IN THE COMPETITION APPEAL TRIBUNAL Case No 1051/4/8/05

Victoria House,
Bloomsbury Place,
London WC1A 2EB

1st November 2005

Before:
SIR CHRISTOPHER BELLAMY
(President)

MARION SIMMONS QC
PROFESSOR PAUL STONEMAN

Sitting as a Tribunal in England and Wales

BETWEEN:

SOMERFIELD PLC Applicant

and

COMPETITION COMMISSION Respondent

Mr. James Flynn QC and Mr. Aidan Robertson (instructed by TLT Solicitors) appeared for the Applicant.

Mr. John Swift QC and Mr. Daniel Beard (instructed by the Treasury Solicitor) appeared for the Respondent.

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CASE MANAGEMENT CONFERENCE

THE PRESIDENT: Good morning, ladies and gentlemen. What we would like, Mr. Flynn and Mr. Swift, is basically to do four things. One is to look first, if we may, at the letter of 25th October that TLT sent in relation to the instructions it says it has received. Secondly, to consider the general state of the case, thirdly, to look at the timetable hereafter; and fourthly, I would like, if I may, to try to articulate what I understand the process of reasoning of the CC to be, leading up to the issues that remain live issues so that my probably imperfect understanding at this stage is on the table, so that the CC in its defence or others at some stage in the proceedings can correct my understanding, so that everybody has a broadly agreed understanding of what the reasoning process has been. We also need to deal with the question of the intervention and any other points that the parties wish to raise. That I think is roughly the order of play this morning.

I wonder, Mr. Flynn, if I could turn first to TLT's letter of 24th October? What I thought we had asked for was confirmation that the decision to discontinue – or not seek relief under, to use your phrase, I think – Ground 1 was a decision by Somerfield PLC, i.e. that would in the normal course mean whatever the responsible organ was, either the Board or some duly authorised person on behalf of the Board. The letter of 24th October did seem to us to be somewhat ambiguous in that it suggests that the decision is in fact the decision of the Consortium, and that Somerfield wanted to go out of its way to make clear that it was the Consortium's decision. So I am wondering to myself whether we do still have some ambiguity in this respect or whether the position is entirely clear, and I do not know whether the CC is now satisfied that the position is at least sufficiently clear for their purposes. Can you help us at all on this – particularly the second paragraph of the letter?

MR. FLYNN: May I just be clear, are we talking about the letter of 20th October rather than 24th?

THE PRESIDENT: Well mine is dated 24th October, from Mr. Hull to the Registrar. I do not know whether you have that?

MR. FLYNN: I do not think I have that letter as such, but I believe ----

THE PRESIDENT: Are you with me, Mr. Swift, have you got the letter of 24th October?

MR. SWIFT: It is being passed up to me, I do not have it in front of me.

MR. FLYNN: Sir, I think the position is this: immediately after the last CMC, TLT wrote to the Treasury Solicitor in the terms of the letter that you have in front of you. After that we have the order and the letter from the registrar saying "Could all correspondence be copied to the Tribunal?" When we appreciated that then the letter was also sent for the attention of the Tribunal, so I believe ----

THE PRESIDENT: So it is effectively the same letter.

MR. FLYNN: I believe it is the same letter, and if your second paragraph begins: "The reference to the Consortium in Somerfield's statement …"

THE PRESIDENT: Yes.

MR. FLYNN: And unless I have misunderstood anything then we should be on exactly the same wording, if not the same date in the letter. So in relation to such clarification as I can give, and I do not know if Mr. Swift has indicated that there is any residual dissatisfaction from his perspective, but the position as I understand it is that Somerfield has entered into what is known as an "implementation agreement" with the Consortium, under which Somerfield is required to obtain the Consortium's consent for various actions, and in certain cases they are, as it were, to accept instructions from the Consortium. So it is the Consortium which requests Somerfield to withdraw the application for relief under Ground 1, but the withdrawal is an action of Somerfield PLC, for whom TLT act and, in my submission, there is nothing left as it were. Somerfield has, through me and now also by letter, stated that it no longer seeks relief under Ground 1, that part of the application is withdrawn.

THE PRESIDENT: "No longer seeking relief" and "withdrawn" have slightly different connotations – which is it?

MR. FLYNN: If we are to draw a distinction between them I do not know that there is a distinction. Ground 1 is no longer pursued. Ground 1 is not a matter of concern to this Tribunal or the Competition Commission. No argument will be addressed to this Tribunal under Ground 1. I have no objection to saying "Ground 1 is withdrawn", Sir, if that is thought to assist. It is simply off the table.

MISS SIMMONS: My difficulty is it is not clear to me whether you accept the decision on Ground 1 or whether you are saying that you are withdrawing it but you do not accept it, but you are not asking for any relief?

MR. FLYNN: Madam, I think it depends what is meant by "accept". Somerfield may have its own views on Ground 1 and how the Competition Commission reached its finding of SLC and those views may be expressed in the Notice of Appeal but they are no longer relevant to anything. The point is in law, as a matter of law, the SLC finding by the Competition Commission is no longer challenged. You will not get Somerfield to say "Hear, hear, we think it is a jolly good thing and they came to the right answer", but that really does not matter. In my submission it is not being challenged. There is no application for review or relief in respect of that SLC finding.

THE PRESIDENT: I suppose what lies behind this part of the discussion, Mr. Flynn, is that we are still slightly unsure, until the case has unfolded a bit further, as to whether Ground 2 can really be addressed without at least understanding and to some extent going into some of the

background that arises primarily under Ground 1. In other words, getting into Ground 2 will, or might – we cannot completely exclude the possibility that we shall be led back into Ground 1, which is why we are pressing quite strongly for a very clear indication as to what your position is as regards Ground 1.

MR. FLYNN: Clearly, Sir, it is our position, and it may be that that is encountering some resistance on the other side, it is our position that you need to understand the SLC finding. Let me put it this way, if I said to you we were withdrawing Ground 1 and we would like to remove from your files everything to do with Ground 1 and you simply concentrate on Ground 2 and it does not matter how they reach the SLC finding I think you would find that rather strange. The fact of the matter is, because we are not seeking any relief in relation to Ground 1 there is no way that these proceedings can led to that finding being questioned. It remains, it has been found and it will not be challenged in these proceedings.

THE PRESIDENT: It may well be that we cannot resolve this now, the case needs to develop a bit further before we do. This takes us back, I think, to part of our discussion we were having last time we met about Rule 12 and the withdrawal of the Application, and whether you can have a partial withdrawal etc.; without reopening that discussion, that rule is there because this is not *inter partes* litigation in the strict sense, there are wider issues affecting the public interest that tend to arise in these Applications and that rule is there as a safeguard mechanism to deal with that. In this particular case from the Tribunal's point of view if we need to understand the CC's findings on SLC – and it looks at first sight as if we do – we may be led back into understanding those findings and understanding the premise upon which the divestment remedy has been ordered. One possibility, which at this stage cannot be wholly excluded, is that as our understanding deepens we find ourselves having a question mark in the back of our minds about the premise upon which the divestment has been ordered. The Tribunal therefore – if I may use the word neutrally – may be facing the possibility of a sort of "trap" because we have been led like a horse in blinkers to look at a particular aspect of the situation. We may find ourselves feeling slightly uncomfortable that the situation cannot in fact be looked at without looking a little bit wider at what the full process of reasoning was. You cannot necessarily consider the reliability of the buttress without looking at the whole cathedral. That is our problem, and it may not be a problem, but it is not one that we feel completely able to exclude at this stage. The process of reasoning might lead us deeper into the case than the simple invitation to look at Ground 2 might imply.

MR. FLYNN: Well, Sir, yes – I hesitate to develop the architectural analogy but if the cathedral is the SLC that will stand and all we are talking about is some remedial work to the buttress, if

you like. We are simply saying that it should be our choice of stone or our choice of stone mason for that remedial work.

THE PRESIDENT: That is your premise, but the question for us may arise at some point as to whether that is a useful premise (or a correct premise) on which we can deal with the case.

MR. FLYNN: Well the examples that have been given or raised so far as causing possible difficulty, Sir, are market definition, which is a stage 1 and not a stage 2 issue, and there in correspondence, as you have seen, we have said that we are content to regard the paragraph of Mr. Ridyard's statement in which he refers (and I think from the CC's perspective gratuitously) to its market definition, we are content to regard that as irrelevant to these proceedings. Market definition at stage 1.

THE PRESIDENT: This is the secondary shopping point, is it?

MR. FLYNN: Yes, it is, Sir, and I think it is para.84(i) of the expert report. The issue of the exclusion of the LADs has also been raised as possibly feeding back into the Ground 1 analysis and on that we say that that is not correct. We have carefully distinguished in Ground 2. The point we are challenging is that the reasons given for excluding the LADS as potential divestees are not good reasons for excluding them as potential divestees. They happen to be the same reasons which were given for excluding them from the competitor set at stage 1. But, as we made clear in the Notice of Application from the beginning, we were never challenging stage 1. As I say, those reasons which have been given as reasons for excluding them from the category of permitted divestees are the same which lead to them being excluded from the competitor set, but we criticise them in relation to divestment and not in relation to competitor set. We say they are an appropriate grocery operator to take the store and they just have as much competitive impact as others which are in the permitted divestee class.

THE PRESIDENT: What about the symmetry point in the first part of Ground 2?

MR. FLYNN: The symmetry point is part of our reasoning for the challenge under Ground 2, and we would say the normal rule is, say in a conglomerate merger, the acquirer already has one business of the kind, takes over another, and the CC finds that that is a problem, orders divestiture. It would ordinarily be the owner's choice, which of his two businesses to divest. We say that is the ordinary rule, all the more so here when, as a matter of methodology the CC's SLC finding was premised on the view that the competition between the stores is symmetrical. That is not our only point in that connection but it is a logic point and we simply say that applying the logic that you did apply in reaching your SLC finding it is now inconsistent to turn round in ordering remedies and saying "Oh but they are asymmetrical", that is our point. If I may say so it will not lead to the Tribunal saying "Quite right, so the SLC finding is flawed." Even if the Tribunal reached that view privately it would not be a matter

for the judgment and it certainly would not be a matter for relief. The finding stands and is unchallenged. This is simply a question of what is the appropriate remedial structure for the SLC that the CC has found.

THE PRESIDENT: Well those are your submissions. I think at this stage all we would wish to do is to put down a marker to the effect that we are not completely clear that Ground 2 is a self-standing ground that can be entirely divorced from other aspects of the case, but in the circumstances, probably the best thing to do is to allow the application to unfold, and see where we get to. I am not entirely sure we can foresee at the moment where we will get to.

MR. FLYNN: No, Sir, I understand that, but I have made some fairly clear statements on the record which you will no doubt cast in my teeth if I tend to stray at a later stage.

THE PRESIDENT: Yes, well, thank you for that. Mr. Swift, do you have any observations on that interchange.

MR. SWIFT: Yes, Sir, good morning, members of the Tribunal. On the letter of 24th October sent to Treasury Solicitors, yes, there is a degree of ambiguity but we were really quite happy to accept the oral assurances given by Mr. Flynn at the last hearing and the letter from TLT; the Appeal appears to be prosecuted by Somerfield on the appropriate instructions of the Board of Directors and that is the assumption which we are going on, so we saw no reason to challenge it.

On the other aspects of the interchange, it is worth drawing to the Tribunal's attention that which will be before you anyway and that is the letter from TLT to Treasury Solicitors on 28th October, and that was in response to the Commission's letter of 27th October which I would describe as our letter for clarification. On the first page of the letter of 28th October TLT say:

> "We do not consider that Somerfield's Notice of Application now confined to Ground 2, raises any uncertainty so as to inhibit the Competition Commission from serving its defence …" etc.
>
> "As to the specific issues you raise, Somerfield responds as follows:"

Then in paras. 1 and 2, and I quote – "… for the avoidance of doubt …" Somerfield says effectively no challenge either to stage 1 analysis, or to the CC's finding of SLC at stage 2, and then at para.2: "The SLC analysis is not challenged under Ground 2." The Tribunal may recall that at the last hearing I put to Mr. Flynn whether he accepted the conclusions of the Commission at section 10, namely, that the acquisition may be expected to result in an SLC in each of the local markets served by the 12 stores referred to in paras. 7.18 and 7.37. Without taking the Tribunal to those paragraphs, they refer to the acquired stores as such; and (b):

"The acquisition may be expected to have the adverse effects on consumers in those markets of higher prices and reduced range of products, loss of choice and poorer service referred to in paragraph 8.3."

Paragraph 8.3 is at p.55 of the report and it is part of a very short section dealing with conclusions on effect of local competition. It is worth, Sir, members of the Tribunal, just reading it through, rather than my reading it into the record.

THE PRESIDENT: Yes, do you want us quickly to glance at it? (After a pause) Yes.

MR. SWIFT: The only point that I am making is that the section on conclusions takes one back into the reasoning and in the conclusions on the effect of local competition. When TLT now say in their letter of 28th October that they do not challenge the conclusions, the findings, or the analysis, I am assuming, for the purposes of our Defence and our witness statements, that that is what they are not challenging – including the finding by the Commission at para.8.2 that Somerfield's consideration of shutting either the acquired or the existing store in redacted number of the areas we have identified "… is likely to be to the detriment of shoppers currently using that store since it is them most convenient available to them." No challenge to the analysis or the findings must, in my submission, mean no challenge to any paragraph including 8.1, 8.2 and 8.3, and that is not for reopening when we come to remedies.

Indeed, since section 10 – the conclusions – takes one back to para.7.18 and 7.37, to be found at pages 43 and 49 of the report, again when one comes to consider the processes by which the Commission reasoned on remedies, the starting point is that finding at 7.18:

"We identified 10 stores which … all had revenue-weighted diversion ratios of 14.3 per cent. or above and an illustrative price increase – or equivalent reduction in quality, range or service as a result of the merger – of at least 5 per cent. The ten stores whose acquisition is therefore in our view likely on that basis to give rise to the prospect of an SLC (i.e. an expectation of an SLC, but subject to our consideration below of entry in the counterfactual) are as follows: ..."

and then they are set out. Para.7.37 is dealing with the closed stores of Kelso and Littlehampton, and again at para.7.37 the Commission said (line 3):

"We would expect diversion ratios and potential price rises of Kelso and Littlehampton to have exceeded the thresholds set out in paragraph 7.12. The acquisition of these two stores is also therefore likely to give rise to the prospect of an SLC, i.e. an expectation of an SLC subject to our consideration of entry and the counterfactual."

Those three interlocking sections are, in our submission, extremely important. They are the natural funnel through which one proceeds to section 11 of the report (p.58) which, not surprisingly, starts with the words "We are therefore required to consider whether action should be taken for the purpose of remedying, mitigating or preventing the SLC or any adverse effects …" and so on and so forth. That is the starting point and that is why we sought some clarification. The Applicant's argument is that notwithstanding those findings of fact and notwithstanding that analysis, when it comes to remedies the Competition Commission has no discretion, and I refer to the first argument under Ground 2 as the "no discretion" point.

THE PRESIDENT: No discretion to choose between the acquired and the existing?

MR. SWIFT: At that point I have no discretion other than to hand over to the Applicant the entire responsibility of selecting which stores to divest and to whom, subject possibly – but this is not made clear in the Notice of Application, it is in a footnote to Mr. Ridyard's statement – subject to I think it is called "divestment potential", aspects of saleability. But subject to that the CC has no role to play and in our letter of 27th October we were seeking to establish "Is that really your case?" Or is it essentially – and this is getting very "techy", I think it is footnote 32 to paragraph 102 of the Notice of Application, and in case I have got it wrong I will turn it up now.

THE PRESIDENT: We have it right in front of us, Mr. Swift, we knew you were about to go there and we have already opened it.

MR. SWIFT: Footnote 32 is brought into the text in para.103. Paragraph 103 says:

> "The SLC identified by the CC arose because of the transfer into common ownership of stores previously under separate ownership in local grocery markets."

That is the sort of ownership point. But then we have this footnote (the Ridyard footnote) about equal competitive constraints. So one reason why we put the letter of clarification is: are you saying that you are not going so far as to say there is no discretion, but that the Commission is bound by the theory which it is alleged to have adopted, and this is the theory to which reference is made in para.77 of the Ridyard statement at p.23.

THE PRESIDENT: Yes, that seems to be their case.

MR. SWIFT: Quote:

> "The characteristics of the divestment store are not important for remedying SLC under the CC's theory. The sale of a proximity store would restore competition equally as well as the sale of the acquired store."

So that is why we wanted some clarification. Having listened to my learned friend this morning I think I am a little bit wiser but not to the point where I would say that we are completely clear as to what they are saying, because if they really are saying that irrespective

of whether this is a Somerfield/Morrison's acquisition in the case of any horizontal merger once the Commission finds an SLC as a result of an increase in concentration, the CC has no power whatsoever to intervene and control the process, despite its clear duties under s.35 of the Enterprise Act.

THE PRESIDENT: Yes – this is not the occasion to be making your main submissions. (Laughter)

MR. SWIFT: I was simply clarifying our position as we see it in response to what we believe their position to be.

THE PRESIDENT: Thank you, yes.

MR. SWIFT: If I have gone too far I apologise to the Tribunal.

(The Tribunal confer)

THE PRESIDENT: Very well, there it is. The situation I think is not entirely satisfactory, but our view is that we should now press on as best we can with the next steps in the case and see where we get to. I think it is unlikely that before the hearing we are going to get very much more clarity than we have at the moment, obscure though some points still are – at least in our minds. The question I think we now ought to address is that of timetable. The next step would normally be the CC's Defence. Mr. Swift, you told us last time that you had been working very hard on the Defence, it is now a more limited document than it may once have been. We thought perhaps would next Tuesday be appropriate – Tuesday, November 8th?

MR. SWIFT: Well we are still in difficulties on this question of clarification. My learned friend was offering us Friday, 11th November. We were proposing Defence by Monday, 14th and on that timetable, on our calculation that we were going through yesterday, subject to all the remaining steps, in our submission the Tribunal could hold the hearing – if it were convenient to you, Sir, and members of the Tribunal – in the week beginning December 12th.

THE PRESIDENT: Working back the provisional hearing date we had in mind was Tuesday, December 13th and, although we may not need it, we have pencilled in Wednesday, 14th in reserve, as it were, but Tuesday, 13th for the hearing. We had envisaged that following the Defence there would be sequential skeleton arguments, i.e. they put their skeleton in and then you put yours in. We had in mind Friday, 18th November for Somerfield's skeleton and Friday, 2nd December for your skeleton, giving you two weeks after their skeleton. On Somerfield's skeleton of Friday, November 18th they really ought to have the Defence no later than the 8th in order to have time to do the skeleton, if we are to meet a December hearing date and not compress the timetable too much.

MR. SWIFT: But by eliminating the need for a reply and moving straight to skeletons – I say this with great trepidation, because you are in charge of the procedure, the timetable – if the

skeleton was put to the Monday 21st, rather than Friday 18th, they would still have a clear week if we delivered our Defence on 14th.

THE PRESIDENT: Well they need at least 10 days after the Defence, I would have thought.

MR. SWIFT: Would the 11th be acceptable to you, Sir? That would give them 10 days to 21st.

THE PRESIDENT: Mr. Flynn, let us see what you have to say. We do not want to hold the hearing any later than the 13th.

MR. FLYNN: No.

THE PRESIDENT: So the timetable we had envisaged for skeletons was 18th November for you and 2nd December for Mr. Swift, and on that basis one of the questions is how long you need for your skeleton after you have received the Defence?

MR. FLYNN: Well I heard you say you thought we needed 10 days, Sir, and I would have thought that is the least we need really, so if that could be accommodated – it is tight, but do-able I would say. May I just say, there is obviously no provision for a reply in ----

THE PRESIDENT: There is not, and I should have articulated that more clearly. I think the skeleton will play the role of the ---

MR. FLYNN: Can I just put down a marker in case it should be necessary. What we put in our suggested timetable is a reply and, if so advised, any further evidence. It might just be that there were points of economic expertise that would arise from the Defence as to which we would feel the need to call on Mr. Ridyard's service rather than to put in a skeleton.

THE PRESIDENT: It might be, this is a point I want to explore with Mr. Swift in a moment, we are not at all sure that there is much need for further evidence.

MR. FLYNN: It may well not arise, I simply put that as a possible marker, if there are matters – presumably there will be some response to what Mr. Ridyard has said, and it may simply be that that is not a matter for legal submission, so if I could just float that, and we can have a further discussion or I can apply nearer the time in the light of whatever is served on us.

THE PRESIDENT: If, and I am not quite sure why we should, but if we accepted Mr. Swift's suggestion of Friday, November 11th, and your skeleton by close of play on Monday, November 21st, and we held the CC to their skeleton on 2nd December that would still be the same effective timetable.

MR. FLYNN: That would be the same timetable and I think we could work with that, as I say there is just the possible reservation about the need for reply evidence should it arise.

THE PRESIDENT: Yes. On the two main parts of Ground 2 can I just clarify two points? One as regards divestment of acquired stores, am I right in thinking that we have actually only got four stores in issue now?

MR. FLYNN: Well, Sir, it is a question of principle. Our point is that the choice should be Somerfield's, and while matters clearly were discussed between the Commission and Somerfield in the inquiry it may be for reasons I do not know – commercial marketing reasons – Somerfield's view on which is the appropriate divestment store may have changed, so I think we shall be arguing this as a question of principle rather than store.

THE PRESIDENT: Well I am just wondering how far that might be open to you to argue, Mr. Flynn, because in 11.22 the CC has given reasons for deciding as it did in relation to Middlesbrough Linthorpe, Newark, Pocklington and South Shields, whereas in 11.14 they say there is agreement in relation to Filey, Poole Bearwood and Whitburn, and therefore we do not actually have any reasoning in the report about those latter three stores, and I am not entirely sure that you can reasonably attack the report for having arrived at a conclusion upon which there had been an agreement at an earlier stage.

MR. FLYNN: Sir, if the basis of the attack is that the choice should ordinarily be for Somerfield and Somerfield given a period for divestment, to make that choice and comply with the stipulations, then I would say that is consistent, and we can make that argument.

THE PRESIDENT: Well, we will see.

MR. FLYNN: I think you had another question, Sir?

THE PRESIDENT: Yes, my second question on the second part of Ground 2, which is the LADs point, am I right in thinking this is partly a timing issue, that is to say 11.24 to 11.28 envisage that ----

MR. FLYNN: The period is confidential, Sir.

THE PRESIDENT: The period is confidential, thank you for reminding me of that – envisage that there should be an initial stage and if nothing is achieved within the stipulated period of time then the circle is widened – may be widened – to a wider circle, so it is not, as it were, an absolute prohibition on the LADs it is a qualified prohibition that depends to some extent on timescale.

MR. FLYNN: And our point is that they are as good as anyone else to be included in the first phase.

THE PRESIDENT: In the first stage?

MR. FLYNN: Yes.

THE PRESIDENT: Yes, I am sorry, Mr. Swift?

MR. SWIFT: I am very glad you raised the point, I was plainly going to raise it myself, four or seven – if seven, why not twelve? Why not reopen the whole lot? If my learned friend is right all the reasoning here is a waste of space, the Commission was acting *ultra vires* in even going through it. Certainly, that is something on which we would be looking for a Ruling from the Tribunal because if the Tribunal does want a reopener, then plainly we will have to provide

for ----

THE PRESIDENT: Well this is Judicial Review, Mr. Swift, and normally in Judicial Review we look at the Decision that we have and see whether the Decision that we have is quashable on normal Judicial Review grounds, and where there has been an earlier agreement it might be a bit difficult to criticise an authority for relying on the agreement in coming to the view that it reached in its report, but it is a matter for argument hereafter.

Could you just enlighten me on one thing? You have mentioned more than once the question of evidence, witness statement and so forth, how do you see that? In principle we have your report, it is a very full report – to what point is the further evidence directed as you envisage it at the moment?

MR. SWIFT: Again, we have reached no final conclusion on this. In terms of the first argument under Ground 1, and that is the relevance of the diversion ratio, I would be proposing to put in some evidence to rebut the Ridyard allegation on which the Notice of Application is so heavily reliant, that as a matter of logic the calculation that one adopted for the purpose of arriving at the findings of SLC in some way estopped the Commission from looking at the facts on the ground when determining aspects of PQRS – that would have to be addressed, because this is meeting an argument in the Notice of Application which is referred to obviously as one of Somerfield's arguments in the Competition Commission report. Naturally, the Competition Commission cannot be expected to reproduce the vast amount of evidence that Somerfield put in, in the course of that. Again, mindful of the fact that it is Judicial Review I would limit that to what is absolutely essential.

The other aspect goes to the facts on the ground, as to whether this Tribunal would appreciate additional evidence, for example, maps. One could say that if one looks, for example, at the arguments in 11.22, the four stores, as you can see the facts there cover less than a page but they conceal a mass of evidence as to what was found by the Commission on the ground. Again, it would be a matter for the Tribunal to decide on, I suppose admissibility in weight, but I would rather be in a position of offering the Tribunal more so that you could actually see what was done to the extent that you regard it as relevant, rather than just say "Well, we will just stick to the report".

So far as the separate issue of the LADs are concerned, my current view – I will discuss this with the clients – is that we need very little more (if anything) to rebut Mr. Ridyard's arguments, though for my part I cannot see an issue of law there. The LADs issue appears to me to fall very well within the area of irrationality, or "did it fall within the bounds of reasonable judgment for the Commission on the evidence before them?" I know this is not the time to be submitting anything, I am supposed to be talking about the additional

evidence, but my current view is that very little extra evidence would need to go in respect of the LADs point. That is where we stand.

THE PRESIDENT: Thank you yes.

(The Tribunal confer)

THE PRESIDENT: Mr. Swift, I think a certain amount of limited geographical background about 11.22 might be of some help – it is a bit difficult to understand exactly what is happening on the ground in Middlesbrough, for example, there seem to be a number of stores ----

MR. SWIFT: I look forward to taking the Tribunal on a guided tour through parts of the North and Scotland.

THE PRESIDENT: Partly because there seems to be an Eastbourne Road in both Middlesbrough and South Shields, which I think must be not quite what is intended to be said – that is in 11.34 and 11.22 – it may be that you mean another road in 11.34 I do not know. But some clarification on where what is where would help.

MR. FLYNN: Sir, I hate to interrupt but that is again confidential.

THE PRESIDENT: Well the fact that there is a certain road in those locations is public knowledge.

MR. FLYNN: Yes, but nevertheless it could be relevant.

THE PRESIDENT: It is not marked as confidential in the copy in front of me, Mr. Flynn.

MR. FLYNN: In that case I apologise for the interruption, but it should be, Sir. The last sentence of 11.34 is ----

THE PRESIDENT: Yes, but it is not marked at 11.22, however …

MR. FLYNN: There we are.

MR. SWIFT: Plainly, Sir, I am looking both at the published version and the complete version and we will have to take care, but the position of stores on roads in the United Kingdom is, so far as I know, in the public domain, it does not have to be supplied under the Freedom of Information Act. (Laughter)

THE PRESIDENT: With any luck that is true, yes. Very well, we have a timetable which I think is all we can achieve now.

Could I just very briefly sketch out my own, as I say, imperfect understanding of what, as it were, has gone on in this case, because we may need to write a Judgment at some later stage just explaining briefly the background, and I would like to be clear as to what has actually happened, so this is a very provisional explanation of what I understand to have happened, and I would be very glad if, in due course in writing, I could be corrected or put right.

As I understand it this is the first time that diversion ratio analysis has been used in United Kingdom merger control. Hitherto, much of the relevant analysis has been largely

based on isochrone analysis, i.e. how many stores in the relevant competitor set will remain post merger in certain local geographical areas defined by travelling times. What stores are in the competitor set and what are the appropriate isochrones to use may raise difficult issues, but the approach of the "fascia count" was the essential approach adopted by the CC in its Safeway Report in 2003 and in the earlier supermarkets' inquiry in 2000. In the 2003 Safeway Report the CC considered that a reduction to three or fewer fascias was presumptively sufficient to affect competition adversely, as I think that the present Somerfield Report acknowledges at para.6.75. What the approach has been in this case, as I understand it, is that the CC conducted, as it were, its analysis in two stages. At the first stage they essentially followed the approach of the Safeway Report by carrying out what was, in effect, a fascia count considering some very detailed arguments as to what the competitor set was, what the appropriate isochrones should be, and so forth, as a result of which they arrived at the conclusion that there were some 56 stores at this stage 1 of the analysis, where, on a fascia count, the result of the merger would be 3 or less fascias.

It then appears that the CC's approach was to regard this as a "potential" competition problem rather than just stopping there as the Safeway Report might have done. The CC proceeded to a stage 2 analysis using diversion ratios. A diversion ratio – and this is now putting it in very crude terms, and you will forgive me for over simplifying and probably misunderstanding how it works – is an attempt to measure how far in the identified potential problem areas Somerfield and Safeway/Morrison had been rivals before the merger. This is done by measuring, by means of a consumer survey, how many customers would switch from Safeway/Morrison to Somerfield if the former were no longer available, or vice-versa. If, for example, 50 per cent. of Safeway/Morrison customers would switch to Somerfield in a given locality on the various assumptions made, that would show a relatively high degree of substitutability between the two stores implying that the stores in question exercised an important competitive constraint on each other. That I think is explained at para.7.4 of the Report. One can do this analysis – diversion ratio analysis – either on the basis of customers or on the basis of revenue (para.7.7).

However, at this stage of the analysis it seems that the CC did not again regard a high diversion ratio standing alone as giving rise to the necessary expectation of a substantial lessening of competition, even in those areas where the fascia count was three or less. The CC then looked at an additional element, namely those areas where the stores had, according to the CC, high margins and, as I understand it, by the margin here we are talking about the gross margin, i.e. the difference between the cost of goods and selling price, but not including other costs such as rent, staff, distribution, promotion, general overheads and so on.

The CC then says (I think it is again at para.7.6) that neither high diversion ratios nor high margins in isolation need indicate that a merger has potential anti-competitive effects. It is, according to that paragraph, a combination of a high diversion ratio and a high margin that gives rise, or may give rise, to a substantial lessening of competition. That is essentially the theoretical approach. To carry this out in practice among other things the CC caused to be carried out a survey by NOP to establish diversion ratios at the 56 problem stores, and for the purpose of its further analysis the CC used a threshold diversion ratio of 14.3 per cent. – something I will come back to in a minute – which is explained in para.7.12 of the Report.

Then using the methodology which is set out in Appendix D to the Report (particularly para.13) the CC calculated illustrative price rises to see whether, post-merger, there would be price rises in excess of 5 per cent., which the CC regarded as significant. The results are shown in Appendix E and that shows 10 stores that had an illustrative price rise of more than 5 per cent., and thus giving rise in the CC's view to a substantial lessening of competition. Those 10 stores are listed in the Report.

In addition, by way of a further analysis that one need not spell out at this stage, the CC arrived at the conclusion that a similar result would have been reached in relation to two stores that had closed at Kelso and Littlehampton, had those stores remained open. All the stores that are identified as problem stores apparently had gross margins above 20 per cent. which the CC regarded as high margins.

The estimated price rises and the methodology for reaching them depend – the result depends – in part on whether the demand is described as "linear" or "isoelastic". If linear, six stores would have been affected, rather than the 12 that the CC decided on. According to the CC an isoelastic demand shape is more to be expected. That is all, as I say, predicated on the diversion ratio threshold of 14.3 per cent. which is spelt out at para.7.12 of the Report, which is apparently based on a model where there are eight firms in a market, each having 12.5 per cent. That model assumes (assuming symmetry) a diversion ratio of 14.3 per cent., which is one-seventh.

It is at this point that I for one have a little difficulty with the next step in the analysis, and it is something on which I would be glad of some clarification in due course in the Defence, which is how exactly this works in relation to para.7.12 of the Report, where it is said that a merger of two of the eight firms in question would give rise to a market share of 25 per cent., and that is basically the reason for adopting the 14.3 per cent. diversion ratio. The question that is in my mind – and I am sure it can be cleared up without difficulty – is that if, on this hypothesis, you have eight firms in the market and you have a diversion ratio of 14.3 per cent., while initially the merger of two of those firms may give rise to a market share of 25

per cent., does it necessarily leave them with a 25 per cent. share of the market, considering that there are six other competitors? If the merged firm should attempt to raise prices, the diversion ratios would surely kick in and they would all finish up with 14.3 per cent. But that, I am sure, is something that can be cleared up as we go along but which is a puzzle in my head at the moment.

However, what we seem to have here is a situation in which on the one hand the Safeway rule concerning three or less fascias is not regarded by the CC as in itself sufficient to establish a substantial lessening of competition, but on the other hand, a methodology that seems to rely as its starting point on a reduction from eight to seven may lead to a substantial lessening of competition, and that at first sight again, from my humble and initial view, is an analysis one is struggling a little bit to get one's head around, in that in many previous circumstances something that goes down to three or less would have been regarded as giving rise to SLC, but something that goes down from eight to seven would not necessarily have been so regarded. So it would be helpful, certainly as far as I am concerned, to sort that out from a conceptual point of view as part of the background to this case.

The other general point simply to mention (which probably does not now arise since Ground 1 is not pursued) is that, as it has emerged, the Report contains a great deal of factual material which is extremely helpful and relevant, but a number of parts of the analysis proceed upon the basis of assumption, and one question that would often arise in cases like this is how far the assumptions made can be verified empirically by what is actually happening on the ground? That may or may not be a relevant issue when we get to Ground 2, which is the only ground that is still alive.

The little explanation I have just given is an attempt on my part to clarify my own thinking as part of the background to the case and the approach to be adopted, and I would be very glad to have any comments you may feel that are relevant to make when you come to the Defence or the skeleton arguments so that we are all clear what the correct background to the case is in dealing with the points that arise under Ground 2.

MR. SWIFT: Thank you, Sir, I would obviously like to come back with a response when I have read ----

THE PRESIDENT: Read the transcript.

MR. SWIFT: -- the transcript. Again, I am just thinking this through. While, of course, we as a public authority would like to assist the CAT in any way that we can to understand the background, these questions or queries that you put are put at a time when the Applicant in a Judicial Review no longer seeks to challenge the analysis or the findings of an SLC.

THE PRESIDENT: That is right.

MR. SWIFT: Without going through it now one would have to consider therefore ----

THE PRESIDENT: Well you may not want to throw any light on matters, Mr. Swift, but we have to write a Judgment which sets out the background, and we have to make the background as understandable to the general reader as we can.

MR. SWIFT: I am not going to make any more submissions on that point, but it does seem to me that this does raise an interesting procedural and substantive issue for the Tribunal, if it is asking me now to supplement, in the form of further statements, the reasoning in this Report.

THE PRESIDENT: No, I am simply asking for the things that puzzle me at this stage of my reflection, and it should not be too difficult to explain it – I am sure there are some very simple explanations that I have missed.

MR. SWIFT: We will come back to you on it, Sir. Thank you.

THE PRESIDENT: Thank you. I think, unless there is anything else, the last thing we need to deal with is the intervention.

[See separate transcript for the Tribunal's ruling]

On the assumption, at least provisionally, that we will not need another CMC before the main hearing I think we meet next at the hearing. If, for any reason we do need a CMC, or any party would like to have one then you will be notified through the usual channels. Thank you very much.

(The hearing concluded at 12.15 p.m.)