IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1099/1/2/08

Victoria House,
Bloomsbury Place,
London WC1A 2EB

16th January 2009

Before:

VIVIEN ROSE
(Chairman)
PROFESSOR PAUL STONEMAN
DAVID SUMMERS

Sitting as a Tribunal in England and Wales

BETWEEN:

NATIONAL GRID PLC Appellant

- v -

THE GAS AND ELECTRICITY MARKETS AUTHORITY Respondent

supported by

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

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HEARING (DAY 2)

APPEARANCES

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

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

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

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

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

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THE CHAIRMAN: Yes, Mr. Turner.

MR. TURNER: Madam, I am grateful. Before kicking off today we have prepared, in order to speed things up, four brief notes which I hope the Tribunal will have had made available. I will briefly say what those are. First, in place of making oral submissions on this matter, there is a note entitled "Effects on CMOs". That is responsive to the part of the Decision finding an actual foreclosing effect on competition because of effects on the CMOs in the market at the time. It will enable me to deal much more quickly with this orally, to the extent that it is a relevant issue at all. That is that note and I say no more about that for the moment.

The second, similarly, is a note entitled "Note of Smart Metering and the MSAs". Again, you will recall that one of the alleged effects of these agreements is that they impaired the introduction of new technology, and that is what that note deals with.

The two remaining notes, which are a single sheet of paper, are responsive to points that arose in questions yesterday. Taking them in turn, the first is entitled "Note: National Grid's position on sale of its installed meters". This is our current response to Professor Stoneman's questions to clarify whether National Grid had refused to sell any of the installed meter stock. Very briefly, the position you will see from this is that it was not ruled out. At para.5 we refer to an internal strategy paper talking about then developing proposals for selling meters when National Grid was confronted with the problem of the stranding risk and deciding what would be its best option to pursue. It then refers further in the note to certain practical difficulties that were perceived to arise, such as at para.8, uncertainty as to the lawfulness of continuing to use the imperial meters, if those were sold. We do not believe that active discussions were entered into with other parties subsequent to that. We have not finally been able to check, unfortunately, overnight the precise position, but we believe, as I said yesterday, the position was it was expected for these reasons that National Grid would get little value from a sale of these assets, and attention moved over to the developing plan to develop these Legacy MSA agreements, the so called "Project JAM".

The final note is a note relating to an issue that arose yesterday about bargaining and market definition. In the discussion that arose yesterday the question was raised about whether we are saying, very crudely, that a new and replacement meter somehow turns into a product in a different market, a legacy meter, the moment that you put it on the wall. I just need to ensure that I have got across our essential point. I am not going to go through this short note now, but I would invite you to read it, and the other parties, to avoid any

misunderstanding. Our essential point in response to that is one about the timing of negotiations when you are negotiating for continued provision of meters and what that means for your bargaining power. If you come to negotiate to provide meters to customers before any meters are on the wall, at that stage, and before you have sunk any costs, you are, in our submission, in a much stronger position bargaining wise than if you have to try to negotiate terms only afterwards, after the meter has been placed on the wall and the costs of installing it have been sunk.

Our point is that the conditions of competition and the competitive constraints that you are under when you are bargaining in that latter position are different. You are in a more exposed position because you are trying to negotiate when you have sunk the costs and you can be held to ransom. That is why one reason why our case is that table 4 in the Decision which reports these very high market shares is misleading.

I must just emphasise that our much bigger point about all of this is that even if you declare that National Grid had a 100 per cent market share because it owns all of these Legacy meters, this is not the sort of case where you can infer from that, as Ofgem does, that National Grid has market power. In many cases, as you know, where you find a firm that has very high market shares is valuable because it indicates that that firm is likely to be able to increase its prices profitably without sufficient competitive constraints. In the circumstances of our case, National Grid says that this very high market share of the installed base does not mean that National Grid was able to raise its prices in that way. Very briefly, it could not increase the prices of the installed meters to anti-competitive levels because there are the price caps which apply. It could not force gas suppliers to deal on unfair terms because they have regulated P&M terms there.

Thirdly, and coming back to this market definition issue, National Grid had to bargain from a position where it had already made these customer specific investments in the meters. So the installed base was highly exposed to being ripped out without compensation as fast as was feasible in the circumstances. Our main point is to just draw attention to the difference between that situation and the situation where people in advance, as in a tendering situation, are bargaining with the gas suppliers for new and replacement meters, which has a different dynamic.

It is set out in the note and I do not want to take any more time up now about that.

Those are the notes.

THE CHAIRMAN: Just on the smart metering point – I am not sure whether this is going to turn out to be what has happened, but if it was the case that at the time that the decision was

taken it looked very unlikely that smart metering would happen in the foreseeable future, but it has since become apparent that it is more likely to be relevant over the next few years than was thought, what is the position of the Tribunal as regards taking into account those subsequent developments in our jurisdiction to consider the appeal against the Decision?

MR. TURNER: Can I answer that in two ways, first, as a matter of principle, and second as a matter of fact. As a matter of principle, we say the gas suppliers were entitled to make the contracts that they did and take the decisions that they did at that time, and that is the relevant point in time for you to look at when you are assessing this risk. Perhaps I went over the board papers rather quickly, but the gas suppliers each did think to themselves, "Well, in a realistic timeframe, imagine if new technology could be brought in, what would that do to costs?" Now, they did not know exactly, obviously, but what they did do was that they assessed the range of sensitivities and they made some quite strong assumptions, and then they compared that against what was on offer. We say that that was a competitive process, and the fact that a little bit further down the line you might suddenly find that unexpectedly a new product shows up does not alter the lawfulness and the competitive nature of the deal that was originally done, in the same way as if I make an arrangement for a mobile 'phone on a particular contract, and then suddenly I see that although I am bound to my contract, something better unexpectedly appears, I still have to comply with the payment completion arrangements in my own contract. That is the point of principle.

The point of fact - and it is partly covered by this note - is that nothing has happened to upset this analysis at all. There is a reference at the back of the agreed statement of facts to one development which is a little company called Utilitas, which is marketing something that is a smart meter, under particular conditions. It is marketing that to prepayment customers only in a particular region of the country, subject to a cancellation charge of about £150 if the customer does not want it any more. It is under those sorts of arrangements.

That is very far away from Ofgem's idea in the decision, which is that what National Grid did was to block a programme where gas suppliers would replace older meters as they became free to replace -- or very cheap to replace with smart meters because no-one ever thought that that would be the way that things would be done. Therefore, the gas suppliers' assessments were bang on then, and remain absolutely accurate now.

I am going to tackle abuse. There are two points, just before I get there, which are important to cover and which are both relevant to the central issues of foreclosure in the case. The first is - and I believe I did not cover this sufficiently yesterday - the implications of that

review of the gas suppliers' board papers. It struck me from one of the questions yesterday that I need to make this clear. The case against National Grid has been put as follows. National Grid did not compete in response to the new competition. It should have dropped its prices. That would have been competitive. Instead, National Grid reacted by trying to protect itself against the need to compete by negotiating these Legacy MSA contracts which included an objectionable structure of exit charges. By doing that it is said that gas suppliers and their consumers have been denied the fruits of competition - lower prices, improved customer service and the new technology. That is very crude, but I hope not an entirely inaccurate summary of the case against us. What the gas supplier documents illustrate is that that is fundamentally misconceived because the major gas suppliers all considered in those board papers -- They are thinking to themselves, "What are the magnitude of benefits that we can derive from arranging for CMOs to carry out an accelerated replacement programme of these installed meters at much lower prices?" The fruits of competition.

They have used sophisticated financial appraisals. They look at a range of sensitivities. National Grid, as those papers demonstrate, had to compete against those benefits. It had to beat them in what it gave to customers. You will recall, for example, in I think the first of those papers, the British Gas board paper saying that the cost savings from the reduced rentals which it would get under the Legacy deals were equivalent to a complete wholesale replacement of the entire Legacy stock in under seven years. British Gas then compares that with what it could hope to achieve through, if you like, that other vision of competition - the accelerated replacement. We had to beat that.

If you have the BP bundle and go back to the BG board paper at Tab, p.18 -- This is a paper by their Chief Executive, Mr. Mark Clare. In the second paragraph under the heading 'Proposal' the Chief Executive says,

> "The contract will provide significant benefits in the early years when most of the meter stock is with Transco. Savings for the first full year are £X and the contract provides an NPV equivalent to an accelerated meter replacement programme of less than seven years. A seven-year replacement programme is not considered to be a realistic alternative option, given the impact that this would have on customers and operations. Ofgem are also likely to oppose it".

A little bit further down, in the third paragraph,

> "The attached chart shows the benefit of the proposed legacy deal compared to (a) a normal replacement programme, and (b) an accelerated programme replacing

Transco's meter stock over an eight year period (which we believe is the most aggressive exchange programme that could be delivered)."

I think that the chart in question you will find in the next tab at p.29. There is certainly a chart which does that. My copy is not perfectly distinct. You see the picture from this. It is entitled 'Meter Provision Costs to British Gas'. What you have in the thick black line at the top is the regulated P&M prices. Then there is a dotted line - normal replacement programme. Then a white line with triangles - accelerated replacement programmes. There you see them looking at the savings they get under the accelerated basis. At the bottom, very faintly, but much lower there, proposed Legacy deal. So, you see the sort of assessment that the company there is making for itself about the respective benefits of the Legacy deal and what I will call, if you like, 'the fruits of competition'.

This is why we say the negotiation was not a block, but it was an act of competition. It is why the Legacy agreements are the outcome of competition. These contracts delivered themselves the fruits of competition to customers and consumers. That is my first point. I think that is fundamental.

The second observation arising from the same thing is this: these gas supplier assessments are also relevant now to Ofgem's new argument that you should assess foreclosure (which we are coming to) on the basis of what they call the 'no PRC counterfactual'. That is because the gas suppliers compared the Legacy MSA deal against a 'no PRC counterfactual'. In every case, apart from the case of EDF who preferred to stay on the regulated terms, the gas suppliers conclude that the Legacy deal is better for them and better for their customers, and does not exclude competition and does not impair realistically new technology. That is the first area I wanted to cover.

THE CHAIRMAN: The Board minutes are dated November 2002, but it was some time later that the legacy agreements were actually concluded?

MR. TURNER: Yes.

THE CHAIRMAN: But are you saying there is no subsequent updating of this exercise?

MR. TURNER: I am not saying that because the Board papers cover a range of dates, you have seen some of them dated 2003, some of them 2004, the picture remains exactly the same. As a matter of fact, in that particular case I think that there is an updated table a little bit later on in the process, but giving the same sort of message at p.33. Here you have a later version, it seems of the same sort of thing. The main differences are that we have additional lines to reflect certain developments, but I do not believe that even this was the final outcome. What you see, for example, in the faint grey line is something entitled "Previous

proposed legacy deal" – it is hard to make out – but underneath that you then have something: "New proposed legacy deal" which is even lower. Now, that may reflect the fact that, as Mr. Avery points out, in the course of the negotiations the price came down. Then, as you know, there was this issue about business rates and the bottom line in the table with the black circle is entitled "New proposed legacy deal" including rates. You see that that comes up and is higher, but after that – as you also know – there was then a further deal done in which British Gas and National Grid split the difference, and I do not think that that final line is therefore reflected on this graph.

The essential point is that that is the way it was approached. That is how we see you should approach the issue.

PROFESSOR STONEMAN: Can I just ask you something about this figure "provision cost to British Gas"?

MR. TURNER: Yes, is that on p.29?

PROFESSOR STONEMAN: The one you took us to, 29. You have the P&M line, now is the normal replacement programme, the accelerated replacement programme, are those numbers based upon British Gas having P&M contracts? What happens to those two lines if British Gas are on the proposed legacy deal with the PRCs? What have we got here?

MR. TURNER: Absolutely. I believe that what you have said is correct, they were thinking to themselves if we enter into the legacy deal, forget the P&M terms that is the line marked "Proposed legacy deal" which runs at the bottom of the figure, showing the lower costs. The other lines represent accelerated, or a normal, a slower replacement pattern under conditions where you are still on the P&M terms, but you engage your CMOs to carry out replacement, and you make savings because they put in meters which are cheaper than the meters that are there at the time.

PROFESSOR STONEMAN: Yes, what I am trying to get at is whether there is a middle route here that would involve being on the legacy deal and actually claim the PRCs by taking on the CMOs? Or put it another way around the bottom line – is it assumed in the bottom line that everybody has these meters for 18 years and pays no PRC?

MR. TURNER: I am with you. Under the Legacy MSAs, as you know, there is the freedom for the gas supplies to engage CMOs, and a number of them, I cannot remember whether British Gas here is one of them, says to themselves: "We can take the legacy deal and we can also get CMOs to replace meters and put in cheaper meters, and get savings that way as well". Whether that happens to be factored into this line or not, that effect, I am afraid I cannot tell you. What I can say is that even if it does that might explain that they have fully

taken that into account and it helps to explain why it is so low. Even if it does not it is still far lower than the costs of proceeding in the other way.

PROFESSOR STONEMAN: Yes, but that must mean that these four lines here are costs for different age mix bundles of meters, so you are not comparing like with like, especially when you get to the end. If you have different age mix bundles of meters here, when you get to the end you have an inherited stock of a different set of ages, and therefore you cannot compare them.

MR. TURNER: Well I believe that you can and the gas suppliers all approached it in the same way and from their point of view they are approaching it entirely rationally and sensibly and, indeed reflecting what, from their point of view are the real economic savings to be made because they are interested in the across the board picture that comes out of all of this and under the legacy MSA deal you envisage the entire stock progressively being replaced over the period at the free rate, and you can put in cheaper meters as you go. The actual ages of the stock does not really come into that because that is not how the Legacy MSA works. Similarly, under the P&M contracts if you stay on that you can replace on whatever basis you like, but you only need to replace (and you only do replace) the policy meters which are not necessarily the old ones at all and the customer requested exchanges for your own reasons as well, so again there is no necessary relationship between the replacement pattern and the age of the stock.

PROFESSOR STONEMAN: Let us take then the accelerated or normal replacement programmes, so this is where you are buying your meters from CMOs and most of the CMOs are giving out contracts – is it a five year PRC? They have a five year length after which you pay a PRC – you have to pay a PRC ----

MR. TURNER: It is 20 years.

PROFESSOR STONEMAN: The CMOs is all 20 years, is it?

MR. TURNER: Yes, it is.

PROFESSOR STONEMAN: Ah, then I am mistaken.

MR. TURNER: My friends are probably going to take you to what those arrangements are but I can tell you right now it is a 20 year "lock-in" if you like, if I can use that term without being emotive, but the position is that there is a primary period and a secondary period, and the point is that they are, under their contracts, the exclusive meter providers for British Gas for that primary period, but the meters themselves have protection all the way.

PROFESSOR STONEMAN: Then the point becomes less relevant.

MR. TURNER: Okay. We can no doubt return to this, we will have a witness from British Gas here.

Only one other point relating to competitive entry and foreclosure before I dive into this. When you read the Decision, when anyone picks up that Decision and reads it cold you get the impression that the Legacy MSAs have substantially or completely blocked the market to CMOs just as it was open to competition. So we will need CB1. If you go in it, for example, to para.4.166, p.108 of the external numbering. What Ofgem is doing in this paragraph is responding to the point National Grid makes that actually you can replace large numbers of meters under the Legacy MSAs and the response of Ofgem as you will see from the end of this paragraph is:

> "In particular, the effect of the Legacy MSAs to inhibit suppliers from switching meters in the short and medium term, when competition with NG is nascent. The fact that it is possible for suppliers bound by the Legacy MSA to have switched a substantial number of meters by the end of 15 or 20 years is insufficient if by that stage competition has been stifled through earlier market foreclosure."

They put it quite strongly there, and at various points in the Decision, not there, they talk about preventing switching to CMOs. That expression – you find it, for example, in 4.1 right at the beginning of the abuse section – is not just emotive, it is inaccurate, because the Legacy MSAs do not prevent switching to CMOs. What they do is discourage or disincentivise the gas suppliers from engaging their CMOs, using the CMOs they have engaged, to replace more meters than the level envisaged by the glide path, as opposed to engaging them in the first place, switching to CMOs. It is a different thing. It is only about the volume of meters above a certain level, but not about the question whether you actually engage CMOs at all.

THE CHAIRMAN: It is a disincentive to replace the meter, whether to do so with a new National Grid meter or a new CMO meter.

MR. TURNER: That is right.

THE CHAIRMAN: The gas suppliers who have not engaged a CMO, they still risk going into the Take or Pay zone or incurring PRCs if they get National Grid to replace more than the free allowance of meters, even though one might have thought that it is in National Grid's interests for everyone to be churning their meters. I do not mean "churn" in the sense it is used here, but because it is more business for you, I suppose.

MR. TURNER: Whether you have a CMO contract or not, and it is easiest to think of British Gas which has the CMO arrangements, the point is that it is not disincentivising its gas suppliers

engaging CMOs, switching to CMOs, it is word play in a sense. You are absolutely right, what it does do is disincentivise the gas suppliers, because of the charge, from replacing more than a certain number of meters. I think it is important to get that straight when you are talking about foreclosure, particular because, as I mentioned yesterday, the Decision does not report the very rapid and substantial progress that has been made by British Gas's CMOs in the market, which is set out in our notice of appeal.

PROFESSOR STONEMAN: So you say it does not disincentivise CMOs from talking to British Gas?

MR. TURNER: Being engaged by British Gas.

PROFESSOR STONEMAN: Being engaged by British Gas. Might it not, because of the smaller size of the market, disincentivise people from setting up as CMOs, limiting entry to the market because the market is smaller than it might otherwise have been?

MR. TURNER: We have no evidence or investigation which supports that sort of proposition. There is a suggestion in the Decision, you are right, that this is a market where there are economies of scale, and so forth. If there is much more to go at it could be cheaper and you might be able to offer cheaper products.

As a very, very general level of principle, you might say that that is something that is worthy of investigation, but it is not something that is investigated in this case and there is not any actual evidence that people have ever thought to themselves, this makes it unprofitable for CMOs to be engaged. You will hear the contrary case. Naturally you will hear all sorts of grumbling as this goes on, but that is ----

THE CHAIRMAN: I know what this grumbling is about and they are right in a way. Yes, the point is that it is a smaller ----

MR. VAJDA: Madam, it is a pleasure when one's point is made just by grumbling!

THE CHAIRMAN: What is striking about all these board papers that you showed us is that nobody seems to say, "Well, we ought to sponsor this new entry by engaging the CMOs so that they continue to be there to exert a competitive pressure on National Grid". That does not seem to enter into it.

MR. TURNER: What they do say, and I can find the references, in some cases is, what about competition, and they note to themselves that the contracts allow the scope to bring on CMOs if they want to, and that would bring additional benefits. They all essentially take that for granted.

So then you get a question, if you were really going to investigate this seriously you would want to know, is the issue with economies of scale such that these contracts are really

closing things off for people? Not only has that not been investigated, you have got the evidence that it is not the case by the facts on the ground.

THE CHAIRMAN: We understand the point you are making and I am sure other people will have things to say about that.

MR. TURNER: Yes. I am reminded that I did not point this out yesterday, that there have been also certain further developments in the market. We talked yesterday about the stalling of tenders. You may not have picked up, if you have got CB2 there, tab 20, I think it is the last page in the whole bundle, the market development since the Authority's Decision. For completeness, you will see that with two of the major gas suppliers there have been certain further developments. Eon gave a formal notice of election under its MSA agreement that it wanted to carry out non-NG provision itself in certain respects. SSE has issued an election notice to appoint two commercial meter operators as from April 2009, OnStream and Scotia Gas networks, and that is against the background of the MSAs.

Mr. Holmes reminds me, of course, that in-house provision by these people is just as much competition as the CMO arranging for competition with National Grid metering as well.

THE CHAIRMAN: That was not included in that table you showed us yesterday.

MR. TURNER: That table in para.263 of the notice of appeal precedes these developments.

THE CHAIRMAN: What about in-house supply?

MR. TURNER: These two developments here are since that table.

THE CHAIRMAN: I understand.

PROFESSOR STONEMAN: You did tell us that nobody wanted to in-house supply because of the cost of owning meters is an unnecessary risk. Does that mean that situation has changed now?

MR. TURNER: I do not know further details about how this is being arranged than is presented here, I am afraid, sir. We might be able to find out.

The final point which has been put at me before I get on to abuse – give you some abuse! – is that Mr. Avery, and I will give you the reference at para.25 of his statement, when he is talking about British Gas's thinking when it decided to enter into the legacy agreements, and he said that they saw benefits in keeping three players in the market. They took the view at that time that that would be a healthy thing to do, and they said that the Legacy MSAs allowed them to do that.

Finally then, abuse: I would ask you to go to p.65 in the Decision. What I would like to do in a few minutes is just establish, because of its importance given the development of the argument, what is the structure, what is the logic of Ofgem's Decision. It is a decision

about abuse by means of foreclose of effective competition. As I said yesterday, Ofgem accepts in this case that competing for contracts with cancellation charges is consistent with normal competition in this industry. That is the way the competition can happen. It is not restrictive.

I referred to the defence. I think perhaps it may be a good idea also just to show you what their expert said from an economist's point of view. If you would take WS4 and go in it to big Tab 9, you have there the witness statement of Professor Paul Grout. On p.2138 at paras. 20 and 21

> "This raises the question of what features a rental contract might have in normal competition.
>
> I note first that it is a standard feature of many rental contracts for durable goods that they last for a specified minimum period, and that the customer has to pay some sort of termination fee in order to exit before the end of that period. The combination of the minimum rental period and the termination fee gives a degree of protection to the owner, who is otherwise exposed to the risk that part of his investment will be lost if the buyer chooses to rent from a different seller. This is particularly important where the owner incurs costs up-front which will be lost if the customer terminates the rental contract. This is clear in the case of DCMs, in respect of which the majority of the cost is installation costs and the meter itself has little or no re-use value".

That is Ofgem's expert talking about what is normal.

MR. VAJDA: If you could go back to para. 8 of Professor Grout's statement -----

THE CHAIRMAN: I think Mr. Turner should make progress on his submissions.

MR. TURNER: I am grateful. I do not mind grumbling, but otherwise I might not get through it.

MR. VAJDA: I am not asking the Tribunal to take up time. I am just drawing it to the Tribunal's attention.

MR. TURNER: So, returning then to the Decision, working on the basis of what Professor Grout says, and Ofgem accepts, if the Legacy MSA is a competitively-priced deal for renting a portfolio of these meters, and on the basis that its cancellation charges, by design, achieve payment completion -- They have been organised so that National Grid is simply no worse off if you do take the meters out earlier than committed to, what here is the problem? What is the source of the anti-competitive foreclosure in this case?

Paragraph 4.4 in the Decision tells us that it is not the MSAs in toto - it is two specific features of the Legacy MSA. (a) is the early replacement charging arrangements and the

structure of them, which is the Take or Pay arrangements and the PRC arrangements. (b) is the bundling of meter maintenance. By the way, I may as well say here in relation to the PRC arrangements that you know that the Decision consistently talks about the PRC arrangements as average arrangements. In fact, flat rate is the far more accurate term than average because you do not arrive at these PRCs by looking at the actual ages of the meter stock in any way and then taking an average figure - for example, based on an assumption that they are free to replace after, say, twenty years. The mechanism is described in the agreed -- this part is not agreed -- in the Statement of Facts at paras. 145 and 148. If you would just perhaps open CB2, Tab 20, para. 145 (which begins at p.56 of the manuscript numbering) -- I am not going to go through this detail now, but essentially if you skip to para. 148 what is said is, "Contrary to Ofgem's apparent belief, this approach does not start by taking PRC values for different ages of meters within the portfolio, and then 'averaging' across them. It proceeds on the basis that, under the agreed glidepath, there are equal numbers of meters removed in each remaining rental period over the contract term, and therefore also equal numbers of meters corresponding to each remaining rental period (in months). The PRCs set for each year are most aptly characterised as the 'payment completion' values for the relevant year, and **not** as an average of values for meters of different age".

In other words, if you like, rather than actual ages of these meters, what this assumes is contracted ages - and even that is a slightly misleading way of putting it - and that an equal number of meters is taken out every rental period over the full-term of the contract.

Paragraph (b) refers to the bundling of meter maintenance. I comment only that here it is said to add appreciably to the foreclosing effects of the first feature - the early replacement charges. Later on, as I said yesterday, and in the operative part of the Decision, this second feature is not considered to have an impact serious enough to be classified as objectionable by itself.

Paragraphs 4.6 to 4.34 are all about the legal test for abuse, including what is meant by the term 'foreclosure' in competition law. I will come back to that. There is then a short section on context. Ofgem then analyses foreclosure in a very long section, extending from 4.43 to 4.127. That is the entire section. The content is very important because it shows the integral nature of the comparison of the age basis and the PRCs, which is what Ofgem says can be taken as a benchmark - a useful counterfactual - for its assessment of foreclosure.

Beginning at 4.86 you get the extended discussion of the relevant counterfactual which is supported by a number of annexes at the end of the Decision. At the end of that - at 4.98,

4.99 and down to 4.101 - Ofgem finds that an age-based approach to PRCs would have given more scope for meter replacement to competitors than the structure which was used by National Grid. His comparison involves a number of steps: (1) Ofgem starts by assuming that it is realistic to think of the gas suppliers wanting to replace about half a million more credit meters, each of the first three years of the contract than the MSA free allowance of 980,000. That is 4.72 and 4.73 of the Decision. If you look at 4.73 (because I will return to that), that is said to be reasonable (to use the language of the Decision) in relation to the actual levels of replacement that BGT had contracted for ahead of its signing of the Legacy MSAs. After the first three years Ofgem assumes that the level of the replacements is cut back to what gas suppliers would expect to be the minimum number that they have to engage in to root out inaccurate and faulty meters and to carry out customer-requested exchanges.

The next thing Ofgem does is to work out what such a level of replacement of these additional meters would cost under the Legacy MSAs cold. That is paras. 4.74 to 4.78.

The third thing is that Ofgem applies that same replacement scenario - I am assuming 500,000 more meters a year for the first three years - to its aged-based counterfactual, under which all of the policy meters regarded as free to replace, any meter over 20 years old is free to replace, and you have a system of progressively increased charges for meters in between, for the younger meters, that is 4.86 to 4.98.

Now, what about the values for the age related PRCs, which Ofgem uses as its inputs? Ofgem says at 4.97, on p.89 of the external numbering:

> "These age-related PRCs are derived directly from NG's calculations of the averaged PRC level for 2004, although with an adjustment having been made to NG's avoidable cost assumptions to bring them in line with a more reasonable assessment of avoided costs."

If you see footnote 310 as well along the same lines at the bottom:

> " Again, this figure is calculated so as to achieve the same revenue as the MSA PRCs over the life of the meter."

What Ofgem then finds when it applies these charges and that structure to its replacement scenario is that the charges would be much lower for additional replacements, and that is 4.98 and 4.101. Its conclusion therefore is that the Legacy MSAs are more restrictive than this benchmark.

Then, beginning at 4.102 Ofgem turns from looking at the process, identifying the presence of the restriction to its practical effects, and it considers the impact of the foreclosing

activity it has found on competitors, customers and consumers, and the number of chunks. The grand conclusion is 4.127 on p.98 where Ofgem says:

> "For all of these reasons, the MSAs have the actual and likely effect of foreclosing competition within the relevant market."

Note here that it does refer to the problem as being that gas suppliers cannot switch to CMOs without incurring artificially high switching costs. As I said yesterday in opening remarks, this reference to the switching costs, or the associated economic incentives on the gas suppliers being objectionable because they are artificial is a repeated theme in the decision and with that you turn to the law. What is the test for abusive foreclosure? 4.6 in the Decision starts by referring to the classic case of *Hoffmann La Roche.* That case refers in the definition to "recourse to methods different from those which condition normal competition".

Pausing there, it may not be possible, as in this case we accept, to identify, if you like, a normal way of doing business based on past experience in competitive metering, because there has not been much, but you still have to have a benchmark for assessing whether some specified conduct is hindering effective competition. That is rightly taken for granted by Ofgem in the Decision. If you look at the facing page, 4.11, first sentence:

> "The CAT regards the relevant counterfactual to be a question of fact to be decided by reference to various interrelated facts and considerations."

So Ofgem correctly assumes here that the analysis of foreclosure does involve measuring this conduct against some counterfactual and it goes on to attempt to do that.

4.14 then gives a definition of the term "foreclosure" based on the European Commission's Staff discussion paper of December 2005. That has been superseded and we now have the Commission's published guidance from December 2008, and may I ask you to turn back to A6, tab 20. Paragraph 19 on p.8 sits under the heading: "Foreclosure leading to consumer harm ("anticompetitive foreclosure"):

> "The aim of the Commission's enforcement activity in relation to exclusionary conduct is to ensure that dominant undertakings do not impair effective competition by foreclosing their rivals in an anticompetitive way and thus having an adverse impact on consumer welfare, whether in the form of higher price levels than would have otherwise prevailed or in some other form such as limiting quality or reducing consumer choice. In this document the term "anticompetitive foreclosure" is used to describe a situation where effective access of actual or potential competitors to supplies or markets is hampered or eliminated as a result

of the conduct of the dominant undertaking whereby the dominant undertaking is likely to be in a position to profitably increase prices to the detriment of consumers."

Paragraph 20, which refers to the way the Commission approaches its work, says:

"The Commission will normally intervene under Article 82 where, on the basis of cogent and convincing evidence, the allegedly abusive conduct is likely to lead to anti-competitive foreclosure."

and it then goes into the factors it will generally take into account. What is of interest over the page in the last section above para.21 is that the Tribunal says half way into that:

"This assessment will usually be made by comparing the actual or likely future situation in the relevant market (with the dominant undertaking's conduct in place) with an appropriate counterfactual, such as the simple absence of the conduct in question or with another realistic alternative scenario having regard to established business practice."

That is the Commission's guidance. The crucial point is this: the need for a benchmark in an Article 82 foreclosure case is absolutely clear for any serious analysis. For example, take predatory pricing, to show predatory pricing where you cross the line it is not enough to point to low pricing by a dominant firm and say that that has hindered entry, which it might well have done, and higher pricing in the short term by the dominant firm would have led to more new entry which, in turn would have had all the benefits of greater dynamic competition and so on and so forth. Then you can assume consumer gains in the long run. The law establishes that anti-competitive foreclosure happens when there is pricing below some objective cost benchmark, not just pricing below some entrant-friendly higher prices. I say that while asking you to cast your minds back to the nature of some of the complaints you saw from the industry about National Grid's agreements when they were announced. In this very case Ofgem says that National Grid could perfectly normally and lawfully have dropped its rental prices for installed meters without any payment completion protection to meet competition from new entrants, it says "There you are that is normal competition". Consider this, if National Grid had dropped its prices of these installed assets, all their sunk costs, it would have killed off any competition from new entrants, resulted in no competitive market structure at all. National Grid then keeps a higher market share than it has done under the MSAs, possibly a monopoly and with the prospect of increasing its rentals again once the CMOs have given up.

What happened in the lay sense is total foreclosure. Ofgem says in its skeleton at para.99, "this would have been welcome" – welcome, because it would have reflected normal competition. It would not have been anti-competitive foreclosure. Our reaction to that is, that is a nonsense, that would be the destruction of the project of competitive metering altogether through this low pricing. That would have been, by any reasonable light, foreclosure. That would have been exactly what the industry had been complaining about in the early stages before this investigation was getting going, their fear. Yet Ofgem says that is welcome foreclosure. This points up the need for Ofgem to apply some benchmark against which to measure the supposedly objectionable charging structure in the Legacy MSAs as being anti-competitive foreclosure.

Our key proposition is this: that ultimately in a case where, like this, the allegation is that the particular structure of charges, the payment completion charges, is what is causing anti-competitive foreclosure. You need to establish what extent of replacement you would expect to find under some normal competitive conditions, such as, for example, where the meters are simply sold, the assets are simply sold with an up-front payment, and then you ask yourself whether this allegedly abusive conduct is materially blocking that replacement. This point is set out in our skeleton argument at para.31(h).

Based on that there are two essential questions for you to resolve, which I hope are reflected in that short hand-out I gave.

PROFESSOR STONEMAN: Just before you go on to that, para.31(h), is that the one that comes with the associated mathematical appendix?

MR. TURNER: I will check whether that is ----

PROFESSOR STONEMAN: In your skeleton. I would like to ask you if any of your expert witnesses are going to talk to that?

MR. TURNER: The answer to that question is that is based on a report and the opinion of Dr. Williams, and Dr. Williams can speak to those matters, yes.

PROFESSOR STONEMAN: That is all I wanted to know, because I have problems with it.

MR. TURNER: Absolutely.

As I was saying, you, therefore, in our submission, have two essential questions that you need to resolve. First, looking at the way Ofgem has done this, question number one, is an age base system of charges an appropriate benchmark at all in the circumstances of this case, given what you know about the context and the negotiations in the industry?

Question number two, has the comparison with an age base system of charges been meaningfully executed by Ofgem in the Decision or not?

I am going to have to speed up a little. The first question, is an age base system of charges an appropriate form of benchmark in the circumstances of this case? In the Decision itself, if you look at 4.89, Ofgem gives its reasons for having used this for its counterfactual. That is at the foot of p.86, and it says:

> "As they are the contractual form used by CMOs, UMS and NG in the N/R MSAs, age-related PRC arrangements are a useful counterfactual against which to compare the effects of the Legacy MSAs on the development of competition."

It goes on in that paragraph to say that they do not necessarily represent the benchmark for normal competition for reasons which have been given in the supplemental statement of objections concerning National Grid's dominance.

I need just to chase that down. Would you pick up PD2, which has the supplemental statement of objections and turn to tab 31, p.1130 of the external numbering. You have at the foot of that page the paragraph that they are talking about as their reason, 5.9. The reasoning really picks up in the second sentence:

> "When the CMO contracts were negotiated and agreed the CMO's contract terms were affected in important respects by the behaviour of NG in negotiating and concluding the MSAs. The Authority therefore thinks it is not correct to assume that other CMO's practices represent good evidence of a 'normal' method of competition in the domestic gas metering market."

That is a mistake. The CMO contracts with British Gas are all in similar form. The Meter Fit contract was actually concluded in May 2002, which is apparent from the time line on p.20 of the Decision, when the Legacy MSA negotiations were only just starting and the Legacy MSAs were a twinkle in the eye. So that qualification by Ofgem falls away.

The justification from an economist's point of view, Ofgem's economist, for why age base charges you would expect in normal competition to arise for the installed Legacy meters appears in their expert, Professor Grout's evidence. For reasons of time perhaps we will come back to this, but it is paras.22-26 of his report, WS4, tab 9. What he says in particular is that National Grid could be expected to want to put in place charges that make it more attractive to replace the older assets first because those are going to be less valuable than the younger assets – in other words, you are using the structure of these exit charges as a sort of estate management tool by the meter provider, National Grid.

Our case is that what is being overlooked in that economic point of view is all the other legitimate considerations that went into the decision to use these flat rate PRCs that declined progressively every year down to zero. You have seen those in particular from the slide

presentation we looked at yesterday. They are summarised in paras.22 and 23 of our reply, which we also looked at earlier. Essentially they include the high transaction costs that were perceived of an age base system and significant numbers of old meters with unknown ages.

Pausing there, these high transaction costs, that has to be a salient feature when you are assessing what is an appropriate form of charging. They also refer to there being under the legacy arrangements perceived greater flexibility for meter operators to take out meters in the same area with no charges applying, even though those meters might be of varying ages, because meters together may well not be all of the same age.

Lastly, they refer to the fact, which you will see reflected in gas suppliers' and particularly British Gas's papers as well, of stable and predictable volumes of free removals every year achieved by this structure which British Gas in particular said it wanted for its CMOs.

On top of that, and still thinking about Professor Grout's rationale, the legacy agreements also do include a means for National Grid to root out the non-valuable meters, the inaccurate policy meters, by steering gas suppliers specifically to replace these out of a wide pool. Policy meters are nominated of course on a big pool on the replacement schedule, and then you have to replace those to keep the stock healthy.

At British Gas' request there was also included in the structure the Take or Pay or below-line rental band as a tolerance device so that instead of incurring full whack PRCs, if you happen to go above the glidepath in a particular year you can pay lower amounts based on a yearly rental for those meters. For the record - and we will come to it - Dr. Williams grapples with Professor Grout's economic opinion on normality here in his second report at paras. 120 to 125 (which you will be reading before he gives evidence).

My summary: Given the unique circumstances of the negotiation over the terms of continued provision of 20 million installed Legacy meters in one go, there was no compelling practical, and no compelling economic reason, to use a system of age-based PRCs. National Grid's system was hammered out in discussions with the major customer, British Gas in particular, and it was fully responsive to British Gas 'asks'. It was natural. It was unobjectionable.

Having said that, is there some other obvious benchmark in this sort of case when you, the Tribunal, are assessing whether National Grid's charges and the Legacy MSAs have crossed over a line and have caused anti-competitive foreclosure? In fact, we say there is such a benchmark and Professor Grout himself pointed it up in his report -- Perhaps on this one if you would pick up Grout again in WS4, Tab 9, p.2135. What he says at para. 10 is,

> "The most common, and perhaps the most obvious, way of paying for products which share many of the characteristics of meters is sale by way of an upfront payment. This is the standard payment arrangement for comparable items of similar cost, such as radios, and for other items with high installation costs, such as in-built washing machines or dishwashers, even though the cost of purchasing these items is significantly higher than the cost of a DCM or even a PPM".

Then, at para. 13 he says,

> "In principle, I therefore consider that, following the separation of gas meter and maintenance payments from transportation charges and the opening up of the meter market to competition, it would have been consistent with 'normal competition' for National Grid to sell the meters to gas suppliers for a one-off payment".

We entirely agree with that. Selling assets cannot be foreclosing regardless of whether, in economic terms, dis-incentivises you then going forward from taking a slightly cheaper asset in the future.

So, we agree with that, but please consider the implications. The replacement incentives that gas suppliers would have had if they bought the meters for a one-off payment would have been consistent with normal competition. So, now we are entering the territory of this annexe. We say that that gives you a clear benchmark. In the case of sale you have committed to pay for the meters with their sunk costs, and you are only going to replace them if the additional benefit of a new meter outweighs all the costs of outlay on the new meter. In the case of a rental under terms where you have got payment completion, you equally commit to pay for the meter if it is replaced early. We say the position is exactly the same. You have not already paid it. You have simply committed to pay it for the future time. You have got the same incentives to replace the installed meter with a new one.

So, then, the question is, now coming back to what National Grid did, would you expect National Grid's charging structure in the Legacy agreements to result in some smaller level of replacement than in that kind of normal situation? We have one significant point to make about that, which is that you would expect the opposite to be the case here because the Legacy MSA glidepath was not just arranged to allow enough replacement to recover the ordinary run of replacements that you would expect every year and to which Ofgem and the MMC limited the Capex allowance in the price control every year.

On top of all that, it provides for this substantial amount of freebies - the additional discretionary replacements to cover not just the customer-related exchanges (whatever you

want for that), but, as PowerGen said in one of the board papers we looked at yesterday, a whole tranche of fully working good meters on top for free, over and above the natural replacement cycle. Ofgem's estimate in the Decision (which I am happy to go with for present purposes) is of around 130,000 fully functioning credit meters every year on top of CREs.

The next question: Does the issue of the Take or Pay or below-line rental band in any way affect that conclusion that the Legacy MSA charging structure is not foreclosing? We say that it does not do so. If you pick up our skeleton I will try to take that as quickly as possible by reference to this. At paras. 73 and 74 of Tab 14 in CB2 -- We think what it boils down to is ultimately two points (p.37 of the skeleton). The first point is that the avoidable costs, which is the issue here, in relation to the credit meters are, in National Grid's own assessment, very small. Ofgem makes a half-hearted attempt to say, "No, you have got those wrong". The respective positions are set down there in writing, and I cannot go into them in detail now. Ultimately, we say it has not got a serious basis for its assertions to the contrary. It was not investigated by them. There is no reason to think that the absence of a deduction for avoidable costs when you are in this BLR band has any material impact on replacement incentives and no industry party has said, "Well, that materially impacts our incentives". By the way, it is, of course, National Grid's position that whether it is PRCs or you are in this band, either way, of course there is a dis-incentive as compared with it being free to replace. That is the first point.

The second point is set out at para. 74, particularly (b) and (c). That is to remind the Tribunal that the BLRs are part of an overall package under the Legacy agreements which provides for this generous level of free replacement including the working meters under the glidepath. Because it allows working meters to be replaced free of charge, if anything, you are talking about replacement above the benchmark level. We say that any effect - if there were an avoided costs additional disincentive effect to take into account, that is more than outweighed by this feature of the package which is that it gave such a large amount of replacement entirely for free each year.

Now, with the Tribunal's permission I am going to leave there the question of whether Ofgem was tilting at the right counterfactual, the right benchmark at all, and turn to the question, which is also important, of whether they did it right. Was the age-related counterfactual meaningfully executed by them in this Decision? There are two aspects to this: (1) the credibility, the solidity of its replacement scenario, assuming that the gas suppliers would have wanted to replace half a million more meters in aggregate every year

for the first three years; (2) the execution of the age-related counterfactual which they then apply to their replacement scenario. The replacement scenario is, as I mentioned a bit earlier referred to at para. 4.73 of the Decision at p.83. Essentially you ask yourself why is Ofgem saying that we should be looking at a situation where the gas suppliers are wanting to replace more than half a million or more meters additional to the glidepath every year for the first three years of the contract, 2004, 2005, 2006, where does that come from? What they say is that these scenarios are reasonable in relation to the **actual** (emphasised) levels of replacement that BGT had contracted for ahead of its signing for the Legacy MSAs. So what they are saying is that before the Legacy MSAs trample over this with their muddy boots that is what British Gas was envisaging its CMOs were going to be doing. This turns out to be a false statement. If you turn to CB2 tab 8 you have National Grid's supplemental submissions when we finally got to the bottom of this and were permitted to put in submissions to address it, at tab 8, p. 741, the relevant paragraphs are 25 to 41. I will ask you to read them for yourselves later. The essential point is this: at para. 27 we set out that extract from the decision, at 28 we say we then discover that these alleged reductions in volumes were not based on information about the actual levels of replacement BGT had contracted for at all, but on certain estimates by Ofgem and nothing else. We go on to say that those estimates were completely flawed, and it is para. 29 that the actual evidence available to Ofgem in fact shows that the reduction in volumes for the two independent CMOs, in Ofgem's eyes the relevant CMOs in relation to the finding of abuse, amounted to a very small number, undermining the proposition that the 50 to 65 per cent is conservative. We then go on in the subsequent paragraphs to address that. The only point I will mention briefly is that if you go over the page to p.16 and look at one of the CMOs, Meterfit, you actually find that the MSAs where Ofgem had assumed the yellow highlighted reduction mentioned in para.36, was completely wrong; based on the information in the file we showed that Meterfit's volumes actually went up year on year and that will be a matter we can go into when my friends speak.

MR. RANDOLPH: Yes.

MR. TURNER: But you will see in any event that the basis for what Ofgem take for their replacement scenario is, on our case, flawed and wrong.

THE CHAIRMAN: But nonetheless we have the evidence of Mr. Lewis and Mr. Neil Williams, and perhaps Mr. Southgate, as to the negotiations over the reduction in volumes.

MR. TURNER: Yes.

THE CHAIRMAN: And as far as I am aware you are not planning to cross-examine those witnesses?

MR. TURNER: Yes.

THE CHAIRMAN: So if we are to take the evidence of those witnesses in the absence of cross-examination as accepted by you, your submissions on this volume point need to take that into account.

MR. TURNER: I am grateful for that indication. Madam, would you mind giving me the precise references, maybe not now, that you are referring to. I will make only one comment at the moment which is for our part we have the two British Gas people giving evidence for National Grid now, Mr. Avery and Mr. James, who also give evidence on the those particular issues and they are, of course, being cross-examined.

THE CHAIRMAN: Yes, but Mr. James was the boss of Mr. Lewis and Mr. Williams, and Mr. Avery was Mr. James's boss as far as I understand it?

MR. TURNER: Yes.

THE CHAIRMAN: So you have two of the team batting for you, but two of the more junior members of the team are batting for CML?

MR. TURNER: Well let us see what they say. I will need to go back to their statements, but – and I will be corrected if I am wrong about this – I do not believe that they say that the Meterfit volumes for a start dropped as a result of the renegotiation.

MR. RANDOLPH: They did not, but Paul King does. I am slightly concerned about the fact that Mr. Turner has said as a statement or assertion that volumes actually went up. There is a major debate on that issue. I have noted in passing from one of Mr. Turner's many notes this morning, that this issue is again dealt with as an issue of admissibility, so I do not want the Tribunal to think that this is just a matter that can go forward without more, there is also the point not only that relates to CML but also with regard to Meterfit following on from your question with regard to non-examination of witnesses because of course Mr. King says quite clearly that volumes went down.

MR. TURNER: Well we will deal with what Mr. King says in context. That is actually a good example of a case where we have the documents which actually show exactly what has happened, and Mr. King, if anything gives his opinion on the motivations for certain changes that took place.

THE CHAIRMAN: Well I do not want to get into this now but I just want to point out the relevance of the evidence. I am very far from suggesting that you should cross-examine

more people than you have already said that you want to, but you need to make sure that your submissions are not inconsistent with the stance that you have taken as to the evidence.

MR. TURNER: That is a point very well taken, madam, we will check that. I say now, only for the record, that we do not believe that what I have just said, and our position, for example, in relation to Meterfit and, indeed, CML is inconsistent with that evidence, but we will look at that.

PROFESSOR STONEMAN: Can I just ask for a point of clarification? It seems to me that the argument you are making is that the introduction of the MSAs did not affect CMO volumes, is that correct?

MR. TURNER: We say that they did not lead to a reduction in the volume for Meterfit, these people who are actually there, we say that there is no obvious reason for thinking that they led to a reduction in the volume finally made available to CML. CML had its contract finally struck in December ----

PROFESSOR STONEMAN: There is no need for the details, just the main point.

MR. TURNER: Okay, that is the point as regards those independent CMOs in the market, but on the more general level of principle I am happy to accept for National Grid that contracts which contain payment completion charges, exit charges as opposed to the P&M style no notice agreements may be expected generally to lead to lower levels of replacement.

PROFESSOR STONEMAN: Because it seemed to me in many ways that National Grid did a very bad deal, they gave away lower prices and they did not get any increases in quantity, you are saying, and so you are a great deal worse off than if you had stuck with P&M contracts in the first place.

MR. TURNER: The way that matters may have turned out and whether it turned out commercially to be a bad deal for National Grid is one thing, the issue that the Tribunal is concerned with is effects on competition and the market; you may reach your own conclusions about the commercial merits of the deal.

THE CHAIRMAN: Mr. Turner, we are now half way through the morning session, is that a convenient moment just to have a short break?

MR. TURNER: It is, madam.

(Short break)

MR. TURNER: Madam, with a fair wind I am going to do this, I think. Nonetheless, two further points of clarification have been helpfully drawn to my attention before I continue. The first is, we believe it is the case in relation to that British Gas table that the low bottom line proposed Legacy MSA deal did factor in that British Gas had CMOs which it would be

using to replace meters which were cheaper than the installed meters. So that was included in the effects.

Secondly, madam, on the issue that we were discussing before the adjournment, to clarify, although we will look at those passages, our case is that the precise extent of an impact on these individual CMOs is ultimately irrelevant or of very tangential relevance. We are picking up on the remarks which you made at one of the earlier CMCs about this, which I remember all my friends violently agreeing at the time, going into what caused any particular change in their arrangements, what factors led to changes in volumes is a satellite area which raises all kinds of considerations. At the level of principle you have our position that the inclusion of exit charges as opposed to there not being any may be expected to have an effect in leading to less replacement in the market than would otherwise occur.

The reason I was mentioning it in this context is for this reason only: Ofgem, for its age-related counterfactual, has these replacement scenarios. It tells us what they are based on. We are following that through to show that it was not based on anything solid.

I return then to the question of the execution of this age-related counterfactual in the decision and the construction of the age-based system of PRCs under it. The Decision purports to give what I am going to call 'a revenue-neutral' construction of its age-related counterfactual. If you have open the Decision, we have already looked at 4.97 where they say that the age-related PRCs are derived directly from National Grid's calculations for the Legacy MSAs and Footnote 310 where they refer to the figures being calculated to achieve the same revenue as the MSA PRCs over the lives of the meters.

But, then, if you go forward to paras. 4.160 and 4.161 on p.106 the matter is further addressed by Ofgem. Paragraph 4.160 says,

> "Figure 12 [on the facing page] shows the age distribution of National Grid meters and plots an age-related PRC over twenty years. That is the one which is used in the counterfactual. By averaging the PRCs instead of using age-related PRCs as National Grid does in the NR contracts and as the CMOs do, National Grid increases the level of early replacement charges that suppliers would pay on removal of any of the pool of relatively old meters compared with the use of equivalent age-related charges".

So, there again, implicitly it looks as though they think that we have taken the ages and done an average which we have not. It then goes on at para. 4.161,

> "The use of age-related charges that in some are equivalent to the PRCs in the MSAs does not, as with the PRCs themselves, properly reflect customer-specific

> sunk costs or take into account properly avoided costs. This approach shows that even with a revenue-neutral construction of an age-related PRC there is a less restrictive counterfactual arrangement and thus demonstrates that National Grid has not adopted proportionate measures".

There is then a qualification about the entitlement to get some particular amount of revenue. It appears to us clear from this that they are saying that Ofgem believes it has arrived at a revenue-neutral construction with its age-related PRCs. When it says in the second sentence of para. 4.161, "This approach shows that even with a revenue-neutral construction --" it is talking about what it has just been discussing, which is its age-related counterfactual and the structure of charges there in Figure 12. It cannot be anything else.

Finally, if you pick up the supplemental statement of objections, you see quite clearly that this was their thinking in PD2, Tab 31, at p.1110. At para. 4.45,

> "As the PRCs under the Legacy MSA are higher for a significant number of meters, this suggests that National Grid could have structured the premature replacement arrangements in ways that were likely to enable them to recover the same revenues but were less restrictive of competition".

It seems to us absolutely clear from the Decision itself that they have continued with that line of reasoning. In the Decision that is what they think that they have done. This is important because of the very recent *volte face* executed on this question by Ofgem since the time of its defence. If you go to Tab 3 in CB1 you have the defence. At p.613 you find para. 364. Ofgem's defence says,

> "The PRCs used in the counterfactual are derived from National Grid's calculations of the averaged PRC level for 2004".

[It refers to 4.97. Then this, which has been withdrawn,

> "If National Grid were to charge the same amount of rental as it does under the Legacy MSA, it would therefore recover roughly the same amount under the counterfactual as under the Legacy MSA. The whole point of the counterfactual is to show that, even with a revenue-neutral approach, there is a less restrictive counterfactual [Decision 4.161]".

Now, that has been withdrawn because it has been recognised by Ofgem in correspondence, quite fairly, that it is not right. But, for the reasons I have given, that is the reasoning in the Decision - para. 4.161 and the other references. Why does it matter? Revenue neutrality is essential if Ofgem is going to prove that it is the structure of the charges which is restrictive - not just the fact that Ofgem is covertly making available larger numbers of free

discretionary meters. But, on inspection it turns out that that is exactly what is going on. If you open the Notice of Appeal at Tab 2, I would invite you to turn to p.485 (of the external numbering, within Annex 5), near the back. (After a pause): You have graphs here. Those plot the Legacy MSA -- There is the straight line in blue for the Legacy MSA replacement profile. Anything under that blue line is free to replace. What has been done in red is to take the Ofgem age-related counterfactual, assuming that policy meters are free to replace, assuming faulty meters are free to replace, assuming meters over twenty years old are free to replace. It plots the red line to show you for each year of the contract, under Ofgem's counterfactual, how many meters are committed to and how many are free to replace. What you can see is that Ofgem's approach is simply committing the gas supplier right from the start to renting fewer meters over the term and makes available many more free meters every year to replace. The graph underneath has a slightly bigger drooping belly and the reason for that is because Ofgem have also said that customer-requested exchanges have to be paid for. So, those are going to be paid through the nose by the gas supplier, but they are not treated as discretionary replacements. But, nonetheless, they are within the overall level of replacements that take place and if you take that into account you just get a slightly -- perhaps it is the scale of the graph, but you get a larger effect. Either way, what you see is lower numbers of meters actually contracted for year on year.

Now, another way of getting at this point accessibly is if you turn back to Table 8 in the Decision - CB1, Tab 1, p.89. There we have Ofgem's PRCs which it says it has extracted from the Legacy MSA Agreement, and in the third column it has the actual number of Legacy meters, as opposed to an even number assumed to be replaced free every year under the Legacy Agreement, which are over 20 years as a matter of physical fact in any year. Take, for example, year one, we know that the Legacy MSA makes available 980,000 credit meters each year, so that is the Legacy Agreement. This age related counterfactual in year one is giving you 821,000 free older meters straight away, that is the first thing. You have then got to add to that the number of free younger meters under Ofgem's scenario, and just go back a page to table 7, where what they have looked at is the number of free meters under their approach which are less than 20 years old. They have split it for the first three years of the contract into policy replacement maintenance and customer requested exchanges to see the overall numbers which would be either free to replace entirely or just need to be paid for as non-discretionary in customer requested exchanges under Ofgem's approach. It adds up over three years to about 2 million – exclude CREs for simplicity, it is 1.5 million over three years, about 0.5 million a year. Add 0.5 million of the younger free

meters to the 821,000, which are the older free meters, and that gives you, excluding the CREs, about 1.3 million for the comparison for the first year. If you add in the CREs, which Ofgem also treats as compulsory but which have to be paid for, Ofgem allows for almost 1.5 million replacements as against the glidepath number in each case, which is 980,000.

THE CHAIRMAN: Because table7 is a three year total, so you have to add one third of that on to the 821,000?

MR. TURNER: Yes, so 821,000 plus 500 I am corrected is about 1.3 million, and you play that against the 980,000 under the Legacy MSA. So when you are doing this sort of thing it is not surprising, and it is uninformative that Ofgem finds its counterfactual – hey presto – makes it cheaper to replace addition discretionary meters beyond the glidepath allowance. Ofgem's response to this is in its skeleton argument at paras. 116 to 118 if you would turn to that, it is on p.40 (947 of the bundle numbering). At para.116 Ofgem begins:

> "116. NG criticises the age-related counterfactual on the grounds that it is not revenue neutral. As NG recognises, this is principally because of the treatment of policy replacements, which are free under the age-related counterfactual, whereas they come out of the glidepath allowance in the Legacy MSAs."

Pausing there, we do not say that at all. It is not because of the policy replacements alone or mainly or principally, it is the overall effect. Ofgem then goes on in the rest of para. 116 to say that you could achieve revenue neutrality by doing something which we say is illegitimate, which is that you make the so-called non-discretionary replacements – very expensive – and you then have the option to make the additional optional replacements, the discretionary ones very cheap. But, what you do then, is to force gas supplies, if you think about it from their point of view, to enter into a completely different sort of contract from the Legacy MSAs at all, and one which is completely contrary by the way to what British Gas said it wanted to achieve in these negotiations, which I showed you at the outset, where they essentially have to pay through the nose – huge amounts of money – by way of PRCs for certain non-discretionary replacements. You could do it that way, but that is really comparing apples with pears.

In para. 118 Ofgem reports National Grid's point that if you want to make replacements cheaper in the first few years of the contract or overall, you do not have to substitute age-based PRCs for the Legacy MSA glidepath at all. All you have to do is to have a shortened glidepath, or change its slope, just take a glidepath approach and make it go down sharply in the first three years and then level off. Then they say Ofgem itself actually suggested using

a shorter glidepath. A shorter glidepath, they say here, rather than a change to the structure, this offensive structure, would not have restricted competition; that is what they say at the end of 118 – "also not restrictive and therefore not abusive." They say the only reason why they did not do that as their counterfactual – let us have a look at their reason: the reason the Authority has not put it forward as a counterfactual is:

> "the reason that the Authority has not put it forward as a counterfactual is that the Authority has grounded its counterfactuals in what is seen in the real world."

So in other words, Ofgem has lost any anchor of what is the benchmark for anticompetitive foreclosure by this paragraph. Its position is that lower rental commitments from the gas suppliers via an adjusted glidepath is less restrictive than the higher rental commitments with a longer or higher glidepath. Yes, that is right, in the same way that higher prices are less restrictive than lower prices. But, at the same time, Ofgem accepts expressly – if we go back to para.113: "This is not an excessive pricing case."

I could go on about this for a long time but you will hear more about it. I will conclude on that by saying that Ofgem's case on foreclosure developed in the Decision as a whole is not coherent and, for all those reasons, it fails. That deals with the Decision on foreclosure.

It brings us to the so-called "No PRC counterfactual" which has come to the fore; the announcement in the defence that this counterfactual in the Decision was only ever the alternative and that Ofgem relies on its no PRC counterfactual in the Decision.

Pausing there, this description was odd, and I refer you to the reference in our reply and I think the document is at CR2 158A, where Ofgem's legal adviser, when the parties were thinking about a list of issues for this case actually wrote to National Grid objecting to us including this as an issue in the case, with the words: "The Decision does not compare the legacy MSAs to a no-PRC alternative". Their legal adviser says that to us. Nonetheless the defence, and now the skeleton puts forward this case that the use of any payment of completion arrangements and any PRCs in the long-term rental contracts should be treated as restricting competition. Based on that idea Ofgem fastens on the regulatory P&M contracts, which do not have any PRCs, and it says that those represent the appropriate counterfactual for assessing whether there has been abusive foreclosure. I have made lots of the points about this already so I can be very short.

Number one, you cannot prove that a particular structure of PRCs is abusive by pointing to the fact that the allegedly dominant firm has got the option of doing nothing, i.e. remaining on the P&M terms, any more than you can prove, for example, that a particular rebate structure adopted by a dominant firm is abusive by saying it need not have had any rebates

at all. Similarly, you cannot prove that price cutting is abusive by saying the dominant firm had the option of not cutting its prices, because that is more entrant friendly and less restrictive of competition. You have to identify the norm which the dominant firm has to observe. Where is the point when the line is crossed? We say that once you accept that there is not anything in itself abnormal about early replacement charges, the only issue remaining on Ofgem's case is whether the structure of the PRCs was abusive, which is the focus of the Decision.

This new argument that National Grid could have just had no payment completion terms at all, which it might have done, is entirely beside the point. The no PRC counterfactual, apart from anything else, is irrelevant, because PRCs in themselves are not anti-competitive or restrictive. In any event, this comparison that is made would not avail Ofgem at all in showing that the structure of charges was abusive. Under this no PRC counterfactual you would have what Ofgem's own representatives, or some of them, a voice within Ofgem, recognise would be inefficient and artificial levels of replacement activity, we say are actually obviously excessive.

As all the parties expected in the negotiations, the most likely practical alternative to reaching a deal on the Legacy MSAs was certainly that everyone would remain on these no notice terms. That would have entailed National Grid continuing to charge, because it maximised its value, at the high price cap levels and the gas suppliers responding by taking out meters quickly to maximise their value. I said at the outset today that the gas suppliers weighed up those alternatives, those options, themselves. They are placed at the hub of competition in this new competitive metering market. They saw not only the big benefits for themselves which could be expected to be passed through, the price benefits, they thought about disruption to customers, they thought about competition, they decided that the rate of replacement envisaged by the Legacy MSAs left them and their customers better off by any reasonable lights. We have seen that.

I turn then to the effects, the part of the Decision which, having dealt with foreclosure, says, "and actually it caused a lot of harm, harm to consumers, harm to customers". It falls into three main segments beginning at 4.102, if we return to the Decision, p.90. In this first section, which is entitled "The actual impact on competition of the costs of switching", what Ofgem is doing is examining the impact of the Legacy MSAs on the three British Gas CMOs: CML, Meter Fit and UMS, and it looks at each of them in turn. In each case, what it finds is that British Gas reacted to the MSA by dropping the volumes of work that it was

prepared to make available so that it would not go over the glide path. It says it has actually foreclosed competition, this contract.

Next, at para.4.111 and following under the heading "The Legacy MSAs deprived customers of the benefits of competition", you have a price comparison which is carried out by Ofgem. What this does is to compare the prices of individual meters under the Legacy MSAs and under British Gas's contracts with the CMOs. Ofgem finds the legacy prices are higher and it concludes this has harmed the interests of customers and consumers.

The third stage begins at 4.120 on p.96. It is entitled "Restrictions in meter replacements do not benefit customers". Ofgem here refers to two matters of principle concerning the interests of customers. It says at 4.120 that the MSAs are a way in which National Grid and not gas suppliers have decided on, dictated, the rate of replacement of installed meters. Dominant firms should not dictate the rate of replacement, it should be for competition and customers to decide that.

At 4.122, there is an eyebrow raising paragraph, the proposition being that if gas suppliers choose to replace a significant number of meters before they reach the end of their operating life, this decision would not be inefficient or wasteful in any meaningful sense. This is because the mantra of the dynamic benefits that would be brought.

Finally, fourth, over the page, 4.123 and following, under "Product innovation", Ofgem now finds that "artificially high" – the words used in 4.123 – switching costs are likely to have distorted gas suppliers' incentives to upgrade meters.

You see, if you go to p.98, footnote 336, an important footnote:

> "For the avoidance of doubt, as the preceding paragraphs illustrate, it was entirely predictable at the time of entering into the MSAs that the ability to introduce new technology would be impeded."

I can take each of these briefly in turn, and I have handed up notes on two of them.

Impact on the CMOs: madam, as you indicated at the September CMC, we accept the point that the precise impact on these CMOs' volumes of business with British Gas are a matter of tangential relevance at best. Our key points as far as we see them are, number one, I have said already that we accept the general principle that under the P&M terms its likely that there would have been more replacement of meters by gas suppliers.

Number two, we do not accept that under the age based structure of PRCs, a properly construed age base structure, it is likely that there would have been any more replacement of meters by gas suppliers and Ofgem counterfactuals, certainly for the reasons I have given about its flaws, do not show that.

Number three, if it should be necessary to debate in this court the precise effects on each of CML and Meter Fit of the coming on to the scene of the legacy agreements, we say, as I have said, that the hard evidence bears out no impact on Meter Fit whose volumes are not reduced and no obvious impact on CML either. All the effects, because there were effects – we accept that – were focused on UMS, the National Grid entity, where there was a significant reduction in the volumes that it had as a result of the re-negotiation of its contract with British Gas.

That is all I want to say about this part of the Decision which focuses on the precise impact on these CMOs and the causes of it.

The price comparison which began at 4.111 and following: that is dealt with in our supplemental submissions and I will merely give you the references. Those are at CB2, tabs 8 and 10A. Our overriding point is that Ofgem has swung a large red herring across the still waters of the court - in short, because they fail to take into account the price reductions via the MSAs on the basis that any businessman would do, which is the across-the-board savings from which the gas suppliers and the gas consumers benefit. That is the appropriate basis to consider the benefits of the act of competition that led to the MSAs and the price reductions in them.

THE CHAIRMAN: You are saying then that a businessman would take into account the fact that the reduction goes across the whole of the Legacy meter base rather than relates just to the new meters that are installed. But, how is that consistent with your argument that having the Legacy meter base does not give you an advantage in getting the new business?

MR. TURNER: If being able to reduce price is an advantage you are able to reduce price.

THE CHAIRMAN: You are able to spread the reduction. That is the sort of dominant firm's discount, is it not? It is a kind of loyalty thing - you spread the reduction over a much larger number of units.

MR. TURNER: One has to be careful. If you express it like that, it sounds as though we are gaining some economies of scale by spreading over a large base. It is not. For every unit, every single meter among the population that is subject to these agreements -- For every single one there is the same cost reduction. There is no spreading of fixed costs giving you economies of scale, or anything like that. All meters are reduced by the same equal amount across the board. So, the only advantage is that I am able to take a bigger hit -- I am able to drop my meters in price. It is not an economies of scale issue.

Effects on nascent competition. The frustration of dynamic efficiencies from being achieved. That is the third area. If you pick up our skeleton again in CB2, Tab 14 we

address that at para. 68. We see this as essentially linked to the thesis in the Decision, the reasoning which I have not fully addressed yet, that the first three years are the crucial years. Like a young plant, that is when the competition is embryonic and nascent, and it is particularly crucial then not for there to be any impediment to the CMOs because you need to get them going. That is why, in the paragraph we looked at earlier, Ofgem dismisses National Grid's point - although it accepts it - that you can switch out a very substantial number of meters under the MSAs over a longer term. It says, "Ah! But you have to focus, for the analysis, on the first three years". We make in response to that, at para. 69 of our skeleton, three short observations. At para. 69(a): no-one is suggesting, and Ofgem does not, that these CMOs were not able to establish viable businesses in the first three years, or that they have not gained a large chunk of the new and replacement work, however you define the market; (b) that in view of that, even if you had more cheap or free replacement opportunities in the first three years, why, you ask, is that going to lead to this stronger competition from everybody in the longer term than if, if the replacement profile is different, you have more replacement opportunities further down the line to take advantage of? It comes out in the wash. (c) is a point about, why are you assuming anyway that over twenty years of age you should necessarily draw the line and say that these meters become free to replace?

What Ofgem seems to suggest in the Decision, particularly at para. 4.166, is that competition needed a vigorous helping hand in the first three years and that its age-related counterfactual with what we say are its skewed charges helped achieve that. Our response is that we cannot see any basis for taking that as your logic for foreclosure.

The last point is the impact on innovation.

THE CHAIRMAN: I suppose that leads us to a question of whether, in its capacity as an enforcer of Article 82, Ofgem is properly influenced by considerations which in its capacity as regulator of the market and opener-up of this market to competition, factors which would be relevant to it in that latter capacity, whether those are also relevant, and it is the capacity in which it is before us in this case because one can quite see that as a regulator Ofgem would say, "Well, it is important when we decide what the structure of the market is going to be put in place, that competition is encouraged in the first three years". But, whether that is an appropriate way for it to approach its competition law enforcement role may be something we need to think about.

MR. TURNER: That is a very interesting point. It is a good point. We say, as a matter of principle, obviously for the competition enforcement rules one is not in the business of

entry assistance. It is a range of options open to even a dominant firm. It has those options available, but it is not the question of using the competition rules to promote some particular outcome.

However, secondly - and I would emphasise this - I have seen no basis for even assuming that in the first three years this kick-starting effect is somehow of particular value to the overall development of the competitive market.

THE CHAIRMAN: No. That was your first point.

MR. TURNER: Yes. I turn, then, to impact on innovation - the last leg of the foreclosure and abuse section. Ofgem's case, as you have seen, was entirely predictable - that the ability to introduce new technology would be impeded. That is at odds with the assessment of all the major gas suppliers which you have seen. In its case (if you have open paras. 4.123 to 4.126) there is actually very little relied on for this strong statement about 'it was entirely predictable'. In fact, there are only two things that are relied on: (1) in para. 4.124 is a comment from a BG official, Mr. Robin Beasley, which was out of line with the full detailed assessment of British Gas, which you have in the board paper, to which Mr. Avery also speaks in his witness statement. Paragraph 4.125 is relying on EDF and its perspective. But, even EDF did not regard the MSAs as impeding the introduction of new technology. I will not go back to it, but one of the board papers that we looked at yesterday was the EDF board paper (BP1, Tab 6). If you go back to the reference I went to then you will see that EDF itself said, "This is not going to harm new technology when they looked at it internally". But, moreover, and even more strongly, when EDF made a submission to Ofgem in this case -- Let us have a look at what it said at PD4, tab 82 at p.2353. We are now in a letter to Ofgem from EDF, when it has seen what Ofgem is doing. It is referring to what it calls the statement of Objections of 27th April 2007 (that is the supplemental statement of objections) and EDF is giving its views. At 2353 look first at paras. 16 and 17.

> "16. Ofgem refers in paragraph 3.72 [the SSO] to the "real risks" taken by the five major domestic gas suppliers in signing the MSAs, that they would be unable to respond to large scale increases in the demand for smart metering. EDF Energy considers that this assertion is unduly lenient. By singing these agreements, the five suppliers in question ensured substantial returns to their shareholders.
>
> 17. Furthermore, the assertion overstates the risk position of the suppliers in relation to smart metering. It was never likely that there would be large scale increases in demand, because the realistic expectation was that smart metering would only be

introduced gradually, and therefore the glidepath in the MSAs would have enabled the suppliers to respond to predicted demand."

Now, this comment as well everything else on the file does not make it into the Decision which finds that it was entirely predictable that smart metering would be impeded. While you are on that page you may have noticed higher up that this falls within a section entitled: "Absence of buyer power", where EDF actually takes issue with Ofgem as having mischaracterised the gas suppliers' lack of buyer power. If you read paras. 13 and 14 – take 14:

> "As Ofgem rightly finds in paragraph 3.73, NG was a "must deal" partner, due to its large installed base of meters. However, as paragraph 3.73 also finds, suppiers had a choice of remaining on the P&M contracts or signing the MSAs. Thus, although suppliers were unable to negotiate changes to the terms of the MSAs there was no inescapable or unavoidable compulsion on them to sign the MSAs. Ofgem has therefore over-stated the suppliers' lack of bargaining power."

My comment on that is that he is right in what he says about the balance of bargaining power. He is wrong in fact in what he says about suppliers negotiating changes to the terms of the MSAs. You have seen some of the evidence and we have set out in our submissions the concessions and the changes that British Gas in particular rung out of National Grid and they led the charge. National Grid's view was that once it had crystallised the form of the Legacy MSA contract that should be offered to all parties on an equal basis to avoid a non-discrimination problem. To the extent that that is what the author is referring to, that may be right, but beyond that the comment is misconceived.

THE CHAIRMAN: Were there negotiations with EDF about the Legacy MSA before they decided not to sign it?

MR. TURNER: Yes, you may remember, although I think some of the negotiations took place a little bit later than the others, that that very colourful document that I took you to from EDF was the one where they said "They have made us this offer …" – that was where I read out the figure that I should not have read out – ".. why are we rushing around, all risk sits with Transco; they are the ones who are feeling the pain", or words to that effect. They did consider it at that stage, yes and it was offered to them.

The next point is this, and I have foreshadowed it, the Legacy MSAs were, in fact, more congenial to smart meter replacement than the P&M contracts, and if you think about it you can see why. The no notice contracts which would have encouraged more replacement by the CMOs with their PRC arrangements (very high PRCs in the first years and extending

over a 20 year period) would have meant replacing over the first three years, that is up until 2006, dumb meters with cheaper dumb meters, subject to these very high PRC protections. So if smart meters then turn up on the horizon the gas suppliers are actually worse off in being able to put in the new technology than they are for Legacy MSAs – a point which was made by I cannot remember which one of the gas suppliers in the Board paper, which we went to yesterday.

Next, no one in the industry has identified the charges in the MSAs, the charging structure, certainly as a block to the introduction of new smart meters, so far as we can tell. Even Ofgem, in its response to the BERR Consultation 2007 has identified other issues. That is in the notes that I handed up.

The final conclusion, and then I hope to deal briefly with maintenance, objective justification and penalty very rapidly in the remaining time. There is no case on any sensible basis of comparison with an alternative world or benchmark, that MSAs resulted in any harm to customer or consumer interests. On the contrary, and the gas suppliers are not here intervening, but you have seen their documents, these are contracts very much in customers and consumers interests.

I turn then from early replacement charges to meter maintenance. We know from para.4.21 of the Decision, if you turn to that again (p.70, CB1) that maintenance bundling, not having a separate charge for the maintenance, is not alleged as a separate abuse. It is said to exacerbate the foreclosing effect of the MSAs, particularly in the case of PPM, (prepayment meters) on the basis that National Grid is excluding CMOs from the chance to replace faulty meters when they carry out maintenance visits, and the detailed reasoning is contained at 4.81 to 4.85. Our submissions on this, in case I need to abbreviate now, are in para. 80 of our skeleton, and I will make the following points.

First, so far as the prepayment meters are concerned I return to what I said at the outset, Ofgem has not positively found a foreclosure effect resulting from the early replacement charging structure in the Legacy MSAs which would then be increased by not allowing CMOs to maintain its installed PPMs. We discussed at the outset the point that Ofgem uses the phrase in para. 4.79: “The impact is likely to be less pronounced than in the case of DCMs. However, in its skeleton (para.167) Ofgem says that is the positive finding, and we say that is not right, and that is fanciful.

Secondly, it is in any case perfectly legitimate and unobjectionable for National Grid to maintain its own assets rather than allowing its competitors to do so. I will give you the reference only to this because we refer back in our submissions in a Chinese box style to

our first set of written representations at paras. 286 to 287, PD1, tab 8, p.253. In fact, I may have the time to cover this, having given you that reference if you would not mind picking up PD1 I will just clarify what our point is. As I say, it is PD1, tab 8, p.253. (After a pause) It is actually quite short, I need not have bothered.

> "The combination of Meter provision/maintenance in the MSAs reflects custom and practice. It is a feature of the RGMA contracts. There was an extended period of negotiation of the new RGMA contracts in the period 2001 to 2004, which involved open industry meetings (often including representatives of the Authority). Although at the beginning of that process some Gas Suppliers asked National Grid to consider separating out maintenance of its Meters (in particular [industrial] and [commercial] meters), at the end of the process there was consensus that it was reasonable for National Grid to retain the right to maintain its own assets, and no one sought regulatory intervention to overturn that position."

There you have it, it is not some unique feature of these Legacy MSAs, it is there in the P&M contract. Indeed, the tariff cap, the price cap, set by Ofgem bundles maintenance and provision.

The third point is that the regulatory cross-subsidy, as we describe it, has this practical implication: it means that National Grid's PPMs uniquely have been constrained to be priced at less than their full cost of provision. It is an important element of the factual and economic context because it means there is not a significant possibility that gas suppliers want to replace the installed National Grid PPMs with substantial numbers at least of CMOs' PPMs while this regulatory backcloth is there. The evidence shows that that is exactly what influenced British Gas at least in its approach to the matter. We saw one part of the one of the documents yesterday touching on this. That is para.80(c) of National Grid's skeleton.

That is all I wanted to say about the PPM side of things.

Turning to DCMs, credit meters, it is not, in my submission, a fair reading of this Decision that the meter maintenance issue is a real concern. Would you go to the Decision, the conclusions on abuse at 4.182, p.112. What you see is that in its conclusions Ofgem begins at 4.181 by dealing with the abuse resulting from the cumulative effects of the early replacement charging arrangements. That is 4.181. You then have the findings on the maintenance in 4.182, and what they say is:

"Furthermore, irrespective of whether gas suppliers use competitors to replace meters, NG will continue to replace a significant proportion of prepayment meters during maintenance visits."

The reasoning runs on from that.

"The Authority considers that this increases the foreclosing effects of the early replacement charging arrangements …"

In its conclusion, therefore, it is clearly and strictly limited to the prepayment meters and appreciable addition to foreclosure arising from not allowing CMOs to replace PPMs in maintenance visits, because that is all it says.

THE CHAIRMAN: The fact is that if they replace it then that is one against the glide path, is it not, it is one free allowance meter taken up or used up, whereas if they just maintain it and do not replace it then there is no effect on the main number of free allowances. So it is the combination of the fact that the maintain them and they, in fact, replace them and that that replacement counts towards the glide path which is the impact of the bundling of maintenance on the case.

MR. TURNER: Madam, you will remember that this was an issue at the CMC.

THE CHAIRMAN: That was a different point. That was a point about density of operations and, "Oh, well, if we could do the maintenance work then that would help us organise our work", and that we are not going into. Just purely looking at the effect of the agreement and maintenance, I think we ----

MR. TURNER: Madam, we say not. We perhaps then need to look again at the reasoning. It is not a question of the CMOs being disadvantaged – forget density for a moment – because they cannot get a profit from doing maintenance operations.

THE CHAIRMAN: No, I am not saying that at all. I am saying that it is because there is a tendency to replace meters rather than maintain them and that that replacement uses up one of the free allowances, that is the relevance of the maintenance bundling.

MR. TURNER: Madam, we say no, because the way that it is expressed in the Decision – let us look at their reasoning – is simply that if you allow CMOs to do maintenance work on the meters – take the PPMs – in some cases where maintenance is required, and I think the evidence is that it is about 85,000 a year out of 600,000 maintenance visits a year, you cannot simply maintain it, you have to replace it. In that group of cases, the 85,000 a year, National Grid puts in its meter, a new meter of its own instead, and the CMO which has not been allowed that chance cannot put in a meter of its own.

Let us have a look at the reasoning, I will go it, because that is the logic of the Decision. Would you go, first, to 4.4(b), you have the first reference, which is that under both these agreements:

> "… bundled meter maintenance appreciably increases the foreclosing effects of the Legacy MSAs where maintenance visits lead to the replacement of meters which are automatically supplied by NG under the N/R MSA."

The next reference is 4.21, p.70:

> "We do not consider the bundling of maintenance with the provision of meters under the MSAs to be a separate abuse. The bundling of maintenance clearly exacerbates the foreclosing effects of the MSAs. This is because even where a supplier is using one or more CMOs to provide new and replacement meters, NG's maintenance of its legacy meter stock will lead to NG replacing both PPMs and DCMs. NG will then supply these meters under the N/R MSAs. The number of meters NG replaced as a result of such maintenance visits is significant in the context of the foreclosure effects created by the early replacement charges …"

and then it is a numerical point –

> "… (for example 15% of PPMs are replaced on maintenance visits …)"

that is the 85,000 –

> "... (…which accounts for 30% of the glide path). But they would not be sufficient or significant enough in the absence of these other features to constitute a separate abuse."

You then have the major explanation of the case at 4.81-4.85, and beginning at 4.83:

> "When a legacy meter is replaced by NG on a maintenance visit (other than where that visit followed an emergency call-out), the newly installed meter will be provided to the relevant supplier under the N/R MSA. Since the N/R MSA also bundles the maintenance with charging for the provision of existing PPMs, a significant proportion of PPMs provided on the N/R MSA will also be replaced by National Grid on maintenance visits, again irrespective of whether a supplier is appointed as CMO to undertake their meter replacement activity.
>
> 4.84 Therefore, a signatory to the MSAs which has 'elected' out of the N/R MSA by BGT will find that it is nonetheless contractually caught under the N/R MSA for meters replaced as part of maintenance of the Legacy meter stock. In both situations, the length of the arrangements will effectively be prolonged (the MSAs will in reality be indefinite ----"

which we dispute.

Then, finally, the only other reasoning you have is what is in 4.182 which is all about replacing -- Because we do the maintenance and not the CMOs we get the chance to put in our own meter and they are denied that opportunity. That is how we read the case against us. We have not read it in another way. If I may, Madam, it may be that that is something that can be picked up subsequently, depending on what others make of it. "Objective justification." I shall be very brief. Our skeleton covers that at paras. 84 to 87. I shall not take you there, but the essential point is that for lots of the reasons I have already covered -- Fully efficient contracts. They gave efficient incentives as opposed to the distorted incentives under the previous arrangements which Ofgem itself was worried about. Not just in the interests of efficiency, but also in the interests of consumers. I have developed that. Finally, Penalty and Directions. That is in paras. 88 to 97 of our skeleton.. It gives all the relevant references which I shall not rehearse. But, I will refer to Ofgem's pushback on the points that are in issue in its skeleton at CB2, paras. 179 to 197. This is quite an extensive part of the Ofgem skeleton. In passing, you see at 180.2 that despite the embracing of the 'no PRC counterfactual' there is a recognition that some sorts of early replacement charges, i.e. those which are 'normal' in the circumstances of the relevant market and/or which do not lead to foreclosure would be compatible with competition law does not lessen the obligations on National Grid. So, even here, even in their skeleton there is still at least a recognition that you can have some sorts of charging arrangements which are normal. However, the three points I will make on penalty and what Ofgem says are as follows: at para. 180.4 there is a reaction to our point that Ofgem's case changed significantly. I have shown you the way that they presented it in the first SO where the use of any payment completion charges would have been an abuse in and of itself and Ofgem directed National Grid, or proposed to, not to include any, but only to compete on the basis of short-term arrangements and dropping prices. That did fundamentally change when you came to the April 2008 supplemental statement of objections. What is said is that the case changed in only limited ways. We say that it moved from that original position to this detailed quantitative claim which you find in the Decision ultimately. That case in the Decision is embraced by any industry participant, and it never has been, and even the CMOs who are here today, because their interest is obviously in trying to achieve a situation where there are maximum opportunities available to them have not said that it is any part of their case that, "This age-based structure would have been wonderful for us, would have worked well".

The second point: so far as Ofgem's involvement in all this is concerned what we pointed out in our Notice of Appeal was that some of the basic ideas which are the focus of criticism in the Decision -- the use of early replacement charges, the glidepath -- although not all of the details of the contract, that is true, were discussed with Ofgem's officials. National Grid was also aware, as many other people in the industry were aware, that Ofgem was concerned about premature replacement and thought it was inefficient. We can give you numerous references for this. It is against that background, we say, that if you ever get to the stage of finding National Grid guilty and needing to consider what penalty to impose, that has to be taken into account. A significant voice within Ofgem - and, indeed, we say a dominant voice at the time of the February 2003 management paper - considered that the negotiations over the MSA contracts would help to deal with an industry problem and that a market solution could lead to an efficient industry outcome.

Ofgem says in its skeleton at para. 186.1 about this that up to February 2003 we were talking about discussions relating to National Grid's proposal to modify the network code and that after February 2003, once it was clear that National Grid was looking at a separate contract, Ofgem steps back and has no further role. You have seen some information on this already. It is simply, we say, not the case in fact. Well before, and into, February 2003 Ofgem was aware that separate contracts were being negotiated, and it expressed its view about that. It cannot be controverted.

Ofgem says, "Are you making a legitimate expectations argument?" at para. 183 of its skeleton, and it declares at the end of that para. 183, "National Grid must clarify this at the earliest opportunity". I will now clarify this at ten to one, in finishing my opening submissions. We are not making a legitimate expectations argument - namely, an argument that we had a legitimate expectation that no-one would challenge this behaviour as unlawful. We are making a point which goes to, if there is any need for a penalty, mitigation and I have explained why.

The last point at para. 192.1 of Ofgem's skeleton. This is a response to us pointing out that in any event this case has got quite a lot of complex and special features, and if you are going to find us guilty you really have to take into account that it presents unusual difficulties. It was by no means obvious to National Grid that there was any abuse of dominance. You have seen from at least two of the internal National Grid documents - and you will hear also if he is asked about it, from Mr. Shoesmith - that National Grid saw its obligation to facilitate competition. National Grid, in arranging its charges, was punctilious

about, “Well, is this a problem from the point of view of the law and competition?” It acted accordingly. That also needs to be taken into account.

THE CHAIRMAN: I think there is authority - which no doubt someone will point me to if it is relevant - about what you have to be negligent about in order to trigger the ability to impose a fine.

MR. TURNER: Yes.

THE CHAIRMAN: Now, you have said several times that you accept that these contracts generated dis-incentive for people to replace meters ----

MR. TURNER: Above the glidepath level.

THE CHAIRMAN: -- above the glidepath -- the free allowance -- below the glidepath level.

MR. TURNER: Below it, yes.

THE CHAIRMAN: To that extent you accept, I suppose, that there is therefore foreclosure though you would say it is not anti-competitive foreclosure.

MR. TURNER: I was on the point of saying foreclosure but not as we know it.

THE CHAIRMAN: Right. Now, whether or not you thought that was against the law, I am not sure are you relying on that as part of there was no negligence and therefore no fine, or just as a mitigation point that if there is a fine it should not be so much as has been imposed?

MR. TURNER: Madam, it is the latter, your reasoning is quite right, that if the company foresaw that its behaviour would have what would then be characterised as adverse effects, then whether or not it applies the correct label is a different matter and, yes, that is the legal position. But what that then does is give the Tribunal, or Ofgem, the jurisdiction to impose a penalty and what we then draw attention to is that when you are considering mitigation it becomes a very important factor.

THE CHAIRMAN: In your skeleton you take both points though, you say there was no negligence, and therefore there should be no fine and, in the alternative, if there was negligence then the fine should be lower. Do you still maintain those ----

MR. TURNER: Thank you very much, madam, I will look at that and let you know if we maintain our position on that.

THE CHAIRMAN: Yes, thank you.

MR. TURNER: At all events, and looking at it for the moment as a mitigation point, when we look at 192.1 Ofgem’s point is:

> “ … to the extent that this case raises new or complex issues, that simply serves to highlight how important it was for NG to seek proper advice and to act with caution;”

A simple answer, the evidence shows that National Grid acted with immense sensitivity and caution.

Before I close, there is one point, although not a huge point, I have been asked to draw to your attention. If you turn to Mr. Avery's witness statement, which is WS1, tab 2, he makes a point which I failed to but should have done, and that is at para. 105 on p.621. I would like the Tribunal to bear in mind at this point who Mr. Avery is. He is not a National Grid official, he does not have to give this evidence. He is giving his evidence because this is exactly how he saw it, and he was the senior British Gas man.

> "105. In retaining maintenance for itself National Grid did not block off a route to market. If a call comes in from a customer that requires a meter to be maintained British Gas' call centres can direct the call to whoever they like. So if they want their CMO to take the opportunity to switch out a meter then they can direct the call …"

They get a false call, and they can say to the CMO "You go and replace that."

THE CHAIRMAN: Yes, well that was the point that I had in mind when I explained how I thought bundling of maintenance was relevant because the idea in the Decision of there being a maintenance visit is not quite right, because it is up to the gas supplier to decide whether there is going to be a maintenance visit or not, and we have seen other people's evidence that says that whenever you get into the house you swap out the meter if you can, nobody is repairing these meters at the moment. So that is why was my interpretation of the effect of the bundling was slightly different from what you showed me in the Decision.

MR. TURNER: Madam, I am sorry, I now understand, the penny has dropped at this point. You will have seen, perhaps, somewhere else in Mr. Avery's evidence, or at any rate it is part of the documentary record, that the original idea that British Gas had for its CMOs was that they would replace meters on a "first visit fit principle" – that is the phrase used. So they go along and once they are in the household they put in their own meter. They then drew back from that to allow National Grid to continue maintaining its prepayment meters.

THE CHAIRMAN: Well not maintaining them, replacing them.

MR. TURNER: And replacing them, which would be, yes, with its own meters, and then subject to its own points scale.

THE CHAIRMAN: Yes, and the question is why did they draw – well that may be the question – why did they draw back from doing that?

MR. TURNER: Because it was much cheaper.

THE CHAIRMAN: No doubt other people will give a different reason.

MR. TURNER: Well you will have the evidence on that.

THE CHAIRMAN: It is just that maintenance bundling is quite a sophisticated point; what the effect of that is.

MR. TURNER: Yes. It does remind me there was one other point I should also make on the same topic. It is drawn to my attention PPMs are not often replaced. We are talking about 85,000 a year, but that point applies in spades for the credit meters, insofar as Ofgem is still saying, which I believe they are, "our Decision also applies to the possibilities for credit meters to be replaced on maintenance visits." That is because, certainly when you come to the credit meters, the number of maintenance visits and the number of DCMs which are replaced on maintenance visits is absolutely trivial. It is in the agreed statement of facts at para.16. It is in the Decision itself and it amounts to only around 11,000 a year out of a legacy population of 17.5 million in 2004. The Decision refers to that, if memory serves, at 2.21 – it is less than 0.001 per cent of all credit meter replacements, and cannot be viewed as material.

Madam, that, subject to any questions, concludes our submissions. I have not dealt with the order of witnesses which I can briefly mention now, because the Tribunal's letter asked us to address it.

THE CHAIRMAN: The only point I would make, but it is not a question for you to answer now, is that how the PRCs that you showed us the table of in the Legacy MSA, I am not clear in my own mind where those come from, what those represent. You said that they are not some kind of averaged age-related calculation. I am assuming that here is some present value of future rental payment?

MR. TURNER: Absolutely.

THE CHAIRMAN: If you could just point me at some time at your convenience, or produce a note or something which explains how those amounts which dwindle down ----

MR. TURNER: Yes, I took you to paragraph 148 in the agreed statement of facts. The preceding paragraphs, which I referred to but did not read, set out exactly how it was done (paras.145 to 147). Underneath that, if you wish, I can also refer you to other detailed descriptions which have emerged of it. But the essential idea is that you start with the notion that you are renting a portfolio of meters.

THE CHAIRMAN: Let me stop you there, Mr. Turner, I think we will take the short adjournment, I just make that point. I will look at those paragraphs and then if I am still unclear I will let you know.

MR. TURNER: I am obliged.

THE CHAIRMAN: So we will come back at 2 o'clock and listen to Ofgem's submissions, thank you very much, Mr. Turner.

(Adjourned for a short time)

THE CHAIRMAN: Yes.

MISS CARSS-FRISK: Madam Chairman, may I begin by handing up yet a further version of the Decision, I am afraid, but I hope it will help. It has the references to all the documents in the footnotes, all the bundle references typed in, and it is also properly paginated, so it can be used instead of, if need be, or in addition to, the version that we have. (Same handed)

THE CHAIRMAN: So should we slot that in then to CB1?

MISS CARSS-FRISK: That would probably make sense. I appreciate, of course, that you have been marking up the version you already had, but it may just be useful for you to have those document bundle references there. You may want to have both, in fact, behind the same tab.

I should also explain that this version contains a few corrections, I believe wholly uncontroversial *errata*, to the Decision that had been made after the Decision was issued but had not found their way into the copy you had. So this is now the final complete and correct version.

I would like to begin, if I may, with a thumbnail sketch of our vision of competition, of how we see the key points in this case, and then come back to address you in a little more detail on each aspect. I do not propose here to respond to all the factual matters that Mr. Turner mentioned yesterday, but I may come back to those in due course in dealing with the other matters.

Turning to the thumbnail sketch, we say there was one market for legacy and new and replacement meters, as is powerfully illustrated by the fact that Grid had this fear that it would not recover its sunk costs precisely because new and replacement meters were such a good demand side substitute for Legacy meters. That fundamental point is not altered by the fact that Grid had sunk its costs in the Legacy meters. We do say that Grid clearly was and is clearly dominant in that single market. Of course, it had a market share as at January 2004 of 97 per cent. We say there is nothing here to displace the presumption that that puts it in a dominant position.

We accept that the largest gas supplier, British Gas, had some market power, but by no means sufficient to negate the power of Grid in this case. The fact is that Grid was a "must deal" partner for the suppliers, and British Gas would be compelled on any view, including

on its own assessments, to take a very large proportion of its meters from Grid for a considerable number of years.

We know that Grid was extremely fearful of the potential impact of competition here, and it set about – it makes no bones about that – finding some way of seeking to recover its sunk costs, which of course then resulted in the MSAs, which allow for, and of course that is important, no more than about 5.5 per cent of the opening legacy stock being replaced each year free of charge. Of course, because the exit charges in the Legacy MSA took no account of the age of a particular meter but were based on an average, there was no opportunity for suppliers to seek to mitigate the impact of switching costs by replacing older less valuable meters first.

We say the net result of the Legacy MSAs is clearly that the volumes of meter replacement that were available to the CMOs have been restricted. There has been an actual foreclosing effect of the MSAs and that is very clear, we will say – or will become clear – from, not least, the evidence of the interveners, whose evidence we have been told will not be challenged.

Of course, I should add that the Authority does not need to show actual effect. Likely effect is sufficient, but in this case it did find, in our submission rightly, an actual effect on competition.

What is Grid's fundamental answer to this? As we see it, it is really to say that because we had sunk our costs, we are entitled to guarantee a certain revenue stream in order to recover, they would say, part of those costs. We are entitled to do that regardless of the impact on competition. No undertaking has such an entitlement, and that applies with particular force to an undertaking such as Grid that was and is dominant.

We have referred, of course, to dominant undertakings' special responsibility, which means that what might be seen as normal permissible behaviour in a competitive market would not be permissible necessarily for a dominant undertaking. Grid has never, so far in these proceedings and still has not, faced up to that special responsibility. I do not believe that Mr. Turner has dealt with it at all so far.

Of course, it is true that it is difficult to identify what then would be a normal competition in a market such as this precisely because of Grid's dominance. What we do say is clear is that there were a number of options available. There was the age-related approach, one of our counterfactuals, there was the possibility of a contract with no premature replacement charges, and indeed the possibility of up-front installation charges.

Ultimately, whether Grid is able to recover its sunk costs or not, or even part of them, should be, of course, a matter for competition properly applied, and the problem with the MSAs, as I have suggested, is that they really proceed on the basis that Grid is entitled to guarantee this revenue stream regardless of the foreclosing effect.

Of course, Grid has made a lot of the idea that the gas suppliers were happy to sign the MSAs, even wanted to do so, but it is perfectly possible for an arrangement to be abusive even if it is desired by the dominant undertaking's commercial partner. That in no way, in our submission, provides an answer. The fact is that these contracts effectively allowed Grid to set the rate at which meters would be replaced and hence to determine, in a sense, the level of entry of the CMOs and their ability to expand in this market. So the MSAs are fundamentally foreclosing. I am not sure there is really much debate about that at this stage. Perhaps the only question, the only main question, that remains is, was Grid entitled to recover its revenue stream because it had these sunk costs, notwithstanding the foreclosing nature of the contracts, and we, of course, say not so.

One of Grid's key submissions here appeared to be, and this is what we have said is a new point that is not actually in the notice of appeal, but leaving that to one side for the moment, the point really is that replacing a working meter is inefficient. So, if you have an arrangement that sets up disincentives to replacing a working meter, then that is efficient – this is the ownership analogy – and therefore, by definition, cannot be foreclosing. Of course, we do very much take issue with that proposition because competition law is, after all, about ensuring or seeking to ensure an efficient outcome through the process of competition, not through the application of some *a priori* model.

So Grid cannot simply say, "Well, not efficient to replace the working meter. That is what the MSAs really achieve by way of incentives. Therefore, they were absolutely fine in competition law terms. If that were right, then one can imagine someone who has sunk its costs incredibly inefficiently and would yet say, "We're entitled to recover them in this way and as long as there are dis-incentives to replacing a working meter, that is absolutely fine, and it does not matter how long the arrangement is, or how foreclosing it actually is in its effect".

That really is our case in a nutshell.

Turning then to the different parts of the case - and, of course, market definition first of all - as we pointed out in our skeleton at para. 13, Grid has not dealt in its skeleton with the issue of geographic market at all. I certainly understood Mr. Turner now to be really accepting that that is not an issue for us. So, I will not trouble you with any submissions on that.

So far as the principles of market definition are concerned, of course, they are well-established, but particularly as Mr. Turner did, I think, accuse us yesterday of misunderstanding at least an aspect of it, it may be useful if you just remind yourselves of the key bits in the Commission's Notice on this which you have at A1, Tab 22. First, we have para. 7 on p.2 of this print-out, which I would just remind you says,

> "Relevant product markets defined as follows: 'A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use'".

If we then go to the heading 'Basic Principles for Market Definition' and para. 13,

> "Firms are subject to three main sources of competitive constraints: demand substitutability, supply substitutability and potential competition. From an economic point of view, for the definition of the relevant market, demand substitution constitutes the most immediate and effective disciplinary force on the suppliers of a given product --"

That is really the bit that we would emphasise - the primacy, as it were, given to demand side substitution. Just to complete the picture on the law here, can I take you very briefly to this Tribunal's Decision in Aberdeen Journals which you have at Authorities Volume 2, Tab 41 at paras. 96 and 97 at p.1116.

> "96. The foregoing cases indicate that the relevant product market is t be defined by reference to the facts in any given case, taking into account the whole economic context, which may include notably (i) the objective characteristics of the products; (ii) the degree of substitutability or interchangeability between the products, having regard to their relative prices and intended use; (iii) the competitive conditions; (iv) the structure of the supply and demand; and (v) the attitudes of consumers and users.
>
> 97. However, this checklist is neither fixed, nor exhaustive, nor is every element mentioned in the case law necessarily mandatory in every case. Each case will depend on its own facts, and it is necessary to examine the particular circumstances in order to answer what, at the end of the day, are relatively straightforward questions: do the products concerned sufficiently compete with each other to be sensibly regarded as being in the same market? Are there other products which should be regarded as competing in the same market? The key idea is that of a competitive constraint: do the other products alleged to form part

> of the same market act as a competitive constraint on the conduct of the allegedly dominant firm?"

Now, applying that approach in this case we make two straightforward points. First, it is clear that new and replacement meters which, of course, include the meters supplied by the CMOs are demand side substitutes for Legacy meters, and that, of course, as I said, was a particular concern for Grid in this case. As Mr. Turner accepted yesterday, new and replacement meters do provide a competitive constraint on Legacy meters - again, the whole point of Grid's concerns.

That is not a question of misguidedly looking at potential competition at this stage contrary to the Commission's Notice. It is looking, as I said, (a) at demand side substitutability and (b) at actual constraint, actual competition being provided by new and replacement meters. So, we have not fallen into the error that we were accused of.

It may be sensible for you to remind yourselves of how we deal with this in the decision at this point (p.45 of CB1, the external numbering. Paragraphs 3.13 to 3.14, particularly at para. 3.14. One sees at 3.14 that, of course, the Authority here refers to Grid's argument about different conditions of competition, but then crucially concludes,

> "Nevertheless, it is clear that, by their very nature, N/R meters are very good demand side substitutes for Legacy meters from a gas customer or supplier perspective and that they provide a competitive constraint on Legacy meters".

That is really the crucial conclusion which, in our submission, cannot be faulted. Now, Grid has accused us - not really in oral submissions, but in their skeleton - of paying too much, or even exclusive attention to the intended use and physical characteristics of a meter. But, as I hope that this passage has shown you, we have not done that. In fact, we have quite properly applied the relevant criteria as set out inter alia in the Commission's Notice. Now, of course, intended use and physical characteristics are important, and we have taken those into account - but by no means exclusively.

As then to different competitive conditions, as I have said, the Authority mentioned that in para. 3.14 but did not consider it sufficient to change the ultimate conclusion, and the fundamental problem with Grid's contention here is it really focuses on the perspective of Grid itself entirely. It looks at the fact that Grid has sunk its costs, but that is to the exclusion of looking at how it appears from the perspective of the gas supplier, and indeed ultimate customers but gas suppliers, for whom, as I said, new and replacement meters were very good substitutes indeed.

I have talked about Legacy Meters and new and replacement meters as though it were absolutely clear what the distinction is, but there have been different definitions of that distinction in the course of the case. I really mean Legacy Meters being those that were installed at the time and cost sunk at the time when the Legacy MSA was signed, or were signed, and then contrasted to other meters that were installed thereafter. But in fact, that is not the definition that Grid has used, certainly not always. They kicked off with a definition that was simply taken from the Legacy MSA, i.e. referring to the date of 1st January, all meters installed before that date were Legacy Meters – any meters installed thereafter were not. But if that was meant really to refer to whether meters had been installed when the Legacy MSAs were agreed then of course it did not work because most of the suppliers actually signed the Legacy MSAs after 1st January.

Having said that, Dr. Williams as we understand it then in his second report made it clear that no, it was not a question of simply using the date in the Legacy MSA but it was actually looking at whether costs were sunk at the date when the agreement was signed, whenever that was. Yesterday we seemed to get a further definition from Mr. Turner when he actually said "Any meter, as soon as it is installed and the costs are sunk it becomes a Legacy Meter". Well that, with great respect, as a definition we say does not make an awful lot of sense in the context of how Grid have otherwise put their case, not least looking at the table of market shares that they have referred to, you will recall at the notice of appeal para. 263, core bundle 1, p.248. It may be worth going back to that to remind ourselves. Page 248, where of course Grid would point to that table of new and replacement meters installed in the different years and would say that this shows very healthy entry by the CMOs and lack of dominance and so forth, well that really does not make sense if you adopt Mr. Turner's definition of "legacy" and "New/Replacement" meters yesterday. To be fair, I think, judging by one of the notes that were handed up today Grid have now actually gone back to the definition that was adopted by Dr. Williams, when he said it is all about whether costs were sunk at the date when the Legacy MSAs were signed. That is how I understand the position.

Now, may I flag, if we need to, we will perhaps – and I hope we will be permitted to – respond to Grid's various written notes in writing ourselves.

Leaving that difficulty of definition to one side we can just come back to that fundamental point about new and replacement meters being demand side substitutes and actual competitive constraints, as well as, of course, being physically the same, and in terms of their intended use.

It may be that Mr. Turner's real concern here was that in this case the very large market share simply does not indicate dominance; I think he said that yesterday, in the context of looking at market definition. If that is the real concern, then really the argument should take place within the context of the issue of dominance, but it is not a reason to define market in a way that is very artificial, which is what we would suggest Grid have sought to do.

I should perhaps just mention another point that Mr. Turner did not refer to, but it is certainly contained in Grid's expert evidence, Dr. Williams again, it is his second report where he refers to three Commission Decisions concerning truck tyres and automotive products. You have them in bundle A6, but I do not actually propose to ask you to look at them now, but just to make our key point about them, which is they were really designed to prove that we were wrong to say that products which share identical characteristics and usage may never be in separate product markets, and all I would flag up is that that was not (and is not) our case and we entirely accept that those Commission decisions are examples of products with identical characteristics and uses that were held to be in different product markets really there, because of different consumer groups.

Very briefly, so far as supply side substitution is concerned, we did not really feature again in Mr. Turner's oral submissions but it does remain in Grid's skeleton so I should perhaps just explain our position. We have said that electricity meters are not supply side substitutes for new and replacement meters and they are not therefore part of the same product market (Decision paras.3.3 to 3.39). It appears that Grid is saying "Ah, no, but actually they are supply side substitutes" if you focus on the new and replacement market as they see it. That, of course, assumes at this point the very thing that remains in issue, i.e. that there is a separate market for new and replacement meters.

We, of course, have said single market and on that basis we have said the electricity suppliers do not provide supply side substitution in any relevant sense and there is no challenge to that view, so far as I can make out.

THE CHAIRMAN: There is a distinction though, your submissions so far have all been in terms of meters rather than the metering service, which is I think what you found that the relevant product market was, not the market for the meters, but the market for the metering service.

MISS CARSS-FRISK: The relevant service, yes.

THE CHAIRMAN: Now as far as the supply substitutability is concerned I can see that an electricity meter is not a substitute for a gas meter, and it may be difficult for people who make electricity meters to change to making gas meters in terms of production of the item, but are we not here more concerned with the ability of people who provide electricity

metering services to enter the market for gas metering services, which they can do (as these have) by buying electricity meters?

MISS CARSS-FRISK: As it seems to us we are really concerned with the package; we are concerned with the provision of meter and attendant services where the Authority has found, as I said, that the electricity meter providers in fact are not able to provide a competitive constraint for these purposes; it is really the package we are concerned with and, as I say, I do not understand there to be a challenge to that if we are concerned with the single market looking at Legacy and new and replacement meters together, which is of course the finding that we have made.

Just picking up one other point on supply side substitution, this relates to Grid saying in their skeleton argument that there are limits to the contestable market and you may need here just to open Grid's skeleton argument briefly, which is core bundle 2, p.863. It is Grid's skeleton, para.23(a), where they say:

> "Ofgem is also mistaken in denying the relevance of supply side substitution from electricity meter providers in assessing the (differing) competitive conditions applicable to the supply of new and replacement and Legacy Meters.
>
> a. The contestable gas metering market for N/R business is, naturally, not equivalent to the size of the entire installed base of Legacy Meters. Once Meters are installed, where normal and efficient replacement incentives apply, they will not be replaced except in the case of failure/inaccuracy, where a functionality exchange is required, or if a new Meter offers some incremental benefit sufficient to justify sinking the installation costs afresh. There is therefore no basis for Ofgem to dismiss supply side constraints from the CMOs on the basis that, whilst they have entered the market relatively quickly, '*they have not established sufficient scale to act as an effective competitive constraint on NG given NG's very high market share and installed meter base*'."

All I would pick up here is that reference to the size of the contestable market where normal and efficient replacement incentives apply. This argument then really assumes that you have a market where there are cancellation charges which, on Grid's argument, would provide normal and efficient replacement incentives. Of course, that is very much in issue and would be the product of the Legacy MSAs, and in any event the key point for looking at this is surely the time before the entering into of the Legacy MSAs when, in fact, clearly Grid did not have in place arrangements that provided for what Grid would call our efficient

replacement incentives. On that basis, the contestable market would actually not be cut down in the way that Grid has suggested. So that is the response to that point.

That really completes what we would say about market definition.

Turning then to the question of dominance, we rely on three key matters to show dominance, as Mr. Turner rightly identified yesterday, firstly, Grid's extremely large market share, secondly, barriers to entry, and thirdly, the lack of sufficient countervailing buyer power. We have said that Grid has not challenged our case on dominance if we are right in our definition of "one single market" here, and that Grid, in fact, has chosen to address this really on the assumption, and only on the assumption, that it is right that there are two separate markets. Yesterday I know Mr. Turner said, "No, no, that is not correct", but, to be frank, is not clear to us on what basis he says we are wrong here. If one looks at the notice of appeal – and for your note it is a very long section – paras.260-380, one does see, in our submission, that Grid has chosen to deal with this matter separately for new and replacement meters where they deal with market share and barriers to entry, and then separately for Legacy meters where they focus on countervailing buyer power.

In case this point may be important, can I just remind you of the concluding section of this part of the notice of appeal. It is core bundle 1, p.285, starting at para.378:

> "Ofgem's case that National Grid was (or remains) in a position of dominance in an overall market for the provision of Meters (both Legacy and N/R Meters) is misconceived. It is based on a flawed analysis, since the position in relation to Legacy Meters and N/R Meters requires to be addressed separately.
>
> There is no solid basis for Ofgem's finding that National Grid is in a dominant position in relation to the provision of N/R Meters. Nor is there any solid basis for Ofgem's finding that National Grid was in a position of dominance vis-à-vis the major gas suppliers in relation to the negotiation of the Legacy deal in 2002/2003."

So in that summary, as it seems to us, one really gets Grid's approach, "Well, you just cannot look at one single market and so we are going to look at it in terms of two separate ones". We pointed this out in our defence at paras.114-115, and Grid has not actually sought to disagree until yesterday. They did not say in their skeleton that we were completely wrong about this.

So there we are, we really just invite you to take our submissions on this against that background. In a sense, they may not be relevant at all if we are right on this point.

Looking first at market share, and on Grid's suggested assumption that there was a separate market for new and replacement meters, we do say that considering the table in the notice of

appeal that we have already looked at today, but perhaps you can have it open again, para.263 of the notice of appeal, p.248. If one looks at that table again and if we are right that you can consider Grid and UMS together for these purposes, then of course one sees that Grid actually has installed over 60 per cent of the new and replacement meters between 2005 and 2007.

Grid, I think, would say that we are not entitled to make this point, but really it arises only by way of response to their point that one needs to focus on two separate markets here, which argument of course is not based on the finding in our Decision, which was of a single market.

The other response, the substantive response, that Grid makes is that it is not permissible to look at UMS and National Grid metering as one undertaking here. We say it is on well established principles, because here we have National Grid Plc controlling both UMS and National Grid metering. It is the ultimate parent company controlling both, and they are all, therefore, part, we say, of one undertaking. We have cited the case of *Viho Europe* in this context, which it may be useful for the Tribunal to remind itself of. It is Authorities bundle 1, tab 18. It is paras.15 to 17 on p.7 of the print-out:

> "It should be noted, first of all, that it is established that Parker holds 100% of the shares of its subsidiaries in Germany, Belgium, Spain and the Netherlands and that the sales and marketing activities of its subsidiaries are directed by an area team appointed by the parent company and which controls, in particular, sales targets, gross margins, sales costs, cash flow and stocks. The area team also lays down the range of products to be sold, monitors advertising and issues directives concerning prices and discounts.
>
> Parker and its subsidiaries thus form a single economic unit within which the subsidiaries do not enjoy real autonomy in determining their course of action in the market, but carry out the instructions issued to them by the parent company controlling them.
>
> In those circumstances, the fact that Parker's policy of referral, which consists essentially in dividing various national markets between its subsidiaries, might produce effects outside the ambit of the Parker group which are capable of affecting the competitive position of third parties cannot make Article 85(1) applicable, even when it is read in conjunction with Article 2 and Article 3(c) and (g) of the Treaty. On the other hand, such unilateral conduct could fall under

Article 86 if the conditions for its application, as laid down in that Article were fulfilled".

So, we, of course, home in on the reference to group companies forming a single economic unit. It is not just the fact that they are part of the same corporate structure, but it is also a question of them being under the same strategic control as Grid itself has accepted.

THE CHAIRMAN: That is the curious thing - that there is market share both for UMS and for National Grid. Now, I am not sure whether there is enough track record to be able to say what happens when people invite tenders. Do both National Grid and UMS put in competing tenders or does only one them compete? How does it work? (After a pause): It may not be a question that you can answer. I just wonder whether there is something different in nature in the business that National Grid gets and the business that UMS gets that leads to this slightly curious ----

MISS CARSS-FRISK: It is true that there is the bidding markets issue, which I was going to come on to that Grid has referred to - that UMS, together with the CMOs, did engage, in a sense, in bidding through competitive tender, as it were. But, of course, one point we make here, apart from some other points about bidding markets, is that clearly we would say UMS could be expected to derive some advantage from its connection to National Grid in terms of Grid's presence, reputation, experience, know-how, etc. in the market. So, the fact it is true that UMS would be appointed in a different way does not, in our submission, mean that they are not part of the same commercial undertaking for these purposes, and does not mean that it is wrong to group them together in assessing dominance - of course, assuming that we are looking at new and replacement as a separate market.

THE CHAIRMAN: So, the 38 percent there for 2005 - does that relate to meters that go on to the new and replacement National Grid contract?

MISS CARSS-FRISK: Yes.

THE CHAIRMAN: Whereas the UMS ones are subject to some different contract?

MISS CARSS-FRISK: That is right. Effectively, UMS deal on CMO terms. So, they are, in that sense, to be grouped together with the CMOs. However, for the purposes of, "Are they part of the same commercial undertaking?", they are.

THE CHAIRMAN: Yes.

MISS CARSS-FRISK: I was going to show you in that context what Grid itself had said in answer to questions from Ofgem about this topic. It is at PD3, Tab 39. There you have Grid's answer at p.1722, dated 1st August, 2007. If you go to p.1729 you have the heading 'Status of UMS'. Question 7:

"Please explain why you consider it reasonable to include UMS, the wholly owned subsidiary of National Grid, as a new entrant when considering the pace of development of competition and success of new entrants in providing new and replacement meters".

What they say is,

"We refer to Duncan Sinclair's e-mail of 27th July, 2007, in which he provided clarification of the issue of concern to the Authority".

There is then a reference to Mr. Sinclair having said in the penultimate sentence in para. 1,

"For the avoidance of doubt, our position is that as a mater of law all parts of the group ought to be treated as a single undertaking".

Now, Grid's answer then at para. 2 is,

"There are two separate questions which should be disentangled. The first is whether UMS should be considered a separate undertaking from National Grid Metering in terms of the overall strategic control and direction of National Grid's business as a whole. So far as that is concerned, the answer is 'No'. The second question is whether, in accordance with the Authority's question here, the example of UMS casts any light on the pace of development of competition and success of new entrants in providing new and replacement meters. In our submission, it plainly does so, given the special features of the relationship between NGM and UMS, and indeed the Authority's own Statements of Objection rightly proceed on this basis. For that reason, when examining the gains achieved by new entrants in the face of the MSAs, it is right to include the market share of UMS".

If you then go to para. 3,

"The Authority is concerned, in this investigation, with whether features of the MSAs (to which NGM is a party) foreclose the market to other CMOs. It is reasonable to include UMS as a new entrant in this context, even though it is a wholly owned subsidiary of National Grid. This is because:

(a) In competition law, the term 'undertaking' means a single economic unit for the purposes of the subject-matter of the agreement (or conduct) in question. Where one is dealing with two or more subsidiaries, it is relevant to ascertain whether those subsidiaries belong to a single economic unit within which the subsidiaries do not enjoy real autonomy in determining their course of action in the market.

(b) In the present case [and this is really the significant passage] , UMS is run at an operational level independently of NGM, for regulatory reasons. Each has its own management structure with separate Business Operations Directors and finance managers. Its contracts are negotiated separately and each makes its own arrangements for its workforce. The two companies do share a Managing Director but his function is to manage the strategy and performance of metering in National Grid: the more traditional Managing Director's role is carried out by each company's separate Business Operations Director. The only other functions that are shared are human resources, health and safety and IS/change management".

THE CHAIRMAN: Does UMS only relate to British Gas?

MR. TURNER: Madam, no. It is the company, as my learned friend rightly says, which is the tendering entity, and which tenders on the same terms as the other CMOs. It does tender for work other than that for British Gas. In the passage I took you to this morning about new developments you will see that one of the gas suppliers - I think it was SSE - has recently awarded new work, and it has awarded it both to UMS and to Scotia.

THE CHAIRMAN: But at the time of the Decision was all UMS' work with British Gas?

MR. TURNER: At the time of the Decision, yes. There were what may come up later in the case, these churn contracts. So, it starts with British Gas, but if the householder moves to another gas supplier, such as Npower, who then takes over the household, then they have to establish a relationship with the new gas supplier. Those are the so-called churn contracts. UMS, like the other CMOs, has churn contracts with other gas suppliers.

THE CHAIRMAN: It may be that this will become clear as we go along.

MISS CARSS-FRISK: I think Mr. Turner has confirmed what I understood to be the position, which is that at the time of the MSAs and at the time of the Decision, UMS had in fact only obtained work from British Gas, but subject to these churn contracts which were referred to. But, we are told that there has been a recent development thereafter.

THE CHAIRMAN: Yes, so the National Grid contracts are then with the meters that are referred to as there are with the other gas suppliers, and in the other British Gas areas ----

MISS CARSS-FRISK: I am so sorry, madam, I was being offered some instructions.

THE CHAIRMAN: That is all right.

MISS CARSS-FRISK: May I possibly ask you to repeat the question?

THE CHAIRMAN: It is unfair to press you on this but I think it would be useful at some stage to have some idea as to how it comes about that a new meter is replaced by National Grid

rather than UMS or by UMS rather than National Grid, so we can understand a little bit as to how this split comes about.

MISS CARSS-FRISK: We can certainly seek to obtain further detail on that but, as I understand it, that is simply by bilateral agreement, but not through the tendering process unless it is part of a meter being replaced in connection with maintenance as we have seen, and then you have the link between the Legacy MSA and the new and replacement MSA, but if I can obtain further elaboration on that I certainly will.

THE CHAIRMAN: Thank you.

MISS CARSS-FRISK: Now just to complete the point we were making here, having highlighted how the two entities shared a managing director, and also various other teams, perhaps I can just give you the reference: Mr. Shoesmith of National Grid in his second statement at para.6 also refers specifically to a strategy team that was shared between these two entities. So all of this, we would say, providing powerful support for the idea of one business unit for relevant purposes. And, of course, one should not forget that, as is recorded in the Decision – this is paras.3.91 to 3.93 – National Grid Gas senior management, when negotiating the MSAs did link that deal and work being provided to UMS (the UMS deal) so again underlining, we would say, how the two businesses were part of the same unit. This much is accepted by Grid (see notice of appeal, para.362). It is true that Grid also signalled to gas suppliers and investors that it had the intention to consolidate National Grid metering and UMS into one company (see Decision, para.2.37) and, as I understand it, that is still advertised as the intention on Grid's website. I am told yes, although I can see that Mr. Turner is dying to jump up and offer an objection.

THE CHAIRMAN: If it turns out to be relevant we may need to pursue it further.

MISS CARSS-FRISK: Grid, of course, say here: "Well, Ofgem you are being inconsistent", I think Mr. Turner may have said we are trying to ride two horses at the same time, because we are saying that in order to assess dominance, applying the legal test, you have one single undertaking here which shows a more than 50 per cent market share, but then "At the same time", says Mr. Turner, "you are relying on what happened to the meter replacement volumes of UMS to show that they were reduced because of the legacy MSAs and how is that consistent. Well we say "perfectly consistent; only one horse in fact", one is applying the legal test of dominance, and the other is simply saying: "Let us look at the effect that the Legacy MSAs are having". To judge that it really does not matter whether UMS is part of the same undertaking legally or not as Grid, it is simply a question of saying: "The Legacy

MSAs had this effect, that UMS's volumes needed to be reduced in order to cater for the glidepath allowance. That much I do not think is actually in dispute.

As for this argument then about competitive bidding playing a role here, I do not think Mr. Turner particularly picked that up orally yesterday, but it is in Grid's skeleton para.25(d) and 26(d). The argument, as we understand it is, again focusing now exclusively on new and replacement meters, there was a bidding market and that was sufficient to displace any presumption of dominance. We would say "Hold on a minute", if you look at what happened, UMS was awarded four out of the seven British Gas regions and, as I have already suggested, UMS would have had – even in that process – a considerable advantage through its association with Grid, to put it neutrally in that sense. In any event, we would say there do appear to be doubts as to whether bidding markets really make such a big difference in this context. Here we referred to an article by Mr. Paul Klemperer, which you have at Authorities' bundle 6, tab 15, called "Bidding markets". If we look at p.1 of the print out, and I am only going to refer to some very short passages, under the heading "Introduction" the third paragraph down:

> "Three distinct strands of thought seem to lie behind the widespread view that antitrust can safely ignore markets conducted through bidding processes. First are the claims, heavily pushed by legal and economic consulting firms, that in "bidding markets", market share does not imply market power, that the existence of two firms is enough to imply perfect competition, or even that just one firm is enough."

Then I would just jump to the next paragraph that says:

> "This paper explores and – I hope – explodes, these myths."

I would not dream of trying to persuade you that Mr. Klemperer's view is inevitably the one and only view in this field, but I would suggest that at the very least it casts doubt on Grid's argument that we are concerned with bidding so all is fine and dandy and there is no question of dominance.

THE CHAIRMAN: It is not so much a question of bidding, it is a question of how quickly the market share is going to be eroded over time, and what that shows. Suppose that National Grid had decided the were going to exit this market, they would deal with the Legacy meters, but they were not going to go into the business of replacing them, and gradually they would then be replaced, or quickly they would be replaced, so that this table here would just show other people's market entry. Now, it may take some time before their market share comes down from the 98 per cent, whatever they start with, or the 100 per cent

they start with, before it comes down to below 50 per cent, but what does that tell us about their market power? I suppose here we are talking about the market power in relation to the deal they struck for those Legacy meters which they are still dealing with.

MISS CARSS-FRISK: Well it certainly tells us, in our submission, that there are considerable barriers to entry by the sheer logistics of the matter for anyone who wants to come into the market, simply because Grid sits there on its vast installed legacy base. That is one point. But, of course, we are then looking at, in a sense, the single market that includes the Legacy meters that we have defined where, in fact, I would just remind you that Grid's argument about bidding markets, as I understand it, is actually confined to what they would see as the new and replacement meter market. It is only within the confines of that sector, to use a neutral word, that there is any sort of bidding.

THE CHAIRMAN: And also the volumes are insignificant when you compare them to the overall stock, but are significant when you compare them to the total new and replacement meters.

MISS CARSS-FRISK: Precisely. That indeed would be our point. The other point we make here is that because you have the relationship between the Legacy MSAs and meters being replaced in connection with maintenance and then automatically going on Grid's new and replacement contracts, you do, of course, have what Mr. Klemperer – I say "of course" – refers to as a "lock-in", in the sense that the outcome of one contest, i.e. the making of the Legacy MSA, actually has a determining effect on another, i.e. translating that, results in meters actually automatically being replaced and going on the new and replacement agreement. That is another reason we have cited in our skeleton as to why the bidding markets' argument does not really help Grid.

Just to pick up the reference in Mr. Klemperer's article – p.2 of the print-out – what one needs to look at is just above the middle of the page, the heading A "(Ideal) 'Bidding Markets'", and the third paragraph under that heading:

> "Although it can be debated whether the European Commission actually intended this to be a general definition of a 'bidding market', this is certainly a common interpretation. That is, the term is associated with contests where …
>
> 3. 'Competition begins afresh for each contract, and for each customer'. That is, if there is any repetition of a contest, there is no 'lock-in', by which the outcome of one contest importantly determines another."

That is where we get that reference from.

I am helpfully told by Mr. Kennelly that I should tell you that in our skeleton we refer to a different print-out of the article, so we have cited different page references for Mr. Klemperer. I think we have cited p.6 and p.4, when in fact you have seen on this print-out it is pp.1 and 2.

Turning then to barriers to entry and expansion, you may want to remind yourselves of para.3.68 of the Decision, which I know you were invited to go to yesterday. You have the whole section on barriers to entry and expansion starting at p.56, para.3.66, but then really the reasoning at 3.68, making this point that, of course, it is important to have economies of scale, density is important, and the gas meter has characteristics which makes entry and expansion on a significant scale difficult in a short space of time, not least because of the practical logistics of buying and installing a large number of meters, and one should factor in here the need to have a competent workforce to deal with all that, all of which we would suggest very clearly gives Grid a huge advantage, certainly in the broader market that we have defined.

Mr. Turner said, or certainly his skeleton said, there is no evidence or analysis for any of this really, and he said, "Where is the competitive advantage for Grid, where is it?" I think he was focusing there on his narrower market of new and replacement meters only. We say that as far as that is concerned, you do have a perfectly reasonable reference to what we are talking about at para.3.74 of the Decision, which makes this point about the need for economies of scale and density, and says at the end:

> "This gives NG a significant advantage in carrying out new and replacement work."

I think you were taken yesterday to the footnote 222, which refers to how:

> "… the legacy business has some fixed costs and therefore a higher number of meters would lead to a lower unit cost so supporting a platform for growth in the future."

Even forgetting the Legacy meters in a sense, we would say fairly clearly Grid will have advantages just in relation to the new and replacement work because it has its established network systems, workforce, and so forth. Of course, it can also get the density through combining replacement with maintenance work. In our submission, there really is not much, frankly, in Grid's complaint here. Even on their definition of the market, there are barriers to entry.

Turning then to countervailing buyer power, which of course is particularly important in relation to the legacy side of the market, the test I do not think is disputed. It is, of course,

Hoffmann-La Roche, and one looks at whether the allegedly dominant undertaking can behave to an appreciable extent independently of its competitors' customers and ultimately consumers. We do stress that phrase to an appreciable extent. What that translates into is that an undertaking may, of course, be dominant even if there is some countervailing buyer power, so long as that power is not sufficient to negate the power of the dominant undertaking. Contrary to what Grid has at least at times suggested, we have always accepted that there was some countervailing buyer power, certainly in British Gas in this case, but the point is that it was not sufficient. Grid would remain a 'must deal' partner for a number of years. Even on British Gas's own most optimistic assessment as to how quickly it can switch out the meters, which was eight years – that is all of them ----

THE CHAIRMAN: Do you say it is a 'must deal' partner not just in relation to the installed meters, but in relation to new and replacement meters, that it would be difficult for a supplier to decide to have all its new and replacement meters with somebody other than National Grid?

MISS CARSS-FRISK: I do not think that is how we put it in the Decision, but I can certainly see the point that that would be difficult simply because of the practicalities of the situation, the difficulties of entry, which meant that there simply were not many CMOs to choose from, and there were those logistical difficulties anyhow.

There is also indeed, I was going to come on to, the issue of maintenance replacements that we come back to where the 'must deal' aspect of the contract, i.e. the Legacy MSA, between Grid and British Gas, would then also result in, as it were, a 'must deal' arrangement, which is the new and replacement agreement.

In this context, Mr. Turner of course referred to the new Commission guidance that came out in early December that you have at Authorities bundle 6, tab 20, which perhaps you should have it open just for completeness. Mr. Turner highlighted para.11, among others, and he referred to whether an undertaking is able to set its prices above the competitive level. The first point we would make is that that is no doubt one criterion by which you assess dominance, but not the only one. But, the second point is that Grid was able to set its prices above the competitive level in the Legacy MSAs because you cannot assume that the P&M terms - the terms with the price cap - represented the competitive level here. You have to of course look at the prices being offered by the CMOs. There is no dispute that the Legacy MSA prices were higher than those.

MR. TURNER: Madam, just for the record - I am not standing up whenever it is said there is no dispute, there is no challenge, but take it as read that it is not always accepted.

MISS CARSS-FRISK: I am not sure if I should take it that this particular point was not accepted or just every ----

MR. TURNER: You can take it that this particular point is not accepted.

THE CHAIRMAN: Just remind me what the point was?

MISS CARSS-FRISK: The point was that Grid was actually able to set prices, or to achieve prices above the competitive level because you cannot assume that P&M prices represent the competitive level. You have to factor into the analysis that there was a significant difference in price between the rentals in the Legacy MSAs and the rentals offered by the CMOs. That is so even after, as we will see in due course, you make every allowance for Grid's various complaints about our price comparisons which you may have seen in various supplementary submissions. But, making every allowance, we say the fact is that there was a significant difference. So, not able to set above the competitive level.

In a sense, that also provides the answer to a slightly different point that Grid has made, which is, "Well, even if, in a sense, Grid was a 'must deal' partner, the Legacy MSAs were not 'must deal' terms because you had the alternative of the P&M terms". That is not really much of an alternative in the sense that those prices, as I have said, were above the competitive levels, we would suggest. Then, of course, we have the point which I think you, Madam Chairman, made earlier about Grid sitting there with this vast installed base of meter, being able to offer an across-the-board reduction which it may well be that the gas suppliers and British Gas in particular was content to take up at the end of the day. But, none of that suggests that Grid was not dominant or undermines the fundamental indications of dominance in this case.

Of course, one must bear in mind here the nature of the price reduction. In a sense, what you have here is British Gas taking over Grid's risk and getting what you might call a price reduction in return. But, to what extent is it really properly a price reduction? It is transfer of risk through the PRCs. I am not suggesting this whole case should turn on whether it is properly a price reduction or not. But, it is right to note, we would suggest that that is the bargain - this transfer of risk.

THE CHAIRMAN: That is why we explored a little bit yesterday to what extent that risk was factored into the price cap set by Ofgem, which they continued in the P&M contract. I think what Mr. Turner was saying is that there was some amount factored in, but actually it was smaller than National Grid would have liked.

MISS CARSS-FRISK: It is certainly right that it was factored into the price cap. Mr. Stephen Smith deals with that in particular. Of course, we have been told that his evidence is not

going to be challenged. So, I would refer you to that. He powerfully makes the point that there was a very helpful adjustment, shall we say, to Grid in relation to the price cut, particularly looking at cost of capital. But, it is agreed that it was looking to deal with this in part. It was, of course, something that Grid accepted at the time. They did not seek to challenge the price control as they could have done. One of the things - that I think I can say without giving evidence - which has puzzled the Authority is that Grid accepted that on the one hand and then comes back and says, "Oh dear! We have all these potentially stranded assets and sunk costs. Now we want to re-open the price cap issue to see if we can get more" when one might have thought that when the cap was originally set and an allowance was made for that, that they might have raised the point then. But, anyhow, that is what happened. Then, of course, as you have seen, after a while the idea emerged of dealing with it through commercial negotiations instead. So, the answer to your question is, "Yes, a part of the risk had been allowed for, but Grid were not content with that".

Just for your reference, it is Mr. Smith's witness statement at paras. 43 to 50.

The final point I wanted to make here about P&M terms and the role they play is that we do stand by our much-criticised submission that there was an element of uncertainty for the gas suppliers here in that they had the choice, yes, of remaining on the P&M terms as EDF did, but they could not be certain that prices might not actually go up after the cap had been lifted. Now, we know that Ofgem had said, "We intend to lift the cap when competition is established" as they hoped it would be. Grid says now, "Well, of course, the price would not have gone up once competition had been established". We say simply, "Well, there is no guarantee of that" One would have had to have seen what actually happened, assuming that there was competition in the market and the cap had been lifted. It may be that Grid would have taken advantage of what I think Mr. Turner referred to as 'inertia' in the hope that it would hang on to a sufficient number of supplier customers in relation to a sufficient number of meters for it to be sensible to raise its prices. But, this is all speculative. That is the whole point - that there was a speculative element there.

THE CHAIRMAN: Is there anything in the board papers that we have been shown some of which indicates that that was a factor which any of the gas suppliers took into account?

MISS CARSS-FRISK: No, madam. I do not believe that there is. I think the highest I can put it - and, to be fair, the highest the Authority has put it - is that this is a factor that was objectively present. But, I cannot say, "And here is a sentence that says, "We were much influenced by this point".

As for the way the negotiations went with the suppliers then - and, of course, British Gas in particular - Grid has complained that this was not properly analysed in the Decision. We are a little puzzled by that because if you look at paras. 3.75 to 3.98 in fact we would say - and that is without inviting you now to read through all of that again. I know you have looked at it before. But, just glancing at it, we would say that there is very considerable analysis of the relevant matters there - reference to Grid being a 'must deal' partner; the seriousness of the threat made by British Gas; Grid's own view; the view of British Gas, etc. Of course, it is paras. 3.86 to 3.88 in particular.

Just picking up 3.88, Mr. Turner quite rightly made the point - and we apologise for that - that we have managed to mis-quote one of the bits of that document at 3.88 in our defence. It is absolutely right that the penultimate sentence at 3.88 is correct, and in our defence we had put it slightly incorrectly. But, the point remains good that this document which you have at SD3, Tab 88, does suggest that Grid saw itself at that time in October 2003 as being in a strong position. It may just be worth going back to the document for me to make that good, so SD 3, tab 88.

MR. SUMMERS: May I just ask, in the second revised document that you circulated today, which you said did contain certain corrections of errors, is it an error which is of the type which has been corrected in this document?

MISS CARSS-FRISK: No, because the error happily is not in this document, the error is the error in the defence.

MR. SUMMERS: Yes, that is fine.

MISS CARSS-FRISK: So it did not need to be corrected here. So tab 88, p.1435. So that, as you have seen, is what is described as "Project Jam Way Forward". On p.1433 I think we discovered, or it was mentioned yesterday it should be 2003 not 2002, the date. If you look at 1435 under the heading "Current Status". "Project Jam at critical stage with two key issues", and the second bullet point:

> "We accepted an LOI (Letter of Intent) from BGT 10 months ago which doesn't reflect the change in risk balance – we need to get past this"

I mention that only because it shows that what is said here is not confined to the non-British Gas suppliers, but it actually deals more globally with the position. I picked that up because, of course, the passage where the defence have misquoted refers to non-BGT suppliers at para.3.88, so I just wanted to make it clear that the document as a whole is concerned with the global position including British Gas, so under the heading "Context":

"Climate for effective competition not moved on at the pace originally envisaged and stranding threat is therefore [materially] weaker than 12 months ago."

Then the third bullet point:

"Competitive threat from non-BGT shippers in the short to medium term is low. BGT finding mobilisation of MOs more difficult than expected."

Then under the heading: "What we now want":

"We still want to do a deal now because:

We are in a strong negotiating position now which may weaken as market develops."

I just wanted to emphasise that and clarify where we were.

THE CHAIRMAN: Is it then your case that the ultimate terms that were concluded were changed from the letter of intent which was arrived at? The letter of intent was arrived at at a time when people did not know that the CMOs were going to have so many teething problems, what this is saying is: "Look, actually they have had all these teething problems, therefore we should go back and try and do better". Now, I think Mr. Turner took us to something that showed that actually they did not or were not able to improve on the terms that had been agreed before those teething problems became apparent and the shift in bargaining power may have taken place. What do you say about that?

MISS CARSS-FRISK: We are just seeking to lay our hands on the letter of intent, but my understanding is, and I will be corrected if I am wrong, that there was a reduction in rental but that beyond that the essential terms of the deal remained as they had been.

THE CHAIRMAN: So it is not your case that they were able to take advantage ----

MISS CARSS-FRISK: That Grid were able to take advantage at that point

THE CHAIRMAN: -- that Grid were able to take advantage of the teething problems that had become apparent in the roll out of the CMO contract?

MISS CARSS-FRISK: No, I do not think I can say that, it actually went the other way as I understand it, but I will endeavour to find chapter and verse for you and do a precise comparison.

The other point I just wanted to emphasise, it is para.3.84 of the Decision, and of course in the documents, in the bundles, the reference to British Gas's own assessment that an eight year period they believe was the most aggressive exchange programme that could be delivered.

Now, we have always accepted that some concessions, as I have suggested, were obtained by British Gas, but what we would not accept is that they were substantial concessions and

there is overwhelming evidence to that effect. We will of course hear from Mr. Avery in due course but, as we mention in our skeleton, he really just refers to a price comparison. It is probably worth again coming back here to the point, just very briefly about what the price reduction means, i.e. in exchange for the transfer of risk, as I have said – at least we would suggest that played a big part in it. So far as British Gas's bargaining stance is concerned, as we have said in our defence (and I think repeated in our skeleton) it can really be described pretty much as bluff and posturing. Grid, I think, has actually suggested that a shorter period than eight years was a realistic threat in terms of accelerated replacement, but as we have seen the reference in the defence that simply is not right, and there are several documents that show that, that British Gas thought that eight years was the most aggressive that could be achieved. It is important that Mr. Avery, as you will see, himself accepts that there was an element of bluffing and posturing in all of this. Just for your reference it is para.32 of his statement, he says in terms "Whilst we were telling National Grid that we would exchange their meters in five to seven years we did not in practice intend to do that. Again, in the passages I have taken you to in the Decision one sees a quote from National Grid effectively saying: "We will take the risk and see how quickly you can do it, i.e. saying: "We are prepared to call your bluff on this. So they knew that British Gas was bluffing, and British Gas has effectively accepted it was, there we are it was a threat that was made, if you like, but it does not seem that anyone believed it. On that basis we would say it really does not indicate any overwhelming bargaining power on the part of British Gas – far from it – certainly not enough to negate Grid's power.

Now, Mr. Turner referred to EDF specifically in this context and he took you to some slides at BP1 tab 6, I am not sure we need to look at them in detail again. I would just make two points about that document: one, it does not appear to suggest any particular bargaining strength on the part of EDF in its terms, and it is of course written in the context of someone who is recommending that the legacy contract should be signed, p.56 of tab 6, so understandably perhaps – no criticism – the author might indeed seek to present it in a way that would suggest that it is not a matter of Grid exercising particular power. But, ultimately, of course, we know that EDF decided not to sign up to the Legacy MSA, which is significant, too, we would suggest. Similarly, perhaps without going to it, the other document at SD3, Tab 108, which Mr. Turner referred to, again it should be seen in the context that EDF chose not to sign the deal despite, in that document, appearing to be very confident of their position in relation to that very deal.

MR. SUMMERS: Is it the case that they did not sign the contract or that they decided to delay signing the contract?

MISS CARSS-FRISK: They decided not to go with the Legacy MSA at all.

MR. SUMMERS: Thank you.

MISS CARSS-FRISK: As far other suppliers, or suppliers more generally, I should pick up a point we have made in the defence and in the skeleton which is that the documents suggest that on what they saw as their top issues about the Legacy MSAs they were not able to achieve anything at all in their negotiations with Grid. The relevant passages in the Decision, for your note, are paras. 3.95 to 3.98. But, the documents which set out this business of their issues and what happened are, first of all, at SD3, Tab 89, which I would invite you to go to at p.1444. There you have an internal e-mail within Grid. One sees that it says, on looking at the second half of the page,

> "Colin, Richard asked me to send you a copy of the updated shipper matrix, which reflects the latest discussions with shippers on Jam. I have also included the top issues for each shipper, as you suggested".

If one then goes to p.1459 one sees there the top three issues set out for the various suppliers. We have this in detail at paras. 150 to 152 of our defence, i.e. a detailed commentary on all of this. However, can I just say that if you compare those top three issues for the suppliers to the situation a little bit later chronologically, in January 2004, you will see that nothing had changed.

The next document then is SD3, Tab 103, p.1543. You see there the left-hand column:

> '"Status/Issues: British Gas - None outstanding: LE Group - Very nervous about eighteen year contract --"

As I say, the point is that they were not able to achieve any change on the key issues. Finally under this heading we have referred also in our skeleton to one of the document actually annexed to Grid's own skeleton here, which you have at SD2, Tab 57. It is another perhaps small-ish piece of the puzzle, but, nevertheless -- It is an Npower briefing note, dated 7th February, 2003, which again suggests that there was very little scope for negotiation with Grid in relation to these contracts. It is p.1247, starting at the bottom of the page,

> "MDS have modelled (on behalf of Npower) the level of discount required to match the British Gas reduction, and concluded that the charge for a credit meter should be reduced by around £4 per meter per year. Transco have yet to make a firm offer, but have strongly indicated that their proposed reduction will be in the

region of around £2. they have further indicated that there will be little room for negotiation around this offer".

That really completes, as I suggested, what we are going to say about the negotiations with suppliers at this point.

Can I then just mention, Mr. Turner issued a heartfelt complaint yesterday about, well, the argument about sunk costs and how that put Grid in a terribly weak bargaining position and that that had been ignored by the Authority. Can I just say that it is specifically referred to in para. 3.76 of the Decision. We would say that on any fair reading of the Decision - and following analysis - it is apparent that the Authority has noted the argument, taken it on board, but concluded that in the light of all the circumstances that they set out in some detail, Grid nevertheless had market power.

I should mention perhaps Professor Grout's analysis here. You may recall that his report refers to how sunk costs can actually weaken ----

THE CHAIRMAN: If you are leaving the negotiations now -- One thing that is slightly curious is that it seems that National Grid is negotiating separately with each of the gas suppliers, but I thought we saw somewhere - or it was said - that because of non-discrimination obligations it has to apply the same terms to everyone. Or, is that only in relation to price? To what extent would it have been possible for them to meet these concerns for the individual person expressing them? There, does then the best, most favoured nation apply - that they then have to give that concession to everybody?

MISS CARSS-FRISK: Yes. As I understand the position, Grid said, certainly to the suppliers, that they could not really change, as I understand it, any of the significant aspects of the deal because of this non-discrimination obligation. Our position would be, "Well, that really was something of an excuse being offered" because one could not read the non-discrimination obligation as being an absolute obligation. Of course, as in relation to any such obligations there is always a question of objective justification. Is there good reason for treating someone differently? Sometimes the obligation not to discriminate means that you must treat people who are in a different position differently. So, frankly, it does not appear to us that that was much more than an excuse. I am sure that there will be protests on that, but that is just describing ----

MR. TURNER: Madam, I will just clarify. As you see from these documents, the negotiations were conducted with the other gas suppliers as well on the evolving proposal. To that extent, non-discrimination does not come in yet. Once the deal had been signed and crystallised with British Gas, then National Grid says, "We're not able now to

discriminate". In response to Mr. Summers' question, the position with EDF is that they were late, and that explains the dates on the documents you have seen. The complaint was, "Well, now that we have come on the scene, we are being told we cannot be given different terms". That is where the non-discrimination obligation came into play.

MISS CARSS-FRISK: For your reference, it is para. 3.96 of the Decision at p.63 where reference is made to this point and to how Grid had raised it. You have,

> "The relevant licence conditions requiring the licensee (National Grid Gas plc) to conduct its transportation business (which includes the provision of metering services for the purposes of this condition) in the manner best calculated to secure that no gas supplier obtains any unfair commercial advantage (including in particular any such advantage from a preferential or discriminatory arrangement) and to avoid undue discrimination and undue preference between any persons or class or classes of persons in the provision of metering activities. This is not an absolute obligation not to discriminate. Provided that any differences in terms could be objectively justified, the licence condition does not prevent National Grid offering different terms to different suppliers".

So, that is how it is put in the Decision. I probably put it slightly more highly than that.

Mr. Kennelly and Mr. Jones have helpfully found the reference to the letter of intent - SD2, Tab 51.

Professor Grout's analysis then about how sunk costs can give the incumbent an advantage. I think Grid is actually objecting to us putting that argument forward. However, we would say, "Well, it's simply a response to Grid having said in their Notice of Appeal that sunk costs automatically weakened the bargaining power of Grid" (Notice of Appeal, para. 305). Of course, Dr. Williams' first report also makes that point. So, we say that here we have our economic expert (or one of them) putting forward, as it were, a counter-argument. What is wrong with that, we ask rhetorically.

In our skeleton - and perhaps no need to go to it now - we have cited the *All Sports* case (Authorities Bundle 3, Tab 57, paras. 59 to 62), just setting out the basics. I am sure you will be very familiar with it, as to when an Authority can adduce further evidence or further materials, etc. We would say that this falls precisely within what is contemplated there in terms of responding to an Appellant's points.

So far as the substance of that debate is concerned, of course you have to hear it from Professor Grout and Dr. Williams in due course. Really, Professor Grout says, "Well, it does not matter for these purposes that the CMOs may be able to decide, or have their

contracts actually agreed before they sink their costs". That does not undermine his analysis that the incumbent's sunk costs may give it an advantage because of its incentive to compete aggressively etc. So, he will say, "Well, in fact, those sunk costs, far from undermining Grid's strength, may have created further barriers to entry for the CMOs, or may have affected the terms on which the CMOs were prepared to enter". But, as I say, you will of course hear from Professor Grout about that.

Finally here, I should perhaps pick up the reference to Mr. Howdon, on the part of Ofgem, having expressed a view that Mr. Turner would say was somehow inconsistent with our case. Just to remind you, that is SD2, Tab 56. It is right that Mr. Howdon is a senior economist at Ofgem, although he is not the senior economist. He is one of several. He is not at director or managing director level. If one looks at what he says at para. 15 of this document, which was dated 5th February, 2003 to the management committee. At para. 15, which you were taken to, on p.1244 he says,

> "Allowing Transco to sign commercial contracts with shippers would seem to be the most effective means of ensuring an efficient industry outcome. [So far, entirely neutral.] Transco's licence requires them to provide meters upon shipper request and these meters would be provided on the current price controlled terms with no premature replacement charge unless a shipper requested otherwise. This weakens the ability of Transco to abuse market power in setting the terms of its metering contracts since the regulated default option is always available".

I have made our submissions about the availability of the default option. The point I would make here is that, of course, Mr. Howdon is actually talking about the ability to abuse market power being somehow weakened. But, he is actually not dealing with the prior question of whether Grid was dominant at the relevant time, which we say, on all the evidence, it clearly was.

Moving on then to the question of abuse ----

THE CHAIRMAN: How much longer do you intend to go on this afternoon? I am considering whether we should take a break.

MISS CARSS-FRISK: I am entirely in your hands. I think I am making quite good progress. So, there probably is no need to sit any later than you otherwise would. As I say, I am entirely in your hands.

THE CHAIRMAN: Let us continue then until you come to a convenient point at some point after four o'clock.

MISS CARSS-FRISK: I will press ahead with what we say about the law on abuse. That may be convenient. That is something we deal with at pages 25 to 68 of our skeleton. That seems a very long chunk, but I am not going to go through all of it. Of course, there is no real dispute, I do not think, about the relevant legal principles. It is probably more about their application in this case. But, referring to the Commission's discussion paper of December 2005, which you have at A5, Tab 74, I would just like to emphasise the point made at para. 58 of that paper about how it is not necessary -- This is referring to the definition of exclusionary abuse as set out in *Hoffmann-La Roche*. Then at para. 58,

> "This definition implies that the conduct in question must in the first place have the capability, by its nature, to foreclose competitors from the market To establish such capability it is in general sufficient to investigate the form and nature of the conduct in question. It secondly implies that, in the specific market context, a likely market distorting foreclosure effect must be established. By foreclosure is meant that actual or potential competitors are completely or partially denied profitable access to a market. Foreclosure may discourage entry or expansion of rivals or encourage their exit. Foreclosure thus can be found even if the foreclosed rivals are not forced to exit the market --"

I emphasise that really in response to one of the points Grid has made, which is, "But, look, the CMOs are in business. They have not been completely excluded from the market". Well, that is not an answer. But, the key issue, perhaps, is what is meant by normal competition. In relation to that we would ask you to look at para. 54 of the same discussion paper still (Tab 74 in A5, p.3209): "The essential objective of Article 82 when analysing exclusionary conduct is the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. The concern is to prevent exclusionary conduct of the dominant firm which is likely to limit the remaining competitive constraints on the dominant company, including entry of newcomers so as to avoid the consumers are harmed. This means that it is competition and not competitors as such that is to be protected. Furthermore, the purpose of Article 82 is not to protect competitors from dominant firms' genuine competition based on factors such as higher quality, novel products, opportune innovation or otherwise better performance, but to ensure that these competitors are also able to expand in or enter the market and compete therein on the merits without facing competition conditions which are distorted or impaired by the dominant firm."

Of course, we stress here that we are not, in our submission, concerned with competition on the merits in the sense that it is just described there in that we are not concerned with Grid offering a particularly good service, etc. or competing on price. We are concerned here with Grid saying that normal competition, or I suppose they would say competition on the merits includes our entitlement to protect our sunk costs in this way and to guarantee our revenue stream.

THE CHAIRMAN: I am not sure that is quite how they put it. I think how they put it is that the competition that takes place is as to which is the best contract where all those contracts make some provision for the supplier to protect their sunk costs from being stranded that the competition is between contracts which all share that feature.

MISS CARSS-FRISK: Well insofar as, if I understood, madam, your point, insofar as we are talking about whether there was in some sense a competition at the time when the MSAs were entered into we would say that first of all one needs to bear in mind then the dominance and the advantage of course of Grid at that stage, but also that would not, in our submission, meet the point as to the exclusionary effect of the contracts then entered into and their effect on competition more broadly in the market as in the ability of the CMOs to enter and expand, etc.

Of course, as I said at the outset, we do stress that special responsibility of the dominant undertaking which concept Grid has not, to my knowledge, ever disputed as a relevant legal principle, and I am not sure how it could but, as I said before, it has never faced up to in the course of these proceedings. Perhaps I could just take you to one authority *Van den Bergh Foods* at Authorities' bundle 3, tab 49, paras. 157 to 159 at 157 there is a reference to *Hoffmann-La Roche* and then at 158:

> "Consequently, although a finding that an undertaking has a dominant position is not in itself a recrimination, it means that, irrespective of the reasons for which it has such a dominant position, the undertaking concerned has a special responsibility not to allow its conduct t impair genuine undistorted competition on the common market.
>
> 159. The Court finds, as a preliminary point, that HB rightly submits that the provision of freezer cabinets on a condition of exclusivity constitutes a standard practice on the relevant market. In the normal situation of a competitive market those agreements are concluded in the interests of the two parties and cannot be prohibited as a matte of principle. However, those considerations which are applicable in the normal situation of a competitive market, cannot be accepted

> without reservation in the case of a market on which, precisely because of the dominant position held by one of the traders, competition is already restricted. Business conduct which contributes to an improvement in production or distribution of goods and which has a beneficial effect of competition in a balanced market may restrict such competition where it is engaged in by an undertaking which has a dominant position on the relevant market. With regard to the nature of the exclusivity clause, the Court finds that the Commission rightly held in the contested decision that HB was abusing its dominant position on the relevant market by inducing retailers who, for the purpose of stocking impulse ice-cream, did not have their own freezer cabinet, or a cabinet made available by an ice-cream supplier other than HB, to accept agreements for the provision of cabinets subject to a condition of exclusivity. That infringement of Article 86 takes the form, in this case, of an offer to supply freezer cabinets to the retailers and to maintain the cabinets free of any direct charge to the retailers."

Perhaps a little bit too much factual detail there that we do not really need, the key point is obvious. What might be perfectly acceptable in a competitive market will not necessarily be so where you already have an effect of the dominant undertaking.

The third matter I wanted to mention so far as the law is concerned, is that of course all the Authority has to show, and this really already comes from the Commission's discussion paper and it is probably common ground, is that the MSAs had a likely foreclosing effect on competition or, to put it slightly differently, that they were capable of having that effect, or tended to have that effect, so it is not actually necessary to show actual effect even though we have done so, we say in this case and made such a finding, and that is the *British Airways* case at A3, tab 51 – perhaps no need to go to that.

So far as harm to consumers is concerned, of course the Authority did find that the effect of the MSAs has been to cause such harm but I would just make the point that legally it is not necessary of course to show direct impact on consumers in that way, that is another point coming out of the *British Airways* case and perhaps it should be turned up just for that point (vol.A5, tab 76). (After a pause) I am sorry, I fear I may have the wrong reference here, forgive me. Everyone is very kindly trying to help me, I am very grateful – it is A5, tab 76.

THE CHAIRMAN: This is the Court of First Instance.

MISS CARSS-FRISK: I now see I had made a note of the correct reference, A5, 84.

THE CHAIRMAN: The reference that you gave us before ----

MISS CARSS-FRISK: That was A3, tab 51. So this is tab 84 in tab A5, para. 106 at p.3798:

"Moreover, as the Court has already held n paragraph 26 of its judgment in *Europemballage and Continental Can*, Article 82EC is aimed not only at practices which may cause prejudice to consumers directly, but also at those which are detrimental to them through their impact on an effective competition structure, such as is mentioned in Article 3(1)(g)EC."

We have referred in our skeleton also, which I just draw to your attention for your note, to the opinion of Advocate General Kokott in that case, which is in the same bundle at tab 76, which is important in our submission because of its emphasis on the whole scheme of Article 82 being to protect the structure of the market and thus competition as an institution with consumers being indirectly protected, and that is para. 68 of his Opinion.

It is actually 4 o'clock, and that is the end of what I was going to say about the law, so that may be a convenient moment?

THE CHAIRMAN: Well provided that you are confident that you will be able to finish by – is it lunchtime on Monday?

MISS CARSS-FRISK: Yes, I shall make sure I do.

THE CHAIRMAN: Do we need to start early or shall we start at 10.30?

MISS CARSS-FRISK: I would have thought 10.30 would be enough. It may be, as I said, that will produce something in writing in response to Grid's notes.

THE CHAIRMAN: Thank you very much. We will resume at 10.30 on Monday.

(Adjourned until 10.30 a.m. on Monday, 19th January 2009)