Neutral Citation Number: [2010] EWCA Civ 114

Case No: C1/2009/1573

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM
THE COMPETITION APPEAL TRIBUNAL
[2009] CAT 14

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 23/02/2010

Before :

LORD JUSTICE PILL
LORD JUSTICE DYSON
and
LORD JUSTICE RICHARDS

- -

Between :

National Grid plc	**Appellant**
- and -	
(1) Gas and Electricity Markets Authority **(2) Capital Meters Limited** **(3) Siemens PLC** **(4) Meter Fit (North East) Limited** **(5) Meter Fit (North West) Limited**	**Respondents**

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- -

Jon Turner QC, Josh Holmes, Meredith Pickford and Laura Elizabeth John (instructed by **Pinsent Masons**) for the **Appellant**
Monica Carss-Frisk QC, Brian Kennelly and Tristan Jones (instructed by **the Gas and Electricity Markets Authority**) for the **First Respondent**
Christopher Vajda QC and **Kassie Smith** (instructed by **Hill Hofstetter LLP**) for **the Third Respondent**
The other Respondents did not appear and were not represented at the hearing of the appeal

Hearing dates : 18-20 November 2009

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Judgment

Lord Justice Richards :

1. In a decision published in February 2008 the Gas and Electricity Markets Authority ("the Authority") found that National Grid plc ("National Grid") had abused its dominant position in the market in Great Britain for the provision of domestic-sized gas meters, contrary to section 18 of the Competition Act 1998 ("the 1998 Act") and article 82 of the EC Treaty (now article 102 of the Treaty on the Functioning of the European Union). The Authority imposed a penalty of £41.6 million and ordered National Grid to put an end to the infringement. On an appeal under section 46 of the 1998 Act, the Competition Appeal Tribunal ("the Tribunal") substantially upheld the finding of abuse of a dominant position but reduced the penalty to £30 million. National Grid now brings a further appeal, under section 49 of the 1998 Act, against the Tribunal's decision. It contends that the Tribunal erred in law in upholding the finding of abuse and/or that the penalty set by the Tribunal was manifestly excessive and wrong in principle.

The background

2. The following summary of the background is drawn almost entirely from the Tribunal's decision, to which reference can be made for a fuller account: see [2009] CAT 14, at paragraphs 3-29.

3. Every domestic customer for gas is obliged to receive the supply of gas through a meter. There are two types of meter: domestic credit meters ("DCMs") and pre-payment meters ("PPMs"). Consumers using DCMs are billed periodically on the basis of a meter reading or an estimate of gas used over the preceding period. A PPM requires the consumer to pay in advance for gas, for example by using a prepayment card. In total, there are approximately 22 million domestic gas meters installed in Great Britain, of which about 90 per cent are DCMs and 10 per cent are PPMs. The typical life of a meter is 20 years for a DCM and 10 years for a PPM, though meters can in practice remain installed at a property for considerably longer than those periods. Whenever a DCM is removed from a property, it is generally discarded. A PPM, on the other hand, is a much more expensive item and, if removed before the end of its useful life, can often be refurbished economically and installed in another property.

4. Although National Grid did not take over from its predecessor, Transco plc, until 2003, it is convenient to refer throughout to National Grid. Historically, National Grid had a monopoly of gas transportation and of the supply of gas meters and ancillary services. It installed, and retained ownership of, the gas meter and provided a gas metering service to the gas supplier, the cost of which was recovered from the charges set by the regulator for the overall transportation business. Following the introduction of competition into the domestic supply of gas in 1998, the regulator began consulting the industry on how to enable other companies to compete with National Grid in supplying gas meters. In order for such competition to be possible, it was important to separate out the charges for metering services from those for gas transportation. That was done for the purposes of price control. A new five year price control was put in place in April 2002, for the first time setting an identifiable price cap for National Grid's metering charges.

5. In 2002 the Authority also launched an industry-wide review, referred to as the Review of Gas Metering Arrangements ("RGMA"), designed to encourage competition in gas meter provision. Central to the strategy was the supplier hub principle, which placed the responsibility on gas suppliers to appoint meter operators to supply and install meters at their customers' premises and to provide ancillary services, such as maintenance, in respect of those meters. This required gas suppliers and meter operators to move their existing arrangements onto a new contractual basis. The contracts entered into between National Grid and gas suppliers were known as Provision and Maintenance ("P&M") contracts, the terms of which had been developed multilaterally by the industry as part of the RGMA process. Under the P&M contracts there were no upfront charges for the installation of a meter. National Grid was remunerated by monthly rental payments from the time of installation until the meter was removed. Suppliers were able to replace National Grid's meters at 48 hours' notice without incurring any additional charges. The rental prices contained in the P&M contracts were in line with the cap set in the April 2002 price control.

6. Over the years prior to the setting of the price control in 2002, the prices charged for gas meters by the meter manufacturers had fallen substantially. By 2002 National Grid had become concerned that competing meter operators ("CMOs") entering the industry following the RGMA would be able to undercut the rental rates in the P&M contracts, and that if this led to the replacement of National Grid's installed meters it would deprive National Grid of the rental income stream from which it had expected, prior to the introduction of competition, to be able to recoup its costs of installation. This would lead to an outcome that National Grid referred to as the "stranding" of its assets. It claimed to face the risk of losing about £600 million out of an investment of some £1.4 billion in meters. Having failed to secure an adjustment to the price control to compensate it for the risk of asset stranding following the introduction of competition, National Grid began negotiations with each of the gas suppliers for a new contract covering the continued rental of the meters that were already installed in customers' premises (generally referred to as the "legacy" meter stock). The proposed terms involved on the one hand a significant reduction in the rental price and on the other hand a commitment by the gas supplier to rent a certain number of meters each year.

7. As a result of those negotiations, in January 2004 National Grid entered into two meter services agreements ("MSAs") with British Gas plc, the principal supplier of domestic gas: (1) a contract covering the existing base of installed meters owned by National Grid as at 1 January 2004, pursuant to which British Gas would rent a declining minimum number of meters per year, with early replacement charges payable by British Gas if the number of meters rented fell below that minimum ("the Legacy MSA"), and (2) a contract covering any meters installed by National Grid on or after 1 January 2004 (the "New and Replacement MSA" or "N/R MSA"). Between January and August 2004 National Grid entered into equivalent contracts with other gas suppliers, though one supplier (Electricité de France) chose to keep its legacy meters on the existing P&M terms.

8. For its part, British Gas had decided to take advantage of the opening up of the market to competition by awarding some of its metering work to CMOs. Following a formal invitation to tender in August 2001, tenders were submitted by a number of potential CMOs. They included Capital Meters Limited ("CML"), which is partly owned by

Siemens plc ("Siemens"). They also included Meter Fit (North West) Limited and Meter Fit (North East) Limited, a special purpose vehicle created by United Utilities plc and jointly referred to as "Meter Fit". Negotiations were also started with Utility Metering Services Ltd ("UMS"), a subsidiary of National Grid which trades as OnStream.

9. Between May 2002 and December 2003 British Gas appointed Meter Fit as its meter services provider in North Wales and North West and North East England; UMS in Scotland, the Midlands, the South East and South West of England and South Wales; and CML in East Anglia and most of London. The contracts entered into between British Gas and the CMOs generally lasted for 20 years, including an initial period (usually 5 years) in which the CMO had the exclusive right to install meters for British Gas in the relevant region (subject to certain exceptions where the choice of installer was effectively outside British Gas's control).

The meter services agreements (MSAs)

10. Since the precise way in which the MSAs operate is important for an understanding of the issues in the appeal, it is helpful to set out the detailed description given by the Tribunal at paras 21-29 of its judgment:

> "(a) <u>The Legacy MSA</u>
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> 21. The Legacy MSA terms apply to all domestic meters rented as at 1 January 2004 by National Grid to the gas suppliers who signed a Legacy MSA contract. The aim of the contract is to ensure that however quickly the gas supplier decides to replace National Grid's meters with those of the CMOs, National Grid's on-going income from that gas supplier is to some extent protected. The contract first identifies the number of meters that the gas supplier is renting from National Grid at the start date. The gas supplier commits either to rent from National Grid in each month a defined proportion of that initial population or to make additional payments to National Grid if it does not rent that defined proportion. The period covered by the commitment is 18 years in respect of DCMs and 7 years in respect of PPMs. The number of meters that the gas supplier must pay for declines by an equal number each month over the given period (subject to the adjustments referred to below). The number of DCMs that the supplier is committed to paying for thus diminishes by 1/216th each month (i.e. 18 years' worth of 12 monthly periods). The initial population of PPMs is allowed to reduce by 1/84th each month (i.e. 7 years' worth of 12 monthly payments). This contractual monthly reduction in the commitment is described by the parties as 'the glidepath'.
>
> 22. Before 2004, DCMs had been replaced at an average annual rate of 5 per cent. The Legacy MSA allows for replacement at a level of about 5.5 per cent per year. The effect of the glidepath, so far as DCMs are concerned, is that gas

suppliers can replace, free of penalty, a number of meters slightly in excess of the historic rate at which National Grid had replaced them before the RGMA. The Legacy MSA therefore shielded National Grid to some extent from the possibility that the opening of the market to competition would spur gas suppliers to replace its meters at a much faster rate than they had done when National Grid was the monopoly supplier.

23. The allowed number of charge-free meter removals is adjusted each year to take account of the fact that end-customers are lost and gained by one gas supplier to another over the period. So if a customer decides to change his gas supplier, the meter at that premises will move from being covered by the old supplier's Legacy MSA to being covered by the new supplier's Legacy MSA (assuming the new supplier has signed a Legacy MSA). The glidepath is reset at the start of each month with any necessary adjustments to reflect changes in market share during the course of the previous month being made to the following month's rental commitment.

24. In any month where the number of meters rented is in fact lower than the number that the glidepath indicates should have been rented in that month, the supplier incurs certain charges. If the remaining legacy stock in fact rented is between 90 per cent and 100 per cent of the glidepath commitment, the supplier continues to pay the full rental due for the number of meters that it was supposed to be renting at that point. In this judgment we refer to this 10 per cent tolerance band as the 'Take or Pay zone' and to the charges set for removed meters falling in the Take or Pay zone as 'Below Line Rentals' or 'BLRs'.

25. If the remaining stock actually rented that month is below 90 per cent of the glidepath commitment, the supplier must pay National Grid the BLRs for the meters in the Take or Pay zone and in addition pays a one-off fee per meter for any meter beyond the 10 per cent Take or Pay zone. This fee is referred to in the Legacy MSA as a 'Premature Replacement Charge' or 'PRC'. If a supplier removes meters beyond the Take or Pay zone and pays PRCs for those meters, the on-going commitment under the Legacy MSA is reduced by the number of meters for which a PRC has been paid. The glidepath is adjusted to reduce the overall number of meters rented but also to reduce the monthly diminution in the rental commitment. This means that the gas supplier has to rent fewer meters as a result of paying PRCs but the number of meters he can remove each month is also reduced so that his commitment to rent at least some meters under the Legacy MSA still lasts for 18 and 7 years in the case of DCMs and PPMs, respectively.

26. The amount of the PRC payable declines annually over the term of the glidepath. The list of PRCs for DCMs shows 18 separate PRC fees, one for each year of commitment, declining from £58.44 in year 1 to £1.19 in year 18. The list for PPMs shows 7 separate PRC amounts, one for each year of commitment, declining from £37.95 in year 1 to £1.74 in year 7.

27. According to National Grid, the PRCs are calculated on the basis of the net present value of the rental revenue foregone in the future from the early replacement of the meter before the expiry of the 18 year obligation (or 7 year obligation in the case of PPMs), less the costs National Grid no longer incurs as a result of having one less meter installed. PRCs are adjusted annually on 1 April each year in accordance with the Retail Prices Index ('RPI'). An alternative higher set of PRCs is payable where National Grid is of the reasonable opinion that a gas supplier has removed a disproportionate number of younger meters. This extra charge, according to National Grid, is designed to compensate it for the reduced likelihood of the remaining stock of assets lasting until the end of the glidepath, something that would in turn lead to a reduction in rental income.

28. It is only the commitment to pay for a certain number of meters that has an 18 year or 7 year duration. The Legacy MSA itself is indefinite in duration. If the gas supplier does not in fact choose to replace all its National Grid legacy meters with new meters it must, of course, still pay rental to National Grid under the Legacy MSA for all the meters it in fact rents. At the end of the 18 year commitment period, the gas supplier will no longer have to pay BLRs or PRCs if it then decides to replace legacy meters with new National Grid or CMO meters. The rental set by the Legacy MSA is adjusted over the period of the contract in line with inflation.

(b) The New and Replacement MSA

29. The N/R MSA covers meters installed by National Grid on or after 1 January 2004. The contract also includes PRCs but there is no Take or Pay zone and hence no BLRs. PRCs are not calculated on the basis of a scheduled glidepath which reduces annually but on the number of years that have elapsed since the individual meter was installed. The PRC therefore declines over the assumed life of the meters, which is taken to be 10 years for PPMs and 20 years for DCMs. The PRCs in the N/R MSA are, according to National Grid, designed to compensate it for the present value of lost revenues that National Grid would have received had the meters remained in place for their assumed life, net of the present value of costs saved as a consequence of early replacement.

11. National Grid is responsible for ensuring the accuracy and safety of its meters. Batches of meters that are shown, on the basis of testing of a sample, to fall outside a fixed accuracy threshold are entered on a replacement schedule. Under the terms of the Legacy MSA, National Grid specifies a number of meters from the replacement schedule that the gas supplier must replace in a given year. These replacements are referred to as "policy replacements" and are considered "non-discretionary" because the gas supplier is required by National Grid to ensure that they are carried out. The gas supplier does not have to use National Grid for these replacements. The category of non-discretionary replacements also includes the exchange of a DCM for a PPM, or vice versa, at the request of the gas supplier or the consumer, as well as the replacement of a faulty meter.

The proceedings

12. The proceedings concern alleged breaches of section 18 of the 1998 Act and article 82 of the EC Treaty. Section 18 provides:

> "18.(1) … [A]ny conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.
>
> (2) Conduct may, in particular, constitute such an abuse if it consists in –
>
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
>
> (b) limiting production, markets or technical development to the prejudice of consumers;
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
>
> (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts.
>
> (3) In this section –
>
> 'dominant position' means a dominant position within the United Kingdom; and
>
> 'the United Kingdom' means the United Kingdom or any part of it.
>
> (4) The prohibition imposed by subsection (1) is referred to in this Act as 'the Chapter II prohibition'."

13. Those provisions are modelled on article 82, which contains materially identical provisions in respect of abuse of a dominant position within the common market in so far as it may affect trade between Member States.

14. The main findings of the Authority as set out in its decision were as follows: (1) the relevant product market was the market for the provision of installed domestic-sized gas meters including the ancillary service of meter maintenance in Great Britain; (2) National Grid was dominant in that market; (3) National Grid had abused that dominant position by entering into long term contracts which restricted the rate at which gas suppliers could replace National Grid's meters with meters offered by CMOs; and (4) the abuse had been committed negligently, so as to engage a liability to a financial penalty under section 36 of the 1998 Act. As well as imposing a fine of £41.6 million, the Authority directed National Grid to put an end to the infringement and to refrain from engaging in conduct having the same or equivalent exclusionary effect.

15. In its appeal to the Tribunal, National Grid took issue with the Authority's findings on market definition, dominance and abuse, as well as the level of the fine and the time for compliance. The Tribunal dismissed all aspects of the appeal, save (1) to make clear that the finding of abuse was limited to the terms of the Legacy MSA and did not extend to the N/R MSA, and to restrict the operative part of the decision accordingly, (2) to reduce the penalty to £30 million, and (3) to extend the time for compliance with the decision. The further appeal to this court is limited to the issues of abuse and penalty.

Abuse: the Tribunal's decision

16. The Tribunal began its discussion of abuse by quoting what it described as "the classic description of an abuse contrary to Article 82 EC", in Case 85/76, *Hoffmann-La Roche v Commission* [1979] ECR 461 at paragraph 91:

> "The concept of an abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition."

It also referred to the "special responsibility" of a dominant firm not to engage in conduct which damages competition in the market which is already affected by its dominance (citing Case 322/81, *Michelin v Commission* [1983] ECR 3461, paragraph 57).

17. The Tribunal then set out the conclusions that the Authority had reached on abuse, as follows:

> "85. In the Decision the Authority concluded that:

(a) The MSAs impose significant switching costs on gas suppliers who wish to replace a larger number of meters than is allowed without penalty under the glidepath. The early replacement charges in the Legacy MSAs are triggered by modest levels of meter replacement;

(b) The BLRs paid for meters that have been removed take no account of avoidable costs and the suppliers' ability to leave the Take or Pay zone is constrained by future non-discretionary replacement requirements …;

(c) The level of the PRC in the first year of the Legacy MSA, £57 per meter for DCMs, is high relative to the commercial benefits that gas suppliers would expect to obtain by switching to a cheaper CMO and will reduce their incentive to switch;

(d) The bundling of meter maintenance by National Grid exacerbates the effect of the Legacy MSA provisions because meters replaced on a maintenance visit are replaced by National Grid rather than the CMO and count against the "free" allowance under the glidepath. But in the absence of other restrictive factors of the MSAs, the requirement to take maintenance from National Grid would not of itself appreciably restrict competition and so is not a separate abuse;

(e) The Legacy MSAs have had an *actual* foreclosing effect on competing CMOs;

(f) The Legacy MSAs have deprived customers of the benefits of competition in terms of lower prices and reducing or removing the incentives on suppliers to improve technology and introduce smart meters.

86. The Authority therefore concluded that the MSAs have the actual and likely effect of foreclosing competition within the relevant market. They are long term contracts that limit significantly the commercial benefits that gas suppliers and customers could obtain if there was more effective competition in the market and suppliers could switch to CMOs without incurring artificially high switching costs.

87. Critically, the Authority recognised that the use of early replacement charges may be necessary and proportionate to allow for the recovery of customer specific sunk costs such as the cost of the installation of the meter. But the Authority's conclusion was that the Legacy MSAs were not a necessary or proportionate means of recovering those costs. First, the Authority found that the rentals payable in the Take or Pay zone do not reflect a reasonable estimate of National Grid's avoided costs (given that the company is no longer required to maintain or provide other services in relation to the meter).

> Secondly, the Authority found that a different contract structure linking charges payable on early replacement to the age of the meter would have protected National Grid's position but would have been cheaper for the gas suppliers. This latter point relates to extensive expert evidence and argument over whether the age-related counterfactual should have been 'revenue neutral' …."

18. The Tribunal went on to consider, over the course of the next 42 pages of its judgment, the various arguments put forward by National Grid, most of which were rejected. The Tribunal's analysis, so far as relevant, is considered below in the context of the individual grounds of appeal advanced before this court.

19. Having considered National Grid's arguments, the Tribunal expressed its conclusion in these terms:

> "200. The Tribunal upholds the Authority's finding that the early replacement provisions of the Legacy MSAs constitute an abuse by National Grid of its dominant position. They clearly have a foreclosure effect in discouraging gas suppliers from moving more of their business to the CMOs and hence are likely to delay the reduction of National Grid's market share. The effect of the Legacy MSAs was demonstrated by British Gas's actions taken to reduce the volume of business it provided to some of the CMOs once the terms of the Legacy MSAs had crystallised. It is true that National Grid has incurred sunk costs in providing the installed meter to the gas supplier without an upfront charge. But this does not justify putting in place charges which may have the effect of maintaining volumes of replacement at little more than the level that applied when National Grid was a monopoly supplier. The disproportionate nature of the early replacement charges is, in our judgment, amply demonstrated by the comparison carried out with the terms in the CMO contracts and in National Grid's N/R MSA. There are some minor aspects of the Decision where we have found that the Authority was not justified in coming to the conclusions it did. But the main finding of abuse set out in the Decision was, in our judgment, undoubtedly right."

Abuse: the issues

20. National Grid advances four main grounds of appeal against the Tribunal's decision to uphold the Authority's decision on abuse. In summary, they are that the Tribunal (1) erred in its approach to the question whether the agreements involved "recourse to methods different from those which condition normal competition", (2) erred in its approach to the question of anti-competitive foreclosure, (3) erred in finding that the agreements had the actual effect of foreclosing competition, and (4) erred in finding that the agreements were not in the interests of consumers.

21. In his opening submissions for National Grid, Mr Turner QC emphasised that the case concerns early replacement charges or "payment completion terms". He submitted that the Tribunal's finding that the use of payment completion terms can constitute anti-competitive behaviour is a novel one, as is the route by which the Tribunal reached its conclusion, and that the Tribunal's approach departs from a consistent line of authority. Further, it is important that the dividing line between lawful conduct and anti-competitive behaviour is clear, but the Tribunal's reasoning does not show where that line is to be drawn or how far National Grid needs to go in changing its contracts so as to make them lawful. These themes run through the detailed criticisms advanced under the various grounds of appeal.

The approach of the appellate court

22. Otherwise than in relation to the amount of a penalty, an appeal under section 49(1) of the 1998 Act from a decision of the Tribunal lies only on a point of law.

23. The distinction between a point of law and a point of fact or of expert appreciation needs to be borne clearly in mind. An illuminating passage on this, in the context of abuse of a dominant position, is to be found in the judgment of the Tribunal in *Napp Pharmaceutical Holdings Limited v Director General of Fair Trading* (Case no.1001/1/1/01, 15 January 2002) on an application for permission to appeal to the Court of Appeal:

> "24. It is trite to say that a point of law is to be distinguished from a point of fact. As is well known, it may be difficult to say, in any given case, where the border lies between the two. In the present case, the issue is whether Napp has committed an 'abuse' within the meaning of the Chapter II prohibition. At one end of the spectrum, the Court of Justice and the Court of First Instance have laid down certain legal principles which apply when determining whether the Chapter II prohibition has been infringed. Whether we had, for example, ignored a relevant decision of the Court of Justice, would, we would have thought, be a point of law. At the other end of the spectrum, there will plainly be points of primary fact. For example, whether in this case Napp's prices to hospitals were or were not below the cost of raw materials is a point of fact. However, between these opposite ends of the spectrum there will, so it seems to us, often be questions arising under the Act which are essentially questions of appreciation or economic assessment of a more or less complex kind, depending on the circumstances, in which the Tribunal will be called upon to assess a range of factors, bringing to bear such expertise as it has, in order to determine such matters as the boundaries of the 'relevant market', the existence of 'barriers to entry', whether 'dominance' is established, whether a response by the dominant undertaking is 'proportionate' and so on.
>
> 27. In the present application, for example, a substantial part of Napp's argument on the hospital pricing abuse is that its pricing policy constituted 'normal competition' …. Whether, on the

> facts of this case what Napp did can be defended on the ground that it constituted 'normal competition' does not seem to us to be a 'point of law' as such, but rather a question of appreciation of the various interrelated facts and considerations discussed in paragraphs 231 to 352 of the judgment."

24. In refusing a renewed application for permission to appeal in the same case, Buxton LJ, in the Court of Appeal, held (see [2002] EWCA Civ 796, at paragraph 34):

> "These findings do not and could not involve points of law, at least unless it were to be contended that the conclusions had been arrived at on the basis of no evidence at all: something that is not and could not possibly be said. They cannot therefore be reviewed in this court. But even if we did have authority to review such findings, as the conclusion of an expert and specialist tribunal, specifically constituted by Parliament to make judgments in an area in which judges have no expertise, they fall exactly into the category identified by Hale LJ in *Cooke v Secretary of State for Social Security* [2001] EWCA Civ 734, as an area which this court would be very slow indeed to enter."

25. To the same effect as that last point are the later observations of Baroness Hale in *AH (Sudan) v Secretary of State for the Home Department* [2007] UKHL 49, [2008] 1 AC 678, at paragraph 30:

> "… This is an expert tribunal charged with administering a complex area of law in challenging circumstances. To paraphrase a view I have expressed about such expert tribunals in another context, the ordinary courts should approach appeals from them with an appropriate degree of caution; it is probable that in understanding and applying the law in their specialised field the tribunal will have got it right: see *Cooke v Secretary of State for Social Security* [2002] 3 All ER 279, para 16. They and they alone are the judges of the facts. It is not enough that their decision on those facts may seem harsh to people who have not heard and read the evidence and arguments which they have heard and read. Their decisions should be respected unless it is quite clear that they have misdirected themselves in law. Appellate courts should not rush to find such misdirections simply because they might have reached a different conclusion on the facts or expressed themselves differently …."

26. Those observations were directed at the position of the Asylum and Immigration Tribunal but apply with equal or greater force to the Competition Appeal Tribunal, which has a high level of expertise in its specialist area: the panel in this case, consisting of Miss Vivien Rose, Professor Paul Stoneman and Mr David Summers, included both an expert competition lawyer and an expert economist. Mr Turner drew various distinctions between this case and *AH (Sudan)*, but in my view none of them undermines the essential point made by Baroness Hale about the need to approach

decisions of an expert tribunal with an appropriate degree of caution. That applies over and above the consideration that the Tribunal in this case had the benefit of hearing witnesses of fact and expert witnesses over a period of two weeks and inevitably had a much better grasp than this court can have of the evidence and issues as a whole.

Ground 1: normal competition

27. The Authority had accepted that, in a market where long lived assets were installed in customers' premises and those assets had minimal re-use value if removed, it was legitimate for meter operators to protect themselves against the stranding of sunk costs if the customer decided to replace the assets with those of a competitor, and that in normal competition a meter operator might adopt various methods to achieve this, including upfront payment, cancellation charges or adjusting the rental prices. It had found, however, that the use of early replacement charges in the Legacy MSAs was not a necessary or proportionate means of recovering the relevant costs and was abusive.

28. This led to an argument by National Grid which the Tribunal summarised as follows:

> "89. National Grid argued that the Authority had to establish that the Legacy MSAs constituted 'recourse to methods different from those which condition normal competition' [see *Hoffmann-La Roche*, paragraph 91, quoted at [16] above] before it could establish that they were abusive. In this market, the Authority had accepted that it was 'normal', given the nature of the assets, for operators to put some form of premature replacement protection in place in their contracts. No deviation from 'normal competition' had been established by the Authority and hence there was no abuse within the meaning of *Hoffmann-La Roche*."

29. In rejecting the argument, the Tribunal reasoned as follows:

> "90. We do not accept that this is the correct way to interpret what the ECJ said in *Hoffmann-La Roche*. 'Normal competition' there means the parameters which affect a customer's choice in a situation where the customer is free to choose from amongst the products which make up the relevant market. In conditions of normal competition, a buyer will base his purchasing decisions on his assessment of who offers the best price and the best quality product or service. He might, on the basis of these criteria, choose the dominant firm's product and thereby maintain or increase the dominant firm's market share. That does not involve an abuse because the dominant firm has won that business because its product is the better overall offer from the customer's point of view. If the customer subsequently discovers that another company offers a better, cheaper product he will switch his custom to the new supplier – he may switch back again if the dominant undertaking then improves its offer.

> 91. Any form of contract which ties the buyer to continuing to trade with a particular undertaking, even if a competitor appears on the market offering a better, cheaper product or service, inhibits the competitive process to some extent. There may be entirely proper justifications for such contracts and they do not always have anti-competitive effects. But they are still capable of being abusive if entered into by a dominant firm because that firm has a special responsibility not to impede whatever competition takes place on the market.
>
> 92. All *Hoffmann-La Roche* indicates is that a dominant firm is free to compete vigorously on price and quality and similar parameters ….
>
> 93. We therefore do not accept that the Authority's recognition that some form of premature replacement charge would feature in this market under conditions of normal competition rules out a finding that this contract is an abuse. The issue in this case is not whether *any* payment protection arrangements could be justified where a long-lived rented asset is installed without an upfront transaction charge. It is accepted on all sides that such arrangements are legitimate or normal. The question in this case is whether the Legacy MSA goes too far in protecting National Grid from the consequences of competition and whether the agreement's foreclosing effect is too severe to be justified by National Grid's desire to protect the revenue stream generated by its meters."

30. The Tribunal went on to consider in other sections of its judgment the economic effects of the Legacy MSAs and whether the foreclosure effects were too severe to be justified. Aspects of its analysis of those matters are considered in the context of later grounds of appeal. One passage I should mention here, however, since it is referred to expressly in the submissions on ground 1, is paragraph 97, where the Tribunal said that the Legacy MSAs "[operate] in the same way as a contract which obliges the customer to take a certain percentage of its requirements from the dominant undertaking", discourage gas suppliers from replacing the legacy meters with new meters rented from a CMO or under the N/R MSA, and "therefore have the same kind of economic effects as the ECJ described in the *Michelin* case [Case 322/81, *Michelin v Commission*, cited above]".

31. Mr Turner's submissions on this issue proceeded on the basis that the approach laid down in *Hoffmann-La Roche* involves two distinct elements: (a) whether the behaviour in question amounts to "non-normal" competition, and (b) whether the (actual or likely) effect of the behaviour is to hinder the maintenance or growth of competition in the market. He submitted that the Tribunal should as a matter of law have found in National Grid's favour on the issue of normal competition and stopped there, without going on to consider the effect of the arrangements and the question of proportionality.

32. Criticism was levelled at the Tribunal's summary of National Grid's case on normal competition. Mr Turner told us that the case was not that because some forms of

compensation arrangement were normal it followed that all kinds of compensation arrangement would be normal. The case depended on factoring in the particular facts. It was that the compensation arrangements in issue must be regarded as "normal competition" as a matter of law, when (a) the facts show that the arrangements were the natural approach to contracting for payment protection, having regard to the nature of the products concerned, and (b) the only other approach to such contracting that has been suggested (see the discussion of the "counterfactual", below) was neither feasible nor wanted by customers in relation to legacy assets, as this would have increased transaction costs and undermined their flexibility to arrange replacement of National Grid's goods. The behaviour adopted was in itself the natural, efficient and only realistic way to achieve indisputably legitimate ends.

33. Mr Turner relied on a passage in Faull & Nikpay, *The EC Law of Competition*, 2nd ed., para 4.155, which states that in order to distinguish competition on the merits from exclusionary abuses, it is essential to analyse whether the practice in question may be justified by any reason other than the mere aim to exclude competitors: if the practice reduces the costs of the dominant undertaking or otherwise increases its efficiency it will normally be considered as an example of normal competition, even if it contributes to the elimination of competitors not able to match this increase in performance; if, on the other hand, a practice leads to the exclusion of competitors without increasing the efficiency of the dominant undertaking at all, it is much more likely that such a practice would be considered as an abuse. He submitted that that applies *a fortiori* where, as here, the practice in question not only reduces the costs of the dominant undertaking but also reduces the costs of other parties to the transaction and assists their ability to arrange for the competitive replacement of the dominant undertaking's goods. This should have been decisive on the question of liability.

34. In a sweep-up list of points, Mr Turner submitted *inter alia* that the Tribunal was wrong in its interpretation of what was said about normal competition in *Hoffmann-La Roche*, in that the legal definition of normal competition must necessarily include provision for premature replacement charges to protect agreed payments under long-term contracts, in a market where payment protection arrangements are legitimate or normal; and that it was wrong in principle to treat a requirement to pay premature replacement charges as a form of contract which "ties" the buyer and "inhibits the competitive process to some extent" (para 91) or as having the same kind of economic effects as the loyalty rebates in *Michelin* (para 97) or as being restrictive on the ground that they discourage customers from replacing meters they have committed to rent (*ibid.*).

35. The complexities of Mr Turner's submissions on this appeal are such that any summary of them no doubt runs the risk of inadequacy, and the same must have been true of the proceedings before the Tribunal. For my part, however, I do not think that the Tribunal's summary of National Grid's case merits the criticism levelled at it by Mr Turner or that, even if the summary failed to do full justice to the case, it led the Tribunal into legal error in its analysis of the issue of normal competition.

36. At the heart of Mr Turner's substantive submissions on normal competition are the propositions that (1) as a matter of law, normal competition has to be considered as, in effect, a preliminary issue, separate from consideration of the anti-competitive effects of the conduct and from any question of proportionality; and (2) normal competition is a concept with a legal definition, or at least a sufficiently hard-edged concept that it

can be determined as a matter of law whether a particular factual situation does or does not amount to normal competition. In my judgment, both propositions are mistaken.

37. Mr Turner was unable to show us any authority to support the proposition that normal competition has to be considered as a separate issue. The passage at para 91 of *Hoffmann-La Roche* itself does not establish the point. Nor do passages in *Michelin* (at paras 70-73) and in Case C-95/04P, *British Airways plc v Commission* (in particular at paras 23-25 of the Advocate General's Opinion of 23 February 2006), to which Mr Turner also took us.

38. For the respondents, Miss Carss-Frisk QC and Mr Vajda QC submitted that there is an inevitable overlap between the issue of normal competition and the effect of the dominant undertaking's conduct on competition, and that a holistic approach is required. Particular support for that approach is to be found in the judgment of the Court of First Instance in Case T-65/98, *Van den Bergh Foods Ltd v Commission* [2004] 1 CMLR 1, which concerned an allegedly abusive exclusivity clause in the supply of ice-cream freezer cabinets. At paras 157-159 of the judgment the court said this:

> "157. … It is settled case law that the concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of the market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products and services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition [footnote reference to *Hoffmann-La Roche*, para 91]. It follows that Art 86 [now article 82] of the Treaty prohibits a dominant undertaking from eliminating a competitor and from strengthening its position by recourse to means other than those based on competition on the merits. The prohibition laid down in that provision is also justified by the concern not to cause harm to consumers.
>
> 158. Consequently, although a finding that an undertaking has a dominant position is not in itself a recrimination, it means that, irrespective of the reasons for which it has such a dominant position, the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition in the common market.
>
> 159. The Court finds, as a preliminary point, that HB rightly submits that the provision of freezer cabinets on a condition of exclusivity constitutes a standard practice on the relevant market. In the normal situation of a competitive market, those agreements are concluded in the interests of the two parties and cannot be prohibited as a matter of principle. However, those

> considerations, which are applicable in the normal situation of a competitive market, cannot be accepted without reservation in the case of a market on which, precisely because of the dominant position held by one of the traders, competition is already restricted. Business conduct which contributes to an improvement in production or distribution of goods and which has a beneficial effect on competition in a balanced market may restrict such competition where it is engaged in by an undertaking which has a dominant position on the relevant market …."

39. We were also referred to textbook commentaries on the relevant passage from *Hoffmann-La Roche*, in particular Bellamy & Child, *European Community Law of Competition*, 6th ed, para 10.061, and Whish, *Competition Law*, 6th ed, page 192. Caution must be exercised in relation to Bellamy and Child, since the Chairman of the Tribunal in this case, Miss Vivien Rose, is one of its general editors. But she was not the author of the section on abuse of dominance, and paragraph 10.061 provides a convenient summary of the position:

> "Although in the passage just cited [from *Hoffmann-La Roche*] the Court of Justice refers to 'recourse to methods different from those which condition normal competition, it is clear that this does not mean that an abuse must comprise conduct peculiar to dominant firms or capable of being indulged in only by reason of dominance. Conduct which may be permissible in a normal competitive situation may amount to abuse if carried out by dominant firms because such firms have a 'special responsibility' on account of the prejudice that their activities may cause to competition in general and the interests of competitors, suppliers, customers and consumers. It follows from the nature of the obligations imposed by Article 82 that undertakings in a dominant position may be deprived of the right to adopt a course of conduct or take measures which would be unobjectionable if adopted or undertaken by non-dominant undertakings …."

40. In the light of such material I accept the submissions of the respondents on this issue. I can see no legal error in the approach taken in paragraph 93 of the Tribunal's judgment. The Tribunal was entitled not to treat the issue of abuse as determined by the fact that early replacement charges feature in the market under conditions of normal competition. It was entitled not to isolate the question of normal competition as a separate issue but to ask itself whether the foreclosing effect of the agreements was too severe and to look at matters in the round in deciding whether the conduct was abusive.

41. Nor do the authorities support Mr Turner's depiction of "normal competition" as a concept with a legal definition, or at least a sufficiently hard-edged concept that it can be determined as a matter of law whether a particular factual situation does or does not amount to normal competition. An equivalent expression used in some of the cases is "competition on the merits" (see, for example, para 157 of the judgment in *Van den Bergh Foods Ltd*, quoted above; and para 24 of the Advocate General's

Opinion in *British Airways*, cited above), but that is far from being a legal definition or the expression of a sufficiently hard-edged concept to enable factual situations to be included within it or excluded from it as a matter of law. Whether there has been recourse to methods different from those which condition normal competition is a question of expert appreciation. I agree with what the Tribunal said about this in para 27 of its judgment in *Napp*, quoted at [23] above. The point was made by reference to the facts of that case but applies equally in relation to the facts of this case. In reaching the overall conclusion it did, the Tribunal must be taken to have found that the Legacy MSAs did involve recourse to methods different from those which condition normal competition. Such a finding was a matter of judgment for the Tribunal. A judgment of that kind is not open to frontal attack as being "wrong in law". A *Wednesbury* challenge was not mounted on this issue, but I am satisfied in any event that it was reasonably open to the Tribunal to make the judgment it did.

42. In so far as Mr Turner sought to identify specific errors of law in the Tribunal's reasoning at paras 90-93 and 97 of the judgment, I would reject those submissions too. I might not have expressed myself in all respects in the way the Tribunal did, but I see no legal error in its analysis: questions such as whether the agreements had tying effects were again matters of expert appreciation for the Tribunal.

43. I would therefore reject National Grid's case under ground 1.

Ground 2: anti-competitive foreclosure

44. Ground 2 relates to the Tribunal's analysis of the economic effects of the agreements and in particular whether they hindered the growth of competition in the market (i.e. whether there was an anti-competitive foreclosure effect). It breaks down into a number of sub-grounds, each of which is subject to considerable elaboration. In order to understand the points, it is necessary to provide a brief summary of how the Tribunal approached the matter.

45. In a section on the economic effect of the Legacy MSAs (paras 94-98) the Tribunal referred to cases relating to various forms of tying contracts (requirements contracts, fidelity rebates, bonus arrangements). At para 97, in a passage to which I have already referred, it said that Legacy MSAs operate in the same way as a contract which obliges the customer to take a certain percentage of its requirements from the dominant undertaking. At para 98 it observed that Legacy MSAs "are not a cost recovery arrangement but a revenue protection arrangement", but that National Grid's case was that, nonetheless, they were legitimate because the revenue guaranteed by them fell far short of the Regulatory Asset Value (or "RAV", on which returns on assets were calculated for the purpose of the regulatory price cap) which it regarded as a good proxy for its unrecovered sunk costs aggregated over the whole of the legacy meter installed base. The judgment continued:

> "The key question for the Tribunal is whether the Authority was right to conclude that the foreclosure effect arising from the Legacy MSA was too severe to be justified by National Grid's admittedly legitimate interest in ensuring that it was able to recoup some of the costs that it had incurred in installing the legacy meters."

46. The Tribunal then examined three different ways in which the Authority had measured the foreclosing effect of the Legacy MSAs.

47. The first was to compare the size of the PRC (the premature replacement charge) with the benefit that the gas supplier would expect to obtain from switching to a cheaper CMO. In relation to DCMs, the PRC was taken to be £57 in the first year, which was said to be high compared with the annual saving a gas supplier could expect to make on the rental if it incurred the PRC and installed a CMO's meter, given that annual rentals were about £11 per meter. The Tribunal agreed that "this comparison supports the Authority's conclusions on abuse because the cost incurred if the gas supplier has to pay a PRC on a meter is so high that it is likely to be more than the savings the gas supplier can expect from renting a cheaper CMO meter" (para 99). In relation to PPMs the position was more complex but the outcome was that the Tribunal did not read the Authority's decision "as drawing any conclusion on foreclosure effect from a simple comparison of the first year PPM PRC with either PPM rentals or cost of installation" (para 100).

48. The second way in which the Authority measured the costs that the Legacy MSA provisions imposed on gas suppliers was to work out how much a gas supplier would have to pay National Grid if it exceeded the glidepath. There was evidence on this from the Authority's expert economic consultant, Mr Tim Keyworth. He carried out calculations on two scenarios in the case of DCMs (namely replacement of (i) 50 per cent, and (ii) 65 per cent, more than the glidepath allowed in each of the first three years of the contract), but only on the first of those scenarios in relation to PPMs. National Grid challenged various aspects of the calculations and the assumptions on which they were based. The Tribunal rejected those arguments, finding that "the exercise carried out by the Authority to calculate the marginal and average cost of exceeding the glidepath was a legitimate one and was carried out fairly", and that "it supports the conclusions that the Authority drew from it" (para 118).

49. The third method relied on by the Authority was to compare the costs of carrying out a given replacement programme under the Legacy MSA with the cost of carrying out the same programme under one or more "counterfactuals". The main counterfactual was an age-related one, that is a contract in which the size of the early replacement charge was smaller for older meters than for younger. For that purpose the Authority drew from the contracts of CMOs and from National Grid's own N/R MSA, under which the early replacement charges depended on the characteristics of each specific meter replaced, notably its age. The Tribunal summarised the approach the Authority had adopted (paras 120-127). It then turned to examine at length National Grid's challenges to the age-related counterfactual (paras 128-144). I will come back to some of the points at issue when considering the details of the case advanced under ground 2 of National Grid's appeal. The Tribunal concluded by rejecting National Grid's criticisms of the counterfactual and finding that "this was a useful exercise properly carried out by the Authority", and that "it supports the Authority's conclusions that an age-related approach would have provided CMOs with significantly greater opportunities to engage in meter replacement programmes, whilst gas suppliers would face early replacement charges that would be substantially lower than those likely to be payable under the Legacy MSAs", which "in turn supports the Authority's conclusion that the Legacy MSAs went too far in protecting National Grid's revenue streams and were therefore not justified" (para 143). The Tribunal did

not think it necessary to go into detail concerning the Authority's reliance in the alternative on a counterfactual which included no PRCs (para 145). Finally on this topic, it rejected National Grid's argument that the correct counterfactual was the sale of the meter by the meter operator to the gas supplier, together with related arguments (paras 146-156).

50. The Tribunal turned next to consider the effect of bundling of maintenance (paras 157-163). The Authority had not found that maintenance bundling was itself an abuse, but had said that the fact that meters were sometimes replaced by National Grid on a maintenance visit affected the CMOs' business in two ways: first, it meant that the new meter would not be a legacy meter which the gas supplier was likely to want the CMO to replace; and secondly, because a replacement carried out on a maintenance visit counted against the free allowance under the glidepath, the effect was to reduce the number of discretionary replacements that a CMO could expect to be asked to replace without the gas supplier incurring an early replacement charge. The Tribunal concluded that maintenance bundling did aggravate the effect of the Legacy MSAs in the two ways the Authority had found.

51. Mr Turner submitted that the Tribunal's approach to the issue of anti-competitive foreclosure involved a number of errors of law. He advanced his case by reference to six sub-grounds (grounds 2(a) to (f), considered at [58] to [75] below). As an overarching theme, however, he submitted that in order to determine whether conduct has, in the language of *Hoffmann-La Roche* para 91, "the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition", it is necessary to have a clear, objective and realistic *benchmark* to distinguish non-abusive from abusive behaviour and to enable a dominant undertaking to know on which side of the line its behaviour falls; and that the Tribunal's approach to assessing whether the early replacement charges hindered competition overlooked the need for such a benchmark.

52. In support of that general point, Mr Turner referred to a number of cases where in his submission a benchmark of some kind has been used: Case C-62/86, *AKZO V Commission* [1991] ECR I-3359, at paras 70-72, where the court laid down the criteria, in terms of the relationship between prices and costs, for determining whether a dominant undertaking has engaged in predatory pricing; Case C-418/01, *IMS Health v Commission* [2004] ECR I-5039, at para 38, where it laid down three conditions for a finding that the refusal of a copyright owner to give access to a product or service is abusive (namely, that the refusal is preventing the emergence of a new product for which there is a potential consumer demand, that it is unjustified and such as to exclude any competition on a secondary market); *British Airways*, cited above, at paras 70-77, where the court set out indications given in the case-law as to the cases in which discount or bonus schemes are not merely the expression of a particularly favourable offer on the market but give rise to an exclusionary effect; and Case T-271/03, *Deutsche Telekom AG v Commission* (judgment of 10 April 2008, paras 188-193), where the court held that the existence of an abusive margin squeeze must be established by reference to the costs and prices of the dominant undertaking rather than by those of competing undertakings, and that any other approach would be contrary to the principle of legal certainty (since, if the lawfulness of the dominant undertaking's pricing practices depended upon the particular situation of competing undertakings – information which is generally not known to the dominant undertaking

– the dominant undertaking would not be in a position to assess the lawfulness of its own activities).

53. Mr Turner also submitted that the relevant provisions of competition law are concerned with the actual or likely effects on competition in the real world; and any comparison used for the purpose of testing whether arrangements have the actual or likely effect of hindering competition must therefore be based on alternative arrangements that the parties would or might *realistically* have made instead. He referred to a document issued by the EC Commission in December 2008, *Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings*. Para 20 of the document gives a broad description of factors that the Commission considers to be generally relevant to an assessment of anti-competitive foreclosure. Paragraph 21 states:

> "21. When pursuing a case the Commission will develop the analysis of the general factors mentioned in paragraph 20, together with the more specific factors described in the sections dealing with certain types of exclusionary conduct, and any other factors which it may consider to be appropriate. This assessment will usually be made by comparing the actual or likely future situation in the relevant market (with the dominant undertaking's conduct in place) with an appropriate counterfactual, such as the simple absence of the conduct in question or with another realistic alternative scenario, having regard to established business practices."

54. I would reject Mr Turner's overarching submission as to the need for any finding of abuse to be based on a benchmark. It is true that benchmarks of a kind have been applied in certain pricing contexts, such as in drawing a dividing line between competitive low pricing and abusive predatory pricing, and that according to para 21 of its guidance document the Commission's own approach to assessing anti-competitive foreclosure is *usually* to make a comparison with an appropriate counterfactual. There is, however, no rule requiring the use of a benchmark in every case, let alone a benchmark that will tell one precisely where the line between lawful and unlawful conduct is to be drawn. The question whether an abuse exists is highly fact-sensitive and dependent upon an evaluation of a wide range of factors, in the light of the general principles expressed in *Hoffmann-La Roche* and other cases. It does not have the precision that Mr Turner claims for it. As stated in Bellamy & Child, para 10.058:

> "Article 82 does not provide a comprehensive definition of abuse. The specific instances set out at Article 82(a)-(d) seek to specify categories of prohibited conduct …. However, concepts such as 'unfair' and 'competitive disadvantage' are inevitably unclear in their scope and highly dependent on factual appreciation, so that the distinction between conduct on the part of a dominant firm which is permissible and conduct which is prohibited as abusive is often a difficult one. For the dominant firm, the assessment of its actions in any particular case will be a question of fact and degree, in which the

> following considerations are relevant when assessing whether a credible case of anti-competitive conduct is made out ….”

The text then sets out ten considerations, including “(v) how far the conduct in question is normal industry practice or, on the contrary, is exceptional and plainly restrictive of competition”, and “(ix) whether the adverse impact of the conduct is ‘proportionate’ to any legitimate commercial interest or public policy objective which may be identified as an ‘objective justification’ for such conduct”. The benchmark approach contended for by Mr Turner does not feature. Reference is made to benchmarks in a later passage, at paras 10.104-10.110, concerning exploitative or excessive pricing (a form of abuse which is not alleged in the present case), but it is plain that even in that context the use of comparisons in the assessment of abuse is a very flexible exercise.

55. In *British Airways*, one of the cases to which Mr Turner referred, it was found that various bonus schemes for travel agents had the object and effect of excluding British Airways’ competitors from the market. Although the court referred to “indications” given by the case-law as to the cases in which discount or bonus schemes give rise to an exclusionary effect, those indications did not involve the application of a benchmark; and the decision in the case depended on an examination of all the circumstances rather than on drawing a particular dividing line by reference to a benchmark. Indeed, the Advocate General observed at para 25 of his Opinion that “[i]n the area of rebates and bonuses it is particularly clear that, in individual cases, it is difficult to draw the line between legitimate conduct and the prohibited abuse of a dominant market position”.

56. It follows that in my view there was no requirement for the Tribunal in the present case to apply a benchmark of the kind for which Mr Turner contended.

57. The use of counterfactuals as a tool of appraisal is plainly permissible and of potential value. What is appropriate by way of counterfactual, however, is a matter of judgment for the decision-maker. There is no rule of law that the counterfactual has to take a particular form. The Commission’s guidance document refers to a range from “the simple absence of the conduct in question” to “another realistic alternative scenario, having regard to established business practices”. It does not say that the alternative scenario must be based on alternative arrangements that the parties to the contracts in issue would or might realistically have made instead, and there is no principle requiring the adoption of such a restrictive approach. The purpose of the counterfactual is simply to cast light on the effect of the conduct in issue. It is for the decision-maker to determine whether a counterfactual is sufficiently realistic to be useful, and to decide how much weight to place on it. This is an area of appreciation, not of legal rules.

58. *Ground 2(a)* picks up the submission about the need for any comparison to be with a realistic alternative. The main method of comparison used by the Authority and approved by the Tribunal was the age-related counterfactual, under which the early replacement charge was smaller for older meters than for younger. National Grid challenged that counterfactual before the Tribunal on the ground that it would not have been feasible for the parties to enter into such a contract at the time the Legacy MSA was negotiated. Producing the information about the age profile of the legacy meter stock had involved a huge amount of internal work by National Grid, and at the

time the agreements were negotiated there were a very large number of installed meters on which the company had no reliable information. In dealing with this point the Tribunal continued (at para 129):

> "National Grid also referred us to contemporaneous documents which make clear that neither National Grid nor British Gas thought it was either feasible or desirable to have an early replacement scheme which relied on the characteristics of specific meters. For various practical reasons, both parties preferred a scheme which involved a flat rate charge because this minimised transaction costs and maximised the flexibility that the gas suppliers had in deciding which of their portfolio of meters they replaced at any given time."

59. There was an issue before us as to whether that passage merely set out National Grid's submission or amounted to a finding by the Tribunal that it was not feasible for National Grid and British Gas to enter into arrangements under which the early replacement charge depended on the age of the specific meter. I doubt whether it was intended to be a finding, because the Tribunal's subsequent reasoning did not depend upon it (see below). I would also be surprised at such a finding, because the contemporaneous documents to which we were taken did not seem to me to be sufficient in themselves to justify it, though they certainly show that an approach based on the age of the specific meter was considered by National Grid and British Gas to be undesirably complex. In any event, nothing ultimately turns on the point, because the Tribunal dismissed National Grid's argument for these reasons:

> "130. In our judgment this criticism is based on a misapprehension of the function of the counterfactual in the economic analysis required in a case such as this. The Authority does not have to establish that the parties would have preferred to enter into a contract along the lines posited in the age-related counterfactual. The age-related counterfactual is based on features of other contracts operating in the market, namely the CMO contracts and National Grid's N/R MSA. The question the Authority is asking is 'what would have been the position if the parties had operated a system in relation to the legacy meters similar to the system that now operates in relation to new meters?'. We regard that as a useful avenue of inquiry even if there would have been logistical or financial difficulties in setting up such a system. As Ms Carss-Frisk QC argued in her closing submissions, the Authority is not setting out to prove that the counterfactual is what would or should have happened or that it would have been preferred by the parties. It is simply asking what would be the result if they had."

60. In my judgment, there was no error of law in that approach. As I have said, there was no requirement for the Tribunal (or for the Authority whose decision the Tribunal was reviewing) to adopt any particular form of counterfactual. The Tribunal was entitled, as a matter of reasonable judgment, to conclude that the age-related counterfactual

was a useful avenue of inquiry. It was sufficiently rooted in the realities of the market to justify weight being placed on it.

61. *Ground 2(b)* is that the age-related counterfactual was based on an obvious and fundamental error of comparison and was illogical or perverse, since the hypothetical arrangements against which the Tribunal compared the Legacy MSA would not allow National Grid to achieve the same degree of compensation for early replacements and thus did not compare like with like.

62. The Authority had originally asserted that the age-related counterfactual was revenue neutral, but acknowledged during the hearing before the Tribunal that in fact it generated a lower revenue than the Legacy MSA. National Grid put forward detailed criticisms of the lack of revenue neutrality, supported by the evidence of Mr David Matthew, an expert witness who provided a detailed critique of the evidence of the Authority's witness, Mr Keyworth. The Tribunal dealt with this as follows:

> "137. In our judgment this criticism of the age-related counterfactual and Mr Matthew's evidence is misguided. There would be much force in National Grid's argument if the Authority had simply picked the various inputs in the counterfactual at random. If it had simply used lower PRCs or higher numbers of free replacements in an arbitrary manner, the fact that they resulted in lower overall costs would not have told us anything useful. But the point about the counterfactual was, as Mr Keyworth repeatedly stressed, that it was 'rooted in market reality' …. [Reference was then made to what Mr Keyworth had said about this in his evidence.]
>
> 138. The counterfactual is therefore looking at what bargains have in fact been struck in the sector of the market where meter operators are subject to competitive pressures. These meter operators are incurring the same *kinds* of customer specific sunk costs as National Grid has incurred, albeit not necessarily the same *level* of costs. It is relevant to ask to what extent those meter operators have been able in their negotiations with British Gas to protect their revenue streams from the risk of early meter replacement. To put it another way, it is relevant to look at what kinds of arrangements other meter operators regard as giving them adequate revenue assurance such that they are prepared to conclude contracts, enter the market and carry out meter replacement on the basis of those arrangements. Having identified those terms, the counterfactual then assesses what would have happened if those kinds of provisions had been applied to the legacy meter stock – would gas suppliers have been better off? That is a perfectly valid question to ask and constructing the counterfactual as Mr Keyworth has done is a good way to find out the answer to that question. It does not matter whether the age-related counterfactual is value or revenue neutral. What matters is that it is based on the contractual terms under which competing CMOs have been prepared to enter the market. If the counterfactual shows that

> gas suppliers *would* be better off under the counterfactual than they are under the Legacy MSA, that points to a conclusion that the Legacy MSAs go further than they should or need to go in order to protect National Grid's revenue in a competitive market.
>
> 139. We agree with Mr Keyworth that it would only be necessary to ensure that the age-related counterfactual was revenue neutral compared with the Legacy MSA if the Authority accepted that National Grid was *entitled* to receive from the gas suppliers the level of revenue that is generated for it by the Legacy MSAs (that is some part of the RAV). The Authority is very far from accepting that and they are clearly right to reject any such suggestion ….. Even though the Authority has not treated this as an excessive pricing case, it is still entitled to find that the level and structure of the early replacement charges in the Legacy MSA create a disproportionate disincentive for gas suppliers to move their business to new entrants. The Authority was therefore entitled to find … that the charges provide a level of protection for the dominant undertaking which is far greater than the new entrants were able to achieve in their negotiations with the same customer."

63. Mr Turner submitted that the Tribunal's reasoning referred to no coherent legal principle or objective benchmark for determining *why* National Grid should have to recover a smaller amount of the costs it had incurred in providing the legacy meters, nor how much less revenue it would be legitimate for National Grid to recover in order to avoid committing an abuse. The Tribunal was operating in an area of purely subjective discretion. It was further submitted that in relying on such an obvious and fundamental error of comparison the Tribunal was guilty of illogicality or perversity.

64. Those arguments again demand more of the counterfactual than is warranted. It was a matter of judgment for the Tribunal whether the counterfactual was useful even though it would generate for National Grid a lower revenue than the Legacy MSAs; that is to say, it was a matter of expert appraisal, not of arbitrary subjective discretion. The Tribunal gave a reasoned basis for its view that the counterfactual was still useful. I do not accept that it was perverse to rely on the counterfactual in circumstances where it was not revenue-neutral. Nor, for reasons already given, do I accept that it was incumbent on the Tribunal to indicate by reference to a benchmark what specific level of costs it was lawful for National Grid to recover.

65. *Ground 2(c)* is that the Tribunal's approach depended on cherry-picking parts of contracts concluded by National Grid's competitors and using a patchwork quilt of these and other arbitrary elements to make up the hypothetical contracts in the counterfactual. This is said to have been contrary to the principle of legal certainty, perverse and based on no evidence to support the claims about the competitors' contracts.

66. The argument about cherry-picking was canvassed before the Tribunal. One point taken was that the UMS contract provided in certain circumstances for a 25 year

rather than 20 year scale of PRCs for DCMs. But that applied in very limited circumstances and the Tribunal found that it not detract from the fact that the industry "standard" outside the Legacy MSA was to treat DCMs as likely to be in place for 20 years (para 141). A more important point was explained and considered by the Tribunal as follows:

> "142. National Grid complained that the counterfactual also ignores the fact that the CMOs have a five year exclusivity period at the start of their contracts and (though there was some dispute about this) that after that exclusivity has expired, British Gas can only replace the CMOs' meters in limited circumstances. But we consider that the Authority was right to conclude that it would not make sense to replicate all the terms of the CMOs' contracts into the counterfactual. Those contracts are entered into by firms which are not only non-dominant but also new entrants into the market. As Mr Keyworth pointed out, at least one of the contracts – the UMS contract – does allow replacement in the secondary period by another party of any of the CMO's installed meters and in all three of the contracts, the PRC payable where the meter *can* be taken out in that period is clearly based on an age-related structure. We do not agree with National Grid that there was unfair 'cherry picking' of those aspects of the CMOs' contracts which served the Authority's purpose in devising the counterfactual."

67. In so far as it is said to have been contrary to the principle of legal certainty for the Tribunal to rely on the contracts of CMOs *at all*, the point was based on para 192 of the judgment in *Deutsche Telekom*, cited above, where the court said that if the lawfulness of the dominant undertaking's pricing practices depended upon the particular situation of competing undertakings – information which is generally not known to the dominant undertaking – the dominant undertaking would not be in a position to assess the lawfulness of its own activities. In my view, however, the situation here is very different from that under consideration in *Deutsche Telekom*. It seems to me that in developing a counterfactual for use as a tool of appraisal it is plainly appropriate to have regard to the arrangements entered into by competitors in the market (the Commission's guidance document refers to "established business practices"). Further, the key feature of the counterfactual was the setting of early replacement charges by reference to the age of the specific meter; and that was a feature with which National Grid was itself perfectly familiar, since it had looked at the possibility of adopting such an approach in the Legacy MSA and had in fact adopted that approach in its N/R MSA. I can see no breach of the principle of legal certainty in the Tribunal's approach on this issue.

68. As to the contention that the age-related counterfactual depended on unreasonable cherry-picking from the contracts of the CMOs, it is true that features of those contracts were omitted. The most important of the omitted features was the five-year period of exclusivity followed by a substantial degree of protection for the remainder of the twenty-year period; but that feature, whilst acceptable in the contract of a new entrant, would not have been acceptable in the contracts of the dominant undertaking,

and it is therefore understandable why it was omitted from the comparison. More generally, I come back to the fact that the content of the counterfactual was a matter for the expert judgment of the Tribunal, and in my view it was open to the Tribunal to take the course it did. I do not think that the omission of features of the CMOs' contracts deprived the counterfactual of all utility or made it unreasonable for the Tribunal to rely on it. Equally, whilst there is a degree of tension between what the Tribunal said about the nature of the counterfactual in para 138 and what it said in rejecting the cherry-picking argument at para 142, I am not persuaded that there was a fundamental inconsistency capable of invalidating the Tribunal's approach.

69. *Ground 2(d)* arises out of the absence of any age-related counterfactual in respect of PPMs. The Authority did consider PPMs in the context of its second method of measuring the foreclosing effect of the Legacy MSA. That involved working out how much a gas supplier would have to pay National Grid if it replaced 50 per cent more meters than the glidepath allowed in each of the first three years of the contract (see [48] above). The Authority concluded that the impact of the provisions on the costs to a supplier of replacing more PPMs than scheduled in the glidepath was likely to be less pronounced than was the case for DCMs. This was held by the Tribunal to amount to a finding of foreclosure, albeit not as severe as in the case of DCMs (para 108). Mr Turner submitted that this, taken by itself and without any additional age-related counterfactual, provided an insufficient basis for the Tribunal's finding at para 200 that the early replacement charges were disproportionate for PPMs as well as for DCMs and that they had a foreclosure effect: the Tribunal's finding was perverse.

70. Since there is no legal requirement for a counterfactual at all, the absence of an age-related counterfactual in respect of PPMs cannot in itself be the subject of complaint. What is more troubling is the Tribunal's finding of an abuse in respect of PPMs in circumstances where there was no such counterfactual and the only specific exercise carried out was the limited one referred to above. That is, on the face of it, a tenuous basis for a finding of abuse. On the other hand, it is very difficult for this court to gauge the full significance of the exercise carried out by the Authority: the Authority found a foreclosure effect on the basis of it and in the absence of any indication to the contrary the Tribunal must be taken to have accepted the Authority's finding on this point. Moreover, in reaching its overall conclusion the Tribunal took into account that the effect of the Legacy MSA was aggravated by maintenance bundling; and the position of PPMs (which are more likely to be the subject of maintenance visits) was considered at some length in that context. In my view all this serves to underline that, whatever its own doubts may be, the court should be very slow to interfere with the assessment made by the specialist tribunal on an issue of this kind. I am not persuaded that an error of law has been established.

71. *Ground 2(e)* also relates to PPMs but goes one step further than the previous ground. What is said is that if the age-related counterfactual were applied to PPMs, customers would be able to replace *fewer* meters without an early replacement charge under the counterfactual than they can under the Legacy MSA: there is a finding of fact to that effect in the Authority's decision. Thus the counterfactual would allow *less* competitive activity on PPMs than do the supposedly abusive contracts actually entered into by National Grid. This is relied on as showing an inconsistency in the Tribunal's approach as between DCMs and PPMs, and as creating a Morton's fork and a logical fallacy in the Tribunal's reasoning: by adopting the contested

arrangements, National Grid is said to have unlawfully restricted competition; yet had National Grid instead adopted the very arrangements used as the Tribunal's own benchmark, it could have been attacked for restricting competition on the (more valuable) PPMs.

72. Although this point was mentioned briefly in National Grid's excessively long and detailed notice of appeal to the Tribunal, it was not developed as an issue before the Tribunal, as one sees from para 6 of the Tribunal's judgment on the application for permission to appeal:

> "National Grid's second point seems to be that Legacy MSAs allow more free replacement of PPMs than are allowed under the CMO contracts. Although National Grid refer to this point having been raised in the 559th paragraph of their Notice of Appeal, this is not a point that was made in National Grid's skeleton argument or during the course of submissions at the hearing. It is not a point that the Tribunal was invited to consider and it is not appropriate for National Grid to rely on it now."

73. I am not satisfied that the point was developed before the Tribunal in a way that made it necessary for the Tribunal to deal with it, or that it is open to National Grid in the circumstances to advance it in this court as a ground of appeal on a point of law against the Tribunal's decision. In any event, although the point has some force to it, I am not persuaded that it is strong enough to carry the day for National Grid. The Legacy MSA was found to have a foreclosure effect on the second of the three methods of comparison used by the Authority, which included calculations for PPMs based on the scenario of replacement of 50 per cent more than the glidepath (see [48] above). The age-related counterfactual was looking at a different scenario. The fact that, on that scenario, suppliers could have replaced fewer PPMs without an early replacement charge than under the Legacy MSA does not rule out a finding of abuse in relation to PPMs when an overall assessment is made. Thus, whilst it would have been interesting to see how the Tribunal dealt with the point had it been called upon to do so, I do not accept that the point exposes a fundamental flaw in the Tribunal's analysis.

74. *Ground 2(f)* is that the Tribunal was wrong to place any reliance on the first way in which the Authority had measured the foreclosure effect of the Legacy MSAs, namely a comparison between the size of the PRC and the benefit that the supplier would expect to obtain from switching to a cheaper CMO (see [47] above). That approach, in Mr Turner's submission, was not capable of distinguishing between lawful and unlawful compensation arrangements.

75. I do not think it necessary to spend any time on this point. It seems to me that the comparison was consistent with a finding of abuse but could not of itself have provided a sufficient basis for such a finding. That does not matter, however, since in practice this was only one, and the least significant, of three ways in which the foreclosure effect was assessed.

76. For those various reasons I would reject the case advanced by National Grid under ground 2.

Ground 3: actual effects of the agreements

77. Ground 3 relates to the actual effects of the Legacy MSAs, in particular the question whether the agreements resulted in British Gas reducing the level of replacements undertaken by the CMOs. The Tribunal dealt with this topic at paras 164-186. It referred to the Authority's finding that the agreements had had an actual foreclosure effect on the market, in that they had resulted in British Gas tightening the terms of its contracts with the CMOs in order to minimise its exposure to the early replacement charges. The Tribunal considered each of the CMOs in turn. It found that the Authority's conclusion in relation to Meter Fit was not adequately supported by the evidence. It upheld the Authority's finding that the Legacy MSA had an actual foreclosure effect on the amount of business that British Gas gave to CML. It also found that the Authority had been entitled to rely on a reduction in the volumes of replacements undertaken by OnStream (UMS) as evidence of actual market foreclosure. It concluded:

> "185. We find therefore that the evidence as regards CML and UMS supports the Authority's findings that the Legacy MSAs have had an actual foreclosing effect on competing CMOs and that this is likely to make it more difficult for the CMOs to compete with National Grid for even the limited numbers that suppliers might want to replace using a CMO."

This was picked up in the statement in para 200 that "[t]he effect of the Legacy MSAs was demonstrated by British Gas's actions taken to reduce the volume of business it provided to some of the CMOs once the terms of the Legacy MSAs had crystallised".

78. National Grid's complaint about the Tribunal's approach is that it involved a comparison between (i) an indication about volumes of CMO business which was given by British Gas in its invitation to tender at a time when (abnormally, owing to the regulatory history) National Grid's meters were subject to *no* payment protection arrangements at all and could therefore be removed without having to pay any compensation charges; and (ii) the amount of CMO business that British Gas was willing to offer once it had struck contracts with National Grid that *did* contain compensation provisions. It is submitted that such a comparison was incapable of forming an appropriate benchmark for demonstrating that the Legacy MSA hindered competition. It is further submitted that the comparison was starkly inconsistent with other parts of the judgment: at para 145 the Tribunal had found it unnecessary to resolve issues surrounding a counterfactual which included no PRCs; and at para 93 and elsewhere there was a clear recognition that some form of early replacement charges would feature in the market under conditions of normal competition.

79. National Grid does not appear to have advanced this argument before the Tribunal and it should not be permitted, in my view, to rely on it now as a ground of appeal on a point of law against the Tribunal's decision.

80. In any event I do not consider there to be any substance to the argument. The Tribunal was entitled to consider the effect that the Legacy MSAs had had in practice on British Gas's willingness to place business with the CMOs. The difference in background circumstances between the original indication of volumes and what happened later was capable of affecting the weight to be attributed to the exercise but

it did not render the entire exercise invalid. It is also of some significance that the Tribunal looked not only at the difference between the original indication of volumes and the volumes actually contracted for when British Gas entered into contracts with the CMOs, but also at the effect of the Legacy MSAs on the British Gas's conduct thereafter: thus in the case of CML it found "very telling" certain correspondence in 2006 which showed that British Gas was pressing to reduce the volumes to the minimum required under the contract, clearly because it wished to avoid compensation payments under the Legacy MSAs (para 181). I see no inconsistency between the Tribunal's exercise and its view in para 145 that, in the light of its findings on other methods of comparison, it was unnecessary to resolve the issues surrounding the no-PRC counterfactual: the fact that it was unnecessary to consider that particular counterfactual did not preclude the Tribunal from considering the actual effects of the Legacy MSAs even if British Gas's original indication of CMO volumes had been given in a context in which it did not have to pay PRCs to National Grid.

81. I would therefore reject National Grid's case under ground 3.

Ground 4: the interests of consumers

82. At paras 187-192 the Tribunal dealt with the question whether the Legacy MSAs deprived consumers of the benefits of competition. The Authority had found that the Legacy MSAs harmed consumers because, in relation to DCMs, gas suppliers could not pass on the lower costs of CMO meters as compared with National Grid meters. National Grid argued that the essential flaw in the Authority's approach was that it overlooked the fact that the Legacy MSAs gave gas suppliers immediate savings in rentals across their entire meter portfolio compared with the P&M charges that would otherwise have been levied. The Tribunal did not accept that argument. It said that "[w]hat the Authority is seeking to identify here is not the overall benefit to consumers of the introduction of competition into the market but the effect on consumers of the fact that fewer cheaper meters are being installed than would be installed absent the Legacy MSA glidepath"; and that it was not right to regard the P&M charges as the charges that would otherwise have been levied, "because in a competitive market where there were no barriers to entry, National Grid's prices would have to fall to compete with the cheaper CMO product" (para 188).

83. The Tribunal also rejected an argument that the Authority should have taken into account further benefits to consumers arising from the Legacy MSAs, in the form of the minimisation of customer disruption (being the disruption that occurs where a gas supplier decides to replace a working meter in order to benefit from lower CMO prices). The Tribunal took the view that this was not a point available to National Grid: "[i]t is for the gas suppliers competing with each other in the domestic gas supply market to weigh up the advantages for their customers of having the lower gas price resulting from a pass through of a lower meter rental against the disruption involved in having the meter replaced. It is not for National Grid to 'protect' the gas suppliers' customers from an accelerated replacement programme" (para 192).

84. Mr Turner submitted that the across-the-board price reductions effected by the Legacy MSAs were part and parcel of the contested arrangements and were important for gas suppliers (who looked at the overall metering costs) and for consumers (who, as a result of competition between suppliers, would get the benefit of cost savings

accruing to suppliers). It was therefore perverse to leave those price reductions out of account when assessing the benefits to consumers. Further or alternatively, there was no evidence to support the apparent finding that the price reductions would have occurred anyway as a result of the introduction of competition into the market. As to the issue of consumer disruption, Mr Turner submitted that the only relevant evidence before the Tribunal was that gas suppliers had considered that their and their customers' interests were *furthered* by the contested arrangements, and that the Tribunal's finding that the gas suppliers had been deprived of the ability to make a choice was on the basis of no evidence. Nor was there any evidence for the finding, if made, that certain individual consumers would be better off owing to the activity of CMOs gradually replacing National Grid meters in their particular homes with cheaper ones.

85. It is common ground that in order to find an abuse it is not necessary to prove direct harm to consumers. The competition rules promote consumer welfare indirectly by their effect on market structure and the promotion of competition. As the Court of Justice said in *British Airways*, cited above, at para 106, "Article 82 EC is aimed not only at practices which may cause prejudice to consumers directly, but also at those which are detrimental to them through their impact on the competition structure". In refusing permission to appeal, the Tribunal considered that that was a sufficient reason for rejecting the arguments raised by National Grid under ground 4. It seems to me, however, that the arguments go beyond a contention that no direct harm to consumers had been proved, and that what the Tribunal said in its permission judgment is not sufficient to dispose of them. At the same time I would firmly reject Mr Turner's attempt to rely on the reasoning in the permission judgment as a basis for attacking the Tribunal's decision on abuse.

86. The main point being made by National Grid, as I understand the submissions, is that the Tribunal concentrated on the adverse effect on consumers of the reduction in competition arising from the Legacy MSAs and did not take into account, as a countervailing factor, the indirect *benefit* to consumers of the lower prices under the Legacy MSAs. The point as to benefit needed to be considered because National Grid and the Authority had agreed that the advantages of the Legacy MSAs should be considered in the context of assessing anti-competitive foreclosure rather than under the separate head of objective justification, and the Tribunal had been content to follow the course agreed (see para 94 of the judgment).

87. It may be that, by considering everything in the context of anti-competitive foreclosure rather than examining under the head of objective justification what was effectively a defence of consumer benefit, the Tribunal did not deal with that defence as clearly as it might have done. I am not persuaded, however, that the Tribunal failed to have regard to any important consideration in its overall assessment. It had clearly in mind the point about the lower prices of the Legacy MSAs as compared with the existing P&M contracts. It did not consider, however, that the P&M charges were a valid basis of comparison, because in a competitive market where there were no barriers to entry prices would fall. Accordingly the argument about the lower prices of the Legacy MSAs did not help National Grid: in the absence of the Legacy MSAs, the competitive process would have led to lower prices; and although National Grid's evidence was that it would have kept its charges at the level of the P&M contracts, the Tribunal considered that National Grid would have had to lower its

charges in order to compete with the cheaper CMO meters and avoid losing business to them. All of this was in my view a matter of appreciation for the Tribunal. I am not persuaded that the Tribunal's analysis involved findings of fact for which there was no evidential support. No error of law has been established.

88. Similarly, there was in my view no error of law in the way the Tribunal dealt with the issue of consumer disruption. This, too, was a matter of appreciation for the Tribunal. Again I am not persuaded that its analysis involved findings of fact for which there was no evidential support, and again no error of law has been established.

89. I would therefore reject National Grid's case under ground 4, as in relation to the case under grounds 1 to 3. This means that the appeal against the Tribunal's decision on abuse should in my view fail. I can therefore move to consider the appeal against penalty.

Ground 5: penalty

90. National Grid's case with regard to penalty is that the fine of £30 million imposed by the Tribunal, although lower than the fine originally imposed by the Authority, was still manifestly excessive and wrong in principle, and that it should be nullified or reduced to a token amount.

91. As regards general approach, the way the Tribunal should deal with the question of penalty can be seen from the judgment of this court in *Argos Limited and Others v Office of Fair Trading* [2006] EWCA Civ 1318, quoting from and approving the Tribunal's own decision in *Napp Pharmaceutical Holdings Limited v Director General of Fair Trading* [2002] CAT 1. In *Napp* the Tribunal had said that "in fixing a penalty, this Tribunal is bound to base itself on its own assessment of the infringement in the light of the facts and matters before the Tribunal at the stage of its judgment" (para 499), but that "it does not seem to us appropriate to disregard the Director's Guidance [considered below], or the Director's own approach in the Decision under challenge, when reaching our own conclusion as to what the penalty should be" (para 500). Lloyd LJ, giving the judgment of the court in *Argos*, commented as follows:

> "163. In *Napp*, and in turn in the two judgments under appeal, the Tribunal commented on the application of the Guidance by the Director (in *Napp*) and by the OFT (in the present cases), then went on to set out its own views on the seriousness of the infringement, and to make its own assessment of the penalty, on the basis of a 'broad brush' approach, taking the case as a whole. The Tribunal carried out a 'cross check' to see whether the amount so arrived at would be within the parameters set out in the Guidance, and concluded that it would be. It seems to us that this is an appropriate approach for the Tribunal."

92. An appeal on penalty lies to this court under section 49(1)(b) of the 1998 Act and is not limited to a point of law. The correct approach of this court to decisions of the Tribunal with regard to penalty is, however, made clear by further passages from the judgment of the court in *Argos*, at paras 165 and 231. In the latter passage Lloyd LJ stated:

> "As we have said, this Court should recognise that the Tribunal is an expert and specialised body: this Court should hesitate before interfering with its assessment of the penalty needed to mark the gravity of the infringement which has occurred and to deter future infringers."

The court was not persuaded in *Argos* that it should interfere with the Tribunal's assessment of penalty.

93. The Tribunal approached the issue of penalty in this case by referring first (at para 201) to the OFT's *Guidance as to the appropriate amount of a penalty* (December 2004, OFT 423), mentioned above. The Authority was required to have regard to that guidance and, in accordance with the practice laid down for itself, the Tribunal did have regard to it. Para 1.4 of the guidance states that the twin objectives on financial penalties are (i) to impose penalties on infringing undertakings which reflect the seriousness of the infringement, and (ii) to ensure that the threat of penalties will deter undertakings from engaging in anti-competitive practices.

94. The Tribunal summarised the Authority's approach as follows. The Authority concluded that the infringement was serious. The maximum starting point for the most serious anti-competitive conduct was 10 per cent of turnover in the relevant product market. The Authority concluded that the appropriate starting point in this case was 4 per cent of turnover. The application of a multiplier of four to take account of the duration of the infringement between 1 January 2004 and the date of the decision led to a figure of £41.6 million. The Authority considered that none of the potential aggravating or mitigating factors was sufficiently serious to influence the penalty.

95. Before the Tribunal, National Grid's main argument in mitigation of the fine was that the Authority had been involved all along in the discussions about the development of the Legacy MSAs and had not made clear to National Grid that it had serious concerns about its terms. The Authority's denial of that suggestion led to extensive consideration of the issue by the Tribunal and to the making of relevant findings of fact. Important aspects of those findings are set out below:

> "208. We have considered carefully the meeting notes and correspondence between National Grid and the Authority over the whole period. These must be seen in the context of the fact that the Authority was the architect and main driver of the process of opening up metering services to competition. … It must have been clear to the Authority that the terms of National Grid's contracts dealing with the legacy meters were absolutely key to the success or failure of the RGMA project. Given the importance that the Authority has attached to the success of the RGMA project, we are surprised that the Authority did not consider that it was part of its role either as an industry regulator or as a competition law enforcement agency to steer the industry participants away from making private arrangements which risked jeopardising the competitive process to a serious degree. The Authority appeared content for National Grid to enter into contracts with the gas suppliers

which it now considers, according to the Decision, have had a significant actual anti-competitive foreclosure effect and hindered the development of the business of the CMOs.

209. Both National Grid and British Gas are undertakings with long experience of working under regulation and are used to conducting their business under the scrutiny of the regulator and indeed of having major aspects of their business decided or at least influenced by the regulator. Ms Frerk [a senior official at the Authority] records in an email in August 2002 that at a meeting at the end of June 2002 the Authority had invited National Grid: 'to come up with a creative solution to the problem of premature replacement of meters' which did not involve a re-opening of the price control and which offered benefits to customers. In response to that invitation, National Grid wrote to the Authority in August 2002 proposing the introduction of premature replacement charges linked to a reduction in annual rentals as 'the most transparent and most effective' way to reduce the current incentive for premature replacement. The letter closed with the National Grid Head of Regulation saying that he would welcome the Authority's views on their proposals. The paper attached to that letter sets out the proposal in more detail and again invites the Authority's views on the approach. There followed meetings between National Grid and the Authority in August and September 2002 and further correspondence where the Authority outlined several detailed concerns about the proposals and National Grid responded to those concerns by changing the proposals. Overall, we can well understand National Grid's surprise and dismay when the Authority opened its investigation into these agreements under the 1998 Act and imposed such a substantial fine.

210. There were two particular points which the Authority put forward to show that they had not given any comfort to National Grid in the course of the discussions. The first was that, so far as the Authority was concerned, the issue about the stranding of National Grid's assets had been dealt with in the earlier decisions which set the 2002 price control. …

..

214. … In our judgment, the correspondence and meeting notes all point to the fact that the Authority did recognise, despite the bargain struck in the 2002 price control, that National Grid could legitimately impose early replacement charges in its commercial contracts in order to recover some of its sunk costs. National Grid understood this to be the case and acted accordingly.

> 215. We also accept National Grid's point that it believed that it had the support of the Authority in trying to slow down the replacement of legacy meters in order to avoid the disruption to customers caused by a programme of accelerated meter replacement. We do not accept that the Authority's concern was limited to a very rapid programme of replacement or 'hell for leather replacement' as Ms Frerk put it. …
>
> 216. Even if some of the Authority's senior management believed it was beneficial to replace working meters in the short term to push National Grid to reduce its prices, that was not the message that came across from the Authority to the industry participants. The industry understood from their discussions with the Authority that the Authority's concern about the public perception of waste and inconvenience arising from opening up this market was more general than that. Again, National Grid interpreted this as a reason why the Authority would not object to National Grid and the gas suppliers putting in place a contract which spread replacement over a longer period than might otherwise occur.
>
> 217. We reject the criticisms levelled at National Grid in the Decision that the company did not discuss the introduction of PRCs openly and frankly with the Authority. …
>
> 218. This is not to say that sectoral regulators are in all cases required to step in and sound some warning bells on competition grounds if they see market developments taking a worrying turn. Neither are we saying that if a company sends a draft contract out of the blue to an official within the regulator it can then claim to have tacit approval if the regulator does not take action. But the Authority was closely involved in and concerned about the roll out of the RGMA project from start to finish and there were internal meetings of the Authority at which National Grid's proposals for its contracts with the gas suppliers were discussed in detail. In our judgment, the history of the discussions in the particular circumstances of this case merits a significant reduction in the fine."

96. The Tribunal then stated (in para 219) that it had considered the other points in mitigation raised by National Grid, for example that the case raised a novel point and that the Authority's case against National Grid had changed during the course of the investigation. It also bore in mind that it had reached different conclusions from the Authority on a number of minor issues. However, in its judgment none of those points affected the level of fine. The Tribunal continued:

> "220. Taking all these points into account, the Tribunal has concluded that a fine of £30 million properly reflects the seriousness of the infringement and the mitigating factor arising from the Authority's involvement with the development of the Legacy MSAs."

97. Mr Turner submitted that the Tribunal's approach to the issue of penalty was erroneous. First, the Tribunal took the Authority's starting-point (of 4 per cent of turnover) and then worked down from that to reflect the mitigation, whereas the correct approach would have been for the Tribunal to make its own overall assessment of penalty and then to use the Authority's decision as a cross-check (see *Argos*, para 163, quoted above). Secondly, although a broad brush approach towards penalty is appropriate (*ibid.*), it must not be an unreasoned approach; yet the Tribunal's conclusion at para 220 was arrived at without any independent reasoning on the seriousness of the infringement.

98. As to the Tribunal's assessment of seriousness, Mr Turner made three broad submissions. First, a reduction of just over 25 per cent in the fine originally imposed by the Authority was not an adequate reflection of the extent of the Authority's involvement in the process that led to the making of the agreements.

99. Secondly, the Tribunal was wrong not to reflect, in the level of the fine, the novelty of the issue and the fact that the Authority's case changed during the course of the investigation. The position under EC law is that "[i]n cases where an important aspect of the decision is novel, the Commission may impose no financial penalty or set only a symbolic fine" (Bellamy & Child, para 13.170 and the cases there referred to). The same approach should apply here. Moreover the mitigating factors listed at para 2.16 of the OFT's Guidance include "genuine uncertainty on the part of the undertaking as to whether the agreement or conduct constituted an infringement". There is no previous case in which compensation arrangements have been found to be abusive. In its ruling on costs the Tribunal recognised that "there is some merit in National Grid's argument that the case on abuse raised novel points" (para 15). The changes in the Authority's case against National Grid were substantial. In its original statement of objections the Authority's case was that the use of *any* early replacement charges was anti-competitive and an abuse. Much later it issued a replacement statement of objections which did not attack the principle of early replacement charges but took issue with National Grid's particular arrangements. Even then the Authority was saying that National Grid could have structured the early replacement provisions in ways that were likely to enable it to recover the same revenues but were less restrictive of competition. That was the basis on which the Authority's decision was adopted. Only at a late stage of the proceedings before the Tribunal did the Authority accept that the age-related counterfactual on which it relied was not revenue neutral (see [62] above), but it maintained its case on abuse. Mr Turner submitted to us that if the regulator cannot say with certainty where the vice lies, a finding of abuse should not attract a financial penalty.

100. Thirdly, the Tribunal did not mention a number of other points relied on by National Grid as going to the seriousness of the abuse, including (a) that the conduct in question occurred at a time of transition from a regulated industry in unique circumstances when there was an unprecedented threat to National Grid and there was no guidance as to how it should behave; (b) customers did benefit from the price reductions under the agreements, and (as found at para 199 when considering the roll-out of "smart" meters) innovation was not impeded; (c) British Gas was content with the agreements (as found at para 67); and (d) the Tribunal had overturned the Authority's findings of abuse in so far as they related to the N/R MSA, which ought in itself to have led to a significant reduction in the level of fine.

101. As to deterrence, the Authority had said in terms that it would not be appropriate or necessary to increase the level of the penalty to act as a deterrent. The Tribunal said nothing about deterrence. Mr Turner emphasised that no deterrence element was appropriate: National Grid openly appraised the regulator of what it was doing, and it was not clear what more it could have done to ensure that its agreements were compliant with the competition rules.

102. For my part, I do not accept that there was any legal error in the Tribunal's approach to the issue of penalty. It was appropriate that it should have regard to the way the Authority approached the matter and why the Authority fixed the fine at £41.6 million. But there is no reason to believe that the Tribunal's conclusion at para 220 was anything other than the product of its own independent assessment, on the basis of the broad brush approach approved in the case-law. That is how I read the paragraph. I acknowledge that at the end of para 218 the Tribunal referred to a mitigating factor as meriting "a reduction in the fine", but I read that as referring to a reduction in the level of fine that would otherwise be appropriate, rather than as showing that the Tribunal was proceeding from the Authority's starting-point and working down from there.

103. Nor was the Tribunal's conclusion an unreasoned one. The Tribunal dealt at length with the main argument advanced by National Grid, concerning the involvement of the Authority in the process that led to the making of the agreements. It explained why it regarded this as a significant mitigating factor. It went on to state in para 219 that in its judgment none of the other points in mitigation advanced by National Grid, nor the fact that it had reached different conclusions from the Authority on a number of minor issues, affected the level of fine. It proceeded in para 220 to set out the level of fine that it considered appropriate. That was a properly reasoned approach. It was not necessary for the Tribunal to deal more fully with the points mentioned, or to make specific mention of every single point raised by National Grid, especially as the other points, although covered in written submissions, were evidently not the main focus of the argument at the hearing.

104. It follows, too, that the Tribunal did not fail to take into account any of the points of mitigation relied on by National Grid. It said in para 219 that it had considered them, and it gave what it described as examples. There is no basis for doubting that all points were considered.

105. This all goes to show the absence of legal error in the Tribunal's approach to penalty. The court must still consider, however, whether the penalty imposed was appropriate in the light of the twin objectives of reflecting the seriousness of the infringement and achieving deterrence.

106. No separate issue of substance arises in relation to deterrence. The view must have been taken that whatever fine was appropriate to reflect the seriousness of the infringement would also deal adequately with deterrence, and the fine therefore contained no additional or distinct element in respect of it. That was an appropriate view to take in this case.

107. The Tribunal's assessment of the seriousness of the infringement does, however, cause me concern.

108. Most importantly, I do not think that the Tribunal gave sufficient weight to the one mitigating factor to which it attached significance, namely the Authority's involvement in the process that led to the making of the agreements. The history summarised at paras 208-218 of the Tribunal's judgment is remarkable. Like the Tribunal, I can well understand National Grid's "surprise and dismay" when the Authority opened its investigation into these agreements and imposed such a substantial fine (see the end of para 209).

109. On the other hand, the history of dealings with the Authority does not absolve National Grid from all blame. By section 36(3) of the 1998 Act, a financial penalty may be imposed only if the infringement was committed intentionally or negligently. The Authority found that National Grid had committed the abuse negligently. An appeal against that finding was not pursued: the Tribunal records at para 201 that by the time of the hearing there was no dispute that there was jurisdiction to impose a fine in the event that the finding of abuse was upheld. The factors relevant to penalty must therefore be assessed on the basis that negligent infringement was established.

110. It is clear and unsurprising that National Grid was well aware of potential competition law issues. We were shown a document, for example, that referred to possible concerns of the Authority in that "the basic concept of PRCs is anti-competitive, as it 'locks-in' customers". Whilst the Tribunal rejected the Authority's criticism that National Grid did not discuss the introduction of PRCs openly and frankly (para 217), the possible tying effect of particular PRC arrangements was something to which National Grid ought to have been very alert. It could have sought formal competition clearance from the Authority for the Legacy MSA but it chose not to do so. It is not known what legal advice it sought about compliance of the agreement with the competition rules.

111. Even allowing for those matters, I consider that the Authority's involvement in the history provides mitigation of considerable weight.

112. There is also some force in the submission about novelty. It is true that the basic feature to which objection was taken, namely the foreclosure effect, was itself far from novel and that a comparison could properly be made with existing case-law on tying contracts. But the application of such principles to early replacement charges was new; the Tribunal itself accepted that the case raised novel points; and the basis on which the finding of abuse was established did involve a substantial change of position from that originally adopted by the Authority, which suggests an element of uncertainty about the correct analysis. It seems to me, contrary to the view taken by the Tribunal, that these points ought to be reflected in the level of penalty.

113. Of National Grid's other points, the only one to which I would attach weight is the Tribunal's finding that the N/R MSA should be excluded from the finding of abuse. That is not a matter of great weight relative to the finding of abuse in respect of the Legacy MSA, but I think that it ought in principle to lead to a lower penalty than if the finding of abuse had extended to the N/R MSA as well. Yet the Tribunal apparently took the view that it should have no effect on the level of fine.

114. I have concentrated on matters of mitigation, but one must not lose sight of the basic fact that, on the Authority's findings as upheld by the Tribunal, the Legacy MSAs had the likely and actual effect of foreclosing competition within the relevant market, and

that this occurred in a period of transition when the regulator was seeking to encourage a move from a position of monopoly supply by National Grid to one of effective competition. I bear in mind that, as the Authority said in its decision, the practical logistics associated with procuring and installing meters limited the effects compared with foreclosure of other markets where competitors can enter and expand their market share very rapidly. Nevertheless such an infringement was properly regarded by the Authority and the Tribunal as serious, and I would approach the matter of penalty on that basis, subject to the force of the mitigating factors to which I have referred.

115. That brings me to my conclusion on penalty. For the reasons given, I take the view that in setting the fine at £30 million the Tribunal placed insufficient weight on the Authority's involvement in the history and failed to give any weight at all to certain factors to which some weight ought to be given. Of course, the assessment made by the Tribunal, with its expertise in this field and its detailed knowledge of the facts of the case, commands great respect; and, as said in *Argos*, the court should hesitate before interfering with it. The court has experience of the level of fines across a broad spectrum of criminal offences but has little familiarity with penalties in the field of competition law. Notwithstanding those considerations, I have reached the conclusion that we would be justified in interfering with the Tribunal's assessment in this case. Taking a broad brush approach, I consider that the appropriate level of fine would be £15 million, that is one half of the fine imposed by the Tribunal (and equivalent to approximately 1.5 per cent of National Grid's relevant turnover, subject to a multiplier of four to take account of the duration of the infringement). The contention that there should be no fine at all or only a nominal fine is in my view untenable. But the difference between the Tribunal's figure and the figure I consider appropriate is sufficiently large in both absolute and relative terms that I do not think that the Tribunal's figure should be allowed to stand. I would reduce the fine to £15 million.

Conclusion

116. I would dismiss the appeal against the Tribunal's decision on abuse. I would allow the appeal against penalty and would vary the Tribunal's decision to the extent of substituting a fine of £15 million for the Tribunal's figure of £30 million.

Lord Justice Dyson :

117. I agree that the appeal should be allowed to the extent indicated by Richards LJ and for the reasons that he gives.

Lord Justice Pill :

118. I have had the advantage of reading the judgment of Richards LJ in which he has set out not only his conclusions but the background facts and the submissions on behalf of the appellant clearly and comprehensively. In the event, I agree with his conclusion on abuse but wish to make a few comments on the Tribunal's reasoning and approach to the evidence. Some of the comments are also relevant to the size of the penalty imposed by the Tribunal.

119. Whether National Grid had abused its dominant position contrary to section 18(1) of the Competition Act 1998 has to be considered in a context in which, on the one hand, National Grid formerly had a monopoly of the supply of gas meters and ancillary services and, on the other hand, worked closely with the Gas and Electricity Markets Authority ("the Authority") and with its customers, British Gas and other gas suppliers, in attempting to devise a lawful scheme to meet a new situation in which competing meter operators ("CMOs") had entered the industry.

120. The object of the new arrangements is set out at paragraph 6 of the judgment of Richards LJ and the terms of resulting meter service agreements ("MSAs") are summarised at paragraph 7. These included arrangements to cover the existing base of installed meters ("the Legacy MSAs") and arrangements to cover meters installed by National Grid on or after 1 January 2004 (the "New and Replacement MSA" or "N/R MSA"). The details appear in the Tribunal's decision at paragraphs 21-29, cited by Richards LJ at his paragraph 10. Central to the issue were the steps National Grid was entitled to take, without infringing section 18, to protect its existing very substantial investment in installed meters. As will be seen from paragraphs already cited, the "legacy" meter stock was to be protected by a premature replacement charge ("PRC") to be paid to National Grid in defined circumstances. Such protection was also provided in the N/R MSA.

<u>Liability</u>

121. The Tribunal stated the issue, in my view correctly, at paragraph 93:

> "We therefore do not accept that the Authority's recognition that some form of premature replacement charge would feature in this market under conditions of normal competition rules out a finding that this contract is an abuse. The issue in this case is not whether *any* payment protection arrangements could be justified where a long-lived rented asset is installed without an upfront transaction charge. It is accepted on all sides that such arrangements are legitimate or normal. The question in this case is whether the Legacy MSA goes too far in protecting National Grid from the consequences of competition and whether the agreement's foreclosing effect is too severe to be justified by National Grid's desire to protect the revenue stream generated by its meters."

122. At paragraph 54 of his judgment, Richards LJ quotes *Bellamy & Child*, at para 10.058:

> ". . . the distinction between conduct on the part of a dominant firm which is permissible and conduct which is prohibited as abusive is often a difficult one."

The distinction depends on "factual appreciation" and will be a question of "fact and degree". I appreciate National Grid's concern for a benchmark, and for certainty, but it is inevitable that a decision whether, as a matter of fact and degree, an arrangement becomes anti-competitive is a matter of judgment and, subject to errors of law, it is for the Tribunal to make that judgment upon the evidence.

123. On the appellant's ground 1, I respectfully agree with the conclusion of Richards LJ at paragraph 40; there is no legal error in the test expressed by the Tribunal at paragraph 93 and the Tribunal was entitled to ask itself whether the foreclosing effect of the agreements was too severe and to look at matters in the round in deciding whether the conduct was abusive. A detailed and systematic assessment of the arrangements was required to decide the difficult question whether they went too far and crossed the line from legitimacy into abuse, within the meaning of section 18, and whether the infringement had been committed negligently for the purposes of section 36(3) of the 1998 Act.

124. The Tribunal's conclusion on abuse was stated in a single paragraph, 200:

> "Conclusion
>
> The Tribunal upholds the Authority's finding that the early replacement provisions of the Legacy MSAs constitute an abuse by National Grid of its dominant position. They clearly have a foreclosure effect in discouraging gas suppliers from moving more of their business to the CMOs and hence are likely to delay the reduction of National Grid's market share. The effect of the Legacy MSAs was demonstrated by British Gas's actions taken to reduce the volume of business it provided to some of the CMOs once the terms of the Legacy MSAs had crystallised. It is true that National Grid has incurred sunk costs in providing the installed meter to the gas supplier without an upfront charge. But this does not justify putting in place charges which may have the effect of maintaining volumes of replacement at little more than the level that applied when National Grid was a monopoly supplier. The disproportionate nature of the early replacement charges is, in our judgment, amply demonstrated by the comparison carried out with the terms in the CMO contracts and in National Grid's N/R MSA. There are some minor aspects of the Decision where we have found that the Authority was not justified in coming to the conclusions it did. But the main finding of abuse set out in the Decision was, in our judgment, undoubtedly right."

The Tribunal found no abuse in the N/R MSA notwithstanding the PRC included.

125. Light is thrown on the judgment to be made by the reasoning of the Tribunal's decision on penalty, which follows the conclusion at paragraph 200. The Tribunal stated, at paragraph 214:

> "In our judgment, the correspondence and meeting notes all point to the fact that the Authority did recognise, despite the bargain struck in the 2002 price control, that National Grid could legitimately impose early replacement charges in its commercial contracts in order to recover some of its sunk costs. National Grid understood this to be the case and acted accordingly."

126. When considering National Grid's consultations with the Authority before the contractual arrangements with British Gas and other gas suppliers were made, the Tribunal stated, at paragraph 215:

> "We also accept National Grid's point that it believed that it had the support of the Authority in trying to slow down the replacement of legacy meters in order to avoid the disruption to customers caused by a programme of accelerated meter replacement . . ."

At paragraph 216, the Tribunal added:

> "The industry understood from their discussions with the Authority that the Authority's concern about the public perception of waste and inconvenience arising from opening up this market was more general than that. Again, National Grid interpreted this as a reason why the Authority would not object to National Grid and the gas suppliers putting in place a contract which spread replacement over a longer period than might otherwise occur."

127. The Tribunal rejected, at paragraph 217, the criticisms levelled at National Grid in the Decision of the Authority that the company did not discuss the introduction of PRCs openly and frankly with the Authority. Following a reference to earlier documents supplied to the Authority "clearly describing the key ingredients of the Legacy MSAs", the Tribunal stated:

> "In September 2003 National Grid sent to the Authority a six page summary of the terms of the Legacy and N/R MSAs setting out very simply and accurately how the contracts worked. The Authority's assertion that these were provided to the Authority for a different regulatory purpose and not for formal competition law clearance is unconvincing in this case."

Thus National Grid was found to have cooperated fully with the Authority with a view to achieving competition law clearance.

128. These findings appear to me to have merited fuller treatment before the conclusion at paragraph 200 was reached. Moreover, no analysis was attempted by the Authority, either at the time or since, of the level of replacement without PRCs which would have protected National Grid from being pursued by the Authority under section 18. It is not self-evident that the arrangements made with the gas suppliers crossed the line into abuse. Proof was required. At paragraph 208, the Tribunal stated:

> "The Authority appeared content for National Grid to enter into contracts with the gas suppliers which it now considers, according to the Decision, have had a significant actual anti-competitive foreclosure effect and hindered the development of the business of the CMOs."

The Tribunal concluded, at paragraph 209:

> "Overall, we can well understand National Grid's surprise and dismay when the Authority opened its investigation into these agreements under the 1998 Act and imposed such a substantial fine."

129. The first point relied on by the Tribunal in its statement of conclusions at paragraph 200 is the small difference between the annual rate of replacement of domestic credit meters ("DCMs") before 2004 (5%) and the replacement level, that is replacement without a PRC arising, provided by the Legacy MSA (about 5.5% per year) (paragraph 22 of Tribunal's decision).

130. The N/R MSA has been approved as not being anti-competitive. The emphasis placed on the small change in the rate of replacement permitted without a charge being incurred, is not easy to reconcile, in the absence of further reasoning, with the findings about consultation with the Authority. The small difference between 5% and 5½% must have been obvious to the Authority during the discussions which preceded the Legacy MSAs. I understand National Grid's sense of grievance at subsequently being pursued by the Authority under section 18, contentment with the contracts turning into an allegation of abusive negligent conduct.

131. I accept, however, that the Tribunal did, at paragraph 192, consider and reject National Grid's attempt to rely, as a factor for present purposes, on the disruption involved in having the meters replaced. The Tribunal did also refer, at paragraph 188, to the Authority seeking to identify "the effect on consumers of the fact that fewer cheaper meters are being installed than would be installed absent the Legacy MSA glidepath". The Tribunal was, of course, right to have regard to the interests of CMOs and that concern was made clear in the decision. Other issues were considered by the Tribunal in detail.

132. It is a further indicator in National Grid's favour that British Gas, a large company which can be expected, in a competitive market, to look after the interests of its own customers when making contracts for meters, agreed terms with National Grid following careful consideration. This aspect of the case was fully considered by the Tribunal at paragraphs 61-73. The Tribunal found that British Gas was, and still is, content with its agreement with National Grid (paragraphs 67 and 73) but held that such contentment did not establish that the terms are not anti-competitive (paragraph 73). Reliance was placed by the Tribunal on contemporaneous documents showing that "British Gas, like other players in the market, believed it was constrained in how rapidly it could switch out National Grid meters by a perception that the Authority considered that an accelerated programme would raise serious customer disruption issues" (paragraph 70). The Authority had indeed given indications (paragraphs 215 and 216) that factors were present which made a slower rate of replacement acceptable.

133. Linked with the counterfactual considered in the Tribunal's reasoning is the second matter on which the Tribunal relies in its statement of conclusions at paragraph 200, the allegedly disproportionate nature of the early replacement charges which is said to be "amply demonstrated by the comparison carried out with the terms in the CMO contracts and in National Grid's N/R MSA".

134. The Tribunal's approach was stated at paragraph 130:

> "In our judgment this criticism [by National Grid] is based on a misapprehension of the function of the counterfactual in the economic analysis required in a case such as this. The Authority does not have to establish that the parties would have preferred to enter into a contract along the lines posited in the age-related counterfactual. The age-related counterfactual is based on features of other contracts operating in the market, namely the CMO contracts and National Grid's N/R MSA. The question the Authority is asking is 'what would have been the position if the parties had operated a system in relation to the legacy meters similar to the system that now operates in relation to new meters?' We regard that as a useful avenue of inquiry even if there would have been logistical or financial difficulties in setting up such a system."

In its ruling on costs, the Tribunal stated that "the robustness of the counterfactual [the Authority] employed was the key to the overall robustness of the decision".

135. There is in my view force in National Grid's complaint that there has been "cherry picking" of those aspects of the CMOs' contracts which serve the Authority's purpose in devising the counterfactual, though the allegation is rejected by the Tribunal at paragraph 142. I accept that such a counterfactual can be regarded as "a useful avenue of enquiry even if there would have been logistical or financial difficulties in setting up such a system", as stated by the Tribunal. Its limitations as an aid to judgment should, however, be acknowledged.

136. The age of meters and limitations of records were, on the evidence, such that clear conclusions could not be based on it. Neither National Grid nor British Gas thought it was either feasible or desirable to have an early replacement scheme which relied on the characteristics of specific meters (paragraph 129). British Gas's witness said that it "would have been a nightmare". Reasons were given including that there was a very large number of meters installed where the company had no reliable information about date of installation. Moreover, the Authority changed its case, asserting originally that the age-related counterfactual was revenue neutral. The Authority later acknowledged that it generated a lower revenue for National Grid than the Legacy MSA, though the Tribunal reasoned at length that the difference was not in any event material.

137. I have also not been persuaded that, in an anti-competitive context, the five year exclusivity period in the CMO contracts can be ignored. The position of an aspirant to the market is of course different from that of a dominant provider but, to the gas supplier, the aspirant's own anti-competitive measure is surely not a factor to be ignored when comparisons are made in an anti- competitive context. In judging the degree of protection to which the legacy stock is entitled, I do not see why the anti-competitive factor in the alternative agreements can be completely ignored.

138. Further, the general conclusion was reached in the absence of any age-related counterfactual in respect of the pre-payment meters ("PPMs"). They were a significant part of the market and have a higher potential in profit because they are more likely to be the subject to maintenance visits. Richards LJ has considered the

implications of that absence at paragraphs 69-73 of his judgment and I will say no more.

139. At the end of its paragraph 139, the Tribunal stated:

> "The Authority was therefore entitled to find . . . that the charges provide a level of protection for the dominant firm which is far greater than the new entrants were able to achieve in their negotiations with the same customer."

That may be but it appears to ignore the proposition, accepted by the Tribunal at paragraph 93, that a PRC can be justified, where, as was the case with the legacy stock, long-lived rental assets had been installed without an upfront transaction charge. At paragraph 98, the "key question" for the Tribunal was:

> "whether the Authority was right to conclude that the foreclosure effect arising from the Legacy MSA was too severe to be justified by National Grid's admittedly legitimate interest in ensuring that it was able to recoup some of the costs that it had incurred in installing the legacy meters."

140. The Tribunal's conclusion that the disproportionate nature of the early replacement charges is "amply demonstrated" by the exercises actually conducted is in my view putting it too strongly. Moreover, I have not found it possible to accept that decisive weight can be given to a counterfactual with the limitations described.

141. This is not, I hope, to show lack of proper respect for the Tribunal's expertise. I respectfully agree with the Tribunal's view expressed in *Napp Pharmaceutical Holdings Limited v Director General of Fair Trading* (Case no.1001/1/1/01) that "there will, so it seems to us, often be questions arising under the Act which are essentially questions of appreciation or economic assessment of a more or less complex kind, depending on the circumstances, in which the Tribunal will be called upon to assess a range of factors, bringing to bear such expertise as it has, . . ." (the full citation is at paragraph 23 of Richards LJ's judgment). The court must respect the Tribunal's economic assessments but can, and should be prepared to, scrutinise the cogency of the reasoning by which such assessment leads to a conclusion under section 18. The economic assessment must be based on a fair consideration of the evidence and must fairly lead to the conclusions stated. I do not consider that Baroness Hale in *AH (Sudan) v Secretary of State for the Home Department* [2007] UKHL 49, [2008] 1 AC 678 was suggesting otherwise. I do not accept, as counsel came close to suggesting, that the complexity of the issues considered by this expert Tribunal was such that the court should not attempt to scrutinise them. The issues were susceptible to analysis and to a clear and readily comprehensible exposition by the Tribunal in its decision. The mystique of a Tribunal's expertise does not prevent scrutiny by the court of the decision making process.

142. Moreover, having regard to the Tribunal's findings, already considered, about National Grid's constructive approach to the Authority, I fail to understand why resolution of the issue could not have been achieved, or at least seriously attempted, without the need for the elaborate and expensive ritual that has followed. Like the Tribunal I understand National Grid's 'surprise and dismay' at the Authority's

conduct in this particular case in seeking, though successfully in the event, to demonstrate infringement by way of negligent abuse by National Grid.

143. Notwithstanding these reservations, I too have come to the conclusion that, taking an overall view, what counsel described as a holistic view, the Tribunal was entitled to reach the conclusion that the Legacy MSA was abusive in section 18 terms. There was sufficient evidence, and the evidence was sufficiently considered, to enable the Tribunal to come to the conclusion it did. The heavy burden of establishing an error of law in circumstances such as these has not been discharged. The Tribunal concluded, in the course of its reasoning though not in these words in paragraph 200, that the Authority was:

> ". . . entitled to find that the level and structure of the early replacement charges in the Legacy MSA creates a disproportionate disincentive for gas suppliers to move their business to new entrants."

Penalty

144. Richards LJ has considered the factors involved comprehensively. The comments I have ventured to make above also bear upon the appropriate level of penalty. I agree with the analysis of Richards LJ and agree that the level of penalty should be substantially lower than that imposed by the Tribunal.

145. I also give weight to the novelty of the situation, as stated by Richards LJ at paragraph 112. I give weight to the "genuine uncertainty on the part of the undertaking as to whether the agreement or conduct constituted an infringement" stated in the Office of Fair Trading Guidance (December 2004) to be a mitigating factor. I agree with the sum of £15 million proposed by Richards LJ. To that extent, I too would allow the appeal.