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IN THE COMPETITION
APPEAL TRIBUNAL

Case No. 1109/6/8/09

Victoria House,
Bloomsbury Place,
London WC1A 2EB

11th 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 FIVE

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. We have received a number of speaking notes shortly before
2 ten-thirty. What we have done is to read relatively quickly through the interveners' speaking
3 notes to see if we had any questions we wanted to ask about them. It struck us that they
4 read well in the sense that they were perfectly intelligible as they stood, and we did not have
5 any questions we wanted to ask about them. Our inclination, unless either of the interveners
6 wants to press us, is to take those notes as they stand as the interveners' replies. I do not
7 mean to rule out some point of emphasis or something that is not there, but essentially to
8 take the note as a written submission. They seem to make perfectly intelligible reading. We
9 have not, I am afraid, had time, Mr. Sharpe, even to start reading your rather longer
10 speaking note. We are interested in knowing how you would suggest that we would
11 proceed. We can either treat it as an alternative to having to make notes and hear you in the
12 usual way; alternatively we can spend a bit more time and go and read it; alternatively you
13 give us highlights now and we can read the full thing thereafter. I do not wish to impose any
14 of those on you. You can choose.

15 MR. SHARPE: Sir, I think actually the most effective way, if I may suggest, given that I am not
16 going to be here for ever, but you are now seized fully of the case to take it forward, would
17 be for you to retire it, to read it, and to come to your view to its intelligibility. Perhaps
18 allow me a moment to emphasise one or two points, but, more importantly, to respond to
19 any questions that might arise following your reading. We burned the midnight oil and it
20 was designed actually to meet our side of the bargain that we would not detain you for long
21 on this.

22 THE CHAIRMAN: I think, without yet having had a chance to read it, it looks as if it is going to
23 be doing that well. I would think about fifteen to twenty minutes - unless anyone wants to
24 suggest that is not a convenient way to proceed.

25 MR. LASOK: Can I just say this, Sir: there is a defect in our speaking note - that is, it does not
26 have cross-references to the transcript. What we did was to put in bold what the points were
27 and we were going to complete it when ----

28 THE CHAIRMAN: When you got the transcript references, but there was a hiccough because
29 there was ----

30 MR. LASOK: Yes. What I was going to ask the Tribunal was whether it was more convenient
31 for us later today to email you and send you by hard copy another version of the speaking
32 note with the transcript references ----

33 THE CHAIRMAN: With the transcript references included. I think that would be very helpful.

1 MR. LASOK: On the basis of what the Tribunal have said I do not propose to say anything
2 orally.

3 THE CHAIRMAN: So we shall assume the text of the note does not change and the transcript
4 references will be filled in. That would be very helpful.

5 MR. SHARPE: I wonder if we might also do that in due course. One of the problems is that we
6 did not get the transcript until ----

7 THE CHAIRMAN: I have been asked by the support team to communicate their apologies
8 because it was a clerical error and they did what they could this morning to put it right.

9 MR. SHARPE: These things happen. It might assist the Tribunal if we were able to do that so
10 you can follow up the references in due course.

11 THE CHAIRMAN: On most occasions one can remember it in a short case like this, but it is
12 sometimes helpful to have that.

13 MISS DAVIES: Sir, apologies, our note does not have that problem because we managed to do it
14 this morning. It does refer to one document which is not in the bundle which I just wanted
15 to hand up, which is a letter from Lloyds correcting a factual inaccuracy, and the suggestion
16 that the Commission must have assumed that we could replicate its models. We told them
17 clearly that we could not. Whilst it is convenient I will just hand that round now and hand it
18 up to the Tribunal so you have it so that we can all work out where it is going to. It is in the
19 confidentiality ring, not because of this point, but because the remainder of the letter makes
20 some points which are confidential to Lloyds ----

21 THE CHAIRMAN: It is so marked, is it?

22 MISS DAVIES: It so marked, indeed.

23 One other point I should just make in relation to the note, just for your record. At the end of
24 para.8 ----

25 THE CHAIRMAN: Of your note?

26 MISS DAVIES: Yes, if I may. At the end of para.8 we make the point that it is not open to the
27 Commission at this stage to improve its case by seek to quantify. In fact, we have had a
28 note from the Commission this morning telling us they are not proposing to do that. Just to
29 note that, thank you.

30 THE CHAIRMAN: We will resume at 11 o'clock or thereabouts.

31 (Short break)

32 THE CHAIRMAN: Thank you, Mr. Sharpe, it was as we anticipated intelligible. There were one
33 or two what we thought might be typos ----

34 MR. SHARPE: Oh dear!

1 THE CHAIRMAN: -- but if they were intentional they may have a meaning that we do not
2 understand – para. 34, are the words in the second line: “... the POSP as part of the ..”
3 superfluous?

4 MR. SHARPE: “... adds to the effectiveness ...”

5 THE CHAIRMAN: “... of the package ...” is it not?

6 MR. SHARPE: “... of the package of remedies.”

7 THE CHAIRMAN: Thank you. Is there a “not” missing before the last word in para. 58?
8 (Laughter) I think there is!

9 MR. SHARPE: Undoubtedly, thank you.

10 THE CHAIRMAN: Apart from that, I do not think I have any questions. I think Professor
11 Stoneman may have a question.

12 PROFESSOR STONEMAN: Paragraph 38(a), one of the issues I often get in the classroom with
13 economists is trying to separate out shifts of a demand curve from shifts along a demand
14 curve, and I wonder to what extent whoever drew up this note might have fallen into that
15 trap in that the greater competition I took it would shift the demand curve, whereas the
16 increase in sales to which you are referring as compensating is in fact a shift along the
17 demand curve and so you are actually comparing two things that should not be compared.

18 MR. SHARPE: First of all, I wrote this so I am responsible for it, and I do recall dim and distant
19 days the difference between an increase and an expansion in demand, I think one represents
20 a movement in the demand schedule and the other one represents an expansion of demand
21 brought about typically by price changes. Allow me just a moment. (After a pause) It is
22 actually quite difficult to even graphically represent what is going on here as you pointed
23 out on the first day, with respect. Professor Yarrow attempted to do that and I may revert
24 to that because I think what his report showed was correct for what he was intending to
25 show, namely, a reduction in demand, all things being equal – we were about to say *ceteris*
26 *paribus* – it is the only Latin I am allowed to use in a courtroom – which meant for any
27 price on any given set of information or consumer awareness there would be a systematic
28 movement of the demand curve to check it to the left. There is no difference at all between
29 Mr. Colley’s representation and Professor Yarrow, it is all a question of what happens to the
30 elasticities and I do not think anything hangs on that.

31 In respect of the reduction in demand brought about by inconvenience, we have a
32 movement to the left. That is on day one. Over time, as I understand the Commission’s
33 case, several other factors would come in to play. One of them may be more advertising,
34 marketing and awareness. My understanding of the position there is that that would have a

1 number of effects. It might well move the demand curve to the right because at any given
2 price advertising would kick in and people become more aware and there would be a
3 systematic demand increase.

4 The informational remedies might also serve another purpose and it would make the market
5 more transparent, and the submission would be that that would then make the demand at
6 any given price more elastic, so we have those two sequences at work. If there were more
7 consumer awareness and consumer confidence in the market, consumer awareness may lead
8 to greater price elasticity but it might also lead to an increase in demand because people
9 would have more confidence in the product at any price.

10 I have attempted to go 'round the four corners of the question – have I answered it?

11 PROFESSOR STONEMAN: Nearly.

12 MR. SHARPE: Of course what the Commission is arguing, as I understand it, is that the package
13 of remedies would have a dynamic effect on this market. That, of course, does not insulate
14 them from analysis, that is very much the heart of our case, and to attempt to quantify that,
15 although you read in our submission we do draw a distinction, which I am afraid others
16 seem to have lost, between quantifying effects and measuring them. There is quite a
17 difference between measuring precisely or measuring at all and saying something is greater
18 than or less than another, as long as the proposition is supported by evidence.

19 A simple point in conclusion here is that the Commission refers to “dynamic” effects, when
20 we look at their modelling, if the impact of the dynamic effects is, as Mr. Swift described it
21 yesterday, this would be the improvement in the market place, giving rise to competitive
22 forces, I think he alluded to Professor Hayeck which worried me a little bit, it was actually a
23 peculiarly inapt allusion because Hayeck was an economist who believed you could not
24 predict how markets will work, these are forces at work which lead to unpredictable results,
25 and he wrote it at a time when the orthodox in economics, particularly in Eastern Europe,
26 was all in favour of planning – earnest planners doing graphs, calculating consumer
27 surpluses, making assumptions about industrial output of tractors in Hungary, or whatever –
28 that is where Mr. Swift comes from. (Laughter). Of course, I was paraphrasing the
29 appendices in the report as well.

30 What we have here, if we remember the assumptions in the static analysis we have the
31 dramatic reduction in price to a level where no super normal profits have been made. I
32 guess that is a proxy for what would happen at the end of this process, this Hayeckian
33 process. So in a sense an important dynamic effect has been implicitly modelled and in
34 addition to that any elasticity demand would indicate where that would likely end up with

1 increased volume – and that too has been modelled. So it is a false antithesis in a sense to
2 say there are dynamic effects and there are static effects, because in the modelling they
3 have, to a marked degree taken into account where the dynamic effects might go. I do not
4 want to push that too far because I think there are other dynamic effects which may not
5 have caught in that, for example, innovation and confidence, and so forth. But they chose
6 not to model this and maybe they are not important, but my simple point is this, you cannot
7 get away in this case with saying the dynamic effects are immeasurable because they have
8 actually assumed the end product of that dynamic process.

9 Now, have I answered your question?

10 PROFESSOR STONEMAN: Yes.

11 THE CHAIRMAN: Just before you do your highlights if, having heard me, that is what you
12 would like to do, we have received another document entitled “Speaking note of the FSA”,
13 is it any different from the one we had yesterday?

14 MR. HOSKINS: No, I was asked by the Registry staff to provide a hard copy of my speaking
15 notes.

16 THE CHAIRMAN: The line spacing is different, but we can take it that the text is the same, can
17 we?

18 MR. HOSKINS: I think you can vertically file the second copy.

19 MR. SHARPE: I am much relieved to hear there is not yet another piece of paper! Sir, just allow
20 me a moment. I do not intend to abuse the privilege you are offering me. As you saw, it
21 was not necessary to deal in detail with much of Mr. Swift’s submissions because there was
22 no detail to address. There is a point, I am afraid, that I am going to have to say because, as
23 we all know, the transcript is a public document. But, yesterday Mr. Swift, I am sure
24 unintentionally, saw fit to bracket Barclays Bank (and maybe by implication others) as
25 those who shun competition and act in an anti-competitive way. Rest assured, if they had
26 done so, they would have been subject to more serious proceedings under the Competition
27 Act, Chapters I or II. There was no hint at all in the course of the investigation that they had
28 committed, wilfully or otherwise, anti-competitive actions. Mr. Swift was quite wrong to
29 stray into that territory and to make the accusation that he did. Moreover, the whole
30 purpose of the market investigation regime is not to investigate the conduct of individual
31 companies - it is to investigate situations, features of a market where there are, in a nutshell,
32 market failures and, to use the expertise of the Commission to identify those failures and put
33 together remedies to resolve them as comprehensively as is practicable. It forms no part of
34 the Commission’s case, and, respectfully, there seems to have been some sort of dissonance

1 as between the Commission's position during the investigation and in its report and its
2 counsel.

3 I make that point because others will read the transcript. It is very clear that they must
4 understand what the position is.

5 Of course, Mr. Swift also repeated the Commission's error in his statement, and here at
6 para. 11, where, as you see, he summarises whether the Commission's intervention would
7 leave consumers better off. Well, at this stage, on the fifth day of the hearing, that is
8 absolutely the wrong test. The test is not whether the consumers would be better off; it is
9 whether or not the costs of making them better off are out of all proportion for achieving
10 that objective. What lies behind this, I think, is the reality of the Commission's case -
11 whatever they may say, they were looking and focusing all the time on the total detriment,
12 looking at the costs of remedying it, and repeating the *Tesco* fallacy.

13 I am sure that Mr. Swift's statement of the law in his submissions to you - which one
14 presumes to be measured, and were indeed measured submissions - it was not an off-the-
15 cuff remark which all of us can make in open court and happily will reflect on it later --
16 This was the essence of his case, and it was wrong.

17 Of course, 12 describes the other remedies. I will not go through that. It was a pity that the
18 FSA did not take the opportunity to explain to the Tribunal the relationship between the
19 Competition Commission's report and their own jurisdiction, and in particular the impact of
20 the ICOBS regime. The effectiveness of the remedies package in totality - and in particular
21 the prohibition - are super-imposed upon the new regime, and in particular the cooling off
22 period and the ICOBS to which I made reference. We gave you our note last Tuesday,
23 which explained elements of this. I would respectfully ask you to return to that in that
24 context.

25 It is probably not necessary to go back to double proportionality because it was never part
26 of our case that you had jurisdiction.

27 At para. 22, in answer to your question, Mr. Chairman, Mr. Swift was obliged to say that to
28 justify an analysis of proportionality he had to establish that the Commission had in fact
29 concluded that its remedies package would be effective to eradicate all the detriments in the
30 market - notwithstanding the magnitude of the problems in the market which he
31 emphasised. He emphasised them in a somewhat partial way, referring to the profitability
32 of PPI. He managed to forget the other side of the coin (if I can use the phrase) - the very
33 low profits in the credit loan sector, emphasising yet again our submission on relevant
34 market - not irrelevant at all, but one has to look at the two together and see them as a

1 package. If you start off looking at one side or the other you get a misleading picture and a
2 misleading analysis. In other words, when it suited him, and the Commission, they are
3 treating this rather like looking at the excess profits in the grocery sector and looking at that.
4 They do understand, in a very careful way that there are two sides to this: the reduction of
5 profitability of PPI through reduced prices and the increase in credit prices. The whole
6 thing has to be modelled, netted out. Conceptually we have no problem at all with that
7 analysis. That is a sensible analysis. Nor do we have any problem, as you see, that the
8 thrust of the remedies will lead to a more competitive market. As you know Barclays and
9 the other banks have accepted, willingly, the other remedies that have been put in place. We
10 are only here to debate one remedy - the prohibition - because we regard that as
11 disproportionate. It adds less than it is going to receive in benefit as a result of its
12 implementation.

13 Now, even the Commission has to admit that it cannot predict how the market will work.
14 That is very much the Hayeckian approach. One has a great deal of sympathy with them in
15 that statement. However, they have to do some assessment of proportionality of any
16 remedy, as we know now. They have, in their report, indicated what the costs are going to
17 be, and there is no argument about that - £100 million; £50/60 million each year. It behoves
18 them to come back with some broad figure of the likely benefit to give them the basis on
19 which to even start the proportionality exercise.

20 Now, of course, Mr. Swift attempted in a gentlemanly way, to detach himself from vulgar
21 modelling and graphs, and econometrics. I am afraid he cannot because he is here to defend
22 the report, and the report itself relies very heavily -- 494, which I have no need to take you
23 to) points to a modelling exercise, and it is explicit that the Commission is relying upon the
24 fruits of that modelling exercise. If they are not relying on the fruits of that modelling
25 exercise, what are they relying upon, other than totally impressionistic views about benefit
26 and cost. When we turn to the modelling exercises I took you to on Monday (and will not
27 take you back), the key assumption is the 60 percent price reduction which we think is
28 totally out of order, and a totally improbable assumption. But, more importantly, whatever
29 we may say about its plausibility, when one looks to the assumptions which underlie that
30 number -- Where did they get it from? We have some notion that in a competitive market
31 excess profits will be competed away sooner or later - we do not quite know when - and
32 therefore that is the end result of the dynamic process which I addressed you on a moment
33 ago.

1 If that is right, there is no evidence to suggest that the Commission has any greater
2 omniscience about the future development of a market. The parties are now offering what
3 is essentially a radically new product. This is a new business model than the one they were
4 organising previously. It is predicated, I think, upon new people coming into the market -
5 not least in a very uncertain future. They are making a range of assumptions. This is a
6 superstructure of assumptions, none of which find any probative basis in the report. If they
7 come to court with a report which said, “For the following reasons we think the market is
8 going to work in this way and in the timescale”, we would have a very difficult case to run
9 and we would not be here. It is because of that evidential void that we feel that we are
10 entitled to come to this Tribunal and say, “Commission, you can really do a better job than
11 this, go away and do it”.

12 It is one thing to assert the markets are going to work and PPI margins will fall, and
13 notwithstanding falling profitability, falling overall market, falling penetration, newcomers
14 are going to be attracted in the market because by definition, this is the assumption, the
15 profits in this area are going to be greater than somewhere else where they can put their
16 money. That is the assumption. That is a conundrum because they do not really reconcile
17 their assumption of maximum benefits based upon normal profitability with a market
18 situation which is going to be sufficiently profitable to attract newcomers to come into the
19 market. On the face of it, that seems a very difficult set of conclusions to reach. I do not
20 know what the answer is, but I do know that I cannot find an answer in the report and I need
21 it.

22 I have to say this: it indicates a degree of regulatory omniscience and skill which even in a
23 world class organisation like the Competition Commission one very seldom sees. The
24 future is an uncertain place, that is true, but no regulator, to my knowledge, and I submit
25 this, would say with confidence that a particular set of remedies as intrusive and as radical
26 as this is going to have, as Mr. Swift was obliged to admit, perfection in achieving the total
27 elimination of the consumer detriments they found. That is a very immodest claim.

28 As for the timescale, you are very familiar with my submissions on timescale. Mr. Swift
29 does his best, with respect to him, but “timely” will not do. *Tesco* said “timely” will not do,
30 and I will come back to Mr. Hoskins’ attempt to distinguish *Tesco*. There is nothing
31 between *Tesco* and us on time.

32 It is self-evident, if I may say so, that the longer a remedy takes to produce a benefit, the
33 greater the cost will be. It would not be possible, because costs have to be incurred, and
34 they are going to be incurred quite quickly with the implementation of set up costs and

1 everything else. It is impossible to do, despite Mr. Colley's best efforts in his expert
2 witness statement, a net present value analysis of what the costs are going to be, so we can
3 see what the price at the time is going to be, because we do not know how long 'T' is going
4 to be. The assumption, of course, in the model is either it is all going to happen overnight,
5 which does not seem right, or they just assume it is going to happen at some time and it is
6 not important for the purpose of the modelling. I think the latter, it did not address the
7 question. So the assumption is that time is not important. Time is vital, and for Barclays
8 Bank and any other bank having to implement these remedies, it is very important to know
9 when – they are going to have to incur the remedies – there will be some social pay-off.
10 I do not know the answer to that. If the Commission knew the answer we would expect to
11 see it in the report and all we get are vague, unhelpful – to quote the President in *Tesco* –
12 useless, I will say, non-judgments, non-assessments of how long it is going to take. If that
13 is right, and it is, how on earth can a proper proportionality exercise have been done if an
14 essential component, a parameter of that exercise, is how much cost is likely to be incurred.
15 We know the set-up cost, we know the annual cost, but how long are those annual costs to
16 be incurred before we can factor in the benefit. Nobody is asking for precise measurement.
17 It is like a straw man, I have never asked for that, not in our case, not in my submissions. I
18 have been very careful, but some quantification, a year, two years, between two and three
19 years. It was on this basis that we calculated the proportionality cost. We do not have that
20 either. We do not know anything at all.

21 As and when, I hope, sir, the Commission go back and look at this again, they really have to
22 consider on the basis of evidence how long this exercise is going to take before we can get
23 some pay-off. It is not a difficult thing for the Commission. Mr. Swift said they can do
24 anything. That is what he said yesterday. In relation to modelling, this can be modelled.
25 There is this important issue of the reduction in demand brought about by what we call
26 inconvenience. The report is quite difficult on this, and it has been made more difficult
27 before the Tribunal. I read the report to indicate that there would be, as a result of
28 something called inconvenience a movement, and I will call it a shift in demand, the
29 demand schedule. I thought this had been acknowledged in the report and I thought it had
30 been acknowledged that it was a detriment. The only argument was the magnitude of the
31 detriment, and the only statement, you will recall in 10.50, "some people had overstated its
32 magnitude", and in any event it would be engulfed by the liberating effect of the remedies,
33 or perhaps more accurately might partially have been met.

34 This is puzzling because on the face of it ----

1 THE CHAIRMAN: Or even more accurately, partially or fully.

2 MR. SHARPE: Partially or fully, I am obliged.

3 THE CHAIRMAN: I think we are taking “engulfed” as an abbreviation, Mr. Sharpe.

4 MR. SHARPE: Absolutely right.

5 THE CHAIRMAN: We all know what you are referring to.

6 MR. SHARPE: That is the pure statement, and we think it is absurd – I hesitate to say “perverse”
7 – that this was not given due consideration – all the weight of evidence accepted by the
8 Commission, an admission that there may only be a partial remedy. One would have
9 thought that some assessment of that effect would have been made. The reasons given for
10 not doing that are very thin. There is the evidence and it is unanimous. Even from people
11 not friendly to the banks, consumers, the Citizens Advice Bureau. We have no notion that
12 they are friendly to the banks and we know very well that they want tougher remedies. The
13 only issue that I drew your attention to was their attitude towards this remedy and they are
14 not fans of it. They think it will make consumers worse off and they have had the courage
15 to say so.

16 We would have expected the Commission to have generated evidence, come to a view as to
17 the effect of that detriment and then factored it into their modelling, but they did nothing of
18 the kind, as you know. Perhaps I mis-spoke. There is enough evidence there for them to
19 have drawn an assumption that the detriment would have existed. There was no need to
20 generate further evidence.

21 PROFESSOR STONEMAN: Yes, it may be a little late to enter this, but is it possible that,
22 because of this convenience aspect, that the suppliers of PPI have actually been charging
23 higher prices and appropriating the benefit of convenience to themselves?

24 MR. SHARPE: Anything is possible. I cannot find any support for that in the report. When I
25 said things have been muddied, because we have moved now to the further set of
26 arguments, I think part of the submission is that it did not really matter because consumer
27 welfare – and I think this is implication behind the question – would actually be increased
28 by the elimination of those sales which had been made improperly and which constituted
29 mis-selling. There is plainly some evidence in the report to that effect on mis-selling. It is
30 one of a number of reasons which lay behind the current volume of sales. Nowhere in the
31 report does the Commission rely upon the provision that this detriment figure, which they
32 admit exists, is attributable in total to such sales, such that consumer welfare would be
33 increased as a result of the reduction in demand. It would be an extraordinary proposition.
34 They do not say it at all in the report and therefore we are not really very interested in what

1 they may say subsequently. In other words, the gross detriment is equal to the net
2 detriment. They could have run an argument because of an element of mis-selling that
3 actually there would be an element of increased consumer welfare as those sales were
4 reduced, but they do not.

5 They would also have to say that the general reduction in demand of that element was
6 totally attributable to mis-selling, or the absence of mis-selling, and there is not the slightest
7 evidence to suggest that.

8 As for pricing, of course, you need no reminding from me that pricing is not an AEC. It is
9 not an issue, it is a detriment, it is not innate.

10 PROFESSOR STONEMAN: Thank you.

11 MR. SHARPE: I gave quite extensive submissions about the inadequacies of the model and about
12 the curious assumptions on which it is based. There is nothing wrong with assumptions in
13 models. May I make myself absolutely clear. It is when you bring that model and apply it,
14 as the Commission have done, to the real world, one has to be very careful whether those
15 assumptions are realistic ones enabling you to translate the product of that model into the
16 real world. That is true of every economic model I think, but in this instance it requires
17 even greater rigor because the extent of the remedy by the Commission's own admission is
18 it is a very intrusive remedy, it is going to be very expensive. I pointed out this is a
19 reduction in price, you have this near doubling of volume which seems very peculiar, in a
20 market as you have seen which is falling significantly and has done since 2002 on the data I
21 showed you in the Commission's report.

22 THE CHAIRMAN: By "near doubling of volume" I think you mean penetration rate.

23 MR. SHARPE: Penetration rate.

24 THE CHAIRMAN: Yes, it is not an absolute doubling of volume, no?

25 MR. SHARPE: Just under, if I recall correctly. Penetration rates – it is penetration rates –
26 increasing I think from 34 to 63 per cent.

27 THE CHAIRMAN: I have the figures in mind.

28 MR. SHARPE: We do not know whether this is right or wrong. It seems very odd based upon
29 the history, but the point is we do not quite know what underlies this, other than a
30 mechanical relationship between the assumed price reduction and the assumed elasticity of
31 demand.

32 In my submissions you may recall on Monday or Tuesday, I pointed out the elasticity of
33 1.54 chosen by the Commission was not the appropriate elasticity of demand. If you are
34 going to look at the industry you need the industry elasticity of demand. What they offered

1 in appendix 3.9, para. 27, and Mr. Swift chose not to respond to this, was the only elasticity
2 of demand as between two PPI providers. We drew your attention to this and supplied
3 citations in our note on Wednesday – which are unfortunately not dated, for which I
4 apologise. Either way what we have here is a set of very extravagant claims, and I simply
5 repeat my submission. They are extravagant and there is a heavy burden on the
6 Commission applying any level of proportionality but especially double proportionality, to
7 satisfy themselves that this highly theoretical model, highly abstract model, can properly be
8 translated into the real world to give rise to recommendations as intrusive and expensive as
9 these. Indeed, Miss Davies pointed out how sensitive they were to the assumptions.

10 PROFESSOR STONEMAN: Could I take you back to the points you made about the elasticity of
11 demand? If I recall correctly you said that the number assumed by the Commission of
12 minus 1.43, it really should be minus 4.5?

13 MR. SHARPE: No, I did not say that. The 4.5 was for one of the other products, not the personal
14 loan product. The more important point from our point of view is it is not easy to work out
15 what the Commission has done here, and I think I respectfully recommend the cold towel, a
16 dark room and a look at appendix 3.9, and especially para.27, because it is abundantly clear
17 they are looking at the own price, but it is also clear they seem to be assuming that the
18 industry elasticity is zero and I find that very odd, because that indicates – I think it is a
19 vertical line, is it not – so that PPI demand is invariant to price. That seems a very realistic
20 assumption, but nevertheless it appears to be the Commission's assumption.

21 I hope I need say no more. That is no the basis for proceeding and plainly it is not the basis
22 the Commission proceeded on because it had this very rapid increase in penetration rates, so
23 it is quite plain they got the wrong elasticity. There is no answer to that, at least from the
24 Commission.

25 PROFESSOR STONEMAN: Right, fine.

26 MR. SHARPE: While I am there on elasticities, you will recall the other side of the coin dealing
27 with elasticity of demand for credit. The Commission's assumption is that the price of
28 credit will go up by 40 per cent. Therefore, that would lead to a reduction in demand within
29 the usual demand curve – Miss Davies took it.

30 We have statements in the report – this is not in my note, and if I may I will deal with it in
31 seconds – the report says, and I take you to appendix 10.11, para.16 for your note, without
32 further information the Commission could not assess the elasticity of demand for credit, so
33 it was a very clear, candid, honest statement. This was not an informed estimate, obviously
34 not, they had no information, they admitted it; they think it might be higher than minus 1.4

1 therefore, 1.54 which, of course, of itself was the wrong elasticity of demand for the
2 relevant one which is the industry elasticity of demand. So far so good. They have no
3 information on which to base the sensitivity of the increase in credit prices with reduced
4 credit demand. When it comes to their model, they do make an assumption, they have to.
5 I can have no possible argument with an assumption based upon expertise, based upon
6 evidence, even making a judgment about which evidence is better than whatever; that is
7 what the Commission is here for, and it is not my task to say they have got it wrong.
8 But, faced with an admission that they had no evidence, they then proceed on the basis of
9 deriving a figure, 0.8, which you will not find in the report, and which only emerged after
10 Miss Davies pulling teeth from the Commission – probably a lot worse than that – getting
11 this figure of 0.8, which can only be, by its own admission, a guess; a guess on the basis of
12 no evidence. So, in other words, you talk about margin of appreciation, fine, margin of
13 appreciation is based and must be based upon evidence, maybe even conflicting evidence.
14 My friend is asking you to accept they had a margin of appreciation to make up numbers, to
15 pluck them from thin air. With respect to the Commission they can do better than that, and
16 should have done better than that.

17 This is not a trivial matter, because the other side of the coin, the impact, the elimination of
18 the relevant consumer benefit brought about by increased consumer credit prices, is a major
19 component in the modelling exercise, giving rise to the £200 million consumer detriment.
20 If you get that wrong, even by a little, then the modelling kaleidoscopically changes and
21 things that look like massive welfare losses actually are completely the opposite; it is that
22 sensitive.

23 That is an easy one in a way, because if we believe the Commission – and we do of course –
24 that they have no evidence, then they go forward with an important metric, a vital metric, on
25 the basis of no evidence, and with respect the case is made. It would have helped if they
26 had acknowledged that in the report; I do not think it would have got them very far.

27 May I just revert to the Commission’s note yesterday in response to Lloyds’ at para. 4 – you
28 have seen this at my para. 57. It is an important new point, actually, which has emerged
29 in note form, not in the pleadings or the skeleton. We know that the Commission took no
30 account at all of higher costs in its modelling, and I have taken you to submissions that said
31 first and foremost we have the implementation costs and the set up costs, so I hope there is
32 no argument about that.

33 Then I took you to their reliance upon increased marketing costs; there was no argument
34 about that, they rely upon increased marketing to make their remedies work; that is going to

1 be cost and they do not actually quantify or even measure those higher advertising costs.
2 You will recall having dealt with it in other financial products, the ratio of advertising to
3 turnover is X per cent, with the inference – but it is not actually spelt out – that fairly
4 significant increases in advertising spend on PPI would be made.

5 With a bit of prompting I also took you to the fact that there are scale effects here and any
6 reduction in output will probably lead to higher costs which should have been factored into
7 their calculation.

8 We are not asking for precision and detailed costs schedules, and everything else, but some
9 recognition that there is an issue here which they could either say is so trivial as to be
10 dismissed for the following reasons ... or is material and we took account of it and we
11 knocked off an element of consumer detriment to take account of it. They did nothing of the
12 sort. They ignored the problem. In other words, they made a decision on the basis, plainly,
13 of inadequate evidence - evidence that they do not actually say it was impossible to get, to
14 acquire, or to factor in. They just did not do it.

15 I was looking meaningfully, but hopelessly, at Mr. Hoskins because on that point alone we
16 can begin to see the relevance of *Tesco*. It is an important point. He should have looked at
17 it. What we have got now is a new point - that as a result of competition costs will actually
18 fall. We do not see that actually in the report. The only condition on which costs would fall
19 would be if you could hypothesise inefficiencies in the current provision of PPI. Now, that
20 may well be true. But, there is nothing in the report to suggest that it is. If they had done an
21 analysis - and they are more than capable of doing this - as to the efficiency or inefficiencies
22 which could be squeezed out - and would be as a result of greater competition - that point
23 introduced as an improvement to the report on bits of paper flying around in Lloyds'
24 direction from the Commission, we would begin to understand where they were coming
25 from. It is another attempt - I am bound to say, not wholly an attractive one - *ex post* to
26 remedy gaps in the Commission's report. It was left to poor Mr. Freeman in the *Tesco* case
27 to do that in a witness statement, which was unsuccessful. Now it is being done across the
28 courtroom floor with bits of paper.

29 As for the FSA's submissions you have them. I have trailed the argument - the straw man -
30 that what we wanted was elaborate quantification to the third decimal point. I reminded Mr.
31 Hoskins gently that there is a big difference between measurement and quantification. This
32 is a new-ish jurisdiction for the Commission in this current form. Investigating markets and
33 mergers - which is an old jurisdiction - does involve making judgments about the future.
34 Nothing I say, respectfully, is designed to influence the Tribunal to say that the Commission

1 cannot make quantitative judgments which are not reflected in measurement. They are
2 perfectly entitled on the basis of evidence to make judgments as to whether something is
3 greater than, less than, likely to be ... That is the body of their expertise, which I respect.
4 But, in so doing they must point to the evidence which gives rise to that. They failed to do
5 so. That is a world apart from saying that they are required to measure everything in sight.
6 That is not my submission.

7 So, much of Mr. Hoskins' submissions against the Commission, in respect of, especially,
8 Ground 3, I think disappears.

9 As for the *Tesco* judgment you have my written submissions which supplement my oral
10 submissions. An heroic attempt by Mr. Hoskins to ask you to wall away from *Tesco*, but,
11 respectfully, in my submission, it fails. There are many features that I have criticised which
12 Mr. Swift has not come back to, where there is simply no evidence. So, we sit all fours with
13 *Tesco*, but my supplementary submission would be, supported by the trilogy of cases with
14 which, Sir, you are familiar - *Mahon, Tameside* ... - supplemented of course by those
15 important decisions given you by Miss Davies of the European Court, and *Unichem* in this
16 court, that it is not necessary for there to be a complete absence of any consideration as
17 such. It is not sufficient for the commission to simply say that they looked at something.
18 This is the worry in this report. It looks as if somebody - perhaps even a lawyer - said, "We
19 have got to demonstrate we have done something. We will tick the box so that we can show
20 that a relevant consideration is being considered". Respectfully, the Commission can do
21 better than that. They have got to go behind the box-ticking and actually provide evidence
22 which enables the report to stack up.

23 Perhaps this leads me on to my last point, which is not here. My friend, Mr. Lasok,
24 eloquently described the role of the Tribunal in remedying essentially the abuse of power.
25 This is a review consideration. We need no reminding. We are not looking at the merits. We
26 are not asking you to. This Tribunal has a supervisory jurisdiction. That jurisdiction
27 essentially has two functions - not one. One is the elimination of the abuse of power. This
28 is the instant case. The abuse of power may be seen as dramatic, but what is being
29 contemplated here is, by admission, a major shift in the way the industry operates in placing
30 hundreds of millions over the years of cost. It cannot be done by arbitrary means.
31 The second role, respectfully, of the Tribunal, in partnership with the Commission, is to
32 ensure that the very high standards that the Commission aspires to -- It aspires to be a world
33 class competition body. On occasion it easily reaches that standard. But, it will only do so
34 if it knows its methods of operation and the rigour with which it pursues evidence is subject

1 to the active supervision of this court. What my friends for the Commission and the FSA
2 were arguing was that it ought to be - and I paraphrase - a light touch regulation; that there
3 should be nothing other than a degree of judicial deference to the Commission. I take that
4 from their repeated references to this margin of appreciation. We do not disagree that there
5 is a margin of appreciation, but the term must be properly applied. It is properly applied to
6 an appreciation of facts which are relevant, based upon considerations which have not been
7 ignored. It is those twin-fold roles of the Tribunal which I respectfully draw your attention
8 to.

9 Two functions but obviously the instant one is the success of our case. But, perhaps more
10 enduringly, if the standard drops, and is allowed to drop in the Competition Commission,
11 then we are all going to be the worse for it.

12 Unless I can assist you further, those are my submissions. I am grateful for the opportunity
13 to have proceeded in the manner that I did after you received my written submissions.

14 THE CHAIRMAN: Thank you very much, Mr. Sharpe. We will obviously consider our decision
15 and let you know in due course when we are ready to communicate it and the means
16 whereby we will do it. We do intend to give a careful confidentiality review to our decision.
17 I will be advised in due course whether the practice of circulating drafts that is applied
18 rigorously in the High Court will also apply here.

19 MR. SHARPE: Sir, the practice is no different.

20 THE CHAIRMAN: We will do it, and obviously any confidentiality concerns that arise from any
21 draft we will listen to and see if they can be addressed by some form of anonymising. At
22 the moment we do not think there will be.

23 MR. SHARPE: Sir, I cannot see any obvious areas.

24 Sir, there is one point of unfinished business. I have been given several bits of paper from
25 the Commission. You will have as well. I have certainly not had an opportunity to respond
26 to any of them. One of them deals with Professor Stoneman's request. I do not quite know
27 how to handle this. My respectful submission is that it adds nothing to the case, save ex
28 post the Commission say they could have done some of the dynamic modelling, but it was
29 self-evident that it was not necessary (I am quoting from their last paragraph). There is a
30 case, Sir, for ignoring this because if you were inclined to take notice of it, I think in
31 fairness we might welcome an opportunity to put in some brief written note. However, my
32 strong instinct is that it adds nothing to the case. What the Commission can do now does not
33 remedy what they should have done in the report.

1 THE CHAIRMAN: I am not sure that that really responds to the question or the Commission's
2 answer to the question. The question was not whether they would now do it, but whether in
3 principle it is capable of being done. The answer we got yesterday was, yes, but query
4 whether with any useful output. I anticipate that this really amplifies that answer.

5 MR. SHARPE: It says that they could have done, but the last paragraph – I have not really read it
6 properly – they could have done, but it was all self-evident and not necessary to resort to
7 modelling to establish it. It begs a lot of questions about what is self-evident in this context.
8 It seems to me rather a high test that it is so self-evident. It is a totally new submission as
9 well.

10 THE CHAIRMAN: If you feel you have to respond to it we will not stop you.

11 MR. SHARPE: I am sorry, Sir?

12 THE CHAIRMAN: We will not stop you from responding to it in writing if you feel you have to,
13 but it is a short document and as far as we can see merely puts a bit of flesh on some bones
14 which were fairly clearly there yesterday.

15 MR. SHARPE: May I take instructions.

16 One final point, sir. There is a good deal of anxiety in the industry about this. There is a
17 lead time before which the systems have to be put in place and people trained and the set-up
18 costs. If things go as the Commission would wish that is fairly soon and people have to get
19 started. What I am getting at is this: it is critically dependent upon the timing of the
20 judgment. I am well aware that you do not know how long you will be, and I know you will
21 be as quick as humanly possible, but would it be possible to give some very broad
22 quantitative estimate, falling short of measurement, as to when that might be?

23 THE CHAIRMAN: I think at this stage that is very difficult, Mr. Sharpe. You will know from
24 the fact that this hearing has been fixed this month, that we are acutely aware of the desire,
25 both of the Commission and of all the other parties, to have these questions resolved as soon
26 as possible. I think you will have to take it that we will continue to bear that well in mind.
27 If we get to a stage where we can give you an indication of when you will get a judgment
28 we will.

29 MR. SHARPE: Thank you.

30 THE CHAIRMAN: I am reluctant, certainly without consultation with my colleagues, just to give
31 it to you now.

32 MR. SHARPE: We can ask for no more than that, thank you, sir.

33 THE CHAIRMAN: One of the reasons why we sought methods of keeping this morning within
34 time bounds is that we want to get on with the process immediately.

1 MR. SHARPE: Thank you.

2 THE CHAIRMAN: Thank you all, you have been of great assistance.

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