system remedy model. Scenario 1 is the 30 percent reduction. What
33 was a gain gets pushed into a £68 million loss. Non-system - £420 million loss. The losses
34 get bigger, the bigger the reduction in demand. Nothing actually all that surprising about

1 that. I ought to emphasise that we are not saying that any of these figures is the figure that
2 the Commission ought to have applied. We are not saying that at all. They are put forward
3 as illustrations of the consequences to the Commission's analysis of assuming a reduced
4 demand for PPI which they clearly contemplated as a potential outcome in para. 10.50.
5 So, although the Commission asserts in para. 80 of its skeleton that it does not agree with
6 any of these percentages, that is nothing to the point. In fact, as it did not make any findings
7 as to the extent of reduction in demand - apart from the fact that it was overstated by some
8 parties - or what was meant by a partial offset - the assertion that is now made, that it did
9 not consider it was any of these, is rather difficult to understand from the report. Anyway, it
10 does not matter. We are putting them forward as illustrative.

11 Whilst we are in Bundle 1, Professor Yarrow has also done some work on this that is of
12 relevance. He did a different exercise though. It is at para.58 of his report in tab 4, p.98.
13 He asked himself the question, "How big a fall in demand would be required to negate the
14 suggested welfare gain to the system remedy?" The answer he gives at para.58, p.98, is 11
15 per cent. Using the system remedy is, of course, a more beneficial approach to the
16 Commission because the system remedy assumes system searching. Also, I should point
17 out, that 11 per cent does not take account of costs of implementation, which, as the
18 Tribunal has heard, are likely to be substantial. I do not understand the Commission to have
19 taken issue with that calculation anywhere in its defence, or indeed in its skeleton. So an 11
20 per cent overall reduction in demand pushes the system remedy into ----

21 THE CHAIRMAN: Can you just give me the Yarrow paragraph again?

22 MISS DAVIES: Paragraph 58, I do apologise.

23 So we would say it is clear that relatively small reductions in demand resulting from a
24 reduction in convenience could dramatically affect the welfare analysis.

25 Just to finish this point, to come back to the point I trailed earlier, Mr. Colley has also
26 looked at it if you look at impact on credit consumers. That is in his second report, which is
27 at tab 12 of this bundle, bundle 1, at paras.38 to 42, p.512 of the bundle. You can see from
28 para.39 that he is making the logical point that I was developing, which is even if you
29 ignore the welfare loss of PPI consumers there is still the welfare loss of credit consumers.
30 In 40, to illustrate that, he has modelled the impact of ignoring the reduction in welfare due
31 to loss of convenience, using the same welfare model he constructed for his first report.
32 That uses the extreme assumption, and it is extreme for the reasons I have explained, that
33 coincidentally all customers who no longer buy PPI are those for whom the product is of no
34 benefit. So he is just looking at the credit side.

1 What he gets here in table 2, he is comparing his original report and you get some figures
2 for ignoring loss of convenience, and to explain what this is, the medium scenario, which is
3 the first line, is a scenario that he explains in para.5.2 of his first report, and it brings into
4 consideration a combination of factors, including a 50 per cent reduction in PPI sales and a
5 lower reduction of price. The reason he has looked at a combination of factors in that
6 section of his report is that he makes the point that if you are doing any proper sensitivity
7 testing and you have got a range of factors that can affect your result you do not just look at
8 them in isolation, you also look at them in combination. If you are only looking at them in
9 isolation you could ignore certain effects. Indeed, that is what the Commission did on some
10 of the assumptions in its models, as I will come to in a little bit. They did not do it on what
11 we submit are the key ones, namely the effect of reduced demand of PPI or the effect of less
12 than a 60 per cent reduction in price, because they just assumed that all else was equal. He
13 has done that in his first report. The reference is para.5.2. On his medium scenario he then
14 gets a total welfare loss, as you can see, of nearly £3 billion.

15 He then in his first line takes away the impact of the PPI unmet demand, and even if you are
16 only looking at credit consumers you still get a total welfare loss of £1.3 billion.

17 Again, it is not the figures, the precise figures, it is the direction that is important here. The
18 direction is still potentially very significant welfare losses.

19 PROFESSOR STONEMAN: Could I ask you, the Colley table 1, to what extent is that
20 reversible? If the policy only has a slight impact and shift in the demand goes out, the
21 benefits would be huge.

22 MISS DAVIES: Yes, it is very sensitive to that, and that is one of the reasons why I am saying
23 none of these are precise figures.

24 PROFESSOR STONEMAN: I accept that. You have obviously got a point to argue, but it works
25 in both directions, I think that is the point.

26 MISS DAVIES: It does, save for the partial point which I keep coming back to in para.10.50,
27 which is that on any view of all of this because of the word “partial” in that paragraph, the
28 Commission is clearly contemplating a potential outcome, a situation in which the demand
29 curve has not been shifted out from the current demand, or it is shifted back, it is less.

30 Sir, that was what I wanted to say about the first of my three topics, which is the reduction
31 in convenience conclusion in para.10.50. I do not know if that is a convenient moment to
32 break.

33 THE CHAIRMAN: Yes.

34 MISS DAVIES: I am making good progress, I should say.

1 THE CHAIRMAN: And you are going to import a bit of that first point back in when we look in
2 detail at the underlay for the ----

3 MISS DAVIES: I am going to come to the modelling exercise separately.

4 THE CHAIRMAN: Let us resume at just after 11.45.

5 (Short break)

6 MISS DAVIES: Sir, I am now moving on to the second of my broad topics, which is the

7 Commission's basis for concluding that there would be an upside to offset that would
8 effectively mean no material contract in sales, the upside of the offset would account
9 effectively for the downside so they do not need to worry about it.

10 That now seems to be the Commission's main answer to the issue of lost convenience. I
11 should say that if everything I have said so far and Mr. Sharpe said about that same point is
12 accepted you do not actually need to go on to this issue, because that is enough. They did
13 not take into account the downside of the equation. Nonetheless we do go on also to attack
14 the view expressed in the report that there would be a sufficient offset upside to the equation
15 and we do so on the basis that it is unsupported by any evidence or proper analysis. Of
16 course, in doing so we are clearly entering here into the territory of overlap with many of
17 the points Mr. Sharpe was making about lack of evidence and I am certainly not going to
18 repeat those; he has made them, we have seen them, but there are a few additional points we
19 would like to make.

20 Again, of course, the starting point is: what is driving the upside? What is driving the
21 increased volumes of PPI sales? In the Commission's view it is the reduction in PPI prices
22 and that we can see from para. 10.50 and I should make it clear that we are not seeking to
23 criticise that as a general conclusion that there would be some effect on prices, although
24 some people made submissions to the Commission during the course of its investigation
25 that the effect would be the opposite and actually there would be an increase in price but we
26 are not attacking the conclusion. What we are seeking to criticise, and what this point is
27 directed to is the reasoning by which the Commission concluded that the reduction in prices
28 would be sufficient to induce sufficient consumers to overcome the reduction in demand
29 produced by the reduction in convenience to maintain PPI sales so as to counterbalance the
30 otherwise effective loss of demand – it is the sufficiency of the price decrease.

31 As Mr. Sharpe said, the Commission did not do any modelling on this point, they simply
32 assumed for their models that there would be a fully effective impact of its remedies, and
33 there would be a reduction in PPI price to 60 per cent. In fact, because they had not sought
34 to quantify the extent of the downwards side of the equation, the extent to which there

1 would be a reduction in demand, they were not actually in a position to do any modelling on
2 the point that I am addressing. They could not ask themselves the question, which would
3 have been a relevant question, what amount of a price increase do we need to achieve, or do
4 we need to expect to achieve in order for any reduction in demand produced by loss of
5 convenience to be offset, because they did not know what the effect of the reduction in
6 demand was, they could not actually go further. In principle, it could easily have been
7 done, you look at a range of very small values, you take the 50 per cent from the HBOS
8 system, and study some other range of what they thought was reasonable, you see what that
9 impact that has on sales, and then you say: “What reduction in price do we need to achieve
10 to counterbalance it?” They did not do any of that, they did not do any sensitivity testing on
11 this issue at all, or at least none that is referred to in the report put forward to the Tribunal as
12 supporting this conclusion.

13 What it did, as far as we can understand it, is approach the matter purely from a qualitative
14 point of view, and simply assume at each stage that the impact of its remedy package would
15 be sufficient to generate what is, on any view, a sea change in both consumer and supplier
16 behaviour, and that it would be sufficient to drive prices down to counterbalance the effects
17 of the loss of convenience. It did that, in fact, by a chain of reasoning which we identified
18 in our statement of intervention, at each stage of which for the reasons that we have set out
19 in detail in paras. 68 to 84 of our skeleton, assumptions were made, unsubstantiated
20 assumptions were made. I am not going to go orally through each of those, it is there in our
21 skeleton, one can see it, but I was proposing to address two of the key factors that affect the
22 analysis, the first being consumer searching and the second being new standalone products.
23 Increased consumer searching in the post-intervention world is of course something that Mr.
24 Sharpe has addressed, and the Commission’s conclusions about that and so I am only going
25 to deal with it briefly, but there are a couple of additional points we would like to make.
26 The starting point is the current situation. What the Commission concluded about the
27 current extent of searching is set out in paras. 3.49 to 3.61 of the report, which are not
28 paragraphs that Mr. Sharpe took you to. I was not proposing to go to them orally but simply
29 ask you to note them and look at them at some other time.

30 In broad terms, what they show is that the Commission had evidence that for personal loan
31 PPI current searching is as low as 12 per cent, for mortgage PPI 21 per cent, and for
32 secondary mortgage PPI 11 per cent, so very, very low levels of searching indeed, and
33 indeed that is part of what the Commission relied on in support of its conclusion as to
34 relevant market. That is the current state of affairs.

1 The Commission then addressed the post-intervention world in paras. 10.43 to 10.45, 10.74
2 and 10.477 of its report. Those are all paragraphs that you went to in fact on more than one
3 occasion with Mr. Sharpe, so I was not proposing to go back to them. The points that they
4 each illustrate is that the language the Commission was using is that language of incentive
5 or encouragement to consumers to search being provided by the remedies package, coupled
6 with the conclusion that if consumers do increase the level of searching that will produce
7 greater price competition. We do not quarrel with either of those conclusions, but the
8 missing link, of course, is to what extent consumers will actually do it, to what extent will
9 they actually act on the incentives, act on the encouragement and start searching and that is
10 simply not answered by saying you give someone an incentive to do something, you have to
11 go on and ask yourself the next question how likely is it that they will actually act on it?
12 I accept that is a prediction as to the future, and any prediction as to the future is necessarily
13 just that, a prediction; it is not a finding that you can make by weighing primary evidence as
14 to whether something has happened when you are looking at something and coming to a
15 conclusion as to the past. It is necessarily a more complex exercise, drawing inferences
16 from relevant facts as to what can be expected to occur. But because of that, because of the
17 additional uncertainties in such a predictive exercise, we submit it is one that ought to be
18 conducted with great care and taking into account the various realistic possibilities that can
19 be envisaged. That is a point that the Court of Justice has emphasised in the competition
20 law context of looking at prospective merger analysis, in a case called *Tetra Laval* which
21 we have referred to and which I did want to draw your attention to. It is in authorities
22 bundle vol.1. It is a merger case looking at the prospective effects of a merger, and
23 assessing whether or not the merger ought to be allowed to proceed, but the Commission, in
24 its defence (para.142) nonetheless accepts that there is an analogy with that case and the
25 analysis that the Competition Commission ought to have been undertaking in this case,
26 because both types of cases are concerned with future events. The relevant paragraphs, first
27 of all just looking at where the Court of Justice addressed this point, paras. 42 to 44, rather
28 than reading them out if I could just ask the Tribunal to read them.

29 THE CHAIRMAN: (After a pause) Yes, what probability is contemplated in the word
30 “plausible”? It is not one one sees in English judgments.

31 MISS DAVIES: I would interpret “plausible” as reasonable.

32 THE CHAIRMAN: Yes.

33 MISS DAVIES: What they are saying – they are making a number of points – first, in a
34 predictive exercise you have to exercise great care because it is inherent in such an exercise

1 that there are a lot more uncertainties than would be in a fact finding exercise as to whether
2 something has happened in the past. That is para. 42. Paragraph 43 is looking at the specific
3 merger context. Paragraph 44 - you are looking at, as they point out in the first sentence,

4 “Chains of cause and effect are dimly discernible, uncertain and difficult to
5 establish. That being so, the quality of the evidence produced by the Commission
6 in order to establish that it is necessary to adopt a decision declaring the
7 concentration incompatible with the common market is particularly important,
8 since the evidence must support the Commission’s conclusion that, if such a
9 decision were not adopted, the economic development envisaged by it would be
10 plausible”.

11 So, you need a particularly good quality of evidence addressing those uncertainties. These
12 are the paragraphs which mirror the double proportionality approach that this Tribunal has
13 adopted in *Tesco*, or which are referred to in *Tesco*.

14 I would also ask the Tribunal to look at para. 39, which is looking at the margin of
15 discretion afforded to the European Commission in a merger review case. If you could just
16 read that. (After a pause): The Court of Justice are making two points there: the first is of
17 relevance for my purposes. The first is effectively the Tameside point, which is that as part
18 of the review you look at whether the material put forward by the Commission is capable of
19 substantiating the conclusions drawn from it. Then they make the point, which is also
20 important, that such a review is all the more necessary - the review determining whether the
21 material is capable of substantiating the conclusions in the case of a prospective analysis
22 required when examining a planned merger. That approach, Sir, was adopted by this
23 Tribunal as applying in relation to a review under s.120 in a case called *Unichem* - which
24 Professor Stoneman will recall - at the next tab of this bundle at p.547 of the bundle, paras.
25 168 and 169. When looking at the question of the standard review under s.120 the Tribunal
26 quoted para. 39 from *Tetra Laval* which I have just referred to. They point out that they
27 regard the approach identified by the European Court of Justice as close to that of the Court
28 of Appeal in *IBA*.

29 “The *Tetra Laval* case is in any event of interest as the approach to be adopted by
30 a court exercising similar jurisdiction to that of the Tribunal”.

31 So, particular care when we are looking at prospective analysis and a need to identify
32 material to substantiate the conclusion.

33 Coming back to consumer searching, and asking the rhetorical question, “What was the
34 basis for any view that the extent of searching would increase sufficiently to drive prices to

1 produce the offset?”, you do not find it anywhere in the report. There is a logic in the view
2 that prices will reduce, but that does not answer it. What is the reason for the sufficient
3 searching to produce the sufficient price reduction? It is important, of course, to recall that
4 unlike some predictions of future events, you cannot rely on past events to help you. To the
5 contrary, the previous behaviour is the exact opposite. I have take you to the figures. Nor
6 could the Commission be relying on the results of similar remedies in the past. There is no
7 comparator. The only time that the Commission has considered a point of sale prohibition
8 was in the extended warranties investigation where it was rejected, in part due to the
9 concerns about the potential detrimental effects. I was not going to take you to it, but the
10 relevant extracts in the report are ----

11 THE CHAIRMAN: I think we know that.

12 MISS DAVIES: Nor are there any consumer surveys asking consumers what they might do if the
13 prices were lower. In fact, there is nothing - there is just nothing referred to anywhere in the
14 report. On analysis, what we submit it amounts to is that it is no more than the
15 Commission’s best guess (to coin a phrase they have used elsewhere in their supplement to
16 the defence - I will be coming to that shortly - to describe one of the assumptions they
17 made). But, with respect that is simply not good enough, particularly for a critical
18 assumption underlying the price reductions that they are assuming, and particularly so
19 where, in this case, they themselves accept that notwithstanding the point of sale
20 prohibition, credit providers who continue to supply PPI will nonetheless retain part of the
21 point of sale advantage. That is inevitable. There are some consumers who have a bank that
22 they like dealing with - their current account bank, or whatever. There are some consumers
23 who having been given the statement of PPI price will just not bother to do anything else
24 and they will go back to their original provider. That is inevitable. Indeed, as we have
25 noted in para. 71 of our skeleton, that is the point that the FSA was making to the
26 Commission: if you allow credit providers to provide a PPI quote at the credit point of sale,
27 you are actually going to end up in a situation where there is less searching than there is
28 now.

29 So, it is by no means self-evident. It needs to be justified, explained, and it was not.

30 We make similar points about the connected, but equally important, issue of the prospect of
31 increased stand-alone PPI provision. All of the analysis of the Commission only works if
32 you have got new people coming into the market offering stand-alone PPI - people to whom
33 the consumer, if he decides to search, can look around and find a PPI product. That
34 competitive pressure was, as the Commission recognised in para. 10.45 of the report,

1 necessary to encourage existing providers to reduce their prices. The Commission address
2 this in paras. 10.55 to 10.57 of the report, which are not paragraphs Mr. Sharpe went to.

3 THE CHAIRMAN: Just before we leave your previous point, is there an inherent assumption in
4 your submission that any analysis of the effect of an increased opportunity or incentive to
5 search upon prices is defective unless you go through the question of how much actual
6 increase will there be? Is that necessarily correct? Or, is the pricing capable of being
7 affected by the existing seller's perception that if they do not reduce the prices then there is
8 going to be increased search and they will get rumbled, as it were?

9 MISS DAVIES: It is if there are stand-alone entries ----

10 THE CHAIRMAN: No. Stand-alone entries -- Sorry. Carry on.

11 MISS DAVIES: All of these are connected. Of course, in making submissions one has to isolate
12 one point, deal with that, and deal with -- I accept that they are all connected and that one
13 has to look at all the assumptions -- the chain of reasoning that the Commission adopted in
14 its whole. We do that in our skeleton, in our statement of intervention. We identify each
15 chain. There is no dispute from the Commission that we have identified the chain correctly.
16 We deal with each of them. As I have said, I am not going to repeat all that because I will
17 be here for a long time if I do.

18 THE CHAIRMAN: So, your answer is, "Read my skeleton".

19 MISS DAVIES: No.

20 THE CHAIRMAN: I have got the paragraphs.

21 MISS DAVIES: I accept that the key driver - the very key driver - is consumers' behaviour
22 actually changing. One can see that, for example, in the Commission's approach to timing
23 because, of course, if no consumers actually did search you may end up in a situation where
24 possibly prices would go back up because the clever PPI provider would realise, "Actually
25 consumers aren't acting on this. We can maintain this. The point of sale advantage is still
26 effective. We can maintain it". That is not what the Commission was assuming. They were
27 assuming a combination of factors to drive it down. But, actual increased search is one of
28 them.

29 Now, stand-alone provision. The Commission addressed this under the heading 'Reduced
30 Consumer Choice' at paras. 10.55 to 10.57. Paragraph 10.55 has confidential information
31 in it. So, I need to be careful. What it records is the Commission being told that there were
32 various current PPI providers who were considering that they would not remain in the
33 market in the post-intervention world. The names of the providers are confidential. So, I
34 cannot say them. But, if the Tribunal reads it, one can see that they cannot be dismissed as

1 simply minor players. (After a pause) Sir, that is existing PPI providers. The Commission
2 actually reached a conclusion about them at the end of 10.57, the last sentence. They
3 concluded, “Whilst some distributors and intermediaries may leave the market --” So, they
4 are expressly contemplating that that might actually happen in para. 10.57. But, they dealt
5 with that by looking at the factor that is paras. 10.56 and 10.57, which is compensating new
6 entry. First of all in para. 10.56 they make the first point that the decision to stay in the
7 market would depend on how many consumers would still buy PPI and how many they
8 could access - in other words, it would be a straight business decision based on expected
9 returns. They noted the views of distributors who said they, or others, would stop selling
10 PPI. ... if we considered that incentives would remain for distributors and intermediaries to
11 continue to provide PPI to their credit consumers. That is because there is a significant
12 source of income and high margins, even though those would be decreased. There is also a
13 benefit to distributors. Then they say,

14 “We expect that even if marketing costs increase and/or penetration rates fall as a
15 result of this remedy, many distributors and intermediaries would still find it
16 beneficial to continue to sell PPI. To the extent that particular distributors or
17 intermediaries choose to exit the market, this would create an opportunity for
18 others to offer PPI on a stand-alone basis”.

19 For that reason there would not be a reduction in consumer choice, even though some may
20 leave. Taking this in stages, if there are some, as the Commission appear to accept, existing
21 credit providers exiting the market, that, in itself, has a negative impact, just to mention, in
22 that the information given to customers at the credit point of sale will not include a PPI
23 quote, because they are no longer in the market, but the provision of a PPI quote is, itself, an
24 important part of the Commission’s reasoning because it is part informing the consumer of
25 the existence of PPI. Even if, at that late stage, they have not been attracted by advertising
26 beforehand, it is part of the package that contributes to increased searching. But the real
27 point here is a broader one obviously. Essentially, what the Commission is doing in this
28 paragraph is asserting that, even with reduced penetration and reduced prices, the
29 Commission expected that many disputers would find it beneficial to stay in the market and
30 even if they did not there would be others who would come in.

31 What that means is that we have a scenario in which, consistently with para.10.50, the
32 Commission is again expressly contemplating a shrinking market in terms of volume as
33 well as market exit and of course very considerably reduced profit margins. That is all

1 wrapped up in, “We expect that even if marketing costs increase and/or penetration rates
2 fall and whilst some distributors may leave the market”.

3 The proposition, in our submission, that nonetheless the market opportunities are
4 sufficiently attractive to expect sufficient people to stay in or new entry is one which is
5 again by no means self-evident. It is, as the Commission recognises in para.10.56, a
6 business decision. You look at the size of the market and the extent of the profit and then
7 you decide. The trouble is that the Commission did not actually anywhere look at the size
8 of the market post-intervention or the realistic amount of profit. Without having done that,
9 to simply assert, “Oh, well, it is all going to be all right, there will be enough opportunities
10 for people to stay in”, you are effectively shooting in the dark, with respect. How can you
11 tell?

12 Of course, we also know, and Mr. Sharpe made submissions about this, that what the
13 Commission is actually assuming in its models is an immediate reduction in price to the
14 effectively competitive level – price equalling marginal cost plus return on capital. They do
15 not say anywhere what they mean by “immediate”, but at most it must be a matter of
16 months. If you factor that in and you ask the question, “How many people are going to stay
17 in the market?” assuming it is also shrinking, “How are new entrants going to come in and
18 recover their costs of entry?” They are not sunk costs, they are new costs. None of that
19 factors into any of this. There is just an assumption it will all be okay.

20 THE CHAIRMAN: So what do you suggest they should have done or could have done to shed
21 light in this particular shooting gallery? You accept they have to form a judgment, I think.

22 MISS DAVIES: What should have done and could have done – I do not want to stray into
23 methodology – is model a reasonable assumption as to reduction in market, which they did
24 not do, how big was the market going to end up, what was the contestable market that was
25 going to be left? They did not do that, they just assumed, and that is the point I have been
26 making. They could have looked at what is a reasonable reduction in price, over what
27 period, how contestable is that? They could have looked at another way, what happens if
28 we assume a very shrunk market and no profits, and given themselves some material to
29 actually base this decision on a properly reasoned analysis.

30 THE CHAIRMAN: It is essentially a sensitivity analysis, is it not?

31 MISS DAVIES: Exactly. It is, but it builds on the very first point which is you have actually got
32 to, bearing in mind that they did accept the partial reduction, the points I have been making,
33 look at what is your realistic potential scenario there and then look at how all these other
34 factors feed in. That might be sensitivity analysing. In all these things there is probably no

1 one answer because we are looking at futures, future events, you are having to look at a
2 range of these ----

3 THE CHAIRMAN: To suggest that doing nothing is inexcusable necessarily contemplates that
4 you could do something.

5 MISS DAVIES: I accept that, Sir, although I just, in relation to that, remind the Tribunal what
6 this Tribunal said in para.161 of *Tesco* where the Commission was saying, “It is all very
7 difficult, what more could we have done”, and the Tribunal picked up on that and said,
8 “Well, if you are saying it is impossible to do this that analysis ought to be set out in a
9 report and explained”. For that reason the report was deficient. They do not say, “We
10 could not do any more, all we can do is make a best guess here”. In fact, it is, in our
11 respectful submission, obvious that they could have done more.

12 PROFESSOR STONEMAN: There does not seem to be any connection between those
13 paragraphs and what is going on in the appendix. In the appendix, once you remove the
14 AEC, the systems remedy, the number of protective advances increases from 340 to
15 474,000 even with a water bed effect – yes?

16 MISS DAVIES: Yes, in the non-system remedy of course it is not that. In the non-system
17 remedy, that is the one they use for ----

18 PROFESSOR STONEMAN: The argument is that what they proposing is closer to a system
19 remedy than a non-system remedy. This section here is talking about some of the existing
20 distributors leaving the market. It does not say that the total number of distributors on the
21 market will fall, does it?

22 MISS DAVIES: Because it assumes compensating new entry.

23 PROFESSOR STONEMAN: It must do. It is really this issue about the reduction in demand.
24 We go almost back to where we were yesterday, we are talking about reduction in demand
25 for individual suppliers or reduction in demand for the market as a whole, and it seems to
26 me that there is an increase in demand assumed for the market as a whole, though it might
27 come out with a reduction in demand to individual suppliers. Should we be worried about
28 individual suppliers? It is the market as a whole that is of concern from a welfare point of
29 view.

30 MISS DAVIES: There are a number of answers to that. That is all true on the system model.
31 The non-system model has the opposite effect, as one can see from table 1, which is it
32 assumes a reduced take up of PPI. The non-system model, we know, is the model that the
33 Commission used to produce the 200 million figure, which is the figure that they relied on –
34 and Mr. Sharpe has made the points about that – to justify their proportionality analysis. So

1 they are, in terms of the figures that they are using for their proportionality view, using a
2 world in which you do have an overall shrinking PPI market. All these points that I am
3 making go to that, because what you have not factored into any of that is how attractive the
4 market remains for people in that scenario.

5 On the system model the Commission actually did not say: “We expect our remedies to
6 operate as a perfect system model either”, they said that they thought the point of sale
7 prohibition would bring about some system effects because it would actually prompt
8 distributors to advertise more. If they advertised more that would increase searching prior
9 to the point of sale, and so on, and we set some submissions out in our skeleton about that
10 point too, and again that is by no means self-evident, we would submit, and is not properly
11 analysed. So you cannot, with respect, simply say: “Look at the system model, the bound
12 system model, the perfect system model” and say that that assumes a growing market and so
13 we can ignore this point because it does not deal with what the Commission has actually
14 done in its report.

15 PROFESSOR STONEMAN: Yes, in fact that was the argument I was expecting you to run, after
16 yesterday’s argument about what are fixed and what are marginal costs. A number of the
17 Commission’s remedies increased fixed costs and therefore you would expect a reduced
18 entry and not an increased entry?

19 MISS DAVIES: That is a point that is also made actually by Mr. Colley in his report when he is
20 coming on to address the separate issue of: “Is it realistic to assume a price reduction of 60
21 per cent?” i.e. the perfectly competitive price. He says in his report that no, you do not,
22 because there are actually fixed costs here, which cannot simply be ignored, they are not
23 sunk because new entrants necessarily to come into the market have to incur some fixed
24 costs, so you cannot just assume that you are going to get to that price. In Mr. Colley’s
25 report one of the things he looks at is what happens to the Commission’s welfare analysis if
26 you assume a less than perfectly competitive price, so you do not have a 60 per cent
27 reduction. He picks the figure of 38 per cent – I was just about to come to it in para. 4.20 in
28 bundle 1 at tab 7, pp.189 to 190. At the end of para. 4.17 he is making the point that I was
29 just making in response to Professor Stoneman’s question, that it is not realistic to assume
30 the perfectly competitive price being one that equates to marginal cost and a return on
31 capital, because:

32 “ ... all participants are likely to incur costs over and above marginal costs, new
33 entrants will need to recover sunk costs of entry and distributors are likely to
34 retain at least some market power associated with the point of sale advantage.”

1 The first point goes to the cost issue.

2 In para. 4.20 he has then said he thinks it is fair for the Commission to contemplate that
3 moving from what it believes is a monopoly market outcome to the competitive one will
4 entail significant reductions in price, and I made that point orally, but the question is “what
5 is a reasonable competitive equilibrium”? The Commission “... ought at least to model a
6 competitive equilibrium that is consistent with its own profitability analysis”. To illustrate
7 the sensitivity of the results to this issue he has in table 3 assumed a 38 per cent price cut,
8 and what one can see that does is on the system remedy significantly reduces the overall
9 welfare gain, and on the non-system remedy it also still leaves a negative welfare position
10 although it is lower than on the bound result and the reason for that is because of the
11 waterbed effect, credit prices do not come down so much in the non-system model, but it is
12 still a very negative number.

13 Coming back to the Chairman’s question: what could you have done looking at stand alone
14 entry? One of the things you could do, if you look at reductions in price by doing this
15 exercise is give yourself a view as to the contestable market, as to what are the potential
16 profit margins that people are going to be achieving, how likely it is that people are going to
17 be entering into this market given its size and profit margin. But, because they did not do
18 any of that, they just simply assumed a 60 per cent reduction to the perfectly competitive
19 price, they had no handle at all by which to measure it.

20 These figures, I should emphasise are looking at the position in isolation of price cut. It
21 takes no account of the point that I have been making earlier of reduction in convenience. If
22 you add the two together as Mr. Colley does later on in his report, you end up with much
23 lower numbers, in both cases negative and very low. I was not going to go through that
24 orally, it is there in Mr. Colley’s report, you can see it.

25 Timing is another relevant factor here in terms of the offset, because para. 10.50 does not
26 tell you anything about how quickly the Commission expected the counterbalancing
27 positive effect to come into play. No doubt the Commission will say, as it now does in its
28 defence, that is because it took the view that its remedy package would be immediately and
29 fully effective, so it is saying the offset would be achieved immediately. On that we fully
30 support and agree with the points that Mr. Sharpe has been making about the lack of
31 analysis to support that key conclusion. The reason for mentioning it here is simply to
32 make the point that it feeds in to the paragraph 10.50 analysis as well.

33 In reality, in our submission, the Commission’s only answer to each of these points is
34 essentially to say “We are seeking to substitute our judgment on these issues for the

1 Commission's judgment on these issues. That raises the legal question as to the scope of
2 review under s.120.

3 Mr. Sharpe has already taken you to the key authorities on that. We have addressed it in
4 paras. 15 to 18 of our skeleton. The only authority in addition to those which Mr. Sharpe
5 took you to, I would ask you to look at in a little bit more leisure, is the *Unichem* decision
6 which I took you to briefly paras. 161 through to 174, where the Tribunal went through the
7 various authorities in a little more detail. But the basic point, in our submission, is clear, it
8 is a perfectly legitimate and well accepted ground of judicial review that the Tribunal may
9 intervene where the material before the decision maker was insufficient to support the
10 decision that was taken. The most recent example of that is *Tesco*, and the paras. from
11 *Tesco* in which this Tribunal is accepting that in particular are 124, 127 and 163. But on
12 that point *Tesco* is nothing new it is simply applying well established principles.

13 In short, what we are saying about all of this is that there were, on any view, very large risks
14 involved in the point of sale prohibition recognised by the Commission and those are driven
15 by the fact that the precise way it operates is dependent on very significant changes
16 occurring in behaviour of both consumers and suppliers at a number of different levels, yet
17 when one goes through the report at each point the Commission simply assumed that the
18 point of sale prohibition would work as it hoped and, indeed, would do so immediately,
19 such that the beneficial effects it believed would be associated with its introduction would
20 outweigh the negative effects it entailed. But in doing so it did not subject any of the
21 assumptions to the detailed investigation that they required and, as a result, the report does
22 not contain the material which would be necessary to substantiate them.

23 That then brings me to the modelling exercise. On the modelling exercise there has, of
24 course, been some developments since skeletons were exchanged, because last week we
25 received the supplement to the defence from the Commission and what we have done for
26 that reason is just put down in writing a speaking note, which I am going to go through, but
27 which gives the Tribunal – because it is not in our skeleton – all the relevant references and
28 indicates where things are left in light of the supplement to the defence. Can I just hand that
29 around. (Same handed)

30 As the Tribunal will obviously now be well familiar but we have just summarised here in
31 para.1, the Commission was using its modelling exercise in appendix 10.9 to 10.11 for a
32 number of purposes. It did it primarily - so far as one can see from the report - because it
33 recognised the relevant customer benefit of reduced credit prices. It therefore recognised -
34 rightly in our submission - that it needed to look at the overall consumer effect -- the net

1 consumer effect. Therefore, it used the models to inform its decision whether it should
2 nonetheless proceed notwithstanding the relevant customer benefit, and what it actually
3 concluded about that, we have summarised in para. (c) of this note, is that although the
4 exercise showed that on the reasonable assumptions the net welfare impact of the remedies
5 would be negative, it could dismiss those because it regarded the negative results as being
6 extreme and highly unlikely, and looking at a more likely set of assumptions both remedies
7 at the two ends of the spectrum would produce a positive net consumer welfare effect.
8 That feeds into the challenge that is being made because Barclays, in their notice of appeal,
9 have made the point that the Commission ought, instead of modelling hypothetical
10 remedies, to have decided where on scale, between system and non-system, its remedy was
11 actually going to be. We support that challenge.

12 More specifically, as we have also seen, the Commission used its models to calculate the
13 £200 million figure for static consumer detriment. That decision was central to its decision
14 on the proportionality package. I accept, of course, that there were other benefits that the
15 Commission looked at - dynamic benefits. I will come on shortly to deal with the point that
16 the Commission now seems to be raising, which is, “Oh, well, it does not matter whether
17 our £200 million figure was right or wrong because there are all these other benefits out
18 there that could justify our analysis”. I will come to deal with that. Let us just deal with the
19 £200 million figure first.

20 What the report tells us in para. 10.94 (para. (e) of the note) is that they got a £200 million
21 figure by using their models. The report does not anywhere tell you how they got to that
22 £200 million figure. It does not tell you which of the models they used, or what the
23 assumptions were. Table 1 - as Professor Stoneman pointed out - does something
24 completely different, which is telling you the results of the two models. You cannot use
25 Table 1 to get to the £200 million figure at all. But, we have now finally got the
26 information in the supplement to the defence last week. We did not get it before. What we
27 got before in the defence was an explanation that they have used the non-system model and
28 that they have adjusted the assumptions to the most likely assumptions. But, on one of the
29 critical ones - and I will come to explain this by looking at the models - credit elasticity --
30 In the defence they were a little bit coy. They did not tell us what it was. They just said it
31 was more modest than the 1.54 PPI elasticity. But, they have finally, in this document last
32 week, identified it, and it is -0.8. That is the assumption that they made. They describe that
33 in their supplemental to the defence as their conservative best guess.

1 The first point we would ask the Tribunal to note about all the modelling exercise - and this
2 is para. 3, and this builds on the points I have been making this morning - is that none of the
3 models take any account of three critical factors. They take no account of reduction in
4 convenience and consequent possibility, probability of reduction in demand. That is my
5 first point. They assume - and this is a point which Mr. Sharpe emphasised in his
6 submissions, and it is an assumption - an immediate reduction in prices to 60 percent. I
7 have just taken the Tribunal to the paragraphs in Mr. Colley's report, explaining why, on
8 any view, that is not a realistic assumption. They also assume an immediate price reduction,
9 which, as I say, we understand to be a matter of months. Mr. Colley has, in his report, done
10 some modelling. If you assume it is in fact a one to two year scenario, its significant result
11 reduces the result.

12 So, for that reason, none of the models can actually be regarded as conservative in our
13 submission because they discount, by ignoring, three potentially critical factors. For that
14 reason also you cannot simply - properly in our submission - just discount the negative
15 effects of the non-system model on the basis that they are unlikely to arise in practice,
16 because you only get to a situation in which negative effects are unlikely to arise in practice
17 by ignoring relevant factors. It also actually means that the system model is potentially
18 significantly over-stating the benefits that could be achieved.

19 There is, of course, also the point about costs. The assumption that was made for each of
20 them, as Mr. Sharpe has explained, was no costs. So, again, if you are simply discounting
21 the scenario it is not enough just to produce a model that shows no negative effect on
22 consumer welfare - you need to go further and be satisfied that on reasonable assumptions
23 there is a sufficient benefit to outweigh costs.

24 What the Commission does, as I have summarised, is to say, "Well, we can discount the
25 negative welfare effects that we got by the non-system models because the assumptions that
26 generate that are extreme and highly unlikely". That is, it is important to note, despite the
27 fact that they confirm - and expressly confirm it now in para. 4 of the appendix to the
28 supplement to the defence - that all of their models are only looking at outcomes within a
29 range of reasonable assumptions. So they did not model anything that they regarded as
30 unlikely to occur. They only looked at reasonable assumptions.

31 One of the key assumptions - as I again summarised - was as to credit elasticity. Now, to
32 explain that in a bit more detail, we do, I am afraid, need to go into the explanation of the
33 models which is given in appendix 10.11. I should say that we are all talking about the
34 models and what the Commission did as if we actually have the benefit of the models - we

1 do not. All we have got is the explanation in appendices 10.9 and 10.11 of the modelling
2 exercise. The Excel models themselves have not been provided.
3 appendix 10.11. The relevant section starts at para. 14 on p.5. This is looking at the non-
4 system modelling. That is the important modelling for these purposes because it was the
5 non-system modelling that produced the potential for very significant welfare detriment.
6 First, in para. 14, they look at the waterbed effect. They make the point that they have
7 assumed for the upper bound - the top of the range - 100 percent waterbed effect. Then they
8 look in their Figure 7 as to the effect of the non-system remedy on consumer and total
9 surplus: sensitivity of results to 'pass-through' assumption. They look there at a range of
10 'pass-through' assumptions from nought to one hundred. The relevant line for all these
11 purposes is the consumer surplus line - the blue one, the top one. Under the heading 'Figure
12 7' you have got a little box saying that one line is consumer surplus and one line is total
13 surplus. I am p.5 of appendix 10.11. The line that is consumer surplus is the top line, which
14 is shown in blue. That is the relevant line. What that is showing is that at somewhere
15 between 72 percent and 100 percent waterbed effect there is a negative welfare effect that is
16 below the line, but at a lower waterbed you get a positive consumer effect. It goes above the
17 line. This is, of course, not taking any account of costs. This is purely welfare effects. They
18 conclude from that that this figure shows that imposing a pure non-system remedy could
19 reduce total consumer welfare since around our 100 percent upper bound post-intervention
20 and consumer surplus is lower. It is not actually just around the 100 percent - it is the whole
21 of the bit between where the line crosses the horizontal axis. So, it is about 72 percent to
22 100 percent.

23 Turning over the page to p.6, figure 8, they then address credit elasticity. What they have
24 done for the purposes of their bound model is assume that credit elasticity had the same
25 value as PPI elasticity, minus 1.54. One can see that on the horizontal line, the left hand
26 side the equation. In dealing with this I am dealing with separate points, of course, to the
27 points that Mr. Sharpe was making yesterday about the assumptions that were made to get
28 to the PPI elasticity figure. What the Commission did was build on that assumption and
29 make assumptions as to credit elasticity. One can see, looking at a range of, as we now
30 know, as the Commission has explained, reasonable values for that input, everything below
31 somewhere round the minus 0.8 figure you get a negative consumer welfare effect, and it is
32 only on the right hand side of the graph at the very low credit elasticity do you get a positive
33 effect. The Commission accepted that in terms in para.16, because they point out that figure
34 8 shows that this result – and “this result” means negative consumer effect – applies across

1 a wide range of values of our second key assumption, the value of market elasticity of credit
2 demand. That is the area below the horizontal axis on the graph.

3 They then do point out that we consider the upper bound value in the same way as found the
4 elasticity of demand for PPI to be generous to the non-intervention as there are good
5 economic reasons to suspect that the market elasticity of credit demand, credit prices, is
6 lower than the elasticity of PPI demand to PPI prices.

7 The economic theory: we do not take issue with the economic theory, but the key
8 conclusion is the last one. However, in the absence of further information we are unable to
9 determine the market elasticity of credit demand. They do not have the information which
10 allows them to put any reasonable framework on this figure. It is somewhere between
11 minus 1.54 and minus 64, but they just do not know where.

12 What they then do in figure 9 is look at the third of their key assumptions for their non-
13 system model, which is the relative price of PPI to credit. They had for their bound model –
14 that is the most negative model – assumed 65 per cent. They look at a range of different
15 figures and again one can see, looking just at that feature in isolation, there is a large part of
16 the range that leads to a negative consumer effect, but as one moves across the right hand
17 side of the graph you go above the line and you do get into a scenario.

18 In para.18 they tell us that their most likely value for this figure is 53 per cent. Just looking
19 at that item in isolation, you have still got a net consumer detriment.

20 Figure 10 then does the combination exercise that I was describing earlier, and looks at a
21 combination of PPI relevant price and credit elasticity. Again, if you do not have colour to
22 explain which line is which, if you look at the square box under figure 10, the left hand line,
23 PPI price 65 of bundle price, that is the lower of the two lines on the graph. The right hand
24 box, PPI price 53 per cent of bundle price, that is the upper one. What that does is, looking
25 at it solely in terms of effects of remedy, not taking into account costs, the upper line shows
26 you that if you assume a 53 per cent relative PPI price above a minus 1.34, or thereabouts,
27 for credit elasticity you get a positive welfare effect.

28 As I said, you cannot just stop there and discount things because there are costs to be taken
29 into account. You cannot just assume, as long as we are confident that credit elasticity is
30 lower than minus 1.34 the non-system remedy produces a positive result because you have
31 got to look at costs and you have actually got to be somewhere further along on the right
32 hand side of the scale if you take costs into account.

33 In para.20 what the Commission concluded is that when they considered the impact of the
34 market elasticity of demand, using both upper bound and most likely values of the relative

1 price of PPI, there is a positive case for imposing a non-system remedy in the markets for
2 PPI within a plausible range of assumption values, but we cannot exclude the possibility
3 that imposing a non-system remedy can reduce overall consumer welfare. It is that inability
4 to exclude a negative welfare effect that led into the point of where on the scheme of
5 remedies actually were the Commission expecting this remedy to fall.

6 What we now know, just while we are looking at figure 10, is that the Commission put a
7 most likely value on credit elasticity of minus 0.8. I perhaps ought to show you exactly
8 how they have explained that in the supplement to their defence. It is at tab 9 of bundle 1.
9 In the appendix which starts at p.444I, at para.7, they say:

10 “It was therefore clear [to the Commission] that the static consumer detriment was
11 some positive number.”

12 They got to that conclusion, as we understand it, by looking at this figure 10, because this
13 figure 10 shows above the credit elasticity of minus 1.34 you are getting a positive number,
14 and that is what they are talking about in para.20. The Commission uses its Excel model to
15 give it an estimate of a potential scale of consumer detriment under some conservative
16 plausible assumptions – in other words, a conservative best guess as to the most like
17 scenario. The Commission did this by picking a scenario that was consistent with the
18 decisions made by the group in factors 1 to 4. Factors 1 to 4 are identified in para.5 of this,
19 and one can see there are four of them. The first is the point that the remedies would not
20 function as a pure non-system remedy. The second, 100 per cent pass through, third, credit
21 elasticity, and fourth, relative prices for PPI. So they are picking in the group a figure, a
22 most likely figure. The conservative best guess is the most likely figure for each of 1 to 4.
23 What this document does not do is identify there what the assumptions were, but if one goes
24 forward to p.444L, in the table 1 in this document they are explaining their calculation of
25 the 200 million figure and you can see in note 2 that this assumes a credit market elasticity
26 of approximately minus 0.8. So what we derive from that is that that is the figure that the
27 group picked when looking at that assumption and the most likely scenario. The problem
28 with all of that, in our submission, is it could not actually be any more than a best guess
29 because the Commission in terms say they do not have the information to enable them to
30 determine the market elasticity of credit demand, that is para. 16, appendix 10.11 and the
31 same point is actually also made, and perhaps we ought to just look at it because it is an
32 important point at para. 17 of appendix 10.9. We do not have sufficient information directly
33 to observe the market elasticity of credit demand, credit prices. They just did not have the
34 material. They thought it would be lower than minus 1.54, but it is absolutely critical,

1 looking at all these figures how much lower it drives the results. It drives, discounting the
2 fact of the non-system remedy which they did in appendix 10.11 and, more critically in
3 some respects, it drives the 200 million consumer detriment figure that they assumed, and
4 we now know that the figure for that was minus 0.8 which, as one can see, looking at figure
5 10 of appendix 10.11, is actually a pretty long way down the range of reasonable values that
6 the Commission had in mind for this assumption. Their range went from minus 1.54 to
7 minus 0.64. Minus 8 is a long way to the right hand side, but there is nothing anywhere in
8 the report, because they did not even reveal the figure in the report, to explain why it is right
9 to make an assumption of such a magnitude, it is simply not there. That means, with respect
10 again to the Commission of course, you cannot regard the 200 million figure as a
11 conservative best estimate as they would like to have it, because they just did not know.
12 What the Commission also say, of course, is that they can salvage the report because of
13 these other unquantified dynamic benefits. I am towards the end of this you will be pleased
14 to know, particularly looking at the time, I am up to para.9 of our speaking note,
15 We accept, of course, that the Commission did express the view in the relevant paragraphs
16 of the report that there would be other benefits, but the short point here is that nowhere in
17 the report did the Commission suggest that the dynamic benefits alone were sufficient to
18 justify the remedy; that is not what they did. They did not look at a scenario and say even if
19 the 200 million figure gets discounted to zero the dynamic benefits are such that we can
20 proceed in this way. Not having done that they certainly did not go further and say even if
21 there is a static consumer loss, a negative figure, that is counteracted by the dynamic
22 benefits.

23 With respect, on a judicial review it is certainly not permissible for this Tribunal to rewrite
24 the report for the Commission, and that is effectively what one would be doing if one
25 accepted the dynamic benefits were sufficient to get 'round all these problems.

26 There is also a hint of a point being made that actually none of this matters because the
27 point of sale prohibition was the only effective remedy, so proportionality does not come
28 into that. We have addressed that at para.10 of our note, it just does not work on the law in
29 our respectful submission, it does not fit with the statutory framework, it does not fit with
30 the Commission's guidelines (we have given all the references) and it does not fit with this
31 Tribunal's ruling in *Tesco*. While we are on that point, if I could just take you back to
32 *Tesco* at paras. 131 and 137. These are paragraphs you looked at with Mr. Sharpe, but in
33 131 the third sentence in particular the Tribunal is making the point that:

1 “a measure will be considered not to be proportionate if it is ineffective with respect to its
2 aim, or if its costs are disproportionately large in comparison with the mischief at which it is
3 aimed.”

4 The Tribunal went on in para. 137, as one can see, to identify the main aspects of the
5 principles and the key one from this point of view is “4” which starts with the words: “... in
6 any event.” “It, in any event, must not produce adverse effects which are disproportionate
7 to the aim pursued.”

8 That is actually what the Commission were accepting they needed to do in the report,
9 because what the Commission actually did in this case was to proceed on the basis they did
10 need to look at the net consumer position, and they explicitly acknowledged proportionality
11 in para. 10.66. They did not just stop once they had decided that the point of sale
12 prohibition was the only effective remedy.

13 THE CHAIRMAN: Can you just help me, you suggest that the hint that proportionality was
14 unnecessary is to be found, according to your note 4 to para. 10 of your speaking note, and
15 para. 41 of the defence.

16 MISS DAVIES: Yes.

17 THE CHAIRMAN: I am just looking at para.41 of the defence and just wondering quite where
18 the hint comes. I am just wondering if you are tilting it to something of a windmill.

19 MISS DAVIES: I think it is the wrong reference.

20 THE CHAIRMAN: I think it is the wrong reference, but I just want to see what this hint is. I am
21 wondering if you have correctly interpreted the hint.

22 MISS DAVIES: Maybe it is the skeleton, I am sorry.

23 THE CHAIRMAN: I rather suspect that this is aimed at the incrementalism approach rather than
24 the question whether proportionality as a whole is relevant.

25 MISS DAVIES: There is a paragraph – if I have misinterpreted the hint then obviously ----

26 THE CHAIRMAN: I am sure, but I had better see where the hint is before I spend a lot of time
27 noting your response to it.

28 MISS DAVIES: Paragraph 41 of the skeleton argument, I apologise. Sir, you are right, it is
29 relating to incremental benefits.

30 THE CHAIRMAN: I think it is, I just think you are tilting at a bit of a windmill.

31 MISS DAVIES: In that case I will say no more about it. There is also a hint in the FSA’s
32 skeleton.

33 Sir, for all those reasons we do submit that the report must be quashed insofar as it relates to
34 the point of sale prohibition. One very final point that we have addressed in this which is

1 there is more than a hint, there is a clear assertion in Mr. Swift's skeleton that the points we
2 are making, that I have summarised in this note in paras.6 and 7, are inadmissible because
3 they go outwith the scope of Mr. Sharpe's notice of appeal, we find that rather difficult to
4 understand. There has been no suggestion of it, although the points are very fairly and
5 squarely raised in our statement of intervention served on 29th May (paras. 69 – 74). The
6 defence did not suggest they were inadmissible, rather at para.78 they addressed the
7 substance of it. It is clearly, in our respectful submission, in any event within the scope
8 because Mr. Sharpe is, as we are, challenging the extent to which it was permissible for the
9 Commission simply to discount the negative effects of its non-system modelling and also to
10 rely on the 200 million figure in the proportionality analysis, so there really is nothing in
11 that point.

12 Conveniently 1 o'clock, but unless I can assist you any further those are the submissions on
13 behalf of Lloyds Banking Group.

14 THE CHAIRMAN: Thank you very much indeed. We will resume at 2 o'clock.

15 (Adjourned for a short time)

16 MR. LASOK: Sir, what I am going to do is to start off with some introductory remarks. I am
17 then going to summarise our case on Barclays Grounds 1A and 2. When I do that I am not
18 going to take you to the particular passages in the report which substantiate the submission
19 that I am making because I am going to make the submission first and then go to the report
20 and run through mainly s.6 and a couple of references in s.10, one of which you have not
21 yet seen. I do not want to dwell too much on particular passages in s.10 because they are
22 passages that you have already seen and which have already been the subject of submission.
23 When I have gone through that I will wind up by making three, I think, short submissions
24 about Barclays Ground 3.

25 By way of introductory remark, the proceedings before the Tribunal are the same as judicial
26 review. They have the same function. It is the function of controlling the exercise of public
27 powers. The control of public powers is based not merely on ensuring that the decision-
28 maker acts within, and in accordance with, the statutory parameters governing the exercise
29 of the power, but there is also an overriding control directed at the reasonableness of what
30 the decision-maker does.

31 One of the functions of this judicial control of the exercise of public power is to ensure that
32 public powers are not exercised arbitrarily. Hence, when the court - or, here, the Tribunal -
33 is confronted with an exercise of discretion, which it appreciates is a matter for the decision-
34 maker and not for the Tribunal, because it is not for the Tribunal to substitute itself for the

1 decision-maker, the focus of the Tribunal's inquiry shifts to those areas that are controllable
2 and that the Tribunal can realistically deal with when ensuring that, for example, the
3 exercise of the power is not arbitrary.

4 So, when the Tribunal looks at what the decision-maker has done, the fact that the
5 decision-maker asserts that it is confident that it has done the right thing, that it is
6 sure that these are things that are of no weight. They are rhetorical
7 pronouncements. The Tribunal is concerned with seeing what lies beneath the
8 rhetorical assertions of confidence and certainty in what the decision-maker has
9 done. So, the Tribunal focuses upon the existence and quality of the evidence and
10 the reasoning demonstrated by the decision-maker. In this type of situation the
11 evidence and the reasoning is laid out, or should be laid out, exposed in a clear and
12 full way in the report.

13 That really, in a nutshell, is what the *Tesco* case was about. In *Tesco* the Tribunal accepted
14 that if it was confronted with a finding or a conclusion in the Commission's report that was
15 self-evident, there was no need to explain or support the self-evident nature of the
16 conclusion. But, when you are not dealing with matters that are self-evident, then the
17 Tribunal needs to be satisfied that there is adequate evidence and adequate reasoning to
18 support the logic and the conclusion set out in the report. So, what *Tesco* is really doing is
19 demonstrating this need for the decision-maker to show that it has the materials and the
20 proper reasoning that leads up to its conclusion. Where the Tribunal identifies gaps, that is
21 the point at which the Tribunal can quash the decision - here, the report. Not irrelevant
22 gaps, but gaps that are pertinent to the reasoning, the logic leading to the conclusion.

23 I move on to a slightly different introductory point. Barclays' challenge is a challenge to a
24 remedy - the POSP - which is entirely general in its scope. It applies across the board, even
25 to the retail PPI. The relief that Barclays is seeking is equally general, without qualification
26 or limitation. It applies to the whole of the POSP. Therefore, in order to determine whether
27 or not Barclays' claim is well-founded in its entirety, it is entirely appropriate to look at
28 how Barclays' arguments work in the context of retail PPI. That is, effectively what SGDFS
29 - Shop Direct - has sought to do. We submit that the situation regarding retail PPI is simply
30 an *a fortiori* illustration of the defects in the Commission's report of which Barclays
31 complains. The cross-over between retail PPI and the other forms of PPI is, of course,
32 clearly stated in the report itself. The Commission fairly draws the Tribunal's attention to
33 the relevance of retail PPI to the other forms of PPI and to the remedies package by
34 referring to para. 10.479 of the report, which I mention. I do not think I need to ask the

1 Tribunal to read it now. That is the paragraph that shows that in the mind of the
2 Commission there were synergies in the remedies package so that, in effect, one PPI sector
3 would have an influence on the other and vice versa. So there is no basis whatsoever for the
4 assertion that retail PPI can somehow be sidelined or regarded as irrelevant.

5 That brings me now to a summary of our case on Barclays Grounds 1A and 2. What the
6 report describes is this - and I am here referring to retail PPI: we do not have a market in
7 which there is one, or a number of distortions which, if removed, will restore the market to a
8 situation in which conditions of competition are undistorted. We do not have that. What we
9 actually have is a series of markets. Each market is effectively identified by reference to the
10 particular supplier of retail PPI. What we also have is a complete absence of competitive
11 alternative products. There are no competitive constraints. What then happens is that the
12 Commission investigates further, concludes that there is, or are, an AEC, depending on
13 whether you regard it as one AEC in totality or a number. The Commission says, "Well,
14 you have to do something about this".

15 What it is confronted with, or what it feels it is confronted with, is not removing one or two
16 quirks and restoring things to an undistorted or normal, or functional state. It is faced with
17 something different. What it has to do, it believes, is to destroy the existing markets and
18 replace them with a new market - a new market that also involves the creation of new,
19 competitive alternatives. It is in that context that we see the emergence of the phrase 'the
20 stand-alone provider'. This constant reference to the stand-alone provider is quite
21 interesting when one sees it in the report because it reminds one immediately Afghanistan.
22 In relation to Afghanistan, for quite some time, there have been calls for more boots on the
23 ground. But, that does not mean literally boots on the ground, nor does it mean that there
24 should be vast numbers of holidaymakers wearing boots ----

25
26 JANE @ 2.10

27 **2.10

28 ... holiday makers wearing boots processing up and down the countryside of Afghanistan,
29 nor does it mean cooks and bottle washers in the army ought to be present in greater
30 numbers in Afghanistan merely because the wear boots. It means that you want to have
31 more properly trained soldiers armed to the teeth. You do not want them sitting around in
32 Camp Bastion, or wherever, you want them out there fighting the enemy. So the reference
33 to stand alone providers is not a reference to operators who are just standing around and
34 doing a bit of providing, it is to operators who are equipped with the means to provide one

1 or more competitive substitutes for the existing retail PPI products, and these people not
2 merely have to have the means to develop these products, they have got to be able and
3 willing to get into this new market and compete.

4 The POSP has no function whatsoever other than to remove a barrier to the possibility of
5 these stand alone providers fully equipped with a competitive alternative substitute and
6 willing to compete in the market. That is the only function of the POSP. It has no function
7 whatsoever so far as competition between the existing retail PPI providers is concerned – no
8 function – because of a finding in the report that I will come to shortly. The whole idea
9 behind the POSP and its sole justification is the necessity to do something to enable this
10 competitive force to have its effect and act as a competitive constraint on the existing retail
11 PPI providers. The problem is that the report tells us why it is that there is no competitive
12 substitute product, why it is that there is no competitive stand alone provider. The report
13 identifies a remedy that the Commission thought, if implemented, would enable the creation
14 of a competitive product and thus break the log jam. The report tells us that the
15 Commission declined to adopt that remedy. Instead it went for something that was not as
16 good and it has no explanation in the report as to why it thought, if it did, that that less
17 effective alternative would do the trick.

18 The upshot is that we have the imposition of the POSP, we have acceptance by the
19 Commission that that will lead to an immediate and significant – that is my own word – one
20 is justified, looking at para.10.51 to say “substantial”, because they refer there to a risk of a
21 substantial fall in sales. At all events we have the certainty stated in the report that the
22 imposition of the POSP will lead to an immediate drop in demand – this is the unmet
23 demand, I should say it is not a drop in demand, it is a drop in sales – it is the unmet
24 demand, and to counterbalance that we have no basis, either in the evidence or in the
25 reasoning set out in the report for concluding that the Commission’s belief that new
26 competition will flood in to fill the void either immediately or over a period of time, for
27 believing that that is true.

28 So there is an objectively ascertainable gap in the reasoning of the Commission. It requires
29 no economic analysis, you can see it, it is there. No answer to this point has been given by
30 the Commission. There is no answer in the defence and the Commission effectively waves
31 the white flag in its skeleton argument because it says nothing. It has nothing to say.

32 I will go to the report itself where I am going to seek to make good the submissions I have
33 just made. As I have said, I want to look mainly at section 6. The way I am going to deal
34 with it is to run as quickly as I can through the parts of section 6 that set out the details of

1 the retail PPI market that are relevant for the purposes of today, and then am going to go to
2 look at the POSP, two passages in section 10, but I will have to come back to section 6 after
3 looking at that.

4 Firstly, could you go to bundle 2, internal page 127, the bundle page is 135. That is the first
5 page of section 6.

6 MR. SWIFT: We do have a concern about just how long Mr. Lasok is going to be on retail PPI.
7 This does not form any part of Barclays case, any more its intervention. We just hope that
8 Mr. Lasok is not using it as an opportunity, as it were, to become an applicant in his own
9 right and have the Tribunal rule separately as to whether POSP and other remedies are
10 appropriate for retail PPI.

11 THE CHAIRMAN: I understand Mr. Lasok's time estimate is quite short. How long are you
12 proposing to be overall, Mr. Lasok?

13 MR. LASOK: By three o'clock.

14 THE CHAIRMAN: In the light of that, I think, Mr. Swift, we will simply hear Mr. Lasok and his
15 submissions, and in due course we will decide how much of it we should take into account.

16 MR. SWIFT: I am obliged.

17 MR. LASOK: Perhaps we could start at 6.5, the second line, retail PPI is offered by home
18 shopping retailers. So it is home shopping we are actually looking at. The last two lines of
19 6.5 refer to the fact that:

20 "This section focuses on retail PPI for credit account retail finance."

21 That is what is meant by "retail PPI".

22 In 6.6, the last three lines refer to the methods of payment. The only one we are interested
23 in is payment by means of credit account facility. That is then described in the rest of the
24 paragraph. At the end of the paragraph it says:

25 "... the clear majority of home-shopping purchases are made using a retail credit
26 account."

27 6.7 describes retail PPI, it insures the outstanding balance. A reference is then made to the
28 benefit derived from the policy, which is described as typically the minimum monthly
29 payment due each month on the credit account, and of course the payment may vary
30 according to the repayment plan. That amount may vary from 5 to 33 per cent of the
31 outstanding balance. The last sentence, the premium is paid monthly, calculated as a
32 percentage of the monthly outstanding balance. Hence the premium varies month to month.
33 6.8 has confidential figures in it, but refers to, to begin with, the average retail credit
34 account balances – that is not a confidential figure, 104 and 400, but then the rest of it you

1 have got confidential figures showing the average monthly premiums. By comparison with
2 other forms of PPI, these are small amounts of money.

3 Then 6.9 refers to the fact that retail PPI is bundled with merchandise cover. That was
4 something that is addressed by one of the remedies and no complaint is made about that.

5 You will observe that retail PPI is not bundled with the credit.

6 Then at 6.10 reference is made to four home shopping retailers who achieved a gross
7 written premium for retail PPI in excess of £1 million in 2007. Those are the four retailers
8 that are referred to in the report as the retail PPI providers. You will see at the end of the
9 last line on that page that retail PPI is a small part of these retailers' overall business.

10 The bottom of the next page refers to the fact (second to third lines) that the distributors
11 sold very small volumes of retail PPI compared with distributors of other forms of PPI. At
12 the end of that paragraph you see that one of the four stopped selling retail PPI except to
13 online customers, and another one stopped selling entirely, so that the existing market
14 consists of two and a bit operators. If you go to p.131 of the document, para.6.15 deals with
15 the sales process and table 6.5 gives a breakdown of the sales' processes of the different
16 players and you can see that there is an active sales process, it is offered at the point of sale,
17 but it is also offered later on with the operator, or the provider contacting the customer in
18 order to make the sale.

19 6.16 at the bottom of the page deals with price. You see that they give in the second and
20 third lines the price of the bundled offer, the retail PPI plus the cost of the merchandise
21 cover, and then there are confidential figures setting out the retail PPI element, not large
22 sums of money.

23 At the end of the paragraph at the top of the next page they say the amount of the premium
24 which related to retail PPI was more than £1, significantly so in some cases.

25 Then there is a curious sentence which says that the price for "CC" (credit card) PPI was
26 around 79p. That figure is derived from an extremely arcane appendix in the report and is
27 not comparable to the prices that you are looking at in 6.16 because it deals with situations
28 where the amount covered is about half the amount that is covered by a retail PPI product.
29 Earlier in the report in paras. 2.83 and 2.92 we can find comparisons of what other forms of
30 PPI involved. 2.83 is at p.40 of the document (p.48 of the bundle). 2.83, at the end of the
31 last sentence, gives estimates provided by *de facto* and you see that the average price per
32 £100 of benefit for end PPI was £4.76, CCPPI £11.70, and PLPPI £18.23. Further figures
33 are given in para. 2.92. It simply indicates that in the case of retail PPI we are actually
34 dealing with much smaller amounts.

1 If you go back to section 6, and to internal page 133 (bundle page 141), we have a heading
2 towards the bottom of the page: “Availability and suitability of alternatives to retail PPI”. I
3 will draw your attention to 6.25 to 6.27, but what I am going to pick out of it is the fact that
4 in 6.26 at the bottom of this page, the Commission identified only two stand alone products
5 that were available as possible substitutes for retail PPI, that is the fourth to fifth lines.

6 There is a confidential figure of the number of those products that were sold in a year and
7 you can see that it is a very, very small figure.

8 At 6.27 on the next page we had quite an important finding by the Commission that these
9 possible substitutes were, in fact, poor substitutes for retail PPI, and the gist of the
10 Commission’s conclusion was that these poor substitutes did not amount to any competitive
11 constraint as a result of which they defined the relevant market as being limited to the retail
12 PPI products offered by the retailers that we have just seen.

13 In para. 6.27 two reasons were given for why these policies were not competitive. We do
14 not need to detain ourselves with the second reason, which was connected with the bundling
15 of retail PPI and merchandise cover, and that of course was the subject of a remedy in the
16 remedies package. We are only interested in the first reason which is set out in line 3, that
17 short term IP and stand alone CCPPI policies do not track the balance of the credit
18 account, therefore a customer will be over or under insured for their balance at any time.
19 What that meant of course was that these policies, as the Commission found, were poor
20 substitutes and it was that problem, the need for a competitive substitute to effectively do
21 the same as the retail PPI product by tracking the balance, that the Commission needed to
22 address in the remedies package if there was to be any function or meaning in the POSP.
23 What I am now going to do is to go to 6.44 on internal p.137 (bundle p.145), it is the first
24 sentence.

25 “We also found that as the average balance on a retail credit account is small the
26 benefits to search for retail PPI would appear to customers to be smaller than for
27 other types of PPI.”

28 Then if you could go to the conclusionary paragraph, 6.76 internal p.153 (bundle p.151) the
29 last sentence:

30 “We therefore define the relevant product market as the supply of retail PPI by a
31 distributor to its own retail customers,”

32 What then happens is, if you go to the next page there is a heading: “Indicators of the extent
33 of competition between retail PPI providers in the supply of retail PPI”. Of course, there is
34 a linkage between market definition and assessment of the extent of competition, and given

1 the market definition you would have thought that this was a bit superfluous, but at any rate
2 in 6.78 the Commission says that they are going to assess in this particular section indicators
3 of the level of competition between retail PPI distributors. There is then a footnote, 31,
4 which says this:

5 “SGDFS said that competition primarily took place at the level of the bundle of
6 merchandise, credit and PPI. However, we found that the relevant economic
7 market was the supply of PPI separate from merchandise and credit.”

8 The Commission did not reject SDGFS’s argument, because it reverted to this later on in the
9 section. What it was saying here was that it regarded its technical definition of the relevant
10 market as paramount, and as determining the analysis that it wanted to carry out.

11 If you go to p.147 (bundle p.145) most of this page is concerned with advertising – a topic
12 in which the Commission found that there was no lack of competition. But what is relevant
13 for present purposes is that in the middle of the page in para. 6.91 where the Commission is
14 finding that the degree and nature of advertising of retail PPI was different from other forms
15 of PPI, the reason that is given, which is set out in the middle of that paragraph is this:

16 “Instead, they ...(the retail PPI providers) ... must attract customers to their retail
17 offering more generally and not by any single price.”

18 So what was going on was that competition between the existing retail PPI providers was
19 taking place at the level of the retail offering more generally. It was not taking place at the
20 level of retail PPI because retail PPI was effectively sold as a component of the retail
21 offering.

22 With that I wanted to turn now to the passage in s.10 that deals with the POSP. It is 10.147,
23 internal p.219, bundle p.227. This is a page headed ‘Retail Credit’ where the Commission
24 looks at retail PPI. At 10.147, at the bottom of the page, they say,

25 “We decided that the point of sale prohibition should apply to retail PPI. Our
26 finding was that [1] a point of sale advantage did exist, albeit to a lesser extent
27 than for PPI sold in other sectors of the market, and [2] we consider that it is
28 necessary to address the AEC found in retail PPI with this element of the remedies
29 package unmodified”.

30 In all probability, what 10.147 actually means is that as in the case of other forms of PPI the
31 point of sale prohibition was intended to address the point of sale advantage. It is extremely
32 unlikely that in this sentence the Commission meant that the POSP addressed all the AEC
33 found in relation to retail PPI. The reason for that is that when we come to 10.36 (bundle
34 p.198) here the Commission says that the remedies package will directly address [1] the

1 AEC arising from the sale of PPI at the point of sale (the POSA), and then, in the next
2 sentence, [2] it will also address each of the following barriers to search that we found
3 contributed to the AEC.

4 The barriers of search that are listed here do not apply in the context of retail PPI. The first
5 one, (a), the perception that taking PPI would increase consumer's chances of being given
6 credit, does not apply in retail PPI (the passages in the report that say that are 6.182, 10.108,
7 and 10.143; (b) the bundling of credit - you have seen in para. 6.9 there was bundling with
8 merchandise cover. There was no bundling with credit; (c) the limited scale of stand-alone
9 provision. The particular problem in retail PPI was the complete absence of stand-alone
10 provision; (d) the time taken to obtain accurate price information. This seems to refer to
11 para. 5.27 of the report, and there is no similar finding in the case of retail PPI. The result is
12 that so far as retail PPI is concerned, we are only looking at the relevance of the POSP to
13 the AEC arising from the sale of PPI at the point of sale, which is dealt with in the report at
14 paras. 6.182 to 6.184.

15 THE CHAIRMAN: Mr. Lasok, I am not sure I understand your submission in relation to 10.36(c)
16 - limited scale of stand-alone provision. This is no stand-alone provision. That is, if you
17 like, a limited scale with knobs on, is it not?

18 MR. LASOK: The point, though, is that the only way that you can address (c) is if at least
19 contemporaneously with the introduction of the POSP, or perhaps before it, you are doing
20 something to deal with the problem of stand-alone provision which is, for present purposes,
21 the creation of, at the very least, the circumstances in which it is possible for there to be a
22 competing product. The POSP really follows on from that. What I am not suggesting is that
23 there had to be necessarily a temporal sequence, because we all know that if somebody
24 wants to make an investment in the creation of a new product, they would like to know
25 whether they can actually sell it, and if they are confronted by an existing barrier, they
26 would probably prefer to have that barrier removed or know when it is going to be removed
27 before they make the investment. So, I am making no time point here. What I am simply
28 saying is that the POSP could not have been regarded in isolation as assisting, in particular
29 in relation to the removal of barriers to search, unless there was something to search for.
30 So, at the very least contemporaneously, as part of a package, you have got to be doing
31 something effective in relation to the creation of an alternative that the consumer can search
32 for.

33 This may perhaps go back to a point that was made earlier today about people's perceptions
34 and prices coming down. Let us suppose that you have got a market and there are barriers

1 to entry. It is decided that if you remove the barriers to entry you make the market
2 contestable and prices will go down. They will go down because the existing players in the
3 market perceive that they are vulnerable to new entry. New entry does not have to take
4 place. The mere threat of new entry is going to cause them to take action to preclude new
5 entry. That is fine as a theory. But, what happens if, when you remove the particular
6 barrier that you have identified, the existing players know that there is another barrier that
7 you have not removed? In those circumstances there is no competitive constraint. The
8 market is not contestable. There is no reason why the existing players are going to reduced
9 their prices. There is no threat.

10 So, in the present situation the POSP cannot be regarded as something that operates in
11 isolation , or, indeed, it operates by reference to the removal of the POSA unless there is, at
12 the very least, a real prospect that there are going to be, or that there are, alternative sources
13 of competition, because you have to have these in order to have the competitive constraint
14 on the existing players. What we have here is the situation in which -- Well, I have
15 already said what we have got here, and perhaps I want now to come to demonstrate that it
16 is what we have got here.

17 What I actually wanted to do was to go to the end of s.6. Perhaps we can look at the
18 POSA? If you go to internal p.166/bundle p.174, at the top of that page, 6.183, you have
19 got three advantages derived from the POSA. We know from para. 6.176 (internal
20 p.164/bundle p.172) that an earlier section dealing with another matter - barriers to entry
21 and expansion - was to be discussed -- or at least the issues were to be discussed in more
22 depth in the context of the POSA. This is the context of the discussion. So, we have got
23 three advantages in 6.183. The first one, which is in the fourth line, is basically an
24 information advantage. The second and third are the fact that effectively the retail PPI
25 provider has, to put it in a colourful way, already got its clutches on the customer. So, in
26 6.184 we have effectively a summary of the problem ----

27
28 JANE @ 2.40

29 **2.40

30 ... in 6.184 we have effectively a summary of the problem and that is that the sale of retail
31 PPI at the initial point of sale and continued exclusive access restricts the extent to which
32 other PPI providers can compete effectively. So it is all about the removing of a barrier to
33 the ability of other PPI providers to compete effectively.

1 I should make this point, that in 6.184 at the end of the first line there is a reference to
2 “exclusive” access. It is entirely clear where this comes from. It is referred to in the last
3 sentence of the preceding paragraph which, at the end of the paragraph in footnote 78, has a
4 cross-reference to para.5.111 of the report which does not refer to exclusive access. It may
5 well be that “exclusive” is superfluous, or at least we do not where the source of this is.
6 At all events, what we are dealing with is a situation in which the function of the POSP is to
7 remove the POSA so as to enable these stand alone providers to have a chance at competing
8 in order to get the business of the retail PPI customers.

9 I also at this stage ought to mention this: if you go to 6.189 on the next page, internal page
10 167, the bundle page 175, we have, after the various AECs identified in section 6 have been
11 summarised in 6.187, the detrimental effects on consumers derived from the AEC. In
12 summary, the AEC identified in 6.187, if you look at (a), was that distributors fail actively
13 to seek to win customers. The important point, in our submission, to note is that the
14 findings made by the Commission were that the distributors did actively seek to win
15 customers. An illustration of that is para.6.15. What they did not do was to use price or
16 quality of the retail PPI policies as the competitive variable by which they competed
17 because of the finding that you have got in para.6.91 that they must – that was the word
18 used by the Commission – compete at the level of their retail offering generally. So the
19 competitive dynamics so far as the existing retail PPI distributors were concerned operated
20 at the level of the retail offering generally, it did not operate at the level of retail PPI itself,
21 which is one of the reasons why I say that what the Commission was confronted with was
22 the necessity actually to break down the existing market structure and radically alter the
23 competitive dynamics in order to create the situation, the end result that they wanted. They
24 certainly could influence the competitive dynamics at the level of the retail offering
25 generally, and some of the remedies do that. That is not what they wanted to do. It was not
26 their target. They were not focusing on doing something at the level of competition in
27 terms of the retail offering generally. They never analysed that. What they did was, they
28 put it on one side and said, “Let us have a look at retail PPI in isolation”. Of course, in
29 business terms for the existing retail distributors that was a wholly artificial construct, but
30 that is what they wanted to do. That is where, of course, the stand alone providers come in.
31 Then (b), at the top of p.167, is the problem about searching. We certainly do not dispute
32 the fact that the POSA is a barrier to search, but the problem is, search for what? In fact, at
33 the time covered by the report, it could not have been a barrier to search because of the
34 absence of a competitive product.

1 Then (c) is switching, and we are not concerned with switching, and (d) is the POSA itself.
2 Then if you look at the detrimental effects on consumers, you have got two which are
3 identified, and again I will put numbers in the paragraph. The second line is (1), higher
4 prices for retail PPI policies than would be expected in a well functioning market; and then
5 we have (2), it was possible that there was less innovation.

6 It is interesting to compare that to para.5.146, which is the parallel passage dealing with
7 other forms of PPI. That is at internal page 126. bundle page 134. If you have got that you
8 will see that there are four detrimental effects. Again, introducing numbers and starting at
9 line 2, we have got (1), higher prices; and then (2), less choice. Then in line 3 we have got
10 (3) demand for PPI was distorted. Then in the next line, (4), the possibility that there was
11 less innovation. I mention that because you can see that there was a clear difference
12 between the detriment for consumers between retail PPI and the other PPI sectors.

13 There has been a debate over the last couple of days about mis-selling and the relevance of
14 mis-selling, which is largely derived from number (3) in para.5.146. “The demand for PPI
15 was distorted” is a phrase that is based upon paras.5.136 to 138. Of course, what has
16 happened is that the Commission protests, *inter alia*, in its skeleton, para.6, about mis-
17 selling and the like, but, in our submission, all of this is a red herring. It is a smokescreen.
18 It is designed to take the Tribunal off the scent because there is no such basis for allegations
19 of mis-selling and the like in relation to retail PPI. Nonetheless, the Commission did, in
20 relation to retail PPI, exactly what it did here. So, even if there had never been this item (3),
21 demand for PPI was distorted, no allegations of mis-selling, and so forth, then the
22 Commission would still presumably have done what it did, because that is what it did in
23 relation to retail PPI.

24 One should also observe, I suppose, that mis-selling can occur even in competitive markets.
25 For example, if you earn £100 by mis-selling a rubbish product and then the Competition
26 Commission introduces changes in the market structure that mean that prices go down so
27 you only earn £10 on each sale rather than £100, it simply means that you are going to have
28 to mis-sell ten rubbish products in order to earn the same money. If you were being
29 sarcastic about this you would say that the problem with introducing mis-selling into this
30 exercise is that if you introduce competition you are introducing an incentive to mis-selling.
31 A lot of people would probably say that it is not a good idea to encourage mis-selling or
32 create circumstances in which mis-selling might increase.

33 Of course, the answer to all this is that mis-selling is not something that we can actually
34 tackle by this kind of exercise, the exercise that the Commission was involved in. This is

1 something that the FSA does. If you start using the tools that are available to the
2 Competition Commission in order to deal with mis-selling, tools that are effectively
3 directed towards ensuring that markets are competitive, it is almost certainly the case that
4 you are going to end up with disproportionate solutions for reasons that have been given by
5 Miss Davies and Mr. Sharpe. You are misfiring, you are doing something that is
6 inappropriate.

7 I might also mention this: that if mis-selling really is at the basis of all this then Mr. Swift
8 ought to be knitting together his white flag, at least so far as retail PPI is concerned, because
9 if mis-selling lies at the heart of all; there was no justification whatsoever for the
10 Commission to have imposed remedies in the context of retail PPI, certainly not remedies of
11 this sort.

12 Perhaps I ought to add a footnote here about impulse purchasing. Impulse buying is not
13 mis-selling. Yesterday, on my way here my learned Junior went into a tobacconist and
14 confectioner. I followed him, not thinking very much about what I was proposing to do
15 and, on an impulse, I bought a packet of mints. I have not regretted that purchase, nor was it
16 an example of mis-selling. The retailer was only too grateful that I should proffer my
17 money in return for the packet of mints. Now, it is true that when I made that impulse
18 purchase I did not spend an amount of time roaming around the retailers' shelves looking at
19 similar competing products, and I did not rush out into the street and spend some time
20 trying to find out whether there was a retailer offering similar and competing products at a
21 better price, it was an impulse purchase. It is not mis-selling. If you want to use these
22 Enterprise Act techniques and methods to deal with impulse purchasing that, in our
23 respectful submission is a clear mis-use of the statutory power. Impulse purchasing is
24 qualitatively different from mis-selling and competitive remedies, in our submission, are not
25 appropriate for dealing with situations such as I have described where you have a person
26 who, on an impulse makes a purchase that may or may not be something that he regrets in
27 the passage of time, but that is not a competition issue. So in our submission impulse
28 purchases are irrelevant. I can understand people talking about mis-selling because it is all
29 part of the basic case advanced by the Competition Commission and the FSA who are
30 clearly adherents to the "dirty dogs don't win" school of jurisprudence, and what they are
31 doing is they are using the allegations of mis-selling in order to cloak the absence of a case
32 in the report properly and soundly based on the Enterprise Act, so it is all a smoke screen.

1 Perhaps we can move on from that to look at this question of, we now know what the POSP
2 was for, we know what it was addressing, it is addressing the POSA as it applies in relation
3 to retail PPI.

4 The idea is to create the stand alone providers, but we have already seen the passage in the
5 report in which the Commission sets out the reason why it is that there is not a competitive
6 alternative substitute product. I drew the Tribunal's attention to 6.27, but it is a point that
7 was repeated by the Commission, we see it in para. 6.165, which is the internal p.162
8 (bundle p.170). It is also repeated in 6.170(a), but 6.165 is quite a good paragraph to look at
9 because there is a clear statement there that the problem is that there is not coverage of
10 adequate competitive quality; you cannot track the balance, that is the problem.

11 So what did the Commission do in order to remedy that. This needs us to look at 10.366
12 which is internal p.271 (bundle p.279) and this is in the context of an informational remedy,
13 because it is here (10.366) that the Commission addresses the question about an
14 informational remedy that would encourage more tailored stand alone PPI products. You
15 see in 10.367 in the first sentence that nearly all parties, and all the stand alone providers,
16 raised objections which are set out in that sentence, to the utility or practicality of that
17 remedy.

18 If you go to the next page at 10.370 you see the conclusion reached by the Commission
19 after it had considered the views put to it, and it says at the beginning of 10.370: "We
20 considered that the provision of this information could in theory allow the creation of more
21 tailored products", and you can see the reference to retail PPI, but then in the second
22 sentence they say:

23 "Given the lack of interest in gaining access to this data we were not convinced
24 that in practice the information would be used in this way and therefore we
25 considered that it was unlikely to be effective."

26 Curiously, we then get to the last sentence in that paragraph where the Commission records
27 that it had decided already to require average balanced data to be included on the annual
28 statement. There is then a cross reference to para. 10.320 which records that, and the
29 Commission simply says that it considers that to be a more effective and proportionate
30 means of facilitating stand alone competition. But this is average balance data, this is not
31 data that is going to resolve the problem that was identified *inter alia* in para. 6.165. If all
32 that the product is doing is tracking the average balance it is going to be in accordance with
33 what 6.165 said, lower quality; and, so far as we can glean from 6.27 it is not going to be a
34 competitive product.

1 Furthermore, in the light of 10.367 and the conclusion in 10.370, the alarm bells must have
2 been ringing in the Competition Commission about all this because their conclusion in the
3 second sentence of 10.370 was that there was not only a lack of interest in gaining access to
4 data that the Commission itself regarded as appropriate to enable the creation of tailored
5 products, but the Commission goes on to say that they were not convinced that in practice
6 the information would be used in that way.

7 This cries out for another paragraph, at least one other paragraph, in which the Commission
8 says that having thought that average balance data might be appropriate we went back to the
9 stand alone providers and, indeed, anybody else; we said to them: "Will it do the trick?" If
10 it does the trick do you reckon that you will go into the market, or is the market too small, it
11 is not worth it? And, if you are going to go into the market, how long do you think it will
12 take you to gear up? Three very simple questions and three very obvious questions, and we
13 see nothing in the report on this at all.

14 This is quite important, when one looks in particular at the evidence that the Commission
15 had about the problems in this market. What we are talking about is home shopping, this is
16 done remotely, and the evidence before the Commission was that the problem with the
17 imposition of the POSP was that it would lead to a drop in sales. Why was it going to lead
18 to a drop in the sales? The reason that was given by SDGFS in its response to the
19 Commission's provisional decision on retail remedies is something that I am about to show
20 you. This the confidential version. My friends have been put on notice that I was going to
21 refer to this. (Same handed) It is going to go into Bundle 1 at Tab 13. It is there already, I
22 think. The passages I wanted to direct your attention to -- In my copy, at any rate, there is
23 handwritten pagination at the bottom of the page which is supposed to be the bundle
24 pagination. If you could go to p.565/internal p.539 there is a paragraph 6.2.3. That contains
25 confidential material. You can see if you read that that because the retailer is dealing
26 remotely with the customer, in order to make the sale you have got to contact the customer,
27 and there is a problem in getting in contact with the customer. This is repeated on the next
28 page, 6.4 to 6.5. (After a pause) You can see that SDGFS had anticipated, based on its
29 experience, quite a significant downturn in sales. This results from the purely practical
30 reasons of making a deal with a customer in this type of market where you are dealing
31 remotely.

32 You will also recall from the report that one of the ways in which the retail distributors do
33 this is through advertising. I mentioned to you that in the advertising section - and the
34 conclusion is at 6.95 - there was a finding that there was no lack of competition in

1 advertising. What happens is that the retail distributors make the information available in
2 catalogues and the like so that the consumer can make the selection. This is where the
3 competition at the level of the general retail offering comes in. But, of course, once you
4 dismiss that, and you are isolating retail PPI and subjecting that to separate treatment, then
5 you have got to acknowledge the fact that when you are dealing with home shopping, where
6 the relationship is remote, there are practical considerations relating to contacting, and
7 keeping in contact with, the customer.

8 This evidence was not disputed by the Commission. All that it said was that some people
9 had exaggerated. We know that some people had put in estimates of loss that were greater
10 than the ones indicated by SDGFS. Of course, when you are looking at this scenario, this
11 particular problem it also raises the question about the ability of stand-alone providers to get
12 into contact and make a sale with the customers. How are they going to do that? Is that not
13 a question that the Commission should have asked as part of the three questions that I have
14 suggested they should have asked? Is the average balance(?) information going to do the
15 trick? If it does the trick, will you go into the market? How long will it take you to do that?
16 As I have said, this could have been done. An answer could have been obtained. No doubt
17 if it had been done, and if an answer had been obtained, it would have been set out in the
18 report. But, there is nothing.

19 So, we have got this situation in which there is no doubt at all that the imposition of the
20 POSP is going to have this (a) significance, substantial effect -- We can say 'substantial', I
21 think. However many percentage points you put on it is a different matter, but it is going to
22 be substantial. But, the problem is that it is not counter-balanced by anything in the report
23 that gives anybody any confidence or any reasonable basis for belief that this is going to be
24 offset by any advantages for the consumer or, indeed, anybody else.

25 In our submission that really is the end of it. I say 'the end of it'. I have overstayed my
26 welcome by five minutes, but what I wanted to do was to just trespass upon the indulgence
27 of the Tribunal for about another five minutes to deal with Ground 3.

28 I am reminded that perhaps I just ought to summarise what I have said on Ground 1A and 2.
29 The problem is that we do not see a remedy that, on the face of it, will be effective to
30 generate the possibility of a competitive constraint from stand-alone providers. So, there is
31 actually no basis at all for the aspiration and hope set out repeatedly in the report in paras.
32 10.50, 10.51, and following that where constantly there is a reference to the fact that all the
33 detriments, the damages that people are concerned about will be wiped away because of
34 enhanced competition. There is actually no basis for believing that in the context of retail

1 PPI. In any event, over what period of time? In a timely manner? What does that mean. I
2 think we know what it means - it means, "We haven't the faintest idea. We believe that
3 with a bit of luck and with fingers crossed something might happen at some stage. If it
4 happens, it will not happen before it can happen. As to when it can happen, we haven't the
5 foggiest". That is what it means.

6 Ground 3. I want to make, I hope, three brief points about Ground 3. The first one is about
7 quantification of the detriment. We know that in the case of PLPPI, mortgage PPI, SMPPI
8 we have got a quantification of £200 million per annum. That is para. 10.494. That was
9 derived from the modelling that we have had a description of, using the waterbed effect.
10 None of this applies in the case of retail PPI because in the case of retail PPI we have got a
11 separate figure of £12.3 million. That was derived not by carrying out a waterbed analysis,
12 or similar modelling. The Commission simply took what it considered to be the level of
13 excess profits that the Commission claimed to have found. The reference to that is 10.496.
14 Now, we have never accepted that that was a correct figure, or that there were excess
15 profits. We are not challenging that in the judicial review proceedings. It is one of these
16 difficult areas, and, of course, it is peculiar to retail PPI. The problem is this - and this is
17 where there is a cross-over with Barclays' case : that the figure of 12.3 apparently
18 represents the entirety of the detriment that the Commission calculated as arising from the
19 AEC in the context of retail PPI, but there is nothing in the analysis to explain how the
20 remedies that it proposes would succeed in addressing the entirety of that detriment or over
21 what period of time. So, realistically our problem is that the costs of the remedy have to be
22 weighed against an unknown figure. We do not know - and there is no explanation in the
23 report - as to what part of the £12.3 million detriment is actually adequately going to be
24 addressed by the AEC. On the basis of the submissions I have already made there is, quite
25 clearly, a problem. The likelihood, we would submit, is that the remedies package simply is
26 not going to address the AEC at all.

27 However, what we have so far as Ground 3 is concerned, is the reappearance of the *Tesco*
28 fallacy. The belief that the Commission is entitled to weigh the entirety of the detriment
29 against the costs of the remedy instead of that part that is going to be addressed effectively
30 by the AEC. Even in relation to that, we have difficulties in identifying the cost and
31 therefore carrying out the proportionality analysis because the Commission lumped the
32 costs of implementation in with all other types of PPI. So we have got 12.3, but we have
33 got no separate quantification of costs that we can compare with the 12.3, and on the face of
34 it at any rate the 12.3 is not going to be addressed by the AEC.

1 The second point concerns this business about the quantified and unquantified amounts. It
2 is trite law that if the decision maker exercising judgment decides to embark upon an
3 exercise in which it investigates, let us say, two things and informs its judgment by reference
4 to both of those things, but it got one of them wrong, then the exercise of judgment is
5 vitiated. The only circumstance in which it is not vitiated is if the Tribunal, the court
6 exercising judicial review or judicial control, is satisfied on the basis of what it has seen that
7 the two factors or the two reasons are wholly independent. There is no basis in the report
8 for concluding that the Commission regarded the quantified and the unquantified amounts
9 as being separately sufficient, they are inter-related. Hence, if, for the reasons given by
10 Mr. Sharpe and Miss Davies, the £200 million figure is unreliable then the Commission's
11 case falls.

12 What I accept to be trite law is actually derived from a judgment of Lord Justice May in a
13 case *R. v. The Broadcasting Complaints Commission (ex parte Owen)* [1985] QB 1153,
14 1177. I give the citation. I can hand up copies if the Tribunal wants it, but because it is
15 settled law I do not suppose that Mr. Swift is going to dispute it.

16 Lastly, and this I think will take a minute, water bed effect. In the computation of the
17 detriment, the water bed effect was not taken into account in the context of retail PPI. The
18 reason was this: SDGFS had submitted that it was not making excess profits. It produced
19 an experts' report from Oxera saying that if it was making excess profits then the
20 competitive dynamics would lead to those excess profits being competed away through
21 competition on the other parts of the package of its retail offering.

22 The Commission decided that there were excess profits, but instead of saying that Oxera got
23 it wrong, or indeed carrying out a water bed analysis, it simply proceeded on the basis that it
24 did not need to carry out a water bed analysis because of SDGFS's initial assertion that it
25 was not making excess profits. That was clearly wrong. We have raised that in the
26 statement of intervention. There is no response to that point at all.

27 THE CHAIRMAN: Can you just remind me of the paragraph, just for my note. I do not want to
28 go to it, I remember it.

29 MR. LASOK: It is bundle 1, tab 8, and it is effectively para.61 on p.238 of the bundle. Page 325,
30 I am told, is the relevant bit in the Oxera report. When I said it was para.61, that is where
31 the quote from the Oxera report is to be found.

32 THE CHAIRMAN: No doubt that paragraph will contain the necessary cross-references.

1 MR. LASOK: It is really the sequence, paras.60 to I suspect 68, just reading it. It is basically just
2 two pages. There is no response to that in the Commission's defence, absolutely nothing.
3 So one assumes that they have conceded that point.

4 Therefore, for all those reasons, in our submission, the relief sought by Barclays ought to be
5 granted.

6 I am just going to ask my junior whether I need to say anything else. No. Unless I can
7 assist the Tribunal any further, those are our submissions.

8 THE CHAIRMAN: Thank you. We would take our short break at this point, but if Mr. Swift
9 wants to carry his bat unused to tomorrow morning it will be a long break.

10 MR. SWIFT: No, Mr. Swift does not want to begin. I would like to exercise what we agreed at
11 the outset on Monday, that I would start tomorrow morning. I would much prefer to do
12 that.

13 THE CHAIRMAN: Yes.

14 MR. SWIFT: May I give the Tribunal just a relatively short reading list. I assume we now finish
15 after this?

16 THE CHAIRMAN: Yes. I cannot think of any reason not to unless anyone else has a reason not
17 to.

18 MR. SHARPE: Obviously I am going to be taking the Tribunal to those key paragraphs in section
19 10, such as 10.72. Just reading 10.72 into the transcript:

20 "We concluded that the point-of-sale advantage contributed significantly to the
21 AEC that we had identified. Given the severity of the competition problems and
22 the scale of the resultant consumer detriment, we concluded that it was necessary
23 to introduce a remedies package that would lead to a new, more competitive,
24 market structure."

25 The question for the Tribunal is going to be, among others, whether the Commission had
26 put itself into the position within the meaning of the judicial review rules to reach their
27 conclusion, but because, as Mr. Sharpe mentioned, AECs can differ in their economic effect
28 – and I think he referred to one being maybe trivial – this is not a trivial AEC. It helps the
29 Tribunal just to look at some of the sections in chapters 4 and 5 so as to get a feel for the
30 severity of the problems. I would suggest 4.73 to 4.96 relating to excess profitability and
31 conclusions on the extent of competition. Then 5, 5 is a long chapter, but I would ask the
32 Tribunal to look in particular at 5.79 to 5.87, which cover barriers to search; 5.88 to 5.119,
33 which is an extensive review of the point of sale advantage. At 5.120 the possible
34 constraints provided by the stand alone providers because of the emphasis that has been

1 given by Miss Davies and indeed Mr. Lasok today to the position of the stand alone
2 providers as now and post-intervention. Then really a critically important section, 5.135
3 and following, which is summarised in our skeleton but does repay a read.

4 THE CHAIRMAN: I am sorry, 5.135 to where?

5 MR. SWIFT: 5.135 to 5.143. That is the paragraph that precedes the para.5.144 which has been
6 read to the Tribunal extensively, and those are the conclusions on factors affecting the
7 nature and extent of competition and that is where the AEC is set out. So 5.144 builds on
8 the earlier points.

9 In terms of the law the only authority that I would ask the Tribunal to look at is 2006
10 Mental Health Review Tribunal case, and that is to be found in the supplementary
11 authorities bundle at tab 3. That is a decision of the Court of Appeal where the judgment
12 was given by Lord Justice Richards. It is quite a long judgment.

13 THE CHAIRMAN: Are there any particular short cuts to squash it?

14 MR. SWIFT: Paragraph 92.

15 THE CHAIRMAN: Thank you.

16 MR. SWIFT: It is interesting before that, but it gets more interesting after para.92.

17 THE CHAIRMAN: Is it just 92 or the section starting at 92?

18 MR. SWIFT: No, it is para. 92 of the judgment, it is p.883 at B of the supplementary authorities
19 bundle. That is the part of the judgment in which Lord Justice Richards refers to statements
20 by Lord Hoffmann in the *Rehman* case and it is all to do with standard of proof when you
21 are considering future events and risks; it is what are the disciplines to be adopted in cases
22 of risk assessment where one is in the area of prediction and uncertainty. Those are cases
23 that are also to be found referred to in the *BSkyB* judgment of this Tribunal, and this
24 Tribunal will probably know that that decision is subject to appeal in the Court of Appeal
25 with the hearing coming up in about six weeks' time, where the leading judge is going to
26 be Lord Justice Richards.

27 THE CHAIRMAN: But you are not asking us to defer our consideration of the matter ----

28 MR. SWIFT: No, no, we are not, no, no.

29 THE CHAIRMAN: -- until the judgment on that case is handed down.

30 MR. SWIFT: No, the principles and the rules are as been stated very fully by Mr. Sharpe and
31 Miss Davies, and we have very little to add, but that is just an extra assessment of the
32 discipline in examining future events and the risks associated therewith.

33 THE CHAIRMAN: Thank you very much. Your time estimate remains as it was, does it –
34 subject to injury time?

1 MR. SWIFT: Subject to injury time, yes. I have been a bit battered over the past two and half
2 days, but I and the Commission are broad enough to counter these adjectives that have been
3 thrown at us so we will come back with some nouns tomorrow. I will start at 10.30 and I
4 would hope to be sitting down at 1 o'clock, subject to injury time.

5 THE CHAIRMAN: Thank you very much.

6 MR. SHARPE: That means then that FSA will then proceed, which I understand will be
7 relatively short.

8 THE CHAIRMAN: You will be after lunch but not immediately after lunch.

9 MR. SHARPE: I do not know what I am replying to so I do not know what the position is going
10 to be.

11 THE CHAIRMAN: I suppose it is a consideration whether we go back up the chain so that you
12 go last after any interveners – it may be they do not want to add anything. Perhaps you will
13 discuss that among yourselves; you will not know yet until you have heard Mr. Swift.

14 MR. SHARPE: Sir, in relation to the very modest reading list my friend has offered you, may I
15 offer you one that you might find helpful to read overnight in addition – it is just a short
16 case, probably best done in tandem with my friend's case, because it is *In re children*, I
17 think it is tab 18 of authorities bundle 1 – it is actually a House of Lords' authority. If one
18 reads, as it were, Lord Justice Richards in the light of this case.

19 THE CHAIRMAN: How much of this case have we got to read?

20 MR. SHARPE: I would say para. 2, 15 and 70 to 72, and perhaps the headnote might well inform
21 you.

22 THE CHAIRMAN: Very well.

23 MR. SWIFT: Sir, my understanding from the Tribunal procedures is that the only person with a
24 right to reply is the applicant.

25 THE CHAIRMAN: Well that may be so ----

26 MR. SHARPE: That was my understanding.

27 THE CHAIRMAN: -- but rights of reply are one thing and if somebody wants to reply without a
28 right to do so the Tribunal will consider any application that is made.

29 MR. SWIFT: We are in your hands on that.

30 THE CHAIRMAN: Yes, thank you. 10.30 tomorrow, I think.

31 (Adjourned until 10.30 a.m. on Thursday, 10th September 2009)