IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1099/1/2/08

Victoria House,
Bloomsbury Place,
London WC1A 2EB

19th January 2009

Before:

VIVIEN ROSE
(Chairman)
PROFESSOR PAUL STONEMAN
DAVID SUMMERS

Sitting as a Tribunal in England and Wales

BETWEEN:

NATIONAL GRID PLC Appellant

- v -

THE GAS AND ELECTRICITY MARKETS AUTHORITY Respondent

supported by

SIEMENS PLC
CAPITAL METERS LIMITED
METER FIT (NORTH WEST) LIMITED
METER FIT (NORTH EAST) LIMITED Interveners

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

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HEARING (DAY 3)

APPEARANCES

Mr Jon Turner QC, Mr Josh Holmes, Mr Meredith Pickford and Miss Laura Elizabeth John (instructed by Pinsent Masons LLP) appeared for the Appellant.

Miss Monica Carss-Frisk QC, Mr Brian Kennelly and Mr Tristan Jones (instructed by Ofgem) appeared for the Respondent.

Mr Christopher Vajda QC and Miss Kassie Smith (instructed by Hill Hofstetter LLP) appeared on behalf of Siemens Plc.

Mr Christopher Vajda QC and Mr Ben Rayment (instructed by Slaughter and May) appeared on behalf of Capital Meters Limited.

Mr Fergus Randolph and Ms Sarah Abram (instructed by United Utilities Group plc) appeared on behalf of Meter Fit.

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THE CHAIRMAN: Good morning ladies and gentlemen. Before we start on this morning's submissions Professor Stoneman has something that he wishes to ask to be produced by the National Grid team. He will explain what it is.

PROFESSOR STONEMAN: I have been thinking about issues over the weekend and I want to get a feel for the impact of the PRCs on the rental cost and so I wonder if you could produce for us data of the following kind. Let us assume zero inflation and I want to generate data that is the annual average rental cost per meter including any PRC payments that are made under the MSA. Now, my understanding is that the MSA works such that if one-eighteenth of the meter stock is replaced each year there are no PRC payments.

MR. TURNER: Yes.

PROFESSOR STONEMAN: So then the rental is just the quoted rental. I would like that to be compared with what would be the annual rental cost of each meter under the MSA if one-seventeenth of the total meter stock is replaced each year and that would be the average over 17 years.

MR. TURNER: Yes.

PROFESSOR STONEMAN: Then the same if one-sixteenth is replaced each year, one-fifteenth each year, each time taking into account any PRCs that are paid.

MR. TURNER: Yes.

PROFESSOR STONEMAN: So it averages the annual rental cost plus any PRCs paid, and we might as well take that down to one year.

MR. TURNER: Yes.

PROFESSOR STONEMAN: All right? Then just to finalise the table could we compare that with the P&M annual rental in which there are no PRCs paid?

MR. TURNER: Yes, we will endeavour to do that.

THE CHAIRMAN: What form you want to do that in is up to you, we do not need it, I do not think, formally in a witness statement, but if you wanted to produce a written note and then ask one of your witnesses when we get to them, I do not know whether it would be a factual witness or an expert witness to speak to that note, that would be fine.

MR. TURNER: Yes, we will take this away and look at it over the lunch adjournment and tell you if there are any problems.

THE CHAIRMAN: Thank you very much, Mr. Turner. Miss Carss-Frisk?

MISS CARSS-FRISK: Yes, madam, may I begin by handing up our note of response to Grid's notes to the issue of possible sale of the meters and also on the impact of the MSAs on innovation. The second of those topics I will deal with in the course of my submissions

today, but we thought it was perhaps helpful to provide a rather more detailed in writing for you responding to the many document references that Grid has made.

THE CHAIRMAN: Do you want us to look at that now?

MISS CARSS-FRISK: I would have thought it probably is not necessary to do that but it could be saved and I will take you to the key points on innovation in due course.

Where we got to on Friday was that I had finished what I was going to say on the law in relation to foreclosure, so I should of course now turn to the facts bearing in mind that Mr. Turner did say on Friday that he accepts that the MSAs have a foreclosing effect although he said not as we know it, i.e. not in an anti-competitive way. So the issue seems to be really now whether what the MSAs encapsulate could be described as "normal competition, competition on the merits" and of course I will come on to that topic. But before I do that I would like briefly to pick up this argument about whether our replacement scenarios that we have dealt with in the Decision are realistic and reasonable, i.e. where we have looked at the potential for 50 per cent or 65 per cent above the free allowance in the glidepath. You may recall that is our Decision para.4.73, it may be worth just having that in front of you again (p.83 of the external numbering). We say there that:

> "These scenarios [the 50 and 65 per cent] are reasonable in relation to the actual levels of replacement that BGT had contracted for ahead of its signing of the Legacy MSAs."

We have been criticised in relation to that so I just wanted to summarise without going into the detail where we now stand on that, which is that we certainly stand by the statement in this paragraph that the replacement scenarios we have posited are reasonable in the light of what it was originally envisaged that the CMOs would have by way of potential replacement activity.

Now, it is right to say that the comparison is not so much with what was actually contracted for as with what was originally envisaged in the invitation to tender. We dealt with Grid's detailed criticisms on this in our supplementary submissions which, for your note you have at CB2, tab 9, and it is paras. 16 to 38. All I would flag up for the moment is that taking into account all of Grid's criticisms we have then carried out various further calculations and the bottom line is that the 50 and 65 additional replacement scenarios really remain reasonable in relation to what was originally envisaged.

THE CHAIRMAN: Would you say again, when you say "originally envisaged" what are you ----

MISS CARSS-FRISK: In the invitation to tender document.

THE CHAIRMAN: That BG put out?

MISS CARSS-FRISK: That is right, yes. Now Grid has argued that we should not be allowed to rely on these further calculations, and as to that we say – referring to *Napp* – why not, when what we are doing is responding to detailed criticisms made of one aspect of our decision rather late in the day, relying on data that is on the file available to both sides, and when we had these "errors" (as they were called) drawn to our attention we responded in this way and, in our submission, it is fair for us to be able to support the decision by carrying out those further calculations.

THE CHAIRMAN: And where are those further calculations described?

MISS CARSS-FRISK: They are in our supplementary submissions, core bundle 2, tab 9, paras.16 to 38. Still on the topic of foreclosure, we do ask you to note that Grid itself has said in its skeleton (para.60(b)) – probably no need to turn it up – that it is of course possible that gas suppliers would wish to replace higher volumes of meters than under the MSAs if people had remained on the P&M terms. Of course, Grid has also said in its skeleton that remaining on the P&M terms is really what is likely to have happened if the MSAs could not have been put in place, so that would appear to be from Grid's perspective the most realistic counterfactual. Now, if that is right, and this links I am sure to Mr. Turner's concession, so far as it went, on foreclosure, then of course there would have been likely to have been more replacement by the CMOs absent the MSA's.

THE CHAIRMAN: Is there anywhere in the papers which tells us how much replacement EDF carried out over this period?

MISS CARSS-FRISK: I am sure there is, madam, but I think, rather than trying to find it now, may I make a note and we will come back to you with the best references we can?

THE CHAIRMAN: Yes.

MISS CARSS-FRISK: I am reminded that I should not have said that the comparison that we had made was in relation to the invitation to tender for each of the CMOs. It was specifically in relation to CML, where the contract was made in December 2003, and so the volumes had already been revised in the light of the proposed MSAs prior to the contract being made.

THE CHAIRMAN: Thank you.

MISS CARSS-FRISK: As then to the evidence of actual foreclosure, i.e. what actually happened to the volumes given to the CMOs, as I said I think at the outset of our submissions, it seems to us very difficult for Grid to maintain the argument that there was no such impact, particularly in the light of the interveners' evidence, which we have been told is not going to be challenged.

So far as our position is concerned, we accept that it may be that the reduction was fairly modest so far as CML and Meter Fit were concerned, although of course you will have to hear the interveners' evidence on that, which may cast a different light on it, but there is no doubt at all that there was a very substantial reduction in relation to the volumes given to UMS.

As to that, so far as we are aware, it has never been disputed by Grid that those volumes were reduced by at least 25 per cent in the light of the MSAs. The best I can do by way of reference here is to refer to a letter that Ofgem wrote on 8th July 2008 to Grid at core bundle 2, p.778. I am afraid that I do not think it is going to be very useful, even to turn it up, because it does not actually have the straight calculation in it. What I am told that we derive from the table in the middle of p.778 headed "Initial DCM volumes", and one sees the different CMOs are listed, and UMS is the first one ----

THE CHAIRMAN: These are National Grid's supplemental submissions?

MISS CARSS-FRISK: This is a letter that we wrote on 8th July dealing with the comparison as to what happened in actual reduction of volume initially given to the CMOs. As I say, our understanding of the statistics here is that you get a reduction of at least 25 per cent, although I am afraid I am not able to explain precisely how at this point. If we can do anything more to assist you in terms of giving you the precise calculation we will do so. Our understanding is that this is not disputed by Grid, that it was at least 25 per cent.

In fact, I should say that, having looked at further data that we realised was available in the file about UMS, which suggested that the initial volumes given to UMS were actually higher than set out here, it would appear that 25 per cent is conservative and that the reduction in percentage terms may actually have been higher than that.

THE CHAIRMAN: This is looking at contracted volumes, so this is not something that you relied on in the Decision, but something that you are relying on because of the criticisms?

MISS CARSS-FRISK: We did not rely on this in the Decision, we did rely on the reduction compared to contracted volumes in the Decision.

THE CHAIRMAN: I thought you said that you were relying on what was in the ITT.

MISS CARSS-FRISK: I should clarify this. There are two separate issues, I am sorry. The issue at para.4.73 is the extent to which it was reasonable to assume 50 per cent or 65 per cent above the glide path. There the position is that for CML the comparison was in relation to the ITT, not the contracted volumes, but for the others it was in relation to the contracted volumes – i.e. for Meter Fit and UMS.

There is then the separate issue as to the extent to which volumes were actually reduced by virtue of the MSAs. That is where we say that so far as UMS is concerned the information indicates the reduction of at least 25 per cent.

So far as CML and Meter Fit are concerned, it is going to be considerably less, but again that will have to await the evidence given by the witnesses for those companies.

I should say that Grid has accepted certainly that British Gas renegotiated the UMS contract at least in part because of the MSA. What Grid has said by way of response here is, "Well, British Gas knew about this mismatch when it first entered into the contracts, and it was really a commercial decision", and we say, frankly, so what, it does not undermine the key point that the MSAs had this impact on work being given to a CMO, albeit a CMO that is legally part of the same undertaking as Grid.

Moving on then to maintenance, of course, as you have seen, we do not say that maintenance bundling is a separate abuse, but we say that the relevant provisions exacerbate the abuse that is otherwise there. It is paras.4.81 to 4.85 of our Decision. This, of course, relates to the fact that only Grid can maintain its own meters. If, in the course of a maintenance visit they replace them, they go automatically on the new and replacement contract, and therefore a CMO is of course deprived of the opportunity of putting in that meter. Also the allowance of free replacement under the glide path is reduced. As we recall, and having looked at the transcript, there was a bit of a dispute about that, or a conversation about that, between Mr. Turner and you, madam, on Friday, where you raised the point about, well, does it not also relate to a reduction in the free allowance under the glide path. Mr. Turner, as we understood him, was at pains to say, no, that is not included in the Decision, and he took you to various parts of the Decision – I think paras.4.4, 4.21, 4.81-85, to say that that is not mentioned there. We say, actually, if you look at some other paragraphs of the Decision it is perfectly clear that we did include a reference also to how the glide path free allowance is reduced. So there really should not be a dispute about that.

I should take you to those relevant paragraphs. It is first para. 2.94 at p.33 of the external numbering. The key passage is really over the page towards the end of para. 2.94, starting towards the top of p.34.

> "As is explained in more detail in Chapter 4, after deducting non-optional meter replacements from the glidepath allowance, gas suppliers are left with only 13 percent of their DCM 'free' allowance, which accounts for less than one percent of their legacy meter stock in the first year of the contract. This figure represents the degree of discretion suppliers have in choosing which meters to replace. The

> proportion of the meters identified above that are free to replace under the MSAs, in the sense of free of charge and optional, will depend on the impact of maintenance (where this leads to replacement by Grid - thus reducing the pool available for third party replacement) and the ability to comply with Grid's policy replacement schedule. These are discussed below".

So, we highlight, of course, that reference within the brackets to 'thus reducing the pool available for third party replacement'. If you move down that page to para. 2.96 you have another reference:

> "The second category of non-optional meter replacement which occurs is in connection with maintenance, which will often lead to replacement of the meter by Grid, in particular for DCMs. This further reduces the number of meters that suppliers can choose to be replaced by a CMO without paying an early replacement charge".

If we move on to para. 4.38 at p.73 one has this:

> "In addition to the level of the rental charge, the services it includes and the customer service level commitments, gas suppliers will be interested to understand what payments are due when non-discretionary meter exchanges have to be made. The Authority defines non-discretionary exchanges as when a meter is faulty (for example, a meter is replaced on a maintenance visit), if it was replaced to meet 'policy' replacement requirements ... or when a customer requests a functionality exchange ----".

So, again in our submission, making it clear that these sorts of replacements on maintenance do bite into the free allowance.

Then, finally, at para. 4.181 at p.112:

> "The Authority finds that even though the Legacy MSAs allow some level of annual meter replacement free of early replacement charges through the glidepath (a starting figure of 5.5 percent for DCMs and 14 percent for PPMs of opening Legacy meter stock which is reduced through meter maintenance leading to replacement and other effects outlined above), that MSAs severely reduce and/or remove the incentive which suppliers have to switch to new entrant CMOs".

So, we hope that by giving you these references we have satisfied you that that additional point is indeed fairly and square made in the Decision.

Now, as for Grid's argument that the Decision only focuses on PPMs, that is not the case if you look, for example, at para. 4.21 on p.70:

"We do not consider the bundling of maintenance with the provision of meters under the MSAs to be a separate abuse. The bundling of maintenance clearly exacerbates the foreclosing effects of the MSAs. This is because even where a supplier is using one or more CMOs to provide new and replacement meters, National Grid's maintenance of its legacy meter stock will lead to National Grid replacing both PPMs and DCMs. National Grid will then supply these meters under the new and replacement MSAs. The number of meters National Grid replaced as a result of such maintenance visits is significant in the context of the foreclosure effects created by the early replacement charges (for example, 15 percent of PPMs are replaced on maintenance visits which accounts for 30 percent of the glidepath)".

THE CHAIRMAN: ... (overspeaking) ...it is significant, then both in relation to PPMs and DCMs?

MISS CARSS-FRISK: Yes. It is simply picking up the point that we have somehow generally referred only to DCMs in the Decision and now we are focusing on PPMs, but have we really included PPMs? We say - and this is the bottom line - "Well, we have referred throughout to both, including in relation to the issue of maintenance".

To complete this reference I was going to take you again, very briefly, to para. 4.81 at p.85 where, about four lines down: "The Authority considers this [i.e. the maintenance issues] is particularly significant because of the extent of PPM replacements that National Grid has typically undertaken on maintenance visits (this is less significant in percentage terms for DCM as proportionately fewer maintenance visits taken place - although where they do, meter replacement rather than maintenance is almost always the result)".

That pretty much completes what we would say on maintenance. Perhaps I should just mention National Grid's point that they were under various statutory duties to maintain the meters. We say that provides no answer because it is not right that - and I do not think they are suggesting - they would be legally prevented from allowing a third party to maintain their meters. Then they point to British Gas having had commercial reasons for actually preferring them apparently to maintain the meters. Again, we say that that does not affect the foreclosing effect of these provisions, taken in conjunction with the rest of the MSAs.

Turning then to the issue of effect on consumers we say, yes, there has been harm to consumers here in the sense that they have been deprived of the benefit of lower prices, better service, and, indeed, innovation such as they might expect in a competitive market.

Paragraphs 4.111 to 4.128 of the Decision. Indeed, we do not quite understand on what basis National Grid appears to be suggesting that there has been no such thing.

But just picking up the price comparison for a moment, we have, fairly obviously, compared the prices under the MSAs to the prices being offered by the CMOs (see paras. 4.111 to 4.119). Grid says, "Well, the proper comparison is really with the prices under the P&M terms - the price capped prices". That is Grid's skeleton at para. 65A. There is probably no need to turn it up. We fail to see why that should be the relevant comparison, given that there undoubtedly were available these lower prices being offered by the CMOs.

As to the detailed criticisms that Grid has made of our price comparison, this again is something that we deal with in those supplementary submissions that I mentioned earlier. Just for your reference, it is CB2, Tab 9, p.795. It is paras. 2 to 15. Again, I do not think it is sensible to take up time now going through the detail of that, but just to let you know where we end up, we have re-calculated this comparison, taking into account all the points that Grid has made. In particular, we have said we accept that we did not originally factor into the CMO price the price that they charge for what are called GR2 meters, which are semi-concealed meters that account for only about 3 percent of the installations by the CMOs in the first three years of their contracts. So, that point we have taken into account, re-calculated, and where we get to is that we accept we have under-stated the CMOs' prices by about 16 to 17 pence per meter, but apart from that the comparison in the Decision stands.

MR. TURNER: Madam, I know Miss Carss-Frisk says she will not take time taking you to our point, 65A of our skeleton but given that she is proceeding on a misapprehension it may be helpful if she did so and then she can address our point.

MISS CARSS-FRISK: Yes, I am of course very happy to take you to Grid's skeleton at CB2, tab 14, p. 886, para.65a . One sees the starting point here is that Grid are saying, under the heading "Prices":

> "Ofgem seeks to show an adverse effect on competition causing harm to consumers by reference to a price comparison between the DCM rental prices offered to the gas suppliers by the CMOs and National Grid respectively. Ofgem's claim is again without merit:
>
> a. Any fair price comparison would need to recognise that the Legacy MSAs offered Meters at greatly reduced rental prices across the board compared with the charges that gas suppliers would otherwise have faced (and which EdF currently faces) under the P&M contracts. The reduced

rentals available under the MSAs were inextricably linked to the commitment to payment completion. The resulting £120m across the board cost savings can be expected to have been passed on, in whole or in part, by gas suppliers to their customers.

Well so far as we can see Grid is making the point that one should make a comparison with the P&M terms, and all we are saying is that it is highly relevant to do what we did which is to compare to what else was available in the market, i.e. the CMO prices.

In addition here we do ask you to take into account that the difference between the CMO prices and the MSA prices are likely to be even greater as you go along, given the index linking in the MSA prices and that of course what the CMOs were able to offer at the time was in itself, or at least may have been affected by the state of the market at that time, and Grid's dominance. So in that sense one may say it is generous to take the CMO prices as a kind of benchmark here.

So far as very direct benefit to consumers is concerned ----

THE CHAIRMAN: Sorry, just going to that point that their prices may have been affected by National Grid's dominance, could you unpack that a little bit? In which direction would they be affected? Are you saying that the CMOs come in under the umbrella price of the National Grid?

MISS CARSS-FRISK: I am really saying that because of Grid's position having the very large installed base, etc. and the barriers to entry that there were and the difficulties of achieving scale and density etc, those factors are likely to have influenced, or may well have influenced the CMO prices so that they were not able to compete by offering even lower prices that they might have been able to offer had those barriers to entry not been there.

I was going to then mention this alleged positive benefit to consumers that Grid refers to of the MSAs which is that they will be saved from all the disruption of meters being taken away and replaced by CMOs. As to that we say that gas suppliers, if they rented meters on perfectly competitive terms, i.e. we say not the MSAs would bear any such issues in mind, but it is not appropriate for Grid to categorise the disincentives that their MSAs provided to any replacement a somehow providing an additional positive benefit to consumers.

That is when we then come to the topic of innovation and here, as I suggested earlier, I propose to make our key points which are set out in the detailed note but not covering absolutely everything in that note.

The first point is, as we recognise in the Decision at para. 4.123 there is, of course, an inherent feature of the competitive process that it is likely to encourage innovation (p.97) and we say:

> "4.123. It is widely recognised that innovation is an inherent feature of the competitive process. Innovation in smart metering is currently being developed. These meters may be initially more expensive to purchase but can lower the total costs of supplying a customer by, for example, allowing the supplier to read the meter remotely, reducing the call centres costs to suppliers associated with customers querying bills based on estimated meter reads or allowing suppliers to switch between PPM and credit mode without the need to visit or incur the costs of installing a new meter. Since the MSAs give rise to switching costs that are artificially high, they are very likely to distort the incentives on suppliers to consider replacing existing meters with more technologically advanced meters."

But, as I said, it is really the key point at the beginning about an inherent feature of the competitive process. So in a sense we are saying there will be a chilling effect on innovation by these MSAs, by the foreclosing effect they have in relation to CMOs. One cannot tell, and one should not make any assumptions as to exactly where we would be on smart metering now if it were not for those long term contracts having been entered into. Of course, it is important to bear that long term feature in mind. There are 18 year contracts so far as DCMs are concerned, so you have to assess the potential impact of the MSAs in that long time frame, and you need to consider not just the impact on smart meters, but generally on improved service, maintenance and perhaps the availability generally of cheaper or smarter meters, though it may not necessarily be the smartest anyone could achieve, but smarter at least than what you had in 2004. So those are absolutely key points in our submission on this whole topic.

Grid says: "Just look at the suppliers at the time when the MSAs were entered into, they were not really too worried about this." The first point we make is this is a matter of objective fact for the Authority and for you and it is not simply a question of what the suppliers thought at the time, no doubt that is part of the evidence, but it is by no means conclusive. As I said it is crucial to look at what might have happened in terms of innovation absent the MSAs and that is the point that so far as we can see the evidence about the suppliers suggests they did not take into account, i.e. the evidence does suggest that they looked at – or at least some of them looked at – the possible impact of the MSAs on their ability to put in smart meters, but the more general point about this stifling effect of

the MSAs on innovation at all they do not appear to have looked at so far as we can see, or at least that was not a main concern at all.

If one then looks at what they did say or think at the time, well some of them undoubtedly were concerned about the impacts of the MSA here – not all, we do not claim all, but some. Here we have highlighted EDF, just to give you one example. We mention them in para.4.125 at p.97, and the underlying document is a Board paper at BP1, tab 5, p.46. I have just realised that, somewhat strangely as it seems to me, the bit I was going to refer you is in a red box suggesting that it is confidential, p.46. It is the first paragraph on the left hand side of p.46. The interesting thing is that it is, of course, quoted precisely in para.4.125 of the Decision. If we are worried about the red box we can of course take it from the Decision itself ----

THE CHAIRMAN: You had better not read it. Do we not have the confidential version of the Decision in the bundle?

MISS CARSS-FRISK: I do not believe that this is a confidential part of the Decision. I am very happy not to read it out, just in case.

THE CHAIRMAN: We will read it to ourselves. (After a pause) Yes.

MISS CARSS-FRISK: I should say that Grid, in its note, has referred to various subsequent EDF documents. As I say, we have a detailed response to documents in our note, but suffice to say that clearly this represents a piece of documentary evidence as to the attitude of one supplier at the time.

So far as British Gas is concerned, you have a reference to concerns on their part in para.4.124 of the decision. That is actually based on Grid's own assessment of what a British Gas representative called Robin had in mind at the time. As one sees from the Decision, it says:

> "Robin is painfully aware that the Legacy deal has 'severely damaged' the business case for automated meter reading."

Just for your note, you have that document at SD2, tab 53, p.1229. There is no need to turn it up.

No doubt Grid will say that there are various reasons for that, or there are glosses that could be put on that, but we will have to hear Mr. Avery in due course about all that. Just to say, yes, there was some evidence.

We have said in the Decision at 4.126 that is the case is now – i.e. at the time of the Decision – much stronger for smart metering than it was when the MSAs were entered into. Grid have responded, "Ah, well, but there is not as yet really a case for such meters". As to

that, we say that we have not said that there is a case at the moment, we have said that it is stronger than in 2004.

Secondly, we have the point that one must analyse the development of smart metering in the context of the MSAs in any event.

Thirdly, we do not accept that there is no evidence, as I think Grid would have it, that the case is now stronger for smart metering. You have details of that in Stephen Smith's evidence. That is WS3, p.1445, if I may just briefly take you to that. It is paras.57 to 58. I think in our skeleton we wrongly said 56 to 57. This is what Mr. Smith says, who will not, of course, be challenged in cross-examination:

> "As acknowledged in the Decision, the prospect for smart meters was unclear at the time the MSAs were signed. However, the business case for scheme meters has become more compelling over the intervening years as a result of a range of factors including: (1) technological advances bringing the cost of smart meters down and the associated communication equipment; (2) renewed interest from suppliers to improve customer service and reduce the use of estimated meter reading; and (3) customers' desire to increase their energy efficiency to help to tackle climate change.
>
> There are clear signs that smart meters are already becoming viable alternatives. For example, Siemens has recently begun to market and install a new 'smarter' PPM that they claim is cheaper than the existing PPM used by NG."

Perhaps I could invite you just to then read to the end of that paragraph for yourselves.

Mr. Smith in para.58 makes a reference to the Government's plans about smart metering. You have, of course, seen a reference to that already in the agreed facts at tab 19 of CB2, and I now refer to the really agreed facts agreed by Ofgem at tab 19, p.1083-16. So there you have the reference not only at para.4 to one undertaking, Utilita, introducing smart meters, but also, of course, very importantly, at para.3, to what has now happened in terms of the Energy Act.

We do not know exactly how the powers under that Act will be exercised, but very, very clearly smart meters are fairly high on the Government's agenda at this point.

One of the interesting things and relevant things, in our submission, is that if one looks at consultation papers that preceded the Energy Act, one sees it being recorded – and I will take you just to one reference, which is also in our note – that there is a concern about stranding of assets in relation to smart meters. Of course, stranding of assets very much includes and refers to, inevitably, the impact of the MSAs, which, in our submission,

supports the point that those documents, those contracts, have played a real role here in relation to these developments.

The reference I had in mind was SD5, tab 155, p.4879. This, as one sees from p.4870, is a "Consultation on Policies Presented in the Energy White Paper" of August 2007, and at 4879 under the heading "Section 2: Policies on billing and metering", at para.2.3 it says:

> "The analysis conducted for the Energy White Paper suggests that smart meters are not universally cost-effective at present. This reflects a number of facts. Smart metering technology is still evolving which has meant that smart meter prices have remained high. Work is also underway to develop standards for smart meter interoperability which may help to reduce costs and help to make their widespread use more cost-effective and compatible with our competitive supply market. Asset stranding and the design and establishment of the communications infrastructure needed to support smart metering also represent key issues to be resolved."

PROFESSOR STONEMAN: Can I ask you, asset stranding, it is not a value free word is "stranding". What exactly do you think it means here?

MISS CARSS-FRISK: We would certainly understand it to include, at any rate, a reference to the costs that would be likely to be incurred in terms of exit charges potentially, i.e. the PRCs in the MSAs if meters were being switched out to replace them by smart meters.

THE CHAIRMAN: Is there anything else in this document that refers to the contractual arrangements between the market participants?

MISS CARSS-FRISK: If I may take just one moment? (After a pause): Yes, I am being assisted by being given a very good reference at p.4925, para. 10.24. That is under the heading which one sees on the previous page 'All Meters Smart Within Ten Years'.

> "However, this option also has several drawbacks. It may lead to significant asset stranding if suppliers choose to replace meters on a geographic, not meter age basis. This will be likely to be influenced by the government's treatment of asset stranding and cost recovery. There could be additional stranding costs because of the terms of the Legacy contracts".

So, there does seem to be a fairly direct link there in the government's thinking between asset stranding and the terms of the Legacy contracts.

PROFESSOR STONEMAN: I must admit, it is still not clear to me. This is not the first document to use the term 'stranding'. I have the feeling that asset stranding is being used as another way of saying, "Economically as opposed to physically obsolescent" and that if an

asset is removed because it is economically obsolescent, that is not stranding in a general sense. It means it is being removed, although it still works, but it is just no longer economic to have it there. If that is what 'stranding' means, it would be useful to know that that is what it means.

MISS CARSS-FRISK: I think, sir, the best we can do in relation to that is, however, to re-emphasise that last sentence in relation to the first bullet point on para. 10.24 which would appear to make that link between that cost specifically under the Legacy contracts and to therefore use 'stranding' in that sense as well.

PROFESSOR STONEMAN: Could I clarify: are you using 'stranding' in the same sense that Grid has been using 'stranding'?

MISS CARSS-FRISK: I am using 'stranding' here really as referring to costs that would be possibly incurred if there was a quick switch out into smart meters.

THE CHAIRMAN: You seem to then be using it to mean switching costs, which is something different. They use the term 'Legacy contracts' here. Is there somewhere earlier on where they have described 'Legacy contract'.

MISS CARSS-FRISK: I am afraid that question I cannot immediately answer. What I can say is that at p.4929 various questions are posed. You have the section headed 'Asset Stranding' at p.4928. One sees at para. 10.34,

> "The stranding of assets has been raised as an issue in the deployment of smart meters. The competitive supply market and its associated customer switching creates significant stranding risks if energy suppliers opt to use different non-compatible technologies".

THE CHAIRMAN: So, there it seems to be saying that it is a problem that arises if one gas supplier puts in a meter and the customer then changes to another gas supplier, and the new gas supplier cannot use that meter. That is what they seem to be talking about.

PROFESSOR STONEMAN: That looks like a question of standards and compatibility.

THE CHAIRMAN: To make sure that everybody - even though they might imply competing meters - ought to be able to use everybody else's meters so that there does not need to be replacement when the customer switches supplier. (After a pause): It may be that we cannot really pursue this on the hoof, as it were. However, this document does seem to be interesting in that it contemplates a complete change in the metering stock within ten years. So, that is within the period covered by the Legacy MSAs.

MISS CARSS-FRISK: It certainly does that. We would suggest that what you have in para. 10.34 in terms of switching, creating significant stranding risks there does link helpfully to

para. 10.24 earlier and the reference to the Legacy contracts there. If we can assist further in terms of setting up a stronger link, we will. However, it does appear to us that it is a fair reading that the concern is about stranding as including the costs of switching here, including the costs of switching under the Legacy MSAs.

Here I should perhaps pick up a point that you raised, madam chairman, on Friday as to the extent to which the Tribunal can take into account further developments at all, i.e. further developments since the date of the Decision. Now National Grid's response on that was, "Well, as a matter of principle the gas suppliers were entitled to make the contracts that they did and take the decision that they did, taking all of this into account". That very much places the focus then on what the suppliers thought at the time. Now, certainly it is right that the lawfulness of Grid's conduct, of course, must be judged in the sense that it either was, or it was not, lawful at the time. But, that does not mean that subsequent evidence may not be relevant to that question, i.e. evidence that may come to light subsequently if the abusive conduct had not carried on, but there was nevertheless subsequent evidence to cast light on that issue before the Decision was made. That, of course, could be taken into account and equally, we say, by you after the Decision was made - if there is relevant evidence.

That was made very clear, we would suggest, by the Court of Appeal in the *Albion Water* case. It may be helpful just to look at that very briefly at A5, Tab 92, paras. 124 to 128 at p.4060, and particularly at para. 127 where Lord Justice Richards looks at the powers of the Tribunal under Schedule 8, para. 3(2)(a) of the Act. He says,

> "In our judgment, the analysis put forward by Mr. Anderson on behalf of the Authority is correct, in particular the reference is para. 3(2)(e) 'to any other decision which the OFT could itself have made' is a reference to the *kind* of decision which the regulator could have made, namely a decision within s.46(3), for example, 'a decision … as to whether the Chapter II prohibition has been infringed'). The provision does not look at the historical position but confers jurisdiction on the Tribunal to make a decision of a kind that the regulator, if still seized of the matter, could have made on the basis of the material now available.
>
> Similarly, the provision does not import the procedural requirements of decision-making by the Regulator. The Tribunal has its own procedures and must act fairly when reaching a decision under para. 3(2)(e) Such procedural requirements do not, however, affect the Tribunal's jurisdiction to make a decision but go to the lawfulness of a decision reached in the exercise of its jurisdiction."

So provide that the parties have a fair opportunity to deal with any new material then it is perfectly open to you to take any such material into account.

That is also supported in fact by earlier decisions of this Tribunal such as *Napp* which you have at A2 tab 40; that is *Napp* paras. 134 and 135 at tab 40 (p.970 of the external numbering) Perhaps I could just invite the Tribunal to read those two paragraphs for itself. (After a pause) Thank you.

In the light of those authorities there is no doubt at all, we say, as to the position on jurisdiction.

Finally under this heading, as to Grid's argument that the MSAs would have facilitated a roll-out of smart metering better than the age related counterfactual, we say that is (or should have been) a matter for the market. Precisely what would have happened to smart metering in a competitive market, absent the MSAs really cannot be determined. It is not clear, it may be – as Grid has suggested would have happened – the parties would have remained on the P&M terms, in which case of course no exit charges apply and there would have been no difficulty about switching over to smart meters. Or, if an age based counterfactual had applied then again the parties could – or rather the supplier could have selected older meters to deal with it and to replace older meters first.

Grid has said: "Ah, but suppliers might want to target particular segments in relation to smart meters". Again, as to that we come back to the fundamental point: they might say that that is what they want to do now in the light of the market as it is, and the MSAs, as they are, but we cannot tell that that would have been so absent the MSAs if, in fact, an age related contract had applied, the incentives and the thinking may well have been different. We simply do not know what the suppliers' strategy would have been then. There is no reason why, if they had wanted to replace in relation to segments of their customers first, no reason why they could not then have targeted older meters within, as it were, the particular segments.

That completes what I would want to say about smart metering at this stage, and then brings us finally to the question of counterfactuals; it is really completing what I wanted to say broadly about foreclosure at this stage.

THE CHAIRMAN: Just one moment.

(The Tribunal confer)

THE CHAIRMAN: I think we will take a break for five minutes at that point then, thank you.

(Short break)

THE CHAIRMAN: Counterfactuals, I think you were going to.

MISS CARSS-FRISK: What are they? We say they are a useful tool, no more than this, to decide whether something has an abusive, foreclosing effect. You look at what would or might have realistically happened. It is not a question of looking at whether, in this case, the suppliers would have preferred a particular scenario to the Legacy MSAs. You of course assume here that the MSAs are off to the table and you look at what might have happened, absent those contractual documents. Nor is it, in our submission, a question of the authority having to specify one particular counterfactual or benchmark that would inevitably have been the one that would have occurred absent the MSAs. It is perfectly sensible and proper, we say, for us to put forward, as we have done, the alternative of an age-related approach that might have occurred, or an approach that involved no exit charges at all. Of course, it is interesting here that Grid itself in relation to no PRC counterfactual – as I have said before, Grid, itself, has suggested that really staying on the P&M terms would have been the realistic alternative absent the MSAs. That is, as it were, their preferred counterfactual compared to the age-related one. If that is right, then yes, there we are, that counterfactual would clearly have involved greater opportunities for discretionary replacement than the MSAs, involving, as it does, no PRCs at all.

I should perhaps pick up, still on the point about a no PRC counterfactual, the argument that this is not really something that we have looked at in the Decision. That is not right – see para.4.89. I know this is a paragraph you have seen many times, it is p.86, but it should be noted, we say, specifically:

> "The Authority notes that contracts containing age-related PRCs are not the only alternative to the Legacy MSAs. It remains open to NG to seek to recover their ***customer specific sunk costs*** without long term contracts through, for example, competitive rental charges so that suppliers do not have an incentive to switch to CMOs and replace NG meters before the end of their useful life. As stated in the SSO, NG's dominance in this market makes it difficult to identify an example of 'normal' competition …"

That is not disputed by Grid, that there is a difficulty of identifying normal competition here.

Grid has said, as I mentioned a moment ago, that they think that the P&M terms are the more realistic alternative, and then they say it should not be assumed that they would have charged competitive rentals under those terms – i.e. that they would have lowered their prices. We say that if that is so, there would still, of course, be opportunities then for a

competitive market to emerge, in a sense maybe even more so, because there would be greater incentives to switch away from those higher prices.

Alternatively, we have said, surely Grid would be likely to lower their prices to something more competitive on a no-PRC counterfactual. That is where Grid's response, as I understood it on Friday, was, if that happened then you would really effectively wipe out any competitive market because no one would switch away from Grid because their rentals would be so low. Of course, we are all assuming here that we are not talking about predatory pricing. We do not agree with that assessment for at least three reasons. One is that, of course, this assumes that Grid's rentals would be so low that there would be absolutely no material switching at all, which is not an assumption that it is legitimate to make, in our submission.

Secondly, you are always going to have some non-discretionary replacements which, as you know from the Decision, have tended to be, certainly in the first three years of the contract, about 850,000 a year. In relation to those, there is very likely to be competition, or at least one cannot assume that in relation to those also Grid's prices would then be so low that no one else would have a look in in this market.

Thirdly, as we have said in our skeleton argument, if it really were the case that Grid remained the player in the market because it had lowered its price to such a competitive level, we would say that would be the consequence of competition on the merits in terms of lower prices. We would not be complaining about that. There would still be the opportunity of course for others to try and go even lower.

Leaving then the no PRC counterfactual and looking at the age related one, the first point to make is that contrary to what Grid has at least appeared to suggest, we do not of course complain only about structure here. We are looking broadly at the level of the discretionary replacement costs, or switching costs, under the MSAs and comparing those to what have happened under an age related approach. So it is the heavy switching costs, but it is not just about structure.

The second point is that the counterfactual is not required to be revenue neutral, contrary to Grid's submission. Straight away, if one looks at the P&M terms as a possible counterfactual, the one we say Grid prefers, or appears to prefer, there you clearly would not have revenue neutrality in the sense in which we use the term – i.e. something that guarantees the same minimum revenue as the Legacy MSAs. You would have no guarantees at all there, because no PRCs, etc.

We say, in any event, leaving that to one side, given the function of a counterfactual, there is no need for it to assure precisely the same minimum revenue. One cannot assume, if you take the MSAs off the table and you look at what would or might have happened then, that the parties would have entered into some arrangement that would necessarily guarantee the same revenue. That is not to say that it is not possible to construct such a counterfactual, and that is the point in paras.4.159 and 4.161 of our Decision, which it may be worth just going back to briefly at p.106 of bundle CB1. That is particularly at 4.161:

> "The use of age-related charges that in sum are equivalent to the PRCs in the MSAs does not – as with the PRCs themselves – properly reflect customer specific sunk costs or take into account properly avoided costs. This approach shows that *even with* a revenue-neutral construction of an age related PRC, there is a less restrictive counterfactual (and thus demonstrates that NG has not adopted proportionate measures). However, as noted above, construing an age-related PRC on the basis of achieving the same revenue as NG would under its existing PRCs assumes that NG is entitled to protect the revenue it has used in construing the MSA arrangements. The Authority does not consider this assumption is sound …"

So we have accepted, and we do accepted, that it is possible, as I said, to construct a scenario on various assumptions whereby the same revenue is guaranteed on an age related basis, and that is what, as you will have seen, Mr. Matthew, one of Grid's experts, has engaged in and has demonstrated on the various assumptions that he makes. The point is that, as far as we are concerned, you need to look at what we have called the switching costs, i.e. the costs of replacing meters over and above those non-discretionary replacements, that supplier will always have to make, i.e. faulty meters, etc. There, even on a revenue neutral counterfactual, factoring in various assumptions so that the total revenue is the same for an age-based approach as for the MSAs, even there the switching costs are going to be lower on an age-related basis, i.e. the costs of what we call discretionary replacement. That is why we say ultimately that Mr. Matthews' calculations do not assist very much. What we have sough to do is to look at the reality here of what might have happened on an age-based approach using the same rental levels as Grid in the MSAs, looking at the actual ages of meters and then arriving at the calculations you have seen which show a rather big - indeed, a very big - difference between what it would cost under the Legacy MSA and under the age-based approach.

In relation to those calculations, so far as we can see, there is no actual dispute about that. The dispute appears to be really as to whether, in a sense, we are obliged to put forward a

revenue-neutral counterfactual - one that guarantees the same revenue. As I have said, we do not accept that that is the case. Indeed, no authority has been cited as to why that should inevitably have to be so. As a matter of principle, it does not follow, looking at the role of a counterfactual.

THE CHAIRMAN: Would you accept that if it is not a revenue-neutral counterfactual then the numbers that you have put in to get to your result have to have some other basis in the factual matrix because if you put in lower numbers you are going to come out with a lower figure at the end of the day. So, the numbers can be calculated either on the basis that they are revenue-neutral or that you have derived them from some other way that makes them reasonable numbers to include.

MISS CARSS-FRISK: As Mr. Keyworth explains, in addition to the Decision the calculations we have made on the age-based counterfactual are anchored in reality in that they are of course based on the model of the CMO contracts and, indeed, the new and replacement contracts, and they assume the same rental levels as under the Legacy MSA, and they then look at the actual ages of the meter population as it was at the relevant time, and looks at the first three years. So, it is very much anchored in the facts of the case insofar as it is possible and sensible to do so. That is why we say it does work perfectly well, albeit it that it is right that we cannot say, and do not say, that it will always result in the same revenue.

Apart from that criticism - that it ought to be revenue-neutral - of course, Grid also says that the age-related approach is not realistic in any event. Here, our first and obvious answer - but I hope still a very good one - is, again, that surely it is realistic when you look at the reality of the situation that the CMOs use this approach as, indeed, does Grid itself in the new and replacement contract.

In addition to that, we say that it makes sense - and is realistic - that a supplier should be able to stop renting an item at the end of its useful economic life without paying an exit charge at that stage. Here we rely in particular on Professor Grout's report where he talks (at paras. 23 to 24) of it being, one may think perfectly understandably, 'attractive to replace low value assets rather than more valuable assets', i.e. meters that are further towards the end of their economic life, whether one talks of twenty years or twenty-five years. It probably does not matter that twenty years is the benchmark used in the CMO contracts.

Now, National Grid says, "Really this is all about whether older meters are more likely to be faulty". They say that there is no perfect correlation between age and accuracy. Well, as to that, and referring to the evidence of Mr. Way in particular, we say that actually, if you look at the statistics they do not support Grid's position - on the contrary, they do show a

correlation between age of the meter and accuracy. But, of course, that is something that will have to be explored with Mr. Way in due course.

The third point we would make here is in relation to Grid's suggestion that on the age-based approach one somehow substitutes replacing older meters for faulty ones. That is certainly not what we are suggesting. It is not at all referred to in Professor Grout's report. For your reference, he says at para. 27 specifically that under normal competition one would expect rental contracts to have the feature that you do not have to pay exit charges for switching out of a faulty meter.

PROFESSOR STONEMAN: At that point can I ask for clarification? This is a counterfactual - the age-related PRCs. Are age-related PRCs considered foreclosing or not foreclosing?

MISS CARSS-FRISK: We have said that they are a potential proportionate, not foreclosing possibility as a counterfactual. We have not put it quite in those terms, but I do not think I could go so far as to say that we have suggested that that approach would be abusive.

PROFESSOR STONEMAN: I just want to make it clear. So, age-related PRCs in the view of GEMA are not abusive?

MISS CARSS-FRISK: The age-related PRCs -- I think 'Yes' is probably the simple answer. I was going to say that one probably needs to look at the particular context and exactly how the age-related counterfactual has been formulated. But, basically the answer to that is, 'Yes, in this case'. That is why we have posed it as one counterfactual.

Turning then to Grid's claim that the glidepath under the MSA in fact allows for efficient and flexible patterns of meter replacement, i.e. positive benefit as compared to the age-related. The first point is that the discretionary replacement costs - the switching costs - on our counterfactual would still be significantly lower. It would be significantly cheaper to engage in discretionary replacement even if you had to look at somewhat younger meters - say, meters aged fourteen to fifteen - in order to achieve sufficient density and access. Just for your reference, that is out Table 8 in the Decision at p.89 (there is probably no need to turn it up).

Secondly, in terms of predicting where you stand on costs, we say that the costs of discretionary replacement would be more easy to predict on the age-related basis because this depends only on the age of the meters - the know-able age of the meters - whereas under the Legacy MSA, of course, it will all depend on the level of non-discretionary replacements and how that eats into the free allowance under the glidepath, so one is related to the other in a way that does not apply under the age-based approach.

As for Grid's argument about "high transaction costs" – I think that was the phrase used – and I understood that to refer to dealing with identifying the ages of the meters and so forth, but we say as the evidence shows, the evidence that Mr. Turner took you to on the first day of the case, Grid has been able to identify the ages of the meters. True it is it would appear that it involved some effort and work, but they have been able to do it and there is certainly no evidence by Grid as to the particular costs that would be likely to be involved. So we say it by no means follows from the fact that some effort was required by Grid there to identify the ages, it by no means follows that the age based approach is therefore unrealistic, or that such a contract might not have been agreed absent the MSAs. Either that or, as we have said, the no PRC option. Again, what appears to be Grid's preferred alternative, the P&M terms.

THE CHAIRMAN: With the P&M terms, if they had stuck with that contract, but had brought the prices down to reflect the amount that they say they were prepared to forego of their stranded costs, Mr. Turner stressed that the revenue derived from the Legacy MSAs is not actually the whole of their stranded costs, but they were prepared to give up that.

MISS CARSS-FRISK: Yes.

THE CHAIRMAN: Assuming that one treats that as a constant in the counterfactual, you would then have to compare the Legacy MSAs with the P&M contracts with a lower rental.

MISS CARSS-FRISK: Yes.

THE CHAIRMAN: But would you still say that that would be less restrictive? It depends, I suppose, how that rental then compares with rentals on offer from the CMOs?

MISS CARSS-FRISK: Well it would be less restrictive of competition certainly in that it would allow the market full play because, depending on the level at which Grid would then set those rentals, lower than the capped level, there would be scope for switching out to the CMOs if they provide lower rental still and otherwise greater benefits, and at no cost of any PRCs to the suppliers.

THE CHAIRMAN: Yes.

MISS CARSS-FRISK: Finally on the question of the realism of the age related PRC, I would just flag up that you have Grid's own witness, Mr. Andrew Spence, whose evidence we do not propose to challenge, that is WS5, tab 21, paras. 24 to 35, where he makes the point that much can be achieved in terms of improving access rates to policy meters in which he also includes older meters for those purposes. Much can be done by an efficient operator to improve access rates involving perhaps fairly obvious things such as proper prior contract

or efforts at contact with the consumer. So I just thought I should add that into the picture at this point. So much for the two counterfactuals that we have referred to.

I would like then to pick up Grid's point that if the incentives to replace are the same as the incentives that would apply in ownership if the meters had been sold, then the arrangement cannot be foreclosing. It is really looking at the various arguments about payment completion.

The first point made by Grid, as we understand it, is that we were wrong to say that payment completion amounts to foreclosure. Our answer is that we did not say that. Looking, for example, at para. 4.127 on p.98 of the bundle, it is clear in our submission that we are not making that point. We are saying that the provisions of these particular contracts in this case had the actual and likely effect of foreclosing. So that is para. 4.127 where we summarise the conclusion on foreclosure, and I am just inviting you to glance at that passage again – I know you have seen it before. So focus entirely on the effects of these particular contracts, not saying that exit charges could never be permissible, hence the age related counterfactual of course. But then, as I said, Grid has this argument that payment completion can never be foreclosing, that is their point – can never be foreclosing – because it provides efficient replacement incentives compared to, or by analogy with ownership, and you will perhaps remember that that is something we have dealt with in an annex to our skeleton argument, whilst also making the point that this is really a new argument that is not to be found in the notice of appeal. I was not going to take you through those points at the moment, but just remind you for your reference it is paras. 15 to 29 of our skeleton. We say Grid should really perhaps seek permission to amend its notice of appeal if it wants to make this point, and it has not done, and if it did the criteria for granting permission would not be satisfied.

But without prejudice to that I would like, if I may, just to sketch out what our response is; it is really summarising what is in our annex, and of course Professor Grout and Mr. Keyworth will be able to deal with those matters insofar as appropriate.

The first point – fairly simple one may think – is that the ownership analogy really fails to recognise that this is a rental market not a market of sale, and there are inherent differences between sale and rental, not least that in sale the purchaser actually acquires the benefit of ownership of the asset in question, something which we have seen Grid was not prepared at the end of the day to engage in.

THE CHAIRMAN: As a question of fact, when one of the CMOs goes into a customer's premises and takes out the National Grid meter and puts in its own meter, what then happens to the National Grid meter?

MISS CARSS-FRISK: Madam, that is, if I may say so, a very good question, to which I ought of course to know the answer, but I look behind me.

THE CHAIRMAN: Well it may be that other people in the room are more likely to have experience of this, and know the answer.

MISS CARSS-FRISK: The best we can do is to say – and that is undoubtedly right – that ownership does not pass, but what happens physically to the actual meter, whether it is then collected by Grid and goes into some great graveyard of meters or, is miraculously after all refurbished and reused I am afraid I do not know, but no doubt Grid ----

MR. TURNER: Madam, we are taking instructions on that point.

MISS CARSS-FRISK: So the first point: this is not sale. The second point is that that reliance on what is described as "socially efficient outcome" (i.e. wasteful to get rid of a working meter), really is not an answer in competition law terms. I know you have that point. Competition law is about achieving efficiency through the dynamics of competition not through some *a priori* model. So we say it is simply wrong in law for Grid to say, "Socially efficient, must not waste a working meter, and that is the end of it", which really appears to be the end of it on their argument. That cannot be right. I know one must always be careful as an advocate to say that cannot be right, but in these circumstances I would genuinely suggest it cannot be right that that is the be all and end all of it.

Then the third main point is that we do say the comparison between ownership and rental is flawed in any event, at least for these reasons. First of all, it assumes, makes the assumption, that the rental arrangement would have a provision for payment completion. Secondly, it does not take account of the fact that in rental of course you have the possibility of improved service, as well as lower prices and innovation that may provide an incentive to switch out for a new meter where you rent. Those incentives would not necessarily apply in relation to ownership. Thirdly, Grid's analogy really does not consider the fact that the capital cost of buying the meter is a fixed definite sum that is paid at the time when ownership is transferred, whereas with rental you have the continuing ongoing relationship where the price is not fixed necessarily over the term of the rental, and there may well be incentives in the course of that relationship for rentals to go down.

These are just some obvious differences perhaps between the two, rental and ownership, that, in our submission, mean that the example, the analogy, really is not one that stands up.

It may be that the most important point, in a sense, is the point I made about social efficiency not being the answer in this case, or indeed in any case, the way it is put by Grid.

THE CHAIRMAN: Just to be clear I understand the point, by "socially efficient" you mean that for some non-economic related reason one should not throw away things that are still functioning properly, but should use them up until they stop working. Is that what you understand the point to be?

MISS CARSS-FRISK: That is how we understand the ultimate basis for Grid's point there, certainly it is not socially efficient to replace a working meter, yes. That is the ultimate point, as we understand it.

PROFESSOR STONEMAN: Did you say that the experts were going to address this issue?

MISS CARSS-FRISK: I am sorry, sir?

PROFESSOR STONEMAN: Did you say you expect your experts to address this issue? It is just that there is a fundamental flaw in the argument that is related to the issue of social efficiency in that they have got the replacement criterion in that note and in the write-up. Basically the note says that a meter should be replaced when the benefit from replacement is greater than the cost. That is only the profitability criterion. There is also an arbitrage criterion that has to be met which says you will replace a meter when benefit from replacement is not only positive but also greatest. That relates the replacement date to the age of the meter and not much else. That is where you get the social efficiency criterion.

MISS CARSS-FRISK: I am quite sure, sir, that our experts are taking a note of every word, and we will be considering that, and I am sure we will be able to deal with in their evidence in so far as it is appropriate. Thank you, sir.

Just running for a second with Grid's point about how it would be inefficient – and I think they have also put it that there would be an artificial and distorted incentive to replace a working meter if you do not have provision for payment on completion. One simple point we make is if, in fact, the rentals are sufficiently competitive and the service levels, etc, that are provided, then the working meter will not be replaced, or is unlikely to be replaced. Presumably, running with Grid's definition, that would not then be inefficient. That, as I say, is running with their argument. Of course, what would happen in that case, or could happen, is that there is a switch out to another supplier, which Grid would be very unhappy about. There is that risk, but we come back to the point that that is a risk that surely any undertaking is required to face, unless of course it says, we are entitled to recover a certain amount. As you know, we have said that comes at least very close to what Grid has been saying in this case.

Turning then to the related topic of objective justification, I can probably take that fairly briefly because Mr. Turner touched on it very lightly in his oral submissions. For your reference, we have quite a lot about that in our skeleton, starting at p.64. The main points are really these. First, again, this point about payment completion – this is Grid's point – providing normal and efficient replacement incentives. You have our point, not always wasteful and inefficient to replace the working meter. Grid cites no authority for that proposition and we say this is not going to be sufficient to provide objective justification. Why should a working meter not be replaced with a cheaper and better one?

Secondly, of course, although Grid may, as we have said, legitimately seek to recover customer specific sunk costs in a manner consistent with the competition rules, again it has no entitlement to recover any particular amount, and so to say we should be assured payment completion, full stop, cannot amount to objective justification.

Thirdly, we would say they cannot justify the abusive conduct by reference to the benefits to gas suppliers. They cannot say, "Here we are, a dominant undertaking, we are now going to foreclose the market by these agreements, but never mind, it does involve a lowering of prices to the suppliers". I know they were not saying that, but the fundamental point is there. They took advantage of their dominance; yes, it did result in some reduction of their prices, but that is not sufficient to provide objective justification.

Fourthly, the fact that some gas suppliers may have been happy to enter into these agreements does not again provide a justification. The willingness of the other contracting party to go along with what we say is the abusive conduct, as we know, cannot be a defence (see *Hoffmann La-Roche* at para.89, probably no need to go to it). That is so at the prior stage of looking at whether conduct is *prima facie* abusive, but it must apply equally as a principle to the question of objective justification.

At the end of the day, as I said at the outset of our submissions, these contracts clearly have a foreclosing effect.

THE CHAIRMAN: Have you moved on from objective justification?

MISS CARSS-FRISK: No, this is part of objective justification. It really is summarising, I hope in one sentence, everything.

THE CHAIRMAN: Just on objective justification, is there still an issue that we are going to have to decide about the burden and standard of proof on objective justification?

MISS CARSS-FRISK: I would not have thought that that is so. We would say there is an evidential burden on Grid, but we accept that the ultimate burden rests on us.

THE CHAIRMAN: Thank you.

MISS CARSS-FRISK: Saying that I could summarise the whole case in one sentence was claiming rather too much. But, the key point, as we see it, is this: agreements have foreclosing effect. There is not really any dispute about that now, but the dispute is as to obviously whether lawful or not. You then look at why it might be lawful. "Well", says Grid, "normal competition". We say, "Not so. Not competition on the merits properly". Crucially, Grid completely ignores its special responsibility as a dominant undertaking. It still has not faced up to that issue at all. It is not disputing that the principle exists, of course. How could it? Nor, I think, does it dispute that it applies here if Grid is found to be dominant. If that is so, that principle must have some meaning. We know that it means that conduct that might be acceptable in another competitive context might not be for the dominant undertaking.

That, of course, links very strongly to Grid's point that payment completion is normal. Well, some kinds of payment completion might be in some contexts, but this kind of payment completion with these heavy disincentives to switching do not - and do not take any account of that special responsibility.

That then brings us finally to the question of penalty. Here the Authority has, of course, found Grid negligent rather than intentional in its abusive conduct. Mr. Turner indicated on Friday that on the basis that Grid could foresee the foreclosing effects of the MSAs, even though it could not foresee that it was actually unlawful, as I understand it on that basis he would accept that negligence is the appropriate label to attach. I know, madam chairman, you have referred to there being some case law on this. We have had a look at that. What we have come up with as probably the best case is the *Napp* case in Authorities Bundle 2, Tab 40. That entirely supports the view that Grid should be found to be negligent. In fact, it may be should be found to have intentionally committed the abuse in this case. It is p.1057 at paras. 456 to 457. At para. 456,

> "As to the meaning of 'intentionally' in s.36(3), in our judgment an infringement is committed intentionally for the purposes of the Act if the undertaking must have been aware that its conduct was of such a nature as to encourage a restriction or distortion of competition. It is sufficient that the undertaking could not have been unaware that its conduct had the object or would have the effect of restricting competition, without it being necessary to show that the undertaking also knew that it as infringing the Chapter I or Chapter II prohibition".

So far actually Grid would fit on what it has conceded within that definition, we would say, of it actually being intentionally. There is then the reference to the two cases.

> "While in some cases the undertaking's intention will be confirmed by internal documents, in our judgment, and in the absence of any evidence to the contrary, the fact that certain consequences are plainly foreseeable is an element from which the requisite intention may be inferred. If, therefore, a dominant undertaking pursues a certain policy which in fact has, or would foreseeably have, an anti-competitive effect, it may be legitimate to infer that it is acting 'intentionally' for the purposes of s.36(3).
>
> 457. As to 'negligently', there appears to be little discussion of this concept in the case law of the European Community. In our judgment an infringement is committed negligently for the purposes of s.36(3) if the undertaking ought to have known that its conduct would result in a restriction or distortion of competition: see *United Brands -v- Commission* ... For the purpose of the present case, however, we do not need to decide precisely where the concept of 'negligently' shades into the concept of 'intentionally' for the purposes of s.36(3), nor attempt an exhaustive judicial interpretation of either term".

Those dicta were then applied, just for your note, in *Aberdeen Journals (No.2)* and also in *Genzyme*, which it may be worth looking at very briefly at A3, Tab 58, para. 684, at p.2006.

> "Genzyme submits, in the alternative to its arguments on the substance, that it has not acted intentionally or negligently, so that there is no jurisdiction to impose a penalty under s.36(3) ... Genzyme submits, notably, that it must be shown that Genzyme knew or ought to have known that its acts or practices 'were not legitimate, amounted to abuses and were not objectively justified in the sense of being irrational;. Genzyme denies awareness of its dominance and of the fact that its policies would have the effect of preventing price competition in Homecare Services. The OFT's case on intent or negligence is inadequate. In the light of the Fresenius/Caremark report, Genzyme could not have known that its practices were objectionable. The OFT accepted Genzyme's policy at the interim measures stage. Bundling was not raised until November 2001, and the margin squeeze abuse was first identified only in the Rule 14 notice in July 2002. Genzyme acted on legal advice in deciding not to grant Healthcare at Home a further distribution agreement".

So, that was Genzyme's argument, but it was actually rejected - not accepted - by the Tribunal. Of course, that is particularly significant for us here because it tackles head-on this point about whether the undertaking is required to know, or should have known, as to

the label of whether its conduct was unlawful, or not. The point we derive from this - as, t be fair, Mr. Turner I think accepted - is that you do not have to have knowledge or should have known in relation to that aspect.

Applying these principles to the facts here then, you have our Decision at paras. 6.11 to 6.12, setting out what it appears that Grid had in mind as to dominance. Page 118:

> "National Grid kept a 'risk log' which included consideration of competition law issues. ... identified the competition law risk arising from the proposed MSAs when he wrote of a Board sub-group paper on 10th December, 2003. [for your note, when you see it in the footnote, that is SD3, Tab 93],
>
> > 'On the risks section of the paper I think that it is important to highlight the regulatory risks. We are a dominant provider, foreclosing the market by offering a commercial contract, complete with a generous incentive payment, with which no-one could possible compete (this is how is [sic] could be seen rather than how we present it). This is bound to attract complaints from disadvantaged MOs and is likely to trigger an Ofgem investigation. Although we believe we have covered all the angles and could defend the contract it is still conceivable that Ofgem could develop a case against us. I therefore think it is important that the Board subgroup is made aware that there is a Competition Act/regulatory risk with the contract, which is more a function of our dominance than anything else."

Then you have the Board sub-group paper referred to at para.6.12, 10th December 2003.

> "These are long term contracts relating to assets in a market in which [Grid] is currently the dominant player. As such they may be subject to regulatory scrutiny and could be challenged under either Transco's licence or the Competition Act. Steps have been taken to ensure the contracts are compliant with both licence and the Act but there will remain a risk of investigation. A Transco nominee will be appointed to audit the operation of the contract to ensure that the competition and regulatory risks are managed on an ongoing basis."

We say those documents do suggest very strongly – indeed mean – one can infer that Grid did understand itself to be dominant. Now, Grid has said that it was just someone playing devil's advocate here really, but we say that if one looks at the terms of those documents it goes rather further than that in relation to the issue of dominance. Once you have that awareness of dominance, and Grid also being aware that it was foreseeable there would be a foreclosing effect, then you have certainly negligence and, in fact, we could say on the

authorities even intention but of course I do not resile from the fact that we pitched it at the lower level in terms of negligence and, of course, that is also reflected in the amount of the penalty that was imposed.

Grid has also made a number of general points as to why nevertheless it cannot be considered to have been negligent. Now, I would only deal with those if there is still really an issue about this. I do not know if Mr. Turner would like to confirm whether there is?

MR. TURNER: As we discussed yesterday, it is the difference between mitigation and the jurisdictional threshold and so my friend does need to address the mitigation points that we have foreshadowed.

THE CHAIRMAN: I think rather what she was asking was: were you still taking the point on the jurisdictional threshold?

MR. TURNER: No, we are not.

MISS CARSS-FRISK: So on that basis then, yes, it appears to be accepted that negligence would be there on the facts as we have presented them. In that case, insofar as the various other factors are still said to be relevant on mitigation, yes I will address them in that context.

MR. TURNER: I am sorry, madam, I should just clarify on the jurisdictional threshold, that itself does raise the question of what "foreclosure" actually means. So if one asks oneself: "Did National Grid know that it was foreclosing or restricting competition?" it takes us back to the argument of substance as in whether it is a restriction of the competitive process at all what they were doing.

THE CHAIRMAN: If we are getting to consider penalty, then that is *ex hypothesi* ----

MR. TURNER: Correct.

THE CHAIRMAN: -- on the basis that it is found to have been an abuse. Now, the question is, on that hypothesis, is your case limited to mitigation of the fine, or are you trying to knock the fine out altogether on the basis that even though this was an abuse, it was still not one committed intentionally or negligently.

MR. TURNER: Yes, well we are not taking a jurisdictional point in that situation.

THE CHAIRMAN: Thank you.

MISS CARSS-FRISK: I think I understand that what is being said then is that if there was an unlawful abuse, which obviously is the first threshold question, then it is accepted that Grid was negligent in relation to that unlawful abuse.

THE CHAIRMAN: That is now my understanding of their case, yes. Mr. Turner is nodding.

MISS CARSS-FRISK: Yes, I am grateful. So the factors as relied on by Grid then no go to mitigation only ----

THE CHAIRMAN: Yes.

MISS CARSS-FRISK: -- and I will address them in that context if I may. The first point, or at least one of the points is that this was a unique case, the context was unique. As to that we say the legal principles are clear, there has not really ever been much dispute about those. As to the application to the facts you could argue that any case in a sense is unique, applying the legal principles to a particular factual context. So we do not really accept that it is unique, but even if it were – or perhaps I should say if it were – then all the more reason for Grid to be particularly careful in relation to entering into this kind of contract that would have gone to negligence, but it certainly also goes to the question of the size of the fine, to mitigation, so that does not help Grid we say.

Secondly, as to the fact that we have accepted that some kinds of exit charges might be acceptable from a competition law context, well, yes, but that again does not lessen the obligation on Grid to be very, very careful that it does not go against the competition law principle. So again that is not a factor that works in their favour we would say.

As for the alleged involvement by Ofgem in the creation of the MSAs, may I deal with that separately in a little more detail in a moment, but what we say is: "Ofgem never gave any comfort to Grid in competition law terms. It did not have the full information, that is one thing, but in any event it never gave any competition law comfort to Grid and on that basis that is not going to work as a mitigating factor.

Fourthly, very briefly, as to the point that the Authority's case has changed somewhat in the course of the investigation well it has only done so in limited ways, as Mr. Smith explains in his unchallenged evidence, and it has done so largely in response to arguments raised by Grid, so again this is not a factor that can somehow count in Grid's favour as to penalty.

Then as to a point made that the Decision looks at aspects of the MSAs that had not actually been put forward by a complainant first off, well we say it is inevitable, and only natural, that certain themes and matters to be investigated will emerge in the course of an investigation. Again, that in itself cannot count in Grid's favour as mitigation.

Finally, Grid has said that you should consider that there is no consumer harm here. Well for all the reasons I have already sought to give you we say there plainly is.

Turning then to Ofgem's involvement – or alleged involvement – we have dealt with that in our skeleton as you will have seen on the basis that we thought Grid might be saying that we had created some legitimate expectation that there would not be Competition Act action taken. Now Mr. Turner has clarified fairly that is not the argument at all. He says it only

goes to mitigation. Well interestingly it was not put that way in the skeleton argument for Grid, but there we are, that is where it now goes.

As to that, of course you have Maxine Frerc who deals with the detail of that at length in her statement. We would say it is important to split the dialogue into two distinct periods to get a handle on this. First between August 2002 and February 2003 there were discussions in the context of the regulatory side, possible changes to the Network Code, there were discussions about Grid getting more assistance, or compensation for asset stranding. But even at that stage of the dialogue Ofgem made it clear that it was not giving any sort of approval or considering Competition Act issues. Here it is probably worth looking just at one letter – 11th October 2002, correspondence bundle 1, tab 3. That is Maxine Frerk writing to Grid, 11th October 2002:

> "Dear Paul
>
> Re: Premature Replacement Charges
>
> Thank you for your letter of 25 September providing further information on Transco's proposals to address the problems associated with stranding of assets.
>
> At our meeting with you and your colleagues on 9 October we agreed that it would be useful for us to write to you setting out our general thinking about the proposals and explaining what additional information would be needed to allow us to make a decision on whether a particular package of proposals was desirable.
>
> In our May 2002 Metering Strategy document Ofgem identified that under premature replacement of meters could be to the detriment of customers. Our understanding is that Transco's proposals are intended to reduce the incentives for premature replacement. Ofgem's position is therefore that in order to be acceptable any proposals to address the problems of premature meter replacement must provide a clear net benefit to customers, and must not prevent the development of competition and customer benefits in the future."

That is really the key point that is being said, apart from providing a clear benefit to customers, must not prevent the development of competition and customer benefits in the future. There is no suggestion of any competition law comfort being given, quite the opposite.

Then at the end of that period of dialogue, as I have described it, February 2003, you have the same signal being sent very clearly, no competition law approval. That is CR1, tab 6, the letter of 18th February, again from Miss Frerk to Grid, and it is probably worth reading the whole letter, particularly under the heading "Premature replacement charges":

"Following further consideration Ofgem thinks that if Transco wishes to bring in alternative metering charges and arrangements through contracts with shippers and suppliers there will be no need for Ofgem to hold a wider consultation at this stage. You specifically asked us for our view on the appropriate level of the domestic credit meter charge. Since this development is to be pursued by commercial negotiation Ofgem has no views on the appropriate level of the charge provided in setting its charges, terms and conditions Transco is compliant with its obligations under licence and, more generally, competition and consumer law."

That is the key passage.

At this stage, Grid has signalled that it is going to seek to negotiate commercially outside the regulated context and Ofgem, in our submission, is making it very clear that Grid has the obligation to satisfy itself in terms of competition law at that stage. That is a letter that we have also mentioned in our Decision at para.6.41.

After February 2003 there were contacts between Ofgem and Grid, but that was for very specific regulatory purposes. One issue that arose in August 2003 related to the question of whether Grid might possibly be benefiting from access to privileged information, as we say at para.6.48 of our Decision, that is that Grid knew about proposals to transfer or remove the business rates from Grid, and the question was whether offered price reductions to the supplier fairly reflected that point. In that context, Ofgem requested copies of draft MSAs, but only in that context. Then in December 2003 again it received copies of draft MSAs to approve the format of the charging methodology that Grid was going to use as a specific licence related issue (see our Decision, para.6.50).

The key point, of course, is Ofgem did not review the MSAs for Competition Act purposes or indeed review them in any detail at all. In fact, it never had full knowledge of how the exit charges were going to be worked out in the MSAs, or generally, as we set out in detail in our skeleton argument. In fact, Grid has accepted in its notice of appeal (for your note, para.785) that even at this stage, the second part of 2003, it did not provide full details of the methodology for calculating the PRCs.

THE CHAIRMAN: The PRCs themselves were presumably by that stage set out in that table to which we were taken?

MISS CARSS-FRISK: Can I just double-check, madam, but my understanding is that we did not have access to those figures. In case I am wrong, I want to just double-check that. Perhaps more importantly, we were not told, as I have said, the details of the methodology behind it.

THE CHAIRMAN: The methodology behind arriving at those figures?

MISS CARSS-FRISK: Yes.
THE CHAIRMAN: The glide path concept, if I can put it like that, was clear by that time, I think.
MISS CARSS-FRISK: Yes, I think it was December 2003 that we were told of the glide path. I am not suggesting that we did not know some of the basic structure of the MSAs.
THE CHAIRMAN: I suppose the simple way to put it is in your decision as to what the level of penalty should be, did you treat this as a covert infringement or do you accept that it was not conduct engaged in covertly by National Grid for the purpose of considering the level of the penalty?
MISS CARSS-FRISK: No, we have never said that it was covert in a sense that ought to increase the level of penalty or approached it in that way. In fact, we have specifically said that we do not say that Grid was under an obligation to inform us. All of this is simply us countering Grid's case which was, and always has been, a very detailed case and a substantial part of its case, although the label was not clear, that we somehow gave comfort to them so that possibly there was this legitimate expectation, etc. We have not held it against them, it is just that they cannot hold it against us, if that makes sense.
THE CHAIRMAN: It is not so much the mitigation or the aggravating circumstances, but does it come into the prior stage of choosing the percentage that reflects the seriousness of the infringement? I am not sure whether that percentage figure is a confidential figure.
MISS CARSS-FRISK: Madam, may I just confirm that this factor of this dialogue, if you like, between the parties and the fact that Grid did not disclose full details of the MSAs was not taken into account as aggravating or mitigating or in relation to the setting of the starting point, the percentage of 4 per cent that was picked.
THE CHAIRMAN: Thank you.
MISS CARSS-FRISK: Grid has specifically said in relation to that starting point of 4 per cent that it was excessive. Again, as we understand it, relying on this argument that the case raised new and complex issues - and you have our points, they are the same as before, not really new and in any event, that meant that the burden was even greater on them to satisfy themselves with proper advice and analysis that they were not behaving unlawfully.
Again, still on the point about selecting the 4 percent, National Grid says there is no adverse effect on consumers, or, indeed, on competition. But, clearly, for reasons given we do not accept that. Then they say that the 4 percent is high compared to the 7 percent that was used in *Genzyme*. Well, we do not accept that, obviously. 4 percent is less than half of what it could have been. So, actually it is a fairly modest starting point. Certainly it is lower - clearly - than the 7 percent that was used in *Genzyme*. So, we would say that it is very

appropriately gauged to the relevant factors here and fact-sensitive in this context. Of course, the Authority has a very wide discretion - as Grid rightly acknowledges specifically in the Notice of Appeal (para. 805(d)) - as to picking the relevant starting point.

That really completes what I would say on penalty.

As to direction, only two points which Mr. Turner did not, I think, deal with orally. We say that the Authority did not need to impose a direction at all. It is clear that the relevant conduct would be prohibited under Article 82, if we are right. But, in any event, the kind of direction that was imposed is very close to the one that was approved in *Napp* at para. 553 (Authorities Bundle 2, Tab 40).

That then completes our submissions on substance. I would only then mention one procedural housekeeping matter if that is convenient before lunch. That relates to a bundle which has about 360 pages in it, marked M1 - Miscellaneous bundle. I am not sure to what extent you have had a chance, or the opportunity, to look at it, or cause to look at it. We have a complaint about that which is as follows: it was provided to us by Grid very, very late in the day on 8th January. The documents there are not documents that have been referred to in any of the pleadings, or by any of the witnesses in their statements. Now, we have said to Grid, "Please can you tell us what these documents go to? Which passages are relevant? Then we can judge whether we are somehow prejudiced by this arriving so late or whether we can deal with it fairly". Grid have so far not been prepared to do that and have said to us in correspondence, "Well, you can just object as and when we seek to deploy the documents in the Tribunal" to which we say that that really is not fair because we are not going to have the chance to consider our position if we are supposed to jump up and do it as soon as the document is put in. At that stage, in a sense, it may be too late anyhow. We say it really is not consistent with the approach of the Tribunal to put in a sizeable bundle of documents where the documents have not been referred to before without explaining what it is all about.

THE CHAIRMAN: So, these documents are not documents that have previously been appended to any witness statement?

MISS CARSS-FRISK: Precisely. That is the point. They are documents from the file. We are told that members of the Grid team have been reviewing the whole file from, I think, 8th October when I think they were given permission to look at confidential aspects of the case file -- confidential documents. But, of course, they had had access to the whole file on a non-confidential basis before that. But, in any event, that is three months ago that this apparently started as an exercise. We then get this bundle on 8th January. We are not saying

necessarily that it cannot go in -- or, parts of it cannot, but we have simply said, consistently with the general approach, that parties should have fair warning as to why documents are picked out of the case file and what they go to. Can we please be told that? But, as I say, that has been refused so far.

THE CHAIRMAN: It seems to me that they are not currently evidence before the Tribunal if no witness has introduced them. If they are to be put in as evidence, then they will need to be supported by some witness statement or by the witness in the box. However, it should be possible to know at this stage, Mr. Turner, which of these documents it is intended to bring into the evidence in that way?

MR. TURNER: Madam, this is a complaint I really do not understand. I have completed my full opening already, and I have not referred to this bundle. As Miss Carss-Frisk says, what we have here is a bundle which results from the exercise carried out by Messrs. Rothwell and Pickering when they were admitted to the ring in October, and also some documents that were put in because of the Meter Fit skeleton that was disclosed on 13th January. The only way in which these documents are going to come into this case now is in one of two ways: either in cross-examination where essentially, as you say, you are putting the document to the witness and it becomes part of the witness testimony, or in closing. So, you have to focus on the closing. If it is part of closing submissions what we have said to my learned friend is that if we feel that a certain document becomes important because of the way that the case has gone, which is only a document on the case file, we will seek permission for it to be introduced as evidence at that stage. At the moment I have no intention to rely on such documents in closing because I have not been able to consider that. We are right in the middle of the other side's case. So, this is not an issue that even arises in principle or as a practical problem.

THE CHAIRMAN: I am slightly concerned though if what you are proposing is that you will, in cross-examining witnesses, be able to pick from this bundle (which is tabbed from 1 to 100) and without the document being properly evidenced before the Tribunal, put it to a witness without that witness having had the opportunity to consider it.

MR. TURNER: Madam, the first point: as you know, in this Tribunal, in any event one is not talking about the strict rules of evidence. But, even under the strict rules of evidence in the High Court, when you are cross-examining a witness you are not restricted to putting to that witness evidence which happens to be within a limited set of trial bundles. So, this is a complete non-point. My friend is not going to say to me in advance, "I am about to cross-examine Mr. X. I will tell you now, 'Here are whole range of documents from this

voluminous case file that I want to put to him so that that can be considered'". It is not the way that business is done in the High Court or in any Tribunal.

THE CHAIRMAN: No. But, if, when you put the document to the witness in cross-examination the witness does not accept it in some way, then it is not evidence before the Tribunal.

MR. TURNER: Absolutely. I agree with that. But, that is only to say that that is the way that things are generally done. In cross-examination, where something is not part of the documentary record, and no specific application is made to the Tribunal to treat it as evidence in itself, then it will only become evidence through the record of the cross-examination of the witness. (After a pause): Similarly, if you take the documents which are not appended to witness statements, but which are appended to the Notice of Appeal, or to the defence, which are simply on the case file, these enjoy no different status from those than merely documents from the case file which are available to the Tribunal.

THE CHAIRMAN: Does that put your mind at rest in any way, Miss Carss-Frisk?

MISS CARSS-FRISK: I am afraid it does not. Can I make first of all just one small point? In fact some of these documents have already been referred to in Grid's note, certainly on supplier procurement of competitive metering services, so they have been deployed in that sense to some extent already, but I am of course concerned about the cross-examination. Where I do very much part company from Mr. Turner is this, that unlike in the High Court in this Tribunal the parties are supposed to put forward at the outset the documents that they rely on (see para.3.4 of the Guide to Proceedings): "Each party's case must be fully set out in writing as early as possible with supporting documents produced at the outset." So the idea is, again unlike always in the High Court, that you do get fair warning of why a document is going to be used, so you do not just have several bundles of general disclosure as you would in the High Court where anyone could pick any document, and I accept, you would not warn your opponent that you are going to pick one document and put it to a witness, but here, as it seems to us, the idea is a different one, that parties should know why a particular document is being relied on, which you would if it is referred to in a witness statement or in a pleading or in the Decision, you would know that this is meant to support the following point. So all I am asking, and have been asking, is that we be given the equivalent of that in advance so that we could then consider whether we are really going to be prejudiced, but we should not be frankly potentially ambushed by having no idea why a document is going to be relied on until it is actually put to one of our witness. That is our only point, but we do stand by it.

THE CHAIRMAN: Well I will consider this point over the short adjournment. Is there anything else that you wanted to say, Mr. Turner?

MR. TURNER: No, madam.

THE CHAIRMAN: We will resume at 10 past 2. Thank you.

(Adjourned for a short time)

THE CHAIRMAN: Mr. Turner, on the matter that we were discussing before the short adjournment, the position I think is this: it is, of course, up to you whether you wish to put to a witness in cross-examination a document that is not currently in evidence before the Tribunal. We are not intending to read through everything that is in M1, and we do not expect the Authority's witnesses to do so either, therefore you take a risk if you do not alert them to the document which you are going to put to them that they may not be able to give you any useful answer in cross-examination about that document. We were a bit perturbed by your suggestion that you might then try and introduce it in evidence at the time of your closing submissions, and you should be aware that we would regard that as a rather exceptional course to take to adduce new evidence which has not been put to an witness in the course of a witness trial. But, as I say, it is ultimately up to you whether you wish to take the risk with a particular document that it may not end up being in evidence before the Tribunal.

MR. TURNER: Madam, I hear and understand that. May I just react with two comments? First, as we see it, yes, this is a witness action but there are plenty of documents here where you are being asked to accept the document as evidence of what it says without it going through the medium of a witness, in fact many hundreds of such documents.

Secondly, my friend just before lunch – by way of example – raises a new point based on the BERR consultation document and takes us to a passage which has never been signalled before, so there is a discussion on it about the meaning of asset stranding in the smart debate, and the meaning of legacy contracts, and what this is all about, and she made certain suggestions for the first time here. Now that is a very good example of something being raised for the first time by way of evidence from a document and asking the Tribunal to take it into account as evidence and draw conclusions from it.

Now, if you put yourself in National Grid's position we have to respond to that sort of argument for the first time raised in the oral hearing based on the document, I am not saying that we refuse to do so and, of course, I am not going to take any procedural point but it may involve us needing to look into that document and into associated documents. I do not have any opportunity to do that now until closing submissions.

THE CHAIRMAN: I am not going to debate this with you, Mr. Turner. The report to which Miss Carss-Frisk referred is, of course, a public document, but let us see how we get on.

MR. TURNER: Yes.

THE CHAIRMAN: As I said, it is up to you but you should bear in mind the points that I have made.

MR. TURNER: I understand.

MISS CARSS-FRISK: I simply want to clarify in response to Mr. Turner that in fact the BERR document that I referred to was mentioned in Grid's own note on technical innovation so we rather sought to respond to that, that is all.

THE CHAIRMAN: Thank you. Mr. Vajda?

MR. VAJDA: Madam Chairman, members of the Tribunal. The submissions that I intend to make are intended to complement those of Ofgem. My submissions are on behalf both of Siemens and CML, and I propose to follow the same order as other parties, namely, dominance and abuse.

Before doing so, and before I forget to give the answer to the question that you asked, madam, before the adjournment, what happens to a meter removed by a CMO so far as CML is concerned, it is made available for collection by National Grid, so National Grid can pick up the meter from us, that is the position.

Coming first of all to dominance. The Tribunal will be aware that Mr. Turner's main focus was on market power and not market definition. On market definition we say that the Authority is plainly right to focus on demand side substitution. If there is demand side substitution there is no need to consider other issues such as supply side substitution or potential competition. I am just going to give the Tribunal the reference, we do not need to go to it, it is para.20 of that Commission Notice A1, flag 22. We say there can be no dispute that a new or replacement meter is a demand side substitute for a legacy meter, that is precisely why National Grid entered into the MSAs.

So we say that the table, table 4, at para.3.63 of the Decision with those market share figures is the correct starting point. It may be worth having that table to hand. (CB1, tab 1, p.55) At the time that the MSAs were actually signed in January 2004 there was only one independent competitor to National Grid actually on the market, namely Meter Fit, and the disparity in market share between Meter Fit and National Grid is colossal. You can see on the table here National Grid 97, new entrant (that was Meter Fit) 1. Indeed, if one goes forward one sees one of the most striking features about this table are the enormous

disparities in market share between National Grid and its competitors, none of whom – even in 2007 – had got into double figures.

Of course, it is well established in competition law that disparity in market share is an important indicator of market power. In this context I also remind the Tribunal that five out of six of the gas suppliers, that is to say everybody other than British Gas, did not pursue their ITTs – as Mr. Turner put it they "stalled" – and therefore they have not appointed any CMOs at all. Their only relationship, as I understand it, with CMOs are *ad hoc* arrangements arising out of customer churn, for example if a customer moves from British Gas to Eon; and of course another factor in the continuing disparity in the market share are the MSAs themselves which, as we know, have been signed by five out of six of the gas suppliers, and we will come on to that, but that is of course the link as it were quite often one looks at the conduct, market power that has also contributed to National Grid having an 89 per cent share in January 2007.

In addition, the Tribunal will of course recall, and this is a point stressed quite heavily in the evidence of National Grid, that Meter Fit was having teething problems (James 1, para.12, WS1, tab 3, p.799) there is no need to go to it, who points out that United Utilities found gas metering – and these are his words – "completely different from electricity metering." We then have Mr. Avery (para.56, WS1, tab 2) saying MF's ramp up rate was much slower than envisaged. He makes the same point at para.92, and I will just give the Tribunal two other references in the evidence, Neil Williams, WS5, flag 12, p.2494, para.36; and Mr. Lee, WS5, flag 14, p.2515, paras.34-36.

In response to that, Mr. Turner's main point is that the bargaining between National Grid and the suppliers which led to substantial cash payments to the gas suppliers is "an act of competition". Therefore, so the argument runs, this is inconsistent with a finding of dominance.

What, in fact, on analysis, Mr. Turner's argument is is a meeting the competition argument, and we do not accept that where an undertaking responds to competition that means that there can be no dominance. We find support for this, which is neatly summarised in the Commission 2005 document at A5, and could I ask the Tribunal to look that up, flag 74.

Can I just take the Tribunal first to p.3197, because it is very important to understand the role of the 2005 and the role of 2008 Commission Papers. Does the Tribunal have p.3197? This is the 2005 document, and it says at para.5:

"This paper draws and elaborates on the Commission's evolving experience with the application of Article 82 as well as on the case-law of the Court of Justice and the Court of First Instance of the European Communities."

So it is effectively Commission experience plus a summary of the case law. If we then go to p.3216, we have possible defence to abuses, and this is to do with foreclosure. Paragraph 77 reads:

"Exclusionary conduct may escape the prohibition of Article 82 in case the dominant undertaking can provide an objective justification for its behaviour or it can demonstrate that its conduct produces efficiencies which outweigh the negative effect on competition. The burden of proof for such an objective justification or efficiency defence will be on the dominant company."

That is important in answer to your question, madam, before the adjournment, and I will come to the *Microsoft* case in due course.

"It should be for the company invoking the benefit of a defence against a finding of an infringement to demonstrate to the required legal standard of proof that the conditions for applying such a defence are satisfied.

In general there are two types of possible objective justifications."

If we go then to p.3217 we see:

"The second type of objective justification is where the dominant company is able to show that the otherwise abusive conduct is actually a loss minimising reaction to competition from others."

That is precisely what we have here, a meeting competition defence. Then the Commission explains this at para.81:

"The meeting competition defence is only applicable in relation to behaviour which would otherwise constitute a pricing abuse. It can in addition only apply to individual and not to collective behaviour to meet competition. For this second type of objective justification it is necessary to apply a proportionality test."

That is of significance in the present case.

"The Community Courts have considered that defending its own commercial and economic interests in the face of action taken by certain competitors may be a legitimate aim. In other words, to minimise the short run losses resulting directly from competitors' actions can be a legitimate aim. This automatically implies that an objective justification is not possible if the dominant company is not able to show that its conduct is only a response to low pricing by others or if the

> Commission, for instance through documents seized at the company, has been able to demonstrate that the objective aim of the conduct is to directly foreclose competitors."

The importance here of this passage shows that the fact that an undertaking needs to respond to competition – for example, to minimise short run losses – is not inconsistent with dominance, because this is being put forward as a defence. This is very important. So the fact that an undertaking cuts its price in response to competition does not mean that there is no dominance. On the contrary, the way in which it cuts its prices may be an abuse, and the most classic example is, say, predatory pricing. It is for that reason that there is a need for a meeting competition defence. Of course, that is because a finding of dominance does not mean that there is no competition, nobody is suggesting that, but merely that competition is restricted.

I have already indicated that that passage and the passage at 77 is instructive also on the question of abuse, because it shows that the burden is on the dominant undertaking to put forward a meeting competition defence, and in doing so it has to show that the conduct is (a) indispensable, and (b) proportionate.

As the Tribunal will be aware, for the reasons set out in the Decision – this is on objective justification, I am going to ahead of myself – the reference is 4.129 to 4.180, and in the skeleton of Siemens, and I give the reference, it is paras.20 to 42, CB2, flag 17. We say that National Grid comes nowhere near meeting either the indispensability or the proportionality condition.

So, madam, we say that the fact that price reductions were obtained by the gas suppliers does interest preclude a finding of dominance. That is very important.

My next point, which is linked to this, is that there seemed to be some suggestion, sub-text or more than a sub-text in Mr. Turner's submissions that you had to have some degree of profitability as a dominant undertaking. Of course, it is well established that a dominant undertaking does not need to be super-profitable, or indeed profitable. Can we put away bundle A5 and take out bundle A1, and go to the case of *Michelin* in the European Court, which is at flag 8, and go to para.59, and bear in mind that Michelin, the well known French tyre company, so far as I am aware, never had the benefit of any regulatory monopoly. It has always been operating, as it were, in the tyre market, which has been an unregulated open market. At para.59 the court says:

> "As regards the additional criteria and evidence to which Michelin NV refers in order to disprove the existence of a dominant position, it must be observed that

> temporary unprofitability or even losses are not inconsistent with the existence of a dominant position …"

We, therefore, say that an inability to recover sunk costs, which is the foundation stone of Mr. Turner's case on this, is also not, of itself, inconsistent with dominance. As the Tribunal will be well aware, we, or Siemens, have challenged whether, in fact, this is actually seeking to recover sunk costs. Can I just give the Tribunal the reference, which is 27 to 32 of the Siemens skeleton?

Now, as we know, the Decision found, at para. 3.81, that National Grid was an unavoidable trading partner. That, as we also know, is a highly relevant factor in determining whether an undertaking is dominant. Now, Mr. Turner's case was that gas suppliers have a choice. He said they had a choice between the P&M contracts and the Legacy contracts. He is right in that, but, of course, both contracts meant that you were dealing with National Grid. It is like Henry Ford saying, "You can have any colour Model T as long as it's black". You could have any contract, but it was a National Grid contract. Of course, National Grid's stance on maintenance (which we will look at, but you will recall that National Grid decided to retain to itself the maintenance) reinforced its position as an unavoidable trading partner.

I come finally on the question of market power to barriers to entry. Mr. Turner did not deny the importance of economies of scale. However, he said, "Well, don't worry about that because we, National Grid, face exactly the same problem". With the greatest respect, that is not an answer. The point here is that economies of scale are easier to achieve for the incumbent with a 97/98 percent market share than a CMO. I would invite the Tribunal to take up WS1, an exhibit to Mr. Avery's witness statement. If we go to p.764, this, I think, is a British Gas response to some questions from the Authority. Of course, as we know, Mr. Avery is a National Grid witness. If we look at p.764 we see in bold type - I am not going to read it out - the question from Ofgem. But, what I am going to direct the Tribunal's attention to is the last paragraph on that page.

> "It is BGT's view that although these additional volumes will make the CMOs' policy replacement targets more achievable, the revised total number of available meters for policy is still vastly lower than the BGT had expected during the Legacy negotiations and lower than necessary to allow the CMOs to achieve reasonable economies of scale".

The next point, which, in a sense, is an obvious point, is that there is of course a relationship between volume and price. We will see, when I come to it (but if I just flag it up for the moment), that because of the volume reductions on CML which were effectively forced on

CML, CML had to increase its prices to British Gas. I would give the Tribunal the reference now, but I am going to go to it later because there is some important evidence - WS4, Tab 10, an exhibit to Mr. Hoskin's' evidence at p.2316.

The final point on economies of scale is this: that it is not just the volume that is important - it is also the mix of work and the need for PPMs. One of the things you will have noticed in Mr. Turner's submissions is to down-play the importance of PPMs in this case. Can I just give the Tribunal the reference to the evidence of Mr. Lewis (who is not being cross-examined)? That is at para. 36 of his witness statement at WS5, Tab 11. He says that the need for PPMs was 'key'. They were key because the overheads of the business were then spread over a larger capital base of assets. But, I will come back to that in due course.

That is all I wish to say on dominance.

I come to abuse. The Tribunal recall that in his opening Mr. Turner said that the issue of normal competition lay at the heart of this case. Professor Stoneman asked Mr. Turner in what sense was he using the words 'normal competition'. Was he using it in a lay sense, or was he using it in a technical sense? Mr. Turner said, "Both".

The important point that I want to make to the Tribunal is that when one is using the phrase 'normal competition' in Article 82 terms it has a specific, if you like, legal meaning. It is in that sense, and only in that sense that it is relevant to this case. It was used, so far as I am aware, for the first time in the *Hoffmann-La Roche* case, which is where it was picked up. The words were 'recourse to methods different from normal competition'. Not surprisingly, since 1979 when the European Court decided *Hoffmann-La Roche*, dominant undertakings have regularly come before the courts to say that in fact their conduct is simply normal competition. Those attempts have generally failed. The Tribunal will be aware that there was a debate in the pleadings on this issue. I can give the Tribunal the references. Siemens dealt with this in its statement of intervention at CB2, Tab 5, paras. 25 to 28, citing the court of first instance case in *Van den Bergh*, which I shall come to in a moment, where the CFI held that a dominant undertaking cannot equate the concept of normal competition with standard industry practice and then say that there is no abuse. That is, of course, because a dominant undertaking has a special responsibility not to allow its conduct to impair competition.

The Tribunal will recall - or, if it has not recalled will no doubt re-read - the pleadings to see that Siemens' analysis of *Van den Bergh* was challenged by National Grid in Annexe A to its skeleton (CB2, Tab 14, p.900). This is the advantage, one might hope, of having written pleadings, because this was then replied to by Siemens in its skeleton at CB2, Tab 17. That

is what I would now like to take up. I would ask the Tribunal to take it up at p.1028, para. 6. What Siemens says there is that,

> "The CFI held that the Commission had concluded correctly that 'by inducing retailers to obtain supplies exclusively from HB under the conditions referred to in paras. 159 and 160 above, HB had recourse to methods different from those which condition normal competition in consumer products'----"

The conditions referred to at paras. 159 and 160 above were:

> " …first, the existence of a market on which competition is already restricted because of the dominance of HB on that market [not eliminated but restricted], and, secondly, foreclosure of that market by the exclusivity arrangements which Access Directive the effect inter alia of preventing competing manufacturers from gaining access to the market".

I would ask the Tribunal to take up *Van den Bergh*. I know that Miss Carss-Frisk took us to that, but there are one or two passages she did not take us to which may be of assistance to the Tribunal. That is to be found at vol.3 of the authorities at flag 49. I would like to pick this up at 1613 because there is a similarity between the arguments of HB and the arguments of NG, and if we pick it up – this is arguments of the parties – 147:

> "HB submits that it is odd to classify as an abuse a practice which is widely employed, which the Commission does not argue has the object of restricting competition, and which is accepted as conferring benefits on the parties to the agreement."

Which is, of course, absolutely key. In that case the retailers were more than happy to get the benefit from HB, the benefit in that case was the freezer cabinet, and the whole point about these foreclosure cases, and the point I will be making time and time again, it is people like my clients who are not at the negotiating table, these are the third parties, the people who are excluded. So the fact that, as it were, there is an agreement and Party A is happy and Party B is happy does not preclude there being foreclosure, after all competition law is public law and not private law.

Then we see 148 a similar argument, in fact we could change it around "National Grid contest Ofgem's argument that the MSAs interfere with the gas suppliers freedom to choose suppliers on the basis of the merits of the products which they offer." So it is exactly the same argument that is being run here.

We then have another variant of an argument that is run, partly in relation to PPMs, because they say at 149:

"The Commission's position on market foreclosure is unsustainable under Article 86 of the Treaty" because you need a *de minimis* threshold and there is not sufficient materiality. We see then the Commission submission and if we look at the bottom of 151, the last two sentences:

> "It adds that HB cannot rely on the fact that the situation arises because of the free choice of retailers. HB has induced them to enter into agreements containing an exclusivity clause …"

There was no predatory pricing or anything in that case, it was an inducement, and that constituted the abuse.

We then have the finding of the court. I did not, in fact, take this Tribunal to what they say on dominant position but perhaps I could ask at some point the Tribunal to read to itself 154 to 156. It was a slightly late change of case by HB because they had accepted at some point they were dominant and then they said that they were not. But you see the emphasis that the court puts on unavoidable trading partner. At 157 we see:

> "It is necessary, next, to ascertain whether the Commission was correct to conclude in the contested decision that HB had abused its dominant position on the relevant market. It is settled case-law that the concept of abuse is an objective concept."

So you are looking at it objectively, you are not looking simply at the subjective views of the two parties to the contract, it is an objective concept relating to the behaviour of an undertaking.

THE CHAIRMAN: Which paragraph are you at?

MR. VAJDA: 157:

"It is necessary, next, to ascertain whether the Commission was correct to conclude in the contested decision that HB had abused its dominant position on the relevant market. It is settled case-law that the concept of abuse is an objective concept."

So objective as opposed to be subjective of the views of the parties to the contract, that is what is significant about the use of the word "objective".

We then have 158 and 159 that Miss Carss-Frisk took us to on Friday. At 158 we have the reference to special responsibility.

Then 159 the court agrees that the practice of HB was the standard practice on the relevant market, and this is the passage that has been read to us so we do not need to read it again.

Then the important passage, which is the one we cite at para. 6 of the Siemens' skeleton, the fact that an undertaking in a dominant position ties outlets in a relevant market by an

exclusivity clause which constitutes abuse of a dominant position within the meaning of Article 86 because it prevents competing manufacturers from gaining access to the relevant market.

Then we see at 162, and if I could just ask the Tribunal to note the last sentence:

> "The Commission then correctly concluded that by inducing retailers to obtain supplies exclusively from HB under the conditions referred to in 159 and 160 HB had recourse to methods different from those which condition normal competition in consumer products."

I fully accept we were not concerned with PRCs, but you can see on the basic thing of abuse you could almost have HB's counsel representing National Grid, and Mr. Turner representing HB, the arguments made were pretty much the same.

The other point to make about HB is that you will see that the CFI have no difficulty in finding an abuse in that case without needing to determine what the benchmark was. You heard a lot about the "benchmark", and without needing to find a counterfactual. I will come back to that in due course because again that is an important part of Mr. Turner's case but you will see in those passages I have taken you to there is no reference to "benchmark" or "counterfactual".

THE CHAIRMAN: Well in para. 148: "HB adds that many of the retailers concerned would not stock ice cream at all if the freezer were not supplied to them", so it looks as if the counterfactual they were putting forward was one where there was no freezer supplied.

MR. VAJDA: Yes, but that is effectively the HB argument.

THE CHAIRMAN: Yes, but there is nothing ----

MR. VAJDA: There is nothing; the court does not say: "That is the way we need to analyse this." It was not the way that the Court of First Instance approached the issue of abuse.

My last comment on normal competition is that we have had a look at what Professor Whish has said about this, and Professor Whish, so far as I am aware is in no way involved in this case. He says something which, in my respectful submission, has a lot of force. It is at p.194 of the extract. He cites at the bottom of 193 the definition in *Roche*, and he says at the top of p.194:

> "This paragraph has been regularly cited in judgments and decisions on the meaning of abuse and in the literature on the subject, but it does not provide an over-arching definition of the term; quite apart from the fact that it does not capture the exploitative practices of a dominant firm, for example, to charge customers excessively high prices, which cannot be said to *hinder* competition,

reference to the idea of 'methods different from those which condition normal competition' is too indeterminate to provide a coherent definition."

So, in other words, one should not get too fixated by this concept of what is or what is not normal competition.

That is all I want to say on normal competition. I am now going to move to the question of foreclosure. As I said, the issue in competition law is what is the effect of the arrangement in a contract between party A and party B, does it hinder the access to the market by C? The fact, as I said, that A and B may have their own commercial reasons for signing does not mean that there cannot be foreclosure. So British Gas's belief that it achieved, and I use Mr. Turner's language, appropriate harmonisation – that is the language used at para.1 of what I will call the CMO National Grid note, do the Tribunal recall that, that was one of the notes that was handed up on Friday. It may be worth digging that out, because I will be referring to that in due course. It is called "Effects on CMOs". Does the Tribunal have the note?

THE CHAIRMAN: Yes.

MR. VAJDA: You will see that towards the end of para.1 there is a statement just before the bit in italics:

"It [British Gas] believed it had achieved such harmonisation …"

That is to say harmonisation between the MSAs and the CMOs. We say that that is not the test. If that were the test Article 82 would be pretty much of a dead letter. I will go on to explain in a moment where, in fact, that belief turned out to be badly mistaken, but the point I am making now is the point that in a sense is not a definitive point. Of course, the Tribunal will be aware that the issue of foreclosure is a much more serious and acute issue in an Article 82 than an Article 81 case. In an Article 82 competition has already been reduced, and it is for that reason that a dominant undertaking has a special responsibility. What others might be able to do that it may not be able to do if it cannot justify the foreclosure effects.

The foreclosure effect that one is looking at in this case is effectively access to the 17 million odd Legacy MSAs. That is the issue here.

Mr. Turner sought to seek some comfort from the recent Commission paper at A6 on foreclosure, and it is important that we go to that. That is volume A6, flag 20. Perhaps we should first go to the passage that Mr. Turner relied on, which is at p.4560. He relied on para.19 to say that foreclosure can only occur where access to the market is:

"… eliminated as a result of the conduct by a dominant undertaking whereby a dominant undertaking is likely to be in a position to profitably to prices."

Do you have that passage, madam?

It is important to see what this document is and what this document is not. You were not shown that, but if you go to the first page of this document, p.4553, you see that it is headed "Communication from the Commission, Guidance on the Commission's Enforcement Priorities". So it is a bit like the OFT, it is an enforcement priority document. If we then go to p.4556, you will see under the heading "Purpose of this document":

"The present document sets out the enforcement priorities that will guide the Commission's action …"

Then we see at para.3 what this document is not:

"The document is not intended to constitute a statement of the law …"

So the statement that Mr. Turner places such heavy reliance on is relevant to the Commission's enforcement procedures, but we say it does not reflect, and it does not purport to reflect, what the case law – that is to say the case law of the ECJ or the CFI – requires for foreclosure. Indeed, if one looks at the passage that Mr. Turner cited there is no reference in the footnote to any ECJ or CFI authority. We say that for the purpose of this Tribunal, and indeed the purpose of any court in the Community, the leading authority on foreclosure, and indeed the binding authority, is the decision of the European Court and the Court of First Instance in *British Airways*. I am not going to go through it in great detail, but I am not aware that there is anywhere in that judgment a finding that the foreclosure case against British Airways depended on the Commission showing that British Airways could profitably increase its prices. If there is a choice between *British Airways* and para.9, you plainly have to follow *British Airways*. I would like to go briefly to the Advocate General in *British Airways* at A5, flag 76. Could we pick it up at p.3276. I am not sure if all members of the Tribunal, but British Airways had a rebate scheme whereby it incentivised travel agents and there was an element of loyalty rebates which effectively tied the travel agent to British Airways. The Commission found that was an abuse, even though there was no contractual requirement on the agent to take all their tickets from British Airways. Indeed, it is instructive in the present case because one of the complaints in that case was Virgin, so quite a strong, powerful, well known company. British Airways appealed unsuccessfully to the Court of First Instance saying this is not an abuse. There was an appeal on law from the Court of First Instance to the European Court which was decided last year, and British Airways lost that appeal as well. This is the opinion of the

Advocate General. Her analysis starts at p.3276. If I could just pick it up at the heading above 37, "(a) No closed categories of abusive rebates and bonuses". Of course, I would say there is no closed category of abuse as such. Then at 40 she says:

> "Contrary to what BA maintains, however, this case-law does not indicate any *closed categories* of abusive bonus and rebate schemes. It cannot in any way be inferred from those judgments that bonuses or rebates granted by an undertaking in a dominant position are abusive only in the circumstances described in detail in those cases" --

Pausing there, what British Airways was seeking to do, which of course, any dominant undertaking says, was to say, "Of course, those other cases are factually distinct from my case. Therefore, although you may have found an abuse in that case, there is not an abuse in this case. She said,

> "It cannot be in any way inferred from those judgments that bonuses or rebates granted by an undertaking in a dominant position are abusive only in the circumstances described in those cases. That would be to ignore the fact that individual sectors of the economy and markets can differ significantly from one to another and that, moreover, economic circumstances are subject to constant change, which, not least, can also entail new business practices.
>
> The decisive factor is rather the underlying thoughts which have guided the previous case-law for the Court of Justice and which can be transposed to a case such as the present.
>
> It therefore needs to be examined first whether the rebates or bonuses granted by an undertaking in a dominant position give rise to a foreclosure *effect*, i.e. whether they are capable of making it difficult or impossible for the competitors of the dominant undertaking to have access to the market and for the business partners of the dominant undertaking to choose between the various sources of supply; secondly, it needs to be examined whether there is an *objective economic justification* for the rebates and bonuses granted.
>
> Whilst, of course, objective economic justification becomes relevant only if the rebates or bonuses granted do give rise to a foreclosure effect, *both* steps in this examination are designed to distinguish abusive from lawful conduct and thus ensure that legitimate price competition does not fall foul of Article 82 EC"

So, that is the role of objective justification - to distinguish between what is permitted and what is not permitted.

She then says at para. 44, half-way down,

> "Nor, contrary to what BA argues, is the decisive factor whether the contractual partners of the dominant undertaking can still choose freely between various sources of supply. Application of Article 82 EC is in no way deferred until there is practically no effective competition left in the market. Its purpose is rather to protect *existing competition* in a market, weakened by the presence of the dominant undertaking ----"

So, that is important on the meeting the competition point because that reinforces the point I made earlier on dominance - that there is competition where you have dominance, and it thus extends much further beyond the second category described by BA.

Then she says at para. 45 that you need to look at all the circumstances, which plainly is right. She then examines the facts of that case.

The European Court adopted the approach of the Advocate General. I will just give the Tribunal the references without going to them: Tab 84 of this bundle, paras. 57 to 80. I would ask the Tribunal to note British Airways' argument. It also ran a normal competition argument at para. 41.

Of course, I accept that this is not a rebate case. However, there is no reason for a different approach in principle in the present case. The categories of abuse are not closed. Here we have conditions in long-term contracts and whatever Mr. Turner says about these not being eighteen year contracts, they could last eighteen years in the case of some meters. They have the effect, we say, and the Authority say, of binding gas suppliers to National Grid. Indeed, as the Tribunal observed in commenting to Mr. Turner, part of the reason that the inducements were so successful was, of course, this huge Legacy base which meant that you could have quite a small reduction in the price, but spread over a large number of 20 million meters that transferred into quite a nice large lump sum in cash. Of course, a CMO which does not have that Legacy base is not in the position to do that.

Also, we say - and we say that this has been found in the Decision - that the MSAs had a noticeable effect on what I might call the margin, and because the glidepath was very critical both at the Take or Pay level and when you went into the PRCs, in the same way that the British Airways scheme had a noticeable effect on the margin.

So, that is what we say on foreclosure.

I now want to turn to the question of objective justification. That was the second question that the Advocate General asked her. We are not saying that any foreclosure is necessarily an abuse. It can be objectively justified. That is what the Advocate General said in *Kokott*.

Siemens has set out the test for objective justification in our skeleton. I have given the Tribunal the references in the Siemens skeleton at p.2242. We would add forensically, if we may, that no doubt the weakness of National Grid's case on objective justification is why its distinguished legal team has concentrated on the issue of normal competition rather than that of objective justification. It is quite understandable. By doing that they have sought to avoid having to meet the rigorous twin hurdles of indispensability and proportionality in objective justification.

I would make two observations on the facts. First, as the Authority found - and it is not in dispute - National Grid reserves the right to levy a higher PRC if a disproportionate number of young meters are replaced. That is the Decision at p.224. But, we look in vain for an equivalent provision whereby if a disproportionate number of old meters are replaced - and you will recall that over 4 million of the initial Legacy stock in 2004 were over fifteen years old, and so we say that plainly fails the proportionality approach -- The second point I make is that Mr. Turner emphasised on the first day of this trial the large number of fully functioning meters after twenty years.

PROFESSOR STONEMAN: Before you go on, can I ask you about your interpretation of 'proportional' there? Is that 'proportional' in a sort of balanced, mathematical sense? I thought it was proportionality with respect to the problem that was trying to be resolved. I thought that was the legal test.

MR. VAJDA: It is. That is entirely right. But, if one is looking at how National Grid should deal with its sunk costs and it is saying, "Well, we're going to levy -- see what extra charge is if you take out a lot of young meters -- What about the old meters?" We say that that lacks a balance.

PROFESSOR STONEMAN: Yes. But, balance and proportionality are different things is what I am saying.

MR. VAJDA: No. No. We would say that the two run into each other. The question is: Was this a proportionate response? The point I am making is that if the MSAs, for example, contained a provision which had reduced PRCs for old meters, any argument that Grid might have on proportionality might be stronger than the argument that they have at the moment because there is nothing to that effect in the contract. That is the point I am making.

The second point that I would make - and this is connected with the point I have just made - is that Mr. Turner emphasised that there were a large number of meters that still operate perfectly well after twenty years. That is undoubtedly true. But, what he did not explain

was how National Grid could justify a PRC on such meters at the same level as a young meter. The fact that a meter is fully functioning in our submission is a different point from the question as to the level of the PRC that you can impose on that meter.

So those are the points that we have on objective justification, subject to this: I think you, madam, asked counsel for the authority this morning about burden of proof, what the position is. Can I, just on that, give you the reference, one of which I have taken the Tribunal to, which is the 2005 Commission Guidance which purports to reflect what the law is, para.77, A5, 74. In the sense the most recent learning we have from the courts is the *Microsoft* judgment and if I could just give again the reference in view of the time, it is para. 688 and that is to be found at A5, tab 86.

THE CHAIRMAN: Does that *Microsoft* decision deal at all with the issue of consistency with the Human Rights Convention of imposing of burden of proof on the company to disprove an aspect of abusive behaviour?

MR. VAJDA: Can I leave that to my capable Juniors and come back to you on that? I am afraid I cannot answer that question.

I now want to turn to the question of efficient or artificial meter replacement. Much has been made that one has to contrast so-called efficient meter replacement against inefficient or artificial meter replacement. It is said that inefficient or artificial meter replacement would raise costs and is against consumer interests.

In the context of the present case we say, with the greatest respect to National Grid, it is not for National Grid to determine when a replacement of a meter would be efficient or inefficient. In a competitive market, as opposed to a regulated market, which this was, it is for the market to decide whether it is efficient to replace a meter or not. That is an important point. It is not for the dominant undertaking to lay on itself the burden, and of course that is why regulation is different from competition. Certainly, if you are regulated monopoly you may get into questions of efficiency with the regulator as to how much he is going to allow you in terms of expenditure for your price review, but if you are dealing in a market which is moving out of regulation the whole point of the gas supplier principle is that it is for British Gas, or the others, to determine when they want to replace the meter, and it does not lie in the mouth of National Grid to say: "You cannot have too many meters being replaced because that is going to upset customers", the decision is for British Gas to decide. British Gas has to weigh up effectively, if you like, the customer disruption issue with cost to British Gas of the meter which of course, ultimately given that we should be in a relatively competitive market on gas supply, it affects competition between British Gas

and the other suppliers, and we say that this artificial replacement argument is like saying that where a consumer is prevailed upon, or changes his software – say his Microsoft software – or his PC, or his car, before it is actually obsolete, it is still fully functioning that that is in some way artificial, and that Microsoft could come along and say: "Windows 95 is perfectly all right, it functions perfectly well, it is inefficient to replace it, but that is not an argument a dominant undertaking can use to justify restricting competition from new competitors on the market.

Mr. Turner then went on to say that the glidepath was "consistent with the organic natural pattern of replacement" (day 1, p.20). But, as I have said, it is not for National Grid to determine what anybody's organic, natural replacements are. We say that in fact the glidepath does not even meet Mr. Turner's own test because British Gas has been restrained by the Legacy MSAs since their inception and has been in the take or pay zone since February 2006, and that is a finding that is made in the Decision at 2.126. The Decision relies on a document that we should go to which is at PD4, tab 69 at 2196. This is a meeting that took place between BGT and Ofgem in 2007. If we look at the "Take or Pay and the glidepath", perhaps in view of the time I could simply ask the Tribunal to read to itself the penultimate paragraph which begins: "GW explained that there are two reasons for BGT." (After a pause) You will see at the end of that it says: "In respect of PPMs BGT expects to exceed", so it is going beyond the BLR, "… the take or pay zone buy the end of the year and be paying PRCs", the end of that year being 2007.

Mr. Wignall, who I think is "GW" gives two reasons, first is the volumes of CMO contracts are greater than the volumes of removal permitted by the glidepath, that is his first reason. The second reason is about the failure to replace sufficient policy meters, and you will remember that is when National Grid then step in and that counts towards the glidepath.

There are some further reasons for British Gas having problems with the glidepath and if I can just deal with the quickly and give the Tribunal the references. First, its allowance in absolute numbers has decreased with its reduction in market share, because although the glidepath is based on percentages its contracts with CMOs are based on numbers and the reference is Lewis WS5, tab 11, para.28. Also he says at para.30 that British Gas failed to take account of the replacement meters and the maintenance counting towards the glidepath. In fact, he goes on to explain that, paradoxically, the problems of the CMOs have assisted British Gas because the CMOs have not been able to perform up to scratch. So at the moment the position is that British Gas is paying National Grid for meters it is no longer using however old they are.

THE CHAIRMAN: But did the contracts with the CMOs not change with the introduction of a ceiling on the numbers of meters they could replace, otherwise there were financial penalties imposed on them if they changed ----

MR. VAJDA: Oh yes, but the fact that a CMO may not meet the target might mean that the CMO might be subject to, if you like, a contractual dispute with British Gas, but it means that that particular meter has not been replaced by the CMO. The consequence of going over the glide path is less severe because the CMO has not actually been able to do the work.

THE CHAIRMAN: I meant the other direction, that there was a penalty introduced on this CMO if they replaced too many meters.

MR. VAJDA: I am told it only applied to Meter Fit.

THE CHAIRMAN: Thank you.

MR. VAJDA: This evidence shows that the belief which is trumpeted at para.1 of the CMO note that BG achieved appropriate harmonisation has not turned out to be correct. That, of course, is another very good illustration why abuse is an objective concept and does not depend on the subjective views of parties to a contract before they sign it. Obviously I am not disputing, and we have got the evidence, they all thought this was a very good thing.

I come to the counterfactual. We have submitted – I say "we", Siemens, but adopted by CML – at para.35 of the statement of intervention, which is CB2, 5, that so far as Siemens was aware no ECJ CFI case decided the need for a counterfactual. That has not, so far as I can see, been disputed by Grid in the pleadings.

Mr. Turner relied on the 2008 Commission Guidance, para.20. In view of the time I am not going to go back to that. You will recall that that is, in fact, an enforcement priority paper of the Commission. It does not reflect the law. You will see when you read it again that it says that the Commission will usually use a counterfactual, and one of them is the simple absence of the conduct in question. That is one of the counterfactuals – in other words, even for the Commission you do not need to look at a realistic alternative because they give two counterfactuals, the simple absence of the conduct in question, or another realistic alternative. The decision at 4.89 refers to the age-related counterfactual as "a" useful counterfactual.

I come to the question, and I can, I hope, deal with this briefly, of prices. We say this is a red herring, it is Mr. Turner's contribution to red herrings in this case. He said that prices here are neither excessive nor predatory. We agree but that does not mean that there is no abuse. He said that you need to look at the MSAs in the round. They are a package. The

lower price does not, as it were, come for free. It is lower prices plus PRCs. You could not have lower prices on their own.

In so far as this is put forward as some sort of justification we say it fails. Consider the question of discounts. Discounts give customers lower prices, but they are part of a package. British Airways said, "Okay, we are going to lower our prices". They did not. They said, "We are going to lower prices and we are going to impose some conditions". What the vice was in *British Airways* was that conditions attached to the discount. Here the vice, we say, is the conditions attached to the MSA prices. So all I am saying is that the fact that this is a package does not in any way make it immune from Article 82.

I come to the last part of my submissions, which concentrate on the effects of this conduct on CML/Siemens. What I am proposing to do, just so the Tribunal has the structure, is say something very briefly about competitive conditions between CML, Siemens and National Grid, and then I am going to look at only, because of time, three specific effects.

Dealing, first of all, with the issue of competition between CML, Siemens and Grid, it is well established that key factors of competition in a market, including this market, are price, innovation, quality of product and service levels. We say that CML and Siemens' products compare very favourably with National Grid on all these measures. The evidence is at Mr. Hoskin's' statement which is at WS4, flag 10, paras.9-19. Dealing with the question of price, CML through Mr. Hoskin produced various tables which have been criticised by National Grid. I just give the reference to the tables, I am not going to go to them. The first is at WS4, flag 10, paras.10-13, then there is an adjustment made in Hoskin 2, which is WS5, flag 13, p.2500.

CML does not accept most of those criticisms, but sought in the annex to its skeleton, CB2, flag 16, p.1015, to adjust the table to take account of those criticisms. We say that the results show that CML's DCM meters are still cheaper than Grid's, and that is particularly para.7 of the annex, and of course that evidence has been unchallenged in the sense of no cross-examination.

Dealing with other matters, that is service levels and quality of products, there have been what I might call a few quibbles by National Grid, that is Mr. Way, para.57, but we say there can really be no dispute that CML is offering a more competitive product than NG. Otherwise, it is hard to see why the larges gas supplier, British Gas, would have appointed a CMO as a CMO in the first place.

In terms of innovation, can I just ask you to take up, very briefly, the witness statement of Mr. Hoskin, WS4, flag 10, p.2165, where he deals with gas prepayment meters. These are

the PPMs. The point that he makes here, and this is relevant to Professor Stoneham's point about stranding this morning, is that the L&G meters which CML use have a modular design which enables straightforward functionality exchange between prepayment meters and credit meters and makes them easily upgradeable to smart meters. The point there is that they are less susceptible to stranding. If at 3.30 I am allowed to show the Tribunal the picture, perhaps we could go to p.2197. We have a picture of this L&G meter with a modular design. The item on the left, that is the basic meter which can operate as a DCM, as a credit meter. Then you have something on the right which slides in, which is the PPM module. So, that is what is meant by 'upgradeable'. That is important because, of course, this is not a smart meter in the smart meter sense. But, the point here - which is the point that my client stresses - is that when one is looking at the question of stranding -- We are producing something which is not only, we say, better than Grid's, but is actually less likely to be stranded because it can be upgradeable. That is a feature of competition.

THE CHAIRMAN: If it is installed as a PPM can you, by removing that thing, change it into a DCM?

MR. VAJDA: Yes. Yes.

PROFESSOR STONEMAN: Can I just inquire though -- It was argued, I think, in one of the early papers that the real cost of installation was the labour cost of getting to and from the property - not the cost of the meter on the wall.

MR. VAJDA: It depends. Obviously there are, if you like, meters which are very, very difficult to get to. But, you will recall that PPMs are considerably more expensive than DCMs. Indeed, they are more sophisticated and they are more liable to go wrong. A DCM is, if you like, more bulk standard. The PPM is a more expensive machine. So, you have a larger capital cost, although obviously the installation cost, I suspect, is going to be pretty much the same for a DCM and a PPM. Of course, the installation cost is very much driven by access rates. This is why PPMs are quite important (and I will come to this): the significance of National Grid maintaining maintenance on its meters is that where you have maintenance on a PPM you have very good rates of access. That is quite significant.

I am now going to go to the first three of my effect. I hope I am going to be about another ten or fifteen minutes.

> The first effect that we draw to the Tribunal's attention - and these, of course, are, in a sense, drawing out what has been said in writing - to the reduction in volumes of DCM between the time of the tender in 2001 and the signing of the BG contract. We do not accept, with some regret, what Ofgem said this morning - that

those were modest reductions. I do not know quite what is meant by 'modest', but we say they were significant reductions.

As Ofgem explained, the Decision found both actual and likely effect. We have got a little document which I will hand up at the end, which is what you might call the pleading document, where we have sought to set out what everybody says on the effects point. Now, so far as this Tribunal is concerned, we asked the Tribunal to uphold the Decision's findings both on actual and likely effect. There are three elements to that.

The first, so far as CML is concerned, is that its volume is reduced in 2003. Happily, there is no dispute about that. If I can take you to the chronology at CB2, Tab 12 you will see at p.833 that this is an agreed chronology as between Ofgem and ... But, we are delighted with this part of it. If we go to p.838 you will see two events there - March 2003:

"BG notified Siemens/CML of a reduction in credit meter volumes of approximately 20 percent ----"

So, that is common ground. Then we see,

"BG notified Siemens/CML of a reduction in prepayment meter volumes by comparison with the numbers previously discussed".

So, there is common ground that there is reduction both in DCM and PPM.

The Decision found that that reduction had a causal link with the MSAs. We ask the Tribunal to uphold that finding.

The decision also found that there were some other factors at play. We are not asking the Tribunal to, as it were, isolate out all the factors here. What we say is sufficient is to show that there was a reduction in CML's volume; that that was caused by the MSA; and that you cannot, as it were, dismiss the MSA cause as sort of de minimis or unimportant. In fact, you do not have a de minimis rule in Article 82 in any case, but we say that it was not de minimis.

I think perhaps in view of the shortness of time I am going to give some references. These are to contemporaneous documents. I am not going to go to them. The first document I am going to go to. It may actually be the source of some controversy because it is in the M bundle. We rather adopt Mr. Turner's view of the M bundle. This is at Tab 21. This is, we say, a document of some significance because it is contemporaneous and it comes from Mr. Lewis, and it is dated 3rd January, 2003, i.e. just after British Gas signed the letter of intent with National Grid for the MSAs. It is internal to British Gas. If we go over to p.120 -- I am not going to read anything out from this because I am reminded that it is all confidential. But, I have some points to make on this. You will see the heading of this ----

THE CHAIRMAN: Would it be easier if we cleared the court then of those who are not in the confidentiality ring.

MR. VAJDA: I am happy to do that.

THE CHAIRMAN: If everybody who is not in the confidentiality ring could leave briefly, please?

(Proceedings continued In Camera)

MR. VAJDA: Would the Tribunal like me to wait.

THE CHAIRMAN: No, I think carry on.

MR. VAJDA: Mr. Randolph has asked me to ask the Tribunal how long the Tribunal is willing to sit this evening, because I had said to him I would be an hour and a half and, like many counsel, I have exceeded my estimate, and I am sure he is getting itchy feet.

THE CHAIRMAN: How much longer are you going to be, Mr. Vajda.

MR. VAJDA: If I am given perhaps another 10 minutes – I think if I have anything I have not done orally if the Tribunal permits me I will just put in a short note tomorrow with references, because I appreciate we have to get on. I do not know how long Mr. Randolph will be.

MR. RANDOLPH: I hope to be able to fit in but it depends how long the Tribunal can sit for. If it is helpful to the Tribunal I am well prepared for my submissions and they will be focused, but equally there may well be questions from the Tribunal and I do not want that to be curtailed, because there are very important points that need to be dealt with relating to Meter Fit, we were the first competitor on the block.

THE CHAIRMAN: If we were prepared to sit until half past four would that enable you both to finish your opening submissions.

MR. RANDOLPH: Hopefully, I will do my very, very best.

THE CHAIRMAN: Let us see if we can achieve that then.

MR. RANDOLPH: I am grateful.

MR. VAJDA: Continuing then on the first effect, if I can just give the Tribunal the reference, I am not going to go to them now: 27th February 2003, we have two internal British Gas emails, which are at WS5, flag 11, p.2482-2. One of them refers to managing legacy, the other talks about post legacy, post correction. I accept there is an issue as to correction, but my point is that legacy is plainly a feature.

Can I just say then the next bit in the chronology, 7th March, when there is an email from Mr. James to Mr. Southgate, and that is to be found at WS5, flag 15, 2772. That is of some importance because I regret to say that in the National Grid CMO note there was what I

might call some selective quotation. There were words omitted, which I am sure was accidental, but I would ask the Tribunal to read the whole of that email, and not just the extract quoted in the National Grid note.

Then the next relevant event is the email from Mr. Lewis to Mr. Southgate of 18th March 2003, WS5, 15/2782. That is quoted accurately and fully in the NG note, but what the NG note fails to do is to make any reference to Mr. Lewis's evidence at paras.18 and 25-35, which includes an explanation as to why Mr. Lewis did not refer to the MSAs as a cause of the reduction.

I think in the interests of time I am not going to go through the other references. I will do that on a piece of paper. I will come to the second effect, which is the October 2003 reductions and the corresponding price increase. The best, and I hope quickest, way of dealing with this is to look at Mr. Hoskin's witness statement, WS4. Given the time I am going to skip that, because effectively all that it shows – we can put it in writing – what the figures are. As I say, there is no dispute that there was a reduction.

What I say by conclusion is that the statement by Mr. Turner on Friday, "no obvious reason for thinking that they, namely the MSAs, led to a reduction in the volume finally made available to CML", we say is unsustainable.

I then come to the third and final effect, which is the bundling of meter maintenance and meter provision. The first point to make here is that this is important in relation to PPMs, because we all realise that maintenance is a PPM issue. We agree with Ofgem that the Decision did make a finding on foreclosure effect in relation to PPM – that is at 4.80. That is obviously a matter ultimately for the Tribunal to look at, but we support Ofgem in that.

There are some points that we need to make in relation to PPMs. First, there is no doubt that British Gas wanted CML to provide PPMs as well as DCMs. It was in the invitation to tender and the reference is WS5/15/2716. I think we will give a few more references overnight on paper. The point that was made at the meeting – there was a meeting on 21st June 2002, between Siemens and British Gas, and there is a minute of that at WS5/15/2748. It is an important document, it is a contemporaneous document and I ask the Tribunal to look at that, because that shows quite clearly that everybody was proceeding on a "first visit fit" principle. That is important. That is corresponding to what Mr. Lewis says in his witness evidence at para.19. There are then two further emails which are again important to look at, 11th June 2002. There are two emails there, WS5/19/2904-1. That was the time in June 2002 that National Grid say to British Gas that meter maintenance is off the table. British Gas, you will see an internal minute saying, "What are our options on that?" It was

only by an email of 18th March 2003 that British Gas told Siemens that National Grid would maintain meters. That is at 2782. So we say that it is quite clear that British Gas wanted Siemens/CML to do meter maintenance. The importance of meter maintenance can be seen in a document that I am going to go to, which is at WS4/8. This is a confidential document, and I will try and deal with this in a non-confidential way. It is 2295. This is the original quotation made by Siemens to British Gas following the invitation to tender. You will see it is dated 11th October 2002. If you go over the page you will see the quotation works, and you will see that it is split into credit and prepayment. The main credit is GR1 – does the Tribunal see that; the prepayment is GR5. What I ask the Tribunal to focus on, and I am not going to mention the figures, is the revenue figures, how important the revenue figures for PPM are. By my calculation they account for 52 per cent of the gas revenue. You have got electricity below, which we ignore, but they are very important in revenue terms, even though in terms of volume, by my calculation, only account for 22 per cent of volume. So do not forget about PPMs, they are important, and they are important to the CMOs because any reduction, and there was a reduction, in the volume of PPM meters has a disproportionate effect on the capitalised value of the portfolio of CML.

What that means in short is that there are fewer meters to cover the overheads which means the cost of each meter will go up, which is precisely what happened in October 2003. If I can find that document, that will be the last document I take the Tribunal to. Can we go to flag 11, I am grateful to Mr. Rayment, again a confidential document but important to see how this works on the ground, p.2313, I am not going to read it out, but can I ask the Tribunal to read under the heading 2.1.1 "Volume reductions". Then over the page you see the recalculated figures, and we now see the figure for GR5, which is the PPMs, which have gone down from the figure at tab 8 to the figure that we now have here. I am not going to read those figures out, but it is a reduction. There is no dispute that there is a reduction. We see then 2.1.2. I would ask the Tribunal to read that, particularly the last sentence, "As a consequence, CML has had to adjust its price". Then if we go to p.2316 -- I would ask the Tribunal to read the heading 'Effect on Annual Rental Charges'. The effect which has been described above has been to -- We see what is said. Then, on 4, 'Cost Mitigation Proposals'. Again, I would ask the Tribunal to read that.

So, we say that you must not under-estimate the importance of PPMs. They were key for the CMOs because they were such a large amount of capex. That is the third of the three effects that I am going to say something about. So, we say there is ample scope to uphold the

decision on actual effect and invite the Tribunal to do so. I will now sit down subject to anything arising.

THE CHAIRMAN: Thank you, Mr. Vajda. Mr. Randolph?

MR. RANDOLPH: Madam, gentlemen, good afternoon. I will try my very best to deal with my submissions in the half-hour available, but if that is not possible it may be, as with Mr. Turner, if it is possible for the Tribunal to start a little earlier tomorrow -- I am very aware of the fact that there are witness summonses out which are returnable for ten-thirty tomorrow. Also, there is the evidence which the Tribunal wants to hear. But, we do have a bit to say and I would like to say it.

Just a small point on the non-graveyard point - in other words, the fact that changed-out meters from Grid do not go into some graveyard -- Mr. Vajda said what the position was with regard to CML. It is exactly the same position for my client, for Meter Fit. What happens is that they go and they are picked up by Grid's contractor. What happens to them thereafter is for Grid, but they certainly do not go into a black hole or a graveyard.

My submissions, madam, this afternoon will concentrate on issues relating to abuse. I adopt, with gratitude, the submissions made by the Authority and by Mr. Vajda with regard to dominance. We do not need to deal with those now. I want to concentrate on abuse. That is obvious, I would submit, with respect. We were the first competitor on the block in the newly liberalised market. We were the ones that first felt the force, we would submit, of what we contend to be the abusive behaviour through the MSAs. If the Tribunal could bear in mind the relevant timeline - because a thread running through Mr. Turner's submissions to you orally has been that you can somehow lump CMOs together. You can in certain aspects, but you should look at the particularities, we would submit, in other manners.

In this regard the timeline is important. You have the monopoly. Then you have the liberalisation of the market, and you have the P&M contracts which Mr. Turner described as a flaw -- or, were flawed. Then you have Meter Fit signing its agreements with British Gas in May 2002. Then you have the MSAs from Grid, signed up with five out of the six gas suppliers - EDF staying on the P&Ms. Then you have, amongst other things, the re-negotiation of my client's contracts with British Gas in the light of the MSAs. We say one of the conclusions of that negotiation was the reduction in volumes available to Meter Fit. That is an important timeline, we would submit. We are a key aspect of that. That is why I want to concentrate this afternoon on questions of abuse.

Ofgem's Decision, which is sought to be appealed by Grid insofar as abuse is concerned, is that Grid abused its dominant position by entering into the MSAs with the five gas

suppliers. That is, for your note, para. 4.43 of the Decision (CB1, pp.74 to 75), and that the abuse (this is important) is that those MSAs have restricted the ability of CMOs to compete effectively with Grid. There is a link between the MSAs and the ability of the CMOs to compete effectively with Grid. As my learned friend, Mr. Vajda, said, the Authority did not only find that the abuse was likely to have occurred, but that it actually occurred insofar as there was not just likely foreclosure - there was actual foreclosure. Again for your note, that is paras. 4.102 to 4.108 of the Decision (CB1, pp.90 to 92). It may be worthwhile going to that because I do not believe that Mr. Turner went to that aspect of the Decision. Madam, at this stage you will only require, I hope. CB1 and CB2. So, at para. 4.102,

> "The Authority also considers that the Legacy MSAS have had an actual foreclosing effect on competing CMOs".

It goes down, at 4.103 importantly,

> "When BGT (which, at the time, represented approximately 60 percent of domestic sized meter demand in Great Britain) became aware of the terms that National Grid was proposing to it in the MSAs, BGT reduced the quantities of meters which it was willing to procure from CMOs, having previously been in negotiations with a number of CMOs to diversify its supplies of gas meters".

We strongly endorse that. Insofar as Meter Fit itself is concerned, para. 4.106 is relevant. Again, you were not taken to this.

> "According to Meter Fit, BGT became nervous in May 2004 about the contract volumes for gas meters, which resulted in a tightening of the maximum replacement caps. It is Meter Fit's view that the introduction of these fixed volume caps, requiring Meter Fit not to replace more than a certain percentage of contract volumes ----"

Just pausing there, madam, that was the point that was raised earlier. That is relevant to us. Effectively, if, under the renegotiated terms, Meter Fit replaced more than a particular percentage - and I believe it was 10 percent over - then that constituted or allowed British Gas to claim material breach and thereby bring about the consequence of a material breach, either termination or damages. So, it goes on,

> "-- is attributable to BGTs having entered into the MSAs".

Again, we strongly endorse that.

> "Under the new contract with Meter Fit, if the volume of meters installed in one year is within a very low range above the cap of the policy exchange work, the volume for subsequent years has to be reduced. If the volume of meters in one

> year is in excess of the low percentage above the cap that is considered a material breach of the Meter Fit contract".

That is the point that I have just made. As I say, we endorse and support those findings. The remainder of my submissions this afternoon will go to demonstrate, I hope, that Grid's attack on them, and on the decision relating to actual foreclosure, is misconceived.

We have already seen - and I will just give you the references in the transcript (I do not know whether you have the transcripts available to you, but they have been very helpfully produced very quickly - and I am very grateful for that personally) - in terms of what Mr. Turner said in opening, he did not deny that there had been actual foreclosure. It was just that it was not anti-competitive disclosure. That is Transcript Day 2, p.8. What the Legacy MSAs do is to discourage or dis-incentivise the gas suppliers from engaging their CMOs using the CMOs they have engaged to replace more meters than the level envisaged by the glidepath as opposed to engaging them in the first place. So you have disincentives and then in relation to your question, madam, transcript day 2, p.41 lines 7 to 14, there was the point about not anti-competitive foreclosure, and Mr. Turner saying: "I was on the point of saying foreclosure, but not as we know it." So we have that, common ground.

The rationale, it seems to me, for Mr. Turner's suggestion that this was "good" foreclosure rather than "bad" foreclosure, was that effectively the MSAs represented normal competition and that can be seen from the transcript, day 1, p.12, lines 12 to 14:

> "The characteristics of business meter provision which makes it normal for providers to compete against each other on the basis of long term rental agreements with cancellation charges, what we have loosely been calling 'term commitment' that is not a block to competition, you should think of it as the way in which competition happens in this market."

The issue of normal competition as a legal principle has been dealt with by my learned friend, Mr. Vajda, and I fully adopt that, and it is Siemens' statement of intervention and their skeleton we strong adopt and endorse that. So theoretically that issue could all go away on the basis that that is correct, and I strongly support Mr. Vajda that it is, there is no entry for normal competition in this particular case, given the particularity and the sensitivity and the special obligations on Grid, dominance does not give rise to rights, it gives rise to obligations to that extent.

In addition to that legal error, which we say wholly undermines his case, we also submit strongly that insofar as Meter Fit is concerned he was wrong to say – and effectively on several occasions Mr. Turner sought to assert that Meter Fit had similar arrangements to the

MSAs. We have been talking about premature replacement charges to the MSAs and Professor Stoneman had a debate with Mr. Turner on that subject. Again, for your note, transcript, day 1, p.12, lines 23 to 26:

> " … the way in which competition works with meter providers includes National Grid, Capital Meters, Meter Fit, UMS, is that it is normal to put in place agreements to compete to provide gas suppliers with agreements which contain some guarantees, these long term cancellation charges."

And then Day 1 again p.51, lines 19 to 20:

> "… like the CMOs have now done with British Gas where they have this PRC protection …"

Then Professor Stoneman's exchange, day 2, p.7, lines 20 to 32:

> "PROFESSOR STONEMAN: Let us take then the accelerated or normal replacement programmes, so this is where you are buying your meters from CMOs and most of the CMOs are giving out contracts – is it a five year PRC? They have a five year length after which you pay a PRC – you have to pay a PRC ----
>
> MR. TURNER: It is 20 years.
>
> PROFESSOR STONEMAN: The CMOs is all 20 years, is it?
>
> MR. TURNER: Yes, it is.
>
> PROFESSOR STONEMAN: Ah, then I am mistaken."

Well, I hope to show you, Professor Stoneman, that you were not mistaken, you are absolutely right. Then, Mr. Turner, with some degree of foresight, says: "My friends are probably going to take you to what those arrangements are …" well, I am. "… but I can tell you right now it is a 20 year "lock-in" if you like," it is not. "… if I can use that term without being emotive …." I will not comment on that.

> "… but the position is that there is a primary period and a secondary period, and the point is that they are, under their contracts, the exclusive meter providers for British Gas for that primary period, but the meters themselves have protection all the way."

Then finally on this section, transcript, day 2, pp.34 to 35, lines 33 to 34 and over the page, lines 1 and 2:

> "The no notice contracts which would have encouraged more replacement by the CMOs with their PRC arrangements (very high PRCs in the first years and extending over a 20 year period) would have meant replacing over the first three

years, that is up until 2006, dumb meters with cheaper dumb meters, subject to these very high PRC protections."

Absolutely is not the case, and we can see that both from the contract, our contract, and also from in effect the Decision itself of Ofgem. Now, given the time, and given the particularities and specificities of our contractual terms, what we have done, and I hope it is of assistance to the Tribunal is produce a short note with regard to a matter I am coming on to in a moment on volumes. What we would be more than happy to do is to produce a short note on the operation itself of the contracts because at the moment I will not have the time to deal with that. I think it is important, but I will take you now to the headline points to show that the Meter Fit contract of 2002, as renegotiated in 2004 did not contain provisions akin to the MSAs PRCs; it is as simple as that.

The agreement itself, in fact, it may be easier, and especially given the time, to go to our skeleton which is at CB2, tab 18, paras 15 to 17. Do you have that, madam, it is p.1954 internally in the bundle. Here we have sought to set out the agreement in 2002, para.15:

"15. Under the 2002 Agreement, Meter Fit charged British Gas for the meter replacement services it provided and also for meter rental. In addition, the following two types of charge were payable:

So two types of charges:

a. a Technology Replacement Payment was charged where British Gas replaced a Meter Fit meter which was fit for purpose with a meter using different technology."

That is effectively a "smart" change, not "dumb to dumb", or "dumb" to even possibly slightly less "dumb", but "dumb to smart".

"The level of the payment declined as the age of the meter which had been removed increased;"

So there is your age related counterfactual, but only relevant to TRPs. The second type of charge is:

b. a Transaction Charge was payable where British Gas required a Meter Fit meter which was fit for purpose to be removed in other circumstances, for instance to effect a functionality exchange from a credit to a pre-payment meter."

We heard from Mr. Vajda a moment ago about the fact that they could slot one module into another. I am not sure whether that is the position with regard to us. But where one had, for

example, a landlord ringing up with regard to buildings that he was dealing with and inhabitants where, for one reason or another, there was a request to go from a DCM to a PPM because of lack of credit or concerns about the ability to pay, then there would be a charge for that. Just carrying on:

> "The level of the Transaction Charge was much lower than that of the Technology Replacement Payment. It was calculated differently according to whether the meter replacement was effected by Meter Fit during the contract period with BG or after that time; after the initial contract period, the level of the Transaction Charge depreciated according to the age of the removed meter."

So again you have an age related provision there with regard to these transaction charges, which are essentially dealing with functionality.

THE CHAIRMAN: But they are only payable if Meter Fit actually does the work, is that right?

MR. RANDOLPH: Where British Gas requires, rings up and says to Meter Fit: "There are 100 DCMs, your meters, your Meter Fit DCMs, and we need you to change them to PPMs because we are concerned about the payment issue, they have fallen on hard times, or whatever", and it could be vice-versa. It could be that you have a whole lot of PPMs, "You, Meter Fit, go out and change them, change your meters to another type of your meter", in other words, PPM to DCM, or DCM to PPM. So in that functionality issue it is provided for in the contract – I am not saying whether it is reasonable or not, it is provided for – that a separate charge should be raised but, as we can see, it is a pretty low charge. What you do not have is some across the board premature replacement charges (as one can see in the MSAs) which are imposed after the glidepath has been exceeded What you do have are two types of focused additional charge.

PROFESSOR STONEMAN: Can I just ask, you did not talk about para.14, but the supply period was in each case initially set at five years. What happens at the end of five years?

MR. RANDOLPH: It is slightly complex, Professor Stoneman, because it was initially set at five years. It was then re-negotiated and there was an extension. There was an add-on one year.

PROFESSOR STONEMAN: Could you then be asked by British Gas to take all these meters away without them incurring any penalty?

MR. RANDOLPH: Without "them", British Gas?

PROFESSOR STONEMAN: Yes.

MR. RANDOLPH: If they required us, as far as I understand it – that is why I am quite keen to do a note on this – at that second stage for some functionality issue, some functionality reason, to change a DCM to a PPM or *vice versa*, then theoretically – I will be corrected if I

am wrong on this – a transaction charge could be levied. Of course, the overall basis of the agreement is that we have this short initial period, and I think, Professor Stoneman, this is where you were coming from looking at the debate between yourself and Mr. Turner on this five year point, one had a very small window, five years, extended to six after the renegotiation, to install, and that was it. After that it was just maintenance, you could not install any more after that. I think I am right in saying that because this is a non-discretionary issue, effectively, we are being rung up and it is said, for whatever objectively justified reason, there is going to be a change from one type of meter to another, then it may well be that the transaction charge was leviable then. My instructions are that actually, not dealing with transaction charges but dealing with technology replacement payments, as at today's date no TRPs have actually been levied, which does not say much about the introduction of the smart meter market, but it certainly does not impact going forward.

PROFESSOR STONEMAN: Let us have it on paper.

MR. RANDOLPH: I think that is right, not least because it is extremely complex. I will, if I may, take you very briefly – I can see the time I have got about seven minutes – to CT3/7. The key part of this very long document is schedule 2, which is at 1697, and going to that page, Professor Stoneman, I see the answer to your question, which is lucky. "Transaction charge":

[Confidential]

As we have seen, that is also age-related.

As I say, we will produce a note on this.

THE CHAIRMAN: The key point that you should cover in your note – as I understand it, a payment completion charge is a charge which is payable regardless of who does the work for taking out that meter and replacing it. So as far as National Grid is concerned, if Meter Fit comes and replaces the meter with its own meter there is no cost to National Grid for that visit because it is not carried out. They say they should have a payment because they incurred costs in installing the one that is now being removed. What I am still not clear about which should, I hope, be clarified by your note, is whether there are charges like that in the Meter Fit contract, not when Meter Fit actually go and visit the premises but when somebody else comes and changes over a meter which was originally put in by Meter Fit. Do you see the point that I am making?

MR. RANDOLPH: I do, and we will deal with that. I think my basic premise is that the point that Mr. Turner was seeking to make was, we have got PRCs just as they have, this is all part of the normal mix, perfectly sensible, why not allow it? What I am trying to do here is

show that we are certainly different. Just to make good that point, at CB1 in the Decision, para.2.69, and this is important because it goes across the board, it is not just Meter Fit, it is the CMO contracts and indeed UMS:

> "A key feature common to the CMO and UMS contracts is that removal of a meter that was installed under the contracts can result in an early replacement charge becoming payable (referred to in the contracts as a Technology Replacement Payment)."

We have seen that.

> "However, no early replacement charge is payable if a meter is identified as faulty (for example on a maintenance visit), or as part of a batch of meters that have been found to be insufficiently accurate and/or unsafe."

That is the policy meter point. Just on that, madam, originally in the 2002 Meter Fit agreement policy meters did not count to the contracted volume. In the 2004 agreement, and we say this is all part and parcel of the adverse effect of MSAs on us, they did. So they counted to the contractual volume. As you have seen already, if you go above the contractual volume by a particular percentage, you trigger the material breach provisions. So that is quite important, because there is no discretion there. If a meter is deemed to be – and I take Mr. Turner's word, "unsafe" is probably the wrong word – wrong for whatever reason or it does not fit within the norms then there is a health and safety issues, all sorts of reasons, it has got to be replaced. For us in 2004 that count towards our contractual volumes. So we say that is rather important. As I say, this is the Decision showing it is a key feature common to all.

So that deals in very short manner, and I will extend that by virtue of a note, with the workings of the agreement which I hope has assisted the Tribunal in seeing the actual factual background, and that is why I say, Professor Stoneman, that you were right, you were not mistaken. I would say that, wouldn't I, but you were not because there is not this lock-in to the PRC extent. Sure, there is potential for these types of charges, but they are focused, very targeted, and in addition they are age related.

We say, therefore, that it is not correct to submit, certainly in so far as Meter Fit is concerned, that the PRCs were just traded across and this constituted normal competition. It is absolutely nothing to do with it.

I have dealt with the time line which, as I say, is important. In terms of the reaction to competition in the market and the link between Grid drawing up the MSAs, the reference that I would like to take you to very briefly is at WS1, tab 1, 57 to 58. That is Mr.

Shoesmith. (Long pause) This is an Ofgem negotiation strategy. It deals with what Project JAM is - a contract to mitigate the risk of stranding. That is the MSAs. That is the whole point. At para. 1.5,

> "[Grid's] Metering has considered a range of options aimed at mitigating the risk of stranding and has concluded that negotiating a deal that offers a reduction in prices in return for a longer replacement period is likely to preserve maximum value".

That is where we have that. Then, going over the page, at para. 3.1,

> "Discourage premature replacement. Central to any deal would be a strategy to discourage premature replacement by meters before the end of their useful lives. This could be achieved either by: a commercial contract offering lower charges in return for a commitment from shippers to rent a minimum number of meters --"

Of course, this is June 2002. So, at that stage Meter Fit had signed, but not ,as I understand it, decided to operate. It had certainly signed its agreement with British Gas. This is the internal note from Grid, dealing with how on earth are they going to deal with what they now perceive to be the flaw in the P&M approach. They come to the idea that something along the lines of an MSA would be a good thing.

It is now 4.31 ----

THE CHAIRMAN: I do not want to put you under undue pressure to finish.

MR. RANDOLPH: Madam, that deals with Mr. Turner's point about normal competition. I have two discreet further points. One deals with the issue of volumes - and we have a paper on that - and the other deals with the very short point on meter maintenance. I do not believe that I will be more than ten or fifteen minutes maximum on that - not least because I have got the additional note. I am in your hands, madam. We can either carry on or, as Mr. Turner was given the opportunity, gratefully taken, to start early, it may be that that would be appropriate. I do not know how the Tribunal is fixed.

(The Tribunal confer)

THE CHAIRMAN: I think we will start at 10.15 tomorrow morning.

MR. RANDOLPH: Thank you. I will impose a cut-off of 10.30 - not least because of the witness summons.

THE CHAIRMAN: Thank you very much everybody.

MR. TURNER: Madam, may I just, in conclusion, make two housekeeping observations? I will not be more than a minute. The first relates to the exchange that we had about cross-examination of the interveners' witnesses. So that everybody is entirely clear of our position - and I thought I should leave no-one in any doubt - is this: that we have no issue with Ofgem that by contrast with a 'no notice' type of contract, the sort of term commitment involved with early replacement charges tend to lead to less replacement than would otherwise be the case. The Tribunal can take that as our position. In view of that, National Grid says that the precise extent to which these CMOs may have experienced reductions and what the explanatory causes were is not a central matter for this Tribunal to resolve. We have looked anxiously, in view of your comments before the weekend, at the statements of the interveners. We took to heart what you said. Our position is that only insofar as these matters are relevant the following are our propositions: that Meter Fit's volumes were not significantly reduced; that the Decision itself refers only, as Mr. Randolph has shown you, to a tightening of these volumes caps' and to the extent that there is any discussion about it, we have the contractual documents.

So far as CML is concerned, I am very grateful to Mr. Vajda. I can say that, yes, we accept that CML's volumes ended up as being lower to a significant extent than the ITT amounts. So, there is no dispute about that either.

As Mr. Vajda also pointed out, it was due to a range of factors. The extent to which the early replacement charges produce a causative effect again will be a matter of dispute, but we say it is not essential for this Tribunal. So, on that basis we are continuing with our position, that we choose not to cross-examine, and others will be able to take that into account in cross-examining National Grid's witnesses over the next two days.

THE CHAIRMAN: Thank you very much.

MR. VAJDA: Madam, that is certainly extremely helpful with regard to my little bit on volumes tomorrow because I may not need to go into as much detail as I otherwise had thought.

MR. TURNER: Madam, the second matter, which is very short, is Professor Stoneman's point raised earlier before the short adjournment. One would not expect replacement when the net benefit of using the new asset exceeds the cost involved, but, when the net benefit is the greatest, as it were, as I understood the point. Simply for the

Tribunal's reference - because it may be in the list of items that I hope the referendeur has passed you at the end of last week -- If you would look at Dr. Williams' second report, Appendix D (which is on the reading list), in WS6 at Tab 22, p.3122, footnote 13.

THE CHAIRMAN: Just remind me then which are the witnesses we are seeing tomorrow, Mr. Turner?

MR. TURNER: Tomorrow we start with Mr. Avery. Then we have Mr. Shoesmith. Depending on progress the next Grid witness is Mr. Mark Way. The last Grid witness, who the other parties have asked to cross-examine, is Mr. David James. Following that, there is only one further witness who I will be cross-examining - Miss Frerk of Ofgem.

THE CHAIRMAN: Thank you very much. We will resume tomorrow at a quarter past ten.

(Adjourned until 10.15 a.m. on Tuesday, 20th January, 2009)