IN THE COMPETITION APPEAL TRIBUNAL Case No. 1104/6/8/08

Victoria House
Bloomsbury Place
London WC1A.2EB

Tuesday, 11th November 2008

Before:

THE HONOURABLE MR JUSTICE GERALD BARLING
(President)

PROFESSOR JOHN PICKERING
MR. GRAHAM MATHER

Sitting as a Tribunal in England and Wales

BETWEEN:

TESCO PLC Applicant

and

THE COMPETITION COMMISSION Respondent

and

WAITROSE LIMITED
MARKS AND SPENCER PLC
ASDA STORES LIMITED
THE ASSOCIATION OF CONVENIENCE STORES Interveners

_____

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

_____

HEARING – DAY ONE

APPEARANCES

Mr. Nicholas Green QC, Mr. Mark Hoskins and Mr. Julian Gregory (instructed by Freshfields Bruckhaus Deringer LLP) appeared on behalf of Tesco Plc.

Mr. Peter Roth QC, Mr. Daniel Beard, Ms Valentina Sloane and Mr. Ewan West (instructed by the Treasury Solicitor) appeared on behalf of the Competition Commission.

Mr. Tim Ward (instructed by Slaughter and May) appeared on behalf of Asda Stores Limited.

Ms Kassie Smith (instructed by Lovells LLP) appeared on behalf of Waitrose Limited.

Mr. Robert O'Donoghue (instructed by SJ Berwin LLP) appeared on behalf of Marks and Spencer Plc.

THE PRESIDENT: Good morning everybody, and welcome. Mr. Green, there are just a couple of housekeeping points, is it convenient just to mention them now?

MR. GREEN: Yes, Sir.

THE PRESIDENT: First, thank you to everybody for agreeing to start earlier today and finish earlier. Just so as people know, can I run through how we hope the timetable will go for the sitting today. The idea is to continue until nearly 11 o'clock, then we will stand and have the two minutes' silence in remembrance of all those who have fallen in the two World Wars and, of course, in other conflicts, and we will do that in court – there might have been some correspondence indicating we would not but I think it would be nice if, in fact, we did that in court. Before that at 10 o'clock there is going to be a fire alarm, it only lasts 30 seconds – Mr. Green, it will probably be you, you will just have to pause for a sentence or two.

After the two minutes' silence we thought we would have a short refreshment break until 25 past 11 and then we will resume and continue until as near to 2 o'clock as we can manage when we will break for the day.

Can I also say before we hand over that we welcome in court today the President, Judges and other staff from the Trade and Industry Appeals Tribunal in the Netherlands. I have not had the pleasure of meeting you yet – I do not know quite where you are sitting – you are very welcome, and I look forward very much to meeting you properly later on today. That is the housekeeping from our point of view, Mr. Green.

MR. GREEN: Sir, Members of the Tribunal, good morning, I appear today with Mr. Mark Hoskins and Mr. Julian Gregory for Tesco (the applicant). For the Competition Commission (the respondent) Mr. Peter Roth QC, Mr. Daniel Beard, Miss Valentina Sloane and Mr. Ewan West appear. For Asda Mr. Tim Ward appears, for Marks and Spencer Mr. Robert Donaghue appears and for Waitrose Miss Kassie Smith appears.

As you know, this is Tesco's application for Judicial Review. The Judicial Review is of the conclusions and recommendations in the Competition Commission's Report of 30th April 2008 concerning the supply of groceries in the United Kingdom market. I should state at the outset that there are many aspects of the Competition Commission's Report that Tesco welcomed. The Competition Commission's basic conclusion was that it was essentially a competitive market and the Competition Commission rejected suggestions that Tesco had engaged in any unacceptable conduct, and there were many beneficial features of the supermarket system which operated in the United Kingdom. Tesco's challenge in this case is as to a specific remedy recommended by the Competition

Commission and, in particular, to one aspect of the remedy in question, the competition test. Tesco has two essential grounds of review and they are classic grounds for Judicial Review. We have summarised the law in this respect in paras. 16 to 18 of our skeleton and I do not propose to address that in any detail. The grounds of our challenge are, in essence, that the Competition Commission failed to take account of all of the relevant considerations and this is a ground which is recognised in the case law as one sounding in Judicial Review and was recognised by the Tribunal as recently as the *Sky* judgment and in *Unichem* and, indeed, in other cases. In this application Tesco recognises that it being the Judicial Review the ability to challenge findings of fact are limited and, as you will have seen, Tesco does not challenge fact findings of the Competition Commission, on the contrary Tesco actually relies – and indeed heavily relies – upon the Competition Commission's particular findings. Indeed, in my submissions today I shall barely depart from the report and its conclusions.

I should add also that simply because, for the purpose of making submissions I will rely heavily on the Competition Commission's findings, it does not mean that Tesco necessarily accepts each and every one of the conclusions in the report. My reliance on the report is reflection of the fact that this is a Judicial Review and the analysis today must necessarily focus upon the conclusions as found and the reasoning which has led to those conclusions.

Before starting substantively there is one other point I wish to make which is that I am not going to address each and every point that we have set out in our skeleton, there are many points of detail that I am going to leave to be addressed in writing, but I am going to deal with our main points and our responses to the points set out in the Competition Commission's skeleton argument.

The appropriate starting point for the analysis is the statutory framework, which is contained in s.134 and s.138 of the Enterprise Act. I would like to invite you to look at those statutory provisions. They are in tab 15 of the authorities' bundle, but I am sure you have them in the Act itself. What I propose to do is to identify the tests which the Competition Commission was bound to apply and the considerations that it was required to have regard to. I am going to start at s.134 which in the Act is under the general heading "Determination of References", and the specific heading to the section is "Questions to be decided on market investigation references". The heading is informative in that it indicates that the Competition Commission must apply its mind to certain questions.

The first paragraphs of this section address the question of the AEC, and they are not the principal focus of my submissions today, but nonetheless in order to put the points I wish to make in context I am going to take you through the early provision.

Section 134(1) says: "The Commission shall …" - so this is concerned with a duty –

> "… on a market investigation reference, decide whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom."

So the first question is that this Competition Commission must, because of the mandatory use of the language "shall" decide whether there are features which, to put it shortly, restrict competition.

Then s.134(2) says:

> "For the purposes of this Part, in relation to a market investigation reference, there is an adverse effect on competition if any feature, or combination of features, of a relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom."

So, s.134(2) is definitional. Equally, sub-paragraph (3) provides definitions of relevant market. I do not propose to read those provisions out. S.134(4) is an important provision. It says,

> "The Commission shall [so, again, Parliament uses mandatory language], if it has decided on a market investigation reference that there is an adverse effect on competition, decide the following additional questions ----"

So, the questions at s.134(4) only arise in the event that there is a finding of an AEC as per the first part of s.134. The first question which the Competition Commission has to address is set out in (a) - whether action should be taken. Since the statute poses the question in that way, it is plainly capable of being answered in a binary way - 'Yes' or 'No'; action should be taken or action should not be taken. There is no compulsion to answer the question in any particular manner. So, the Competition Commission has to ask whether action should be taken by it under s.138,

> "-- for the purpose of remedying, mitigating, or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition";

Then (b),

> "-- whether it should recommend the taking of action by others for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition;"

So, the first two parts of s.134(4)(a) and (b) concern the 'whether or not' question, and they are simply asking whether or not a particular type of remedy should be imposed at all. That is made crystal clear by s.134(4)(c) because it says, in relation to one of the questions the Competition Commission must ask itself,

> "in either case, if action should be taken [so, it plainly contemplates that action need not be taken - it is drafted in the conditional sense] what action should be taken and what is to be remedied, mitigated or prevented".

So, s.134(4) requires the Competition Commission, when it addresses remedies, to decide whether any action at all should be taken. It is by no means a given that simply because an AEC is found to exist that it must then devise a remedy. There is no automatic nexus between the existence of an AEC and the imposition of a remedy. That is clearly common-sense because it may be in some circumstances the case that the cure would be worse than the ill. You may not be able to devise or fashion a remedy which improves the market. If that is the case, plainly Parliament is not forcing the Competition Commission to impose a remedy simply because it has found that an AEC exists.

S.134(5) says,

> "For the purposes of this Part, in relation to a market investigation reference, there is a detrimental effect on customers if there is a detrimental effect on customers or future customers in the form of (a) higher prices, lower quality or less choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or (b) less innovation in relation to such goods or services".

A detrimental effect on customers is therefore defined in fairly traditional terms.

Then, s.134(6),

> "In deciding the questions mentioned in sub-section (4) [the 'whether or not' questions] the Commission shall [so, note the mandatory use of the word 'shall'] in particular [but then you have these words] have regard to --"

So, before going into the substance of the provision, s.134(6) simply imposes a duty to have regard to that which is then set out - namely,

"-- the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effects on customers so far as resulting from the adverse effect on competition".

So, once again, the notion that the Competition Commission is compelled by this objective of finding as comprehensive a solution as possible is a limited one. It is simply something which they must - must - have regard to. They cannot ignore it as a factor, but it does not necessarily lead to any particular solution. It is simply something which has to be taken account of. Of course, it is not the only thing that has to be kept taken account of because of the words 'in particular' in s.134(6). It is simply one factor amongst others which the Competition Commission will have regard to.

Then s.134(7),

"In deciding the questions mentioned in subsection (4) [again, that is the 'whether or not' questions] the Commission may, in particular, have regard to the effect of any action on any relevant customer benefits of the feature or features of the market concerned".

Then in (8) there is a definition of relevant customer benefit.

So, for present purposes I have sought to emphasise the binary nature of s.134(4) - that is a 'whether or not' and I have sought to emphasise that the objective of achieving a comprehensive solution is something which the Competition Commission must take into account but is not bound by - it is simply a permissive factor, but it must be taken into consideration.

The next section which has a bearing upon the exercise which the Competition Commission is bound to perform in relation to remedies is s.138. S.138 provides as follows in (1),

"Sub-section (2) applies where a report of the Commission has been prepared and published under s.136 within the period permitted by s.137 and contains the decision that there is one or more than one adverse effect on competition".

So, s.138(2) applies in the present case because the Commission so found. Then, at 138(2),

"The Commission shall, in relation to each adverse effect on competition, take such action under s.159 or s.161 as it considers to be reasonable and practicable to remedy, mitigate or prevent the adverse effect on competition concerned, and (2) to remedy, mitigate or prevent any detrimental effects on customers so far as they have resulted from, or may be expected to result from, the adverse effect on competition".

> "Again, these are mandatory considerations which the Commission must take into account when selecting a particular remedy. They must have regard to reasonableness and practicability. Those considerations must be in the context of the process of remedying, mitigating, or preventing the AEC".

So, there are three mandatory criteria which must be taken into consideration - the desirability of a comprehensive solution; practicability; and reasonableness. One might have thought there is no great surprise in the identification of those as relevant considerations.

S.138(3),

> "The decisions of the Commission under sub-section (2) shall be consistent with its decisions as concluded in its report by virtue of s.134(4)".

So, the decision in relation to reasonableness and practicability are relevant to the 'whether or not' questions in 134(4). There is a caveat to that -

> "-- unless there has been a material change of circumstances since the preparation of the report or the Commission otherwise has as special reason for deciding differently".

You will have seen from the report that the Commission does not suggest that that caveat applies in the present case.

So one deduces from the statutory language that the Competition Commission is not bound to adopt a remedy at all. Parliament has simply imposed the duty to pose and answer the questions which it has set out in s.134(4) and Parliament categorises these specifically as questions. In answering the question, "Should a remedy be imposed at all?" the most obvious consideration that the Competition Commission would ask itself was whether the remedy would be effective, but that will no doubt be in the context of the notion a comprehensive practicable reasonable solution to address the AEC.

THE PRESIDENT: Mr. Green, is there a tension at all between the apparent discretion whether to impose a remedy in s.134 and the apparently mandatory nature of s.138? You drew our attention to that. I just wondered how you reconcile the two. One seems to say that you do not have to have a remedy although you have got to take account of the need to have a comprehensive solution that is reasonable and practicable, and the other says you shall in relation to each adverse effect.

MR. GREEN: I think there are two answers to that: first, 138(3) specifically says that the decisions under sub-section (2) are to be consistent with the decisions as included under

134(4). So they are not intended to be inconsistent. Secondly, it is, in my submission, clear from the words "take such action as it considers to be reasonable and practicable", but it may turn out that no action is required because it is impracticable and/or unreasonable. It is "such action". The guiding provision is plainly s.134(4) and 138 is principally focused upon the remedy once you have decided to adopt a remedy. If one answers the question "no remedy at all", then plainly the question as to the fashioning of the remedy just does not arise at all. It is just an irrelevance.

If there is any ambiguity, which we would suggest there is not, then the language of s.134(4) is really quite unequivocal, and in particular the conditional 134(4)(c) in either case, "if such action should be taken", leaves no room for doubt, we would suggest.

MR. MATHER: The heading of 138 "Duty to remedy adverse effects" is a strong duty, how would you gloss that?

MR. GREEN: It does not require a gloss. If you answer the question 134(4) that a remedy is appropriate, then you have to fashion the remedy so that it is practicable and reasonable. That is a duty. So duties arise depending upon the answers that one gives to the questions posed in s.134(4).

Indeed, one can see that quite explicitly in the language of 134(4), which says:

> "The Commission shall, if has decided on a market investigation reference that there is an adverse on competition, decide the following additional questions …"

So there is a duty to decide the following questions, and under sub-para.(c):

> "… in either case, if action should be taken what action should be taken and what is to be remedied, mitigated or prevented."

Section 134 would say that if you answer the question in the affirmative, i.e. there must be a remedy, you then have a duty to ask yourself, "What action should we be taking and what is to be remedied, mitigated or prevented?" and for that you then go to 138.

MR. MATHER: So 138 may or may not be triggered on that approach?

MR. GREEN: Yes. When one stands back from it and asks what Parliament must have intended, first of all, we submit common sense tells you that even if you find an AEC it does not automatically mean there should be a remedy. The AEC may be enormous, it may be very modest. It would still qualify in definitional terms as an AEC. The Competition Commission has to decide whether it is proper to impose a remedy. It may decide that the only remedy that it can imagine addressing the AEC is so extreme that it will cause more harm than good.

If you can imagine that in the abstract, then logically you do not impose any remedy because the cure is worse than the initial sickness.

Once one recognises that that is a logical possibility then one is bound to conclude that is the way the Act would be structured. Indeed, in some of the guidance on the application of remedies that we have referred to in our skeleton this point is made quite extensively. It is recognised that a very good starting place for regulators to take as a bench-mark is the "no change", and you should ask yourself in relation to all remedies, "Will the remedy improve the status quo?" If it does not then it is hard to see that there can be a justification for intervention, and I will take you in due course to the guidance. Ofcom's guidance on this is very clear, but there is other guidance. You ask yourself, "Will the remedy improve the situation?" That is all Parliament is actually imposing upon the Competition Commission here. Ask yourself that question as a threshold question.

MR. MATHER: If it will not improve the situation it could not be proportionate, could it? Everyone seems to accept that it needs to be proportionate.

MR. GREEN: That is right. Nobody is suggesting there is not a proportionality test encompassed in the three requirements of comprehensiveness, practicability and reasonableness, and I think in particular reasonableness would bring within it the concept of proportionality.

THE PRESIDENT: Just going back to sub-section (2), it shall "in relation to adverse effect on competition take such action", and then it continues "as it considers to be reasonable and practicable", does that mean, in your opinion, it would be quite rare for it to decide not to take action because it was wholly unreasonable or impracticable to do so?

MR. GREEN: I am sure it is the case that in most investigations in the United Kingdom, at European level and elsewhere, if a regulator finds an adverse effect on competition nowadays regulators are sophisticated enough to fashion a remedy which is proportionate. So it may well, as a matter of practicality, be rare that one would find a situation where no remedy was appropriate, but one could contemplate circumstances where no remedy would be appropriate and the regulators, in particular the Ofcom very helpful guidance, specifically says that should be your starting point. It may be a relatively easy hurdle to jump over, but it nonetheless is the initial question which should be posed. We cannot see any other sensible interpretation of 134(4) other than to say that the initial binary yes or no question has to be posed.

That is the statutory framework. I would like extremely briefly just to identify in the Report where one finds the competition test. I do not at this stage propose to make detailed

submissions about it at all. I simply want to show you where you find the test. It is most conveniently summarised in para.43 of the report which in the bundle I have been marking up, which is file 2, p.17, I understand that the core bundle may have very slightly different numberings. I am going to give you the paragraph number and page number I am working from for all references.. It is para.43 of the report. The competition test remedy, which is the subject of this application is set out in para.43. It is preceded by the Competition Commission's description of the remedy in relation to restrictive covenants, which is set out in para.42. For present purposes I want to focus just on 43 so you have clearly in mind the structure of the remedy which was adopted. 43 states as follows:

> "In addition to the above remedies, which we will implement directly, we recommend …"

and the first point you will need to note is that the Competition Commission is simply recommending these remedies. They are not remedies that they have the jurisdiction immediately themselves to implement.

> "… we recommend that the following measures be put in place in order to address the AEC we found in respect of highly concentrated local markets and barriers to entry:
>
> "(a) The Department of Communities and Local Government (CLG), the Scottish Executive, the Welsh Assembly Government and the Northern Ireland Executive should take the necessary steps to make the OFT a statutory consultee to LPAs [Local Planning Authorities] on all applications for planning permission, whether submitted by a grocery retailer or a third party, for a development of a grocery retail store (including new stores and extensions) where that store has, or after the proposed scheme has been implemented will have, a net sales area in excess of 1000 sq. metres.

The second subparagraph of 43 says:

> "(b) The OFT, as a statutory consultee, should provide advice to the LPA on whether a particular retailer has passed or failed the competition test. Applications would pass the test if within a 10-minute drive-time of the developed store (as calculated according to readily available software):
>
> (i) the grocery retailer that would operate the store was a new entrant in the local area; or

(ii) the total number of fascias (including any of the full range national or regional grocery retailers and symbol groups) operating larger grocery retail stores in the local area were four or more; or

(iii) the total number of fascias were three or fewer and the grocery retailer operating the developed store would operate less than 60 per cent of grocery sales area (including the new or extended store)."

By way of explanation to that, at para.11.93, which in my bundle is p.199, provides a short explanation of the difference between three and four stores in the test and I think it is useful just to pick that paragraph up at this point. 11.93 says as follows:

"Based on our experience in analysing local markets (see section 7), we are confident that where there are four large grocery retail fascias with grocery stores in excess of 1000 square metres in a local area the area is unlikely to be or to become highly concentrated. We therefore decided that all applications that relate to grocery store developments in areas where there are four or more fascias operating grocery stores in excess of 1000 square metres should pass the competition test regardless of the size of the proposed development or the market share of the applicant retailer whether before or after the opening of the proposed development. We recognise that there are areas where three fascias operate grocery stores in excess of 1000 square metres, which are not highly concentrated, but we note that a large grocery retailer would only fail the competition test in areas where there were three or fewer fascias and where that retailer had a market share in excess of 60%."

So that is the test. It is a recommendation. The OFT will advise LPAs on whether the competition test is passed or failed, and a grocer will pass or fail the test if it meets or, as the case maybe, does not meet the conditions as set out in 43(b)(1) through to (3). That is the competition test, we will be coming back to it in considerable detail later on but I thought it was appropriate to identify it at an early stage.

Can I now move to tell you what in a nutshell the two grounds of challenge are? Again, I am simplifying. You will have seen from our Notice of Application and from our skeleton that we criticise the Competition Commission for two failures and they can be categorised and described as follows: first, the Competition Commission failed in assessing the competition test to take account of the fact that the competition test itself restricted competition and will have had an adverse effect upon the AEC. So the Competition Commission failed to have regard to or take account of the fact that the test itself restricted

competition and will have exacerbated the AEC – if you like, the competition test itself has a negative effect on competition. We say that the Competition Commission should have addressed that properly in all of the tests under s.134(4) and the failure to address that was a material failure.

The second way in which we put the criticism ----

THE PRESIDENT: Is this the second ground?

MR. GREEN: It is, yes. That is essentially the first ground. The second ground can be summarised as follows that in assessing the competition test remedy, the Competition Commission failed also to assess the benefit of the competition test. Let me just explain precisely what that means.

The benefit of the competition test is the extent, if at all, to which it reduces the AEC, the test has a benefit because it eliminates a restriction of competition. So to reduce it to a very simple example, if nominally the AEC is 100, one is asking the question to what extent will the competition test reduce the AEC from 100 downwards and that is the benefit of the competition test. There is no real dispute that the Competition Commission did not undertake that analysis, it says that it was just too difficult to do. It has an answer to our first criticism when we say it failed to assess the restrictive effects of the competition test. It says "We did not need to". The essence of this Judicial Review and the task that the Tribunal has is to examine what the Competition Commission did not do and decide whether that is a relevant omission and whether or not the reasons given for that failure by the Competition Commission stack up; whether they are good reasons. As I will show to you, the reasons that have emerged for the omissions have emerged in the defence and in the skeleton, but one does not find them in any material way in the report itself, so I will need to analyse the report as well as the subsequent justifications for the Competition Commission's omissions given in the defence and in the skeleton.

With that introduction I want to turn to the first ground, which is the submission we make that the Competition Commission failed to analyse the restrictive effects of the competition test. I am going to break my submissions into six sections and if I can I would just like to summarise the section headings before I start so you have a form of road map.

Section 1 concerns Tesco's objections – I want to elaborate a little on why we say they have committed an error of omission. Section 2 will concern the Competition Commission's answer as given in their defence and in the skeleton. Section 3 will concern the actual findings in the report because we will submit that the conclusions of the Commission in the report are diametrically opposed to the explanation given subsequently,

and I should add that I do not intend to depart from the report; I am not going to go into the background evidence because virtually 100 per cent of that which we seek to establish is to be found in the Competition Commission's own findings. I will go to Mr. Freeman's witness statement briefly but that is a statement given by the Competition Commission. Section 4 are the implications of the Competition Commission's position as set out in one particular paragraph of the defence, namely, para.102.

Section 5 will be to address certain specific submissions made by the Competition Commission in its defence and then finally section 6 will be conclusions.

So the first part of my submissions on ground one are to elaborate on Tesco's objections. As I said a few moments ago the pith and substance of the point is that the Competition Commission failed to assess the costs of the imposition of the competition test. The Competition Commission has described what it did and did not take into account in selecting remedies in paras. 11.379 through to 11.393 (pp.253 to 256) I will come to those in a moment. It is clear that they did not take account of the adverse effects of the competition test because they list the factors which they did take into account. I will pick that paragraph up in a moment once I have explained in broad terms what we say the objection is. So, we know exactly what they did and they did not take into account because it is clearly set out in the report. We say it is clear that they did not assess the costs of the imposition of the competition test.

The Competition Commission did acknowledge that there was a risk that the remedy which they were imposing would create consumer harm. They explain this - and I will give the paragraph now and come to it later- in para. 11.103 at p.201. They accept there is a risk that there would be consumer harm. If one likes, one can go a little bit further and say that the risk of consumer harm arises because demand would go unmet.

THE PRESIDENT: I will just turn up para. 11.103.

MR. GREEN: They did also recognise that an effect of the competition test would be to prevent 24 percent of existing grocery stores being expanded to meet this new demand (see footnote 334). So, we know that they failed to assess the cost. We know that they identified it as a risk. We know from the footnote at the very least - and, indeed, from other findings that I will show to you later - that the competition test itself would block 24 percent of all grocery stores from expanding to meet new demand.

THE PRESIDENT: It is said that there is a risk that welfare-enhanced store developments were prohibited. So, it might be wider.

MR. GREEN: It may be wider. But, the Competition Commission now say - and this really emanates from the defence and the skeleton - and I am summarising, no doubt overly briefly -- The pith of what they now say is that the risk will be obviated because, in a nutshell, the market will preclude it from arising. The market will do this because when unmet demand arises and you prevent an incumbent from meeting that unmet demand, you will get new entry. So, the explanation given in the defence and skeleton is that of the virtuous circle - unmet demand exists. You suppress the incumbent who is unable to meet it. But, no problem, says the Competition Commission, because new entry will come in in order to absorb that unmet demand. That is their explanation for why they did not take it into account.

Of course, if the Competition Commission is correct, and the barriers to entry are so low that you can foresee that in a reasonably short period of time new entry will emerge and soak up that unmet demand, then I do not think we could justifiably criticise the Competition Commission. But, of course, if they are wrong, and if the Competition Commission's own findings unequivocally point to the fact that the entry barriers will persist and have persisted, and will create almost insurmountable barriers to entry - which is what they do find - then the explanation they now give in their skeleton and in their defence is flatly contradictory to the findings in the report.

So, for the purpose of the Tribunal's test you will be identifying what they did and they did not do, and then the reasons for it.

PROFESSOR PICKERING: Mr. Green, one of the ways in which the market might adjust could be by one of the other major grocery groups expanding. It seems to me that that is some way between the new entry that you are talking about and the expansion of the incumbent. How do you encapsulate that possibility in your argument?

MR. GREEN: First of all, that is not the Competition Commission's position. They do say that the unmet demand will be met by new entry. One of the reasons, I anticipate, that leads to that conclusion is that in one of their appendices they conducted what was called a persistence analysis. In the course of that analysis there is an assessment of the extent to which unmet demand exists in areas of high concentration and the extent to which historically it has actually been met by extensions and expansion. The reality is that they made a finding that new entry does not occur in areas of high concentration and the extent to which any unmet demand is satisfied by simple extensions is limited. Now, the evidence is set out in an annexe, and I will come to that.

At the end of the day, I will ask you to do this: I will ask you to say, "What is the evidence in the report? What are the various findings? In which direction do those findings point?" and then to compare that with the explanations given in the defence and the skeleton to see if they are consistent. I will also take you in due course to every single paragraph that they have pointed to in which they say there is an answer. There are only four or five of them. I will show you that they just do not stack up.

That is the point in a nutshell.

Let me take you next to the Competition Commission's explanation of what they did and why they did it. This is Section 2. I would like to start with their defence. This is Bundle 5.

THE PRESIDENT: We have very helpfully been provided with a core bundle which has the defence in as well.

MR. GREEN: I suspect that the numbering in the core bundle is not the same as in Bundle 5, but I will give you both the paragraph numbers and the page number that I have got for other people who are working from the same file as I am. You will obviously have read these because they are core documents. I am not going to read every paragraph. But, I am going to pick up the main paragraphs in which they set out the key reasoning. If Mr. Roth thinks that I have, in the course of my brief exposition, missed a point, no doubt he will invite me to read another paragraph - and I am happy to do so.

The first paragraph I wish to pick up is para. 80, subparagraph 5. In bundle 5 it is p.340.

There are some introductory observations and then there are sub-paragraphs,

> "i. It is accepted that the competition test cannot, in and of itself, produce new entry or expansion but it does facilitate new entry and non-incumbent expansion".

So, there is first of all an admission that the competition test cannot produce new entry. The highest that it is put is that it facilitates new entry. This is not a point which is analysed in any materiality whatsoever in the report itself, as I will show you.

> "It is not accepted that it adds an addition barrier to entry. It is a (limited) barrier to *expansion* by incumbents with very large market shares who face fewer than three other major competitors.
>
> ii. It is accepted that the competition test will only have a specific additional effect when the planning regime would otherwise permit a development in its absence. This is simply a recognition that the planning regime, whilst it

introduces certain barriers, acknowledges competition as a matter of principle, but does not focus on the identity of an applicant.

iii. It is accepted that the competition test will only affect incumbent retailers so as to prevent local market shares in excess of 60% being achieved by new store openings or expansion. To that extent the competition test is plainly selective; this is a virtue of the test, not a defect.

iv. It is not accepted that extensions are 'unlikely to discourage entry'. The Commission expressly found that extension by an incumbent grocery retailer will make new larger store entry by a rival grocery retailer more difficult. Moreover, by increasing market share, extensions can give rise to or exacerbate the potential effects on competition associated with high levels of concentration. Altogether, the inclusion of extensions within the test was specifically considered in the course of reaching the decision on the competition test and the Commission further considered whether to allow *de minimis* extensions, whether generally or as a 'one-off-, and explained why that would not be appropriate."

Then one finds this important sub-paragraph:

"v. It is obviously correct that there might be a range of reasons why any particular retailer might not enter a local market. However, it is not accepted that a restriction on expansion above a 60% market share would be likely to mean that demand would remain unmet in a local market, as suggested in para.18(5) of the Notice of Application. The Commission found that in general …"

- and you might underline the words "in general" –

"… the UK grocery industry is competitive and that the four largest grocery retailers have been expanding significantly …"

Then you might underline the word "therefore" because, as I will show you, this is an enormous leap in logic.

"… therefore, in general it is likely that at least one of the rival retailers would seek to meet such demand. But the Commission's recommendation takes account of the fact that, exceptionally, that may not be the case, and thus provides that a [local planning authority] LPA may grant planning permission to a grocery retailer who fails the competition test where it is satisfied that identified benefits would result for the local area that would clearly outweigh the detriment from

increased concentration and that the development (or any similar development) would not take place without the involvement of that retailer."

So the key words are that the Competition Commission suggest that because, in general, the UK grocery industry is competitive, it is likely that at least one of the rival retailers would seek to meet such demand.

Why can the risk be ignored, the risk of the adverse effects of the competition test? Because they will not persist. Those will be eroded away by new entry or by conduct by one of the large rivals.

That is para.80. Paragraph 93 is the next paragraph I would like to draw to your attention. Here the Competition Commission is addressing the point which is summarised in para.92, but I think I can read para.93 without going into the previous paragraph:

"As to (i), Tesco is right that the competition test does not, of itself, reduce *existing* levels of local concentration. It makes no such claim; the test acts as a *preventative* measure, inhibiting the emergence or strengthening of highly concentrated local markets. Moreover, while the competition test cannot, of itself, produce new entry, it can *facilitate* such entry. In particular, where there is dynamic competition in the groceries sector, the continuing process of rivalry is expected …"

and then one sees –

"… over time to reduce the numbers of highly concentrated markets by reason of new openings and competitor expansions."

So again the virtuous circle is described, and they here apply two caveats. It assumes the existence of dynamic competition and it assumes over time that this will happen, though there is no analysis anywhere of what is meant by "over time", not by the extent to which it will reduce the highly concentrated market. So it is simply a statement of belief, if you like, it will happen, the remedy is adequate because entry is possible.

Again, I would accept that if entry barriers were low in a sense it would be irrelevant to quantify precisely how long it will take for entry to occur. You can assume rationally that because the barriers to entry are so low that entry will come in and cure the problem of excess prices or an inadequate offering. Indeed, that was the thesis upon which the Competition Commission itself operated, if the barriers to entry are not material one should not be addressing any perceived problems in the market place.

I would like now to jump, please, to Mr. Freeman's witness statement, which in bundle 5 is the tab numbered 3. It is about four-fifths of the way through bundle 5, and the witness

statement starts on p.4025. The relevant paragraphs are found on 4044. The key paragraph is 68, but to put it in context I will take you to 67 and 69 as well. This is bundle 5, p.4044, towards the end of that bundle. I am going to start at para.67, p.4044, under the heading "Future operation of the competition test", and Mr. Freeman says:

> "It was impossible for the Group to model the precise effects of the competition test. That would have required knowing the exact size, location and date of opening of all planned new larger grocery stores and extensions and who would operate the new grocery stores, and making the assumption that the plans of large grocery retailers would not change in response to particular proposed stores, whether their own or those promoted by other retailers, failing the competition test. Nonetheless, the Group was able to form a view of how the competition test might play out over time.
>
> 68 One of the key assumptions …"

I think we are entitled to assume that if Mr. Freeman says it is a key assumption, it is –

> "… underpinning the introduction of this remedy was that store development would be a continuing feature in grocery retailing (Report, paragraph 11.268 and Appendix 3.1 Table 2) in line with the historic trend that the Group had observed. That assumption was supported by the information on landsite holdings and confirmed that the growth in grocery retail facilities that had been observed over previous years was set to continue with most, if not all, large grocery retailers apparently planning to expand. The background to the remedy was thus that continued supermarket expansion was a fact of life."

Then it makes the point that I will elaborate upon later now: even assuming that that is a correct statement, namely that expansion is a continuing feature, the Competition Commission itself found in the course of its persistence analysis that it was not a relevant feature in the highly concentrated areas. So the general observation was found by the Competition Commission not to apply to concentrated areas.

THE PRESIDENT: In concentrated markets?

MR. GREEN: In concentrated markets, yes.

THE PRESIDENT: That is the persistence test?

MR. GREEN: Yes. So there is what we submit is a *non sequitur*, if it is a key assumption that general growth is the answer, because if there is general growth you can deduce that trend will simply operate in areas of high concentration and soak up the unmet demand, then that is simply a *non sequitur*, moreover than that it is provable as a *non sequitur* by reference to

the Competition Commission's own findings. That is their explanation for why they did not analyse the restrictive effects of the competition test.

Then para.69: "The key thrust of the competition test is that it is intended to provide opportunities rather than create new entrants and to ensure that any grocery retailer who wishes to enter a market by building a new grocery store in excess of 1000 square metres is not precluded by the power of an incumbent. To that end the test does three things: (a) it gives a 'free pass' to any genuine new entrant to the market; (b) by including extensions, it removes one of the easiest ways for an incumbent retailer to strengthen an already concentrated position; and (c) it sets an overall limit on the market share that may be held by any one grocery retailer in the relevant local market."

Paragraph 70 starts with the words:

> "On the assumption that grocery retailers generally are seeking to expand, the group therefore considered that the competition test would do two things."

They go on to explain what they view as the efficacious benefits of the 60 per cent test, but it is on an assumption.

So that is paras. 68 to 70. If you now jump to Mr. Freeman's para.72, he says as follows: "The competition test is only a 'cap on growth'" - and this is a phrase that they themselves have used, and it is an accurate description of the effect of the test.

> "The competition test is only a 'cap on growth' in the sense that it prevents expansion by the individual grocery retailer within a specific local market where that retailer already has a market share of 60%. It does not prevent that grocery retailer from expanding in other areas where it does not have such a high market share."

Well that is plainly correct.

MR. ROTH: I am sorry I do not want to take my friend out of course, he said "cap on growth" is an expression "they themselves" i.e. my clients have used. We only use it and that is why it is in quotation marks, because it was being put to us that way by Tesco, it is a quotation from Tesco, they repeatedly said this is a "cap on growth".

MR. GREEN: It is a phrase used in the Report, but I do not think it is something we need to quibble about.

MR. ROTH: As coming from Tesco.

THE PRESIDENT: But in a sense you do not dispute, as it were, the accuracy of the title.

MR. ROTH: Indeed, as explained it is … but in that sense.

THE PRESIDENT: There we are.

MR. GREEN: Returning to para.72:

> "Moreover, because of the general desire on the part of grocery retailers to develop new stores, where one is prevented from developing a new larger grocery store because it fails the competition test, it should be expected that another will come forward to develop a replacement."

That is the explanation and the rationale for the test. We do not need to worry about the adverse effects because new entry will come charging in to the rescue. Then we go to the Competition Commission's skeleton argument and I would like to start at para.11(c). This is p.5 of the skeleton, and one finds the start of para.11. It is in response to a point which Tesco made which is summarised in para.10 and the Competition Commission says in para.10:

> "Tesco suggests that the Commission is seeking to adduce 'entirely new justifications' for the competition test, in particular that it is intended to facilitate new entry. On that basis, Tesco contends that this justification is inadmissible."
>
> 11. This is wholly disingenuous"

Says the Competition Commission . "a) The Report is to be read as a whole, and not to be minutely analysed." We say "here, here", to that. "b) The purpose of the competition test is clearly stated." Then they cite from the test. Then one finds in para.3 the following:

> "In its evaluation of the advantages and disadvantages of the competition test and an order for divestiture as alternative remedies the Commission stated …"

And they cite from 11.266 to 11.268 and I will read them:

> "Whilst our other remedies will ensure that grocery retailers have the opportunity to enter a market to establish a new competing grocery store in the future, store divestitures involve the transfer of ownership of an existing trading store."

I will just provide the context. Here they are explaining why they did not impose a remedy of divestiture, they are explaining a negative.

> "Divestitures would represent a significant intervention in property rights, as well as being disruptive to consumers. We do not believe that such an intervention is supported by the gravity and prevalence of the AEC we found. Moreover, we note that store development is a continuing feature in grocery retailing with the four largest grocery retailers having expanded their UK sales area by 38 per cent between 2000 and 2007…"

And they refer to table 2 of appendix 3.1. "Given this …" (I asked you, I think in the context of their defence to underline the word "therefore" "given this" is now the functional equivalent of "therefore.")

> " 'Given this, it is our view that removing barriers to entry in highly-concentrated local markets and ensuring that store developments do not exacerbate high concentration will be sufficient over time to address the AEC we have found in relation to highly concentrated local markets so that there is no need for us to require store divestitures. Indeed, store divestitures in these highly-concentrated local markets would not effectively address concentration: they would constitute a very limited and one-off intervention in a large and dynamic sector. We therefore believe that the competition test and the controlled land remedies will be more effective remedies over time than would be store divestitures'."

Then one finds this explanation by the Commission:

> "'It is self-evident from this that the reason why the competition test will be sufficient 'over time', along with the removal of the barrier to entry resulting from controlled land, to address the AEC in relation to highly concentrated local markets is that in general a large retailer other than the incumbent blocked by the competition test is likely to develop large grocery stores in those markets'."

I point out at this stage the jump in logic from the Commission's finding of a general feature across all areas that there has been expansion. The leap from that to the conclusion that must also apply in highly concentrated areas, but again this is explaining their rationale, new entry will solve the problem.

Paragraph 12:

> "Moreover, the contrary view postulates that although store development is a continuing feature of grocery retailing, most particularly as regards larger stores, nonetheless in local markets where there is sufficient unmet local demand such that the incumbent would seek to open an additional store (or extend its existing store), but is prevented from doing so by the competition test, *none* of the other larger grocery retailers would open a store or expand in that market. Of course, the Commission has not suggested that such a situation could never arise, but for Tesco to contend that in general and 'over time' in concentrated local markets

with unmet demand, *only* the incumbent with an existing 60% share is likely to seek to meet that demand, is fanciful."

Well I should say that that is not how Tesco puts its case but the underlying theme is consistent that where there is concentrated markets and unmet demand there will be new entry and we will say the Commission's own findings point in a diametrically opposed direction.

Then para .13(b) "the competition test manifestly does not remove or reduce the barriers to entry created by the existing planning system." Well if that is the case one can look at what they found about the planning barriers to entry and since those will continue into the future one is bound to ask the question with those still existing how is new entry to occur?

Then one finds in para. 21 the point I referred to earlier about the Competition Commission identifying the risk:

"Moreover, the Commission expressly had regard to the risk that placing a cap on market share could prohibit beneficial development, and it is not correct to contend that it failed to have regard to that aspect. It considered that such consequence could be most effectively taken into account in the design of the test:"

And they have referred to the Report at 11.35 which I will take you to in due course.

"Accordingly, that it decided, by a majority, to adopt a cautious approach and fix the threshold at 60 percent, not 50 percent, even though this would mean that the test would sometimes be passed by a development but would fail a more detailed competition assessment".

Again, they refer to paragraphs that I will come to.

"Given the AEC and resulting consumer detriments which it had found, the Commission was fully entitled to determine in its judgment that inclusion of such a competition test was appropriate in seeking to [I think the word 'ensure' should be added there, and I think Mr. Roth will correct me if I am wrong] [something] its package of remedies provide as comprehensive a solution as is reasonable and practicable for that AEC and those detriments".

So, their explanation, and the only point they have in relation to the risk of the adverse effects is that they say they took that into account in deciding that the appropriate market share threshold for the competition test should be 60 percent as opposed to something else - in particular 70 percent or 50 percent. But, they identified the risk. They did not go on to analyse its scale in any meaningful way, or put that scale into the process of answering the

questions under s.134. Simply because you identify a risk it is by no means the same thing as taking it into account for the s.134 purposes.

Then one finds at para. 51 of their skeleton -- Although this is a repetition of what has gone before, it contains five words that I will wish to highlight.

> "Tesco argues that the competition test might reduce grocery capacity and result in unmet demand. However, as noted above, Tesco's arguments in this regard are predicated on an assumption that in local markets where there is sufficient unmet local demand such that the incumbent would seek to open an additional store (or extend its existing store), but it is prevented from doing so by the competition test, *none* of the other larger grocery retailers would open a store (or expand an existing store) in that market. Having regard to the other [and then I would like you to underline the words] unchallenged findings of the report, such an assumption of persistent unmet demand is fanciful".

We will show you what the unchallenged findings in the report are.

Then, at para. 52,

> "Nor is there any reason why new store development should not occur as quickly under a competition test regime as under the existing arrangements. The clarity of the test means that grocery retailers can be expected to take it into account when planning their schedule of developments".

The first sentence is the nearest that one finds in the report, defence or skeleton to an indication of how quickly new entry might occur. It appears to be the Competition Commission's case that new store development would occur as quickly now as it would -- in other words, with the competition test in application as it would in the past. Well, that rather begs the question of how quickly it would occur in highly concentrated areas in the past, and, again, as to that there are findings by the Commission and they are either that new entry does not occur, or that when it does occur it is very slow.

Paragraph 55,

> "It is self-evident that the competition test will block certain incumbent retailers from expanding their stores, or place a limit on the extent of possible expansion. But Tesco's conclusion that consumer demand will therefore be unmet rests once again on the assumption that no other competing retailer will expand or enter the market to satisfy that demand. As explained above, this is inherently implausible".

So, I have taken you to the paragraphs where the Competition Commission explains why it did not feel it was necessary to quantify the adverse effects of the competition test. It is because, as I have said, they have this belief in entry as being a quick, easy and effective solution.

So, to summarise the Competition Commission's present position, the competition test will amount to a cap on growth. They have accepted Tesco's submission that that would be the case. It is in the report. There are circumstances where unmet demand could exist or will arise and the incumbent is blocked from meeting that demand. But, says the Commission entry or expansion by others will soak up that demand, and it is fanciful, inherently implausible, etc. for Tesco to submit that unmet demand will persist. A key assumption which underpinned the Competition Commission's decision to recommend the competition test was that generally retailers want to expand and in these circumstances, in general (that is (a)), over time (that is (b)), and where there is a dynamic competition (that is (c)), there will be new entry. The conclusion that the Competition Commission arrives at from all of this was that there was no failure on their part to examine the nature, scale and incidence of the adverse effects of the competition test because such effects would simply be expunged by the market.

That is the Competition Commission's position. Let me now take you to the actual findings in the report itself. I would like to start by identifying the paragraphs where the Competition Commission summarises what the adverse effect is. You will find a summary of the adverse effect as found in paras. 22 to 24 of the report (p.12 of the internal numbering; p.12 of the bundle). These are findings about the adverse effects on prices and offerings in concentrated markets. It is as good a short summary as anywhere in the report. At para. 22,

> "We found that between 11 and 27 percent of larger grocery stores, and between 10 and 22 percent of mid-sized and larger grocery stores are in highly-concentrated local markets. In contrast, few convenience stores face weak local competition.
>
> 23. We concluded that consumers are adversely affected by local markets being highly concentrated rather than more competitive. Weak competition in local markets allows a grocery retailer to worsen the store-specific retail offer at its stores in those markets and earn higher profit margins at those stores. We estimated that the effect of weak local competition on store level profit margins allows large grocery retailers to earn an additional £105 - £125 million in profits

per year at their larger grocery stores. This represents around 3 percent of annual profits for the four largest grocery retailers. The additional store-level profits at mid-sized grocery stores as a result of weak local competition may be of a similar order.

24. We also concluded that a grocery retailer with a number of stores in highly-concentrated local markets can weaken that part of its retail offer, such as pricing, that it applies uniformly, or near uniformly, across its stores nationally and thereby earn higher profits across all of its stores. The scale of the impact on national price levels arising from weak local competition, while difficult to measure, is potentially very substantial. For example, for each 0.1 percent increase in national price levels (i.e. each 1p increase on a £10 shopping basket), consumer expenditure on groceries at the four larges grocery retailers increases by £80 million a year".

That was the Competition Commission's finding. That, if you like, is the restriction of competition that a remedy is going to direct itself to.

Now, the logic of the Competition Commission's position that I have just taken you through in their defence and skeleton has to be seen against the findings of the Competition Commission itself. Let me summarise what we say the findings of the Commission actually were. I am just going to provide you with a narrative summary and then take you through the paragraphs. First of all, barriers to entry exist to retailers who would otherwise enter the market in which there is high concentration. So, barriers to entry exist to concentrated markets. These exist in the form of the planning system and certain aspects of the holding of land banks. So, that is Point 1.

Point 2 - the barriers are persistent, durable and high.

Point 3 - there are other reasons, unrelated to planning or land banks, which may also deter entry or expansion. To give one example, there may simply be no land available to facilitate either an expansion or new entry.

Point 4 - throughout the United Kingdom, including in areas of high concentration, there is substantial unmet demand.

Point 5 - this unmet demand persists over long periods of time and it may exist at levels which would warrant both new extensions and new entry, but – and this is quite important – sometimes it would be at levels which warrant only an extension but not new entry. So the unmet demand may persist over long periods of time, but it may exist at levels which warrant new entry or new expansion – so in other words it is really quite a substantial

unmet demand – or it may actually be at a level which is less than that which would warrant new entry but nonetheless would justify an extension of some description.

Point six - the remedy adopted by the Competition Commission, namely the competition test, was not intended to, and did not, mitigate any of the barriers to entry identified in the planning system. It made some limited inroads into land-bank sites by virtue of its control and restriction of restricted covenants.

Point seven - at the point in time when the competition test is intended to be effective the identified barriers to entry inherent in the planning system will remain essentially unabated.

Those are their findings, and I will now show you why we say that those are their findings. I would like to start with their findings on delays caused by the planning regime, delays and obstacles caused unless this is an appropriate moment.

THE PRESIDENT: We have got a few minutes.

MR. GREEN: Shall I continue for a few minutes?

THE PRESIDENT: Yes.

MR. GREEN: So far as delays and costs caused by the planning regime are concerned, the Competition Commission examined this as part of their analysis of general barriers to entry. They found that the planning process could engender substantial delays and costs, and the relevant paragraphs of the Report for your reference are 7.34 through to 7.68, and in these sections they concluded that the planning process was a barrier to entry to large grocery stores. That was because it was easier to secure suitable sites for smaller stores, and you will find that in 7.38 and 7.39. So the planning process was a barrier to entry to large grocery stores. 7.38 is p.132.

> "The planning regime acts as a barrier to entry or expansion primarily for larger grocery stores."

So it is not just limited to entry but also to expansion. I will make the point that it appears to be subtle, but nonetheless it is a point which I think it is important to make, that the Competition Commission certainly found that it was easier in relative terms for an incumbent to get planning permission for an extension than for a new entrant to get planning permission for an entirely new development. That was an analysis of the relative ease – in other words, it was easier to do A than B, but they do not say that that necessarily means there are no barriers to expansion, it was simply a comment on the relativities between expansion and new development. Here in 7.38 we find a conclusion:

> "The planning regime acts as a barrier to entry or expansion primarily for larger grocery stores. This is because, in general, it is easier to secure suitable sites for

mid-sized grocery stores or convenience stores in those areas where planning consent is already in place or where planning requirements are significantly less onerous, in particular in town centres.

A number of grocery retailers told us that the increased town-centre focus since 1996 had led them to focus on developing smaller stores in town centres and edge-of-centre locations. Tesco told us that it had increased the range and variety of store formats to gain access to a greater number of potential sites. Sainsbury's told us that 'since the 1996 change to retail policy in PPG6, retailers prepared to accept the policy focus of retailing on centre and edge-of-town centre sites of an appropriate scale have not been unduly constrained by the planning system'. To the extent that the planning regime has encouraged convenience and mid-sized stores rather than larger grocery stores through impacting on the development strategy of grocery retailers, this is a further indicator that the planning regime represents a barrier to entry for larger grocery stores."

So a simple point, that the planning process is a barrier to entry and expansion.

A second finding of the Competition Commission was that there was significant, as it was described, need, and here they were referring to planning need identified in the local planning authorities that the Competition Commission had surveyed. They surveyed in excess of 50 local planning authorities and they found material need in about 34 of the LPAs' plans. One can see that in figure 7.1 on p.133 after para.7.43. They refer here to a total of 34 local planning authorities and they identify the number and the amount of need identified in the strategic plans of each LPA. You will see that there are, I think, seven LPAs who identified need of zero to 1,000 sq.m., six of 1,000 to 1,200 sq.m., 14 of 2,000 to 2,500 sq.m., four of 5,000 to 10,000 sq.m. and three 10,000 to 25,000 sq.m. I will come back to concept of need, because "need", as defined in the planning guidance, is a reasonable proxy for unmet demand. Need, therefore, was a fairly endemic feature of the UK market. There are many indications of this and many pieces of evidence which one can refer to.

The Competition Commission also analysed the costs and the risks associated with securing permission and one finds this in 7.45, and they say here:

"The planning system imposes both costs and risks on developers of sites for grocery retailing. These costs and risks take the form of

- the time required to assemble a site likely to secure planning permission and then to achieve planning permission for that site;

- the direct costs of making a planning application as well as the cost of financing any agreements with the LPA that are necessary to secure planning permission; and

- the risk of a planning application being rejected and the costs associated with the application not being recoverable through the new development."

THE PRESIDENT: Mr. Green, I am sorry to interrupt shall we have our two minutes' silence, if that is a convenient moment.

(Two minutes silence was observed)

THE PRESIDENT: Thank you very much. Is that a convenient moment to have a break everyone? Shall we say 25 past?

MR. GREEN: Thank you.

(Short break)

THE PRESIDENT: Mr. Green, as I say, the general intention is to go through to 2 o'clock now, but obviously if any of the key players at any stage would like to have a five minute break just let it be known, we can certainly do that.

MR. GREEN: Thank you. I am sure goes for the Tribunal. (Laughter)

THE PRESIDENT: Thank you for that!

MR. GREEN: Before the break I was taking you through para.7.45 where the Competition Commission had identified three costs and risks associated with securing planning permission which they had summarised as the time taken to assemble a site, and that was on the basis that you may have to put together different plots of land, land may not be available and it may take a considerable amount of time to put together a proposal based upon a sufficiently large plot of land. Then they identified the direct cost of making a planning application and the financing of s.106 agreements, and thirdly they identified the risk of a planning application being rejected and those costs being irrecoverable.

In relation to each of those three instead of just reading you large chunks of the report what I was proposing to do was summarise the points and I will give you paragraph numbers, and I will endeavour to summarise it accurately, but again if Mr. Roth wishes me to refer to anything I am very happy so to do.

As to the time taken to assemble land, this is dealt with by the Commission in 7.46 to 7.51 and they essentially make the following points. First, they say the planning regime focuses grocery retailing developments on town centres, and this limits the availability of suitable land and it therefore causes a delay in the time needed to assemble suitable plots. It not only takes time but it imposes upon the applicant holding costs, namely the costs of tying

capital up while the land acquisition process occurs. You find that in 7.46. They say that they have data from the largest retailers which demonstrates that in about 50 per cent of cases (7.47) it takes more than 18 months to acquire the land. In figure 7.2, which is behind 7.47 on p.134, in 50 per cent of cases it can take more than 18 months and ten, in 20 per cent of cases it can take more than four years, and one can see that simply from the graph which is set out at figure 7.2.

On top of this, (7.48) it can take 10 to 12 months for a full planning application to be submitted, and again that is 7.48 and figure 7.3. In 7.49 and 7.50 the Competition Commission conclude that between 25 and 50 per cent of applications do involve a two stage planning application process and the time would be generally about 40 months. Then they say in 7.50 that additional time can be expended if a planning application is called in, and if it is called in it can be up to 12 months.

They give a conclusion at 7.51:

> "In summary, the entry of new larger grocery stores in a local market is likely to take at least two years …"

two years is the minimum –

> "… and, in many cases, considerably longer. This will include assembling a site, obtaining planning permission and building a new grocery store with proper access and amenities."

Now I would like to move to a different factual aspect of the Competition Commission's findings which is the persistence of market power. The Competition Commission looked at this to see whether there was evidence of barriers to entry into more concentrated markets, and we pick the story up at 7.4 of the report itself on p.125. In 7.4 the Competition Commission says:

> "The pattern of retailer entry and expansion in recent years, and changes in entry and expansion trends over time, provide an indication of the presence and nature of barriers to entry and expansion. The following paragraphs review:"

Then, if you look at the very last paragraph,

"The persistence of highly concentrated local markets for mid-sized and larger grocery stores".

Now, in para. 7.5 the Competition Commission gives general information on store growth. It points out that for larger stores there is a steady growth rate of circa. 3 percent. So, 7.5 is a general position. It is not an analysis of the application of expansion in concentrated markets.

In para. 7.6 the Commission says that entry is generally by one of the big five, and not by other smaller retailers.

In para. 7.9 the Competition Commission recognises that in principle there are incentives to encourage entry into highly concentrated areas - for example, higher profits. Again, that is, I would have thought, an economic truism - that save for barriers to entry, if you spot an area where there are high profits to be earned, that is one factor which would encourage entry.

Then, from para. 7.10 through to 7.12 I will, if I may, read to you.

> "7.10 We examined the experience of new entry near stores that faced few local competitors to assess whether highly-concentrated local markets have persisted over time. In 2000, there were 186 stores larger than 600 sq.m in Great Britain, belonging to Asda, Morrisons, Safeway, Sainsbury's and Tesco which faced no, or only one competitor in the local market in which they operated (monopoly or duopoly stores). In 2006, 160 of these stores (or 86 percent) continued to face no, or only one, competitor (see Table 7.1). The persistence of local concentration is indicative of the presence of barriers to entry in the markets in which these stores are located.
>
> 7.11 Insufficient demand to support an additional store may explain the persistence of concentration in some areas. In our view, however, most of the grocery stores that were identified as being monopoly or duopoly stores in 2000, and which continue to be monopoly or duopoly stores in 2006 are in areas where the local population is sufficient to support an additional store".

Can I pause there for a moment? They refer to Appendix 7.1, which contains a lot of very interesting information, but the point being made there is that monopoly and duopoly stores have persisted in many instances over six years in circumstances where there is a population to support an entirely new store, in other words, such as would ordinarily encourage an entirely new entrant into the market because the volume of demand would support a new store by reference to population. One of their other analyses which equates population with demand demonstrates that there is some sort of a correlation between population and demand.

So, we have got an acid test over six years. Monopoly and duopoly areas. 86 percent of them persist. There is unmet demand. It is not met. Barriers to entry are plainly sufficiently large as to deter new entry and/or expansion. Then,

"7.12 In summary, store entry and expansion activity in recent years indicates that, at a national level:

grocery stores larger than 2,200 sq.metres may face barriers to entry but the number of these stores has been growing at a faster rate than for stores of 280 to 2,200 sq. metres in the period since 2000;

retailers other than Asda, Morrisons, Sainsbury's, Tesco and Waitrose may face higher barriers to entry to opening larger grocery stores;

operators of larger grocery stores may face barriers to the expansion of those stores, but these have not prevented a substantial proportion of these stores being extended in recent years;

convenience stores have entered in substantial numbers in recent years indicating that there are limited barriers to entry for these stores; and highly-concentrated local markets have tended to persist rather than attract new entry".

That is a summary finding in relation to highly-concentrated local markets. The conclusion, of course, they draw is that there are barriers to entry to highly-concentrated markets. As you have seen from the nature of the remedy, the remedy does not affect -- the competition test does not affect the nature of those existing barriers to entry. You have seen that the Competition Commission says that it might facilitate new entry. I will come to that later. But, that is the position as found by the Competition Commission in their summary section. Then one goes to Appendix 7.1 which provides further information. Appendix 7.1 you will find at p.409. The purpose of the exercise which is described in Appendix 7.1 was, as the Competition Commission puts it, to inform its analysis of barriers to entry in local markets. So, we are examining precisely the issue that the Competition Commission says in its skeleton and defence is the answer to all of the woes of unmet demand. The analysis which they carried out was to take 209 stores identified in their report of 2000. This is described in paras. 2 and 3. They then excluded certain stores from Northern Ireland for which they had inadequate data -- You will see that in Footnote 3. They reduce the number of stores that they were examining to 186. In relation to this 186 number they replicated the selection criteria used in 2000 to calculate the competing fascias facing each other in 2006. So, they compared the position in 2000 and applied the same criteria to those stores to see what had happened to them over a six year period. As they say in para. 2, the purpose was to indicate the extent to which new entry has taken place since 2000.

Now, in paragraph 4 and onwards they describe a process that they applied . What I would like to do is just summarise the stages that they went through, and then I will take you to

their conclusions. So, you can break the process that the Competition Commission adopted into the following nine steps. I am just going to call them Step 1, Step 2, and so on. So, Step 1 was to simply ask: How many monopoly stores remained monopoly stores in 2006? That was Step 1. Step 2 was to do the same in relation to duopoly stores: How many duopoly stores remained duopoly over that six year period? Step 3 was to perform a similar task by combining monopoly and duopoly stores: What percentage of combined monopoly and duopoly stores remained the same at the 2006 cut-off point? Step 4 was to ask: How many of the persisting monopolies and duopolies had net sales areas over 1,400 sq. metres? That took you into the area of a large grocery store. How many entailed multiple stores operated by one grocer, and how many have completed extensions since 2000?

So, they examined this trend to see whether it was affected by the size of the store - over 1,400 sq. metres; whether there were any multiple stores operated by the same grocer and whether any of them had actually extended during that period.

Step 5 was to see whether there was scope for additional competing floor space in those areas.

Step 6 was to see whether entry had occurred and whether it had been quick or slow.

Step 7 was to see whether population may have deterred entry - in other words, if there was a low population might that have been the reason why there was no new entry.

Step 8 was whether, and, if so, what percentage of persistent monopoly/duopoly areas appeared capable of supporting an additional store on the basis of population. So, in other words, in persistent areas was there substantial unmet demand which otherwise might have encouraged new entry?

Step 9 was to see whether there were indications of imminent entry or expansion in persistent monopoly/duopoly areas.

Those were the steps that one finds in these paragraphs if you break it down into the process. As to the conclusions, one can pick this up, I think, at para. 4.

"In the following tables we set out the current status of monopoly and duopoly stores. Using the criteria defined in 2000, Table 1 shows that of the 63 monopoly stores in 2000, 50 remain monopolies in 2008 and 10 became duopolies".

So, 50 out of 63 remained monopolies. Then in table 1 there are details. Paragraph 5:

> "Table 2 shows that of the 123 duopolies in 2000, 71 remained duopolies whilst 18 have seen additional competitors entering the area. We note that 29 of the 123

stores in duopoly areas that existed in 2000 appear to have become monopolies in 2006."

So there may have been some increase in concentration. I should add, before one attaches too much to that, that there is at least some indication elsewhere in the Report that that may have been due to the change in the methodology. That is to be fair to the conclusion as it were. They say that may be attributable to a number of matters, the exit of an existing competitor, an increase in net sales area of the target store since 2000, difference in specifications and drive-time model used, differences in the measurement of the size of a store.

Then one has got table 2 which describes the status of monopoly stores. Then para.6:

"Table 3 shows that of the 186 monopoly and duopoly stores identified in 2000 investigation, 160 …"

- in other words, 86 per cent -

"… continue to be in monopoly or duopoly positions in 2006."

It is worth making this point, that since they used as their benchmark the position they had found in 2000 and they examined a six year period, it would be fair to say that the six years is an absolute minimum because it is quite likely that many of the areas that were monopolies or duopolies in 2000 had persisted for a period of time during the 1990s. So we do not know what that is, and actually, if you go back to the 2000 Report, it does not really tell you, because I have looked. It is quite difficult to unpick that particular conundrum, but it is a logical inference to draw that six years is a bare minimum and you might be looking at considerably longer periods of time.

"7. We also find that of the 160 persisting monopolies and duopolies over 600 sq metres, 118 have a net sales area greater than 1,400 sq metres, and of these 11 have another store operated by the same grocery retailer within the isochrone and 36 have applied for or completed an extension since 2000. These vary in size but on average increase grocery sales area by approximately 630 sq metres."

In other words, in 71 out of 118 areas where there was a sales area of over 1,400 sq metres, there was no expansion or site development and no new store under the same name. In other words, in only 47 out of that total was there any form of expansion, and one just works that out by playing around with the numbers, the 1,136 and 160.

One finds in para.8:

"The analysis suggests that there was or is scope for additional competing floorspace in many of these persisting monopoly and duopoly areas. We note that

where entry has occurred it has in some cases been up to four or five years after the 2000 investigation. This illustrates the time it can take for the larger stores grocery market to attract entry into uncompetitive areas."

One has to make the point about para.8 that they are only talking about the areas where there has been entry or expansion because they have found that in 86 per cent of areas the monopoly or duopoly persisted. So in the main there was no new entry or expansion. Where there was new entry it could take a very long period of time, "often", as they say – in many areas there was scope.

In para.9 they assess the trend by reference to population. They say:

"To inform our analysis of whether some for or combination of barrier(s) has prevented entry into the relevant isochrone, we also consider whether a low population may have made competitor entry more difficult. We find that of the 118 persisting duopolies and monopolies with a net sales area greater than 1,400 sq metres:

(a) 93 are in isochrones which have a population that pass the 99 per cent precedent threshold …

(b) 63 are in isochrones which have a population that pass the 95 per cent precedent threshold …"

I will come back to population as a discrete topic in a few moments.

"10. Thus we find that 79 per cent (93 stores of 188) of persisting monopoly and duopoly stores with a net sales area greater than 1,400 sq metres are located in isochrones which appear capable of being able to support an additional store on the basis of population. Using the higher, more conservative 95 per cent threshold, this percentage falls to 53 per cent (63 stores of 118)."

That is a very statistically significant figure – 79 per cent are persistent monopolies and no new entry.

"11. Finally, we identified persisting monopoly and duopoly stores where we have some indication from the main parties that entry may occur in the near future (or since our data was compiled). We find that of the 51 monopolies greater than 1,400 sq metres, 40 have no indication of imminent entry whilst 9 indicate one additional competitor is imminent and 2 indicate two additional competitors are imminent in the near future. Of the 67 duopolies, 53 have no indication of future entry and 14 do. In total, we observe that 79 per cent (93 stores out of 118) …"

- and there is a footnote which says the fact it is also 79 per cent, which is the same figure as in para.10 is a purely a coincidence.

> "…of persisting monopolies and duopolies larger than 1,400 sq metres have no indications of new store entry in the near future. We also find that of the 25 possible future entries, 14 are due to occur within 15 minutes of stores which we would discount on the basis of insufficient population if we were to apply the 95 per cent population threshold.
>
> 12. Moreover, all of the 11 monopolies and duopolies with another store operated by the same grocery retailer within the isochrone would be discounted if we were to apply the 95 per cent threshold. This evidence of actual behaviour in persisting areas demonstrates that entry is (and has been) possible in areas with populations less than the 95 per cent threshold and so, combined with evidence presented in Annex 1, implies more weight should be applied to the findings from using the 99 per cent precedent threshold."

So appendix 7.1 is the analysis which supports the conclusions that I read to you earlier, and it demonstrates that, contrary to what the Competition Commission says, when you have got concentrated markets you do not as a rule see new entry, you do not as a rule see expansion, you do see persistence of high concentration. This analysis was performed to educate the Competition Commission as to the level of the entry barriers which the Competition Commission has concluded existed inherent in the planning regime. The planning regime is not touched, save peripherally, by the remedies or the obstacles which the Competition Commission has found in the past will persist in the future. Unless the Competition Commission can persuade that the remedy they have adopted will so profoundly affect this state of affairs that frankly it is impossible to see, then the reason that the Competition Commission has given for not analysing the restriction effects of the competition test are plainly flawed.

That is just one piece of evidence. There are a lot of other pieces of evidence. It all points in one direction only. That is why I said at the outset that we rely on the Competition Commission's own findings. We do not need to go beyond that.

There is other evidence as to the duration and existence of unmet demand from the analysis of planning need. I mentioned this earlier, and it is worth just dwelling upon the planning authority's own assessment of the fact that need exists and persists. Again, it is not conclusive in its own right, but it is evidence pointing in one direction. Again, we need to look at both the text of the report and annexes. We will start, if we can, at 7.36 of the

Report. This is under the heading "Planning rules and their impact on entry and expansion", it is p.131 of the bundle and the report itself. In this section the Competition Commission was making an assessment of the extent to which there was demand for new stores by analysing the extent to which local planning authorities had quantified a need for additional floor space for retailing and convenience goods which includes groceries, and you will find that in para.7.41, p.132. What the Competition Commission did was to conduct a survey of local planning authorities and it is apparent from the report that the survey and its results were treated as statistically significant because of course they felt confident in relying upon the conclusions that they arrived at. The analysis of need in a planning sense arises in this way: in order to obtain planning permission for a new store, or a larger store, the applicant has to persuade the authorities that it can open a new retail outlet in a city centre, or in an of city centre site. The present planning guidance is found in the document called "PPS6", and under PPS6 in practice it is easier to obtain permission for smaller retail outlets in city centres than for large retail outlets, that is the present planning guidance and you will see that in the following references: 7.37, 7.38 and 7.39. In consequence, retailers who wish to introduce larger stores have to apply for permission for out of centre sites, and we find that in 7.40. The consequence of this is what is described as a "key condition" that has to be met is need because this applies to an out of city centre application, you see that in 7.36. One can see what is meant by need from appendix 7.2, which is p.419, and paras 12 to 14 of this appendix describes the planning framework for grocery retailing. Under the heading: "Requirement to demonstrate 'need' (the need test)" you will see that it is describing the process of applicants wishing to develop a retail site outside of the primary shopping area which has not been allocated to retailing in an up to date development plan, and it explains that they have to demonstrate the need for the development. Then paras. 13 and 14 explain that need is assessed largely in terms which act as a reasonable proxy for unmet demand.

> "13. Need is assessed in both qualitative and quantitative terms. PPS6 states that in assessing need, LPAs should place greater weight on quantitative assessments, while still staking qualitative considerations into account. Quantitative assessments of need seek to assess whether there is an excess of demand for retail floorspace within the broad categories of 'comparison' and 'convenience' goods. Such assessments will take into account factors such as existing and forecast population levels, expenditure on convenience and comparison goods in the catchment area, and existing levels of floorspace in the relevant category."

> 14. The Barker Report expressed support for the 'town centre first' policy and the impact and sequential tests that underpin it, but recommended removing the need test. The Government, in responding to the Barker Report, has said in its Planning White Paper that it will improve the effectiveness of town centre planning policy by replacing the need and impact tests with a new test, which has a strong focus on the town centre first policy, promotes competition and improves consumer choice, while avoiding the unintended effects of the need test. A consultation paper on a revised version of PPS6 is due to be published by the government shortly."

The fact remains that the present test requires need to be established. There is, of course, no guarantee that the Government will change the law, and if it does we do not know what form it will take, so it is not something that is relevant for your consideration.

For present purposes, if I can return to 7.41 on p.132, what I have explained to you so far is by way of preface to the conclusions that the Competition Commission found having examined "need" in the context of their survey of planning authorities. One sees in para.7.41 that their own survey of LPAs –

> "… indicates that 62 percent had quantified a need for additional floorspace for the retailing of convenience goods (i.e. consumer goods purchased on a regular basis, including food, toiletries and cleaning products) in their local development plan. The average area of identified need was 4,600 sq. metres (with a median of 2,500 sq. metres). The majority of LPAs that did not have an identified need for additional floorspace for the retailing of convenience goods were those that did not have an up-to-date development plan. However, a significant minority of LPAs (18 per cent of our sample or ten LPAs) had an up-to-date retail development plan and concluded that they did not have a need for any new retail convenience goods floorspace over the period of the plan."

Now, I deduce that the survey was approximately 53 or 54 LPAs because that is the figure you get from calculating backwards where 18 per cent equals 10 LPAs. What does this tell us? It tells us that in their own survey, and one assumes it was a reasonably representative survey, the local planning authorities indicated that there was substantial need for, amongst other things, grocery retailing. That is consistent with the appendix 7.1 persistence analysis which indicates there is need. It is, of course, a relevant factor which would inform the analysis of the adverse effects of the competition test. I accept entirely that it is

not conclusive but it is evidence going in one direction only. There is significant unmet demand in a wide range of areas.

MR. MATHER: Mr. Green, at para.7.40 right at the end it says: "Tesco, however, stated that it knew of no case where a planning application had failed solely because of the lack of identifiable need." Could you expand on that a little?

MR. GREEN: I think in order to expand I would need to ask my client for precise details – I am happy to do that if I can perhaps come back later on that?

MR. MATHER: Yes, fine.

MR. GREEN: Of course, that may be the case when one is dealing with the generality. Of course, in this case we are concerned only with concentrated markets, and the persistence analysis in appendix 7.1 indicates that even where there is substantial demand sufficient to amount to an entirely new store it may remain unmet for many years.

The next piece of evidence I would like to draw your attention to concerns population. Again, the Competition Commission logically conducted an analysis of population to see whether there was unmet demand in the sense that there were large areas of population which attracted sub-typical or sub-representative number of retailers. If population is growing and can be identified at fairly high levels but there is a small number of retailers, it is an indication that there is unmet demand, particularly if one can get at least some sort of a handle on how many persons would justify an extension or an expansion – 5,000, 10,000, 20,000 new people coming to an area would justify a new store, or an expansion. So the Competition Commission examined the relationship between population and markets in order to further inform their analysis of entry barriers.

We start, as I have done so far, with a very brief summary of what they found. They found that there was a correlation between levels of population and demand. They also found that there were areas where there was sufficient population to justify an entirely new store relative to demand, but it had not happened. In fact, they found, as they put it, many areas where population justified a new store.

There are also areas where an increase in the population may create demand which is significant but less than that which would typically warrant a new store, in other words, significant population justifying an expansion or an extension but falling short a new entry. Let me take those two points separately.

First of all, that the Competition Commission found many areas where there were large populations, but few large grocery stores. Now, I took you a moment ago to Appendix 7.1 There is an annexe to that appendix called Annex 1, which starts at p.413 entitled 'Deriving

Population Thresholds'. In the first two paragraphs the Commission accepts that the relationship between population and demand is, as they put it, 'an important one' and that population levels are "an important factor in determining whether a local market is able to support an additional entry". You will see that in para. 2. The purpose of the exercise was identified in para. 1.

> "Each store that we identify as being in a concentrated local market raises competition concerns. However, in order to undertake an analysis of developments in market structure surrounding a store over time, we need to be aware of the circumstances that would prevail in a competitive local area. That is to say, for a number of the persisting monopoly and duopoly stores, we may find that even in the absence of any strategic barriers to entry, new store entry would have been unlikely to occur".

That is simply because they were trying to determine whether very low populations would have existed even in the absence of a barrier to entry.

They adopted quite a complex approach. Again, if I may, what I am going to do is to try and summarise it by steps because otherwise you have to read the entire annex and then dissect it and work out logically what they did. I hope I am able to summarise the process reasonably precisely. They conducted a really very detailed, very exhaustive analysis.

Step 1 was to take every large grocery store in the United Kingdom.

Step 2 was to analyse the population surrounding the store in the relevant market.

Step 3 was to analyse the number of relevant stores within the market.

Step 4 was to use this analysis to identify threshold populations that currently support two or three stores

Step 5 was to compare this with the population surrounding monopoly and duopoly stores - so, you have, as it were, created a benchmark or a counter-factual against which to measure the monopoly and duopoly stores

Step 6 was to determine if population surrounding a persisting monopoly is lower than the threshold, it would suggest that new entry might not be justified by virtue of population.

Also as part of Step 6, vice versa - to infer whether, if population exceeds the threshold, new entry is justified.

So, they were taking threshold population levels, and they were using those as benchmarks to see whether or not, in monopoly and duopoly areas, there would be a justification for a new store.

The conclusion that they arrived at is that there is a positive nexus between population and demand for larger stores. One finds in para. 9 of this annex the following by reference to Figure 2 -- I am not going to invite you to look at Figure 2 because, frankly, every time I look at it, it makes my eyes go mad. It is virtually incomprehensible. I am sure someone in the Competition Commission understood it. Paragraph 9 says,

> "Figure 2 shows the distribution of population within a 20-minute isochrone area surrounding each larger grocery store, conditional on the number of relevant stores within a 10-minute isochrone of the store. In general, we observe a positive relationship between population and the number of larger grocery stores in an area, although we also find many areas [and that is where I get the word 'many' from] where a relatively low population is supporting a number of larger grocery stores. In addition, we also observe many areas where, despite a relatively high population, there are few larger grocery stores".

The Competition Commission was conducting this particular exercise in relation to the monopoly and duopoly stores that it had used for its persistence analysis deriving from the 2000 report. You see that in Footnote 18. What the evidence again suggests is that there is a prevalence of unmet demand which persists over time, including in areas of high-concentration. The Competition Commission's conclusion was that there were barriers to entry.

THE PRESIDENT: Where do we get that conclusion? Is that what you deduce from ----

MR. GREEN: That is from the text of the report itself that I took it, and this is really the evidence.

The other point which I think comes clearly from this - although it is not so explicitly set out - the second point - is that there is evidence that there may be demand which is insufficient for new entry, but sufficient for expansion. Now, the competition test clearly focuses upon blocking expansion by incumbents. So, it is useful to try and assess the extent to which incumbents may be affected and unmet demand may arise in relation to incumbents. If there is unmet demand which only warrants expansion, then the competition test clearly, obviously risks creating consumer benefit. If it is in a monopoly area, then there is nobody else that can come in and meet that unmet demand because there is no other incumbent, and the demand may not be sufficient to justify an entirely new entry. It depends on the level of demand. If it is a duopoly area, then the other incumbent who may extend or expand is one. If it is a triopoly area, there may be two. So, when you

are looking at the impact of the competition test on expansion in circumstances where the demand falls short of justifying a new entry, then it plainly can have a very material effect. It is relevant therefore to try and work out what level of population justifies a new entry because below that you can get a handle, or an understanding, of whether there is going to be a number of situations whereby only an extension will do. It is quite plain from the evidence and the report that there are going to be significant numbers of areas which would not warrant a new entrant, but which would warrant an expansion.

THE PRESIDENT: Mr. Green, at para. 13 of that annex, I take it that the Commission is saying that actually when they look at case studies, a slightly smaller population is consistent with new entry - if I have understood that correctly.

MR. GREEN: It is certainly true to say that they have given a sort of indicative figure of what population might encourage new entry, but I think it would be right to say that the evidence is variable. I think for logical topographical, urban, social reasons it will vary around the country. What I wanted to show you was the various figures which are given so that you can get a handle on what sort of level of population would justify a new entrant as opposed to an extension. I am not suggesting that there is a consistent position, but what I am suggesting is that from area to area there will be substantial demand which exists, but only justifies an extension or an expansion. The competition test, therefore, bites more sharply upon those areas. It is not a uniform picture. I am not suggesting there is any homogeneity about it. But, there are indications as to where the line would be drawn - for example, in the footnote to Figure 2 where it says,

> "Note ... First dotted line indicates population - 33,870 -which supports 99 percent of stores with another store within ten minutes. Second dotted line indicates population - 44,650 - which supports 99 percent of stores with two stores within ten minutes".

Now, if you just simply take a crude approach and divide that by two or three, you will get a figure for population justifying a single store of 17,000 (by dividing the 33,000-plus by two) and 15,000 (by dividing by three the 44,000 figure). So, that is an indication. I accept it is rough. But, 17,000 and 15,000. The examples given in para. 13 - Gallashields, Scotland - 31,000 for three stores. That is approximately 10,000 per store. Fakenham - 35,000 for two stores. That is 17,500. Newtown - 23,500, for two stores approximately 11,500, Berwick-on-Tweed - four for 24,500, 6,000. It gives you an indication that a fairly substantial number, be it 10,000 or 12,000 or 15,000 is in the ball park for justifying a new store, and the only point I seek to draw is that if you have a figure of, let us say, two-thirds

of that, call it 6,000 or 8,000, new people who come to an area that would justify an extension but not new entry. Again, we have seen the evidence and the persistence analysis that even where there is growth in demand justifying the new entrant, there is often no new entry and only a limited number of extensions.

I should show you a figure which I think it would be fair to say that the Competition Commission did not accept for the proposition for which it was advanced. They do not say it is necessarily wrong for this purpose, 11.30 and 11.32. This is a figure that Tesco gave which puts the threshold at a higher level. I think, for the sake of completeness, I ought to draw it to your attention, p.187.

> "We explored the point, raised by Tesco and Sainsbury's, of whether there were 'natural monopoly' areas, in which the application of a competition test may be inappropriate. We note that some areas with low population, which might be expected to be 'natural monopolies', have more than one store. However, we accept that there may be areas where there are three or fewer fascias present and where the local population is too low to support entry by an additional fascia. It is important to note that our competition test would not have the effect of prohibiting all development by existing grocery retailers in the local area; rather it would prevent development that would lead to one grocery retailer having an unacceptably strong local market position or strengthening such a possibility.
>
> 11.31 We assessed Tesco's claim that, on the basis of its reproduction of the first-stage regression of our margin concentration analysis, our analysis predicts that an increase of 34,052 people leads to an increase of one extra store of above 280 sq metres. From this it told us that 34,000 more people within 10 minutes were required to support an additional store above 280 sq metres – so only expansions and replacement stores would be possible.
>
> 11.32 We agree that there is a general positive relationship between population and the number of stores in an area …"

Then they refer to the Annex.

> "The first stage regression results of our margin concentration analysis also clearly show this positive relationship. However, the purpose of this regression is not to identify the exact relationship between the size of the population and the number of competitors and we do not think that these results show that 34,000 more people are required to support an additional store above 280 sq metres."

So there was some evidence suggesting the figure was higher than those that I have shown you. It is right to say the Competition Commission did not accept that. It does not undermine the point that there will be areas where there is substantial demand reflected by population levels which would justify something falling short of a new store.

Those are various pieces of evidence that I have shown you which actually focus upon what the Commission did in relation to concentrated markets and the existence of barriers to entry. All of these exercises were performed by the Commission to determine whether there were persistent barriers to entry into these markets. All of their conclusions were to the effect that there were barriers to entry in concentrated markets. This is quite irrespective of the fact which the Competition Commission records elsewhere that generally retailers are seeking to expand. That just does not go to the point. It is an irrelevance, and it is an error of logic for the Competition Commission to suggest that that is a platform upon which one can conclude that entry barriers will be easy to overcome.

What I would like to do now is to show you what I believe is a pretty stark inconsistency in the way the Competition Commission puts its case. At the outset I think I identified this as my section 4. This is the implications of the Commission's position in its defence, para.102, and I would ask you, if I may, to pick up the Competition Commission's defence at para.102. This is in my file 5, tab 1. This is in a section of the Competition Commission's skeleton which addresses ground 2, proportionality.

THE PRESIDENT: We are looking at the defence at the moment.

MR. GREEN: Yes, p.3489 at the top. In this paragraph the Competition Commission says as follows:

> "Tesco's assertion that the Commission had, or could have had, the data to calculate the economic benefit accruing from the future operation of the test is wrong and simplistic. It is not feasible to ascribe a meaningful *ex ante* value to the benefit accruing from the future application of the test. Attempting to calculate the future economic benefit would have required the Commission to make highly speculative assumptions about the number of larger grocery stores that would be developed in the future, as well as the timing, precise location and sequence of proposed store developments by retailer and by local area. The degree of speculation required would render the calculation highly unreliable."

So the Competition Commission in a different context is actually advancing the argument that they have not the faintest idea whether entry will occur because they would be required, if they were to form any conclusion on this issue, to engage in highly speculative

assumptions about the number of stores that would be developed – the timing, the location, the sequence by retailer or by area. If that is correct how can they possibly and inconsistently turn round and say that it is fatuous of us to suggest the opposite and that it is self-evident that market entry will occur? Here they are saying they cannot calculate it. This is, in a sense, their defence to our criticism number two, they say it is just all too difficult. If so, let them be hoisted on their own petard. How can they come to any conclusion about entry barriers? If they cannot come to any conclusion how can they then say it is self-evident that in fact entry will occur and will resolve the problem of unmet which you have seen they have found exists persistently in concentrated areas.

That brings me to five particular points which the Competition Commission has made in its defence and skeleton in response to our notice of application. The five particular points are as follows, and I will just list them and then I will deal with them separately. The first is what I have perhaps unfairly described as the "we did it really" point – in other words, we did really take account of the costs of the competition test in the Report, and they told us which paragraphs of the Report they rely on and we can look at them. That is point one.

Point two is what I describe as the "U-bend" point. If you push the water down on one side of a U-bend it will spring up on the other side. They say if you suppress incumbents that will facilitate new entrants. You push one down and the other one, like a jack-in-the-box springs up. They say that is an answer.

Then thirdly, there is the LPA point. If there is unmet demand and no new entrants then the local planning authorities under the scheme that they are recommending will have a right to permit exceptionally an incumbent to expand. So that is the LPA exception point.

Fourthly, there is the 'over time' point, in other words, everything will sort itself out given a sufficiently long period of time, and then fifthly, there is the 'restrictive covenants' point.

One has to say that these points do not spring out at one from the report itself, they are arguments which one finds in the pleadings. We have made submissions in writing as to the propriety in a Judicial Review of a decision maker advancing new arguments, they are well traversed arguments and I do not propose to go into them here.

I am going to start by taking each of those points in turn, and the first is "we did it", and it is an analysis of the Report which the Competition Commission says provides an answer to the criticism we make. If I may I am just going to give you paragraph numbers first of all and then we will rattle through them.

THE PRESIDENT: The "we did it" is that "we did take account of the cost"? We are in cost rather than benefit.

MR. GREEN: Oh yes, we are on cost rather than benefit. The relevant paragraphs that they refer to are 11.78, 11.266 –11. 268, 11.35, 11.99 – 11.103 and then 11.67. Again, for your note, these come out of their skeleton para. 11(c) and 22.

So starting with 11.78 on p.196 one sees the following:

> "The objective of the competition test is to prevent the emergence of highly-concentrated local markets in the future and to prevent the strengthening of strong local market positions held by retailers in existing highly-concentrated local markets. We do not wish to impede the development of new or existing stores where overall they are of benefit, and our aim is not to create a situation in which every local market has a certain number of competing fascias. In particular we do not wish to prevent new entry into an area but rather we seek to encourage it."

Well it does not address any of the facts which the Competition Commission would need to address in order to show that new entry or expansion would meet the unmet demand, and all the facts that exist in the report are those that I have shown to you. This is a statement of aspiration, it is drafted in broad brush terms, there is nothing which supports the Competition Commission's claim that new entry or expansion will occur, it is just a high level statement. It is just a prefatory statement for a subsection which concerns planning applications and which of them should be subject to the competition test. But that is the first one which is identified, and they identify that paragraph in 11(c) of their skeleton.

The next paragraphs are 11.266 to 11.268 on p.231, and these three paragraphs express the reasons why divestiture is an inappropriate remedy and they give the following reasons in these three paragraphs why they are inappropriate. In 11.266 divestiture would create consumer disruption in the short term. It says:

> "We also believe that there is a significant difference between store divestitures and the other remedies we decided to pursue in relation to highly-concentrated local markets. Whilst our other remedies will ensure that grocery retailers have the opportunity to enter a market to establish a new competing grocery store in the future, store divestitures involve the transfer of ownership of an existing trading store. In our view, such a transfer could have disruptive effect on consumers in the short term. Those customers who have chosen to shop at the divested store and who are familiar with that store will either find their store operated by another retailer or will have to find an alternative store to continue shopping with the same retailer."

Well I suppose the nearest one comes to anything which is remotely relevant are lines 3 and 4: "Our remedies will ensure that grocery retailers have the opportunity to enter a market to establish a new competing grocery store in the future." It says what it says, there is nothing which really needs to be added to it, it does not explain or account for the rest of the analysis in the report which emphasises how, in concentrated areas, entry is unlikely and it does not explain how its own remedy could remotely impact upon that situation when the planning barriers remain.

THE PRESIDENT: Of course, amongst the remedies are the remedies in relation to landbanks, and restrictive covenants and so on and so forth.

MR. GREEN: Yes, well I will come to those because it is extremely unclear how those could ever be a remedy in and of themselves, and you simply prohibit a restrictive covenant, it does not mean to say that the person who holds that piece of land has to sell it or has to sell it to anyone in particular; it simply means you cannot impose a particular type of covenant so how that could ever be said to be a total solution is not explained in the report.

11.267 really explains why the gravity and the prevalence of the AEC is not sufficient to justify divestiture.

> "In Section 6 we identified two effects resulting from highly-concentrated local markets. The first effect relates to a lower standard of retail offer in the local markets themselves and the second relates to the weakening of those components of the retail offer, such as price, that retailers choose to apply uniformly across all local markets in which they are present. We believe that the second of these effects will be effectively addressed by the package of remedies we decided to pursue in respect of existing and future controlled landsites (together with the inclusion of the competition test in the planning regime and the requirement on large grocery retailers to notify acquisitions of existing stores in excess of 1,000 sq. metres) We decided that the gravity and prevalence of our AEC finding in relation to these markets in respect of the first effect is not sufficient to justify a divestiture remedy."

Again, all that we have here is a statement of the blindingly obvious. The starting point for this Judicial Review is that they thought their remedies were effective. We are pointing out to you that in our submission they have omitted relevant facts and they have failed to apply the test correctly. It is common ground that they think that what they were doing was consistent with the law and no doubt effective. That is everybody's starting point in a Judicial Review, we simply say they are wrong for X and Y reasons. So the fact that they

recite what is a statement of the obvious is not an explanation of why, given their findings the entry barriers which they have identified will somehow be overcome, it is just a high level statement.

11.268 is very much to the same effect:

> "Divestitures would represent a significant intervention in property rights, as well as being disruptive to consumers. We do not believe that such an intervention is supported by the gravity and prevalence of the AEC we found. Moreover, we note that store development is a continuing feature in grocery retailing with the four largest grocery retailers having expanded their UK sales area by 38 per cent between 2000 and 2007. Given this, it is our view that removing barriers to entry in highly-concentrated local markets, and ensuring store developments do not exacerbate high concentration will be sufficient over time to address the AEC we have found in relation to highly-concentrated local markets so that there is no need for us to require store divestitures. Indeed, store divestitures in these highly-concentrated local markets would effectively address concentration …"

MR. ROTH: There is a "not" there.

MR. GREEN: Oh quite, there is a "not", that is right, I think Mr. Freeman has corrected the "not" and you should put it I think it is after "would" and before "effectively" – yes. In the fourth line up, if you insert "not" and I think you will remember from Mr. Freeman's statement he says that that is a correction which ought to be made.

THE PRESIDENT: It seems to be in mine.

MR. GREEN: We are looking at the same report, I hope.

> "Indeed, store divestitures in these highly concentrated local markets would not effectively address concentration: they would constitute a very limited and one-off intervention in a large and dynamic sector. We therefore believe that the competition test and the controlled land remedies will be more effective remedies over time than would be store divestitures".

So, the only bit of that paragraph which address this issue is the bit in the middle:

> "It is our view that removing barriers to entry in highly concentrated local markets and ensuring that store developments do not exacerbate high concentration will be sufficient over time to address the AEC".

But, you will note that the premise for that conclusion is their general observation - and I emphasise the word 'general' - that grocery retailers have expanded between 2000 and

2007. That is a point which I made to you earlier - that that is an absolute non sequitur. The fact that there is general expansion across the market as a whole tells you zero about the position in the highly concentrated areas, particularly when you have got their own analysis of what happened in the concentrated areas.

Table 2, in Appendix 3.1, is simply a table in a section which is at the neutral section describing each individual retailer. It does establish what they say it establishes - that there is a trend which reflects growth.

The next paragraph which is said to be relevant and which comes out of their skeleton at para. 21 is 11.35 at p.188. The Commission says, "We remain of the view that a competition test is an appropriate tool for preventing emergence of highly concentrated local markets and the strengthening of strong local market positions in the future. We take the view that the other points raised by the retailers in opposition to the competition test (for example in relation to the effect on investment, strategic behaviour, regulatory burden, uncertainty, perverse effects and regulatory 'gridlock') are best dealt with in the design of the test, which is discussed below".

With respect, that says nothing about entry barriers and the point which they now advance as their panacea for all ills.

Paragraph 22 also refers to 11.99 through to 11.103. This is a section in which the Competition Commission is addressing what the market share threshold should be in the competition test - whether it should be 50 or something lower, or higher at 60 or even 70. So, it is not, I emphasise, examining the consequences of the figure that they actually adopt. It is an assessment of where the figure should be. It is true that they do, to a degree, speculate as to the effect. They tell us what their conclusions are. But, we rely heavily upon those to show that they identify a material risk which they do not then go on to analyse. Paragraphs 11.99 to 11.103 are in the following terms:

"In our view, when designing a remedy that will have the effect of limiting store development, we should be more cautious than when designing remedies that will remove barriers to entry and hence promote additional output or capacity and so take a more conservative approach in setting the market share threshold of our competition test".

That seems to be an implicit recognition that the competition test will not remove barriers to entry or promote additional output or capacity.

"11.100 In our Provisional Decision, we proposed a market share threshold of 60 percent threshold, above which a retailer would fail the competition test A number of retailers commented that this threshold was too high with M&S, CGL, ACS and Asda suggesting

various figures or ranges between 40 and 60 percent. We reflected further on the market share threshold in the light of these comments. We think that a level of 50 percent has merit and we are sympathetic to the arguments that a single retailer with a 50 percent market share in a local area is likely to enjoy a strong position.

> "11.101 Two of us (Ms Almond and Professor Gregory) were of the view that our competition test remedy should go further than that outlined in our Provisional Decision, and prevent such concentration occurring in the future by adopting a maximum of 50 percent for the threshold.
>
> 11.102 However, four of us identified a number of concerns with a 50 percent threshold. We were concerned that such a threshold could effectively prohibit development in some local markets. For example, in a market where one retailer held a 60 percent share and one held a 40 percent share, a 50 percent threshold would prevent the larger retailer from growing and the smaller retailer from being able to outgrow the larger one. Though less acute, a threshold of 55 percent gave rise to similar concerns.
>
> 11.103 The same four of us also thought it more appropriate on balance to adopt a conservative threshold for what will be a mechanistic test to reduce the risk that welfare-enhancing store developments were prohibited by the test".

So, they identify the risk and they say they can reduce it, and plainly moving from a 50 to a 60 percent reduces it, but the risk is not said not to exist - it is simply reduced. Going on,

> "In doing so, we accept that there may be some cases where a more detailed competition assessment may have failed a development that would have passed the competition test".

Those are the paragraphs they refer to. It is worth just reading on a couple of paragraphs.

> "11.104 We considered setting the threshold at 70 percent. However, we found a higher threshold such as 70 percent to be too high. Set at that level, there would be too great a risk that a substantial number of new developments that would have a negative effect on competition in local markets would pass the competition test. Indeed, we noted that set at this level, a substantial number of store developments would have passed the competition test that would have failed our own more detailed assessment. We therefore decided in this instance by a majority of four members to two to adopt a 60 percent threshold".

Then they refer to Sainsbury's argument. Then, would you please just look at the Footnote 334,

> "Approximately 24 percent of existing grocery stores would not be able to extend with the competition test at a 60 percent share threshold. This would reduce to 19 percent of existing stores at a 70 percent threshold".

So, 24 percent of the existing stores could not extend at this level of the application of the competition test. When you have the analysis of unmet demand, which the Competition Commission undertook, and the conclusions they arrive at, you can see that there is a potential for, as they put it, 'welfare-enhancing store developments to be prohibited or thwarted'.

So, that is the risk. They recognised it. It is identified. But, that is where they draw the shutters down. There is no further analysis of it at all. The reason for that is that they do not need to because this risk is obviated by new entry. If it arises, this unmet demand will not persist because new entry will come in and remove it.

Then, in para. 22 of their skeleton they also refer to para. 11.67 which we suggest does not advance matters one iota. At p.194,

> "Sainsbury's, CGL, M&S, Somerfield and Aldi suggested that the competition test should be based on local market shares. Several parties commented on the market share threshold above which a grocery retailer should fail the competition test. Asda suggested that if we introduced a share of floor space test, a level of 50 percent would be appropriate. The ACS suggested that a share of over 40 percent should be subject to scrutiny under the test, with a share above 60 percent definitely failing the test. CGL also suggested the use of a variable market share with discretion exercisable. For market shares between 50 and 60 percent M&S suggested that the share above which a development would fail the test should be between 40 and 50 percent".

It does not address the question of entry barriers or why, if there is this unmet demand in high concentrated areas, the issues is going to be -- or, the problem is going to be resolved by new entry.

Now, those are the paragraphs which are relied upon. None of them actually addresses the issue. They are scratching around for stray paragraphs. One has to say that these are the paragraphs that represent their case. One sets beside that a whole phalanx of hard and fast conclusions on entry barriers in concentrated areas. There is an enormous amount of

evidence and analysis on one side of the fence, and there are these few, odd stray comments on the other.

I would invite you to conclude that this is not the way the Competition Commission would operate if it were genuinely going to address the issue. It does not do it through a side wind. It does it head on with proper analysis. You cannot just pluck a few bits from hither and thither and say, "This is satisfactory". That is just not the way the Competition Commission operates. That is the "we did it" point.

The next point is the "U-bend" point. The point is not in the report, save for a few straggling half comments. There is no genuine analysis of this point. It is plainly a new point. The point put very crudely is that if you squash the incumbent you encourage the new entrant. Let me summarise the obvious riposte to this point. In the only paragraph in the report where this point even is hinted at, the Competition Commission finds that two combined factors deter new entry, and the two combined factors are, one, the ease of obtaining permission, or the relative ease, I should say, of obtaining permission for extensions; and two, the needs requirement in local planning authority analysis. So it is a combined effect. You know that nothing in the Competition Commission's recommendations addressees the need analysis. That is simply part of the planning regime. It has been subject to consultation at the governmental level, but the Competition Commission has not addressed it. It remains. Ergo, even if you make obtaining extensions more difficult but you do not modify the needs test then that remains as an obstacle to entry.

The second quick riposte to it is that the Competition Commission examined at appendix 7.1 the *nexus* between extensions and persistence of unmet demand, and I have taken you to those paragraphs, and you will see that the Competition Commission found that even where there was unmet demand you did not even see extensions very often. So suppressing extensions which do not exist is going to have no necessary corollary for new entry. The evidence and the findings of the Competition Commission are inconsistent with the logic which now underpins this new suggestion.

A third quick riposte to the U-bend point is that the Competition Commission, itself, identified other factors which would block new entry, so that if you squashed the incumbent it does not deal with the unavailability of land, and the restrictive covenants point plainly does not. It does not deal with the fact that there may be insufficient demand for a new store but sufficient demand for an extension.

Let me now take you to the paragraphs that the Competition Commission relies upon. The first is 7.67, which is on p.139. 7.67 is a paragraph under the heading "Conclusion on the planning regime as a barrier to entry and expansion", and says:

> "The planning regime places more limited constraints on the extension of existing stores by grocery retailers compared with new larger grocery store entry."

I made the point earlier that this is a comment about relativity. It is not a comment about the absolute nature of the barrier imposed by the planning regime to extensions.

> "An incumbent grocery retailer, by extending its store, will make new larger grocery store entry by a rival grocery retailer more difficult."

There you have got a statement. They say that somebody who extends will make it more difficult for somebody to enter. Presumably that is just common sense, but it does not tell you anything about the consequences of suppressing the extender for the new entrant, because the barriers to entry may simply prevent the new entrant from coming in.

If one jumps back to 7.64, this is the text which then leads to the conclusion, so it is a slightly more detailed exposition of the point. In 7.64 the Competition Commission says:

> "In conclusion, objecting to competitors' planning applications does not appear to be particularly widespread or a significant matter of concern in terms of barriers to entry or expansion."

Then one finds these important words:

> "However, the relative ease of gaining planning permission for store extensions, as evidenced by the number of extensions that we observe, combined with the need test, is likely to provide incumbent retailers with an advantage over new entrants in providing new grocery retailing floorspace in a local market."

So that is the combination point. Even if it were the case, *ex hypothesi*, that by squashing the incumbent you could encourage the new entrant, the Competition Commission's conclusion is that it was a combined deterrent effect, and the Competition Commission's recommendations do not embrace addressing the need test which remains, subject to whatever the government do in their broad base consultation.

That is their "U-bend" point. Precisely where it takes them they do not explain. They have given no explanation of the relationship between the needs test, what effect this has on existing barriers to entry. It does not explain how it can be reconciled with their persistence analysis in appendix 7.1. You may just want to note at this stage para.7 of appendix 7.1, p.411, which addresses the relationship, at least to some degree, between extensions and persistent monopoly and duopoly areas. It demonstrates that in those

concentrated areas there is no clear evidence that extensions will arise, so suppressing them is not necessarily going to have any effect on entry, though in many areas where there is demand for a new entrant there is no extension and yet the monopoly or duopoly persists. The evidence points in the opposite direction.

So if it were a serious point, one would not just find it as a two liner, one would find a detailed analysis in the traditional way that the Competition Commission addresses matters on the relationship between need and ease of obtaining planning permission for extensions, there would be an analysis of whether it was easy *per se* to get extension permission, that they conclude contrary-wise. You would need to know about availability of land, even if suppress an incumbent, could the new entrant find the land, so on and so forth, but none of this has actually been analysed.

That is the "U-bend" point. It pops up, as it were, in a variety of different places.

The third point is the LPA exception point. The Competition Commission's thesis is that if there is unmet demand the LPA will allow the development. The answers to this are really quite obvious. We have dealt with them in our skeleton and I am going to provide you with a summary of the point. The answers to this are as follows: the Competition Commission report includes a recommendation that the CLG – that is the Department for Communities for Local Government – and the planning directorate should issue guidance in line with the final report. So the Competition Commission is recommending that the government act in accordance with the report. You will see that at para.11.56 on p.192. The guidance, according to the same paragraph, should indicate, and the word they use is the "weight" that the LPA should attach to OFT's advice on the competition test. So the guidance is therefore intended to make very clear that an LPA will only operate the exception very, very rarely. At 11.53 they say it is "truly exceptional" – line 3 of 11.53. So you override the OFT's advice only truly exceptionally. That will no doubt be in the guidance, it will be made clear to the LPAs, this is not an exception for good times or normal times, it is a truly exceptional jurisdiction and that will be the guidance.

Then even when we are in the ball park of a 'truly exceptional' circumstance "an LPA will only", and you might underline the word "only" in 11.53, be permitted to allow an expansion if two cumulative conditions are met which are set out in 11.53 and the first condition is that the LPA must conclude that development clearly – so there is an evidential burden, it is not for difficult cases, the development clearly outweighs the detriment. So the poor local planning authority has to analyse the detriment which would arise from the persistence of unmet demand and that means in terms of an analysis of excess prices or

inferior offerings, and so on and so forth, the sort of complex assessment that the Competition Commission carried out and they have then to conclude that permitting the extension it will clearly outweigh that negative consequence, so they have to carry out a cost benefit analysis which, as you have seen, the Competition Commission says it does not like doing in its skeleton argument. That is an incredibly difficult test to meet, not one which LPAs will embrace with enthusiasm, particularly when the OFT has already told them that the undertaking fails the competition test and the company says "We are in a truly exceptional circumstance".

If they meet condition one then they also have to meet condition two, which is:

> " the development, or any similar development, would not take place without the involvement of a large grocery retailer that had failed the competition test."

So there is a 'but for' analysis. So the LPA must be satisfied that if it grants an application by supermarket grocer X that that will not have deterred or thwarted an application by supermarket Y or Z. So how does it do that? Well no doubt it will have to go out to consultation with the other players in the market, and one just wonders how that exercise is going to pan out in these truly exceptional circumstances.

If there is an opportunity for a potential new entrant to thwart and expansion by an incumbent one can imagine numerous scenarios of game playing and regulatory game playing. All one can say at this stage is that those two conditions are high hurdles indeed, and the guidance that will be given is that it will be exercised in truly exceptional circumstances.

In 11.54 in order to ensure that LPAs do not take a cavalier approach to the exercise of this exceptional jurisdiction the Competition Commission says as follows:

"We believe it is important that an LPA should be able to determine a planning application in a manner inconsistent with the OFT's advice only when it has demonstrated on the basis of clear and sound evidence that both of the criteria set out above have been satisfied. It is important that where an LPA takes such a decision, it must set out publicly its reasons for overriding the OFT's advice and must make clear the evidence on which it has done so."

So the burden of proof is on the LPA, it has to publicly justify its decision which will no doubt be a controversial one, and it must be able to articulate in detail with reference to the evidence in public those reasons.

We have no doubt at all that the LPA exception may be a useful addition to the remedies but it is not a solution to an endemic problem of entry barriers; it is not fashioned that way, it will not be framed in that way, the guidance given to the LPAs will be that it is meant to

be a truly exceptional caveat and it just will not operate in a manner which will permit it to be come the norm.

The Competition Commission says, as we have seen from para. 102 of their own defence, that these are highly complex issues, so they say. Well, if it is complex for them, why is it going to be that much more obvious to an LPA?

Mr. Hoskins has given me a cri de Coeur for five minutes.

THE PRESIDENT: Of course. Is ten minutes actually more realistic?

MR. GREEN: Thank you.

THE PRESIDENT: Shall we say 10 minutes and come back just before 10 past.

MR. GREEN: Yes, thank you.

(Short break)

MR. GREEN: One final point, to conclude, in relation to the LPA exception. You will have noted that the Commission found in the report that in general terms one of the obstacles to entry to the planning regime was the cost, the time and the risk. It must follow, a fortiori, that the cost, the time, and the risk will be greater when you are dealing with a truly exceptional caveat to a planning permission than with the normal regime. It must be also likely that an incumbent who will look at the nature of the guidance which is introduced and which reflects the paragraphs in the report -- They are going to say, "Well, I'm just not going to bother because the chances of getting through this truly exceptional regime are vanishingly small. All I am going to do is to prove there is a need and then invite the LPA to go out to my rival and say, 'Will you come in on the basis of this need?'"

So, the system itself is not one which will facilitate applications. I do not think it is intended to be. So, if there are applications, well, that is a question which really would have to be asked -- Will there be applications? The probability is that there will not be many. The general system imposes costs, time constraints and risks. Those will apply equally to the truly exceptional caveat.

Moving on, the fourth point which is referred to throughout the Competition Commission's defence and skeleton is that it will all be resolved over time. But, there is no analysis in the report of what is meant by 'time'. We do not know whether a time frame of two years, or five or ten or fifteen is contemplated. This is an issue the Competition Commission has failed to address. It is no answer to simply say, "Something will happen over time". That is not an answer at all. If one answers that question, "It will happen in twenty-five years", then that plainly is not a satisfactory solution on any view.

The Competition Commission's nearest attempt at an answer is in para. 52 of their skeleton. I would like to just go back to that, if I may, because it repays a little analysis. The first two lines of para. 52 say,

> "Nor is there any reason why new store development should not occur as quickly under a competition test regime as under the existing arrangements".

That rather begs the question: If what the Competition Commission is suggesting is that entry occurs rapidly, well, then the unchallenged findings of the report contradict the suggestion. If the Competition Commission is in fact suggesting that entry will occur at the sorts of rates which the Competition Commission found at Appendix 7.1 then those were rates which the Competition Commission say reflect barriers to entry of a permanent and durable nature. To simply say, "There is no reason why it should not occur as quickly under a competition test regime" may actually be an admission that in fact entry will be slow and tardy.

Moreover - and I do not ask you to turn this up because I will come back to it in the context of proportionality - that conundrum paragraph in the defence - 102 - where they all say, "It's just all too difficult" -- One of the points they specifically refer to there is that it is impossible to make any assessment of the timing of new developments. That is what they claim in para. 102. (Just for your note, that is l.7 of para. 102.) It is impossible to speculate as to the timing of new applications. Well, if so, then how can you say it is even going to be as quickly as under the existing regime.

To put that in context, the Competition Commission itself, in its guidance on remedies, identifies the time at which a remedy will bite, and the speed of its operation as a relevant and important consideration. If I can I would like to show you the Competition Commission's guidance on remedies in Bundle 4 at p.3389. The Competition Commission's market investigation reference guidelines of June 2003 are set out. There are a number of paragraphs which address the question of choice of remedy and the question of speed and timing in relation to those two matters. First of all, para. 4.16 under the heading 'Effectiveness of Remedies'. This is on p.3429 of the bundle. The Competition Commission here identifies a number of general observations to be made about effectiveness of remedies. In 4.14 they address the question of clarity. That is not of concern to us today. At 4.15 we have the prospect of remedial action being implemented and complied with - again, not an issue for today. Paragraph 4.16 is in the following terms,

"A third consideration is the timescale within which the effects of any remedial action will occur. Some remedies will have a more or less immediate effect while the effects of others will be delayed. There may be particular uncertainty about the timescale within which results can be expected when the remedy calls for action by some other person, for example a recommendation to government to change regulations. The Commission will tend to favour a remedy that can be expected to show results in a relatively short time period - so long as it is satisfied that the remedy is both reasonable and practicable and has no adverse long-run consequences".

So, in this paragraph the Competition Commission is saying that the point of time at which the remedy will bite is relevant to both reasonableness and practicability, and it is implicit that it is setting itself the task of being satisfied as to the point in time at which the remedy will bite and the consequences of it - because in the present case, if it is the case that this remedy will take a very long time to occur, this new entry, then even on their own analysis the AEC will persist and the adverse effects of the competition test will exacerbate that AEC.

The other paragraph of relevance is 4.23 under the heading 'Choice of Remedy'.

Paragraph 4.23 is in the following terms,

"In looking for remedies that would be likely to increase competition in the relevant market, or market(s), the Commission will give attention to the time period within which the remedy can be expected to show results. The remedy is not likely to have speedy results, the Commission may choose an alternative remedy or implement additional remedies such as those to remedy the detrimental effects on customers during the interim period. Otherwise, not only might there be uncertainty as to whether the effects would ever materialise, but in the meantime customers would continue to suffer from the consequences of the adverse effects on competition".

Now, we rely on these two paragraphs for the general proposition that when one is assessing all aspects of reasonableness and practicability and where timing is an issue, one can expect the Competition Commission to address the issue squarely in the manner that it traditionally does with vigour and thoroughness.

PROFESSOR PICKERING: Could I just ask you in relation to para. 4.23: Do you think that consideration of proportionality comes into this? The remedy in relation to lack of competition in relation to the supply of a type of biscuit, for example, may well require a

much shorter time horizon than something where it is clearly going to be a major investment decision and is going to be substantially more long-lasting. Would you think that the short run or the speed would be affected by that sort of consideration?

MR. GREEN: The first point is that the Competition Commission has to address it. The second point is: What considerations might they take into account? The importance of the market. The natural speed within which things might occur might be a relevant consideration. There may be other factors. It has to be addressed. They have to focus upon that issue and come to some conclusion. What they have addressed is the extent to which duopoly and monopoly persists, and the extent to which new entry has occurred over that period of time. So, they have addressed that issue for a different reason, to inform themselves as to barriers to entry. Here they are saying precisely the opposite. That is our point - having addressed the issue in Appendix 7.1 and concluded that barriers to entry are such as to prevent quick entry, and when it does occur it takes a long time -- They are now saying it will occur quickly. There is a mis-match. There is an inconsistency between the two positions.

THE PRESIDENT: They are actually saying that it will occur 'over time', are they not?

MR. GREEN: Over time.

THE PRESIDENT: And no less slowly than entry has hitherto occurred, whatever that means.

MR. GREEN: Whatever that means. That is what has puzzled us. If that is their view then they are saying it will occur at a time which reflects significant barriers to entry because that is the findings of fact which they have arrived at.

Now, one can read too much into para. 52, but that is what they have said. No analysis of timing, save for in the appendices - the persistence analysis which addresses this issue. The guidance simply tells you that it is the sort of issue that the Competition Commission, at all the various stages of its analysis, addresses. It is not a transient issue. It is not a peripheral issue. It is a core issue, particularly when it comes to relevance. Here, they are specifically talking about the point in time at which a remedy will bite. But, here, we are talking about, as it were, a consequence of the market. It is a slightly different issue, but, nonetheless, the same intellectual discipline should be applied to the problem.

So, that is the 'over time' point.

The final point I can deal with quite quickly - restrictive covenants. There is a lot in the report which addresses the question of holdings of land. You will have seen that in the end they adopted a relatively limited remedy, which is that they prohibited certain types of restrictive covenant. For your note, a summary of the remedy is to be found in the report at para. 42 on p.16, I do not ask you to turn it up because the point we make is really a short

one and it is an obvious one that even if you restrict restrictive covenants there is no logical or necessary connection between that action which may take years to come to any sort of positive fruition by the time land is sold. There is no necessary connection between that and facilitating new entry simply because you wipe out of a series of freeholds or leases a certain clause tells you nothing about the point in time at which that land will be sold and to whom. I am not suggesting it may not have some effect "over time" but it is peripheral in relation to this particular issue.

THE PRESIDENT: I am just slightly puzzled, why do you need to say that the restrictive covenant remedy will not do much for barriers to entry?

MR. GREEN: It is a point which the Competition Commission says, they say that our package of remedies will be effective, so this is the other remedy. One asks: if the competition test does not reduce the barriers to entry is the other remedy going to actually resolve the problem? That may be the way it is put.

THE PRESIDENT: And if the other remedy resolved the problem ----

MR. GREEN: If it was a complete and total answer in removing barriers to entry ----

THE PRESIDENT: Then why do you need a competition test?

MR. GREEN: Yes, quite.

THE PRESIDENT: That is why I was puzzled as to why you needed to home in on the restrictive covenants at all.

MR GREEN: Those are the five points which the Competition Commission has raised, no doubt there may be others which I have overlooked which Mr. Roth will elaborate upon. I would like now very briefly to summarise our conclusions on ground one, and then I am going to move to ground two.

We submit first that the Commission was bound to assess the cost of the competition test. It is and was a relevant consideration under sections 134 and 138. It goes to both questions, the "whether or not" question and to the remedy, if there is to be one.

Secondly, the Competition Commission did not analyse the cost of the remedy, although they identified a risk associated with it and they were able to identify that 24 per cent of all grocers would be precluded from extending their stores by virtue of it.

In their defence and in their skeleton they explained that the market is self-rectifying because entry will occur to soak up the unmet demand which is the characteristic of the problem which flows from the competition test that there is demand and the competition test prevents it from being met. They say that is the solution, and it is self-evident.

Our next submission is that this is not the reasoning in the Report when it is fairly read, and I think one can reiterate the point that when the Commission does analyse a problem it has in the course of its 60 years done this with immense detail and thoroughness, and it is not an answer, with all due respect, to simply pluck out a few stray paragraphs and attempt to put them together; that is making bricks out of straw.

Most importantly, the next submission is that that assertion that entry barriers will provide the solution is flatly contradicted by their own findings that we rely upon. It follows from that finally that their reason for not analysing this issue in far greater depth, which was a relevant issue, is an unjustified and unacceptable reason by reference to their own conclusions.

THE PRESIDENT: It is inconsistent, you say, with their own conclusions elsewhere.

MR. GREEN: It is inconsistent with their own conclusions.

THE PRESIDENT: And therefore does that go to rationality?

MR. GREEN: It means you are left with a gap for which there is no adequate explanation.

Whether one puts it in terms of rationality or failing to address themselves to a relevant consideration for which there is no good reason, it all tends to boil down to the same thing. One could dress it up with a number of items of Judicial Review clothing.

Before I turn to ground two can I just give you an indication of where I am in terms of time?

THE PRESIDENT: Yes, that will be very helpful.

MR. GREEN: I do not think I am going to finish, certainly not in the next half an hour, but I think I will be finished by about 11.30 tomorrow morning – I think I will need about an hour tomorrow.

THE PRESIDENT: Right. I am looking at Mr. Roth as well and others. We have two days more after today, are we going to fit it in easily or do want to sit at 10 o'clock? If we are going to comfortably accommodate it within our two days more then there is no particular reason to sit earlier, but we could sit half an hour earlier if you think there is risk.

MR. GREEN: I had a brief conversation with Mr. Roth yesterday, we feel we should finish comfortably, but others may have a different view, I do not know how long they are going to take.

MR. ROTH: On the basis Mr. Green finishes round about 11.30 – obviously I do not hold him to that exactly – I do not anticipate a problem at the moment. One can obviously review it tomorrow afternoon if it becomes advisable to ask you to sit at 10 on Thursday, but I do not see any need to ask for that for tomorrow.

THE PRESIDENT: All right.

MR. GREEN: Thank you. I would like, if I may, now to turn to our second ground, which we have labelled "proportionality". I am going to divide my submissions in to four parts, the first part is to identify what our complaint is and to provide you with a description of what the Competition Commission did and did not do. This will also set out their rationale for their conduct, and show you the places where they have explained the reasoning behind their processes.

The second part will be the law and the guidance on the law. The third section will concern the Competition Commission's substantive defence and our response to it, and then I will have some very brief submissions as part four.

First of all: Tesco's complaint and the Competition Commission's response. This is really an effort to try and crystallise the issue. We submit that the Commission failed to address the so-called benefit of its competition test and it failed to balance the adverse effects of the competition test that I have discussed already against the positive effects of the competition test. We say this is required by the terms of the Act and the general test of proportionality.

Put in very simple terms the nub of the issue boils down to their failure to quantify the positive effects of their own test so we are not now concerned with any adverse effects of the competition test by suppressing an incumbent, restricting competition between incumbents and others and an exacerbation of unmet demand; that is ground one. Here we are simply saying that the Commission quite candidly as we now discover from their pleadings accept that they did not quantify the benefit which they expect to flow from the competition test. They therefore have no ability to measure that against the AEC.

In terms of what they did and did not take into account we have a list in para.11.379. This is under the heading "Proportionality". So there is no dispute between us that there is a proportionality test. This is p.253 of the bundle, para.11.379. The introduction to it is in 11.377, under the heading "Proportionality", where the Competition Commission says:

> "In discussing each element of our package of remedies above, we have taken care to ensure that our chosen remedies represented the least-cost, least-intrusive package that would be effective in addressing each of the AECs we found. We are satisfied that our remedies to address the AEC we found in relation to highly concentrated local markets rep the least-cost, least-intrusive package that would be effective. Five of us are satisfied that our remedies to address the AEC we found in relation to the supply chain represent the least-cost, least-intrusive package that would be effective. As noted in paragraph 11.347, one of us did not

support the establishment of an Ombudsman. We do not discuss this aspect of proportionality further in this section."

They then go on in 11.378 to say that:

"In the following paragraphs we assess the proportionality of our remedies …"

and they start with "Highly-concentrated local markets". In relation to those they say in 11.379:

"… we have chosen to address our AEC finding in relation to highly-concentrated markets …"

and they review, one, the scale of the adverse effect. That is the adverse effect of the AEC.

"[2] the costs associated with each of the components of our package of remedies; and

[3] the scope of our chosen remedy."

The first sub-heading, "*Scale of adverse effect*", I read you the summary of that at the outset of the report, but under the heading "*Costs associated with our chosen remedies*" they say:

"There are three components to our package of remedies to address our AEC finding in relation to highly-concentrated local markets. These are:

- the competition test;
- notification of store acquisitions; and
- measures in relation to restrictive covenants and exclusivity arrangements.

We set out below our assessment of the costs associated with each of these components."

I pause there simply to point out that it is accepted by the Competition Commission that they must measure the costs associated with the remedies, which I have been making in relation to ground one. It is not disputed here that this is something which they should actually take account of.

There are two things which come out of this section of the report. First, it is clear that the Competition Commission did not consider or even ask itself to what extent the competition test would erode the AEC – in other words, they never quantified the benefit of their test, its efficacy in reducing the AEC; and secondly, in relation to ground one it is clear they did not consider the costs of the competition test itself, because in the list of costs that they did take account of they only identified the administrative costs of operating the system which they go into in considerable detail.

So simply by looking at what they say they have done in relation to proportionality one can identify where the omissions lie, and those two omissions are very clear from this list.

In the Competition Commission's defence it is not disputed that there is no *nexus* between the AEC and the competition test. This comes out of their defence at para.94, file 5, tab 1, p.3487. We submit that this is a significant concession. This is common ground between us:

> "As to (ii), it is correct that the figure of £105-125 million is not a direct measure of the benefit which will accrue in the future due to the operation of the competition test; it was never considered or presented as such by the Commission."

So we know what the AEC is, because it boils down to that figure which is given there. It is accepted that that is not a measure of the impact of the competition test – in other words, they are not saying that they ever considered that the commission test would erode that excess profits figure. They do not go any further than that, because since they never considered it we do not know to what extent it might otherwise have been reduced.

PROFESSOR PICKERING: Do you mean erode or remove, Mr. Green?

MR. GREEN: Remove…..?

PROFESSOR PICKERING: Remove it entirely. "Erosion" may eat into it.

MR. GREEN: Absolutely. All one can say is that, in so far as you get any guidance from the Report, they say they believe their remedies will be "effective". I do not know if "effective" means you reduce it to zero or to 50 per cent, or 75 per cent, there is just no analysis of that. It is entirely speculative.

The reason for that concession is to be found in 101 and 102 of the defence, which I would like at this stage to go back to, please, which is on the next page, p.3489. One needs to break down precisely what is the Competition Commission is saying in 102. They say, first of all, that it is not feasible – in other words, it is not possible, you cannot do it – to ascribe a meaningful, and then they throw in the words "*ex ante*", but quite what those add to the process I do not know:

> "It is not feasible to ascribe a meaningful value to the benefit accruing from the future application of the [competition] test."

They say it is not feasible which must mean it is not practicable.

> "Attempting to calculate the future economic benefit would have required the Commission to make highly speculative assumptions about …"

- then one could almost number them –

."… the number of larger grocery stores that would be developed in the future, as well as [2] the timing, [3] precise location and sequence of proposed store developments by retailer and by local area. The degree of speculation required would render the calculation highly unreliable."

That plainly is an admission that they did not do the task because they say it is impossible. We, of course, say that, on the basis of information they actually had in their possession, they had actually answered half of these questions. I have shown you paragraphs in which the very points they say they cannot do they actually did do. That is for a later part of my submissions. This is an admission that they did not do it.

So the question, therefore, for the Tribunal is whether they should have done it; and if they should have done it, and they did not, do they have an objective justification which stands up to scrutiny for not having done it. There was a legal question which flows from this which is, if they have not performed this task are they capable of answering the questions posed by s.134? If you have no idea as to the extent to which your test will actually bite upon the AEC, should it be imposing that remedy at all, particularly since you recognise at least a risk of adverse consequences for the market flowing from it?

Tesco submits that the Commission was bound to address the issue of the impact of the competition test on the AEC within the meaning of s.134. We submit that in the absence of them even addressing this question, it was not able to form a rational or sensible view whether to impose a remedy at all and, if so, whether this was an appropriate, reasonable, practicable remedy which is comprehensive within the meaning of s.134 and s.138.

We also submit that it is evident from the data which the Competition Commission did collect that its counsel of despair set out in 102 is nothing more than that, that actually they had more than ample information available to them to conduct an appropriate analysis of the benefits of the competition test.

In our skeleton argument we have identified what we believe is quite an important legal/policy issue which is the nature of the test which a regulator should carry out in analysing remedy. The Competition Commission on the one hand says, "We just cannot quantify it, it is an impossible task". We point to all of the guidance which has been issued by the government generally in the Green Paper, Ofcom, the Competition Commission's own guidance, indications from the Competition Commission decision making practices, indications of this Tribunal which say that even if you cannot quantify something that does not mean that you do not perform secondary or tertiary analyses. You can part-quantify something, you can apply sensitivity analyses, what is called "scenario" analyses, you can

mix quantitative with qualitative analyses. You can go down a detailed descriptive process. These are all well recognised techniques, but for the Competition Commission to say it is just too difficult is not acceptable and simply not justified.

That is the dividing line between us. It really is distilled in para.102. We just could not do it and therefore we did not. We say (a) that is wrong; and (b) if so, then there are consequences, you should not have imposed a remedy in the first place.

MR. MATHER: I wonder if this is a convenient moment just to ask a little about that cost benefit regulatory impact assessment process. As we all know, it is a sort of emerging science, as you have illustrated. Is it likely that government itself would carry out such an impact assessment before adopting, were it to do so, the Commission's recommendation – i.e. I am asking at what is the right point in the process for that to be carried out?

MR. GREEN: It is a recommendation to government. Government under the green book would not logically carry out the analysis which it espouses in that document. Here we have the oddity in which the Competition Commission is not saying, "We are going to leave it to government", they are simply saying, "It cannot be done but we are nonetheless entitled to adopt a remedy even though it cannot be done", and it therefore has to factor it into the duties which are imposed upon them under s.134. They cannot pass the buck to government, and they have not sought to do that. Whether government rejects their para.102 and says, "We will do it", I do not know, that is not really for this Tribunal. It might be an easy way out for the government to say, "If the Competition Commission does not think it can do it, who are we to try and do better?" We just simply say the Competition Commission should have done it in the confines of the duty which Parliament has imposed upon the Commission under 134. The Competition Commission, you might well think, is best placed to conduct the cost benefit analysis, or whatever analysis is required by s.134. This was an exhaustive investigation spanning years. So the government is hardly gong to be in a better position to conduct the exercise than the Competition Commission. If the Competition Commission should have done it but did not then they have committed a legal error. If they had the information available to them on their shelves but failed to do it then again it is plainly an error. We think it boils down to the fact that they just overlooked it.

MR. MATHER: The cost benefit analysis is obviously a balancing exercise, but presumably there is an earlier logical step when you are looking at remedies, which is that a remedy has to be effective.

MR. GREEN: Yes.

MR. MATHER: So before you get to a balancing exercise you have to be sure or satisfied to whatever standard is appropriate that the remedy is effective. Just to clarify, is it part of your submission that we really cannot be satisfied of that either, because if you do not know what the benefit is you do not know whether the remedy is effective.

MR. GREEN: Yes.

MR. MATHER: You have got no idea, and that is not a balancing exercise.

MR. GREEN: It is not really a balancing exercise. The concept of proportionality comes into the structure of the law at a relatively low level because s.134 simply identifies questions. It tells you what has to be taken into account. We are not suggesting that there is not a legitimate margin of appreciation for the Competition Commission, but we do say it must address its mind to relevant questions. If it does so and it comes to a conclusion that my client does not like then it may just be, in judicial review terms, that is tough. We have not challenged the fact findings of the Commission here. We may not like them, but there we are, that is judicial review for you. Our objection is much more elementary. They have admitted they did not do it. We say they should have done so. If you cannot perform that task it is impossible to address your mind to the question the statute imposes upon you. How do you know whether to impose any remedy at all, because in answering that question you have got to know whether the remedy will have any impact upon the adverse effects. If you simply cannot answer that question then it rather suggests that your remedy is not the right one.

Equally, how do you know if the remedy is comprehensive? How can it possibly be known whether it is a solution to use the language of s.134? We just do not know. How can it be practicable? You do not know. Is it reasonable to impose a remedy that you have no ability to measure? We say no.

Those are the dividing lines between us. We know what the Competition Commission did not do and we know why. The question really is what are the inferences one draws from that? They are, in large measure, issues of law.

That is the issue then. The second part of my submissions, and I will try and do as much of this as I can before two o'clock, is the guidance. I would like to go back to the Competition Commission's guidance, which is bundle 4, tab 79 Paragraphs 4.1 to 4.25 contains the Competition Commission's guidance remedies. In these paragraphs the Competition Commission accepts a number of pretty elementary propositions. I am going to pick up the main points which arise. First of all, para.4.7. In this the Competition

Commission recognises that there is no statutory duty to impose a remedy in all circumstances:

> "Although the Commission must always consider the appropriateness of any remedial action, it is unlikely that the Commission, having decided that there is an adverse effect on competition, will decide that there is no case for remedial action, at least before it has given attention to any relevant customer benefits that may accrue from the market features."

That is probably a fair comment, that it recognises that there may be circumstances where no remedy at all is imposed, but they say it is unlikely. As a generality, that is probably unobjectionable. They say:

> "Examples of exceptional circumstances where the Commission may conclude that no action is appropriate might be where the costs of any practicable remedy seem disproportionate in the light of the size of the relevant market or where the only appropriate remedial action would fall outside the United Kingdom's jurisdiction. However, even in these circumstances the Commission, having decided that no action should be taken by it, may recommend action by others, for example, if the matter were of sufficient concern that the OFT or other body with appropriate powers might keep the future conduct of the firms in market under review."

So an implicit and, indeed, I think it is express recognition that there is no obligation to impose a remedy will be that it may be unlikely that they would adopt that course.

Moving from that, can I pick up 4.10:

> "The Commission must have regard to the reasonableness of any remedy and will aim to ensure that no remedy is disproportionate in relation to the adverse effect on competition and any adverse effects on customers."

So there is no dispute that proportionality is relevant.

> "Part of its consideration will include an assessment of the costs of implementing a remedy."

So again, the costs of implementing costs associated with a remedy are said to be relevant to proportionality. They are talking about implementation costs but the same principle would apply to all other costs, there is no reason to differentiate between the two. They say:

> "Adverse effects on competition are likely to result in a cost or disadvantage to the UK economy in general and customers in particular."

One pauses there, if a remedy is unquantifiable but you know there is a risk at least that it will have adverse effects upon competition that is a relevant matter to take into consideration. There is nothing in this paragraph which is inconsistent.

> "Where significant, these costs might usually be expected to outweigh the costs incurred by any person on whom remedies are imposed."

They are accepting that there may be weighing of different costs which have to occur. Then:

> "If the Commission is choosing between two remedies which it considers would be equally effective, it will choose the remedy that imposes the least cost or that is least restrictive."

So there is no dispute that one of the relevant factors is whether a remedy is effective. In express terms the Competition Commission says the same thing in 4.22:

> "In deciding what remedy or remedies would be appropriate, the Commission will first look for a remedy that would be effective in dealing with the adverse effects on competition of the market features rather than seeking to deal with any detrimental effects on customers."

So the Competition Commission recognises and acknowledges that it must look at a remedy according to its effectiveness in dealing with the adverse effects on competition. I would like also to look at the Competition Commission's recent decision in *GEMA*, which is authorities, tab 9. This establishes the proposition which is one of economic commonsense and regulatory commonsense that for the effect of a remedy, amongst other things, to be relevant it is not necessary for it to be precisely quantified.

Let me give you a brief exposition of the background to this case, it concerned an appeal by E.On from a decision of the Gas and Electricity Markets Authority (GEMA) on 5th April 2007 in relation to proposed changes to arrangements for gas off-take from the National Transmission System (NTS). The decision which was being appealed concerned five proposed modifications to the uniform network code. It is quite technical, and fortunately one does not have to go into the technicalities to understand the issue. A number of proposals were the subject of an appeal and one in particular was known as "Proposal 116V", and mercifully you do not need to know about 116V. If you want a summary of it you can note in your own notes para.2.55 of the decision which gives some detail of it. E.On objected to 116V, they described it as "inefficient", and again for your note that is para. 6.141, and they submitted as follows: they said the test applied by GEMA wrongly omitted certain costs from the assessment. They said that the quantified benefits were

speculative and not benefits at all, and they said the net cost calculated by GEMA was substantially understated. GEMA said it was £20 million, E.On said it was £120 million. It was not in dispute that GEMA had conducted a cost benefit analysis, and the relevant point comes out of 6.157 and I accept of course that we are not talking about a precedent in a strictly legal sense. These are all sources of guidance as to what is best or good regulatory practice. We certainly submit that these are the sorts of points which would sound under s.134. 6.157:

> "Thirdly, we accept GEMA's submission that benefits need not be quantified in order for them to be reflected in a CBA, and that non-quantified benefits may be as important, or more important than quantified benefits. However, if a CBA is to be transparent benefits should be quantified where possible. For the same reason qualitative benefits should be explained clearly and in detail so that it can fairly be seen whether there is any potential overlap between the qualitative and quantitative benefits."

So a general proposition that in carrying out some form of cost benefit analysis, and I am not talking specifically about the CBA required under this particular piece of legislation, when you are measuring benefits and costs under an appropriate test you do not have to quantify them exactly and all the regulatory guidance addresses the question of the non-quantifiability of benefits and costs and it says we recognise that in many instances it may be very difficult, or even impossible, to conduct that assessment. But, in all of the guidance it is emphasised that there are alternative techniques which regulators can and should adopt and you do not just pull the shutters down at the end of quantification and say: "We cannot do it, therefore we do nothing." There are other things that you should do in order to be able to assess and weigh the benefit or the cost of whatever it is that one is talking about in the circumstances.

So that was the Competition Commission's view. They accepted the submission of the Regulator that in assessing the benefits of the modification and in its costs that it did not have to undertake a detailed quantification, but that unquantified benefits may be as (or even more) important.

The Tribunal itself endorsed this paragraph as a general statement in the *Vodafone* case, which I can do briefly, and this is at tab 10 of the authorities, para.125, p.44 of the judgment. Here the Tribunal is dealing with an appeal by Vodafone under s.192 of the Communication Act against an Ofcom decision to modify part of the conditions to which it was subject in relation to telephone number portability. In the context of that they were

referred to the *GEMA* case. At para. 124 they set out the paragraph that I have just referred you to. They say at para. 125, "The Competition Commission concluded that the decision of *GEMA* contained insufficient material to support the conclusion that the decision challenged will, or is sufficiently likely to, deliver benefits to consumers and insufficient explanation of the nature and extent of the benefit to be expected. While adopted under the specific statutory framework laid down in the Energy Act 2004 we agree with the Competition Commission's general approach to analysing the regulator's assessment of the costs and benefits of a proposed modification to existing processes".

So, the Competition Appeal Tribunal here was addressing the Competition Commission's general approach, albeit that it was under a different Act. They referred to both costs and benefits and since one is concerned with modifications, one is concerned with something which can be properly analysed as a remedy. Again, we are not suggesting that it is necessarily a binding precedent. It is under a different piece of legislation. But, it is an endorsement of a general approach. When one goes into the government's Green Book and then when one goes into the Ofcom code one sees much more broad brush acceptance of these principles and a more detailed analysis of how a regulator should go about assessing costs and benefits when quantification is impossible.

MR. MATHER: Just to clarify, is it a fact that most of the sector regulators are required to do CBAs by statute and the Competition Commission is not?

MR. GREEN: Some of them are. The tests are certainly different. That is something which the Commission has quite properly pointed out in its skeleton. But, that does not mean that the principles should not apply, whether you are dealing with a cost benefit analysis as defined under the Energy Act or under the Communications Act, relative to a more general test under s.134. There is no magic in the word 'CBA'. It just means that you take the costs and you measure its benefit in an appropriate way. It is not a term of art.

MR. MATHER: But the Enterprise Act and the Energy Act are fairly close together in time. If Parliament had wanted the Competition Commission to carry out a CBA or an RIA in every case it could have legislated ----

MR. GREEN: Yes. Let me be clear what my submission is. My submission, as I stated at the outset, is that there is a test to be applied under s.134. That is the structure of the analysis to which the Competition Commission was required by Parliament to go through. In the layers of analysis which arise under s.134 there are areas where the Commission necessarily, in complying with the test of reasonableness, practicability, in complying with the test of a comprehensive solution - and those are three factors amongst others - should

have examined the costs and weighed them in an appropriate manner against the benefits. It is no more than that. You can call it a CBA. So be it. If one calls it the 'application of s.134', that is equally satisfactory, or 'proportionality'.

Now, the next thing I was going to go to was the Ofcom document which will take me some time. It is a more comprehensive document.

THE PRESIDENT: We have reached the witching hour anyway. Thank you very much.

(Adjourned until 10.30 a.m. on Wednesday, 12th November, 2008)
