IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1008/2/1/02

Sheriff Court
Chambers Street
Edinburgh EH1 1LB

12th January 2005

Before:
SIR CHRISTOPHER BELLAMY
(President)

MR PETER CLAYTON
MR PETER GRANT-HUTCHISON

BETWEEN:

CLAYMORE DAIRIES LIMITED AND ARLA FOODS UK PLC — Applicants

and

OFFICE OF FAIR TRADING — Respondent

supported by

ROBERT WISEMAN DAIRIES PLC
ROBERT WISEMAN AND SONS LIMITED — Interveners

Mr Nicholas Green QC (instructed by Messrs. Ashurst) appeared for Applicants.

Mr Jon Turner and Mr George Peretz (instructed by The Director of Legal Services (Competition), Office of Fair Trading) appeared for the respondent.

Lord Grabiner QC, Mr James Flynn QC and Mr James Goldsmith (instructed by Messrs. Herbert Smith) appeared for the intervener.

Transcript of the Shorthand notes of
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PROCEEDINGS
DAY ONE

THE PRESIDENT: Good morning ladies and gentlemen. We have one or two points we would like to raise before the parties begin – mainly of a housekeeping nature. We had quite recently an application by Wiseman to strike out the part of the Claymore case that related to the Chapter I proceedings. Our present attitude to that is that we do not wish to make a formal order, but we do not wish to hear any further argument from it on the part of Claymore and we do not propose to call upon Wiseman to deal with it any further than has already been dealt with and I hope that suffices to deal with that situation at the moment. That is the first point.

The second point is that we have had an exchange of expert reports that we found helpful – Mr. Haberman's report and Mr. Bezant's report. There has not been any application by anybody to cross-examine either of the expert witness and, as I think we have indicated on an earlier occasion, we are not at this stage of these proceedings particularly keen to go into detail on particular points, still less resolve factual issues. Nonetheless, if either expert would wish to comment further on the reports that have been submitted, perhaps by way of some short oral comments if they found that useful, if indeed they are present today – I do not know if they are present today – we would be quite happy to make time, possibly tomorrow, for that to happen. Otherwise we can simply do the best we can on the material we have before us.

As far as the general timing of these proceedings is concerned, we would hope without trying to compress matters unduly, that we would be able to finish by tomorrow evening. We will see how we go, but we roughly thought that the Appellants (Claymore) would probably take up most of the morning and the early part of the afternoon. We would hope that it may be possible for the OFT to begin this afternoon and continue to the later part of the morning tomorrow, with the Interveners then following relatively briefly because quite a number of the points would be covered by then, with the possibility of short replies taking place tomorrow afternoon. We have not felt it necessary – since we are in the presence today, and have the advantage of extremely experienced counsel – to lay down in advance any more detailed timetable. That is how we are thinking. If anybody is thinking differently they might indicate to us what their position is so we can understand it and take it on board.

The last point at this stage from the Tribunal, although there may be applications and points from the various parties, is that in the OFT's skeleton argument at para.12 an internal OFT submission is produced dated 7th August 2002 and an additional point is sought to be made on the basis of that document. Although I have not been able in the time available to put my finger on it, I have a distinct recollection that, having asked at a relatively early stage in these proceedings whether there was any internal report on this matter which might throw light on the considerations taken into account by the Director General (as he then was), I was

assured that there was no such report. So at some stage in these proceedings, perhaps when the OFT begins, the Tribunal will be glad of an explanation as to why and how this document has just come to light; why the Tribunal was told at an earlier stage that there was no such document, and what (if any) relevance or weight we should now attribute to it. I think that is for the OFT to deal with it when we come to it.

Those are the points that occur to us at this stage – I do not know if there are any other observations or applications from the parties. If not, we can proceed with the Appellants' submissions.

MR GREEN: I am grateful, thank you. Mr. Clayton, Mr. Grant-Hutchison, President, good morning. As you know I appear for the Applicants. Mr. Turner and Mr. Peretz appear for the OFT. Lord Grabiner QC, Mr. James Flynn QC, and Mr. James Goldsmith appear for Wiseman.

So far as timing is concerned, we were aware that we had three days but I contemplated that it might be in your mind that you would seek to do it more rapidly. I would have to go quite fast in order to achieve mid-afternoon, and it will mean that I will be giving you quite a lot of references that I will not take you, to and summarising evidence, because otherwise I simply will not finish it within the day and certainly not within two-thirds of a day.

THE PRESIDENT: Let us see how we get on, Mr. Green. A great deal has been said in writing.

MR GREEN: Indeed.

THE PRESIDENT: We do not want to spoil the ship for a ha'peth of tar at this stage. On the other hand I think now is the moment to concentrate on the main points, and I think it would be very much in your interest to concentrate on your four or five most important points as you see them.

MR GREEN: Yes. Could I ask you to have two documents, please, available at the outset? One is the briefing note which you have just referred to, produced by the Office of Fair Trading on 7th August, because I will be referring you to that quite extensively. The second is a table G to Mr. Lawrie's statement, which is p.377. It may be helpful to extract that graph, because it will make life easier – I shall be referring to it on a number of occasions throughout my submissions.

THE PRESIDENT: It is a scatter graph?

MR GREEN: That is right. Before I get into the meat of the submissions, I would like to make a number of introductory points and the first point concerns the nature of the Decision in this case. The Appeal is unlike I think any other that certainly I have been involved in. There is no clear comprehensive target in this case to aim at. The Decision itself is contained in the

short letter dated 9th August 2002, and the Tribunal rejected the OFT's analysis that it did not contain the Decision. The net effect was, as you will recollect, that there was something of a gap in the reasoning which was then endeavoured to be plugged by Mr. Lawrie's statement. Mr. Lawrie's statement, as you have seen, contains a fairly high level description of the work undertaken by the OFT case team, but it does not contain the sort of detail you would find in a detailed Decision. We do, however, have a number of annexes attached to Mr. Lawrie's statement and Annex G is one such.

The reasoning of Mr. Lawrie was then supplemented by the reply to the request for information and so the reply and the request that constitute the core reasoning of the OFT, as it appears in the pleadings, since then we have had an OFT defence and a skeleton, and then most recently we have had in December, and by virtue of Santa Claus on 24th December, a revised version of 7th August note with manuscript amendments coupled to a response from Mrs Penny Boys approving the decision to close the file.

The memorandum of 7th August 2002 is, in our submission, pivotal because it was a document containing some 39 paragraphs, provided with a view to the decision being taken. It was the operative reasoning which led to the Decision which is in issue in this case. It is contemporaneous, it is set out in detail, it has a conclusions' section and, as I will be submitting in the course of my submissions today, there are material respects in which it substantially differs from Mr. Lawrie's statement, and the reply and indeed as the OFT skeleton acknowledges it adds a number of new, and we submit, fairly startling reasons for the decision to be taken.

THE PRESIDENT: Can I just stop you there, Mr. Green? I would just like to reflect out loud on the position we have got now in this case. The case has now been proceeding for nearly two and a half years. As I recall it, we were initially faced with the short letter to which you have just referred.

MR GREEN: Yes.

THE PRESIDENT: Then after the admissibility Judgment we then explored how best to proceed. As I have just said, I seem to recall being told that there was no contemporaneous record as to what the reasons for the Decision were, but Mr. Lawrie was in a position to reconstruct the reasons and put in a witness statement. The case has since then proceeded for the best part of 18 months on the basis of that witness statement as supplemented by particulars and a certain amount of successive unveiling of things that were earlier treated as confidential. We now, at the last minute, actually get a contemporaneous document which appears to contain the contemporaneous analysis of what the case team then thought the situation was.

Two questions arise, I think. At this late stage should we pay any regard at all to this document, or is it just too late? Secondly, how does the document relate to all the other material upon the basis of which the case has been proceeding so far? Is this document in fact the Decision, or what?

MR GREEN: We are in something of the same difficulty as the Tribunal. We would wish to rely upon it because, in our view – to take one example – paras. 36 to 38, which is the conclusion on the Chapter II investigation contained a new, but in our submission, quite plainly erroneous piece of logic just to find the analysis which led to the Decision. Now we are precluded from putting that in front of you and saying "This is stark raving mad", which we will then submit is a prejudice to us. We would wish to put that to you as being stark raving mad, but nonetheless the motivating paragraphs of this "Decision" which led to the decision which was ultimately adopted.

THE PRESIDENT: Yes.

MR GREEN: It would appear to be somewhat unrealistic to simply ignore it.

THE PRESIDENT: I suppose in my no doubt rough and ready way I have been thinking to myself that it is too late now for the OFT to rely on new considerations that have only just been disclosed, as they seek to do in para. 12 of the skeleton. But it may, on the other hand, be fair and appropriate to allow the Appellants to make whatever points they choose to make on the basis of this document disclosed at the last minute as it is.

MR GREEN: There are certain factual matters which we have not been able to investigate as a result of its late disclosure, but there is an analysis of reasoning contained in this document which is plainly causally connected to the Decision – it was contemporaneous and it was designed to induce a decision which it did induce. It is obviously up to Mr Turner and Mr. Peretz to explain how it came about and I do not want to speculate.

THE PRESIDENT: Well let us go on for the time being then.

MR GREEN: Yes. That is the first point, the relevance of **this** document. The second point is materiality and just simply to remind the Tribunal of the position that was arrived at after the hearing on 24th May last year in relation to the disclosure Judgment, where the Tribunal recorded the Office of Fair Trading's important concession (paras.81 and 120 of the Judgment) that materiality was not going to be run as a defence by the OFT, and that if we identified points of principle then they would not submit that they were *de minimis* in any way. We have concentrated our submissions (and will concentrate today) on that basis.

The third introductory point, which is of relevance, is that the case advanced by the OFT, as indeed reflected in the August note is not one whereby the OFT claims to be confident

of its conclusions. This is evident from the August briefing note, it is recorded in Mr. Lawrie's statement and in the Reply, it is reiterated in the Defence and in the skeleton, where the OFT repeat time and time again that it was not possible to reach a final decision that Wiseman had not infringed the Chapter II prohibition. Of course, the position we are now at is that the Tribunal has found there was a decision of non-infringement, the possibility of which is fully recognised indeed in the briefing note.

The position, as set out in the OFT's briefing note is that it did not believe that it would be probably feasible to take the investigation further and come to a different result. That might ultimately be an important point on the basis of the submissions we make – was it feasible for the OFT to take matters further? Might they have come to a different result? If that is the basis upon which they apparently decided matters, and it was relevant when we made submissions to you at the admissibility stage that the OFT concluded that if it had progressed matters it would not have come to a different result and that was one of the factors which led the Tribunal to conclude that there was a decision of non-infringement. This is therefore not a case where the OFT goes to the wall on the basis that its conclusions were in fact definitive. On the contrary, it is defending the application on the basis that it made no error of principle, but nevertheless, as Mr. Lawrie candidly accepts, it has conducted a rough edged investigation and from this it could deduce no clear conclusion on breach but it was of the view that to conduct a full and further inquiry will probably not advance the chances of a definitive position.

The next introductory point is one concerning the importance of this case, and I make it only really as a riposte to Wiseman's submissions, who suggest that this is an exercise in archaeology and it is all "milk" under the bridge. In fact, this is an important case. It concerns a staple product, milk. It is one of the most important consumer products. It relates to the conduct of an undertaking which covers the entirety of a State – Scotland. It was sufficiently serious for a reference to be made to the Competition Commission by the OFT on 3rd February 2000, and for the Secretary of State to instruct and invite the Director General of Fair Trading to continue to review the market under the auspices of the Competition Act. It is also a case which throws up some not unimportant points of law. It is also – and this is not unimportant – a case where Express/Claymore is of the view that the Scottish Milk Market cries out for clear principles. Claymore is presently not quite in mothballs but it is not as active as it would otherwise be. Claymore and Express do believe that a clear statement of what Wiseman is and is not allowed to do is of pivotal importance for the future of the market.

THE PRESIDENT: If at some point you could just elaborate on what Claymore's present position is, not necessarily to take you out of your stride now.

MR GREEN: I will get clear instructions as to their financial position so as you are aware of it. The next introductory point concerns the fact that this is a Complainant's Appeal and again I would like to address the submissions made in very substantial part by Wiseman, but also to a lesser degree by the OFT about the standard of review. This is an issue which the Tribunal is obviously familiar with, and I will try and keep my submissions in summary form.

This is an appeal on the merits under the Competition Act. The 1998 Act has created a merits' appeal which extends to complainants' appeals under Schedule 8. The standard of review has been created by Parliament to be different from other reviews which are created both under the Competition Act and indeed under the Enterprise Act. I have in mind in particular in relation to commitments where Parliament has taken the opportunity to amend the Competition Act to create a review procedure rather than a merits' appeal. It would have been open to Parliament, had it so wished, to amend the Competition Act further to create a review structure for complainants' appeals, but it did not. When Parliament introduced Judicial Review for commitments it was open to Parliament to amend s.47 to render complainants' appeals subject to Judicial Review and it declined to do so.

So under the Courts' merits jurisdiction you may exercise the same powers as the OFT and you may set aside any findings of fact contained in the Decision. Those are the powers conferred upon you by the Statute. I accept that the argumentation in the Complainant's Appeal may differ and the remedy may differ from that which one finds in a Defendants' Appeal against a penalty or a prohibition, but this does not bear upon the standard of review which is a merits' review. What Wiseman seeks to do for a good 20 or 30 pages of its skeleton is to create a barbed wire fence around the Decision which effectively says to the Tribunal "hands off". That is, we submit, profoundly in error. One only has to look at some of the case law at the European Court level and indeed at the Tribunal level, to see that both levels the courts have examined fundamental issues of cost – as the European Court in *Akzo* put it – because cost was fundamental to the legal issue. It was the pivot upon which legal conclusions were to be drawn. In the interests of time I will not take you to *Akzo* because we have set out the relevant provisions in our skeleton. But the court there, for example, criticised the Commission for treating labour and wages as fixed as opposed to variable and held that that was an error, so the Court of Justice even 15 or so years ago was prepared to review the Commission's Decision as to whether or not to allocate something as fixed or variable. One has seen in *Aberdeen Journals* that the Tribunal expressed views on issues of fact which were

relevant to the issues of law and, if I can summarise them and give you paragraph numbers for later reference.

In *Aberdeen Journals* the Tribunal examined such factual matters as the points in time that revenues exceeded ATC (para. 366). The Tribunal considered whether management accounts understated the negative contribution of a line of activity because certain items of directly attributable cost were omitted, so the omission of costs from ABC was considered (para.368). You examined what the actual directly attributable costs of a line of activity actually were (para.368) and you examined whether the OFT had verified the data supplied by the defendant undertaking (para.368). You examined whether costs should be allocated and how they should be allocated, for example in relation to printing costs in 373 to 377. These cases show that in a merits' Appeal the Tribunal is prepared to engage in an analysis of how costs are addressed, and we say the legal basis of that is set out by the Court of Justice in *Akzo*. It is because those questions are absolutely fundamental to the question of whether or not there is an abuse.

The notion that the OFT has a very broad margin of appreciation on a Complainants' merits Appeal we submit is conceptually incorrect and nothing in the Act fetters the Tribunal's task in that regard. As I say, I am not saying that the Tribunal would overturn every OFT finding if it thought that the OFT had adopted an entirely adequate or proper approach where you simply identified another approach which was equally reasonable. There may be a number of accounting or economic solutions to an answer and simply because you can identify "solution B" whereas the OFT have identified "solution A" is not a reason to overturn it, I would submit, on a merits appeal if you thought that solution A was perfectly adequate.

On the facts of this case we submit that the dilemma – if it is a dilemma that I have identified – cannot arise because the OFT does not submit to you that it ever conducted a comprehensive exercise. On the contrary, it acknowledges that its exercise was, in fact, limited, rough edged and inconclusive. The question for the OFT, as revealed by the documents and the August briefing note was whether they could continue to conduct further analysis to perfect the rough edged exercise which it had already undertaken. In this connection I will mention briefly Wiseman's analysis of case law, which we submit does not assist. They refer, as you have seen, to cases such as *Costello*, *Khatun, Arab Insurance Group*, and to *Thameside*. Plainly on this side of the court we are not suggesting that those cases were wrongly decided. They are classic English Judicial Reviews. For example, *Khatun* – a decision of the Court of Appeal last year – it is of some interest because the OFT was involved, but it concerned the unfair contract terms regulations not competition. But the issue

arose in the context of a Judgment by Lord Justice Laws under the Housing and Homeless Persons Act. He was considering the exercise of discretion under that Act and he referred to classic Judicial Review grounds. That is an ordinary Judicial Review it is not a merits appeal.

Arab Insurance Group is the circumstances in which the Court of Appeal will overturn fact findings by a trial Judge after a full trial and under the CPR the Court of Appeal's jurisdiction is limited to what is described as a "review". Mr Flynn and I had the experience in *Courage v Crehan* of trying to put *Arab Insurance Group* to the Court of Appeal, and being told that they did not necessarily believe it was something they would follow in any event, and the result was as it was. But they are different cases, they are review cases – you have a particular statutory review power and it is a merits appeal. In any event, again as the Tribunal knows, even in cases of review the Court of Appeal, in the *IBA* case made it clear that the context was everything and Lord Justice Carnwath's Judgment at para.90 was even in an ordinary Judicial Review where the court is not hearing a merits' appeal the Tribunal is engaged in an intensive review. So simply by referring to Judicial Review cases we submit is not going to guide the Tribunal in relation to the statutory powers under the Competition Act.

THE PRESIDENT: There is a more recent Judgment by Lord Justice Carnwath in a case called *ReE* which is a National Health Service case, in which the Court of Appeal decide that even on review you can look at facts in certain circumstances, particularly where not to do so might give rise to unfairness.

MR GREEN: Yes, and I think a very similar point is made in para.90 of *IBA* that the Tribunal's jurisdiction, even on a review can extend to facts.

THE PRESIDENT: Yes.

MR GREEN: The sixth and final introductory matter concerns the relevance and effect of the Competition Commission Report. It is, of course, entirely correct that the legal conclusions contained in the report are not binding nor particularly relevant to this Tribunal. On the other hand, a great deal of fact is recorded in the CC Report which was relied upon heavily by the OFT – indeed, including in the briefing note. But there are no clear statements of principle in the CC Report and you may have seen from the transcript of the evidence given before the CC by Wiseman and Express, that the CC were not enamoured of the idea that there was any precedent which bound them. They were not enamoured of the idea that they should follow EC law, and they did not believe that the notion of predatory pricing was a technical term of art which they would be guided by case law on. This is not a criticism of the CC because they were applying the public interest test under the Fair Trading Act. There was no s.60 in the Fair Trading Act which would bring in Community Law. Nonetheless, the facts as set out in the

CC Report are very relevant to the OFT's findings. The CC conducted its inquiry after March 2000 and evidence was given by both Wiseman and Express on 27th April 2000 (supplementary volume 1 page 868 *et seq*). Evidence was given by Mr Wiseman to the CC and indeed that evidence was then relied upon by the Office of Fair Trading in its briefing note of August 2002. You will also see that Mr. Lawrie in his evidence (para.47 and footnote 8) used data in the Competition Commission Report to assess its own conclusions. The OFT treated the Competition Commission conclusions as relevant and correct, and germane to the actual Decision in this case. Again, at this stage, I will deal by way of reference only, in the August briefing note the OFT treated the evidence of Mr Wiseman to the Competition Commission on 27th April as evidence relevant to the legal issue of intent under Chapter 2 (para.35 of the briefing note). They also relied on the CC Report for evidence in relation to exclusionary conduct (paras. 31-33 of the note). We have referred in our skeleton at paras. 130 and 121 to *Napp* and *Aberdeen Journals* where the Tribunal has already assessed the relevance of evidence given and related to the period pre-March 2000. Those are introductory matters. Can I go next to the briefing note, and at this stage I wish to pick up just some of the main points in it. I am using the version that was sent to us on 24th December, with the manuscript markings on them.

THE PRESIDENT: Yes, I think we had better have those. Yes.

MR GREEN: If I first just pick up the manuscript markings as they have been explained to us. The first manuscript marking is on the second page. There is a heading "See E-Mail Reply 9.6" – 9th June. "PB" which is Penny Boys. Then there is a statement:

> "This submission seeks your approval to Margaret Bloom issuing the attached letters. They are also preparing a press release for issue tomorrow which should be reviewed…"

I think it is "in private office pm today".

THE PRESIDENT: "…received in private office".

MR GREEN: "…received in private office pm today". At the very last page of the ----

THE PRESIDENT: Who is that? That is Mr. Lawrie, is it? Who is making these manuscript ----

MR TURNER: Sir, that is Mr. Eric Wilson who is Sir John Vickers' Private Secretary.

THE PRESIDENT: Thank you.

MR GREEN: On the very final page, it says "noted" and then "JV" – John Vickers – and it appears to be on 19th August, which is 10 days after the Decision. The Decision therefore appears to have been taken by Mrs Boys and Mr Mason. Mrs. Boys is the author of the document on the

very last page which would appear to approve the taking of the Decision of rejection of complaint and closure of the file on the basis of the submission.

THE PRESIDENT: And that seems to have been on the same day.

MR GREEN: 9th August.

THE PRESIDENT: The submission is on 7th and **this** seems to be on the 9th?

MR GREEN: That is right, yes. If one goes back to the front page, the covering letter sent on 24th December of last year, the explanation for the service on 24th of the manuscript marked document is – and this is contained in the penultimate paragraph – that the note was not kept on the case team's file. You will appreciate that an "un-manuscript" marked version was sent to us a few days earlier than this which apparently was on the case team's file, but Mrs Boys' letter with Professor Vickers' markings were not on the case team's file and that is why the later version was apparently disclosed to us. It says in the last paragraph that Mrs Boys was on leave returning on 5th January and it would be confirmed with her that she had nothing to add, and I understand that is the case, there is nothing to add from Mrs Boys.

The covering note to the submission starts on the second page and you will see that it was appreciated at an early stage (as per para.2) that the administrative closure could potentially be challenged by Express, the main complainant, either by way of Judicial Review or by challenging the nature of the administrative closure arguing that this is in effect a non-infringement Decision. So it was appreciated that in substance – as indeed turned out to be the case – Express would view this as a non-infringement Decision. In paras. 3 and 4 it is stated that Express has already challenged the investigation team's analysis, in particular the cost breakdown for the assurance, and a failure to investigate exclusive all-Scotland contracts.

> "Wiseman will probably not challenge the outcome of the case although it would have preferred a non-infringement Decision and will certainly be displeased by the paragraphs on market definition and on the Chapter I case. Wiseman was provisionally informed of the Decision on 28th June 2002 and was asked not to disclose this information until the Decision is made public."

So it would appear that a case team formed their view and notified Wiseman on 28th June though the formal Decision and approval was only obtained some six or seven weeks later. They refer in para.5 to the position regarding the Chapter I case, which they say:

> "…has changed following receipt of an anonymous with allegations that need to be investigated. The Decision concerning Chapter I is therefore postponed."

In para. 8 on the next page, under "Background":

"See annex Attached summarising the analysis carried out in the course of the investigation, and listing objections to Express's recent submissions."

You will see that both **this** note and the annex are produced on behalf of all three of the case team – Mr. Maur, Mr. Lawrie and Miss Pope.

What I would like to do now is to identify what the OFT's conclusions were in relation to each of the allegations. In relation to abuse one sees the text at para.12. What is said there is as follows:

"We have not identified clear instances of below-cost pricing that could indicate predatory pricing. We used two proxies of costs, for ATC and AVC, based on Wiseman's response to the section 26, which included a breakdown in 12 cost categories. We considered only costs which were reasonably attributable, leaving aside common overhead costs (which represent only a small fraction of total costs). A measure of direct costs was computed to approximate AVC. We found no instances of pricing below this measure of AVC. However, we are aware of the limitations of this measure (in particular because of the issue of how the costs are allocated) and cannot come to a conclusive view as to infringement or non-infringement on the basis of this measure alone."

In relation to average total cost they address this at paras. 13 and 14. If I can summarise, they say that an important number of below ATC prices were recorded. We know that they relied upon Wiseman's calculations of costs, but they say in para.14:

"… owing to the relative frequency of below total cost pricing, and in the light of the Competition Commission report, it is difficult to conclude the absence of an infringement. A great deal of further detailed work would be needed on both ATC and AVC before a firm conclusion could be arrived at either way. However, in our view the prospect of a conclusion of infringement is not sufficiently high to justify the expenditure of these resources."

So they are not saying that they had carried out a definitive exercise. They had done an exercise which took them to a particular point and they did not want to continue with that exercise and, as a result, they did not feel able to come to any definitive conclusion.

In relation to targeted discrimination, that is covered in para 15 and onwards. They record that they found a considerable amount of evidence of price discrimination; they found evidence of very substantial variations in price – from 12 per cent. to 76 per cent. It is important to note at this stage that they carried out an analysis of price cost margins. What they

did was to obtain information on the cost of a variety of different customers (the cost of supplying them) and then they looked at the margin over that cost. So there will have been a different cost attributable to each of the customers that they examined, and it is quite important to recognise that they were doing it on an individual supply basis.

THE PRESIDENT: Are we talking about customers or are we talking about outlets?

MR GREEN: They carried out their analysis in a number of different ways. We only have a certain amount of information and it has been very difficult for us to verify precisely what they did. There is an important point which comes up and perhaps I will identify it now, because if you have it in mind it will save time later. If you have a net price of 100 which you charge to customers, but it turns out the cost of supplying them varies from 50 to 75 then the cost price margin will be between 25 and 50 for each of that range even though the ultimate price is identical. It is 100. The margin will be different for each of those customers or outlets. That was an important part of their analysis. They were not just looking at the end price to see whether it was the same, they were looking at the difference between the price and the cost.

There is another important point, which I might as well refer you to now in para. 15. You will see that the OFT says:

> "There is also a negative correlation between the height of the mark-ups and volume, except for the biggest customers …"

So in other words, if there is a very large mark-up it means that a small volume is being supplied. If there is a very small mark-up it means there is a very large volume being supplied. There is a negative relationship, and that is logical because costs should vary with volume. In other words, it is cheaper to supply a large volume purchaser. Everybody gave evidence to the Competition Commission to that effect, that it was cheaper to supply a large volume purchaser. If there is a purchaser like a supermarket, which is taking 100,000 litres in one go then there are economies of scale in supplying that single outlet with that volume. If you have to supply 100,000 litres across 20 customers, all of whom are taking a much smaller amount, then it is more expensive. So they did see the correlation that one would expect to see between volume and cost. Of course, a small mark-up means a cheaper cost. It means the price above the cost may only be 6, 7 or 10 per cent. and that means you are getting a cheaper price. If the mark-up over costs is 40 or 50 per cent. then by definition you will be charged more.

They saw therefore there was a relationship – an inverse, negative relationship – between the height of the mark-up and volume, but they did not see that for the biggest customers (for whom there was no such relationship) as prices and mark-ups around 35 per cent. become relatively constant.

They observed in para.16 that price discrimination was common throughout (as they saw it) the industry and they looked at price patterns from two other dairies – Express and Lordswood – and I will deal with those two examples when I deal with price discrimination, but very shortly Lordswood is in the South West of England, owned by Wiseman at the time the data was given. It is hard to see what relevance that has to anything in Scotland, but all they looked at was actual prices there, they did not look at the costs. Equally they refer to Express's submission of 19th June – Express never gave costs it was only ultimate price. So it is very hard to see how you can draw any sensible conclusion. If you just look on the one hand at Express and Lordswood's prices, and then you compare with mark-ups in Scotland, but I will deal with that more fully and show you the references later.

In relation to the patterning they examined – they refer to this in para.17:

"We also investigated the patterns of prices across time periods, geographical location, customer groups, volume and several other dimensions."

They found differential pricing between segments of the market that was consistent with price discrimination. They did not find significant differences of pricing within these market sub-segments that would indicate targeting against the competitor.

"In particular, we found that small buyers will generally generate much higher margins…." again, that is logical and consistent with the finding in para.15 – small buyer, low volume, high margin – "… probably because their custom is a local monopoly. We found some evidence of lower margins in the North of Scotland", and if you would mark that because that is important. Logically, you would expect to see the opposite, because it is more expensive to supply the North of Scotland, you would expect to see higher costs reflected and, indeed, evidence given by Wiseman to the Competition Commission was that when you are supplying at a further distance you would expect to charge more to reflect the higher distribution costs. So the OFT found evidence which was counter intuitive and inconsistent with the observable trend found in para.15.

THE PRESIDENT: In between para.15 and para.17 we slip between the idea of a mark-up and the idea of a margin. Is there a difference?

MR GREEN: I do not think so. We have not seen the underlying data to be able to verify it, but I think that "mark-up" is simply the difference between cost and selling price, and I think "margin" is intended to refer to the same thing.

MR TURNER: It is not material in this context.

MR GREEN: Not material?

MR TURNER: You are right in what you say.

MR GREEN: I am right, thank you. I will deal with our criticisms of their approach to discriminatory pricing later. For present purposes it is important to note the last part of para.18:

> "The competition with Claymore in this part of Scotland is certainly the main explanation, but there is no way to tell from the data whether this is a normal competitive response or if it is the outcome of a deliberate targeting strategy by Wiseman."

So their ultimate conclusion was that they were unable to deduce from their analysis whether or not the price discrimination which they observed was normal or deliberate targeting, so that they came to the same point as in relation to predation. It was an inconclusive end point.

THE PRESIDENT: Can you help me on one point, Mr. Green, which is in my mind and I mention it so it can be dealt with? I have the impression – I would be glad to be corrected if I am wrong – that while this rather large exercise was being conducted by the OFT, the OFT had not actually focused upon the question of which customers were actually former Claymore customers? They had not, in fact, looked at the customers about whom complaint was being made, to see what the prices were to those customers, and what relationship those prices might or might not have to the cost of supplying those customers. They took a more broad base approach ----

MR GREEN: Yes.

THE PRESIDENT: -- looked at everybody and said that at the end of the day, looking in the round, it is inconclusive.

MR GREEN: Yes. We did ask them in the request whether or not they had examined the customers which had been taken from Claymore by Express and they said it was necessary to do that and they had not done it. They said in their answer to the Reply – I will dig it out in a moment – I think it is answer 10.2(d) of the reply, they said that having carried out their general response they did not see any justification for moving to what we have called the "incremental approach", which was an approach which the Competition Commission carried out, which was to look at those precise customers taken from Express/Claymore by Wiseman, to decide whether or not they were being targeted and the prices and margins at which they were being supplied.

The Competition Commission did that in relation to certain customers, because they identify very clearly that if you find some evidence of price discrimination you should focus upon those in respect of which is alleged there is abuse, and they found there was both below AVC and below ATC pricing, and they give examples – I think that is about 2.117, I will give you the reference in the CC Report in due course. There was no incremental analysis and it is at the heart of our submission about methodology, that it is not possible to determine whether

or not there is price discrimination without focusing upon the group of customers to whom it is alleged special low rebated prices are being given, and it is not possible to make a sensible deduction looking at the whole of the Scottish market. You could do that as a benchmark, but you must also look at the incremental customer. So if you want to look at the whole market – fine, do so, but also look at the incremental customers. Or, just look at the incremental customers. But to not do that latter piece of work in our submission is almost bound to result in a concealment of the true position. That was something which we would assert that the OFT should have gone on to do.

THE PRESIDENT: So you say, do you, that the last sentence of para.18 is a sort of self-fulfilling prophesy? There is no way to tell from the data whether this is normal, or an outcome of deliberate targeting strategy because the data you have assembled is simply not the sort of data that you could use that would tell you that anyway ----

MR GREEN: That is right, yes.

THE PRESIDENT: -- without looking further into the particular customers to see what conclusions you might be able to draw in relation to those specific customers.

MR GREEN: There is no explanation anywhere of why further work would not be productive. It is simply a mantra repeated time and time again that no further works will produce a result. There was no explanation of why the incremental exercise would not have been productive, and when we asked the question it was simply said that it was not thought to be appropriate.

THE PRESIDENT: Yes.

MR GREEN: Excessive pricing is, of course, the corollary of price discrimination. They did find very high mark-ups, and that is 19 and 20. Exclusionary exclusive contracting – the objection that we made to this analysis was that the OFT were concerned only with exclusivity terms in contracts. There is not a shred of evidence to suggest that they looked at anything less than 100 per cent. exclusivity, although it is suggested in the skeleton that you were looking at exclusivity, or near exclusivity. We do not find evidence of that. It is not in RBL, it is not in the internal documents, it is not in the briefing note. Indeed, we also take the position that they misinterpreted the position viz the Aberness, because when you read all the relevant paragraphs concerning Aberness the Competition Commission appear to have treated it as an exclusive contract.

THE PRESIDENT: There is reference to a fax of 5th August about Aberness. **This** document is dated 7th August, and they appear to have had some communication with Wiseman on 28th June.

MR GREEN: Yes. But they have apparently informed Wiseman on 28th June that they were going to take the decision that was ultimately taken. We know only what is in this briefing note.

THE PRESIDENT: Yes.

MR GREEN: Again, we dealt at some length the question of exclusive contracts in the skeleton; I will deal with them briefly as a discrete issue later.

I can move on to the section on exclusionary behaviour and at this stage the position in relation to all-Scotland contracts is dealt with from para.30 onwards. I think all one needs to say in relation to that at this stage is the OFT's view on all-Scotland contracts, as set out in the briefing note, was that their legal conclusion turned upon whether or not Claymore was itself engaging in all-Scotland contracts and also seemingly who was first in offering the contracts.

Subsequently and, indeed, in the most recent skeleton argument we have an entirely different analysis of when an all of Scotland contract may be lawful, but for the purposes of this Appeal, if this is the reasoning it is simply that they do not view all-Scotland contracts as objectionable, because Claymore also offered all-Scotland contracts. There is also – if I could pick this up in 34 and then come to the last few paragraphs – an assumption, which we submit is thoroughly confusing, which is that all-Scotland contracts are in some way acceptable because, and I am looking about half way through para.34:

> "…[they] could only be a response to an aggressive move by a competitor in an oligopolistic setting."

When I first read that paragraph I wondered if they were talking about the English market, but they are not. They are referring to the Scottish market as being oligopolistic, and that is made abundantly clear from paras.36-39. So there is some assumption, or some belief in the OFT's mind that in some way the Scottish market is oligopolistic, which is quite inconsistent with the working assumption which is that we are dealing with dominance.

THE PRESIDENT: Again, the OFT had not actually ascertained from Aberness, CWS or anybody else what exactly the contracts actually said or claimed.

MR GREEN: That is right. It is another thing that we asked them, as you see, and it was confirmed that they did not obtain the terms upon which contracts were, in fact, granted. You will note, for example in relation to Aberness, that Aberness was granted an inducement, so the contractual matrix with any particular customer would have been a combination not only perhaps of its written terms, but there may have been consideration passing outside or collaterally to the contract and, without getting into the figures, you will have seen from Herbert Smith's confirmation that the inducement was very substantial. Now, we can argue what is meant by substantial but Herbert Smith confirmed the range, and it seems to us on any

view that is substantial. What the OFT should have done is to identify the incremental customers, asked for the terms of the contracts and asked for clarification of what additional, if any, consideration or inducements were granted or offered, or agreed, with a view to Wiseman winning the contract. That exercise was never done.

THE PRESIDENT: If you take that Aberness inducement which we need not mention in open court, we have a broad idea, but if you take that Aberness inducement as a *de facto* price reduction, it would appear from the evidence we have that you get quite significantly below some measures of cost.

MR GREEN: Yes, because the inducement was a percentage of revenue – I do not think I will say any more about that.

Intent I can deal with shortly. They referred to Mr. Wiseman's evidence and testimony to the Competition Commission where he says he did not view Express as a legitimate purchaser of Claymore. This was the only proof of intent. I will deal with intent as a discrete issue. Then finally, the conclusion, which I want to deal with in a little bit of depth now – again, it will save time later. 36 to 39 we submit is simply an extraordinary conclusion to arrive at, and it is on the conclusion that there is no abuse on the hypothesis that there is dominance. They say:

> "36 The evidence gathered during the investigation is not conclusive on the existence of absence of infringement. Given the complexity and history of the market, one cannot rule out that anti-competitive conduct is not actually taking place. The absence of convincing evidence relating to intent is weakening with the likelihood of an abuse finding."

So it would appear that in the OFT's mind the question of intent was an important one in guiding their ultimate conclusion.

> "37 Express has been lobbying hard to bring elements to the investigation, but has failed on two counts: (1) it has not provided new evidence on Wiseman behaviour; (2) its interpretation of the Competition Act 1998 provision is one-sided which undermines its argument."

THE PRESIDENT: What do you take that to be a reference to?

MR GREEN: Well as you know we put in a detailed submission in June 2002 which set out all the standard case law. We do not know, we can only assume it is because we do not agree with the proposition in para.38.

> "38 The analysis of the team is that the present situation could be the result of an inefficient entry by Express in the Scottish market that would have triggered a

Stackelberg-warfare type of situation. This would mean that Express's strategy in entering the market would have been a mistaken move, the outcome of which would be mutual aggression."

Then they refer to an article by Mr. Dodgson in the bus market, and we have recently dug it out and will provide you with copies – it is not particularly illuminating.

"Views in the industry have tended to find Express strategy suboptimal, as entry in the Central belt sounded like the legitimate move. The "illegitimacy" of Express in Scotland could stem from its location in Nairn.

"38 Wiseman recognised Express as a serious contender for leadership and due to the Oligopolistic situation in the market had to react to Express all-Scotland strategy".

That has plainly got to be viewed as reasoning leading to the Decision because it is contained within the conclusion, and it makes a number of assumptions. First, that the market is oligopolistic. There are two ways of looking at that. Either they are simply confused as to the difference between oligopoly and dominance or, they believe that oligopoly theory is directly transferable to dominance. Either of those is profoundly incorrect.

Secondly, they believe that Wiseman's response appears to have been justified upon the basis that Express's entry into the market was in some way suboptimal, and this was inevitably leading to an outcome of mutual aggression. This rather ignores the proposition, indeed put expressly by members of the CC to Mr. Wiseman, that "you have 80+ per cent. of the market, and any new entrant is going to take your market share so how can you be viewed as 'aggressive' by the new entrant to take your market share?" Everybody has to do that if they want to get a foothold in Scotland.

One cannot avoid the conclusion that para.38 contains legal reasoning which justified the OFT's conclusion in this case and, since we are dealing with a decision of non-infringement the errors contained within it are plainly causal. There is confusion over the relevance of oligopolistic pricing, and there is a plain confusion over the relevance of what is known as "Stackelberg-warfare".

THE PRESIDENT: Do we know what Stackelberg-warfare is?

MR GREEN: It is not something addressed in Dodgson. Dodgson, perhaps just for the sake of convenience – I do not intend to go through it, we will provide you with a copy of the article – it concerns the three authors' analysis of Decisions of the OFT and the MMC in relation to predatory pricing in Scottish bus markets. The OFT and the MMC came to the conclusion that there was anti-competitive conduct under the 1980 Competition Act, so there was no finding of

dominance – it was a Competition Act 1980 investigation. There is a commentary at the back whereby the authors conducted a software based statistical analysis and came to the conclusion that the two companies – the new entrant and the incumbent – were fighting to win dominance. There is an implicit but not express assumption that there was not dominance in the market already. One cannot deduce very much more from this article than that. There is no detailed explanation of what is meant by a "Stackelberg-warfare" type of situation. It would appear to be something to do with mutual aggression whereby the incumbent retaliates against a new entrant.

THE PRESIDENT: Yes.

MR GREEN: Which leads me to the third error which is implicit in these paragraphs, which is that the OFT failed to infer from this situation which they recognise that if that was the case that would be strong evidence demonstrating such intent as was necessary, and such targeting as was necessary to colour their analysis of the other abuses. If you have identified a situation whereby the incumbent dominant undertaking views a new entrant – here of course Claymore has only 6 per cent. of the market, it has just got a new parent – but a new entrant-cum-new owner as suboptimal, that entitles you to engage in mutual aggressive warfare. That appears not to have then led to any further conclusion about intent, and we submit that that was plainly a relevant matter in considering intent.

That is the OFT briefing note. Again, I do not want to do a detailed comparison, but can I just tell you where we see some of the differences between this and Mr. Lawrie's statement. In Mr. Lawrie's statement you will see that it is stated that the law which the Office of Fair Trading purport to have applied is *Akzo, CMB* and *Irish Sugar*. There are no references here to those cases, although Express referred to them in its June 2002 submission. There is no reference in Mr. Lawrie's statement to oligopoly theory or Stackelberg-warfare theory. There is no reference **here** to the Office of Fair Trading not following the guidance of the Tribunal in *Aberdeen Journals* or its own guidelines.

THE PRESIDENT: Was *Aberdeen Journals* out by this stage? I do not think it was, was it?

MR GREEN: That is a very good question, it may be a very unfair criticism. But Mr. Lawrie says that they did not follow *Aberdeen Journals*, it may be that he was doing himself a dis-service.

THE PRESIDENT: Can we just check? Do you happen to have a reference to hand, Mr. Green?

MR TURNER: Sir, Mr. Lawrie's statement was May 2003, that is at tab 4 of the core bundle.

THE PRESIDENT: I have the statement, I am looking for the bit in the statement where he talks of *Aberdeen Journals*.

MR TURNER: Oh, I am sorry.

THE PRESIDENT: Or Mr. Green says he talks about *Aberdeen Journals*.
MR GREEN: Well I might be wrong but that was my recollection.
MR TURNER: Aberdeen Journals came out in the following month, so it would be surprising if he had referred to it.
MR GREEN: Well I might be wrong in which case the point is simply that he did not follow his own guidelines. I will check that, it is a matter of detail – if I am wrong then I am wrong.
THE PRESIDENT: Yes, I suspect that *Aberdeen Journals* did not implant on this aspect of the case.
MR GREEN: That is the briefing note and I dealt with more points than I intended to, but I hope it will shorten submissions later on. I would like now to turn to the substantive issues, and the first issue I wish to address ----
THE PRESIDENT: Are there any procedural consequences that arise from the briefing note? Is it now the situation that we are not quite sure what the reasons were for this case closure, or that we have the reasons but they are wrong, or that we have been told contradictory things, or what?
MR GREEN: I am reluctant to say to the Tribunal that the reasoning in RBL and the reply is now to be viewed as deficient and you should remit it for the further reasons. I think that would just be a step too far. We do point out that the reasoning is novel in the Decision, and it should have been addressed, it should have been right up front that there was this Stackelberg-warfare theory which was right at the heart of the OFT's thinking, and we would have wanted to know what on earth they meant by "oligopoly pricing", and "oligopoly responses", because those are plainly germane to the OFT's Decision. We now have them and we can point out to you that the OFT have not explained them, that the document stands as it does, it was plainly determinative, so we would make those submissions to you. I am very reluctant to ask you to remit it for further reasons?
THE PRESIDENT: No, I am not contemplating doing so.
MR GREEN: On intent, I would like to deal with it this way. We have dealt with the law in our written submissions, and I would like to summarise what we say the relevant intent was in this case. I am reminded that the reference to *Aberdeen Journals* and the rejection of it is actually contained in the Reply to the Request. It may well be that Mr Lawrie was doing himself a disservice by referring to *Aberdeen Journals* because he could not have had it in mind at the relevant time. This is the reply at para.15.1.
THE PRESIDENT: OFT reply?
MR GREEN: OFT reply to our request for particulars, and it is referred to in the revised Notice of Appeal at para.4.9.

THE PRESIDENT: Well it is slightly ambiguous, I think, is it not? He might be referring back to 4.6 though it would seem 4.14.

MR GREEN: That is probably fairer. I think he would have been well advised not to put in the reference to *Aberdeen Journals*.

THE PRESIDENT: The *Aberdeen Journals* reference ought to be in brackets – "… which it so happens was discussed and (*Aberdeen Journals*…..)"

MR GREEN: Yes. Our submission on intent can be summarised as follows. There are three paragraphs in the briefing note which address intent – para.35 which refers you to the evidence given by Mr. Wiseman to the Competition Commission where he said that he did not view Express as a "… legitimate purchaser of Claymore …" There is para.18 where the OFT recognise that the competition with Claymore in this part of Scotland is certainly the main explanation – that was the explanation for the discriminatory behaviour. Then there is the reference to Stackelberg-warfare based upon Wiseman's perception as at least understood by the OFT that Express's entry or acquisition of the shareholding in Claymore was suboptimal. From those matters the OFT did not infer sufficient intent

The main piece of evidence that the OFT relied upon were the submissions to the Competition Commission and I would like to take you to those. Again, I think for the purposes of time ----

THE PRESIDENT: I am sorry, I am just catching up with you, Mr. Green. Just go back to para.18 of the briefing note.

> "Margins are indeed lower in Scotland, which is partly explained by the cost of delivering milk there. The competition with Claymore in this part of Scotland is certainly the main explanation …"

MR CLAYTON: I think they are talking about Northern Scotland.

MR GREEN: That was my understanding, yes.

THE PRESIDENT: That is what comes at the end of para.17, so there are lower margins in the North of Scotland which is the result of competition with Claymore.

MR GREEN: Yes. That is what the OFT says is the explanation for the lower margins in Scotland, and the discriminatory behaviour that they identify. Then the third paragraph is the final paragraph in relation to the Stackelberg-warfare.

So far as the evidence given by Wiseman to the Competition Commission is concerned, this is in supplementary bundle 1.

THE PRESIDENT: What about these "hit lists"?

MR GREEN: Those also play a part, if I can come to that in a moment.

THE PRESIDENT: Yes.

MR GREEN: Starting at p.877 – evidence given after the coming into force of the Competition Act, contemporaneous evidence describing Wiseman's policy as it had been at the end of the 1990s, and still was – nothing suggests that the policy has changed. I will not take you to all the references but I will summarise them and give you page and line numbers for the propositions.

The first relevant point is that Wiseman acknowledged in its evidence that its strategy was abnormal, in other words it was not a response which it would apply in normal competitive circumstances. (877 lines 10 to 20)

Then lines 21 to 30:

"Q So is it the bigger picture that would legitimate targeting?

"A Absolutely. Just the fact that Wiseman has been doing well in the English market, winning the considerable volume of business from Express. This was a retaliatory move to wreck the Scottish market as I described to before. So we rely upon the fact that the motivation was its perception that Express's acquisition of a shareholding in Claymore was retaliatory to wreck the market."

So that has to be put in the context of the dominant undertaking with over 80 per cent. of the market and a new entrant, or even an existing entrant/player with about 6 per cent. of the market. That was in response to a question "What legitimated targeting?" It was not answered with the response "We did not target."

In the same lines – 877 lines 10 to 20 – an important statement starting at line 14:

"It is difficult to Wiseman to accept that we should share certain customers with Express Dairies, for example CWS and Aldi. It is only natural to move to try to secure our position with the CWS."

These were customers whom Wiseman had not supplied to in the past but it now no longer wished to share with Express and this was because Express was coming in, as they put it, to retaliate and wreck the market.

THE PRESIDENT: This suggests that they were supplying some CWS customers?

MR GREEN: That is right.

THE PRESIDENT: Were they?

MR GREEN: Yes, I think so, they were. It was the incremental customers, mainly in the Highlands, which were now the battleground.

LORD GRABINER: Sir, I think the position is that we supplied 75 per cent. Prior to Express's entry we were supplying 75 per cent. of CWS's requirements.

THE PRESIDENT: Thank you.

MR GREEN: So a refusal to share a customer, in other words you want 100 per cent. of their requirement, that is the only deduction one can reasonably draw from the words. "Difficult to accept we should share". If you have 75 per cent. it can only mean you want the other 25 per cent.

Mr. Wiseman acknowledged that is company's reaction was directly attributable to Express's acquisition of its interest in Claymore, and he explained that he considered that Express's acquisition of the interest in Claymore was illegitimate. (p.884, lines 21-35) This is the famous Norwegian Co-operative example.

"Q Would your reaction have been the same if the entrant had been a Norwegian Co-operative? A. "None at all, totally different set of circumstances, totally different." So if it had been somebody else entering the market, some other new entrant, there would have been no equivalent reaction. It was the fact that Express was a major but non-dominant player in England, where Wiseman competed which triggered this response.

Wiseman also thought that Express was targeting its customers. Perhaps I could just show you the other reference, which is p.902 lines 16-30. That is the reference to the acquisition not being legitimate. Mr Alan Wiseman was of the view that the acquisition is not legitimate. It was not legitimate because he did not believe that Express's acquisition of the interest in Claymore was designed to make money.

THE PRESIDENT: Yes, and he, Mr. Wiseman, is saying – I think – that he saw the Claymore acquisition as a spoiling tactic by Express, and that therefore the gloves were off?

MR GREEN: Yes. Then there is an illuminating response at 905, line 25 where Mr Robert Wiseman had said that he thought that his customers were being targeted, and Mr. Mackay – it might have been Professor Cave, it is not entirely clear, but I think it was Professor Martin Cave who put the question:

"Q Another question for Wiseman. I mean, are you being paranoid about thinking that your customers are being targeted. I mean given that you have 80 per cent. of the market almost inevitably anybody coming into the market is bound to attack at least a substantial proportion of that 80 per cent.? A. It is just when we pull the strands of information together, it is obvious that the Express sales' force are looking for outlets that have Wiseman's milk on display. But as I explained earlier it is the aggressive pricing that is taking place in these outlets, it is something we have never seen the likes of before.

"Q (Professor Cave) What are these strands of information? A. Coming back from customers that were buying, for example, "Fresh and Low" from Wiseman but also

may be processing their own milk, these people, you know, taking positions with Express to protect their existing numbers – just all the different strands of information that come back from your bottled milk buyers about 'Split your order and we will not target your outlets in Greenock or in Dumbarton', or where ever."

So the point was put to him "Are you being paranoid? If a new entrant, or someone wishing to expand is going to take customers, there is an almost inevitability about it that they will take customers from your existing franchise, and you view that as targeting?" and the answer is "Well, we have evidence that people are targeting our customers", to which the answer is "of course". In relation to that to provide context, 907 line 1 through to 908 line 6 – in the interests of time I will not read that to you, that is Mr. Davidson's response, saying "Well, we put in written argumentation to you, written submissions and it just not support that we target it".

I do not think it really matters, but I thought you would be interested to see what Mr. Davidson, who is the Chief Executive Officer, Express, said by way of his response.

THE PRESIDENT: This was a joint hearing?

MR GREEN: It was a joint hearing, yes. In that exchange, or in the previous exchange, Mr. Wiseman says "No one welcomes Express in the market place". The hostile animus is palpable. Mr. Wiseman also gave evidence that Wiseman was going to fight tooth and nail with Express anywhere and including in the Central belt. He gave this evidence at 883 lines 14 to 34. I think for present purposes it suffices to just ask you to look at lines 29 onwards:

"I am not necessarily saying I can prove it was below cost, but it was a price that was going to leave Wiseman with a big share of that central belt market with no returns from it. As I said earlier in my comments, the strategy was to remove that probable source of income from Wiseman."

He is referring to Express's competition in the Central belt as being low priced and his conclusion was he was going to win that business because he would remain with a big share but at low margin.

THE PRESIDENT: This document was supplied to the OFT at some point by Express, presumably?

MR GREEN: I think so, yes. Then finally, Mr. Wiseman was asked what he thought was predatory behaviour (873 lines 7 to 22). This is a question from the Chairman, which of course was Mrs Kingsmill:

"Q Mr. Wiseman, I know you can tell me exactly when you think normal competitive behaviour is anti-competitive. A. This part, I am afraid, is unrehearsed.

"Q Yes, well go for it. A. I suppose my answer would be that, you know, if you were moving to a situation where you were supplying customers at below the cost of

production, you know, you're actually willing to lose money to retain a customer, or win you business, that's got to be anti-competitive. But as long as it is I would have thought part of an overall distribution network that you may be able to run arguments about marginal costings or marginal pricings etc. Because of the situation that has evolved elsewhere then maybe you could defend putting, you know, an aggressive price to a customer as long as it wasn't loss making."

So an awareness that selling below cost was plainly not normal competitive behaviour. That must be viewed as context to the creation of the hit list, which is in the core bundle at 288 and 289.

LORD GRABINER: Sir, I am sorry to interrupt and I apologise for doing so, but on three or four occasions there have been references to matters which are supposed to be ----

THE PRESIDENT: I am sorry, I should be keeping my eye on that. Have we ----

LORD GRABINER: It is difficult, I know.

MR GREEN: I will ask you to read as much as possible and I will err on the side of caution.

LORD GRABINER: I do not mind that it is just that odd words are thrown in which an alertness ----

THE PRESIDENT: I do not think we have had a business secret so far – have we?

LORD GRABINER: I think we might have done, actually. But hopefully it is so concealed in history that it is still a secret.

MR GREEN: The hit list is not something we have a great deal of evidence about. [Laughter]

LORD GRABINER: I cannot believe that was an accident!

MR GREEN: I am sorry. 288.

THE PRESIDENT: On a point like this, Lord Grabiner, at some point we have to write a Judgment in this case which explains what has gone on ----

LORD GRABINER: I quite understand.

THE PRESIDENT: -- and I would have thought that it might be difficult to defend the proposition that the fact that there was a document that was entitled "hit list" was in the file was in itself confidential, although the contents of the list and the contents and the customers, and all the rest of it, might well be confidential.

LORD GRABINER: I respectfully agree, and I am conscious of the difficulty of characterising bits of paper in a sufficiently clear way for your purposes consistent with our concerns, but I know you have the point well in mind.

THE PRESIDENT: Yes, Mr. Green. This is Spring 1999?

MR GREEN: Spring 1999, and you will see the top left it is referred to as "Potential customers". One then has a list of areas including those in England and Scotland, and you have an

identification of what one presumes are the potential customers. There is then in the fourth column an identification of individuals who, one assumes, are employed by Wiseman, or acting on Wiseman's behalf who are referred to as canvassers, and there is that information. One does not have information which elaborates on the progress report column, but we make the same points as the OFT itself made during its draft Decision on assurances, which was that this was systematic, deliberate targeting of customers in Spring 1999.

THE PRESIDENT: Have you got a reference for the draft Decision on assurances?

MR GREEN: Yes – core bundle tab 4, p.264-265 paras. 36 to 39. Again, in the interests of time I will not take you to it, but we have analysed it in the revised Notice of Appeal at para.3.39 *et sec*. In the assurances draft Decision could you also please note paras. 44 to 47 on p.266-267. In summary the points made were that there was widespread price discrimination, unrelated to cost, but price reductions were greatest in relation to customers taken from Express and Wiseman had adopted a dedicated and systematic approach to targeting of Claymore customers. I do not think I need say much more either about the list or the draft Decision.

THE PRESIDENT: I am sorry, the draft Decision – where did you say that was?

MR GREEN: Core bundle, tab 4.

MR TURNER: Sir, I think it is just a confusion, it is not a draft Decision, it is the s.35 Notice on Interim Measures.

MR GREEN: I am sorry, it is not a draft?

MR TURNER: It is not a draft or a Decision.

THE PRESIDENT: Tab 4 does not have anything in it.

MR TURNER: Page 255.

THE PRESIDENT: Yes, thank you.

MR GREEN: We rely upon the OFT's conclusion at the bottom of 36 on p.264 about deliberate targeting. Then there is a reference at the bottom of 37 which is deleted.

THE PRESIDENT: (After a pause) Yes.

MR GREEN: We rely also on paras. 45 to 47 of the same document, pages 266 -267 to show that, amongst other things, the OFT was aware (a) of the risk of exclusion; and (b) that this would have a significant deterrent effect upon new entry. All of this was, of course, before the OFT when they took their Decision. It is confirmed by Mr. Sweeny's witness statement where he advances very much the same points that Messrs. Wiseman advanced in the Competition Commission about Wiseman's belief that Express was not a legitimate entrant to the market, entered on a suboptimal and inefficient basis, and was there just to cause trouble. That was

a statement produced for the purpose of this Appeal. That is the evidence on intent which was in front of the OFT. You see from the briefing note that they relied on the evidence given to the Competition Commission. They had in mind the facts which led them to adopt their s.35 document, but they did not deduce from that that in law there was sufficient evidence of intent insofar as was relevant to below ATC pricing, or insofar as targeting is relevant to the law relating to price discrimination.

I would like to move from that, if I may, to substantive issues, and the first concerns the issues we have identified in relation to predatory pricing. At this point it would be helpful to have annex G of Mr. Lawrie's statement to hand. I am going to just try and explain what our central point is in relation to the key issue and the first point, which is in a sense a point about context, is to identify what benchmarks we have about cost. You will see from annex G, the scatter diagram, that on the left hand side there is a series of percentages which are price, total cost margin, and just below the middle there is a zero. So the zero reflects the OFT's assessment of the total cost. Plotted above total cost, and below total cost, are an identification of various customers – I am saying therefore the information which led the OFT to conclude what they did conclude about predatory pricing.

Can I make some general observations about this first of all. You will see that if you raise the cost bar by as little as 5 per cent. you ensnare a very large number of additional customers below cost and, indeed, you ensnare a high percentage of the biggest customers below cost. You will see the volume figures – this is a confidential document so I will not refer to them – the fourth volume figure in litres, and then there are a number of dots around that level between there and the highest number, and they are all at a relatively low margin above cost. So if you increase the cost bar by only a small amount you have an entirely different picture painted of predatory pricing. If you raise the cost bar by 10 per cent. you will see that the consequence is quite dramatic. What that means is that a relatively minor error in the calculation of cost could have significant consequences for any conclusion you arrive at both in relation to predation and price discrimination.

We have in the evidence three different ATC figures given to us. First of all in Mr. Lawrie's statement, and this I think is a confidential figure, so I will ask you just to read it. In Mr. Lawrie's statement para.47, footnote 8. p.233 core bundle. This is marked "confidential" at the top. Would you just read para.47 – I will err on the side of caution.

THE PRESIDENT: Yes. (Pause for reading) Yes.

MR GREEN: If you look at footnote 8 – you need to look at it quite carefully and particularly at the figures which are deleted, because it then gives you the OFT's ATC which they believed was

a reliably close approximate of costs as a whole. So the OFT is saying that a figure set out in footnote 8 for ATC is in fact a reliably close approximate of costs as a whole.

THE PRESIDENT: Yes.

MR GREEN: You will see therefore, in the fourth line up, "Our measure of ATC for May 2000 is…" and then there are two figures. That is the information we have been given as a reliable approximation of costs as a whole. You will see they compared that with the CC figure, which is also the confidential figure in the line above.

Mr Haberman has created ATC and this is at p.155 of the same bundle, paras.5.16 and 5.17. Perhaps if you could read that to yourself I would be grateful.

THE PRESIDENT: (After a pause): That is overall?

MR GREEN: That is overall, you will see the qualification of 5.17, but you will see total costs in the bottom right hand corner of the table at 5.16 for 2001/2000 and you will note the difference between the OFT assessment and Mr Haberman's assessment, and you will see the qualification at 5.17. Would you please note the operating profit margin average. The third source of information is Mr Bezant ----

THE PRESIDENT: I would not have thought that those figures in that table **there**, which are just derived mechanistically from the public statutory accounts are in themselves confidential.

MR GREEN: I would not have thought so.

THE PRESIDENT: I am not saying that you should necessarily mention them.

MR GREEN: I am erring on the side of caution at the moment. I think that is right. Mr Bezant's analysis is on p.621 of the same bundle. He cross refers – well let me just give you the figure first of all.

THE PRESIDENT: Well be careful now.

MR GREEN: Refer you to it. It is half way through the first block table – "Total including central admin. PPL" and then you will see the figure. It is not dissimilar to Mr Haberman's.

THE PRESIDENT: That is the figure for February 2002.

MR GREEN: It is, well if you track through all the references that Mr Bezant gives – he gives a number of references, the data spans roughly the right period, but it is not exactly consonant for February 2002.

THE PRESIDENT: Those figures are quite close, there is not much ----

MR GREEN: There is not much difference, and you will see for example at the top "RBL 1 p.147", then below that "See note 1". When you track back you will find that these are largely references to Scottish Milk prices. In fact, I think they are exclusively references to costs relating to milk in Scotland. He explains how he has arrived at these figures and what they are

for on p.575 of the bundle. If you look at para.3.24 of Mr. Bezant's report. "Appendix 3 to this report sets out my calculation", and he is doing a calculation of total cost. This is in a section starting on the previous page at 3.22, 574. He says:

> "I set out below an analysis of Wiseman's total operating costs which indicate the relative significance of different categories of costs to its overall operations. This analysis is based on information available to the OFT through the data included in the public Competition Commission Report and information the OFT received from Wiseman in exhibit RBL 1 to Mr. Lawrie's witness statements and available to Mr Haberman."

So he has used the same information as the OFT had. He has done his breakdown of costs in figure 1. Then he has provided us with his calculation. It is intended to be an indicative calculation. It is not stated whether this is total operation or just milk, but when you look at the footnotes all the costs which he has built into his appendix 3 relate to information which can be fairly attributable to milk production in Scotland. We do not have more accurate information than this.

THE PRESIDENT: Both figures, that is to say both Mr Haberman's figure and Mr. Bezant's figure we have just been looking at, appear to be quite significantly above both the CC calculations and the OFT calculations going back to footnote 8.

MR GREEN: Yes, absolutely, they do, and there is an explanation for that – or a number of explanations.

THE PRESIDENT: Are you going to tell us about them?

MR GREEN: I am going to tell you about three.

THE PRESIDENT: I thought you might be!

MR GREEN: Mr Sweeney, if you would, p.650. I think this is a confidential figure. Again if you would read that to yourself, please. The figure in pence per litre is at the bottom of the page. What he says is if you deduct that figure in pence per litre from Mr Haberman's figures you come down to something approaching the CC figure. But what is stated by Mr Sweeney is that compiling product costs – I am reading from 9.4.1:

> "In compiling product costs either for internal purposes or for the CC or the OFT, the revenue for this cream was offset against the cost of milk."

So in the data provided by Wiseman to the OFT and indeed to the Competition Commission any revenue which was obtained from bulk cream – let us assume for the sake of argument it was £1 million, you then work out your average total cost, you deduct £1 million and you do whatever pence per litre calculation you need to do. You will see, just by doing a very quick

mental calculation, that the figure for bulk cream is approximately 12 per cent. of the ATC calculated by the OFT/Competition Commission give or take a few fractions of a percentage point. In other words, if you raise the OFT's bar in table G by that sort of figure – call it for the sake of argument 10 per cent. to err on the side of caution – you would then ensnare a huge number of additional customers, and virtually each and every one of the significant volume customers.

THE PRESIDENT: Why would it be illegitimate to net off cream sales?

MR GREEN: Well that is the point of principle, is it not?

THE PRESIDENT: The CC at least seems to have accepted ----

MR GREEN: I do not think that is entirely correct. The CC recorded, but it is not stated anywhere that the CC addressed its mind to the issue. They simply record that that was the case and, indeed, it appears to be a practice which other dairies also engage in for internal management accounts. Let us just examine it as a point of principle. Is it legitimate to take the revenues from an unrelated product – and it is plainly unrelated because it is a different product market.

THE PRESIDENT: It is not an unrelated product, when you process milk you generate cream as well.

MR GREEN: Absolutely, I agree with that, indeed.

THE PRESIDENT: It is a joint product with milk.

MR GREEN: Indeed, it is related organically, but in terms of the legal definition of the product market, this is not a product market in relation to bulk cream. It is a related product unquestionably in organic terms.

THE PRESIDENT: In terms of its price that you are offering to the customer – yes, okay, yes.

MR GREEN: You are not supplying the middle ground customers with bulk cream, it is bulk cream which is used for cakes or export. It goes to a different market, different customers. So I should have its own cost structure. If, for the sake of argument, Wiseman was dominant in bulk cream, then you would be saying what is the total cost of supplying bulk cream? You might calculate that in a number of different ways. It seems to me first of all you could do it on a fully allocated basis in which you take a proper proportion of the total joint and common costs and add those to the incremental costs of producing cream.

THE PRESIDENT: We do not have any evidence about this, do we, Mr Green? Mr Haberman does not deal with this?

MR GREEN: It did not occur to us until we saw it in Mr Sweeney's statement, which occurred after all the evidence had come in. It was one of the last documents that we received.

THE PRESIDENT: Yes, 7th May 2004, well that is some time ago now.

MR GREEN: Yes.

LORD GRABINER: I am sorry to interrupt. It might be helpful to know that the Competition Commission looked at this question. It is in 3.76.

THE PRESIDENT: Yes, it is.

MR GREEN: Which is referred to in Mr Sweeney's statement, which are the two points I have referred to already, that they do it and others also do it, but there is no analysis of whether it is acceptable as a point of principle. It is true to say they appear to have accepted it, but the question is whether or not it is legitimate for the purposes of the *Akzo* test, or the *Tetrapak* test to engage in this sort of analysis, and the Competition Commission did not address their minds to that question. We submit that it is fundamentally wrong headed to engage in this sort of activity. You can think of it in a number of different ways. When one accepts that bulk cream is a different product market, being sold to different customers, if you take all the revenues from that you are pretending that there are no revenues to be derived from bulk cream at all. But if you are to take account of bulk cream, there is a logical economically sound way to do this which is consistent with competition law principles, and it is simply to say "What is the cost of reducing bulk cream, and to what extent does that mean we must take away cost from producing milk?" So if there are joint and common costs you would take those away from milk production costs and you would allocate those to cream, and that would have an effect of producing the average total cost of producing milk, because one or two percentage of your total costs of producing milk would then be attributable to the bulk cream exercise and you would have to calculate that. There is some evidence which I can take you to but we are not concerned with materiality, it is the principle. Commonsense dictates that it cannot be remotely be anything like the figure which Mr Sweeney refers to.

Another way of calculating the cost of producing cream would be to deal with it on a purely incremental basis. You could say it is a by product, we simply add up the incremental costs of producing cream, because it is organic by product, and we will charge customers on that basis and you then ignore the joint and common costs. It does not matter which way you take, there could be other ways. The OFT does not address this. Nowhere do we find it being addressed by the OFT. We submit it is fundamentally flawed to net off the costs of milk by reference to the revenues of an unrelated product. I use the word "unrelated" in a legal sense that it is a different product market. We know from case law that you can have closely connected product markets, and dominance in one can be abuse of the other, and so on.

THE PRESIDENT: If everybody is doing it, as apparently they are, you have still got a sort of level playing field even if there is some theoretical ----

MR GREEN: You could say that about any dominance case. In any dominance case in which the dominant undertaking reduces its costs for whatever reason by some accounting exercise, the fact that other people can do it does not mean to say it is or it is not below the cost of producing the milk. In this case the convention which is engaged is expressly prohibited by the Companies Act when it comes to formulation of statutory accounts. I am not saying that it is prohibited when it comes to management accounts, but it is prohibited in the compilation of statutory accounts – we set out the reference in the skeleton – it comes from the EC Directive. Just for the sake of completeness I will hand up the relevant Directive, which prohibits the netting off of revenues against costs. This is the Fourth Council Directive.

THE PRESIDENT: The consequence of this argument, Mr. Green, would surely be that everybody would have to increase their milk prices by about 12 per cent. ----

MR GREEN: Well not everybody.

THE PRESIDENT: -- indicatively, in order to remain above what you say is total cost.

MR GREEN: All we are concerned about is what the total cost of Wiseman's production of milk is. That is the sole question which arises for the purpose of Chapter II – what was Wiseman's total cost, which was the exercise the OFT was trying to determine. What was its cost? What percentage of sales were below that level and above that level? When the OFT set out its level of ATC in table G it will have calculated that zero per cent. benchmark by reference to the data given to it by Wiseman, which it has accepted has costs netted off against revenues from bulk cream. But what is the exercise the OFT has to find out, or to engage in? It is to calculate the cost of producing milk. From the point of view of first principle, we submit it simply cannot be right, simply because this is a by product, but it is a different product market, that you suddenly take all of the revenues from that and you constrain your level of costs for milk by reference to that. If you are non-dominant no one is concerned with the question, it does not arise. It may be logical, it may be illogical for you to do that as an internal convention. But that does not guide you as to whether or not for a dominant undertaking who has to calculate what its cost is of milk to then pretend that its costs are limited and reduced by something else. Why do you not then take the cost of the revenue from cream or yoghurt, or some other by product and simply say we will pretend you have no revenue from those products at all, and we will use that to reduce the price of milk even further. The reason why it is prohibited in the company accounts, and you will see this from the third and fourth recitals to the Directive – the express

prohibition is contained in Article 7. It is because it is generally considered that you do not get a true and fair view of either the state of affairs of the company or the profit and loss of a company if you net off revenues against assets and liabilities. We say it is *a fortiori* they were netting off revenues from an unrelated product in the sense that I have used the word "unrelated".

MR CLAYTON: And the margins on cream will be included in that revenue figure, so if there was a significant margin on cream that would be included in the revenue figure?

MR GREEN: I imagine so. I think that must be the case, it is your total revenue from cream, whatever it is. The error here can be put in a number of different ways. The OFT do not address this. It is nowhere stated what the OFT's position is on this. We very strongly submit that it was not something the OFT was aware of. There is no evidence that it crossed the OFT's mind. If it did cross the OFT radar there is no evidence that it arose as a significant question for consideration.

We would submit that if it had arisen, the OFT would have at least to have addressed it as a very fundamental point of principle given that one assumes that the statutory prohibition is there for salutary reasons. It is to ensure a true and fair view of profit and loss. If you are going to operate against that presumption one would have expected to see it analysed somewhere, but it is nowhere analysed, either in RBL or in the briefing note. It does not appear to have been included in Mr Bezant's calculation. It was not included in Mr Haberman's calculation – it did not occur to Mr Haberman until we started looking in some detail at Mr Sweeney's statement and the ramifications hit us. It did not occur to us that that paragraph in the Competition Commission Report was particularly significant, although perhaps we should have noticed it earlier.

We do submit this is a really quite important point of principle, and you would expect to see some consideration of that. As matters stand you do not have anything in the Decision, or in the document to analyse the OFT's reasons against. But when there is a statutory prohibition against it for good reason, that otherwise it does not reflect a true and fair view of the profit and loss then it is something that the OFT should take an account of. If we are right that you raise the bar by that 10 to 12 per cent. then you will see very easily the significance that it would have for the OFT's conclusion. Even if it was acceptable to net off a proportion of the revenue it would make a difference. Even a few percentage points increase in ATC is going to have a significant impact given table G.

We are aware of no case or authority where the logic of this netting off has been accepted, perhaps it is also fair to say where it has been considered. I think that is all I should

say. You have the principle now that we are relying on in relation to this netting off issue. It is plainly, we submit, an important and difficult issue, but the OFT should have appreciated it, and should have addressed it. We submit that it is just plainly wrong.

The next point I want to address is cost of capital. Again for the sake of time I will be fairly brief in relation to this. It is common ground that the OFT omitted any assessment of the cost of capital from its calculation of ATC. This is stated in its defence on the basis of the calculation of the cost of capital was complex, and would require data from Wiseman. They also submit that given the benchmarking which the OFT carried out against the Competition Commission's conclusions it was not necessary. So they said "It is complex, we did not do it, it was not necessary." The Competition Commission added in a component for the cost of capital, and we have set out the figure – for the moment I am not certain if it is confidential.

THE PRESIDENT: Yes, let us assume it is.

MR GREEN: I think it is set out in the CC Report. I would like to just check, I would like to refer to it. (After a pause) Yes, p.1010 of supplementary volume 1, it is not a confidential figure in the CC Report, and you will see that they came to a calculation that was fractionally under 1pence per litre – 0.92. So take that figure as indicative of the sort of figure which the OFT would have included to average total cost, had they simply adopted the figure in the CC Report. It is a sufficient working proxy for the OFT to decide whether they need to do more work on it, and 1 pence is approximately 3 per cent. Again it is a rule of thumb, it is not exact. But if you raise the bar by even 3 per cent. on table 9 you will see that it begins to ensnare a not insignificant number of customers. There were quite a large number of quite big players just on the cost line and fractionally over it. My ruler across it, the 3 per cent. margin shows a fairly large number of customers.

So omission of the cost of capital could have had a fairly significant impact upon the number of customers below ATC. It really is not sufficient to say on the one hand "Well, we have been fairly rough and ready in the remainder of our analysis but it is a counsel of perfection that we must go for a perfect cost of capital calculation because it is complex we had better not do it". The Competition Commission gave them a figure, and it would have been consistent with the approach they were taking to simply add it to the average total cost, and raise the cost bar accordingly and then derive conclusions from it.

In the OFT's skeleton, the OFT takes a somewhat different line in response to our skeleton. The OFT accepts that it is necessary to calculate the cost of capital in predation cases (para.59 first sentence) but they repeat the mantra which is that it was unnecessary to do so at this stage of the investigation. With respect, we disagree. If you are trying to form a view as to

whether you should investigate further and close a file, and find non-infringement, when even on your own table G 3 per cent. is going to have a not insignificant consequence then there is no justification for not performing the exercise.

Can I give you two references please, just for a note in relation to the impact to this, Mr Haberman's report para.2.30 p.108, and 5.17, p.155 where he refers to the average operating profit of Wiseman over the period 1999 to 2002. A 3 per cent. increase would eat away very substantially at Wiseman's operating profit. Margins are not great in this industry, they are modest on the basis of these figures. Then if I could also give you a reference I think for later, Mr Haberman 5.31 to 5.33 which is p. 157-158 of the core bundle.

Wiseman's response to this point is to jump on the OFT bandwagon. They endorse what they say. This is their skeleton para.69. They add a further point which, with respect, is unprincipled. Their further point is that if you did add a cost of capital it should relate to the incremental business won from Claymore only. On this basis they say the cost of capital would have been negligible. So you calculate the cost of capital of the incremental business only. It is a clever point, but it is plainly a bad point because it assumes you calculate the cost of capital of only those customers who are the subject of the alleged abuse. It is circular – because you are supplying the marginal cost which, on a fully allocated basis, is below cost, you then pretend there is no cost of capital incurred in supplying them. So it is a self-serving submission and again I can find no authority or precedent to support that conclusion, and it is not one which the Competition Commission applied or even appeared to think about.

In this case the abuse includes exclusionary conduct which resulted in Wiseman winning from Claymore customers it had never bothered with before on the basis which appears to be justified by reference to its marginality. Now, you add the cost of capital because it is a measure designed to assess the rationality of the conduct, and with the dominant undertaking as a whole, and it reflects in the Chapter II case the cost of being in the product market – in other words, in the middle ground. It is not a cost attributable to abusive conduct. So we submit that the OFT should have added, even on a rough and ready basis, the figure given by the Competition Commission. It would have been open to them to perfect it if they thought it needed perfecting. It is an exercise the OFT is well able to do. I just do not accept the submission that it is just too complex. They do it in very many cases I am sure everybody in this room has been involved in. The OFT have many economists well able to calculate the cost of capital. It is stock in trade and it was an error to omit it.

I move from the cost of capital to another category of costs which are omitted from the ATC. These we say are relevant because they are admitted categories. We do not have to

point out to you any more than these are categories which the OFT admits are omitted. We have simply taken the OFT's own analysis of these points and said "If you are out by the admitted margin of 5 per cent. and then in relation to the high level of ABC by the figures you give" then that is in its own right bound, either independently or cumulatively to be significant – or it might have been. They first admit that they omitted 5 per cent. of costs. We deal with this in our skeleton paras. 33 to 38, and Mr. Lawrie admits this in para.47. The 5 per cent. is plainly a guess on the OFT's part, and it is not stated to be anything else. It is a rough estimate of the costs they have omitted from ATC. This is clear from the OFT's briefing note where they simply state that the calculation that has been conducted are approximates, because they omit joint and common costs and because there are inexactitudes in allocation, and you have seen that from the briefing note that I took you to earlier on. There is no way the OFT could work out there was 5 per cent. or 6 per cent. or I suppose to be fair 4 per cent. the nearest the OFT comes to explaining the 5 per cent. is in its footnote 8. There, as you have seen, the OFT compares its figure – a confidential figure – with the Competition Commission's slightly higher figure. But the Competition Commission figure first of all omitted to analyse bulk cream in a way that I have analysed it, and although I have to confess it is not entirely clear it seems fairly clear that the Competition Commission did not at this juncture take account of cost of capital. You would have had to add the 0.92 to the Competition Commission figure set out in footnote 8 to get the true comparison. That is because they deal with cost of capital at a later stage and here they appear to be dealing with a figure provided to them by Wiseman.

But we have set out, and again I am not going to spend time on it now but in our skeleton, paras. 27 to 30 – a section that has got my learned friends very excited – we have explained why we say this comparison between their figure and the Competition Commission figure is in fact an illogical one and the short point is that in May 2000 the cost of raw milk was at its lowest that it had been for a number of years. One year later in May 2001 when the OFT did its own calculation and arrived at its figures for the basis of its Decision the milk price had gone up by 2 to 3 pence per litre. So the comparison between trying to find a comparison in May 2000 which tells you whether you have it right a year later is not a proper comparison, because your May 2000 figures have an artificially lowered milk price. The raw milk price had gone like **that**, and then it went up again, and we set out the figures in the skeleton, and the milk prices themselves are exhibited to Mr. Lawrie's statement, so you can see how milk price is tracked.

THE PRESIDENT: I am not quite sure that Mr Bezant or Mr Sweeney, or both, seem to explain that for working purposes Wiseman takes an average milk price – an average over the year. So I am

not in my own mind at the moment completely clear whether we are working on actuals for the month, or whether we are working on some average.

MR GREEN: We do not know because we have not had provided to us the precise data submitted to the OFT which would have enabled us to verify that. It seems to us that ----

THE PRESIDENT: What were the figures annexed to Mr Lawrie's statement? Does that throw any light on it? You may not want to deal with it now, Mr. Green, but we may need to come back to it.

MR GREEN: Perhaps if it would save time if I come back to it, because the lunch break is coming up and we can just check it over lunch.

THE PRESIDENT: Yes. It is quite true that at p.375 of the core bundle, which is graph E, which is headed "Evolution of Milk Price by product or customer", so yes, that is the price to the customer, but it does not actually tell us what is happening – that is tracked on a monthly basis but it does not tell us what is happening to the raw milk.

MR GREEN: If you look at the black line at the bottom it is a UK figure, but you see, for example, May 2000 you have the trough, and May 2001 you have a considerably higher figure. Now that is UK price.

THE PRESIDENT: That is the raw milk, that last ----

MR GREEN: That is the raw milk, yes. This is the evidence given to us by the OFT.

THE PRESIDENT: Right.

MR GREEN: After the OFT conducted this benchmarking exercise, they came to the conclusion that they were only approximately 5 per cent. out. Our simple point is being 5 per cent. out when margins are low, and when Wiseman's operating profit is typically around that figure, it could make a significant difference, because you see that if you raise the bar on table G by even 5 per cent. it makes a real difference, or might make a real difference. We cannot drill into that any more than the OFT have given us by way of information.

The same goes for two of our other points. First of all, the 3 per cent. add on for administration costs. It is simply stated to be appropriate, it is an approximation. We asked for why they did this and they said "We just thought it was appropriate. If you tell us Wiseman's costs are different, then we will re-evaluate it, but we do not know what Wiseman's costs are." Mr Sweeney says well having seen what the OFT did "yes" it is about right, but no data is provided. We have simply got the OFT plucking the figure out of the air, adding it on. If they are 1 percentage point out, again that could be significant if combined with other inexactitudes. We have dealt with this in paras.41 to 44 of the skeleton. The same point arises in relation to the OFT's admitted errors or omission in relation to the high level of average variable cost –

para.39 onwards of our skeleton and some of it is confidential. It is convenient just to do it through the skeleton argument.

"The high level of variable cost" – what does that mean? You know that the OFT say in RBL that they took two levels of AVC. The directly attributable costs, one can see from both Mr Haberman and Mr Bezant, actually account for quite a high percentage of the total costs of producing milk. So the omissions can be significant because they are a percentage of quite a big percentage. So for example: "39(i) Depot costs were ignored." You will see it is "circa X per cent." We submit that is quite significant. It is not small. This is a percentage of the high level of AVC, so it is a percentage of a percentage.

THE PRESIDENT: They have taken them into account in working out what total costs are?

MR GREEN: We do not know. We are told that these were omitted from the high measure of AVC and what we have taken and set out here is essentially what we have been given in the defence. We do not really know any more than that, because we have not been given the underlying data, and it was an admission made to us in the defence, which was not apparent before that. It was one of the further unveilings of information. Even if 5 per cent. is the percentage of total cost it still indicates that a relatively significant percentage of directly attributable variable costs will have been omitted, a percentage of a percentage.

The range of trunking costs, well at the lower range it might not make a great difference, but it might make a difference at the higher level in subparagraph (ii). We make the comment about the explanation for those figures which to us appears, on the logic of the explanation, appears to be attributable to variable costs not fixed costs. Central admin. costs have already been dealt with.

Then in subcategory (iv) we have another catch group which are admitted, vehicle depreciation, vehicle maintenance, vehicle insurance, licensing and tax costs. We do not know how these figures were calculated, but cumulatively they would appear, at least potentially, to have significance. We do not know more than this. We simply know that these are the figures which have been given to us. We know that 5 per cent. was omitted from total costs. We know that a series of costs were omitted from AVC. We know that estimates and approximations have been added for other factors. We know that in the briefing note the OFT itself acknowledges and accepts that there are inexactitudes and approximations in their assessment of total cost, yet they were still able to come to the conclusion – we say erroneously – on the basis of tables such as table G, that there was insufficient evidence of predation. All of these factors, if we are right only some of them it can make a very material difference. The OFT, we submit, should have gone on to perfect their analysis to undertake a far greater degree of

precision in the calculation of ATC, because this is not a case where small increases do not matter. If table G had shown a huge gap from zero before you started to get any scattering of customers it might have been open to say it really does not matter two hoots. But given the preponderance of customers on or around the zero percentage mark it was not open to the OFT we submit to simply close the file on the basis that further work would not be productive of a further result.

In his report Mr Haberman, as you have seen – and again it has excited a great deal of commentary –

has drawn a distinction between what is called "top-down" and "bottom-up". All that means is that if you start with a "top-down" analysis, you take all the costs that are reflected in published accounts (either statutory or management accounts) and you say we now have a statement of all the costs. We will know what the total is, we have the top figure and we better see when we do the breakdown that it is actually consistent with that high level figure. "Bottom-up" is where you do not start with any benchmark. You simply send out a request for information on the basis of some categories that you yourself have worked out and you try and build up a set of costs. The OFT accepts that it conducted a "bottom-up" but not a "top-down" approach. I do not think that I can go so far as to say that *per se* not adopting "top-down" is in its own right an unlawful way to proceed. There may be circumstances in which a "bottom-up" approach is perfectly reasonable. But the problem for the OFT in the present case is that the OFT has acknowledged the imprecision and inexactitude of its costing methodology – it is quite candid about this. It has adopted an approach which, on its own case, has made it impossible for it to find guilt or non-guilt and therefore it was forced to come to a non-infringement decision. There is no doubt that the OFT put effort into the investigation, but the OFT is not being marked on effort.

A great deal of the OFT's case has been taken up in describing the steps which it adopted in its investigation and it gives the impression (no doubt accurate) that it was very busy. But the question is whether or not that effort was mis-directed, and it is in this context that "top-down" and "bottom-up" becomes significant. We have dealt with it in full in the skeleton (paras.72- 88). Mr Haberman deals with it. The basic points may be summarised as follows. The use of a "bottom-up" approach is consistent with the OFT's self-confessed rough edged approach which Mr. Lawrie concedes is a fair description of their approach to the costs. The OFT justified "bottom-up" upon the basis that all they were doing was trying to decide whether to proceed further.

THE PRESIDENT: I just want to check where this "rough edge" remark comes from?

MR GREEN: Yes, it is Mr. Lawrie's statement, it is towards the end.
THE PRESIDENT: Well he says: "It follows from our analysis", page 241 in the core bundle, he says: "We decided to cut our losses on the case".
MR GREEN: Yes. "It follows that our analysis of the issues ----"
THE PRESIDENT: "… is not complete and contains some rough edges".
MR GREEN: Yes. One way to see whether even your – I do not w ant to use "rough edge" too pejoratively, it is very attractive to do so but ----
THE PRESIDENT: He means it was very approximate, it was an approximation.
MR GREEN: He is accepting the limitations of the exercise.
THE PRESIDENT: I do not think he means it is rough edged with rough and ready ----
MR GREEN: It was not done on "the back of a fag packet".
THE PRESIDENT: -- or something that was the back of an envelope ----
MR GREEN: No, they did a lot of work.
THE PRESIDENT: A lot of work was done.
MR GREEN: Undoubtedly so. If you are going to engage in that sort of analysis then Mr Haberman's point (which we submit is undoubtedly a good one) that if you have the statutory accounts and/or you can get the management accounts, you have a benchmarking that you can do and you can assess whether or not your approximated exercise – whatever one wants to call it – is, in fact, going to be accurate, and it was not an approach which they took. If one is asking oneself the question "Should they have gone on to do more work?" then this is an area in which they could have done more work because it is an accepted accounting practice that you would start with the top level of accounting data and work backwards, and this is something that they could have done.
THE PRESIDENT: The accounting data, according to Mr Sweeney would not have given them the run costs because that is not how the management accounts are prepared.
MR GREEN: Mr Haberman does not suggest that in every respect if you start with either the management accounts or the statutory accounts you are going to get to perfection, that it is a more accurate benchmarking than your "bottom-up" exercise, and undoubtedly from case to case the extent of the information you get may vary, but it was not an avenue that the OFT went down.
THE PRESIDENT: It appears to be the case, and I will be corrected if I am wrong, that the way that the OFT decided they were going to look at run costs was not in fact the way that Wiseman seems to have approached run costs for the purpose of its own internal management accounts, and presumably for the purposes of setting its prices.

MR GREEN: That is absolutely right. Perhaps I can deal with run costs in the five minutes or so before lunch. It is a small, relatively discrete point.

THE PRESIDENT: Yes, well when you get to a convenient point, Mr. Green.

MR GREEN: I will, yes, Sir. It is logical, I think, to move on to run costs. The short point is this, and it is an easy one to make. Everybody who gave evidence to the Competition Commission gave evidence to the effect that the larger volume customers are cheaper to supply. That is logical because there are some economies of scale in supplying large outlets that take large volumes. The OFT recognised this implicitly in para.15 of the briefing note where they say they saw an inverse relationship between volume and cost margin – it can only be explained upon that thesis. But when it came to allocating run costs between (a) middle ground customers and other customers, in other words, supermarkets who are not in the product market; and (b) as between customers within the product market, middle ground, the OFT used volume to allocate costs. They did this in relation to all costs, it was the universal driver, and there is some difference in the evidence as to the extent which volume genuinely governs all costs. Wiseman say it varies from 60 to 79 per cent. If you roughly take two-thirds you will then get at least a handle on the extent to which volume does not drive costs, approximately a third of total costs are not driven by costs – it may be more, we do not have sufficient data to work out precisely what the proportion is.

In relation to run costs, as we have set out in our skeleton, they are approximately 7 per cent. of total costs.

THE PRESIDENT: 7 per cent?

MR GREEN: I think 6.8 is the exact figure, we have been given the reference, so approximately 7 per cent. of total costs. The error is that the method adopted by the OFT for allocating costs between the categories of customers that I have identified is the opposite of the actual driver of those costs, because everybody accepts the greater the volume that a particular customer takes, the cheaper it is to supply to them. However, if you allocate costs by volume you allocate more costs to those customers even though by definition they are cheaper to supply.

The Competition Commission Report recognised this in paras.4.67 to 4.79 – I do not think I need to read it to you, but the point which the Competition Commission made was that distance is the major driver of costs, and that increases in fuel costs meant that any decrease in costs due to the ability to serve larger purchasers was largely offset, and you will note that is para.4.72 of the Report. The Commission says that run costs are driven by volume, drop density and distance (4.67 to 4.72). Wiseman's own evidence to the OFT was to the same effect (see letter 1st August 2001, p.300 core bundle). Mr Haberman makes the same point

(paras. 5.83 to 5.92) distance is the main driver. The error, we say, in the OFT's approach was simply this, that it was contrary to everybody's understanding of how run costs in particular, but other costs also, were to be allocated that you should use volume. Volume plainly was not the driver of those costs. It would have been open to the OFT to recognise that point and to build up some form of formulae which provide some weighting to the other factors. If they had done that it would have been very difficult for us to criticise them because they would have identified and recognised the problem, and we would not have been able to say "error of principle", everybody accepts that costs decrease with volume, whereas your allocation exercise leads to the opposite conclusion. They could have had some formulae, and no doubt there are many in which you have a combination of volume, distance and time, and some formulae which simply gives you a figure for allocating costs and I would not then have been able to say to you that they failed to identify what was plainly an important point, because they would have identified it and taken account of it. This may be where the margin of appreciation arises, that if they had identified formula A then I could not say there was an error of principle, but I disagreed with the quotient, you would say well, that really is for them. But that is not my point, my point is that they simply missed the point, they missed the point of principle.

THE PRESIDENT: When you get to a convenient moment, Mr. Green.

MR GREEN: That is probably as good as any.

THE PRESIDENT: When we come back after lunch, since we are on run costs, there is a passage in Mr Haberman's report 4.18 to 4.20 and the point is made elsewhere in the report, which seems to suggest that the OFT's calculations gave rise to very significant differences in run costs when expressed in terms of pence per litre. I at least would like to explore what conclusions (if any) we draw from that sort of exercise.

MR GREEN: I am sorry, could you just give me the paragraph number again?

THE PRESIDENT: 4.18 to 4.20.

MR GREEN: Thank you.

THE PRESIDENT: Sometimes the delivery cost is 1p per litre, or 1.5p per litre, and sometimes it is over 50p per litre, and what is going on there? Does this give figures that are robust and reliable, is the question, I think.

MR GREEN: Yes.

THE PRESIDENT: Shall we say 5 past 2.

(The hearing adjourned at 1.05 p.m. and resumed at 2.05 p.m.)

MR GREEN: Just to deal with a few housekeeping matters. So far as Claymore's financial position is concerned, we will, if we may, produce a short note which tells you what information is

confidential and what is not about their position. Some information will be available to you from published accounts and there is no problem with that, but there may be other bits of information which are confidential and can be produced in a page or half page note giving you the facts tomorrow.

Just before moving on, can I pick up one point about the benchmarking exercise in footnote 8 and the point which was raised before lunch to the effect that Mr Sweeney had said that data Wiseman gave to the OFT provided aggregated milk prices. It is very hard to know precisely what data was given, but what is clear from footnote 8 is that the OFT does not say that it used an aggregated raw milk price. It says, just reading it as a piece of language, that it used the data for May and you have seen that Mr Lawrie gave monthly milk figures which they plainly had in their possession in the graph which is annexed to Mr Lawrie's statement.

THE PRESIDENT: Yes.

MR GREEN: So we just do not know whether or not they used an aggregated figure. We do not know either whether the Competition Commission used a monthly figure or an aggregated figure.

So far as 4.18 to 4.20 is concerned of Mr Haberman's report, this is in the part of his report dealing with the OFT investigation. It is a comment that he makes in respect of Wiseman's response to the OFT of 1st August 2001, and it is the only data which we had available to us about run costs, and he simply observes that on the basis of the data Wiseman gave to the OFT the results were counter intuitive, and it should have put the OFT on notice that the analysis was flawed. Wiseman explained that they would give to the OFT their lowest cost run and their highest cost run but when Mr Haberman analysed the lowest cost run it turned out to be higher than the stipulated highest cost run. It does not go to much more than that. If you have more profound questions I am going to ask Mr Haberman to answer them himself.

THE PRESIDENT: Well the question that I have that I do not have an answer to in my own mind is what is the real reason for these apparently marked differences in what is here described as "delivery cost", I assume they are talking about run costs ----

MR GREEN: Yes.

THE PRESIDENT: -- between the given figure in 4.18, which is around 1.5, and the figure in 4.19 which goes up to 53.7, which is a difference of about 50 times which seems to suggest that something odd is happening, and I do not quite understand what it is.

MR GREEN: I do not think we know the answer to that. We have not got the underlying data. What one can see, if you jump to p.300 in the same bundle, which is the letter of 1st August 2001 there is some confidential test there which if you read you will see that ----

THE PRESIDENT: Page?

MR GREEN: 300 and 301, it is a letter from Wiseman dated 1st August 2001. This is the core bundle

p.300 ----

THE PRESIDENT: Yes, I am there. Yes, I see, well let us not stop on the detail for the time being.

MR GREEN: If you would like to cast your eye over it either now or later, you will see **here** that Wiseman are making points about the drivers for costs which are completely at odds with the OFT's ultimate methodology. Now whether that goes some way to explain the difference in the figures identified by Mr Haberman I do not know and I am not certain we are going to be able to get an answer, because I do not think we have the underlying data.

THE PRESIDENT: No, I see. Yes?

MR GREEN: Before I move away from run costs, there are one or two concluding remarks I would like to make about it. The obvious consequence of allocating costs by reference to something which does not reflect economic reality is that you are going to ----

THE PRESIDENT: When you say "Does not reflect economic reality" what do you mean by that?

MR GREEN: That does not reflect the true driver of costs which is primarily distance. You can see that from Wiseman's letter, the factors which are identified on p.300 will almost all vary according to distance, but none of them will vary in any material sense according to volume. The Competition Commission itself made very much the same point that predominantly run costs are going to vary according to distance, not volume.

The consequence of allocating costs according to volume is that you allocate higher costs when you should be attributing lower costs. A big volume purchaser is cheaper to supply, but the OFT's hypothesis is that it is more expensive to supply. That inevitably follows. If you have a large customer taking a large volume, on the OFT's hypothesis you are going to allocate a much higher percentage of your run costs to that single customer, even though you accept, and you have given evidence to the Competition Commission that in fact it is cheaper to supply that customer not more expensive, so it is precisely the opposite of the conclusion which is economically logical.

THE PRESIDENT: So you understate the costs that should be properly attributable ----

MR GREEN: Yes.

THE PRESIDENT: -- or you tend to understate the costs that should be properly attributable to middle ground customers?

MR GREEN: That is right because Mr Lawrie explained in his reply to the request for particulars para.7.5 at p.490 that the run cost analysis conducted by the OFT included customers outside of the middle ground, in other words it included supermarkets. So let us take that as an example. Supermarket is a large volume purchaser and you have a run which includes a supermarket within the run. Let us assume for the sake of argument that 50 per cent. of the volume is going to that Safeway (or whoever it is) customer. Wiseman's evidence to the Competition Commission, the Competition Commission's conclusions were that it was cheaper to supply Safeway because you get economies of scale and delivery. Yet, if they got 50 per cent. of volume you attribute 50 per cent. of the run costs to Safeways. You lump more cost on them instead of reflecting the true lower costs. By definition you are then taking away costs from the middle ground, and you are under estimating the true cost of serving the middle ground. It is precisely the point, President, that you have just made – you will tend to underestimate. Of course, the configuration of run costs makes it very complex and there may be innumerable permutations because you do not know how many supermarkets are on a run and the distances will vary and so on. But as a principle, if you allocate your costs by reference to volume there will be an innate tendency to underestimate the costs of supplying the middle ground customers.

THE PRESIDENT: Just while we are on this point, doing one's best to grapple with it, how far is this exercise also affected by the arbitrary and possibly random arrangement of the run according to whether a particular run happens to have on it a large volume customer or not? That is to say that you can imagine that you had a couple of middle ground customers who happened to be bang on the way to some large supermarket or hospital or something and if you take that particular run for those customers on that run, the delivery cost may be very low or almost nil because you are just popping something off on the way.

MR GREEN: You can, as the OFT identify in their skeleton, they postulate extreme examples where even allocating by volume will not distort costs.

THE PRESIDENT: But what I am wondering is what sensible conclusions you can draw at all from an exercise like this if it is all distorted by the fact – "distorted" is the wrong word, I am not seeming to imply anything pejorative, but the whole analysis is affected by what you are carrying to other customers who may or may not be middle ground customers.

MR GREEN: You can still have a fair allocation of costs, provided that you work out correctly what the driver is, and if it is distance which Mr Haberman says is the principle affecting factor, and the Competition Commission concluded it was the principle affecting factor and you have a circle with some supermarkets on the way it may, in terms of distance, be more or less the same cost of supplying each and every one of those customers along the way. That would not be precisely accurate because it is accepted that there was economy of scale in supplying larger volume, so you would need to have some factor adjusting distance. It is certainly not beyond the wit of an accountant to come up with a formula which may not be exact but would be sufficiently robust to reflect what we say is the relevant principle. The relevant principle cannot be volume, it is going to be primarily distance probably moderated by something else, and that will be much more accurate – it certainly will avoid the distortion of volume. Volume is the one factor which everybody agrees is not the driving factor, and it is the one factor which the OFT used.

As I said earlier, if the OFT had said "Well we recognise that volume is going to distort, so we are going to have to have some more slightly more sophisticated formulae which is a mixture of volume and distance and here is our calculation" it would have been very difficult to criticise that, because the OFT would have identified the problem of using volume. As it was they did not. We asked them "Why did you use volume?" and they simply said "It seems to us appropriate". No explanation for using volume, no acceptance of the fact that volume will be inaccurate. No acceptance of the fact that everybody said to the Competition Commission (and the CC found) that volume is inaccurate and it is primarily distance. You are bound to get some form of cross-subsidy between larger volume purchasers, probably outside of the market – supermarkets – and the middle ground. There is going to be a suppression of the cost structure in the middle ground by virtue of using volume, because the OFT accepted that there were supermarkets and Wiseman's evidence accepts that there are supermarkets on the rounds. There is bound to be distortion.

In a case where the margin of error is small, as we have seen from table G, even a modest error caused by losing volume can have very serious results. It goes further than that because it affects the analysis of price discrimination, which I will come to later. If you are trying to work out on a cost/price basis whether there is price discrimination and you get the cost wrong because you inaccurately reflect the differences between different customers, then your entire exercise becomes flawed by definition because your price discrimination exercise is trying to work out margins between non-comparable customers. If you get the cost wrong your

exercise becomes misleading – almost by definition the set of data that you are going to have is not going to be such as will enable you to deduce robust conclusions.

THE PRESIDENT: To take two examples, if you have a run, hypothetically, that includes one supermarket that is half a mile down the road and the lorry then goes on to deliver to more middle ground customers who are all 10 miles away, and 40,000 of the 50,000 litres are dropped off at the supermarket and you then drive on and deliver the other 10,000 between the four of them you are saying on the OFT's approach that the run cost will be loaded on to the supermarket and will not properly reflect the actual cost of delivering to the outliers who happened on that example to be the middle ground?

MR GREEN: Exactly.

THE PRESIDENT: On the other hand, if it is the other way around, and you drop off to the middle ground customers first, and the supermarket is further away then distance and volume may not necessarily give you so much different a result, but it might give you some difference?

MR GREEN: That is right, exactly right. You can imagine all sorts of permutations.

THE PRESIDENT: And in between there are different things.

MR GREEN: Exactly right. Our position is that simply that volume ----

THE PRESIDENT: You get a sort of random result depending on where the other customers are and how big they are?

MR GREEN: Yes. Which is why distance is more accurate, but there may be an element of volume that has to be factored in. We are simply saying that by using volume you lead to an arbitrary allocation. It is counter intuitive and contrary to the evidence given to the CC and it is not beyond the wit of an economist or accountant to devise a more accurate means. No doubt even a more accurate means may have its approximations but it would reflect the correct driver in some way, shape or form.

In term of materiality obviously we do not have to go on and prove that and it is very difficult to know because of the permutations of runs which one might have, and we have not seen the full extent of the evidence which the OFT had, so we cannot do any sort of analysis of that. But you have the point exactly that by using volume you get an arbitrary allocation, and there was a tendency or a risk that if you build into that run supermarkets outside the product market you might risk underestimating the cost to the middle ground.

Equally, if you take the same example and have no supermarket, because the middle ground has a fluctuation of customers within it taking different volumes, you may get an equal distortion even within the same market, and that is where the problem of the price discrimination arises. If you have customer 1 on the round, who is a big volume purchaser, and

then you have a couple of grocers' shops they may take quite different volumes within the middle ground, and you may be dumping more cost on the larger middle ground customer, even though it is cheaper to supply to it. So precisely the same principle can operate to distort the result, both between the supermarket and the middle ground customer, and between middle ground customers of different size.

I am aiming to finish, if I can by about 3.30/3.45 so I am aiming to do a bit more than an hour and, if I can, rather than develop the next point at any length can I give you a reference – RNA 3.81C which is in the core bundle p.338-339, which demonstrates that in relation to run costs that Wiseman had pointed out that the networks which the OFT used were not even the networks which it itself was using. So the OFT's exercise itself was an entirely artificial one, because Wiseman's run cost structure had changed, but the point is set out sufficiently for present purposes in the RNA 3.81C. I would like now, if I may, to move to a different topic.

This is the last topic in relation to predatory pricing, and it is the question of the different classification of fixed and variable costs in the question of time. We have set out our case pretty fully in the skeleton argument. Nothing in the OFT's or Wiseman's skeleton leads us to alter our submissions. The OFT's skeleton simply repeats its defence. As you know, the OFT took as the time period for basing its decision essentially the period of May 2001, and it calculated which costs were fixed, and which were variable over this period.

THE PRESIDENT: Which period – over that month?

MR GREEN: One month of May – May 2001. When we asked about this in the request for particulars it was stated in reply at para.15.1 that the OFT had no particular period in mind in which to assess whether costs were fixed or variable. The OFT in para.42 of RBL explains that they used what they describe as a "short term method" – that was a phrase that we queried. The answer, when we queried it (para.15.1) was:

> "In this context the short term is essentially a comparative concept, that is to say the costs in question could be avoided over a shorter term than other costs. Since the OFT had at that stage no period in mind over which predatory pricing may have been occurring, it being the object of the exercise to establish the extent to which a finding of predatory pricing was likely to the outcome of the investigation the approach to setting a period over which prices were taken to be fixed set out in 4.6 of OFT 414 and discussed in *Aberdeen Journals* did not assist. Rather the OFT's approach, as set out in para.42 of RBL was to take two measures of variable cost."

So the OFT's answer is set out in the reply to the request, 15.1, and it is that they really did not have a period in mind and their own guidance in OFT 4.1, which was discussed

in *Aberdeen Journals* did not assist. Their reasons for saying that were ironically the same reasons as I recollect advancing to the Tribunal in *Aberdeen Journals*, namely, circularity, and I remember the result, namely that the OFT's analysis of the lack of circularity prevailed over mine. In the present case there is no excuse for not having a time frame in mind because the Competition Commission had done the homework for the OFT. The Competition Commission had set out its conclusions in relation to a number of the incremental customers supplied by Wiseman in the Highlands and indeed central belt, and concluded that they were being supplied at below ATC. One has that for example in relation to CWS.

So the OFT had evidence from the CC Report which it plainly had regard to which enabled it to identify the point in time at which predatory pricing below ATC was likely. We are not concerned here with ABC, because the point is for how long was below total cost pricing occurring and if it is a very long period of time do you treat what would otherwise be fixed costs as otherwise variable. So you were simply asking what was the period of time over which we know that the below ATC pricing was occurring. We do know, because the Competition Commission told us that this started approximately two and a half years before the OFT's Decision. The OFT had that benefit, it was not a benefit which they had available to them in *Aberdeen Journals*. This is a singular benefit which the OFT had in this case, and it was therefore on a plate for them to simply take that as the period of time over which to assess whether the costs being incurred could be avoided, over a period of approximately two to two and a half years. It is tailor made for that sort of analysis.

THE PRESIDENT: Are you able to say which kinds of costs that the OFT has treated as variable should or might be treated as fixed, or vice versa – it is the other way around, they were treated as fixed and should be variable.

MR GREEN: Should be variable – it is very difficult to say.

THE PRESIDENT: If you take them over a longer period.

MR GREEN: Yes. Wiseman say of our analysis that it would not have mattered even if you had taken two and a half years because, for example, depot costs involve a lot of expense in setting them up and of course they are not avoidable. Unless you know whether or not, for example, it is a lease of premises – if it is a lease which can be terminated on six months or twelve months notice one does not know whether it is going to be fixed or variable over that period. You do not know whether or not the depot could be sold to somebody else. We do not know what could be done with the lorries. Our criticism can only be that the OFT erred in failing to examine this question. They did not have a period in mind. It was a relevant question because one sees from table G that if a high percentage of the otherwise fixed costs became variable

you would be likely to get a very high percentage of below average variable cost pricing, which would have obvious ramifications.

We are not in a position to assess materiality because we do not have the evidence without knowing such things as lease details, investment costs, whether or not the lorries and the trucks are leased, and so on and so forth. It is very difficult to know whether they could be avoided over two years, but in most industries a two year period would be reasonable. We are able to say with complete confidence that there is at least a strongly arguable proposition that a high percentage, and possibly all costs would be avoidable over a period of that length. I am not able to go further than that without evidence. But the point is that the OFT did not address it.

THE PRESIDENT: You could close the depot or run it on some other basis, or sub-let half of it or something.

MR GREEN: Yes, and that ultimately has to be a question of evidence. We do not have that, it is not in the Decision, it is not in the briefing note. There is nothing for us to grapple with and so we are concentrating on the point of principle which is that the OFT erred. It is not enough for the OFT to say it is circular, because if the OFT was right in their criticism that this was a circular objection it would apply in every single case. There is no reason why their objection here would not be of universal application. So if they are right it does away with this whole question of looking at a period of time over which to assess whether a cost is avoidable. I am not going to take you back to the Judgment in *Aberdeen Journals*, we have set it out fully in the skeleton. You really just have to look at para.15.1 of the reply and ask yourself whether they address their minds to the right question.

Can I turn from price predation to price discrimination? Again, we have set out our case fully in the skeleton and in revised Notice of Appeal, supplemented in Mr Haberman's Report and I would like just to deal with the main themes. As you know, and as set out in the briefing note, the OFT found widespread discrimination involving substantial disparities in the prices paid by customers of equivalent size. Indeed, somewhat ironically Mr Lawrie states in his witness statement that the OFT's finding was in their eyes more robust than that of the Competition Commission (RBL para.64, p.237 core bundle) But the OFT's briefing note concludes that the OFT could not decide whether this observable discrimination was a normal response or an abnormal response. That appears to have been an issue for the OFT at the end of the day according to the briefing note. If that is the only point of law which arises – was there sufficient evidence of targeting to make the observable price discrimination abusive? – then

I simply make the submissions I have already made about intent. We submit that that would be sufficient, if you add the irreducible minimum that the OFT found to intent, we say that that would be sufficient to give rise to an infringement of Chapter II.

I have three principal criticisms of the methodology used. The first I can deal with briefly because we have already discussed it, which is that the OFT failed to examine the position of incremental customers in relation to discrimination.

THE PRESIDENT: Just on this, if you wanted to decide whether certain pricing patterns were targeting would it not be logical to start with those customers who are alleged to be targeted?

MR GREEN: Absolutely, yes.

THE PRESIDENT: And then try to see whether there is anything in the prices that is charged to those customers that gives rise to something that might be described as objective justification, or abnormal?

MR GREEN: Yes, with respect that is at the core of the criticisms that we make, which is that if you apply an across the board survey, you are not going to focus upon the customers who are alleged to be the subject of the abuse. The logical starting place is with those customers to see whether or not those are in fact being treated in some different way, whether or not the approach to them is objectively justified. Indeed, the Competition Commission (para.2.116 and on) did precisely that. Maybe it is not necessary at this stage to read it to you ----

THE PRESIDENT: 2.116.

MR GREEN: 2.116, Mrs Kingsmill and Professor Cave thought that it was appropriate – I will summarise it rather than read it.

THE PRESIDENT: Yes, of course.

MR GREEN: They thought it was appropriate to examine the approach of Wiseman to the incremental customers and they took, for example, CWS, previously Claymore's largest customer, and if you look in 2.118 they refer to the fact that this was the first all-Scotland contract which arose and Wiseman extended its approach to that customer with an all-Scotland offer, and initiated that response (para.2.118). In 2.119 these two members identified a question which was whether Wiseman was attempting to weaken Express/Claymore by offering CWS an anti-competitive price. Then they say in 2.120 the next step was to apply two tests to seek to establish whether Wiseman was offering prices for the purpose of exploiting and maintaining its monopoly by attempting to eliminate a weaker competitor, and that is whether or not it was selling below AVC or ATC.

Then in 2.121 to discover whether Wiseman priced Northern Scotland CWS business at less than variable cost, these members sought to establish the implicit price offered for this

incremental business. So they did go down a series of stages which focused upon the incremental cost or an analysis of the incremental business to see whether it was being supplied at below cost. They set out their conclusions in paras. 4.340 to 4.349 (that is referred to in 2.121) and in those paras. they say yes, there were sales of below cost to CWS.

So precisely the approach which, Chairman, you have just identified was that which the majority followed. 4.340 starts at 1086 of the bundle, and I do not think it is necessary to go to it. The conclusions are that they were supplied low on one basis AVC and another basis ATC. In other words, they were supplying the incremental customers at a loss. This was evidence in front of the OFT when they took the decision, but they did not pursue that same approach. They said when we asked them why they did not pursue that same approach that they did not think it was necessary, and nothing in their general results led them to conclude that this would actually be profitable in some way to the investigation.

THE PRESIDENT: Can you help me on one point that crops up around about here which is, if I may say so on the whole in the Express case, from time to time there is no Express distinction between things that happened before the Act came into force, and things that happened after the Act came into force. If these customers had been acquired before the Act came into force in what sense are they still incremental customers by March 2001?

MR GREEN: I think one would analyse it this way. If you had hypothetically applied the Competition Act to that contract and concluded it was abusive prior to March you would not come to that conclusion legally because the Act did not apply. But if that was the way in which the contract was perpetuated over a period of time which spanned March the abuse continued. I am just trying to think which case it was – there was a case when the United Kingdom joined the EC, in which the European Court had to address the question of contracts, I think it was exclusive distribution contracts entered into prior to 1973 which had effects afterwards. The court held that the continuation of the effects after the accession constituted the abuse, albeit that prior to that point in time they were not. So if it is an anti-competitive agreement entered into beforehand you cannot punish it, but the effects continue, and there is plenty of case law, as you know, which says it is the effects which constitute a continuing abuse.

THE PRESIDENT: Yes.

MR GREEN: In this case we have the evidence of the Wiseman brothers to the Competition Commission that their approach to Express has never changed, we have Mr Sweeney's witness statement which endorses that. There is not a shred of evidence to suggest that their mindset and their strategy towards Express has changed or will change unless they are required to change. That is clear from their evidence. We are still, even in their skeleton argument for this

Appeal, described as “trouble makers” and that is the reason we entered the market. The motivation for their policy persists even to today.

Coming back to methodological approaches we submit that the OFT, when they conducted this analysis should have examined the improvement of business on an ongoing basis. CWS is one example, there are many, many other customers that Claymore lost and we really have no idea upon what basis they were supplied. So this is merely illustrative, we have no idea what Wiseman has been doing since then, and the OFT did not investigate.

The second point in relation to discrimination is that if there are errors in the approach towards predation this would impact on any price discrimination conclusion, because one can see from table G that there is a wide range of pricing both above and below cost, and it is the overall pattern of prices below and above cost which may inform a conclusion on price discrimination. So if, for the sake of argument, the cost line was raised to 10 per cent., and a large number of additional customers including the larger ones fell below cost then that may be the material consideration which would affect the OFT’s conclusion on price discrimination. The OFT cited *CMB* and *Irish Sugar* in Mr Lawrie’s statement but these were cases which did not involve below cost pricing. It is not, however, the criterion which they have used in their briefing note. Their briefing note is much simpler. It seems to be that they got stuck on intent, that seems to be the only consideration which affected the Decision. I think they did not feel able to deduce. It may be buttressed by a consideration that they were not able to deduce anything conclusive from the statistics they had, but it appears to be, reading the briefing note, a question of intent which largely affected them.

The third methodological point concerns volume, which I have already dealt with, that if you have a distorted cost then you are bound to produce figures which will make it more difficult to draw any conclusion as to price discrimination. Yet, we do see from para.15 of their briefing note that even with those distortions there appear to have been trends which we say should have put them on notice. You will recollect perhaps from the letter that Mrs Bloom sent (the original Decision letter) where they said they found discrimination in relation to the health sector, which again one might say should have put them on notice that there was something odd in their results or there was some price discrimination going on, but that these were inferences which they failed to draw. So three criticisms: 1) failure to examine incremental business, 2) errors in relation to calculation of cost to feed into methodology for price discrimination; and 3) volume.

You will see from the briefing note at para.16 that in deciding whether or not there was targeted discriminatory pricing they examined patterns of two other dairies – Express and Lordswood. If you look at footnote 13 – I am not certain if Lordswood is protected data ----

THE PRESIDENT: Footnote 13 to what, Mr Green?

MR GREEN: Footnote to the briefing note – I will tread warily. The OFT apparently looked at Lordswood to see whether or not they could deduce anything by way of benchmark or comparison. You will see what they have said at footnote 13:

> "Lordswood dairy data was provided by Wiseman following its acquisition and shows prices for the Somerfield market of middle-ground retailers."

I do not understand that because Somerfield is a supermarket and it is unclear how a supermarket can be a middle-ground retailer. We are told in the OFT's skeleton at para.69:

> "The proposition that price discrimination could be an inherent feature of this particular industry was also supported by the example of Lordswood's pricing (in South West England), where price discrimination was also present."

So the OFT used an example from South West England, apparently involving Somerfield, a supermarket, as a benchmark against which to assess alleged or ostensible price discrimination in Scotland, and it just does not seem to us that that is a sensible comparator to use ----

THE PRESIDENT: Because what?

MR GREEN: Because it is a different geography. The Competition Commission concluded that Scotland was a different geographical market because there were different, amongst other things, price patterns between England and Scotland. So one of the reasons why you conclude that Scotland is a separate market from England is different prices. To then use prices and England to provide a benchmark against prices in Scotland is not going to be of any significant probative value.

THE PRESIDENT: Would I be right, and I make the point so that the OFT can deal with it in due course, if you come to the conclusion that price discrimination with small middle-ground customers is a feature of the industry as a whole, are you not coming to the conclusion that competition is not effective in this industry as a whole, because if you have effective competition that should normally to a large extent reduce price discrimination by arbitrage and bargaining and other competitive forces?

MR GREEN: That was the conclusion the OFT itself arrived at in the s.35 Notice.

THE PRESIDENT: And it might be a sort of counsel of despair to say "We give up because this whole industry is riddled with monopolistic features and therefore we shrug our shoulders".

MR GREEN: That was a point the OFT was alive to when it drafted its s.35 document, because it said if you see widespread evidence of price discrimination it is at least indicative that there is something wrong, the dominant undertaking is able to price according to the maximum it can get in a particular area.

THE PRESIDENT: What we do not know is whether Lordswood in its particular area has a local monopoly of some sort.

MR GREEN: We do not. The other criticism we make, which is the criticism we also make of the Express comparison is that they only examined price patterns, whereas they did not examine cost price margins. You are not comparing the same thing, and it is hard to see how you can deduce anything from just looking at price patterns in South West England when you have been looking at cost price margins in Scotland – they are different exercises, one is a more sophisticated and refined exercise than the other. Across the price margin assumes that you know something about the cost of supplying a particular customer, and it also means that you are accepting that you may have differential pricing, which is not discriminatory because there are different costs in supplying different customers. You are actually genuinely reflecting differences in cost. So merely because you see differences in price does not, on the OFT's thesis that they were working with, tell you that there is necessarily price discrimination. So comparing price patterns against cost price margins tells you nothing. Precisely the same point arises in relation to their comparison with Express (briefing note 16), and footnote 12 refers to Express's 19th June submission. There is no paragraph or text referred to when you go back to that document which, for your reference, is supplementary vol.1 p.1290. You will see that there is no analysis there which could lead the OFT to come to any conclusion ----

THE PRESIDENT: Could I just glance at that document?

MR GREEN: Yes, indeed. You will see that this is a detailed submission containing quite a lot of law, shortly before the Decision was taken, and actually looking at it on 19th June 2002 it appears to be the day after the OFT had informed Wiseman – 9 days. There is a detailed submission on law and fact and there is attached to it a report from Ernst & Young. The report from Ernst & Young contains, as you have seen, data on customers but there is no data on cost of supply. So one sees the prices and volumes, but there is no information telling you whether or not there is discriminatory pricing, to use that phrase in relation to Express, because you do not know the cost of supply to each of those customers. Take for example, p.1332 and onwards, one does not know what the position is in relation to those customers, whether or not the cost of supply to them is similar. So comparison of cost margin simply against price is not indicative of anything.

THE PRESIDENT: (Pause for reading) Though it would probably be the case, I just do not know whether these prices were not particularly closely related to cost – I just do not know ----

MR GREEN: One does not know.

THE PRESIDENT: -- whether you sell off a standard price list, or a price list less negotiated discount or what?

MR GREEN: I am afraid I really do not have the information to know to what extent it was cost related. The criticism we make is simply that it is an inapposite comparison which the OFT relied upon in order to come to its conclusion. The logical answer for the OFT to arrive at when looking at this is that we just do not know whether it is a good conclusion or not.

THE PRESIDENT: It is of some interest, just glancing at it, one just happens to notice that on the whole the prices to what appear to be undertakings in the health sector do appear to be rather lower than the general run of the prices – if you look, for example, some of the prices on 1333 and 1332.

MR GREEN: Yes, they are taking some pretty high volumes, of course, yes.

THE PRESIDENT: Yes, that may be the volume effect again, I do not know.

MR GREEN: The conclusion the OFT arrived at in the briefing note is set out in para.18:

> "…Wiseman's discriminatory behaviour does not appear to be markedly different from normal competitive behaviour in this market."

That is a conclusion we say they simply were not entitled to arrive at, even if there was price discrimination by others. It must go without saying that a dominant undertaking cannot simply engage in the same sort of price flexibility that a more dominant undertaking can. When one has the background of the evidence given to the Competition Commission about strategy and motive then that should have put the OFT on the clearest possible notice that wide discrimination was almost inevitably going to be accompanied by a hostile animus. For them to come to the conclusion in the last sentence:

> "The competition with Claymore in this part of Scotland is certainly the main explanation …"

that seems to be an explicit recognition of everything that we have submitted.

THE PRESIDENT: That the price discrimination is mainly accounted for by competition with Claymore?

MR GREEN: Because of Express's acquisition of the shareholding of Claymore which triggered a response from Wiseman to customers which had never been served before by Wiseman. Then there is no way to tell from the data whether this is normal or a deliberate targeting strategy.

If what they are looking for is a deliberate targeting strategy since they looked at the Competition Commission transcript then we submit coupled to the hit list every bit of evidence they needed was there. The Competition Commission's investigation would have provided them with the evidence.

THE PRESIDENT: What do you make of that last sentence? It is expressing a number of different thoughts. Thought no.1, discrimination is largely due to competition with Claymore, i.e. the complaint of price discrimination that we have is I suppose to some extent substantiated by the fact that we do think that at least to a large extent the competition with Claymore was causing this price discrimination, but then what is the distinction being drawn between a normal competitive response and a deliberate targeting strategy?

MR GREEN: That is where we say the confusion arises. A number of these paragraphs reflect an acknowledgement that Wiseman's reaction was, because of everything we have seen and heard, due to the acquisition of the shareholding in Claymore – retaliation, fears of Express coming in to ruin the market and so on and so forth. That led, as Mr Wiseman accepted in evidence, to targeting. It does not seem to be denied, or suggested is incorrect. That is why we do not understand why they did not simply come to the conclusion that if you have identified discrimination you have identified that it is Claymore which has triggered the discrimination and you know what the background is, how you can come to the conclusion that they were uncertain that there is deliberate targeting. It seems to us to be a non-sequitur. You have got to the point at which you can say "We know enough about this case to conclude there is unlawful price discrimination".

They seem to be confused by the conclusion they arrived at in para.38 about the Stackelberg-warfare which seems to be a confusion over what may be permissible in an oligopolistic market, and what may be permissible in a dominant market. That would explain the confusion in para.18, if you think that warfare is legitimate under Article 82, then it is going to make it very difficult to actually come to a conclusion as to whether or not it is deliberate targeting, begging the question you are seeking to ask.

THE PRESIDENT: Yes, well we have not come across the Stackelberg-warfare type of situation before – I do not know what to make of it at the moment.

MR GREEN: Can I just give you a reference which has been handed to me – I have not had chance to read it to remind myself of it. Mr. Larg's witness statement provides an explanation of why Claymore's health sector margins are low, and this is p.209-210 of the core bundle.

Before I move to all-Scotland contracts I would like to make one or two points about law, and again in the interests of time I will make the submissions and give you paragraph

numbers to the CFI's recent Judgment of *British Airways* v *Commission* on price discrimination. The relevant paragraphs for consideration are paras.233 onwards, but with particular reference to paras.241-249. The CFI in relation to that case, under Article 82, having cited all its traditional case law, *Michelin, Hoffman La Roche* and so on, stated that a discount is abusive if it tends to hinder. The test which the CFI adopted was a tendency to hinder competition.

THE PRESIDENT: It is not without controversy this particular Decision. I think it is under appeal at the moment.

MR GREEN: It is under appeal, due to be heard some time this year. British Airways is suggesting it is wrong, the Commission is not, Virgin is not suggesting it is wrong either, and consistent with *Michelin 2*.

There is a number of points which we would submit should be uncontroversial, and in any event it is a CFI rule which we at the very least would lead the OFT to ----

THE PRESIDENT: No, no, you are fully entitled to tell us about it.

MR GREEN: There is a number of points. First, discounts are abusive if they create a tendency to hinder. So one is not looking at the complete elimination though it seems to us fairly clear that that was Wiseman's intent. If there was a tendency to hinder competition then there is an abuse. A hindrance can be abusive if it relates to either entry or expansion once in a market (paras. 217, 286, 287)

A discount will be abusive if there is no clear objective justification for it – para.280, citing *Irish Sugar*, 189. At para. 248, a discount scheme, which is not objectively justified, in other words has an exclusionary hindering consequence, may be abusive even if it is non-discriminatory – in other words if it is applied to all customers. It does not have to be differentiated as between customers. If you have a rebate system which applies to everybody equally it can still be abusive.

In this regard I just want to point out the difference between the briefing note and Mr Lawrie's statement. You know that Wiseman gave to the OFT an oral explanation of its price differential policy on 14th March.

THE PRESIDENT: Yes.

MR GREEN: Mr Lawrie in his statement at para.76 says something quite different about it compared to the briefing note. Mr Lawrie is p.240 of the core. Mr Lawrie's explanation was that the meeting of 14th March enabled Wiseman, and I am quoting from the non-confidential part:

"… to provide explanations for its pricing behaviour which we felt were logical and would undermine any attempt to prove that Wiseman's actions departed from the normal competitive response to Express entry."

Then there is the explanation which is confidential, which you can see. You compare that with para.13 ----

THE PRESIDENT: Just one moment. Let me read through the rest of it. (Pause for reading) The explanation there given tends to take me back to the point we have been discussing earlier that at this meeting Wiseman had explained that if you go down particular runs you may get rather random results depending on whether the retailer concerned happens to be on a run, for example, serving a few high volume customers and therefore you cannot really draw any conclusions from the fact that you have a few below cost examples. Once you accept that explanation you tend to blow out of the water the validity of the whole exercise.

MR GREEN: That must certainly be true, it has to be so. You will notice that Wiseman do not say they had any method of calculating costs, internally it appears to be entirely random, which raises a discrete point which is on the assumption that they are dominant ----

THE PRESIDENT: No, but what they are saying is "we do not price on this basis because Wiseman explained the mechanisms at which prices were arrived at", and then they go on to give an explanation which we have to refer to in code. But what is essentially suggested is that there is a rather lack of connection between the price setting mechanism and the exercise the OFT is purporting to carry out.

MR GREEN: Yes, that is right. But the point I wish to make is that para.76 gives the impression that the OFT considered that to be a complete answer.

THE PRESIDENT: Yes.

MR GREEN: Whereas para.13 of the briefing note indicates that it was a partial answer to some of the observed behaviour. If you look at the latter part of para.13 of the briefing note, one line up from page of the note:

"Finally, little evidence of intent has been found, in particular during the section 28 on site investigation. Wiseman was able to give us a logical explanation of its approach to pricing for its various categories of customers which went some way to accounting for some of the observed behaviour."

Now, what appears to be the case is that when the Decision was taken the OFT felt that there was some objective justification in the explanation but it was only partial. It went some way to accounting for some of the observed behaviour. That indicates clearly that they did not find it

fully satisfying and it did not account for all of the observed behaviour. We do not know any more than that.

THE PRESIDENT: Is there not some internal note of this meeting that came to light at some point?

MR GREEN: There is a very genomic note in the court correspondence file at tab 1 and I think this is the transcript – you will find Ann Pope's note of the meeting, she was one of the team. Then there is a typed up version further in, which is not terribly illuminating. It is not entirely clear to whom each of these statements are to be attributed, but it appears that Wiseman gave evidence to the effect that they do not have any form of cost modelling. They do not historically look at the costs of runs and they would never go into the level of detail that they have been going in to for the purposes of the OFT. You will see the statement two-thirds of the way down the first page:

> " …make sure price is in line with shops' … more cost with less volume, lower price for larger volume."

But precisely what one deduces from this is unclear. You will recollect in the disclosure application the OFT accepts that no proper note was taken at the meeting.

I would like to turn now from price discrimination to all-Scotland contracts, which I will deal with as briefly as I can. You will see that in relation to the all-Scotland contracts the OFT found that it was Wiseman who were the first to offer these contracts ----

THE PRESIDENT: Do you mean "Wiseman"?

MR GREEN: Yes, I mean Wiseman. I know Wiseman disagree with this, but the briefing note says that it was Wiseman, and the Competition Commission suggest it was Wiseman. But the OFT, in para.31:

> "CWS was the first account for which Wiseman and Express competed according to the CC report. It seems that Wiseman offered first an "all-Scotland" contract in January 1999 to CWS. However, CWS said that it offered Express/Claymore to come back with a counter proposal by the end of 1999. Also, at a meeting with AC, the Co-op owned processor in the North of England, it was made very clear that if ACC was able to deliver Scottish milk at a competitive price to Co-op stores in Scotland …"

THE PRESIDENT: Should we be careful about this bit, Mr. Green? I am not sure what ----

MR GREEN: Well I will be regardless. If you just read on then.

THE PRESIDENT: -- the position is on this.

MR GREEN: Yes.

THE PRESIDENT: (After a pause) Yes.

MR GREEN: Then if you look at para.32, and I think that is in the non-confidential part of the CC Report, you will see that the position in relation to Alldays is explained to be different. So that is what the OFT says about it and, on our analysis, it really does not matter who was first and who was second.

THE PRESIDENT: What seems to have happened is, because the date is given as January 1999 in both cases, there is an offer by Wiseman for CWS in January 1999. There is an offer by Express to Alldays in January 1999, so the idea of an all-Scotland contract seems to have been fashionable around January 1999.

MR GREEN: There is a chronology attached to the CC Report at p.1146 of supplementary volume 1 which gives the CC's chronology between 5th December 1998 and 7th May 1999. The entry for January and February 1999 you will see the CC record evidence which one would not be able to decide who was first, but it may be that it was about that time that the issue became relevant. One has to remember what the all of Scotland contract was – it was an attempt by Wiseman to catch those customers in the Highlands that it had not caught before on the basis that, as Mr Wiseman explained to the Competition Commission, they were not going to share customers with Express. You will see that 3rd May 1999 was the first time express/Claymore begins trading in the Central belt. So it started its life in the Highlands, it expanded only later.

The OFT's analysis seems to arrive at the conclusion that what is decisive is who goes first. It may be even fairer to say that the reasons why the OFT came to no conclusion about all of Scotland contracts is that the reasoning is extremely unclear. There seems to be confusion over the relationship with exclusive contracts. The OFT's own analysis of all of Scotland contracts has varied as pleadings have developed. We have had an entirely different version in the skeleton to that set out in Mr Lawrie's statement. One can identify a number of possible explanations for the OFT's position. First is that they considered it highly relevant who went first. Secondly, that they would only investigate all of Scotland contracts if they found they were exclusive.

THE PRESIDENT: Is an all of Scotland contract not exclusive by implication?

MR GREEN: Yes, if you are supplying their total needs and you have a price and a quantity. Remember, Mr. Wiseman did not want to share customers, and in relation to CWS had 75 per cent. and wanted the other 25 per cent. It is *de facto* exclusive. The other possible ground for the OFT's Decision is that this was all okay in an oligopolistic setting, which is para.34 of the briefing note, and their conclusion is:

> "On balance it is doubtful that further investigation would lead to a conclusion that there has been an infringement."

We know that they did not examine the incremental business, so we know that they did not examine whether the turning of a partial contract into an all of Scotland contract was justified in terms of price or otherwise. In this circumstance it seems to us all we could do is stand back and ask, almost as a question of first principle, what is wrong with an all of Scotland contract? What were the real questions that the OFT should have been asking themselves? There is very little case law on all of Scotland, or delivered pricing, but there is a certain amount which the Competition Commission has examined over the years; there has been a number of EC cases, and there is quite a lot of US jurisprudence. I am not going to take you to it, but I am going to hand up just a text book on delivered pricing which shows you that there are two vices which arise out of delivered price arrangements.

THE PRESIDENT: This whole industry seems to operate on delivered pricing, and the price that all retailers are offered by everybody is a price that apparently includes delivery.

MR GREEN: Yes. The purpose of the analysis does not alter matters. You will see that I have a more than passing interest in this case, but I have only included it because it provides a summary of the case law, and there is no particular point I want to take you to here except that it provides a sort of review of the cases both in UK/US/EC.

THE PRESIDENT: I seem to remember this figured heavily in cement.

THE PRESIDENT: It did, and BPB, both in the Competition Commission and the MMC (as it was then), this is in footnote 374, it refers to *Plasterboard* and Cement, and *Building Bricks* – we are going back quite a time for that. Certainly it was in Cement, in the Restrictive Practices Court.

There were two vices with delivered pricing. Not all delivered pricing is bad, but if you have a single price covering the entirety of a large territory there are two potential problems and the Regulator should address its mind to each of these problems. The first is discrimination between close and distant customers; that you are charging each of them the same price albeit that the cost of supplying both is different. The second is because the local customer is in effect subsidising the distant customer it makes it very difficult for the non-dominant competitor to compete with the distant customer, because the dominant undertaking is not reflecting the cost of supply to that far distant customer, and anybody who wishes to compete for that far distant customer up in the Highlands will find it very difficult.

You can think of it in graphic terms in this way, that if you have your head in the oven and your feet in the fridge you are going to suffer pain at the extremities but the ambient temperature might be perfectly reasonable. That is what is wrong with delivered pricing – or might be wrong. What you actually do to make them acceptable is you have zones. You may

have three, four or five zones whereby the cost is largely reflected in the price. Wiseman always said when they gave evidence to the Competition Commission that they will ordinarily reflect cost of distribution in price – that is what they do as normal, and that is the evidence which they gave to the Competition Commission.

If you are an equally efficient but smaller competitor trying to compete with a dominant undertaking you are going to find it very difficult to compete in the furthest flung territory.

THE PRESIDENT: What we do not know in this case is how that works out in practice because although what you say may be theoretically right, in this particular case Claymore at Nairn is much closer geographically to the farthest flung territory than most of Wiseman.

MR GREEN: Yes.

THE PRESIDENT: And so it may or may not matter to them.

MR GREEN: It may or may not matter. Again, we do not have the data. The OFT did not analyse it in these terms, and I think for present purposes it is difficult to go much beyond saying "What were the questions that the OFT should have identified as relevant, because if they did not conduct this exercise, and therefore it is impossible to make any detailed submissions about the actual effects. We are concerned here, so far as Claymore is concerned, with the Highlands. This was a territory that hitherto Wiseman had not served, but that is in its own right a strong indication that the motivation for entering into the all of Scotland contracts and the delivered pricing was exclusionary, and that should have put the OFT on notice that it was a serious matter for investigation – regardless of whether it was exclusive or not, and regardless of whether other competitors felt they had to compete on an all of Scotland basis.

THE PRESIDENT: It is true that – it depends on the circumstances – you might have a customer, let us say CWS for example though I am not thinking specifically about CWS, that has quite a number of outlets in the Central Belt close to Wiseman's depots in the Central Belt. Wiseman comes along and says to CWS: "I will give your outlying Highlands' outlets the same price as I am giving you in the Central Belt", to which CWS immediately said "Yes, wonderful". That might be a case – it might not be a case, but it might be a case where you are offering a price for the Highland outlets that is not related to costs, the cost of delivering for you to the Highlands is greater, and you are depending on the level of the price such advantage that Claymore has by being at Nairn may not be sufficient to counteract the advantageous price that is being offered on the basis that the Central Belt price will be offered to the Highlands.

MR GREEN: Yes.

THE PRESIDENT: So you would have to look at it and see.

MR GREEN: You would have to look at it.

THE PRESIDENT: An all of Scotland contract is a sort of mixture of possible exclusion and possible discrimination.

MR GREEN: Yes, and there are questions which case law suggests you should ask.

THE PRESIDENT: Well on the other hand you have one contract for one customer on the national basis which seems to be a fairly standard practice in this industry.

MR GREEN: It is fairly standard but it does not mean to say that a dominant undertaking and/or with a particular intent is entitled in all circumstances, because it is not the mere fact of the all of Scotland contract. What the case law suggests is that it may be perfectly rational to have zones so that you may be have four or five pricing zones which broadly reflect cost differences. So you can have an all of Scotland contract, but you may have to have a relatively small number of prices which reflect raw cost differentiations and differences, and a number of arrangements with zonal pricing have been accepted.

There are a series of questions which the OFT did not ask and which it should have asked.

THE PRESIDENT: But you say – I think – do you, if you look at para.34 we seem to be coming back again to the conclusion that even if you could establish some kind of exclusionary effect from the all Scotland contract, or some kind of discriminatory effect, you would still be up against the problem of reasonable response to an aggressive move by a competitor in an oligopolistic setting, which is the same point that I think is being made in 38.

MR GREEN: Yes, whatever that means, which cannot be right if that was what influenced the OFT that this was in some way an oligopolistic setting, or the logic of oligopoly extended then it just cannot, on any view, be right.

THE PRESIDENT: Yes.

MR GREEN: They cross-refer to Mr Dodgson's ----

THE PRESIDENT: It is a different article.

MR GREEN: I think it is the same article.

THE PRESIDENT: No one is 1986 and the other is 1993. Mr Dodgson seems to be ----

MR GREEN: … dodging around all over the place!

THE PRESIDENT: -- quite ----

MR GREEN: Prolific. Anyway, we may need to track down whatever the 1993 article says. There are two other points ----

THE PRESIDENT: It is the split. This briefing note to some extent seems to reflect the same split that the CC found, that half of the CC thought you need to look at it as dominance, and

predation, discrimination on a local basis, and the other half of the CC said "Look, come on, this is a tremendous price war between two companies that are both old enough and ugly enough to look after themselves.

MR GREEN: Once they had come to the conclusion it was a Scottish market, and once you had come to the conclusion, which is the hypothesis for this Decision, that Wiseman is dominant, then that analysis must disappear. There can be no trace of it which can legitimately be left. If you conclude that it was the whole of the United Kingdom market which was what Wiseman was angling for in the Competition Commission investigation then it is perfectly rational – it is a UK-wide market, we are all big and we can fight it out as we please. If you are wrong on that and it is a Scottish market with an incumbent dominant position then the analysis simply cannot wash.

Two final points. First, references in *Aberdeen Journals* to a similar point (paras.378 to 381) dealt with in the revised Notice of Appeal (RNA) para.440. In those paragraphs in *Aberdeen Journals* the Tribunal stated that when a the company advanced the argument that it was simply pricing on a marginal basis that was something which on the face of it looked questionable and would at the very least require investigation, and that is a reasonably accurate description with an all of Scotland contract. If you take CWS and you go from 75 per cent. with an all of Scotland contract taking the other 25 per cent. you have to look at it on the incremental basis to see whether or not it is rational, and that was a point which we think has an analogy with the analysis in *Aberdeen Journals* paras.378-381.

Finally, the points that we have just made were made by an economist, Mark Williams, to the OFT in a short document which is in supplementary volume 1, p.1421 on 25th June 2002. Mr Williams makes a number of points, but in short he reflects his frustration that despite best efforts he has not been able to engage with the OFT in the debate on this issue because they do not seem to want to engage with him. He says first that you cannot ignore the context of Wiseman's admitted statement that Wiseman viewed Express as illegitimate, and that it viewed its entry as aggressive to which it was entitled to respond. Secondly, he says that the contracts were won because Wiseman offered all of Scotland contracts and Claymore being located in the Highlands was effectively unable to compete for and it was with an exclusionary intent and effect. He sets out a series of arguments which he knocks down – he is criticised for this by the OFT, we say most unfairly as attacking straw men. His point here, as you will see, was well, we tried to engage with the OFT over this and they refused to and so I am going to work out what points might be raised against me and analyse them and then send them to the OFT which he then does.

Then he says in s.3 on p.1424 that there are a series of implications that … the Wiseman strategy as legitimate, and he identifies a series of the possible exclusionary effects. What we say about this is simply this, that it was a series of issues posed to the OFT. We have now seen their true reasoning, but this raised serious questions which simply required to be answered. He did not quite put it in the terms that I put it in relation to the case law, but when you boil it down to its bare essentials he is making the same points. We get nothing by way of proper response to that, we never did, and Mr Lawrie deals with it at I think para.92. He simply says that this was simply a series of straw men which he knocked down, we get no comment or analysis or response, and there never was any. That is all I wish to say about all of Scotland contracts.

The final main topic, and again I can deal with it relatively briefly, is exclusive contracts. The short point which we have made in the RNA and in the skeleton is that the OFT wrongly focused its search on 100 per cent. exclusivity terms. It is set out in the skeleton at 166-174, which summarises our position and our response to the OFT's position and, indeed, Wiseman's position. The OFT's analysis also contained another distinction which we with respect view as meaningless, which was really a commentary on the all of Scotland contracts. They believe there was a critical distinction to be drawn between exclusive contracts and all of Scotland contracts, which to us is pretty meaningless. I mean it is not quite as clear why you need to consider an all of Scotland contract is any different from exclusivity and why all of Scotland would only be illegal and abusive if they contained an express exclusivity term (paras.173-175 skeleton). I do not need to deal with that now.

The main point I wish to address is the OFT's exclusive concern being 100 per cent. contracts. It is stated in the OFT's skeleton that that was not entirely fair. They say that they were not looking for just 100 per cent. contracts, 100 per cent or near 100 per cent. As I said earlier, we do not see any evidence that they were looking for anything other than 100 per cent. contracts. In relation to exclusivity in the briefing note this is dealt with in paras.21-23. They refer to Aberness. They conclude in relation to Aberness that they could not find that an exclusive agreement had been entered into. They acknowledge that in relation to Aberness Wiseman was the principal supplier. They say:

> "23 A reading of the CC report leads to some doubt as to whether these agreements were or were not exclusive. Express has claimed repeatedly that they are, at least on a *de facto* basis. However, we received evidence that at least some of the customers involved did not consider them so. In view of such mixed evidence we are not in

a position to reach a conclusion as to whether or not Chapter II has been infringed in this connection."

It is very difficult to know what to say about this, because there is obviously a large number of contracts out there. We know what happened in the Aberness contract, there was an inducement paid and the CC did conclude that it was exclusive, and it is clear when you read all of the paragraphs that that was the case. We do not know what position Wiseman had with other customers in the Highlands because nobody examined them, and the OFT did not call for these contracts. So how the OFT can say on the basis of the evidence "We are not in a position to reach a conclusion" when they did not examine the terms of the contracts, is very hard to know.

Even in relation to Aberness they plainly, we submit, misread the CC's Report. Just to take you through the relevant paragraphs in the CC Report, you will see what sort of contract Wiseman was looking for. First of all, the CC Report at 2.103, p.972. If you would cast your eye over that. I am not certain how much of this is a business secret, so perhaps if you read 2.103 and you will see a reference to a "gentleman's agreement" towards the end.

THE PRESIDENT: I do not think any of it is confidential, because it is all in the public version.

MR GREEN: I think that may be, this is the public version, yes. So at 2.103 there is a reference to the one-off payment. There is a reference to Wiseman remaining a main supplier of fresh milk and cream through Aberness's company for at least the next three years, though it is for the continuation of business depending on Wiseman to maintain exacting standards on service and price, Aberness said it could withdraw from the deal at any time, and note the conditional "if" – "if it felt that Wiseman's performance was falling short". They said that they believed in maintaining diversity of competition. They have given the percentages. It appears that Wiseman accounted for 82 per cent. of Aberness's requirement, but they thought they had a gentleman's agreement with Aberness. Now, this is what Aberness said about its contract. Plainly, to understand what is meant by it you need to get its terms. It appears the CC did get the terms, if one goes on one finds first at para.5.29, which is at page1095, under the heading "Contracts with Retailers" where the CC is recording Wiseman's evidence, that they did not have, except in on case, deals with retailers which specified that Wiseman would act as their exclusive supplier. Retailers were able to walk away from deals if Wiseman failed to deliver the requisite quality and service. The exception was Aberness. They referred to the letter, and there is a quotation from the letter.

"This ensures that providing we do everything to the reasonable standard of service and product quality you rightly expect we will remain your single supplier of fresh milk and cream for at least the next three years."

Now, that is an exclusivity contract subject to some form of quality control. That appears to be confirmed by the CC later at 6.87 and 6.90. In 6.87, p.1124 we asked Aberness whether there had been any agreements, arrangements or practice as between suppliers of fresh processed milk delivered around retailers in Scotland which had affected prices or customers purchasing preferences, which might be anti-competitive. The reply, they currently supplied all Mace stores in Scotland at exactly the same cost price for all three accredited suppliers. They did have an agreement with Wiseman to supply into most of the company owned stores but this was not sole or exclusive as Mitchell was a dual supplier to a number of these stores. This company agreement had initially been instigated by Express/Claymore but after extensive renegotiation both suppliers and Aberness had reached a gentleman's agreement with Wiseman, that Wiseman would be the main supplier.

Then Aberness say in 6.90 that in their experience Wiseman winning new business from middle-ground retailers in the last year or so had certainly not involved inducements or pricing policies that were anti-competitive.

What we actually have is a record of the terms in 5.29 which have every appearance of being exclusive. There appears to have been some sort of negotiation around that, and some sort of inducement payment. Aberness was obviously delighted with it, so naturally enough did not conclude that it was anti-competitive. What it actually demonstrates, if one adds up the evidence, is that Wiseman's policy in relation to the Highlands, was no doubt to engage in a series of negotiations of a variety of natures – we see this from the hit list – with a view to winning that business, doing whatever it took. If it was an inducement, so be it. If it was a main supplier agreement, so be it, if it was an all of Scotland contract, so be it. We do not know what other varieties of contract Wiseman entered into, but we do know that they had a policy of winning that business at all costs. You would in those circumstances expect to see a variety of contractual forms. On that basis the OFT should have examined the forms to see whether they were contractually exclusive, or near exclusive, or whether they contained main supplier arrangements, or whether they were just *de facto* exclusive. There may be a series of different contractual types which, in isolation, collectively would have an exclusionary effect, and the OFT did not examine that. It did not ask for the contracts.

THE PRESIDENT: Do we have the fax of 5th August that is referred to in para.22 of the briefing note? I think we probably do somewhere?

MR GREEN: We will make inquiries. Supplementary bundle 1378. 1390 is a letter from Aberness to Ian Larg of Claymore on 26th July 2002, and I think that will add to the content.

THE PRESIDENT: We do not know what the "better deal" is?

MR GREEN: No. The case law on this I think is fairly self-evident. One is looking to see if there is an exclusionary effect or deterrent tendency. This would be the same whether it was Article 81 or Article 82. We have set out in our skeleton the European Court's ruling on *de minimis*, in particular the section on access clauses in that Judgment, which makes it clear that even under Article 81 a less than 100 per cent. exclusivity obligation may be restrictive of competition that is *a fortiori* under Article 82, but really there should not be much doubt about that. What the OFT should have done is to get the contracts, examine the terms, knowing the context in which the contracts were entered into, this Stackelberg-warfare then it was inevitable we submit that they should have done the homework, which they did not do.

There is some information about the terms in Mr Larg's witness statement which is core bundle p.206/207. (After a pause) The inference which has been drawn is that the prices would appear to be below the cost. Those are inferences of course, we do not know, we can only draw inferences from information which is publicly available, but the OFT could have found out.

The only other matter I wish to address, and I am in your hands on this – in fact the only other matter I am left with – is the Article 81 point. Now, we dealt with it in the skeleton, I am in your hands if you want it dealt with any more, I was not certain if you did not want it dealt with as a preliminary issue, or you did not want it dealt with at all. I am happy to leave it in the skeleton, it is a short point, and it is a short point which we raised in the revised notice of appeal. It is simply the linkage between the Chapter I and Chapter II investigation, and that is the point which we have raised in the RNA and in the skeleton. I am happy to leave it in writing or deal with it as you wish.

THE PRESIDENT: I think it is best left where it is at the moment, Mr Green.

MR GREEN: Those are my submissions, unless I can assist you further.

THE PRESIDENT: No, thank you very much indeed. Yes, Mr Turner.

MR TURNER: I do not know how you would like me to proceed.

THE PRESIDENT: I do not know how you would like to go on. The Sheriff's Court normally rises at 4 o'clock. We do not have to rise at 4 o'clock. I do not know how you would like to proceed. Would you like time overnight to reflect, or whether you would like to take one or two preliminary points you can conveniently get rid of now?

MR TURNER: I will open very briefly now in a matter of minutes, and then reflect overnight to see how I can economise on submissions for tomorrow, and see what submissions I can divide with Lord Grabiner.

The OFT's essential submission is of course that there is nothing wrong with the OFT's approach to the investigation in this case. The decision to close its file was entirely unobjectionable. I have listened to everything that Mr Green had to say today about the OFT's investigation and reflected upon what he has put in writing. It is with regret that we say that those submission contained a distorted picture of material points in the Office's investigation which it will be necessary for us to put right, at least so that the Tribunal has got the Office's perspective on the points which were the key pillars of its decision to close the file.

I will deal with this in detail later, but to pick up immediately one example of this which relates to the practice of exclusive or exclusionary contracting, and I will begin with the all of Scotland contracts. The suggestion was raised that the all of Scotland contracts are themselves implicitly exclusive. Sir, you will remember that you mentioned that and Mr Green assented to the proposition. That is demonstrably not the case. The all of Scotland deals involve the offer of a single price to a customer for all of its outlets, wherever those are located, but it implies nothing about exclusivity or commitments. That is the key point which the Office has sought to reflect in Mr Lawrie's statement, and which it sees as a major point of distinction.

THE PRESIDENT: Have we got a copy of an all-Scotland contract?

MR TURNER: We do not have a copy of such a contract. We do not have on the other hand any reason to suspect, as I was going on to say, that these involve exclusive terms. When one turns to the practice of exclusionary exclusive contracting the fact was that there was no, or at least extremely thin evidence, of any exclusivity contracted by Wiseman, whether it was going to be to supply 100 per cent. of the customer's requirements or any lesser amount. That is why we say that when you look at the issue of commitments, exclusive contracting the issue falls rather away.

Mr Green took you in the briefing note to some paragraphs on this, but he did not move forward to para.33. If you look at that, cast your eye over it, you will see that there was reasoning there that the Tribunal should be aware of, because this is the way in which the Office was considering the evidence, and the question of any problem with exclusive contracting. What I would like to do very briefly now is just to show you the paragraphs in the Competition Commission's Report which are referred to there, if the Tribunal would not mind picking up the Report. Starting at para.4.266, p.1066 – the first of the paragraphs referred to.

THE PRESIDENT: Does the CC define anywhere what it means by an all-Scotland contract?

MR TURNER: I am not sure that the CC gives a precise definition of that term, but what I think is uncontroversial between everybody is that it does involve offering a single price to a customer for all of its outlets. That is the way certainly that it explains it in the competition that took place – the specific contracts for CWS and for Alldays and for others.

THE PRESIDENT: Yes

MR TURNER: So if you glance first at 4.265 you see there that there are some chains mentioned, including CWS and Alldays, Morning Noon & Night, that Express/Claymore service and which switched to Wiseman, and taken together that they accounted for around 40 per cent. of Express/Claymore's volume at the end of the year 1998.

Then moving on:

> "With respect to exclusivity none of these accounts were subject to a written contract although letters setting out arrangements for supply were sent in some instances. Indeed, it would appear that in general there are very few written contracts between milk processors and retail customers for the supply of fresh processed milk. For example, CWS said that after its deal with Wiseman in early 1999 it told Express/Claymore that there was nothing to stop it coming back with a counter proposal towards the end of 1999".

Then just dropping towards the end of that paragraph, the sentence that begins: "More generally": "More generally, in our survey of middle ground retailers" and I pause there, that was a survey of about 520 middle ground retailers –

> "…of which 80 per cent. of respondents were independent retailers, 97 per cent. said that there were no conditions attached to milk purchases. Only three respondents cited conditions which could be construed as exclusive supply arrangements."

We took that at face value. There were no conditions attached to the purchase of milk. So far as Aberness in particular is concerned, Mr Green did not take you to paras. 6.88 and 6.89 of the Report, but only to the paragraphs around that. Aberness is the one case where there was some suggestion of exclusivity, or at least of commitment as a condition of purchasing. At 6.88 the Competition Commission reports Aberness as telling it that:

> "Wiseman had never had any contracts with Aberness's retailers for the supply of fresh processed milk which stipulated exclusivity of supply. It would not agree to such a contract because Aberness encouraged competition to keep the ongoing pricing competitive against the larger supermarkets. Aberness believed that being in many camps kept it in a stronger competitive condition."

And then 6.89, just the last sentence:

> "Aberness noted that the initial price reductions had been instigated by Express/Claymore in a bid to secure footholds further South from their operating base in the Highlands."

And that went to the point, Sir, that you mentioned that at this time the all of Scotland contract did appear to become fashionable.

THE PRESIDENT: What, however, was the CC's finding on this point?

MR TURNER: The CC's finding was in Chapter II, which Mr Green did take you to, which in my submission is expressed in diluted terms, that was para.2.103. There are certain parts of that which I will mention. Aberness:

> "We asked Aberness whether it thought that the actual agreement with Wiseman was exclusive. It told us that it was clear that it was not."

Then:

> "Aberness said that it could withdraw from the deal at any time if it felt that Wiseman's performance was falling short."

In other words, terminable at will, and then a few lines further down from that:

> "It saw the deal with Wiseman as very much a gentleman's agreement that was pen-ended and easy to get out of."

Now, Mr Green accepted that when one is looking for an abuse by way of exclusionary contracting that one needs to have at least some flavour of foreclosure of the market, making it difficult for competitors. If this is the extent of the evidence on exclusionary contracting it is extremely thin. As I say, I will develop these submissions later on, but what I felt the need to do is to draw to the Tribunal's attention the need to see these points for what they are at the outset.

The essence of the case is that the Office carried out a good and thorough investigation and the analysis was designed to enable it to obtain a working picture of Wiseman's pricing practices in the Scottish middle ground. That was both in terms of outlets and in terms of customers. You will remember that you asked Mr Green whether the analysis covered outlets or customers? The answer was that it enabled one to look at both, and that is exactly what the Office did, although it preferred to look at matters at the level of customers.

The Office reviewed the results of its analysis and the other evidence that was available to it, which included the Competition Report, and it made no error of approach and it did not ask itself the wrong legal question in any way. Indeed, it is my understanding that has been only faintly urged upon you today, that wrong legal questions were posed by the Office of

itself. Instead, Mr Green has concentrated his attack on errors of approach of a different nature which he said made the results of the OFT's analysis inherently unreliable for the task that it was facing. There were one or two points of legal analysis which I will need to deal with but on the whole Mr Green's analysis drifted away from those.

The way that I would propose to structure my submissions is as follows. First, I will give a short summary of the main elements of the Office's work in its investigation of Wiseman's pricing practices and, in doing so, I will endeavour to pick up some of Mr Green's points so that it will not be necessary to return to them and so that the Tribunal will see from the Office's perspective how the Office felt that it was getting to the bottom of things in its investigation.

Secondly, I will look at the nature of the Decision that emerged from all of this work, and in that connection, if it is convenient to the Tribunal I will address the significance of the case team's summary, and would defer a consideration of its implications until that stage, although I am perfectly prepared to deal with it earlier if necessary.

Thirdly, having looked at the nature of the Decision with which you are confronted, I will turn to look at the appropriate level of scrutiny for the Tribunal in the case of a Decision of this kind, where the Office has decided to transfer its resources to other more promising cases.

Finally, I will respond to the remaining specific points mentioned by Mr Green and in doing so hope to pick up some of the essential legal propositions that should guide the Tribunal in this case.

Sir, if it is convenient I will address you on those matters tomorrow and discuss with Lord Grabiner how best to divide up the work.

THE PRESIDENT: Thank you very much, Mr Turner. Very well 10.30 tomorrow.

(Adjourned until 10.30 a.m. on Wednesday, 13th January 2005)