IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1299/1/3/18

Victoria House,
Bloomsbury Place,
London WC1A 2EB

11 June 2019

Before:

PETER FREEMAN CBE QC (Hon)
(Chairman)
TIM FRAZER
PROFESSOR DAVID ULPH CBE

(Sitting as a Tribunal in England and Wales)

BETWEEN:

ROYAL MAIL PLC — Appellant

- and -

OFFICE OF COMMUNICATIONS — Respondent

- and -

WHISTL — Intervener

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HEARING – DAY 2

A P P E A R AN C E S

Mr Daniel Beard QC, Ms Ligia Osepciu and Ms Ciar McAndrew (instructed by Ashurst LLP) appeared on behalf of the Appellant.

Mr Josh Holmes QC, Ms Julianne Kerr Morrison and Mr Nikolaus Grubeck (instructed by Ofcom) appeared on behalf of the Respondent.

Mr Jon Turner QC, Mr Alan Bates and Ms Daisy MacKersie (instructed by Towerhouse LLP) appeared on behalf of the Intervener.

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Tuesday, 11 June 2019

(10.28 am)

Opening submissions by MR BEARD (continued)

THE CHAIRMAN: Mr Beard, good morning.

Before we resume our scaling of the heights of legal analysis, Professor Ulph has a couple of points he would like clarifying.

PROFESSOR ULPH: I would just like to clarify a couple of points you were making yesterday.

When you were talking about the issue of comparability between NPP1 and APP2, you said that there was a value to having extra flexibility by using APP2 compared to using NPP1.

MR BEARD: Yes.

PROFESSOR ULPH: Would you accept you could state that proposition the other way round, and say there's a cost, a non-price cost, of being on NPP1 relative to being on APP2?

MR BEARD: Well, insofar as the NPP1 restrictions apply, such that you've got to have the Royal Mail fall-to-earth across the 83 rather than across the zones, I think that would be a redescription that must be right in those circumstances. As with so many of these things, it depends on which side you're looking at it from.

PROFESSOR ULPH: Absolutely. Thank you. That's helpful.

So my second point was later on in your argument you were arguing that it would be impossible for Whistl to stay on NPP1 --

MR BEARD: Yes.

PROFESSOR ULPH: -- up to 31 SSCs through a combination of paying overcharges or surcharges and arbitrage. So it would have been cheaper to be on NPP1 vis-a-vis being on APP2.

MR BEARD: Yes.

PROFESSOR ULPH: That is a comparison purely in terms of the prices.

MR BEARD: Yes.

PROFESSOR ULPH: It doesn't take account of the non-price cost.

MR BEARD: Well, I'm not sure that the issue about the rolling out makes a difference to that. If your question is really, well, actually what you're doing here is you're not taking into account the non-price cost that is attributable to NPP1 in any of these comparisons, I think, I hope fairly, said that you have to take the rough with the smooth with NPP1, that you get restrictions and then you do get other benefits.

So in all of this the analysis is taking into account those restrictions, what you refer to as

non-price costs in relation to these matters, and then the calculation that's being done in relation to roll-out to 31 is implicitly treating those non-price costs as part of the scheme of arrangements in relation to NPP1.

So I'm not sure it's right to say they're not taken into account. It's that the prices that are set in relation to NPP1 are set with those tolerances and those non-price costs built in.

PROFESSOR ULPH: I think that's a slightly different point though. Those tolerances are about the prices you pay for being on NPP1 relative to being on APP2, but the non-price costs are different types of costs altogether.

My understanding of the argument you were making was that that argument did not include the non-price costs.

MR BEARD: I'm sorry, the non-price costs for NPP1 ...

THE CHAIRMAN: Or the costs of having to adjust the price plan to fit --

MR BEARD: Yes, it's meeting all of the thresholds. So we focused on the 83 SSC spread and the tighter tolerances and so on. There are a range of other parameters in relation to NPP1. If what you're saying is that all of those imposed non-price costs on customers of NPP1, as I say, one can see it in those terms. I don't think that's rejected.

In terms of the analysis of roll-out, it's entirely right that what you are doing is taking into account those non-price costs as implicit in the arrangements for NPP1, and then I'm not sure if the question is focusing on the fact that you would then use arbitrage out to 31 SSCs using ZPP3? I'm sorry, I think I'm misunderstanding the question.

PROFESSOR ULPH: Okay. Let me go back again.

My argument is that there is a non-price cost to being on NPP1 vis-a-vis APP2.

MR BEARD: Yes.

PROFESSOR ULPH: Just because you have to structure your arrangements so you fit the requirements of doing that. And that's a non-price cost.

MR BEARD: Yes.

PROFESSOR ULPH: When you were doing a comparison between being on NPP1 vis-a-vis APP2, and the costs -- you argued it was cheaper to be on NPP1 vis-a-vis being on APP2, all the way up to 31 SSCs.

MR BEARD: Yes.

PROFESSOR ULPH: My understanding of your argument was that that comparison is purely in terms of the prices you would pay, including surcharges, including all the arbitrage opportunities, but did not take account of the non-price costs. I just wanted to clarify --

MR BEARD: I don't think -- it doesn't separately quantify those, because I think one of the things that is considered is the fact that the demand varies between customers.

So when you talk about non-price costs, obviously that would vary enormously between different groups of customers, and so those that are amenable to NPP1 are those for whom those non-price costs, as you put it, are perfectly rationally incurred, I suppose is the way it would be looked at.

So I think that -- I'm not sure that the fact that those non-price costs are effectively not separately considered in relation to these analyses changes the inherent question about how you do comparability between those two groups of customers.

PROFESSOR ULPH: I agree it doesn't change the argument about comparability, I accept that. Thank you. That's been helpful.

THE CHAIRMAN: Does that mean that your assertion that it would have been rational to stay on the -- to roll out to 31 SSCs, that holds good even if non-price costs are taken into account?

MR BEARD: Well --

THE CHAIRMAN: Or are you saying it's impossible to calculate?

MR BEARD: I think that the exercise that we're looking at is, first of all, are they comparable, and then is it justified? And the third element was could they roll out given these arrangements? And what is said by Ofcom is no, they can't roll out, they can't be on NPP1, given the arrangements in place.

And we say, no, that's just factually wrong in those circumstances. If it's factually wrong, then you lose the element of the notional discrimination against the direct delivery operator.

It's not clear in those circumstances that the aspect of non-price costs affects the prior analysis of those other two issues, comparability and justification that we're focused on. It's a separate question of fact in relation to the extent of roll-out.

So I think that in those circumstances the non-price cost issue that's being raised by Professor Ulph doesn't affect that third strand of argument in relation to discrimination because it's a factual question that arose in relation to the position.

PROFESSOR ULPH: Can I take the point in a slightly different way.

Would you accept that when you were making that comparison, the comparison was essentially in terms of the prices that Whistl would pay for being on NPP1

vis-a-vis APP2?

MR BEARD: It is --

PROFESSOR ULPH: Including surcharges and arbitrage?

MR BEARD: In carrying out the analysis as to what's rational, yes, that undoubtedly is right. That is the way that that assessment, I believe, has been done, but these are matters that obviously can be tested with the experts who have done the calculations. But yes, my understanding is that that's the case.

PROFESSOR ULPH: Okay, thank you.

THE CHAIRMAN: Right. We can go back into the safer territory of Post Danmark II.

MR BEARD: Yes. That was where with we left it yesterday and I was going to go to the case itself.

If I may, just before I do that, obviously we were focusing on AEC and the case law. What I'm going to do is finish off on the case law and then just go back to the key parts of the decision. Before I do that, I think it's just worth reminding -- the tribunal probably has it very closely in mind -- what was actually submitted by way of AEC analysis to Ofcom in response to the SO when we're thinking about this.

I'm not going to go through the details of the reports, but it would just be worth pulling out Royal Mail bundle 6 at page 429. I haven't gone for

tabs because there are multiple tab 2s. It's the second tab 2 in this bundle in my version. So this is Mr Dryden's report which sets out the consideration of how you sensibly go about carrying out an AEC test in the circumstances with which we're dealing.

So what he is doing is considering the nature and circumstances of both the market and the allegations being made against Royal Mail, and then designing an AEC test that is appropriate to those functions. You can see that summarised in terms of his application of the EEO price/cost tests on page 439, where he's been instructed to develop such an appropriate test, and he considers the relevant theories of harm and takes into account a whole range of relevant circumstances in relation to how these matters are dealt with. Obviously in the remainder of the report he considers how those theories of harm have to be considered and the structure to be focused upon.

I will just touch on in passing, because it's something that has been raised, for instance at 2.12, just over the page on 440, he considers issues related to the design of the test having regard to, for example, VAT issues. So he's here thinking about a whole range of considerations as to how you build an appropriate AEC test in these circumstances.

But he then doesn't do the lifting an application, as it were, of the AEC test. We then have to go on to -- or back to RM5A for that. As I say, I'm not going through the details of his reports, I just wanted to highlight what they were.

THE CHAIRMAN: RM5 which?

MR BEARD: 5A. If we go to page 513. So this is the report of Mr Harman, 27 November 2015 it was submitted.

There you see in particular at 1.25 what he is saying is -- I'm sorry, page 523.

He makes clear there that what he's doing is carrying out the analysis using the framework that's been developed by Mr Dryden, and then you see in section 2 the summary of conclusions, and then further on, consideration of the relevant economic framework, the generic modelling that is used in producing the answers and so on.

So those are the two key AEC reports that were submitted in response to the SO. There were prior economic reports submitted in the course of the administrative procedure, but given the importance of the point I was highlighting in Intel yesterday, that where this sort of material has been provided as an evidential basis, it lies with the regulatory authority properly to consider those matters. I just wanted to

draw the tribunal's attention to what there was in particular here. It's not all of it, but those are two of the key reports.

So with that in mind, I was just going to go then to Post Danmark II which I summarised our broad advances on yesterday, but it's worth going to it, given the emphasis Ofcom places on it. Authorities bundle 9 at tab 103.

This is a preliminary reference case. It's one concerning rebates, but it's a rebates case that Ofcom most certainly wants to rely on in the context of these proceedings.

If we pick it up at paragraph 51, what you'll see is the summary of the nature of the question that has been asked:

"... the referring court asks, in essence, the court to clarify the relevance to be attached to the as-efficient-competitor test in assessing a rebate scheme under Article 102."

Then if we go down through to 55:

"The as-efficient-competitor test has been specifically applied by the court to low pricing practice ... selective prices or predatory prices."

So that's Post Danmark I and Akzo and France Telecom, and indeed to margin squeeze,

TeliaSonera.

Then 56:

"As regards the comparison of prices and costs in the context of applying 102 to a rebate scheme, the court held that the invoicing of negative prices, that's to say prices below cost prices, to customers is not a prerequisite of a finding that a retroactive rebate scheme operated by a dominant undertaking is abusive. In that same case the court specified that the absence of comparison prices charged with cost didn't constitute an error of raw."

And that was Tomra.

What's interesting there is it's just a focus on negative prices, in other words prices below cost, not necessarily prices above cost but without enough headroom for an as-efficient-competitor compete.

But in any event he goes on, 57:

"It follows that as the Advocate General stated in her opinion, it is not possible to infer from 102 or the case law of the court there was a legal obligation requiring a finding to the effect that a rebate scheme operated by a dominant undertaking is abusive to be based always on the as-efficient-competitor test.

"Nevertheless, that conclusion ought not to have the effect of excluding on principle recourse to the

as-efficient-competitor test in cases involving a rebate scheme for the purpose of examining its compatibility."

So it's just -- it's a very, very different tone and approach from Intel here because what's being said is, well, actually it's not clear that you really do need to think about this as-efficient-competitor issue, but we're not precluding it.

Then 59, over the page:

"On the other hand, in a situation such as that in the main proceedings, characterised by the holding by the dominant undertaking of very large market share and by structural advantages conferred by the undertaking's statutory monopoly which applied to 70% of mail on the relevant market, applying the as-efficient-competitor test is of no relevance inasmuch as the structure of the market makes the emergence of an as-efficient-competitor practically impossible."

Now, that is obviously one of the paragraphs that is being quoted but as I'll come back to, that doesn't do, even on Ofcom's approach, the work that is needed for the purposes of defending its decision.

At 60 it says:

"Furthermore in a market such as that at issue in the main proceedings, access which is protected by high barriers, the presence of a less efficient competitor

might contribute to intensifying the competitive pressure on that market and therefore to exerting a constraint on the conduct of the dominant undertaking."

Now, here it is very markedly different from the approach being considered in Intel, and in particular Intel, paragraphs 133 and 139, where of course the emphasis was on the distinction between foreclosure and anti-competitive foreclosure and the focus on that watershed being the consideration of as-efficient-competitors, not protecting less efficient competitors.

61:

"The as-efficient-competitor test must thus be regarded as one tool amongst others for the purpose of assessing whether there is an abuse of dominant position in the context of a rebate scheme, and so consequently it's not a necessary condition."

Is the conclusion for the purposes of the answer to the question posed by the referring court.

The approach, with respect, here is wholly unclear, and you can see why. The Intel Grand Chamber, dealing with rebates, as was being dealt with here, did not adopt any of this, and instead referred to the Post Danmark I authority.

Now, in particular it's worth noting that, whilst it doesn't specifically say so, it doesn't suggest that the as-efficient-competitor test is irrelevant, you can see that from 58, and doesn't come up with any other threshold test. Although it refers in 60 to "the presence of a less efficient competitor might" contribute to intensifying competitive pressure, that's a "might", it's not suggesting that you can assume that less efficient competitors do, even in the circumstances where you're in the framework of paragraph 59 of AECs are impossible.

And insofar as paragraph 59 is creating in this context some exception to the consideration of the AEC, I think there are two points to make. First of all, there's a difference between the practical emergence of an AEC and the usefulness of an AEC test, and so even at its highest 59 is not saying that where the actual emergence of an AEC is impossible, you should just ignore an AEC test, albeit it does say it's of no relevance as the structure of the market makes it impossible. If it is going so far as to say the test is irrelevant, that is clearly wrong and it is not sustainable in the light of Intel.

But more than that, if this exception does exist, and it means that where an AEC could not practically

emerge, then in those circumstances an AEC test is not relevant, it is an exception, and would need to be construed extraordinarily narrowly. And this is all before we have Intel. It would need to be construed narrowly, and it would mean that any regulator that was relying on this exception would very clearly and specifically have to articulate why it was emergence of an AEC was practically impossible.

That's taking all of this decision on its face. As I say, we do not accept it is good law because of the difference in approach that is adopted in Intel.

Now, it's of course right, Intel didn't come out and say actually the court in Post Danmark II got it wrong. But then the European Court never does. Indeed, you can see in Intel the sort of language it uses on occasion when it wants to diverge. It either does it by silence and adopting a new approach, or euphemisms such as "clarification" are used.

But what is so striking here is that you have two cases on 102 concerned with rebates. In the first, the AEC in Post Danmark II is qualified, is subject to these exceptions, and in the second taken afterwards by the Grand Chamber, there is nothing of that and no approval of this approach.

MR FRAZER: Are you submitting that Intel overruled by

silence, as it were, Post Danmark II?

MR BEARD: Intel sets what the European law now is, I think is the correct approach. So the European Court never actually overrules anything it's done before. But in terms of what the European law is, in practical terms effectively it is saying, yes, don't apply that sort of approach, because you don't end up with a sensible guideline.

But even if you can read them together, what Post Danmark II clearly does not do is say that where you are provided with AEC analysis, you can ignore it.

MR FRAZER: Although what it's saying is it might not be relevant in certain circumstances. Those circumstances were very different to the ones in Intel. So you're assuming that -- I think I understand you, you're submitting that Intel is the correct law and that Post Danmark II can't survive it even though it's only, as it were, defeated by silence. But the circumstances in Intel wouldn't have required the court, I think, to confront Post Danmark II.

MR BEARD: Well, if there is a situation -- no, I think there are two points to make here.

First of all, if Intel is leaving open the exception in Post Danmark II, because in Post Danmark II it's said it is impossible to create an AEC, then in those

circumstances you would have expected the court in Intel to have considered that and referred to it, given that this was all before them. They don't do any of that, so we do say by silence they're saying no exceptions.

But even if you can say, well, look, the facts are different, it's still remarkable because of course what was being said in relation to Intel was it's a vast company with vast market share, and actually of course that whole argument in Intel was there's a tiny contestable share of the market, can you actually meet it? So if an AEC emerging was a really relevant exception, you would have thought that that would have been something that would have been raised there.

But let's just assume for the sake of argument that the exception in Post Danmark II persists. It is clear following Intel that that exception would need to be narrowly construed. These references to alternative tests would accordingly need to be narrowly construed. And that in Post Danmark II what you were dealing with was a situation where you had a state monopoly that was granted under statute certain benefits that applied throughout the market, and therefore meant that it was very hard for anyone to enter at all in the circumstances. If that is a sufficient basis, then the national court or authority would have to explain

extremely clearly why it was that there was no possibility of an AEC emerging.

Of course what we see in this case is to the contrary. There is no finding of practical impossibility of an AEC emerging. I'm going to come on to that in the decision.

So even if you say no, actually I can see that Post Danmark II, the exception could still persist, even though the thrust of Intel is much more emphatic about the importance of the AEC test, in those circumstances you would need very clearly to spell out why it was practically impossible for an AEC to emerge before you could then say an AEC test is not relevant such that you are in practice overriding that proposition in Intel which says if evidence of an AEC analysis is put forward, the regulatory authority or a court is bound to consider it.

MR FRAZER: Okay. So my understanding is you're making two points here, correct me if I am wrong.

MR BEARD: Yes.

MR FRAZER: So in relation to Post Danmark II, you're saying either Intel somehow overruled it by silence in the way you've explained, or that it survives, but it survives as an exception and that you're going to argue the exception doesn't apply in this particular case?

MR BEARD: Yes.

MR FRAZER: And alternatively, you're also saying that Ofcom didn't successfully argue that the exception applied in this case?

MR BEARD: Well, it's more the latter because of course we're dealing with a decision here. So it's not at large whether or not we have a general assessment before this tribunal of practical impossibility. It's does this decision make it out?

MR FRAZER: I understand that.

MR BEARD: But yes, I'm happy to take it on those two bases.

THE CHAIRMAN: Do we attach any significance to the fact that the reporting judge was the same in both cases?

MR BEARD: Do we say a hobgoblin is -- the consistency is a hobgoblin of small minds. I don't know. In these circumstances it's very difficult to say that the findings in Intel are really consistent with what's said in Post Danmark II because of the very different emphasis in relation to a rebate case, and so I don't think we can assume that somehow there's an implicit protection of Post Danmark II because it was the same -- one of the judges was the same.

After all, Intel is the Grand Chamber, so there's more than just the consistent judge here as well.

THE CHAIRMAN: Please carry on.

MR BEARD: So one other authority whilst we're in this bundle, MEO. It was concerned with a particular situation involving price discrimination and TV rights.

If we can pick it up at 22. Again, this is a preliminary reference case.

MR FRAZER: It's tab 108.

MR BEARD: I'm sorry, did I give the wrong reference? I apologise.

THE CHAIRMAN: I was wandering into other cases.

MR BEARD: I was going to just pick it up at 22:

"... questions which should be examining together the referring court asked in essence whether the concept of competitive disadvantage for the purposes of subparagraph (c) in the second paragraph of 102 must be interpreted to the effect that it requires an analysis of the specific effects of differentiated prices being applied ..."

So analysis of the specific effects of differentiated prices being applied.

"... by an undertaking in a dominant position on the competitive situation of an undertaking affected and as the case may be whether the seriousness of those effects should be taken into account."

Previously I took you to some of the paragraphs where they were considering the application of the

prices and how to approach these matters. It's just worth going over the page, picking it up at 30:

"... in order for it to be capable of creating a competitive disadvantage, the price discrimination referred to must affect the interests of the operator which was charged higher tariffs compared to its competitors. When it carries out the specific examination referred to in paragraph 28 above ..."

Sorry, I skipped over. I think we may have referred to -- if we go back to 28:

"As the Advocate General submitted, it's necessary to examine all the relevant circumstances in order to determine whether price discrimination produces or is capable of producing a competitive disadvantage."

So when considering that exercise, the competition authority or the competent national court is required to take into account all the circumstances of the case submitted to it.

So it then says in relation to that:

"It is open to such an authority or court to assess in that context the undertaking's dominant position, the negotiating power as regards the tariffs, the conditions and arrangements for charging those tariffs, their duration, and their amount and the possible existence of a strategy aiming to exclude from the downstream market

one of its trade partners which is at least as efficient as its competitors. See by analogy Intel at 139."

Then it goes on and reaches the conclusion you will see in the operative part in bold:

"The concept of competitive disadvantage ... must be interpreted to the effect that where a dominant undertaking applies discriminatory prices to trade partners on the downstream market, it covers the situation in which that behaviour is capable of distorting competition. A finding of such competitive disadvantage doesn't require proof of actual quantifiable deterioration in the competitive situation but must be based on an analysis of all the relevant circumstances of the case, leading to the conclusion that that behaviour has an effect on cost/profit or any other relevant interests of one or more of those partners so that that conduct is such as to affect that situation."

So it answers the question in quite broad terms. But what we say is it's clear from this that, again, where evidence of an AEC is being put forward, and this is specifically in the context of a discrimination case, it must properly be considered and assessed.

Indeed, we go further and we say that to engender legal certainty, where evidence of an AEC not being

foreclosed is put forward and not rebutted, then we don't see what the basis is for making a finding of a pricing infringement and we say that is an approach that is set out and reasoned through Intel and Post Danmark I, and this approach in MEO in relation to this preliminary reference is entirely consistent with that, because an AEC analysis here provides the basis for a dominant entity to assess whether or not its conduct is problematic as much as anything else.

Of course it's right that here the court talks about it being open to the regulator to consider these matters, but what it's saying is that if all of these -- if these materials are put forward, then it will have to consider those issues.

THE CHAIRMAN: Mr Beard, if in your submission Post Danmark is an exception to Intel -- I know that's not your preferred argument, but if that's your submission, how is an authority meant to assess whether the AEC test in a particular case is relevant or not? Is it not by considering all the circumstances?

MR BEARD: Well, I think that there would be -- the approach that you would have to take is to identify whether it was, in the circumstances of the particular market, it was impossible for an AEC to emerge.

THE CHAIRMAN: That's the only circumstance you see --

MR BEARD: That's the only circumstance that's specified in Post Danmark II.

THE CHAIRMAN: Right. It seemed to me at one stage you were suggesting that in order to decide that an AEC test was irrelevant, you had to assess it and in a sense perform it, which of course makes the finding of irrelevance rather futile. You're not saying that?

MR BEARD: No. What I'm saying is that if you're talking about an exception, if you're saying you don't need to consider the AEC material that's put forward by a party in relation to pricing case, you don't need to consider it, we say that's not consistent with Intel.

Ofcom say, ah, yes, but there is an exception in Post Danmark II where the emergence of an AEC is practically impossible. At which point we say, well, if that were correct still, post Intel, what would be important is that you prove the exception applies. In other words you show that it is practically impossible for an AEC to emerge in this market.

THE CHAIRMAN: And you are suggesting they haven't done it.

MR BEARD: I'm more than suggesting it. I'm going to show you why they haven't, very clearly.

But there is just -- can I just very briefly go to one other case. It's in volume 8 at tab 88, it's the Deutsche Telekom case.

I want to pick it up -- I've taken the tribunal to earlier parts of this case. If I could just pick it up, page 38 of 54. Here you have the complaint concerning this application of the as-efficient-competitor test because this was a case where the as-efficient-competitor test hadn't been applied in relation to pricing practices as we saw previously.

Then over the page on 39 we've got findings of the court. Then at 198 in the consideration of the proper application of the AEC test, it said:

"In that regard it must be borne in mind that the court has already held that in order to assess whether the pricing practices of a dominant undertaking are likely to eliminate an competitor contrary to Article 82, it's necessary to adopt a test based on the costs and the strategy of the dominant undertaking itself."

It cites prior case law in relation to that.

Then if you just go over the page to 202:

"Such an approach is particularly justified because as the general court indicated in essence in 192 of the judgment under appeal, it's also consistent with the general principle of legal certainty insofar as the account taken of the costs of the dominant undertaking allows the undertaking in the light of its special

responsibility under Article 102 to assess the lawfulness of its own conduct. While a dominant undertaking knows what its own costs and charges are, it does not as a general rule know what its competitors' costs and charges are."

This is emphatic and it is clear, and I have already indicated how Ofcom have gone badly wrong in relation to consideration of AEC matters, but I'll come back to that now.

So if we may, could we go back to the decision.

MR FRAZER: Just on a general proposition that you've just raised, will you be relating that to the facts of the case itself? Because one can look that as a general proposition without any critical comment at all, but it would be interesting to hear whether you believe that it affects the viability of the decision in the circumstances which Royal Mail faced in assessing its own conduct.

MR BEARD: Yes. I will -- if I understand, sir, your question correctly, I'll be specifically picking it up in relation to Ofcom's findings in 7.200, which are the very brief findings in relation to AEC tests here, where they say you've got it wrong because you used Royal Mail's costs.

So if we could pick it up just in the section that

I very briefly went through previously, page 237, from paragraph 7.191, and you will recall there were four points being made.

So 7.192:

"Case law of the CJEU does not require a price/cost to be applied in all cases involving alleged abuse of dominance."

Second, differential, not the case of pure primary or first degree discrimination. Third, relevant market characterised by high barriers to entry. Then fourth, without prejudice, we don't consider it necessary to carry out the test, and some brief observations on the material.

I'm just going to work through those, I hope relatively swiftly.

Now, in and of itself the proposition that the case law of the CJEU doesn't require price/cost tests to be applied in all cases involving alleged abuse of dominance position. We didn't have any issue with that proposition. What we do have an issue with is what is then said thereafter, which is that where you're dealing with a pricing abuse such as this, that in those circumstances you can ignore material that is put forward of an AEC not being foreclosed in a market.

And it is striking here, the extent to which in

making out its case in relation to these issues, Ofcom strains to avoid any reference to the CJEU in Intel but having, when it was a general court decision, loomed large in the SO. Instead we have Post Danmark I and Post Danmark II being highlighted.

THE CHAIRMAN: It's in section 5, surely.

MR BEARD: Yes, it's in section 5. Section 5, it is there. I'm going to come back to that. I don't want to be unjust.

THE CHAIRMAN: Are you going to refer back to section 5?

MR BEARD: I'm going to go exactly to that in a moment.

THE CHAIRMAN: You wouldn't want them to repeat themselves, would you?

MR BEARD: Repetition is of no virtue. Accuracy is.

7.193, it refers to Royal Mail relying on Post Danmark I. Royal Mail actually is obviously relying on Intel. It put in submissions after --

MR HOLMES: I hesitate to interrupt, but the final sentence refers to the reliance on Intel. I think these submissions perhaps --

MR BEARD: I'm going to deal with those precise points in a moment.

THE CHAIRMAN: Let's concentrate on the substance.

MR BEARD: Post Danmark I, what we put forward. And then it said:

"It is clear that such a test is not a substitute for an assessment of the relevant conduct in light of all the circumstances of the case. Royal Mail's arguments are premised incorrectly on the assumption that an EEO test is determinative."

That is just wrong. It is a misunderstanding of Royal Mail's case and it is a misunderstanding of Intel. Intel says you can consider all the relevant circumstances. One of those relevant circumstances, indeed a key relevant circumstance, is evidence of foreclosure or otherwise of an AEC.

That's absolutely clear from the judgment we saw yesterday, and that has always been Royal Mail's position. And we do say, and we have said, well, look, if we put this material forward and you haven't answered it, that will be determinative of the position. But it is also correct that we are saying it's an all circumstances test because that's what Intel says.

Then it goes on:

"For the reasons given at 5.105 to 5.107 above, Royal Mail's reliance on the CJEU's judgment in Intel in this regard is misplaced."

So we go back to those paragraphs, 5.105 through to 5.107.

So 5.105, this is in the legal section:

"Royal Mail submitted that it is necessary for Ofcom to carry out a price/cost test in this case to assess the effect of the price differential. In support Royal Mail has presented reports prepared by its external advisers. Royal Mail states that the results of the price/cost test indicate that an EEO could operate profitably on the market and as such, the price differential did not place any efficient competitors at a competitive disadvantage.

"The crux of Royal Mail's submission is Ofcom has not conducted any economic analysis of the price differential. Compass Lexecon's price test demonstrates that the implementation of the price differential, even taken together with the zonal tilt, would not have foreclosed them as efficient competitor. The ECJ's Intel judgment requires Ofcom to rebut this evidence which currently stands unchallenged."

So it wasn't that we were saying it is alone determinative. That's not what we said.

5.106:

"With respect to the applicable legal framework we make three points in response to the arguments made by Royal Mail. First, there is no dispute that in reaching its decision on whether the price differential in the CCNs amounted to abuse, we have to consider the likely

effects of the conduct in all the circumstances. What those relevant circumstances are and/or the appropriate tools for assessing them depends on the particular facts of the case."

We recognise it's an all circumstances case.

Second:

"Intel doesn't overrule or even address the finding in Post Danmark II, as well as in Tomra, that a price/cost test is neither legally required nor appropriate in all cases. Intel addresses a different issue, namely the consequences of the Commission having carried out and relied on such an analysis in its decision for the general court's consideration of any appeal."

That is wrong. The gravamen of Intel is not simply that the Commission in Intel carried out an AEC test. The gravamen of Intel is that Intel put forward evidence that an AEC was not foreclosed. The Commission considered it and got it wrong, Intel said. The general court said we don't even need to think about it. The ECJ said you are wrong. It is important. That is what is said in paragraphs 133 and 139 of Intel. So that is inappropriate. And insofar as what is being said is that the exception in Post Danmark II is maintained, that's not what is dealt with there.

So the reasoning on Intel is flawed. It is considering that it doesn't need to worry about AEC because it's misunderstood Intel and the interrelationship with the other case law. Tomra doesn't add to Post Danmark II in this regard.

Third:

"Intel doesn't impose an obligation on a competition authority to carry out its own price/cost test or rebut through a similar analysis any price/cost test put evidence by the concerned undertaking."

Yes, it does. There's no dispute that Ofcom has to consider all evidence put before it and address it as part of its decision-making, but that doesn't translate into an obligation to accept the type of evidence put forward by the undertaking is relevant or appropriate.

Then:

"To the extent necessary, we address the price/cost analysis by Royal Mail ..."

In the paragraphs we're going to come back to. That's it. It's wrong.

THE CHAIRMAN: I come back to what I asked you before. Doesn't it appear that the difference between you is that Ofcom says considering all the circumstances allows them to avoid the AEC test issue, and you're saying that the AEC test and consideration of whether an AEC is

feasible is part of the consideration of all the circumstances. That's the issue, isn't it?

MR BEARD: Well, it is the issue as it is put in Intel, absolutely. And Intel makes it absolutely clear that where you're dealing with pricing abuses, and evidence is put forward of an AEC analysis, you have to deal with it.

THE CHAIRMAN: We'll hear what the others have to say in due course.

MR BEARD: Well, we say that the law is clear. And obviously you're going to hear from the economists on the virtues the AEC tests and otherwise, but we say in relation to the legal situation -- because if we go back then to the sections of the decision that consider the AEC tests, so I was dealing there with section 192, section 193.

We say even if section 194 is correct, where it says:

"... price/cost test is not capable of identifying all the circumstances in which a dominant undertaking's conduct hinders, hampers or impairs competition, the prohibition of abuse does not seek to protect only as efficient or equally efficient competitors. As found in Post Danmark II, the prohibition is also concerned with maintaining competitive constraints exercisable even by

less efficient competitors where the dominant undertaking enjoys an overwhelmingly dominant position in the relevant market."

There they're hanging on to that single phrase, "might", a less efficient competitor might offer competitive constraint. So again it's actually a misreading of Post Danmark II, this paragraph. But more than that, nothing this paragraph suggests that you can avoid a proper engagement, analysis and critique of AEC evidence put forward by a party in line with the Intel test.

So then it says:

"As a matter of law, AEC or other form of price/cost is not a prerequisite in all cases for determination."

That isn't the relevant question here.

Then we come on to the second point:

"As we have outlined above, the price differential is not a case of pure primary line or first degree discrimination. But in any event, the issue is not whether the NPP1 or the APP2 prices are too low, indeed, Royal Mail expressly rejected any package that involved significant revenue dilution ... case of potential example of margin squeezing. We are not seeking to establish whether the prices charged to all customers by the dominant undertaking make it impossible for

a competitor at the same level of undertaking to compete on price."

So there are two things to identify here. First of all, what seems to be being done is a suggestion that the general statements that are made in Post Danmark I and in Intel are somehow to be delimited or qualified by whether or not you can label this as pure primary line price discrimination or not, and we say that is not the approach. Indeed, Intel more generally is saying do not look at things in terms of just labelling them. That was one of the severe criticisms of the court -- of the upper court of the general court in relation to exclusivity rebates: don't just look at labels.

So we say that's wrong. But it's also interesting:

"We are not seeking to establish whether the prices charged to all customers by a dominant undertaking make it impossible for a competitor at the same level of the dominant undertaking ..."

They're not looking at impossibility here.

Then they go on in 7.198 to talk about how the price discrimination didn't involve any lowering of prices. As I have already adverted to, this emphasis on how you describe discrimination is not helpful. It falls into the trap of using the labels inappropriately.

If you look at 7.198, further down, it says:

"Thus we had to assess whether the price discrimination at issue involved Royal Mail leveraging market power over an indispensable input for operators on the associated retail market in order to make such entry less likely, even if not impossible."

So again, they're not looking at impossibility of entry.

Then it goes on:

"As set out in subsection (e) above, we found that price differential would have had a material impact on an entrant's profitability which would be reasonably likely to make entry significantly more difficult, thereby reducing an entrant's incentive to roll out. No price/cost test was necessary or appropriate to establish whether Royal Mail's conduct was abusive in this matter."

So, again, don't need to consider it at all.

Then we come on here in 7.199 to say:

"As we have explained in detail in section 7B above, the relevant market in case was characterised by high barriers to entry. In particular, given Royal Mail was and remains overwhelmingly dominant, it benefited and still benefits from significant economies of scale and scope, and was an unavoidable trading partner with control over an indispensable input for potential scale

entrants into the bulk mail delivery market, thus potential entry into bulk mail delivery was vulnerable to exclusionary conduct. Conduct which hindered the emergence of less efficient scale entrants to bulk mail was reasonably likely to limit a potential source of competitive pressure."

Well, we'll deal with that in relation to experts, whether or not that is correct:

"An EEO AEC test is not relevant these circumstances."

Well, there are two points to raise here. First of all, it's drawing on authority that is not consistent with the approach in Intel and, as we'll come on to hear, is not consistent with a sensible approach to legal certainty or indeed proper economic analysis by simply saying that less efficient scale entry might give rise to some sort of benefit, it's just presuming it. But more importantly, it's not here saying that AEC entry is impossible.

So in all of the sections that deal with why an AEC is inappropriate and they can ignore it, they do not grapple with the Intel proposition and do not rebut the Intel proposition that if you've been given this material, you need properly to engage with, critique it and be able to reject it, otherwise you are in danger of

protecting foreclosure but not anti-competitive foreclosure, and that is what Intel focused upon.

Then we go over the page to the fourth, and this is all without prejudice. So you don't need to look at this AEC stuff at all, those reports I took you to. But if you do, then these are our brief observations.

This is the entirety of the analysis so far as we can see of the reports that have been put forward. As I've already traversed, (a):

"The EEO test advanced by Royal Mail is based on Royal Mail's costs, which its own advisers appear to acknowledge are not likely to be similar to those of an entrant, it assumes a conversion rate of 100%. In their report, Compass Lexecon note that the sensitivity analysis which was carried out which made certain adjustments to the inputs of the modelling for the base case EEO model may be considered closer to the position of a new entrant. It is therefore clear that their EEO test approach is not a realistic basis for assessing the impact of a pricing practice in the context of an overwhelmingly dominant undertaking responding to nascent competition in the market."

No. The AEC test plainly has to be carried out on the basis of the Royal Mail test. Compass Lexecon did carry out a sensitivity analysis, they recognised there

may be different costs for other entrants, but that doesn't render the AEC analysis irrelevant. You need to focus on it and consider it.

When they say at the end it is not a realistic basis in an overwhelmingly dominant -- where you have an overwhelmingly dominant undertaking, if that is trying to say this is kind of the exception in Post Danmark II, it doesn't do that.

THE CHAIRMAN: I'm sure in a former life economists told me that all economic modelling has to faithfully reflect reality. Isn't that what this is getting at?

MR BEARD: Well, what economic modelling has to do in these circumstances is carry out, where you're talking about an AEC test, a proper modelling analysis in circumstances where you're dealing with, as Deutsche Telekom recognised, a situation where a dominant undertaking has to be able to understand what it can and cannot do in certain circumstances.

THE CHAIRMAN: That's your legal certainty point.

MR BEARD: It is the legal certainty point. That is why the modelling in relation to AEC has to focus on costs. It is then true that the economists go on and do sensitivity analyses, and they are candid about the way in which those sensitivity analyses work, but that is not an argument for rejecting the consideration of the

AEC test here.

THE CHAIRMAN: Aren't they just saying here that the test your clients put forward did not appear to them to reflect reality, albeit based on Royal Mail's costs, isn't what they're saying here at (a)?

MR BEARD: If what they're saying is that the AEC test using your own costs doesn't necessarily reflect the costs of another entrant, that is almost invariably going to be the case. But the critical point is it doesn't render the AEC analysis irrelevant.

THE CHAIRMAN: No, but it --

MR BEARD: And it is not a basis for rejecting it either.

THE CHAIRMAN: But it is a valid point in itself.

MR BEARD: Well, I think that's why the economists do say we recognise that we use our own costs but we don't know what the other people's costs are. But for the purpose of what we need to do here, that is the valid test. They then carry out a sensitivity analysis. But if the valid test is look at your own costs, as is required by Deutsche Telekom, as is required by considerations of legal certainty, you can't say that the AEC analysis is irrelevant in the circumstances because, after all, one of the things you are doing with an AEC test is looking at -- you're making an assumption of the efficiency of the dominant undertaking, effectively, and saying

someone that is as efficient as that will be able to compete.

In those circumstances being able to say, well, at our level of efficiency other people can come in, it might be that people were vastly more efficient than us. I don't think that would be the case here. But if that were the situation, that would be something that would be of relevant concern to competition law, which is what Intel is saying in relation to it. But that is sensibly using the benchmark of own dominant undertaking's costs and to that extent that is the reality in relation to the efficiency benchmark.

PROFESSOR ULPH: Could you maybe state the chairman's point in a slightly different way, that you could start with the dominant firm's costs. You could try to reflect what you think are all the relevant ways in which potential entrants might face different costs than those of the dominant firm and try to adequately build all that into your test. Would that meet your criteria of some degree of legal certainty that you're not using the costs of the entrant, you're using hypothetical costs?

MR BEARD: Well, I think inevitably the AEC test that we're talking about has to start with the costs of the dominant undertaking. We say that that is the relevant benchmark that should be used. But even if you then go

on and have to flex from those costs and make certain assumptions, that's actually what was done here. Because you see that in (b) in relation to the sensitivity analysis, because what is done by the economists here is they say, well, we take the AEC analysis on the basis of our own costs and that's how we analyse these matters because that's the right test in these circumstances, given the other issues that we're talking about. But we have gone on and carried out a sensitivity analysis where we flex our costs, making certain assumptions about the positions of other entrants. And that's what the sensitivity analysis does.

But you'll then see the criticism that's made of that by Ofcom in (b), which is to say:

"The sensitivity analysis carried out by Royal Mail's advisers assumes a roll-out profile based on Royal Mail's estimates of the likely operating costs of a new entrant."

Well, it's not clear what else they were supposed to do in those circumstances.

And (ii):

"Assumes an initial conversion rate of 60% rising to 80%."

So again, it's making certain assumptions about the

different position of an entrant from Royal Mail.

However -- this is their criticism -- each of the scenarios examined by Royal Mail's advisers is still based on Royal Mail's own downstream costs. But the point here is they actually are doing what you're suggesting. We say that isn't necessary for the AEC test, but that is actually what the economists did here. They took what they knew and then they began to flex it in relation to these matters.

The key point is that they have done this, but we say you don't have to do that sort of analysis for the relevance of this test because of course the more that you require people to be carrying out these flexings of an AEC test, the more you undermine the importance of legal certainty which is what underpins why you use the dominant undertaking's own costs in the first place.

But the point I would make here is insofar, Professor Ulph, as your approach would be -- I'm sorry, I'm not attributing it to you, but the approach you were articulating was to start with the dominant undertaking's costs but then think constructively about how you might flex the assumptions in relation to them. That was actually done here, and the criticism is, well you started and you're using your own costs. And that is not a valid criticism and it's not a valid basis for

rejecting the analysis.

PROFESSOR ULPH: I think my point was a slightly different one, that I don't see that necessarily you eradicate legal certainty. If you think carefully about all the ways in which a potential entrant's costs might differ from those of the dominant firm, that could still give you quite a good degree of legal certainty as to the outcome of the test.

MR BEARD: Well, I think one does need to be careful. We have the law from Deutsche Telekom saying -- and other cases, saying, in order to engender legal certainty, it's right to use the dominant undertaking's costs. I can see from an economic point of view it's -- the point is the more that you flex, the more that you explore these matters, then the closer you get to the reality of the position of the entrant. I can understand that. But that is undoubtedly on a sliding scale of legal certainty, and the more you move along it, the less legal certainty you have and frankly the further you are from the real authority on this. But I think, and with good reason, the court does that because of course the AEC test is ensuring you've got headroom as an efficient entrant to come in.

But I think the other point that it is important to emphasise in relation to all of this is: this work was

done by the experts, we say they went beyond what was needed in order to carry out the required AEC evidential analysis as specified through Deutsche Telekom as required to be considered under Intel, and do we have here any detailed engagement with any of that material, those two reports? We don't. We have these brief observations that are predicated on, well, you used Royal Mail's costs.

Well, that is frankly a wholly inadequate basis for rejecting any consideration of that material, and that's the fundamental point, even if one can have arguments about precisely how you deal with the AEC test.

I should say we're not saying that there's only one way of doing an AEC test. We recognise that there are arguments you can have about what the appropriate costs are that you use in the AEC tests. So we can see that faced with evidence coming forward from a dominant undertaking, one of the things a regulator might do is say we actually disagree with the cost measures you are using or the methodology you are using for the costings, your own costings in these circumstances. We can understand that.

That sort of criticism of an AEC, that is the sort of thing that would fulfil the engagement requirement that Intel is talking about. You just don't have any of

it here. It doesn't exist.

So if I just go on then down to (c), "Other relevant factors not considered":

"Royal Mail's assessment of a notion of as-efficient-competitor also fails to capture a number of other factors which are relevant to an access operator's decision as to whether to enter. A potential entrant would take into account risk as well as expected profitability. The price differential reduced the upside potential for higher profits from entering into bulk mail delivery and increased the downside in the event that entry proved unsuccessful."

Well, actually you will hear from Mr Dryden how -- and Mr Harman how these matters are in fact taken into account in relation to the operation of the AEC test that was put forward by them, so it's not a good factual answer. But more than that, this sort of generalised point about whether risk is upside or downside to an entrant, if what you're saying is that somehow there needs to be some sort of detailed calibration about what that equation would be, then you do move a very long way down the legal certainty spectrum if you're trying to put those matters in any detailed form, and frankly, Ofcom don't do that.

Then:

"As discussed in section 6, Royal Mail had a number of advantages unrelated to costs such as reputation and experience and VAT status."

Well, as I already just touched upon, even in just opening those reports, those are matters that Mr Dryden was considering in relation to the operation of the AEC test, and of course an AEC is treated as having those reputation and experience advantages. Indeed, that's one of the benefits of an AEC test. You don't have to get into this sort of counterfactual analysis.

So when it says this would make it more difficult to attract customers even if an entrant could match retail prices, this is missing the point in relation to the operation of the AEC.

There is one point, I think, that it is necessary to pick up there. You'll see in (ii) at the end of that first sentence on VAT status, it says:

"Royal Mail advisers acknowledge Royal Mail had a tax advantage but argue an EEO would have been able to offer VAT-free retail price."

So that's how the AEC is constructed.

Then it's an interesting sentence at the end of that footnote:

"As discussed above, emergence of an as-efficient-competitor could have been practically

impossible in this case."

Now, the first thing to say in relation to this is it seems to be trying to use the language of the exception in Post Danmark II. But of course it isn't, because what it's saying is the emergence of an as-efficient-competitor "could have been" practically impossible.

Then the other point is that it talks about "as discussed above", but there is no discussion above of practically impossible. In fact, the only references to practically impossible, the only statements of practically impossible, are back in paragraphs 588 and 590 in the legal section which are just referring to Post Danmark II.

So there is no discussion, and indeed, as I've already indicated, when we look at paragraphs like 7.198 and also 7.165, what is made clear by Ofcom is that it wasn't trying to identify whether entry was impossible.

I took you to 7.198, but can we just go back to 7.165:

"For the avoidance of any doubt we have not concluded, nor was it necessary for us to conclude, for the purposes of finding an abuse, that entry was rendered impossible or totally unprofitable by the introduction of a price differential. This application

would result in complete foreclosure of the bulk delivery market."

So it's making clear that it's not thinking about impossibility generally. There is no discussion of whether or not it would be practically impossible for an AEC to enter. Indeed, that statement appears to suggest that they are disavowing any finding of such impossibility.

So far from there being as discussed an analysis of whether or not it was practically impossible for an AEC to enter, no such discussion exists and, indeed, the decision appears to proceed on a different basis.

So just summing up in relation to this section, we say --

THE CHAIRMAN: Are you going to deal with the other --

MR BEARD: Sorry, the final point on 7.201, that it wasn't dealt with -- that an EEO wasn't carried out beforehand. That doesn't add anything to this analysis. It's plain that if you carry out an EEO subsequently, and an EEO is met, then in substance the competition test is met. And the critical thing is that -- or the requirements to provide material are met. As Intel put it, you need to put in the evidence in the course of the administrative procedure, and that's precisely what was done in response to the SO. So 7.201 doesn't assist Ofcom in

any -- it's not a substantive point at all.

THE CHAIRMAN: 7.202 suggests that there was an internal analysis contemporaneous.

MR BEARD: "The internal analysis of that impact is consistent with our findings based on our assessment of all the circumstances of this case that the price differential was likely to give rise to a competitive disadvantage."

We don't understand what is being said that means that the EEO analysis that we have put forward, a detailed EEO analysis, is somehow flawed, and the contemporaneous material doesn't suggest that, as we'll come on to see in the evidence.

THE CHAIRMAN: No doubt we'll hear that. But I think what is being said against you is this sophisticated AEC evidence is actually produced as part of the administrative procedure after, quite considerably long after the event. You're entitled to do that, but its credibility has to be perhaps tested against what your clients did at the time they were making the various price changes.

MR BEARD: Well, I don't think anything --

THE CHAIRMAN: Sorry, announcing the various prices changes.

MR BEARD: Anything that -- I don't think there's any basis for suggesting that the credibility of the material,

which is certainly far more detailed than was carried out beforehand, I'm not suggesting otherwise. There was not the sort of detailed EEO analysis carried out beforehand. But that's not the point here. The point is it's relevant analysis that the law says needs to be considered, and the reasons given for not considering it are mistakes, and the rebuttal of it, such as it is, is fundamentally flawed.

We're not saying that AEC is some sort of magic test, we're not saying it's perfect, but it does engender a sufficient degree of clarity --

THE CHAIRMAN: I'm glad you're not saying that. We might have difficulty with that.

MR BEARD: We're ensuring -- it is a test, though, that ensures that we're not simply encouraging inefficient entry, and that is why it is put down as a benchmark and why it is adopted as it is in Intel, because it is consistent with the overall goal of protecting consumer welfare as a matter of economics, but it isn't entirely synonymous with carrying out some global consumer welfare test, and that is understandable.

In the circumstances, we say that the approach that's been adopted here is just plainly inadequate. There hasn't been a proper engagement with those reports and analysis that needed to be undertaken.

Now, of course, we are going to hear about the flaws, virtues, otherwise, of AEC tests and other tests, and that will of course be interesting. But here we do need to bear in mind the reasoning in the decision and not some broader debate about the virtues or otherwise of AEC tests, and also the law in relation to these matters, and we do recognise that what economists may think would be the ideal way of dealing with the analysis of particular situations may be different from the way in which the law considers it appropriate.

THE CHAIRMAN: Is that a good moment to pause?

MR BEARD: Yes, that is good moment to pause.

I should say, as far as we're aware, there's nothing in the any of the pre-announcement material that suggests that Royal Mail thought an AEC would be excluded.

THE CHAIRMAN: Ten minutes.

(11.45 am)

(A short break)

(11.59 am)

MR BEARD: The next topic I briefly want to deal with, which we've obviously dealt with in our note of appeal and reply, is the test that is used by Ofcom which focuses on a material reduction in the profitability of a specific competitor.

We see the consideration of these matters in the decision in those sections preceding the ones that we've just been dealing with. So if you have the decision in front of you, in section E it's under the heading "Price differential amounted in effect to a penalty", is what is referred to. That's at 223.

But if we look at the specific subheadings, 224:

"Price differential would result in a significant increase in access costs for end-to-end competitors."

Then if we go over, 226:

"Impact of the price differential would have been material as illustrated by reference to its likely effects on Whistl."

Then if we go on to 229:

"Financial impact of this magnitude would make entry significantly more different for access operators."

Now, what I'm going to deal with is two points, as I indicated at the start. One, why the profitability test, the material profitability test isn't the right way of dealing with these matters, and we say that is explained by Mr Harman inter alia, but the broad point is that it is effectively an untethered test, it doesn't set a proper threshold in relation to these matters, because what is then said is that the materiality exists because the additional cost of the price differential,

in particular to Whistl, would represent a significant proportion of its costs, would reduce its profits by approximately half, and exceeds the value of some particular investment.

We say but that sort of metric is not the way in which you should properly deal with these matters, and perhaps it's useful to bear in mind what we have quoted in paragraph 44 of our skeleton, but you need not go to it. Just for your notes, it's authorities bundle 2 at tab 20, the Attheraces case, which was a price discrimination case where it was found that there was a significant loss of profitability, around half the profits, and what the court said was that that in and of itself was insufficient to identify competitive disadvantage.

We have quoted the relevant paragraphs in our skeleton, paragraphs 277 and 278:

"What Attheraces objected to is BHB taking half their profits especially when Phumelela are supposed to be parting with less than a third of theirs. What ATR have not established, however, is that the price differential goes beyond falling more heavily on one buyer than the other, as it obviously does, and actually or potentially distorts competition between them. Their case is that at least in the situation before the court,

the two effects are indistinguishable.

"In our judgment, the two effects are distinct and sequential and the sequence has to be, but has not been, proved in that case."

We say that trying to use some sort of general materiality threshold falls into the trap of not proving competitive disadvantage. And we say that the reason we understand that Ofcom have reached this approach is probably due to a misunderstanding of a particular case, the TeliaSonera case.

So if we could go to that, which is at authorities bundle 8, tab 90. So in this case what we're dealing with is a telecommunications dispute. In particular about pricing and in particular concerns about margin squeeze are at issue.

If we pick it up at paragraph 25:

"As regards the abusive nature of pricing practices such as those in the main proceedings, it must be noted that subparagraph (a) of 102 expressly prohibits a dominant undertaking from directly or indirectly imposing unfair prices.

"Furthermore, the list of abusive practices contained in Article 102 is not exhaustive ..."

27:

"The concept of abuse of a dominant position

prohibited by that provision is an objective concept relating to the conduct of an undertaking which, on a market where degree of competition is already weakened because of its presence through recourse to methods different from those governing normal competition, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition."

So that's a paragraph that we've seen previously, particularly in Deutsche Telekom, referring to hindering competition.

We then see, as we go through here, that at paragraph 28 the court is asking itself:

"In order to determine whether a dominant undertaking has abused its dominant position, it is necessary to consider all the circumstances."

29:

"Those are principles in the light of which the referring court must examine the pricing practice at issue in the main proceedings in order to establish whether it constitutes an abuse.

"In particular, after ascertaining whether the other conditions for the applicability of Article 102 arise in the present case, for instance dominant position, and trade affected by its conduct, it is for the referring

court to examine in essence whether the pricing practice introduced by TeliaSonera is unfair as far as it squeezes the margins of its competitors on the retail market for broadband connection ...

"A margin squeeze, in view of the exclusionary effect which it may create for competitors who are at least as efficient as the dominant undertaking, in the absence of objective justification, is in itself capable of constituting an abuse within the meaning of Article 102.

"In the present case there would be such a margin squeeze if inter alia the spread between the wholesale prices for ADSL input services and the retail prices for broadband connection services were either negative or insufficient to cover the specific costs of ADSL input services which TeliaSonera has to incur in order to supply its own retail services to end users so that the spread does not allow a competitor which is as efficient as that undertaking to compete for the supply of those services to end users.

"In such circumstances, although competitors may be as efficient as the dominant undertaking, they may be able to operate on the retail market only at a loss or at artificially reduced levels of profitability."

The point I just want to emphasise here is that the

court is contemplating two sets of circumstances. One is negative margins, in other words, the wholesale price is actually lower than the retail price that the dominant undertaking charges, or positive margins, but positive margins that are so small that they are insufficient to cover the specific costs of the provision of the retail services by the dominant undertaking.

So that's what negative margins and positive margins are being used to refer to there.

(Pause)

I'm sorry, Ms Osepciu suggests that I may have said that retail prices were lower. I meant higher, I apologise.

But I think that the point is clear. The situation is that the wholesale price is such that there is not just a small margin between wholesale and retail, but the price is such that there is actually a negative margin between the wholesale price that's offered to the market and the retail price that is being offered by a dominant undertaking.

Then we go on to "The prices to be taken into account", further down.

39:

"It must be recalled in that regard that the court

has already made clear that Article 102 prohibits a dominant undertaking from adopting pricing practices which have an exclusionary effect on equally efficient actual or potential competitors."

At 41, this is again a statement about:

"In order to assess the lawfulness of the pricing policy applied by the dominant undertaking, reference should be made as a general rule to the pricing criteria on the costs incurred by the dominant undertaking itself and on its strategy."

Then we go through 42 through to 45 dealing with the pricing practices, and in particular at 44 the importance of legal certainty in relying on own costs and prices.

Then at 45:

"It cannot be ruled out that the costs and prices of competitors may be relevant to the examination of a pricing practice at issue in the main proceedings. That may in particular be the case where the cost structure of the dominant undertaking is not precisely identifiable for objective reasons."

So just going back to the discussion we were having earlier, here it's saying legal certainty, rely on your own costs. There may be rather particular circumstances where you can't use your own costs, but it's identifying

rather specific counter examples.

46:

"It must therefore be concluded that when assessing whether a pricing practice which causes a margin squeeze is abusive, account should as a general rule be taken primarily of the prices and costs of the undertaking concerned on the retail services market. Only where it is not possible in particular circumstances to refer to those pricing costs should those competitors on the same market be examined."

So quite a strong statement being made there about which costs you use for this exercise.

Then if we go over the page to page 10 of 17, picking it up just below the sub-heading at paragraph 60. The sub-heading is "Whether an anti-competitive effect is required and whether the product offered by the undertaking must be indispensable". So it asks -- it identifies in 60 the referring court's question, whether the abusive nature of the pricing practice depends on whether there is actually an anti-competitive effect and, if so, how that effect can be determined, and seeks to ascertain whether the product offered by TeliaSonera must be indispensable for entry for there to be an abuse.

Then there are some further citations of

Deutsche Telekom which I think I have already taken the court to.

Then at paragraph 64:

"It follows that in order to establish whether such a practice is abusive, that practice must have an anti-competitive effect on the market. But the effect doesn't necessarily have to be concrete. It is sufficient to demonstrate that there is an anti-competitive effect which may potentially exclude competitors who are at least as efficient as the dominant undertaking."

So again it's the standard phraseology of: need actual effects of the conduct or likely effects of the conduct.

Then it says:

"Where a dominant undertaking actually implements a pricing practice resulting in a margin squeeze on its equally efficient competitors for the purpose of driving them from the relevant market, the fact that the desired result, namely the exclusion of those competitors, is not ultimately achieved, doesn't alter its categorisation ..."

So again, that's very much along the lines of AstraZeneca that we dealt with yesterday.

67:

"In the present case it is for the referring court to examine whether the effect of TeliaSonera's pricing practice was likely to hinder the ability of competitors, at least as efficient as itself, to trade on the retail market, the broadband connection services to end users."

Need to take into account all the circumstances, 68.

69:

"In particular, the first matter to be analysed must be the functional relationship of the wholesale products to the retail products. Accordingly, when assessing the effects of margin squeeze, the question whether the wholesale product is indispensable may be relevant."

Then at 70 it says:

"Where access to the supply of the wholesale product is indispensable for the sale of the retail product, competitors who are at least as efficient as the undertaking which dominates the wholesale product market and who are unable to operate on the retail market other than at a loss, or in any event with reduced profitability, suffer a competitive disadvantage on that market which is such as to prevent or restrict their access to it or the growth of their activities on it. In such circumstances, the at least potentially anti-competitive effect of a margin squeeze is

probable."

But it's important here to bear in mind what we identified become in paragraphs 32 and 33. What's being talked about here is reduced profitability in the context of a margin so small that you can't cover your costs. It is not talking about reduced profitability generally.

If we go on, 72:

"However, taking into account the dominant position of the undertaking concerned in the wholesale market, the possibility cannot be ruled out that by reason simply of the fact the wholesale product is not indispensable for the supply of retail product, a pricing practice which causes a margin squeeze may not be able to produce any anti-competitive effect even potentially."

That's quite a bold proposition. It's saying if the product in question is not indispensable, so a pretty high threshold, actually you may have no issue of anti-competitive effect at all in relation to pricing practice.

"Accordingly, it is again for the referring court to satisfy itself even where the wholesale product is not indispensable. The practice may be capable of having anti-competitive effects on the markets concerned."

And secondly:

"It is necessary to determine the level of margin squeeze of competitors at least as efficient as the dominant undertaking."

So first of all, focus on as-efficient-competitors.

"If the margin is negative, in other words if in the present case the wholesale price of ADSL services is higher than the retail price for services to end users, an effect which is at least potentially exclusionary is probable ..."

So where you've actually got a negative margin, it's actually here only saying that an exclusionary effect is probable. It is not saying it's definite, even when you've got a negative margin.

"... taking into account the fact that in such a situation the competitors of the dominant undertaking, even if they are as efficient or even more efficient, would be compelled to sell at a loss. If on the other hand such a margin remains positive ..."

So it's positive in the sense that was identified previously.

"... it must then be demonstrated that the application of that pricing was, by reason for example of reduced profitability, likely to have the consequence that it would at least be more difficult for the

operators concerned to trade on the market concerned."

What you can see there, from 73 and 74, is that what's being said is if you have a negative margin that's been defined before in 32 and 33, then it is probable you will have a potential exclusionary effect but you still have to look at all the circumstances.

On the other hand, if you've got a positive margin, which again is a positive margin but one not covering costs of the dominant undertaking, then it must be demonstrated the application of that pricing practice was by reason of, for example, reduced profitability, likely to have the consequence that it would be at least more difficult for the operators concerned to trade on the market concerned.

Now, what Ofcom has essentially done is fixed on this paragraph, this approach here, on reduced profitability, and untethered it from the measures that are the context of the consideration in this case.

We're not talking about any old loss of profitability, we're talking about as-efficient-competitors to start with and we're talking about a situation where if you've got a negative margin, then it's probably going to be an issue, but if you've got a positive margin in the sense that's used earlier on, then you've got to consider all the circumstances.

What it is not saying is that you can leave aside the AEC analysis, and you can just generally think about a reduced profitability test. Of course, that all makes sense because what it's doing is seeking to engender a degree of legal certainty in the way in which you do these matters.

We say, therefore, that the approach that's been adopted to this: has there been a reduction in profitability, which leaves Ofcom with the difficulty of trying to set what the relevant threshold is, has actually been springboarded off a misinterpretation of the key case in the field.

So we say that's the wrong approach. But we say in any event, the assessment of profitability, this material impact on profitability, is flawed.

THE CHAIRMAN: Is that it for TeliaSonera?

MR BEARD: Yes.

Now, there are two points that I'm going to make in relation to this, both of them relate to evidence which the tribunal is going to hear in more detail in due course, and that is that, as Mr Harman has shown, the profitability analysis undertaken by Ofcom simply does not evidence a material or substantial loss of profitability which undermines competition. That must be key here.

He actually goes further. Not only does he show that they've failed to evidence a material or substantial loss of profitability which would undermine competition. If you did a more sensible analysis of profitability, even, so sticking with profitability, and actually you use an internal rate of return analysis, you end up with further evidence that suggests that conclusions reached by Ofcom are fundamentally flawed.

It's for that reason that we say that the profitability analysis, even if you take it in general terms, cannot be sufficient to show a competitive disadvantage in relation to the practice we're dealing with here.

We've obviously picked these matters up in our notice of appeal at paragraphs 6.45 through to 6.57, but actually what I would like to do is just turn briefly to Mr Harman's report to set out the points in relation to these matters. This is Mr Harman's fourth report. It is in core bundle 3 --

THE CHAIRMAN: We are going to hear from Mr Harman, I suspect, at some length.

MR BEARD: Yes, I imagine that's true. But in terms of just summarising the points, I'm just going to zip through the report.

I'm conscious, as, Mr Chairman, you indicate, that

we are going to hear evidence in relation to these matters so I'll deal with them briefly.

THE CHAIRMAN: Yes. I don't know whether this is the moment to ask you how you are doing against your own timetable.

MR BEARD: I think I'm broadly on track, is the answer. The legal analysis in relation to ground 1 and in relation to AEC are obviously the parts of the submissions that were going to take the longest time. So I recognise that in relation to the other grounds, I'm going to summarise where we are and then deal with matters further after evidence.

THE CHAIRMAN: Yes. I was going to say, the skeletons in this case were really quite helpful to us, from all parties. We wouldn't want to repeat them orally.

MR BEARD: No.

THE CHAIRMAN: Would we?

MR BEARD: I'm doing my best. It's almost like some kind of Just a Minute game, where I will make the points but without using any phraseology, sentence or danger of consistency.

THE CHAIRMAN: Just a Day, rather than Just a Minute.

Right, Mr Harman.

MR BEARD: If I could just very briefly then turn to Mr Harman's report, it's tab 4 in -- it's tab 4 in the core bundle. I'm looking at it in its original state.

If we go to the background section, which is section 3. First of all it's just worth picking up, the tribunal will be well aware, but Mr Harman, in addition to the first Harman report, this is at 3.2, which I took the tribunal to earlier, Mr Harman has done two further reports that were submitted during the course of the process relating to Whistl's business plans which no doubt we will be coming back to.

If we go over the page to 3.8. As Mr Harman rightly says, and I hope I illustrated in submissions earlier, in talking about his first report, which was the implementation of the AEC test, he rightly says that the decision does not address his report. He puts it charitably, "in detail". I don't think he even warranted a footnote, but I may be corrected on that.

We then see summaries of the consideration of the Whistl business reports and chronology of events. But at paragraph 4 he picks up the concept of materiality in the decision and in doing that he's approaching it from the economic point of view rather than the legal point of view that I have just been picking up by reference to TeliaSonera, and explaining why it is that there is a real difficulty with using a materiality standard, as appears to be used by Ofcom in its assessment in the relevant parts of the decision, in circumstances where

it lacks proper and clear objective parameters.

He says that if you are going to be using some sort of materiality standard, you need to ensure an objective approach. You see that just above 4.11, and then at 4.13 he explains that it should have an objective standard, and he then goes on to suggest that the appropriate way of dealing with this would be to adopt the approach that a rational investor would use, and that's 4.16, which is to use an IRR approach.

He then at section 5 moves on to look at the assessment of materiality in the relevant sections of the decision. In particular, he picks up one of the key and poignant diagrams that Ofcom relies upon. One can see that just above paragraph 5.7 in his report. It's actually -- for your notes, it's figure 7.7, just under paragraph 7.145 in the decision.

This is a diagram that Ofcom relies on quite heavily in relation to -- or as an illustration of the proposition that it puts forward that actually the impact of the price differential would be substantial on access prices because the red bar is seen as the additional access payments that would have to be made, and what one sees is that for a direct delivery operator which is considering the percentage of its own delivery that it's going to be engaged in, you end up with

a situation, according to this diagram, that initially, presumably when on NPP1, you have no extra payments, as soon as you move on you get extra payments for being on APP2. That reduces your profitability and therefore creates a problem for you.

Mr Harman carries out a critique of that diagram and indeed the reasoning in the decision in that section in the following paragraphs about why it is that the points made and then illustrated in that diagram are misrepresentative, and I won't go through those, in 5.11 through to 5.16.

But the outturn is the diagram one sees at figure 5.2, just above paragraph 5.17, which presents a very different picture when one is considering what impact on competition the arrangements would have.

Just to explain, Mr Harman in the yellow part of the slice is indicating surcharges being incurred whilst staying on NPP1, and he's then looking at switching over to APP2 and looking at it to a more accurate, as he put it, scale. No doubt there will be questions asked about that in due course. I draw your attention to it because it is the illustration that is relied on or the reasoning that is then illustrated in paragraphs 7.142 through to 7.146 in the decision.

He then looks at financial impact on Whistl as the

particular specific company, albeit, I think quite rightly, saying a single company is not the relevant benchmark to be looking at. That's at 5.18 onwards.

He considers at 5.19 the various metrics that Ofcom uses to compare the costs to Whistl's various positions. The first is, as I have already indicated, Whistl's profits as an access operator, the second is the forecast profits as an end-to-end operator, and the third is LDC's pending investment levels, and he footnotes where those matters are dealt with in the decision so I won't go back through the decision. Those are the relevant metrics that Ofcom relies upon.

Then in 5.23 he explains why those metrics are wrong as useful benchmarks. That's a summary at 5.23. Then he goes on to explain the situation in more detail through the remainder of section 5.

He also highlights the possibilities of using other metrics at 5.34, which I think he's come into criticism of by Ofcom. But I think it's important to emphasise what he's doing here. He's dealing with what Ofcom have put forward and say these metrics do not give you a sense of an anti-competitive impact, a competitive disadvantage, even though you may be dealing with increased costs and loss of some profit.

In section 6 he then goes on to consider the impact

of the price differential on an end-to-end operator. He considers this in more detail using his IRR approach.

I just draw your attention to 6.13, where the figures that one sees as the outturn of this analysis, and I'm not going to refer to them given that some of them are confidential, illustrate just how far above any orthodox weighted average cost of capital the level of return would be, notwithstanding the changes that were being put forward to NPP1 and APP2 in the CCNs.

I'll come back to section 7 in a moment, but that, I hope, sets out the reasoning why those sections of the decision to which I have referred, running from 7.142 through to 7.166 in particular, but also throughout that section, betray a failure even if you are using a profitability, a material profitability threshold, to show that it is operating in such a way as to result in competitive disadvantage.

The next topic that I briefly want to deal with is the approach that's adopted in the decision in section 7F. If you could keep Mr Harman, not necessarily open, but nearby, because I'm going to come back to him in a moment.

Section 7F, this is the section in the decision, starting at page 250, where Ofcom says.

"Developments in the market support our finding that

the introduction of the price differential was reasonably likely to distort competition."

So what it's saying is, well, we've made these findings that the introduction of the price differential was reasonably likely to distort competition, and then we've looked at what happened in the market and we consider that what actually happened in the market confirms and supports our prior finding.

Now, there are three points I'm going to make here. The first is this is a wrong approach. The second is that a causal error or causation error is made in the analysis in this section in any event. And thirdly, that it's just wrong in fact.

So just looking at the approach that's been adopted here, I think the inspiration for this approach actually comes from a remark in particular made by Mr Justice Roth in the Google Streetmap case, which for your notes is in authorities bundle 3 at tab 33. That case, as you may recall, concerned the allegation that Google had abused its dominant position on the market for online search services by offering more favourable displays to its own results -- on its results page to its own mapping service than to rivals.

Mr Justice Roth, looking at this, considered various factors and one of the things he considered as to

whether or not this did have an anti-competitive impact was whether or not, since this had been happening for some time, you could actually see that developments in the market illustrated or evidenced the allegations of anti-competitive effects. Because essentially you have a funny situation where you're dealing with conduct that has occurred, you're not required as a regulator or someone coming before a court to prove that there are actual anti-competitive effects, you only need to show that the conduct was likely to result in anti-competitive effects. However, if the conduct has been going on for some time, you would expect that those likely anti-competitive effects might well materialise.

So what Mr Justice Roth was doing, in line with other case law, was saying, well, this has been going on for some time, let's see if those likely effects have really materialised. And if they have, then obviously we can use that as relevant evidence in support of the case. If they haven't, then that suggests that the likely effects really didn't exist in the first place.

In the event, he concluded that the likely effects alleged hadn't come to pass and this was evidence that undermined the allegations of abuse of dominance. He was using it as a sort of form of cross-check to his analysis of the situation and the conduct in question.

But obviously here the whole exercise is slightly odd because what is being done here is that Ofcom are praying in aid what they say is evidence of what happened in a market where the pricing in question didn't ever take place.

Now, Ofcom's case is that once the prices were announced or issued or introduced but not implemented, that amounted to a pricing abuse, price discrimination, in particular because no further steps were required by the dominant undertaking in relation to these matters, and they say, well, and the fact that a third party, Ofcom, intervened to stop the effects actually arising, that doesn't matter, it's still an abuse. We know that from the way they put their case in relation to ground 1, and we've explained why that's wrong, and fundamentally wrong.

But it's obviously further misconceived, when it comes to trying to draw on what happened in the market, to suggest that what was done by Royal Mail in relation to its pricing was anti-competitive or could generate likely anti-competitive effects, because by definition the events in the market were not driven or affected by any actual pricing. It's one thing to say "We stepped in to stop X happening but it was a breach in any event". It's another thing to say, "Even though we

stepped in to stop it happening, what transpired in the market is nonetheless evidence that the breach or the conduct, if it had happened, was likely to have an anti-competitive effect". We say that's just clearly wrong. It's the wrong approach to adopt here. What could at most be said of what happens in the market is that it evidences what concern arises in relation to uncertainty pertaining to pricing.

But as we discussed yesterday, and we have repeatedly stressed, that is not the case put in the decision. The theory of harm is built around price discrimination, and they cannot have a new case. A theory of abuse based on market uncertainty is just nowhere articulated either in the SO or in the decision. And you can't shift -- having not had it in the SO, you couldn't shift to include it in the decision. But in fact we don't see if in the decision, and as I said yesterday, we've explained in our reply that it would be wholly inappropriate for a range of reasons even to go down that route as Ofcom. But certainly permitting Ofcom to advance any alternative case in these proceedings would be entirely contrary to rights of defence and issues of legal certainty.

But as I also stressed yesterday, such an allegation would be misconceived because Ofcom hasn't referred to,

and we're not aware of any precedent that sets, a test for how you would assess that sort of market uncertainty.

Now, of course, yesterday, we discussed how novelty doesn't necessarily defeat an abuse of dominance case and the categories of abuse aren't closed, but it would be incumbent on the regulator clearly to spell out that new abuse and clearly articulate the necessary parameters of the abuse and the associated theory of harm, and that would be particularly acutely important of course in circumstances where uncertainty in markets is actually a feature of dynamic competition. After all, it's the essence of unlawful anti-competitive collusion that it removes uncertainty between market participants.

So dealing with uncertainty is just all entirely part of the normal process. So to have a theory of harm that says uncertainty creates the competitive disadvantage would be radical and require very clear reasoning, and of course a critical part of any test would be you would have to consider how you assessed the probability of the conduct which it is alleged would be abusive if it came into effect actually coming to pass and how that fitted in to those parameters.

Now, as I say, none of that is set out in the SO or

in the decision, but apart from failing to set out the relevant legal parameters for any novel category of abuse, Ofcom has entirely failed to explain how the supposed uncertainty allegation would actually amount to an abuse since the reasoning in the decision is focused on the effects that would have occurred if Royal Mail had applied the prices in the CCN. And we have a situation here where, in circumstances where the CCNs were known to be subject to the suspension provisions, that in those circumstances they would have been scrutinised by Ofcom, and the uncertainties, as I highlighted yesterday, would actually be that in those circumstances the uncertainty was in relation to legality, a fear of legality.

This really matters for section F because insofar as the price differential is in any way relevant, as I say, what would be being said is that the impact on the market was the uncertainty that was generated by the risk of them being lawful, and there couldn't be any possible finding of abuse in those circumstances that market participants were concerned that pricing might be lawful.

So we say that this slightly surreal world we've got into of looking at the developments in the market in circumstances where the pricing was not put in place and

was actually subject to suspension is simply the wrong approach and not what Mr Justice Roth, in talking about cross-checks, had in mind at all.

So wrong approach. But there's a further error made in the way in which this cross-check analysis is carried out. You'll have seen from the way we set it out, both in the notice of appeal and in the reply, that what Ofcom say is, well, all we need to show for the purpose of identifying competitive disadvantage is that the evidence that we see indicates that the price differential was a material contributing factor to anything that occurred that it then relies on as evidence in support of its case.

Now, that material contributing factor analysis is something that we just don't normally see in any orthodox causation situation in law. So far as we can see, it's used in a slightly unusual situation which results from a situation where there can be multiple causes and you can't identify which one is relevant, but in very acutely strange circumstances.

We've provided the authority of Fairchild v Glenhaven. That's in authorities 1 at tab 12. There's no EU law or UK competition law precedent or guidance that's relevant, but you'll see that Fairchild is very, very different because that was concerned with a case

for personal injury. It was a mesothelioma claim where the victim had been exposed to asbestos by multiple employers over the course of his career and in the circumstances it was impossible for the claimant to demonstrate which employer or which particular instances of exposure had actually caused his illness, what was the but for cause which would be the ordinary cause in these circumstances. You couldn't tell whether it was but for the exposure with employer A, employer B or employer C.

So in those circumstances, the House of Lords in a very unusual situation considered it appropriate to disapply the usual but for causation test so as to avoid a fundamental injustice to the claimant not being compensated at all. So in order to recover from a given employer, the claimant simply had to show that the employer had materially contributed, rather than but for the actions of the employer the claimant would have suffered the illness.

So it was a distinct exception to the ordinary causation rules and we don't understand why it could possibly be appropriate to apply this alternative causation test in this context. It would need to be shown that it was but for the price differential that the competitive disadvantage arose.

So we don't understand why this causal modification is appropriate. It isn't justified. We say it is wrong. But what we certainly say is that when it comes to this sort of cross-check analysis that they're trying to carry out in section 7F, this is again applying the wrong legal test.

In other words, if you're carrying out a cross-check on actual events to work out whether there's support for a finding of likely anti-competitive effects, you must show at least that the conduct in question was a but for cause of the events you're relying upon. That just isn't the modality employed by Ofcom here and that is a wrong legal approach.

We say -- and this is why this may or may not matter -- that the available evidence shows that the announcement, the promulgation of the CCNs, was not a but for cause of LDC's or Whistl's decisions. At its strongest, the evidence relied on by Ofcom and Whistl illustrates that the announcement of a price differential was one of a number of factors that was taken into account in the decision-making, both during the period of infringement and thereafter. There is a degree of ambiguity about what Ofcom is focusing on here, but there is no evidence for analysis --

THE CHAIRMAN: The decision actually says that, doesn't it?

MR BEARD: I'm sorry?

THE CHAIRMAN: The decision actually says what you've just said at 7.256.

MR BEARD: 7.256?

THE CHAIRMAN: "... the ultimate decision ... to exit the market took account of a number of factors going beyond the implications of the CCNs or the price differential in isolation.

MR BEARD: Yes, it does, but what it says in 256 is:

"The delay to, and suspension of, Whistl's roll out, to which the price differential materially contributed, was likely to be one of the relevant factors in the overall decision-making ..."

So it's using the wrong test there.

THE CHAIRMAN: If it's a material contributor, then it suggests there must be other factors.

MR BEARD: Yes. What has to be shown is that it is the but for cause of the competitive disadvantage. That's the point I'm making in relation to these issues.

THE CHAIRMAN: Understood.

MR BEARD: We say in any event the evidence does not make this out. For that, we then perhaps usefully go back to Mr Harman's report and section 7 is the easiest way to summarise these points.

Now, of course, I recognise that in relation to

these matters, again, we're going to be dealing with evidential questions, but I just highlight what Mr Harman has done in section 7 of his report concerning his analysis of the material he's seen from an economic point of view or from his expert point of view as to the way in which rational operators would deal with the information they had and the decision-making in those circumstances.

Of course, critically, we don't here have any witnesses from LDC or PostNL in relation to any of these decisions concerned with investment decisions. Indeed, there's a very strange phenomenon that arose in this case that in fact it was Royal Mail's solicitors that ended up chasing Ofcom to go and gather evidence from LDC and PostNL. It's just worth noting this, if we may go to bundle 7C, tab 66.

This is a letter from Royal Mail's solicitors of 14 August 2015. This is after the first SO has been provided incompletely to Royal Mail, but to Royal Mail's solicitors. It says:

"Royal Mail have been unable to identify material on the case file which it expects that Ofcom will have sought regarding allegations which are central to the theory of harm outlined in the SO. These categories of material set out below.

"Documents and evidence provided by LDC ..."

There's some particulars:

"Documents and evidence provided by PostNL."

Then there's also documents and evidence provided by customers at Whistl.

That was specifically a request, rather a prompt to Ofcom that actually there was serious evidential deficiencies in what was being put forward in the SO in relation to the evidential base pertaining to LDC and PostNL in relation to these matters.

Thereafter, there were some further exchanges, and in particular there was some very limited follow-up with LDC.

We don't have all of the exchange of correspondence that follows on from this in the bundles and I have arranged for clips of that to be provided so that the tribunal has it and I'll pass it round. I'm not going to refer to the documents further today. I'll just refer to one of the responses that eventually came back from LDC after the various chasers.

It's rather remarkable not for what it showed, but for what it didn't. It's in core bundle 4, tab C, at tab 153.

THE CHAIRMAN: Have we finished with RM7B?

MR BEARD: Yes. I'm not going to go through this letter in

detail. As I say, I'll provide the remainder of the correspondence in relation to these issues.

MR FRAZER: Which bundle are we in?

MR BEARD: Core 4C, the third of the core evidence bundles. It's actually the last document there.

As I say, there was some to-ing and fro-ing between Ofcom and Royal Mail about the evidential basis on which they were proceeding, and there was some contact between Ofcom thereafter and LDC in relation to various matters. You'll see on 153 this is a letter from LDC:

"We refer to the formal ... notice given under section 26 ... in respect of Ofcom's investigation in relation to prices, terms ... on which Royal Mail offers ... access."

They provide various documents. They also answer certain questions on timeline of events and any other documentation.

It's just worth going over the page in relation to request 6:

"... please explain the reasons why LDC decided not to complete the agreement of 13 December 2013."

I just highlight the third paragraph:

"The view was that Royal Mail had manipulated the pricing matrix applicable to the market. LDC and TNT Management's due diligence (including interviews with

Ofcom) had concluded that Royal Mail's ability to alter its price zoning was restricted and we expected Ofcom would enforce the regulatory access to the market for players. However, ten months after TNT's complaint about Royal Mail only a consultation had been launched on the rules which was unlikely to be concluded until summer 2015, with then the prospect of a further lengthy drawn out appeal by Royal Mail. This effectively gave no regulatory certainty to the business plan and, although investment decisions are made based on many different factors, this influenced the assessment provided by TNT Management."

I think I'm just going to raise two points in relation to this. Obviously these are matters that will be considered further in due course. It is striking that what is being talked about there is price zoning. That is the zonal tilt issue.

The second point to highlight is that the real concerns here are about the time that Ofcom is taking to carry out a consultation in relation to these matters, because the consultation referred to there is the consultation on zonal pricing which was carried out under the ex-ante rules which everyone thought was going to apply in relation to these circumstances.

So the point I want to make is a brief one at this

stage, and --

THE CHAIRMAN: They were right that you would appeal.

MR BEARD: Well, actually no, because of course zonal prices --

THE CHAIRMAN: You're going to say a different decision.

MR BEARD: -- are the love that dare not speak its name at the moment, but I'm sure we'll --

THE CHAIRMAN: I thought you were going to say it was not long or drawn out.

MR BEARD: Well, the zonal pricing analysis was both, but it's instructive that the zonal pricing analysis is what LDC is focusing on in relation to that.

The point I make is a much broader one by reference to that. It's the dearth of material in relation to LDC and PostNL. Ofcom have obviously worked very closely with Whistl in relation to these matters, but I think the appropriate Mandy Rice-Davies caveat applies in relation to that. They would say that in relation to various matters, wouldn't they? Insofar as they are dealing with speculation about the position of LDC and in relation to PostNL, who we understand may have been subject to no questions by Ofcom at all, issues in relation to the relevant evidence are going to need to be explored further.

I'm very briefly just going to touch on what is

effectively section 7D, which is the section in the competitive disadvantage decision chapter on an allegation of deliberate strategy on the part of Royal Mail. Plainly it is a matter that is going to be explored in evidence, in particular with Dr Jenkins and Ms Whalley, in relation to the issues that are there raised.

We have already seen the situation articulated in the case law that the infringement of Article 102 is an objective concept. Yes, it is correct that purpose and intent can be taken into account.

Whistl, in its statement of intervention at paragraph 40, seeks to elevate intention as a consideration and it prays in aid three cases that have rightly not been relied on by Ofcom to try and support this argument.

We deal with those three cases in our reply at paragraph 5.18. They are Compagnie Maritime Belge, Tetra Pak II, and ITT Promedia. ITT Promedia in particular is an interesting case because, of course, ITT Promedia was the allegation that you could engage in abuse of dominant position by engaging in litigation, and ITT Promedia left the position that you couldn't necessarily rule that out as a possible abuse. We can see that.

But it's also instructive that what was said in ITT Promedia was that one needed to have a very clear and high threshold before you permitted any finding of abuse in relation to someone seeking to clarify or vindicate their legal position.

Now, I won't overemphasise the analogy with the position here where Royal Mail had built in a structure within the contract which meant that essentially, if people objected to what it was doing, then in those circumstances they were effectively protected by suspension whilst the assessment of these matters was going on. But the threshold that is set in ITT Promedia rather illustrates just how, in circumstances where Royal Mail has ensured that there is a mechanism of protection, a particularly high threshold would be required for suggesting that there was any problem at all, particularly when the practical outcome was that the pricing in question was never applied.

As I say, what we're going to see in the evidence from Ms Whalley, and indeed Dr Jenkins, will explain further the decision-making process and why it was not a nefarious intent that was being adopted by Royal Mail. It was conscientiously seeking to ensure that anything it did was compliant with its regulatory requirements and was taking relevant advice accordingly.

I'm conscious of the time. I don't have very long to go in relation to this, but perhaps it's best to pick it up at 2 o'clock, if I may.

THE CHAIRMAN: Certainly.

(1.00 pm)

(The short adjournment)

(1.58 pm)

MR BEARD: Mr Chairman, members of the tribunal, before the short adjournment I was just touching on section D in part 7 of the decision. I'm conscious that these issues to do with the findings by Ofcom of a deliberate strategy to limit competition that are made by Ofcom are very much predicated on particular documents which are no doubt going to be commented upon by witnesses. They also depend on consideration of the context in which these matters are dealt with and the views in particular of the witnesses that are coming forward.

In the circumstances, if I may, in terms of context, can I refer the tribunal and just provide notes to section 3 of the notice of appeal, which sets out or summarises some of the relevant context here, matters that are developed further by Ms Whalley in her statement.

For your notes, the notice of appeal section 3 is in tab 2 of core bundle 1 and begins at 346.

Now, as to the consideration of the various plans and documents, how they fit in to the story of development of options by Royal Mail, their consideration by external advisers, in particular Oxera, and their significance, which is very heavily relied on, as we understand it, by Ofcom, those are matters which are going to be dealt with inevitably by the witnesses. So in that regard I would ask the tribunal, as it no doubt will in advance of hearing the evidence of each of the witnesses, to review the statements which no doubt have been read already by Ms Whalley and Dr Jenkins in particular in relation to these matters, because they set in context how it was that Royal Mail wanted and needed, it felt, in order to deal with the inevitable scrutiny by Ofcom under ex-ante regime, as expected by all, or alternatively under competition law, to provide proper justifications for what it was doing, and in doing so were considering issues of cost and indeed issues of value to customers, how customers should properly be dealt with, and indeed how that should all be thought about in the context of the universal service obligation.

As you will hear from the witnesses and as you can see from the statement, what is plain is that Royal Mail did not engage in a deliberate strategy to eliminate

Whistl from the market. Very far from it. What it was trying to do was justify the changes that it wished to make pursuant to its concerns in relation to the universal service obligation.

But I'm not sure that now, without going through substantial amounts of the core bundle at the very least in order to tell this story, I'm going to usefully advance matters, and I leave that therefore for the witnesses to deal with in due course.

With that then, I will move on to the fourth ground which is concerned with whether or not Royal Mail's conduct was objectively justified.

As you'll have seen from the pleaded case, Royal Mail submits that the introduction of the price differential, if and only if it amounts to an abuse and therefore grounds 1 to 3 are rejected, was in fact justified under Article 106(2) of the Treaty or, alternatively, under 102 itself.

In doing this, and in light of the fact that I've moved through the intentions section or strategy section rather briefly, I will set out a little bit more of the background in relation to the USO, and then address the tribunal on the substance of the objective justification. But it is just worth focusing on what the thrust of Ofcom's response is here.

In broad terms, and this can be seen from Ofcom's skeleton argument, in particular at paragraph 46, the broad point made by Ofcom, and highlighted in paragraph 46 of its skeleton, is it's not really a matter for Royal Mail. Royal Mail can't rely on its own assessments in this regard as to justification.

Now, that in and of itself is a rather bold submission. One only needs to go back to the terms of Article 106 of the Treaty itself to recognise that Article 106 doesn't involve any specification that it has to be a regulatory authority or state that renders the assessment of justification.

I don't know if it's useful to go to it, it's in the authorities bundle 1 at tab 4. Authorities bundle 1, tab 4.

(Pause)

So this is just an extract from the Treaty which has Article 102 on the first page. If we go over the page to 106 -- obviously there we have the text of the specific (a), (b), (c), (d) examples in 102.

106:

"In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither act enact nor maintain in force any measure contrary to the rules in

the Treaties."

In particular, 18 of 101 to 109.

But then 2:

"Undertakings entrusted with the operation of services of general economic interest or having a character of a revenue-producing monopoly shall be subject to the rules contained in the Treaty, in particular the rules on competition, insofar as the application of such rules does not obstruct the performance in law or in fact of the particular tasks assigned to them. The development of trade must not be affected to such an extent that it would be contrary to the interests of the Union."

Then 3 is:

"The Commission shall ensure application of this article ..."

Which is the standard implementation requiring it to put forward legislation as appropriate.

But it's clear that 106(2) is not a provision that says it's only the regulator that can decide or assess justification.

Now, in many circumstances it may well be a state or a regulator that considers these issues, but to say that Royal Mail can't rely on its own assessment is simply not correct. It can, but then that assessment can

properly be tested. There's no doubt about that. Ofcom can disagree with it. There's no doubt about that.

But it is perfectly right that Royal Mail can make this sort of assessment, and Ofcom doesn't have some kind of great precedence in relation to these issues.

MR FRAZER: Mr Beard, on that, do you need to show that 106(2) is directly effective in order to make your case or not?

MR BEARD: I think there's no issue but that we can rely on 102 -- 106(2) in relation to these matters. I'm not sure that any point is being taken that there's any issue as to the direct effect of 106(2) in relation to the application here. I'm not sure -- I don't recall Ofcom ever raising that, so I think it's treated as being directly applicable here, yes.

MR FRAZER: I think there was something in the Whistl skeleton possibly, but we will come on to that no doubt in due course.

MR BEARD: I'll deal with that in due course if necessary. But in terms of it being sufficiently clear and unconditional, I don't see any reason why it wouldn't be treated as directly effective in the same way that --

MR FRAZER: I think it also depends on whether it's, by its nature, capable of affecting individual rights.

MR BEARD: Yes. Plainly 106(2) can affect individual rights

in these circumstances, I think is the position, because it affects the position of the SG -- the undertaking that has the particular grant of rights in the circumstances.

THE CHAIRMAN: It's the words "insofar as the application of such rules does not obstruct performance of the particular tasks" that you're relying on?

MR BEARD: Yes.

THE CHAIRMAN: That's an exception to the rule, isn't it?

MR BEARD: Yes.

THE CHAIRMAN: So that must be strictly construed.

MR BEARD: Well, insofar as it's an exception to the generality of the operation of competition law, that is true. But in terms of the overall role and purpose of 106(2) to ensure that services of general economic interest can clearly operate, clearly it does afford a margin of discretion as to how it's to be applied, and the language there is also instructive, it is of obstruction, not absolute prevention.

THE CHAIRMAN: No doubt we'll hear more about that.

MR BEARD: I'm sure. But nonetheless that is the proper interpretation.

In respect of the suggestion that is made by Ofcom in paragraph 44 that the situation is that it's not for Royal Mail essentially to take the law into its own

hands in relation to these matters, Ofcom relies on the Hilti decision. Hilti, you will recall, is the case where the nail gun maker was applying an economic tie in relation to the sale of the nails and the tying arrangement was said to be unlawful. In those circumstances Hilti said: but what we were doing inter alia was putting in place restrictions such that there could not be sale of dangerous products, or there was no risk that dangerous products were available to the market. And as the court there rightly pointed out, that wasn't a justification that was acceptable in terms of competition law because there was a whole other range of relevant protections that assisted under the law for dangerous products.

Here the situation is very different because what we have here is a situation where Royal Mail had been told by Ofcom that it should have, and exercise, commercial freedom, and that Ofcom has set down a relevant threshold in terms of financeability which pertains to the universal service obligation and its performance, and what we're considering here is Royal Mail acting in pursuance of that threshold.

We can see the threshold described, if I may, in the March 2012 statement on the new regulatory framework which is in bundle RM2A. It starts at 347, but the page

I'm going to take you to is 400.

(Pause)

So here is a summary of decisions made by Ofcom in the culmination of the section entitled "Financially Sustainable Universal Service", and what it says at 5.47:

"In summary, therefore, having performed further analysis as described above and considered all the response to the consultation, we believe the following conclusions are consistent with securing a financially sustainable universal service under Royal Mail's new regulatory framework."

So this is the liberalised framework:

"The activities undertaken for the purpose or in connection with the universal service define the appropriate boundaries of the business relevant to our duty in relation to financial sustainability.

"An indicative EBIT margin range of 5 to 10% is appropriate and consistent with the need for Royal Mail to earn a reasonable commercial rate of return commensurate with the level of risk within the business. While a certain element of judgment is necessary, we consider this should bring it more in line with its peers and more likely to be consistent with encouraging investment in the network."

So that is the set of parameters which Ofcom find are appropriate to ensure that Royal Mail will be able to finance the universal service pursuant to the obligations it is under that I'll just briefly come back to.

Furthermore, as part of this new regime, it's clear that Ofcom had indicated that it would only consider acting in relation to concerns on financeability once Royal Mail had taken relevant commercial steps. It's the quid pro quo for the liberalisation. You are being liberalised but you have to help yourself.

One can see that in fact in a following document, the March 2013 final guidance, which is in bundle 2B, it's at tab 48. The position is essentially summarised in fact in the executive summary at 1.9. This is actually under the head of "Assessing the impact of end-to-end competition and Royal Mail's response":

"In summary, if we anticipate Royal Mail's return will fall below 5 to 10% EBIT margin on a sustained basis, we would expect to intervene unless we conclude that this is due to Royal Mail failing to take appropriate steps to respond to challenges posed by competition, such as failing to improve efficiency levels."

This is borne out more fully, that point in the

executive summary, at paragraph 4.12, page 489. It says, 4.12:

"To understand fully the potential impact of end-to-end entry, it would also be necessary to consider the potential for commercial responses by Royal Mail to mitigate the direct impact of increased competition. As discussed in section 3 of the new framework, Royal Mail has significantly more commercial and operational freedom to set its prices and make product changes in a timely manner than was previously the case. There's a range of ways in which Royal Mail might respond to increased competition."

Then the first bullet is changing commercial strategy. There's then a discussion of zonal pricing.

Then the last sentence of that bullet:

"In addition, Royal Mail has the flexibility to negotiate changes to its contracts both with its retail and access customers ..."

Then it says:

"... subject to competition law and the existing ex-ante regulatory conditions on access."

Of course we knew all about them.

So what Royal Mail says is that if you are finding that what we were doing was somehow amounting otherwise to wrongly discriminatory behaviour, we were in fact

doing that to secure the very goal that Ofcom has set.

At paragraph 45 of its skeleton what Ofcom says is, well, that doesn't work because what we were suggesting there was a lawful commercial response. But of course there's a circularity there because what we're saying is if Royal Mail is wrong about its position on grounds 1 to 3, we're saying it's still lawful because there's a justification. So saying that it's subject to competition law isn't instructive in this regard.

Indeed, 46 in the skeleton includes a very odd proposition:

"Insofar as Royal Mail disagreed with Ofcom's conclusion on the threat of universal service, it was open to it to challenge them."

What is it that Royal Mail should have been challenging? Should it have been challenging the 5 to 10% EBIT thresholds? Should it have been challenging the fact that Royal Mail under the new regime was being given commercial freedom and was to exercise it?

It doesn't make any sense to suggest that what was required was a challenge here, and it's not quite clear why Ofcom even raises it in the context of these proceedings. What is being said here is that the account that was given in that March 2013 paper, as informed by the March 2012 paper and the thresholds

there set out, was these are the thresholds, you need to go and take steps to ensure that you can hit those thresholds, obviously you must act lawfully, but in those circumstances we are not going to intervene. What we're going to do is leave you to it and see how you get on.

So in those circumstances we say what we were doing was perfectly in line with the protection of the USO.

We've described in some detail, or Ms Whalley has described in her witness statement in particular at paragraphs 16 to 26, the nature of the universal service provider obligations. Those obligations are to collect and deliver a very wide range of specified products to a specified timeline, including, for example, first class next day delivery. It requires us to operate those deliveries six days a week to all geographic areas of the UK, at a uniform price, regardless of the varying costs of delivery.

That legal framework for the universal service is set out in the documents. I won't go through any of them in detail. The Postal Services Act section 31, for your notes, that's in bundle RM2A at tab 8. The Universal Postal Services Order, that's RM2A at tab 9.

Then there are a series of designated universal service provider conditions, a number of those are

provided in RM2A and are referred to in Ms Whalley's witness statement. If you want references, the pages are 291, 313 and 317.

So the major point of the USO is it doesn't matter if on a particular day a particular postbox only has a single letter in it or indeed none, Royal Mail has to go and check. And it doesn't matter if on any day it's only one house in a particular street that has a letter to go to it.

THE CHAIRMAN: The Ardnamurchan lighthouse is the one that's always quoted.

MR BEARD: Yes. I'm not even going to go down that road metaphorically.

THE CHAIRMAN: There's no road.

MR BEARD: No, I'm guessing not. That's the nature of lighthouses, as I understand it.

The point is it means that the costs of delivering the universal service are inherently high and relatively fixed and they also significantly exceed the revenues which the services generate.

Now, the universal service amounts to the majority of the cost base for Royal Mail's network, the network that enables delivery six days a week, and so in order to be viable, the universal service has to be cross-subsidised by revenues from other parts of

Royal Mail's business. Now, of course cross-subsidisation can happen in two ways. Royal Mail can use revenues generated from deliveries to geographic areas which are cheaper to deliver mail to, urban areas cross-subsidising rural ones, or it can use revenues from more profitable products, such as parcels, potentially, to help cover the cost of the universal service. But as Ms Whalley makes clear in her witness statement, this doesn't come close to fully covering those costs, which leaves a considerable shortfall which has to be found from elsewhere, and of course has to be found from elsewhere against a background of a substantially declining business in letters.

By contrast, of course, competitors in the bulk mail delivery market are not constrained as to locations which they deliver mail to, or the products they offer or the prices they can charge. Direct delivery entrants can cherry-pick, they can cherry-pick the most profitable geographical areas and products, so they can focus on low cost areas with high population density, they can focus on providing a slower and therefore lower cost service, delivering three days a week rather than six, they can focus on cheaper types of mail such as mail that's machine readable and pre-sorted by the customer. Then they can use the Royal Mail access

regime for any other services that are not economically attractive to them.

The potential for cherry-picking has long been recognised. Indeed, the Hooper reports as they're referred to, and are mentioned by Ms Whalley in particular, paragraphs 51 and 61 to 64 in her statement, which were independent reviews of the postal sector, recognised the concerns that arose in relation to cherry-picking in the downstream market and the potential of that to undermine the cross-subsidies that are fundamental to the operation of the USO.

The reason the cherry-picking is so dangerous is because of course it reduces the volumes of mail flowing through the universal service network, and therefore decreases revenue that would otherwise be available to cover those costs of the universal service. It increases the per unit cost of each item, and that in turn risks the need to actually raise the uniform price, leading potentially to further cherry-picking entry and consequently the need to raise the uniform price again.

This is, I think, what is referred to as the graveyard spiral by Dr Jenkins in her witness statement, paragraphs 4.2 to 4.3. That's in bundle C2 at tab 2.

So what we see is Royal Mail anticipating that, absent the price changes contained in the CCNs, with the

continued roll-out of cherry-picked areas, Royal Mail will be forced into a position where the universal service would be in an economically unacceptable condition in terms of its financeability. More specifically, Royal Mail's analysis demonstrated that roll-out would erode Royal Mail's EBIT below 5%, thereby requiring significant price increases for universal service products.

The context for this is, as I've said, set out in the statement of Ms Whalley, but it's also instructive to look at the statement of Mr Simpson. If we could just turn that up, it's in the witness statement bundle or in Royal Mail 4. The witness statement bundle is core 2 and it's at tab 3 in that bundle.

Now, I'm not going to work through Mr Simpson's statement because again he's going to give evidence, I just want to pick out two diagrams.

It's core 2, C2, or it's RM4. It's either of the two. And I'm just going to pick up figure 2 on page 8. 8 in the internal number, it's 122 externally.

I just draw the tribunal's attention to this diagram which shows the very significant decline in letter volumes and at the same time the very significant growth in access services being provided.

The next figure that I simply want to draw the

tribunal's attention to is on page 14, on financeability. What we see there is the red line is at 5%, the bottom end of the EBIT range. What one can see is that for a very prolonged period it didn't even meet the bottom end of that range, including the period when these CCNs were put forward. There is a brief period where that threshold is met and then it declines again.

So it's against that background that Royal Mail issued the CCNs. Concerns about avoiding cherry-picking, undermining the universal service, as we'll see, was a key motivation behind the CCNs and Royal Mail was acting with the objective of preserving its ability to meet the universal service obligation by maintaining an EBIT, or in fact achieving an EBIT, within the economically acceptable range. It did all of that very much cognisant of the ex-ante and competition regulatory scheme that existed, but if nothing else, we say that this conduct could be justified by reference to the need to ensure that the universal service was financeable.

Now, in terms of that objective justification test, if I may, I'll just turn to one or two of the cases.

The first of the cases I just wanted to pick up is the Ambulanz Glockner case, which is at authorities bundle 5, tab 67. As you'll see from paragraph 4 in

this judgment, the issue which arises in this case or arose in this case was concerning the operation of a public ambulance service which had been essentially assigned to particular recognised medical aid organisations. You'll see over the page, at page 8, that the schemes that had been put in place effectively granted those medical aid organisations a de facto monopoly in relation to these matters.

But the bit I wanted to take you to in terms of legal approach is at 56 and 57. So here the Member State had conferred this monopoly on the ambulance organisations, and at 56 it says:

"Article 90(2) of the Treaty, read in conjunction with paragraph 1 of that provision, allows Member States to confer on undertakings which they entrust the operation of services of general economic interest exclusive rights which may hinder the application of the rules of the Treaty on competition insofar as restrictions on competition, or even the exclusion of all competition by other economic operators are necessary to ensure the performance of particular tasks assigned to the undertakings holding the exclusive rights.

"The question to be determined therefore is whether the restriction of competition is necessary to enable a

holder of an exclusive right to perform its task of general interest in economically acceptable conditions. The court has held that the starting point in making that determination must be the premise that the obligation on the part of the undertaking entrusted with such a task to perform its services in conditions of economic equilibrium presupposes it will be possible to offset less profitable sectors against profitable sectors and hence justifies a restriction of competition from individual undertakings in economically profitable sectors."

The key phrase there is "economically acceptable conditions". So that test of economically acceptable conditions, we say here, is set out effectively by what Ofcom itself has determined as the relevant financeability threshold.

Now, Ofcom instead has rejected Royal Mail's submissions on objective justification of the decision broadly for three reasons. First of all, it says there were alternative, less restrictive measures by which the viability of the universal service could have been maintained. Secondly, a target EBIT of above 5% is not an appropriate benchmark against which to measure the viability of the universal service. Sorry, the first of those points is at decision, paragraph 8.30. The second

is at decision, paragraph 8.33. Then thirdly, the viability of the universal service is adequately protected by the broader regulatory framework and, in particular, Ofcom's power to intervene to protect the universal service, that's 8.34 to 8.35.

But if we look at each of those points, the first is that, not surprisingly in the light of the language of Ambulanz Glockner, there isn't a necessity test under 106(2). It isn't such a strict necessity test. One can see that from a couple of other cases in this bundle.

First of all, if one goes to tab 58 in this bundle, the Commission v Netherlands case. I'm only going to take you to one paragraph, paragraph 58.

So 58 says:

"Whilst it is true that it is incumbent upon a member state which invokes Article 90(2) to demonstrate that the conditions laid down by the provision are met, that burden of proof cannot be so extensive as to require the Member State, when setting out ..."

I'm sorry, Mr Chairman. I thought you were --

THE CHAIRMAN: I'm listening as well as writing.

MR BEARD: "... when setting out in detail the reasons for which, in the event of elimination of the contested measures, the performance under economically acceptable

conditions of the task of general economic interest which it has entrusted the undertaking with, in its view be jeopardised to go even further and prove positively that no other conceivable measure, which by definition would be hypothetical, could enable those tasks to be performed under the same conditions."

So it's not saying that you have to show positively that there are no other conceivable measures.

If we go on to a further case here at 66, which is the TNT v Poste Italiane case, I just want to go to paragraph 54 in that judgment. So tab 66, perhaps start at paragraph 53:

"... it is necessary to point out that an undertaking like Poste Italiane, responsible by virtue of the legislation of a Member State for securing the universal postal service, which entails the duty to collect, carry and distribute post throughout the territory of the Member State concerned, irrespective of the profitability of the sector being served, constitutes an undertaking entrusted with the operation of services of general economic for the purposes of 90(2).

"Third, it is apparent from the case law of the court that it is not necessary, in order for the conditions of the application of 90(2) of the Treaty to

be fulfilled, that the financial balance or economic viability of the undertaking entrusted with the operation of a service of general economic interest should be threatened. It is sufficient that in the absence of the rights at issue, it would not be possible for the undertaking to perform the particular tasks entrusted to it, defined by reference to the obligations and constraints to which it is subject, or that maintenance of those rights is necessary to enable the holder of them to perform tasks of general economic interest that have been assigned to it under economically acceptable conditions."

So there's no requirement here that the financial balance or economic viability of the undertaking providing the SGEI would be threatened if the measure weren't adopted. Rather, the question is whether the restriction is necessary in the sense described above, in other words in the Commission v Netherlands sense, to secure performance of the economically acceptable conditions.

So in sum, Article 106(2) permits an undertaking, a margin of discretion to determine the steps that are necessary to secure economically acceptable conditions for the delivery of SGEI, service of general economic interest. Therefore, the fact that there may exist

alternative measures is not an answer to this justification case.

As I say, the second point that is made against Royal Mail in this connection is that a 5% EBIT target isn't the appropriate benchmark. Now, we do not understand this contention. Ofcom gives no adequate explanation for its rejection of a target 5% EBIT as a benchmark for evaluating whether Royal Mail can provide the universal service in economically acceptable conditions. Its analysis of the target EBIT metric is confined to a single paragraph, that's paragraph 8.33 in the decision. All it does there is say it's one of a number of metrics that may be used.

Now, there's no detail what those other metrics might be, or indeed how Ofcom applied them when evaluating Royal Mail's defence under Article 106(2), and this is despite the fact that Ofcom has consistently identified, as I say, and as I have shown, that an indicative EBIT margin of 5 to 10% is a reasonable rate of return commensurate with the sustainability of the universal service.

So Royal Mail hasn't been splitting the difference in the range that's been given, it's been taking the bottom end of that range that was provided to it.

Then, as I say, the third point that's made against

Royal Mail in this connection is that the regulatory framework means that in these circumstances there is no proper justification. But Ofcom is wrong to say that the universal service is adequately protected through the exercise of its regulatory functions under the Postal Act, and it's wrong to say that that is sufficient to mean that the justification here does not operate.

Royal Mail has raised the threat to the universal service with Ofcom on a number of occasions. Ofcom has repeatedly declined to take action to protect the universal service despite, first of all, legitimate concerns about cherry-picking, but also, as we have seen, the fact that Royal Mail's EBIT was below 5%.

At the same time, as I have already indicated, Ofcom encouraged Royal Mail to adopt a commercial response and in doing so Ofcom effectively indicated that action from Royal Mail was a prerequisite to a detailed regulatory consideration. Now that Royal Mail has taken such action, Ofcom contends it shouldn't have done so. Ofcom contends, instead, that its apparently infallible judgment not to intervene precludes Royal Mail from taking steps, and we say that cannot be right in the circumstances.

So we say that the arguments put forward by Ofcom as

to why it is there is no objective justification in this case are flawed.

Unless I can assist further --

THE CHAIRMAN: You're not going to go into Article 102 objectively?

MR BEARD: No, I'm not going to go further. The same points arise in relation to Article 102 in relation to --

THE CHAIRMAN: The test is stricter, though, you would say.

MR BEARD: There is an argument as to whether or not it's stricter. We say it's not stricter, but in any event in relation to this we can rely on 106(2).

THE CHAIRMAN: Right.

MR BEARD: That then takes me on to ground 5.

THE CHAIRMAN: Can we put a few files away?

MR BEARD: Yes, please.

THE CHAIRMAN: A few treaties.

(Pause)

MR BEARD: Now moving on to ground 5, which is infringement of essential procedural requirements, this pertains essentially to a somewhat remarkable situation which in summary is that we have two statements of objection that were issued in this case. The first included all sorts of details regarding Ofcom's findings or proposed findings that the price differential was likely materially to impact on Whistl's costs and

profitability. Then following a challenge brought by Royal Mail to the procedural adjudicator, Ofcom, rather than receiving an adjudication, pulled that first statement of objections and issued a new statement of objections which withdrew all of the detailed relevant figures and material. It had been kept confidential previously. Nonetheless, when it came to the decision, that material reappeared, and we say that is obviously an improper procedure that has been followed.

Now, these issues regarding procedural requirements are concerned with the section of the decision at 7.147 through to 7.160. It's worth just turning that up.

So we have referred to this as the materiality analysis, and it's in particular the materiality analysis in relation to Whistl. We've already explained why this is the wrong approach and it's wrong just to focus on an individual entity, but Ofcom does so.

What we see here in the decision, in these paragraphs, over these four pages, is the net present value of the additional access costs that Whistl would have faced, it is said, as a result of the price differential during the period 2014 to 2018. Then a comparison of those additional costs with Whistl's access profits in the year 2013 to 2014 where Ofcom found that the additional costs amounted to

a significant amount of Whistl's profits. And then further comparison of the additional access costs with Whistl's projected profits where Ofcom calculated that additional costs of -- the additional costs were calculated at 55% of Whistl's projected EBIT. Then there's further comparison of the additional access costs with LDC's proposed investment.

Now, it's evident that for Ofcom this materiality analysis was key to its overall finding of abuse. We've explained why it's wrong, but nonetheless this is Ofcom's case. But the remarkable thing is that none of this analysis was put to Royal Mail. In order to illustrate that, we need to go back to the SO, and when I say the SO, I mean the second SO which is in RM8, tab 2. It's a slim volume. So this is the second SO.

What we see here at paragraphs 7.87 through to 7.89 is what is apparently the case being put that blossoms into those paragraphs into the decision.

What one sees here is:

"The mechanism by which the price differential was capable of discouraging entry can be illustrated concretely by reference to Whistl's costs at different stages of roll-out. We used Whistl's costs as those are the only available example we have of costs of an entrant. This is intended to provide an illustration of

the potential magnitude of loyalty-inducing effects outlined, rather than show the impact of the price differential on a particular competitor.

"Under the contract change notices, Whistl's access charges on APP2 would have been around £9 million higher in 2014 as a result of the price differential than they would have been without it. This is calculated as the volume of Whistl's expected access mail in 2014 in its business plan at the time of the complaint multiplied by 0.25p per letter differential.

"If the expansion of its bulk mail delivery operations had proceeded according to its plan, this additional cost would have fallen slightly in future years as it would have been using Royal Mail's access services for fewer letters as it expanded. Whistl would have had the chance to avoid this additional cost by switching to NPP1 and halting its roll-out plans. We've considered the present value of these additional costs in the period 2014/2018 using the access volumes in Whistl's business plan. These additional costs are significant in the context of Whistl's forecast profits, amounting to approximately 60% of forecast profit in Whistl's business plan before the notified price changes."

So you've got three paragraphs there. In contrast,

in the decision, you have a substantial section that deals with these matters in much greater detail and refers to a large number of figures and details in relation to Whistl's operations that were simply not provided to Royal Mail at the time of the SO.

Now, just to recap on the relevant background, which isn't in dispute, the original statement of objections, which is actually in the preceding tab issued by Ofcom in July 2015, contained evidence and reasoning which it's now clear was substantially the same as the materiality analysis we see in the decision. Ofcom, as I said, refused to provide that original analysis to Royal Mail on the basis it was confidential.

Now, that was itself a remarkable proposition, the idea that you provide a statement of objections to a person who is going to be subject to a proposed criminal sanction but you redact the material relied on from it.

This was what was raised by Royal Mail with Ofcom and when Ofcom maintained that it could keep confidential material in the SO with Ofcom's procedural officer.

I would like to take you just to the letter to the --

THE CHAIRMAN: Can we just be absolutely clear what was not

reproduced in the second statement of objections. Take the one we're looking at, 7.87. That's there, isn't it?

MR BEARD: Yes.

THE CHAIRMAN: 7.88 is there?

MR BEARD: Yes. All of the figures -- everything in blue that you see --

THE CHAIRMAN: Then it stops, doesn't it?

MR BEARD: Yes. Then all of the figures that you then see there --

THE CHAIRMAN: No chart. And then it resumes in the third sentence of 7.90.

MR BEARD: Yes, that's right. So all of that --

THE CHAIRMAN: Okay, thank you.

MR BEARD: That's absolutely right. And then if one turns on -- what you see subsequently is more extensive material as you turn on. All of the blue confidentiality throughout this report, this SO, is blue confidentiality material that was not provided to Royal Mail.

This SO was made available to Royal Mail's legal advisers but not to Royal Mail.

THE CHAIRMAN: There's an email, there's a few estimate figures.

MR BEARD: There are a lot of figures in relation to this that are removed. So in terms of being able to make

submissions about the details of the figures relied upon ...

THE CHAIRMAN: A lot of the blue, you talked about the blue, are just names. I say just names, I don't mean any disrespect to them. They're not --

MR BEARD: No.

THE CHAIRMAN: There are figures, I accept that.

MR BEARD: Sorry, no. I think one needs to be careful. It's the blue. The green redactions --

THE CHAIRMAN: Maybe I've got the wrong blue.

MR BEARD: I think where they're names, they're generally green, and those are redactions for the purposes of these proceedings. Blue --

THE CHAIRMAN: I'm not colourblind.

MR BEARD: Sorry, just let me illustrate. If you go back to page 75 external numbering in this document, you'll see at paragraph 5.100 some redactions. Is that ...

THE CHAIRMAN: I'm afraid not in this one, no. There aren't any redactions.

MR FRAZER: Are there none in the footnotes?

THE CHAIRMAN: I may be privileged with a special edition.

MR BEARD: Right, okay. We'll have to make sure it's replaced.

THE CHAIRMAN: I should be careful what I say. More careful than usual.

I have a green-free text.

MR BEARD: It sounds like Mr Frazer may well have the green --

THE CHAIRMAN: Mr Frazer, as usual, is one step ahead.

MR BEARD: Professor Ulph, does yours have green in as well?

PROFESSOR ULPH: Yes.

THE CHAIRMAN: There you are.

MR BEARD: You have been specially chosen, Mr Chairman.

THE CHAIRMAN: I don't think a lot turns on it for the point you're making.

MR BEARD: It doesn't. I was just making sure that you, Mr Chairman, understood what redactions I was referring to.

For the purposes of your version --

THE CHAIRMAN: It's all that blue.

MR BEARD: Yes, it is all the blue. But I imagine it's all the redactions in your version then.

THE CHAIRMAN: Yes. I've got your point, which is that there are a number of figures.

MR BEARD: Yes. So if we could just go to bundle RM7B at tab 88.

MR FRAZER: Are we done with this?

MR BEARD: Yes. I'm going to refer to the notice of application which correlates the various figures, but yes.

So after the receipt of the SO that contained

confidential information that was to be withheld from the very person to whom the SO was directed, lawyers for Royal Mail wrote the following objection to the procedural officer. There were exchanges that preceded.

Tab 88.

THE CHAIRMAN: Tab 88?

MR BEARD: I'm sorry, yes.

You will be familiar, I haven't gone through the procedural officer rules and guidelines, but this is where you've got a procedural complaint in relation to the way the complaint is operated by Ofcom, you first of all have a route of challenge to Ofcom's approach by making an application to the procedural officer.

THE CHAIRMAN: Mm-hm.

MR BEARD: What you'll see there, and I'm not going to go through all of it, is a discussion of the factual background. Then if you look over the page at external page number 368, you'll see an overview of the law dealing with issues of common law and natural justice which goes through some of the case law about closed material and confidential material being withheld from those that may be affected by criminal or civil penalty, and the case law is very clear that that is not something you can do unless you fall within the scope of specific statutory schemes.

Then over the page at 371 you have Article 6 of the ECHR, right to a fair trial, where you similarly have clear indications as to how these matters work, in addition fundamental rights of the defence under EU law.

Then over the page again at 373, "Considerations Under the Enterprise Act", which does provide certain obligations to keep sensitive material confidential but doesn't in any way abrogate those broad and fundamental principles under common law, EU law or ECHR law. Those that are potentially affected by a criminal sanction, which is what this is, must see all the evidence relied on against them.

Ofcom, perhaps recognising that a misstep had been taken in terms of the fairness of procedure, as I say, did not contest the application before the procedural officer and instead withdrew that first SO.

We were then issued with a second SO, to which I have taken the tribunal, and the situation was that in relation to the analysis of Whistl's profitability and costs, Royal Mail during the course of that administrative procedure was in a position where it couldn't engage with the sorts of detailed figures that had been involved in the first SO, it hadn't seen them in the first SO and they'd been withdrawn from the second SO.

THE CHAIRMAN: Who was it disclosed to?
MR BEARD: Legal advisers only.
THE CHAIRMAN: Only legal advisers?
MR BEARD: And economists, I believe.
THE CHAIRMAN: Including Mr Harman, for example?
MR BEARD: Yes, I think that is potentially the case. I'll confirm. I think it was disclosed to Mr Harman, but of course no instructions could be taken in relation to any of those matters.
THE CHAIRMAN: I think you drew attention to a passage in his statement where he'd commented on Whistl's business plans.
MR BEARD: Well, yes, he has commented on Whistl's business plans, but of course those were matters that had been disclosed previously and not in relation, I believe, to any of the material that was specifically withheld in relation to the SO.

But in any event, in terms of the representations that could be made on Whistl's profitability and costs, which were what those figures went to, in fact, Royal Mail was only able to make very limited submissions in relation to those materials because, of course, they hadn't been disclosed and had been withdrawn. They weren't being relied upon.

The position in law is very clear, that if you don't

rely on something in an SO, then in those circumstances you are not entitled to rely on it in a decision.

It's perhaps just worth jumping ahead and looking at the law on this.

THE CHAIRMAN: Transocean Marine Paint?

MR BEARD: I wasn't going to go there. I was going to go to something slightly more recent which is the UPS case.

THE CHAIRMAN: It's quite recent to me, Mr Beard.

MR BEARD: I'm not sure we've even got Transocean Marine Paint in our 11 volumes but --

THE CHAIRMAN: We've actually found an authority that is not in the bundle.

MR BEARD: No. We can provide copies in due course.

THE CHAIRMAN: I've got a copy.

MR BEARD: It's in volume 9 of the authorities bundle, Mr Chairman, at tab 113.

Now, this was in fact a merger case, and a merger case where econometric modelling had been developed by the Commission. Some of the econometric modelling had been provided to the parties to the merger process, but then late on in the process modifications were made to that modelling and those weren't disclosed and there was an objection taken to reliance on that modified modelling in the final commission decision.

If we pick it up at paragraph 35:

"The Commission claims, however, not to be obliged to disclose all amendments to a model developed with the co-operation of the parties to the operation on which the statement of objections is based. The Commission states that, at that stage, changes may be made to the statement of objections and the amendments to the models are equivalent to internal documents, which cannot be accessed pursuant to the right to have access to the file.

"Admittedly, the statement of objections is inherently provisional and subject to amendments to be made by the Commission in its further assessment on the basis of the observations submitted to it by the parties and subsequent findings of fact. Because it is provisional, the statement of objections does not prevent the Commission from altering its standpoint in favour of the undertakings concerned and it is not obliged, in doing so, to explain any differences with respect to its provisional assessments as set out in that statement.

"However, those considerations do not permit the inference that subsequent to the statement of objections, the Commission can modify the substance of an econometric model on which it intends to base its objections without that modification being brought to

the attention of the undertakings concerned and allowing them to submit their comments in that regard. Such an interpretation would be contrary to the principle of observance of the rights of defence and provisions of Article 18 ... which first require the Commission to base its decision only on objections in respect of which the interested parties have been able to comment and, second, establishes a right of access to the file which is available at least to the parties directly concerned. Further, such material cannot be classified as an internal document."

So in those circumstances what the submission is saying is even though you had the econometric modelling, so you could go away and look at it, play with it, make submissions on it, what the court does is it looks at it and says: even that modification that you then relied on, that had to be disclosed and it was unfair not to. Because you need effectively, in order to exercise your rights of defence properly, to be able to comment on all of these issues and to do so at a relevantly formative stage in the process.

Of course, this is being said in the context of merger control, not in the context of the imposition of a criminal sanction potentially.

Then there is further consideration of the

consequences of this over the page, and in particular at paragraph 56:

"It follows from the above that the general court did not err when it held in paragraph 2.10 of the judgment that the applicant's rights of defence were infringed with the result that the decision at issue should be annulled, provided that it has been sufficiently demonstrated by the applicant not that, in the absence of that procedural irregularity, the decision at issue would have been different in content, but that there was even a slight chance it would have been better able to defend itself. See Solvay.

"Consequently, contrary to what is claimed by the Commission, the general court was not entitled to reject as ineffective the plea alleging infringement of rights of defence relied on by UPS at first instance."

So, first of all, here we have a merger case where even just a modification to the modelling that had been provided was an infringement of the rights of defence. And, furthermore, it's not a question of whether or not the decision would have been different, it's whether there was even the slightest chance that you would be able to better to defend yourself.

I'm going to move on to a couple of other cases. I don't know whether now is a good moment to take five

minutes?

THE CHAIRMAN: Are you still on track?

MR BEARD: Yes.

THE CHAIRMAN: Okay. We'll take five minutes.

(3.07 pm)

(A short break)

(3.17 pm)

MR BEARD: Just to sort out the issue about the redactions and the coloured bits and so on, the authoritative, I suppose, list is actually found if you go to RM7B, tab 87.

THE CHAIRMAN: Tab 57?

MR BEARD: 87, I'm sorry.

PROFESSOR ULPH: Which tab is it?

MR BEARD: 87.

So this is the letter that accompanied the second SO and you will see at the bottom of the first page it says:

"Annexed to this letter is a schedule setting out the changes made to the relevant paragraphs."

So the definitive list of changes, so the removals of the confidential information are set out in that table. What you'll see is that, for example, in relation to paragraph 4.17, that particular reference, the confidential text has been removed, and therefore

it's not been relied on in the SO.

But in relation to paragraph 6.61 to 6.62, Whistl share of bulk mail delivery, the redactions have been removed and the information is disclosed.

You can then work through to the next one: deleted, not relied on, deleted, not relied on, and so on.

So this is the authoritative list. I know this isn't helpful in terms of the colour coding in your -- but it sets out, just in case there are any confusions about what it is, all the different versions that people have.

But what is also clear from this is that it was not being relied on, this material, in the SO. And as we've already seen in relation to the UPS judgment, where you're not relying upon material, you're not including it, you can't then add it in subsequently in relation to your approach to the decision. Indeed, that just circumvents the whole process of the SO.

I was dealing just before we rose with the UPS judgment. If I may, can I just turn back and reinforce the point by reference to the Advocate General's opinion which is just in the preceding tab, so authorities 9/112.

This is under the heading, beginning at paragraph 36, "Application of the rights of defence to

econometric analysis". It appears from paragraph 36 there was an awful lot of argument about whether or not the econometric analysis was a tool or part of the facts in evidence which the Advocate General refers to as a somewhat secondary theatre of war.

But then at 38:

"... observance of the rights of defence requires the addressees of decisions which significantly affect their interests to be placed in a position in which they can effectively make known their views as regards all elements on which the authorities intend to base their decision."

And I say a fortiori in relation to cases pertaining to criminal sanctions.

"An econometric model, such as the price concentration model in issue here, undoubtedly constitutes an element on which the Commission essentially relied in its competition law analysis."

Then down at 40:

"It is also otiose to muse on whether the econometric model used constituted an inculpatory element or an exculpatory element. For the rights of defence to be observed, it is essential that the undertakings concerned be placed in a position in which they can effectively make known their views as regards

all elements on which the Commission intends to rely in a merger control decision. It is not the Commission, but rather the undertaking concerned itself which examines whether specific elements from the case may be helpful for the purposes of its defence. In order that the undertaking can make this decision, it has to be made aware without distinction of all the elements on which the Commission intends to rely. What is more, all of the elements identified by the Commission in the merger control proceedings must be made available, that is to say ultimately also elements on which the Commission for its part may not wish to rely."

So actually it's going further there in relation to these matters.

THE CHAIRMAN: So the keyword is "elements".

MR BEARD: Yes, but it is "all elements" --

THE CHAIRMAN: Her translator puts "elements" in italics, not "all".

MR BEARD: Yes. But the word is still there, whether or not it's italicised.

THE CHAIRMAN: You gave it emphasis, and you're entitled to do that, but it's your emphasis, not hers.

MR BEARD: Yes, quite so. But I'm drawing attention to the fact it exists as a word, I'm not interpolating in those circumstances.

So we say, taking those points together, what we have is a situation where the approach that was adopted in relation to the first SO was fundamentally wrong. There is no circumstance in which you can properly be providing an SO, a statement of objections, a proposed infringement decision in relation to a competition infringement that is criminal this nature, to actually redact from it and yet seek to rely on material that the person to whom it is addressed cannot see.

Ofcom were right to remove that material. Having done so, it formed no part of the SO and they were not entitled then to rely on that material in the decision because all of that material should have been made available in the SO such that it could have been commented on by Royal Mail and its advisers under their instruction, and essentially what has happened here is that you have a situation where the procedural adjudicator, before whom that challenge is made, on the basis that if you're going to rely on stuff, we must be able to see it at that formative stage in the investigation, is taken out of the process. Because Ofcom says, right, we're pulling all this material. So the application falls away. And then it revives itself in the decision. That's plainly an inappropriate course of action in the circumstances, and it's unfair.

So let us just look at the way that Ofcom puts its essential defence on this ground. It says, well, it just makes no difference. That's broadly for six different reasons, and all of them are wrong.

The first reason it puts forward, which is in its defence at paragraph 243, is that Ofcom reached the same conclusion in the decision as it did in the reissued SO.

Well, we've just been through clear authority that says that is no answer, and it is obviously no answer. The fact that you have stuck with your position is no answer as to whether or not it was a fair procedure you followed in sticking with your decision. It overlooks the obvious point that the findings in the decision might have been different. Or, to put it in terms of Solvay, was there the slightest chance we could have put our case differently at that stage of proceedings in relation to that material had it been provided to us then, and the answer to that is plainly yes.

Second of all, Ofcom argues that it was obvious that Ofcom would continue to rely on the calculations underpinning the original analysis in the reissued SO. But it really is very far from obvious that Ofcom would rely on that analysis in the decision, made all the clearer in that table, which actually sets out what the changes in redactions were, where it specifically says

not relied on in the SO.

So it's plainly wrong to say either that Ofcom could rely on that material or that it's obvious it would do. I won't go back to the terms of the procedural officer letter in that regard.

So faced with these issues, it was clearly inappropriate and wrong for Ofcom to proceed as it did and it is not obvious that it was somehow going to revive reliance, notwithstanding that it withdrew the material in the light of the procedural officer application.

The third point that is raised is that Ofcom claims that all of the relevant information relied on for the original and materiality analyses was included in the case file in any event. That's in the defence at 244. That is, with respect, irrelevant. It is not the documents themselves that are important, it's the conclusions which Ofcom was drawing from them and the reliance being placed on them.

In that regard, I would just take you to one case, if I may, the AEG Telefunken case. Volume 4, tab 48 of the authorities bundle.

I'm just going to go to paragraph 27. This, as one can see at the top of page 3192, is a case concerning in part infringement of rights to the defence, and here it

is clearly the position as is set out in 21(a), (b) and (c), that objection was taken to failing to provide the complete text of a letter, using in the contested decision documents which hadn't been mentioned in the SO, and adopting a decision inter alia on individual cases not mentioned in the statement of objections.

We say there's no difference here between whole documents or parts of documents and pieces of information. Plainly there isn't.

If you go to 27:

"In this connection it must be observed that the important point is not the documents as such but the conclusions which the Commission has drawn from them. Since these documents were not mentioned in the statement of objections, AEG was entitled to take the view that they were of no importance for the purposes of the case. By not informing the applicant that these documents would be used in the decision, the Commission prevented AEG from putting forward at the appropriate time its view of the probative value of such documents. It follows that these documents can't be regarded as admissible evidence for the purposes of this case."

So an undertaking is entitled to assume that information or documents not relieved on in the SO are not of importance for the case, and the fact they may or

may not appear on the case file is immaterial in these circumstances.

Now, the next point --

THE CHAIRMAN: But they drew a fairly limited conclusion from it, didn't they?

MR BEARD: Well --

THE CHAIRMAN: In that case, a long time ago.

MR BEARD: Sorry, they drew a relatively limited ...

THE CHAIRMAN: Limited conclusion from the omission.

MR BEARD: Yes, they did in that case a long time ago. But the point I'm making there is that, taken in the context of what we're dealing with here, what you have is a situation where you can't assume -- the defence that's put forward is, well, worry not, these materials were included in the case file. But if you don't know that material is going to be relied upon in the decision, you don't put forward your submissions, and that's all that's really being said, that's all I'm deriving from AEG.

THE CHAIRMAN: I understand that's what you're relying on, I just draw attention to paragraph 30.

MR BEARD: Yes. I'm not demurring in relation to precise consequences in that case.

What we see from the later cases, and in particular UPS and the recognition of Solvay, is it's the slightest

chance test that is relevantly applicable in relation to these matters. All I wanted to do in relation to this older case was pick up the point in relation to material being on a case file not being an answer.

THE CHAIRMAN: Old cases have their uses. They come back to bite you sometimes.

MR BEARD: So in relation to that, we say this just isn't an answer to the UPS point that we've put forward.

Then the next point that is made is that there were extensive submissions made on the relevant calculations. That is a point that's raised in the defence at paragraph 248, it's the point that's put by Ofcom. And its defence is:

"It is clear from the final form of the SO that this assessment remained part of the case that Royal Mail had to answer. In its response to the SO and Ofcom's letter of fact, Royal Mail made extensive submissions on the relevant calculation, including in expert evidence and by reference to Whistl's business plan."

Yes, it did in relation to those matters. But it was not in a position to know the significance or reliance on any of the particular numbers, nor was it in a position to take instructions in relation to any of those matters when those had not been disclosed to it.

So Royal Mail hadn't seen the calculations in

question that are used in the decision prior to that decision. So to the extent it was able to put in representations to the SO, it wasn't putting in representations on the sort of calculation that's actually relied upon finally in that section of the decision to which I have taken you to.

Then the fifth point that is raised in the defence at paragraph 251/252 is that Ofcom claims that in all the circumstances the information not included in the SO would not have changed the outcome.

Well, with respect, this is just a reiteration of the previous defences and is one that doesn't deal with the fundamental proposition that in the course of the administrative proceeding, Royal Mail would have been able to position its responses differently, and answer the particular calculations differently, had they been put to it in the course of that process.

The fact that the outcome Ofcom wanted to reach as articulated in the SO, Ofcom would be sufficiently single-minded to ensure that it reached in the decision notwithstanding anything we put in, is again no answer to the points of unfairness.

To assume that there is nothing that could be said by Royal Mail that can make any difference is a very bold proposition in the circumstances.

Then sixthly, the defence suggests at 241 and 242 that Royal Mail is suggesting that the decision must be an exact replica of the SO. But that isn't Royal Mail's position at all. Royal Mail accepts that the SO is inherently provisional and that Ofcom may develop its analysis based on the undertakings, representations and subsequent findings of fact, but any such modification would then have to be put back to the undertaking. That's one of the things that's highlighted in UPS at paragraph 36.

And Ofcom relies on Schneider Electric and says that that shows that the decision in question doesn't have to be an exact replica of the SO. We, as I say, recognise that, but in fact Schneider doesn't in any way assist it.

Could we go to authorities bundle 5 at tab 69. Just picking it up, it's only one paragraph, 438. So it's on page 4190. 438:

"According to well-established case law, the decision need not necessarily replicate the statement of objections. Thus it is permissible to supplement the statement of objections in the light of the parties' response whose arguments show that they have actually been able to exercise their rights of defence. The Commission may also, in the light of the administrative

procedure, revise or supplement its arguments of fact or law in support of the statement of objections."

Well, in circumstances where the rights of defence are met, of course there can be modification. But that doesn't qualify the outturn that I referred you to in UPS at paragraph 36.

I'll just quote it again, I won't go back to the case:

"Because it's provisional, the statement of objections doesn't prevent the Commission from altering its standpoint in favour of the undertakings concerned, and it's not obliged in doing so to explain any differences with respect to its provisional assessments set out in that statement."

So we're not saying it has to be an exact replica, but it does mean that the requirements of UPS have to be met, and where you haven't relied on material, you're not allowed to rely on it against us in the decision if there were the slightest chance that in the course of the administrative procedure our arguments would have been different and might therefore have influenced the outcome at a formative stage when an assessment is being made.

THE CHAIRMAN: Does paragraph 440 of Schneider tell us anything?

MR BEARD: Well, in general terms it's setting out that all of the relevant information needs to be included. But of course the subsequent case law that I have referred you to spells out that it is the details of that information that needs to be provided as well.

THE CHAIRMAN: So you would say elements have replaced information?

MR BEARD: Well, we would say that this is information and it's all the information needs to be provided. What Mr Holmes may well say, I suppose, in relation to this, is that you didn't need this information in order to be able to defend yourself. But of course, what it's really talking about is the exercise of the rights of defence, which is of course what is being contemplated in UPS and Solvay, which is being able to comment on these matters, not just be able to put forward broad propositions in defence.

So I'm not sure necessarily it does, I'm not sure we take issue with the shape of the thinking in Schneider in that regard, but I don't think it's sufficient --

THE CHAIRMAN: It was a merger case as well.

MR BEARD: Yes, indeed it was a merger case as well. And you have our submission that the position is a fortiori.

So we say that Ofcom's reliance on the materiality analysis was a breach of the rights of defence and the

principles of procedural fairness.

I think it may just be useful, just so that you have it, in our notice of appeal we did seek to outline, in paragraphs 8.5 to 8.11, more details in relation to a number of the key redactions that are there. So that reference may also be of assistance to the tribunal in considering these matters.

THE CHAIRMAN: Thank you.

MR BEARD: I won't go through them in any further detail. Nonetheless, we say that in those circumstances it was a breach, and insofar as the effect of it circumvented the procedural officer process, there's something egregious about the breach, even if the number or quantity of redactions is limited, and the tribunal in those circumstances should not rely on those sections of the decision in relation to these matters where an unfair process was followed.

We don't go so far as to say this undermines the entirety of the decision.

THE CHAIRMAN: I was just going to ask you where you wish us to go with that point.

MR BEARD: Well, I don't think we can rightly -- we can properly say that what is considered here is such that it is necessarily going to undermine all elements of the decision. Depending on where Ofcom places its weight in

defending its decision, of course, and I must reserve my position on that, we're looking at the decision as a whole, what we would say is that in relation to that section and the considerations therein, the position must be that those sections fall away with whatever concomitant consequences come for the robustness of the decision as a whole.

It is important to bear in mind that so far as the decision is concerned, that section really consists of the only real economic analysis in the decision, and therefore that section may transpire to be disproportionately important in the defence of the decision, and in those circumstances the decision in the light of that, and potentially other circumstances, wouldn't be able to stand.

But I think the precise consequence of these failures will only properly be able to be the subject of submissions once we've heard the extent to which Ofcom are continuing to place weight on these particular sections, but we say they are important, they must fall away. If that were to mean the tribunal considers that the decision can't stand, that would be the entirety, but at the very least those parts of the reasoning must go.

THE CHAIRMAN: Is that why you haven't made any interim

application in relation to this ground?

MR BEARD: No.

THE CHAIRMAN: Why haven't you made any interim application in relation this ground, Mr Beard?

MR BEARD: Because in relation to these grounds, once the SO and the decision are issued, the idea that the appropriate and efficient means of dealing with these sorts of situations is to issue interim applications rather than seeking to appeal, in circumstances where you have a limited period to deal with these issues, is obviously more sensible to put it in as one of the grounds in a notice of appeal.

THE CHAIRMAN: You are not asking us to deal with it as a preliminary matter, you didn't do that either.

MR BEARD: No, well, we certainly wouldn't have suggested that in circumstances where the entirety of these matters were being dealt with, that it was the most efficient way of the tribunal disposing of these issues, because obviously we recognise that one of the issues you have to take into account when you're considering the impact of unfairness is looking at the decision as a whole.

In those circumstances I'm not sure the tribunal would have profoundly thanked us if we'd have come forward and set out an argument that said: this element

of the decision is important once you have considered all of the other elements, and indeed it is important also to consider these issues in circumstances where, if and to the extent that there are other flaws in the decision and other flaws in the reasoning or evidential basis of the decision, this, even if you were to think of it alone as not being sufficient to overturn the decision, may cumulatively have that impact. And in those circumstances, if we had brought it before you as a preliminary issue and you had thought, well, actually there is a real problem here, but we are not sure about the impact of it, we would have then been rehearsing all of these issues at a full hearing.

So there is a range of issues why a preliminary issue wouldn't necessarily have been a delight for anyone other than perhaps the lawyers presenting.

THE CHAIRMAN: Delights and non-delights. That's what we're here for.

The other question I suppose is you say what is the conclusion we should draw? That we don't rely on this material? That Ofcom can't rely on --

MR BEARD: Ofcom cannot rely on this material.

THE CHAIRMAN: Is there any evidence that you would say is inadmissible?

MR BEARD: Sorry, any of the evidence that's inadmissible?

I don't think we seek to render evidence inadmissible in circumstances where we're making an appeal against the decision.

THE CHAIRMAN: So we can look at everything, and you want us to apply appropriate weight in the light of what you said.

MR BEARD: I think that is always going to be the position in relation to these proceedings. There will be circumstances where we say no, there are limits, you cannot put forward evidence in relation to these matters. There are going to be observations made about some of the evidence that is put forward in this case and the weight that the tribunal should afford it. But that doesn't mean that the sensible course is to go round trying to strike out particular paragraphs in relation to it in advance.

So no, Ofcom can't move away from its decision. It is not in a position to supplement that decision and put forward different grounds, otherwise this process would be undermined. I think that was something that was articulated, as I recall very clearly, by Sir Christopher Bellamy back in the Napp litigation. We have the judgments, or some of them, in the bundles. I can go back and find the references in relation to --

THE CHAIRMAN: I know the Napp case from a previous

existence. Thank you, Mr Beard. Move on.

MR BEARD: With that, I am going to conclude by dealing with ground 6 in relation to penalty.

Now, inevitably, in relation to penalty submissions, these are matters which I'm going to pick up more fully in closing and I'll only deal with these matters rather briefly now. But what I say at the outset is that in relation to this decision, the imposition of a penalty of £50 million on Royal Mail is a penalty that requires one to step back and indeed take a breath. Because putting forward a notice to change a contract, a change which never came to occur in relation to that contract, in relation to price discrimination pertaining to prices that were never charged, in respect of an infringement that covers a total of six weeks, in circumstances where the reason why that price differential was not charged was because Royal Mail had gone to great lengths to ensure that there was a safety valve mechanism in relation to any changes, means that this penalty is simply not justified on any basis. It is wholly disproportionate and unreasonable.

In fact, before I go into more of the details in relation to the penalty, we say that it doesn't clear the first of the two hurdles for imposing a penalty at all.

The first is that we say that there was not intentional or negligent infringement of competition law, which is obviously a statutory pre-condition for any imposition of a penalty, and we say that for the following three reasons.

First of all, there isn't any precedent for Ofcom's finding of an infringement of this sort in respect of a notice being put forward for a change of contract at the end of a period in respect of price changes that were never charged or paid. So the idea that Royal Mail should have known that that step would amount to a breach of competition law cannot be taken as correct.

What we see in documents -- we touched on one or two yesterday -- is that obviously competition law concerns were very much in the mind of Royal Mail, but they pertained to the implementation of those changes. There is no evidence that's been put forward that suggests that the simple fact of giving the notice was understood by Royal Mail to give rise to any vulnerability in relation to competition law.

The second point to highlight in this regard is that Royal Mail did not believe that the announcement of the CCNs would be contrary to competition law or have an exclusionary effect on the market. We know that the suspension clause was put forward, inserted into the

access contract, specifically to guard against any sorts of effect, and in those circumstances the assumption that there would be a breach of competition law when all concerned recognised the complaint was highly likely is one that is not made out.

The third point to note is that Royal Mail did go to considerable lengths to try to ensure that the announcement of the CCNs would not infringe competition law when they were implemented, and this did include in particular engaging Oxera to stress test the proposed price changes.

Now, Ofcom seeks, somewhat selectively, to rely on extracts of that advice, but there is no basis for considering that Oxera and its representatives believed that price differential would have an exclusionary effect or be contrary to competition law. And as I say, Royal Mail adopted a deliberately precautionary approach to the level of the price differential which was set considerably lower than that which Royal Mail's analysis indicated was justified. We saw yesterday considerations of a range of figures for the price differential, ranging from 0.2p up to 0.5p as being potentially justified. As we know, the price differential was brought in at the lower end of that range.

And throughout the process we also know that Royal Mail sought to engage constructively with Ofcom. This is not some case where there was no contact between Royal Mail and Ofcom, and Royal Mail was in any way shy of explaining to Ofcom what was going on. It was well aware that it needed to do so.

All of those factors taken together show there is no deliberate strategy by Royal Mail, there was no negligence or intent, and therefore that statutory threshold is not met. The inescapable conclusion of all of this material is that Royal Mail was genuinely and legitimately unaware that what it was doing by issuing those notices, by introducing the CCNs, as it's put, was anti-competitive in nature. So we say at that first statutory hurdle it fails.

Secondly, we say that to impose a penalty in these circumstances is contrary to principles of legal certainty. The principle of legal certainty that's embodied in Article 49 of the EU Charter and Article 7 of the ECHR, and recognised as fundamental in the considerations in the case law that we've already seen.

Now, those fundamental principles in Article 49 and Article 7, they require the criminal penalties, including in particular the competition infringements, may only be imposed in accordance with laws which were

sufficiently certain at the time of the relevant conduct, and what it does is it operates to preclude an interpretation of a rule of criminal law that wasn't reasonably foreseeable at the time of the conduct in question.

Now, Ofcom has been unable to point to a single instance in which Article 102 has been interpreted as prohibiting the introduction of CCN type conduct similar to Royal Mail. Yet despite this, Ofcom denies it has adopted any sort of novel interpretation of Article 102. That's obviously wrong. The decision undoubtedly seeks to extend the application of Article 102, and in particular the notions of discrimination that are articulated through Article 102(c) to the introduction of CCNs, which were the announcement of prices that were notified for change in circumstances where those prices were never actually changed in the contract and never charged or paid.

We've already touched upon how we say the decision can't put forward a brand new abuse of creating market impact by announcement of future intentions of threats, sabre-rattling or generating uncertainty, but certainly that would be an entirely novel approach, and I have articulated already today why the ingredients thereof are not made out in the decision.

Another factor that goes to issues of legal certainty is the conclusion that the anti-competitive effect of such abuses should be judged by reference to whether or not they have a negative effect on the profitability of any competitor, apparently without constraint. There is no threshold as to the inefficiency of a competitor whose profitability could be affected in accordance with the test that is put forward by Ofcom in relation to Royal Mail.

Again, this is based on entirely novel metrics of assessment. These are unprecedented developments in the interpretation of Article 102. They couldn't have been foreseen by Royal Mail at the time the CCNs were announced. And certainly Royal Mail's conduct fell well outside the scope of what's referred to in Atlantic Container as the classic abuses envisaged by 102. Atlantic Container, I won't take you to it, but it's in bundle A6 at tab 70 and the relevant paragraphs are 1617 and 1618. There, as you'll recall, in relation to the liner conference arrangements, although it was found to be abusive because it wasn't found to be a classic abuse, and it wasn't manifestly clear, in those circumstances no penalty was found to be appropriate.

Is it worth turning that case up? Would that be of

assistance?

THE CHAIRMAN: Let's turn it up.

MR BEARD: So authorities bundle 6 at tab 70.

THE CHAIRMAN: It would be a shame to leave 2 inches of paper unturned.

MR BEARD: Yes. There are a number of these decisions where perhaps there should be a convention that only about two pages are ever copied because it's the same two pages every time.

If one goes to page 3801, 1617 at the bottom of the page:

"The abuse resulting from the practices on service contracts do not constitute a classic abuse within the meaning of Article 6 of the Treaty. Contrary to the Commission's submission, the practices in question can certainly not be likened to cases of outright refusal to supply which have already been held to be abusive by the case law relating to inter alia ceasing to deliver an existing customer where there is nothing unusual about that customer's orders, refusing to supply a customer so as to reserve for oneself a derivative market, to supply a customer so as to protect exclusive rights.

"In the present case, whilst it's true that by the practices in question, the TACA parties restricted the availability and content of service contracts, they in

no way deprived shippers of the possibility to have their cargo carried by conference members on the trade in question, whether under service contracts or at tariff rates. The Commission itself stated that paragraph 553 of the contested decision, the practices the question didn't constitute an outright refusal to supply, but in its own words a refusal to supply other than on the basis of unfair conditions."

So what they are talking about here is what we now refer to as a constructive refusal to supply, and I think most lawyers now would, competition lawyers would say constructive refusal to supply is plain and obvious. But not at that time.

"Furthermore, while the relevant restrictions in relation to service contracts may be qualified at paragraph 592 of the contested decision as a serious infringement within the meaning of the guidelines, their objective in seeking to restrict price competition, which the applicants cannot seriously deny since they justify those rules by the need to preserve the stability of the tariff rules, it is not manifestly clear that such rules constitute an abuse within the meaning of Article 86."

So it was a constructive refusal to supply based on price restrictions in order to maintain tariffs as

higher, and yet that was not said to be at that time a classic breach or manifestly clear.

MR FRAZER: To what extent do you think this kind of approach has been dented by the approach in AstraZeneca?

MR BEARD: I don't think it's been dented by the approach in AstraZeneca. I think in the circumstances of AstraZeneca, where what had happened was that the company in question had implemented its actions by making the relevant submissions which it knew to be misleading, it was recognised in those circumstances that making misleading representations would clearly be within the scope of what are referred to as classic abuses.

Now, I recognise that of course many people have said, well, AstraZeneca, it's not manifestly clear. It isn't a classic abuse. It's an extension. That does not mean that this case law has been circumvented or overridden by AstraZeneca, and I think one does need to look at the particular circumstances of AstraZeneca and recognise that that particular manifestation of actively misleading a regulator was seen to be manifestly clear as an abuse in those circumstances.

MR FRAZER: Because it wasn't competing on the merits?

MR BEARD: Well, I don't think it can just be competing on the merits, because I think arguments about whether or

not it's competing on the merits -- I think it's because it crossed over into what would ordinarily be called deceit. I think that is probably going to be the critical factor in AstraZeneca. If you lie in those circumstances, you know you're putting yourself in real jeopardy, if you lie in order to achieve a particular advantage.

So I think although AstraZeneca could be seen as something of an extreme case within the structure of this sort of analysis, I imagine it's the instinctive sense that dishonesty is something that taints the way in which an assessment should be taken.

But I take the point that AstraZeneca is undoubtedly stretching the concept of manifestly clear, but I think it's the deceit. As one knows, as soon as one traverses into areas of fraud all sorts of different rules apply, and I do wonder whether in relation to AstraZeneca it is because it savours of dishonesty and deceit that you ended up with a readiness on the part of the court to admit a penalty which otherwise you wouldn't have had imposed under this scheme. I think if it had been an innocent misrepresentation or that that had been the position that had been adopted, I wonder whether AstraZeneca would have come out the same way in relation to penalties, because you may well have been achieving

the same competition outcome by an innocent misrepresentation in the sense that you would be obtaining the relevant protection that could skew the market, but I can see that in those circumstances it may well have been considered differently. It's difficult because of the particular fact set.

MR FRAZER: It is. Thank you.

MR BEARD: So if we just go over the page to 1621:

"In those circumstances, the TACA parties could, notwithstanding the case law to the effect that agreements entered into by a dominant undertaking are liable to constitute an abuse, legitimately have been unaware that their practices on service contracts were likely to be regarded as such. It was only at the hearing that the Commission explained for the first time, whilst the contested decision found that the rules laid down by Article 14 of the TACA were contrary to Article 85 of the Treaty only insofar as they applied to individual service contracts, but not insofar as they applied to conference service contracts. The decision established that those rules were in any event contrary to Article 86 of the Treaty, including in their application to conference service contracts."

So the decision had spelled out Article 86 and the Commission had amplified that in relation to Article 85

at the hearing. But what is key here is the nature of what was being considered and then the two tests, and to pick up the point made by Mr Frazer, those tests are not overridden, notwithstanding I quite accept that AstraZeneca may be seen as something of an extreme example in relation to them.

So that's the second of the relevant thresholds that have to be passed in relation to even consideration of whether a fine will be imposed, and we say they had not passed.

Going back to the submission I made in opening these points in relation to penalty, we say that the setting of the level of penalty as it was done in relation to this case in all of the circumstances of 50 million is quite wrong and inappropriate, and in the circumstances this tribunal, using its full jurisdiction in relation to penalties, must in any event therefore revisit and quash or substantially reduce that penalty in the alternative.

Now, we have set out both in our notice of appeal and reply and in relation to expert evidence a number of more technical issues in relation to errors made in relation to the penalty. Just for your notes, the relevant sections of the notice of appeal are section 9 and reply section 8, and I'm not going to go through

these in great detail. I will refer briefly to a series of these points and the relevant evidence, but undoubtedly there is going to be further consideration of the evidence in relation to these matters in due course.

We recognise, of course, that Ofcom is seeking here to apply penalty guidance and we're not for present purposes taking issue with the steps in relation to the penalty guidance, what we are concerned about is the way in which those steps have been applied.

The first of those steps is the starting point in relation to any relevant turnover that is going to be considered as the basis for penalty, and what we say is that Ofcom clearly adopts a severely overinflated starting point, 20% in a range of 0 to 30.

20%, that is indication of a very serious infringement in relation to pricing -- I repeat myself -- not implemented, suspended by reason of our suspension provisions. It is quite unreal and unreasonable to start at that level.

Just as a benchmark, we indicate that in Intel prolonged infringement was found by the Commission. I know it's on appeal, but just for the purposes of penalty setting, 5%. Global action to foreclose its rival, implemented through a whole range of schemes, 5%.

Ofcom has simply diverged from any sense of reality in relation to the way of approaching this penalty.

MR FRAZER: Intel was under different guidelines.

MR BEARD: Yes, it was under different guidelines. That's absolutely true. But nonetheless, proportionately, you've still got a very significant difference here. You're looking at two-thirds of the maximum of the guidelines in relation to this.

I also think that, although it's under different guidelines, my recollection is that the Intel framework is the 0 to 30% starting point in relation to that step. I'll confirm that.

MR FRAZER: Thank you. You may well be right.

MR BEARD: So I'm not demurring that it's Commission guidelines rather than national guidelines, but I think the -- because it used to be in the UK that it was 0 to 10% and then we moved it outwards, but I think we moved it outwards in line with the national ...

(Pause)

So Ofcom has chosen the absolute top end of the 10 to 20% range with which it's dealing, as is set out in paragraph 10.70 in the decision. So it hasn't said that it's the most serious, but it has said it's at the absolute top end of the mid range.

Those next to me have just confirmed the Commission

guidelines do go up to 30%.

MR FRAZER: Thank you very much.

MR BEARD: So we say the starting point is plainly wrong.

Then we say, secondly, that Ofcom's wrongly calculated Royal Mail's turnover and has done so by revenue associated with bulk mail delivery for D+2 or later services in all parts of the United Kingdom. This was the market definition used for the assessment of dominance, but that definition overestimates the markets affected by the abusive conduct, making it a very poor proxy for the scale and impact of the infringement which one is looking for in relation to step 1.

In particular, it was inappropriate for Ofcom to define the geographic market on a UK-wide basis, and essentially what it does is it treats all local markets as homogeneous.

Now, this is obviously one of those topics where further evidence is going to be heard, and in particular these are matters that are dealt with by Mr Dryden in his report, at section 11 of his report. I'm not going to go through that, but it's at tab 3 in the third core bundle, beginning external page numbering 167, where he deals with the relevant principles determining relevant turnover, Ofcom's general approach, and then the geographic market definition which starts at page 170.

Then he also has a critique of the product market dimension, starting at page 178.

As I say, he makes out why it is that the relevant turnover assessment is --

THE CHAIRMAN: It's quite clear these points are made in the context of the penalty calculation.

MR BEARD: Sorry?

THE CHAIRMAN: It's quite clear these points are made in the calculation --

MR BEARD: Yes, absolutely. The heading --

THE CHAIRMAN: You're not contesting the product or geographic market?

MR BEARD: No, we're not testing the geographic market for these purposes. This is under a section, my response to Ofcom's assessment of penalty. So there is no issue.

On the other hand, the fact that we're not challenging market definition in relation to dominance doesn't in any way, we say, affect these issues. We may have all sorts of issues with how market definition operates and dominance is assessed.

THE CHAIRMAN: You are not raising them in this appeal?

MR BEARD: We're not raising them in the context of this appeal, recognising that there may be issues in relation to that that are potentially for another day or potentially are not germane to this appeal for these

purposes.

THE CHAIRMAN: Another day, Mr Beard?

MR BEARD: Another day. Always another day.

Having provided those references to Mr Dryden's statement, I won't go through the work that he has done and that we have reflected in our notice of appeal and reply in further detail in relation to step 1, but the third more technical point in relation to the penalty that we do want to highlight is in relation to step 2, where a duration multiplier of 1 is applied. Ofcom says that 1 is appropriate because there are no exceptional circumstances justifying a lesser multiplier.

Now, we struggle to see what more exceptional circumstances you could have but the non-implementation of the prices, a suspension mechanism. Indeed, a suspension mechanism, of course, that took longer to kick in because it was a suspension mechanism that had been modified at Ofcom's instigation. Of course, if it were the case that the original proposed suspension mechanism that operated, that it was merely a complaint that triggered the suspension, it would have been even a shorter period.

So six weeks for CCNs that were never implemented in those circumstances do render this case exceptional and unusual, and it is plainly wrong simply to treat it as

if it were an infringement across a year, which is in effect what the duration multiplier of 1 does in relation to these matters.

Then the fourth point I would raise in relation to the steps in the penalty calculation, which does go back to the more general propositions that we have put forward, is that the adjustment in relation to proportionality that Ofcom makes that it says is appropriate is plainly inappropriate in all the circumstances. It has not done what was required of it to take a step back and see this infringement that has been found in context, in the round, looking at what actually occurred, and also considering proportionality in relation to the nature of Royal Mail's activities more generally.

Ofcom has limited itself to considering proportionality by reference to the size of fine relative to Royal Mail's financial health and seeking to deter infringements in circumstances where you have a situation where Royal Mail has made clear that it does not want to engage in any conduct that could in practice be implemented such as adversely to affect competition contrary to competition law or the ex-ante regime and does not, in considering the proportionality, look properly at the nature of the announcement of notices,

the introduction of the CCNs, as it is put, and the fact that they were suspended and the prices never charged or paid.

Those are factors that are critical to any proper proportionality assessment and they've not properly been taken into account. So those broad issues in relation to step 4 in the calculation become of particular importance.

In relation just to one remark, just to go back, the position we set out in relation to Article 106 and the position in relation to objective justification in respect of Article 102 are considered, since the tribunal asked about that specifically at the end of those submissions, in section 6 of our reply dealing with the relevant paragraphs of the defence. It's there that we set out the comparative relationship between Article 102 and Article 106(2), and the relevant paragraphs of our notice of appeal are paragraphs 7.15 to 7.18.

THE CHAIRMAN: You're not reneging on that in any way?

MR BEARD: No, that is the position in relation to those matters. I'm hoping that's just providing a useful shorthand since I was asked about the position in relation to 102 at the end of submissions on 106(2).

THE CHAIRMAN: Without repetition or deviation.

MR BEARD: Indeed.

So in those circumstances, you have our opening submissions in relation to grounds 1 through to 6, and in particular we have, I hope, articulated the legal issues that arise, especially in relation to matters of implementation, discrimination, but particularly in relation to the operation of any competitive disadvantage test in respect of these matters.

Unless I can assist the tribunal further, those are the opening submissions of Royal Mail.

THE CHAIRMAN: Thank you, Mr Beard.

Can I take it at 4.20 that you don't want to go in with the nightwatchman?

MR HOLMES: I'm raring to go, sir, but I think I would rather begin fresh tomorrow morning, if that suits the tribunal.

THE CHAIRMAN: So 10.30 tomorrow.

MR HOLMES: I'm grateful.

THE CHAIRMAN: Thank you very much.

(4.20 pm)

(The hearing adjourned until Wednesday, 12 June 2019 at 10.30 am)

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