The Planning Inspectorate

Report to the Secretary of State for Transport

by L Rodgers BEng (Hons) CEng MICE MBA

an Inspector appointed by the Secretary of State for Transport

Date: 5 January 2012

HARBOURS ACT 1964

DOVER HARBOUR

OBJECTIONS TO HARBOUR DUES FOR 2010 AND 2011

Inquiry held on 13-16, 20, 21, 27-30 September and 14 October 2011

File Ref: DPI/X2220/11/9

GLOSSARY

The Act	The Harbours Act 1964
CA	UK Competition Act 1998
Capex	Capital expenditure
DETR	Department of the Environment, Transport and the Regions
DFDS	DFDS Seaways (formerly Norfolkline Shipping BV)
DfT	Department for Transport
DHB	Dover Harbour Board (also 'the Board')
EBIT	Earnings before Interest and Taxes
EBITDA	Earnings before Interest, Taxes, Depreciation and Amortisation
ECJ	European Court of Justice
FPUG	Ferry Port Users Group
HRO	Harbour Revision Order
ILO	Integrated Landside Operation
KPI	Key Performance Indicator
MPUK	Modern Ports: A UK Policy (DfT, November 2000)
MTP1	Modernising Trust Ports: A Guide to Good Governance (DETR, January 2000)
MTP2	Modernising Trust Ports (second edition) (DETR, August 2009)
The Operators	P&O, DFDS & SeaFrance (also 'the Objectors')
P&O	P&O Ferries Holdings Ltd
PCC	Port Consultative Committee
PIM	Pre Inquiry Meeting
PMSC	Port Marine Safety Code
Port	The Port of Dover
PwC	PricewaterhouseCoopers
RMT	The National Union of Rail, Maritime & Transport Workers
ROCE	Return On Capital Employed
RX	Re-examination
SeaFrance	SeaFrance SA
SoS	Secretary of State for Transport
SPG	Ship, passenger and goods dues
T1	Terminal 1 (The existing terminal)
T2	Terminal 2 (The proposed new terminal)
TFEU	Treaty on the Functioning of the European Union
TUPE	Transfer of Undertakings (Protection of Employment)
WACC	Weighted Average Cost of Capital
XX	Cross examination

CONTENTS

ANNEXES

CASE DETAILS

File Ref: DPI/X2220/11/9
The Port of Dover, Kent

- The objections are made under Section 31 of the Harbours Act 1964 against the dues charged by the Dover Harbour Board as from 1st January 2010 and 1st January 2011.
- The objections are made by P&O Ferries Holdings Ltd (2010 & 2011 dues), DFDS Seaways (formerly Norfolkline Shipping BV)(2010 dues) and SeaFrance SA (2011 dues).
- In each case the stated grounds of objection are that the charges ought to be imposed at lower rates than those which have been imposed.

Summary of Recommendation: that the ferry charges demanded by Dover Harbour Board for the years 2010 and 2011 should be approved

Procedural Matters

1. I have been appointed by the Secretary of State for Transport (SoS) pursuant to section 31(4) of the Harbours Act 1964 ('the Act') to hold an Inquiry into the objections outlined above and to report to her with recommendations.

2. I am satisfied that notice of the objections was properly publicised. Copies of the relevant notices for both the 2010 and 2011 objections are included in the core documents.[1]

3. I held a pre-Inquiry meeting (PIM) on the 11 August 2011 the purpose of which was to discuss procedural and administrative matters relating to the Inquiry. A note of that meeting is included in the core documents.[2] At the PIM it was agreed by all parties that the Inquiry would broadly follow the rules under the Highways (Inquiries Procedure) Rules 1994.

4. It was confirmed at the PIM that only P&O Ferries had made timely objections to both the 2010 and 2011 dues. SeaFrance had objected to the 2011 dues but had made a late objection to the 2010 dues and DFDS had objected to the 2010 dues but had made a late objection to the 2011 dues. The Department for Transport (DfT) had treated these late objections as representations. However, as P&O, DFDS and SeaFrance ('the Objectors' but for consistency with the submissions hereinafter referred to collectively as 'the Operators') intended to present a common case at the Inquiry, Dover Harbour Board (DHB) accepted that in the interests of expediency and efficiency all three of the Operators should be regarded as having objected to both the 2010 and 2011 dues. Their representations would, in any event, need to be taken into account in any recommendations. It was also agreed that the 2010 and 2011 dues were not combined charges and thus fell within the scope of Section 31 of the Harbours Act 1964.

5. Only DHB and the Operators gave evidence at the Inquiry. However, written representations were also made. The Board of Trustees of DHB Pension and Life Assurance Scheme made representations in respect of the 2010 and 2011 objections and Mr Kevin Richardson (General Manager, Port Operations/Harbour Master), Mr William Read (DHB employee) and the National Union of Rail, Maritime & Transport Workers made representations in respect of the 2010 objections. The

[1] CD/02/01 - 13
[2] CD/13/03

material points are presented later in the report. Although DHB also made written representations in respect of the 2010 and 2011 objections and there were further representations by the Operators[3] these are not addressed separately in this report – the respective cases presented to the Inquiry having addressed the material issues.

6. Section 31 of the Act deals with the right of objection to 'ship, passenger and goods dues'. The Operators and DHB agreed at the Inquiry that the charges to which the objections applied were those in the Ferry Tariffs booklet published by DHB for 2010[4] and 2011[5] and contained in the sections identified as 'Conservancy Charge', 'Harbour Dues', 'Passenger Dues', 'Wharfage' and 'Security'. The Ferry Tariff booklets note that "ferries" are those vessels or other craft that operate approved cross-Channel services to and from the Port of Dover and that the tariffs relate to services and facilities at and within the Ferry Terminal, Eastern Docks and the Freight Clearance Facility, Western Docks. DHB's commercial vessel and marina tariffs are contained in separate tariff booklets.

7. Although the Inquiry was originally scheduled to sit for 10 (non-consecutive) days between 13 and 30 September 2011, in the event an extra day was required for closing submissions. Due to the main parties' previous commitments, this took place on the 14 October 2011.

8. I made an accompanied tour of the harbour and its surroundings on 5 September 2011, prior to the opening of the Inquiry. I was accompanied by representatives of DHB and the Operators but heard no representations during the visit. Although the weather conditions meant that the tour was confined to land this has not affected my recommendations.

9. This report contains a brief outline of the Port of Dover, its operations and those of the ferry operators before moving on to present the cases for the main parties based on their closing submissions.[6] A summary of the other written representations follows. I then set out my conclusions and recommendations.

10. A list of those appearing at the Inquiry is appended at Annex A, the core documents are listed at Annex B and the Inquiry documents are listed at Annex C. These include the proofs of evidence for each witness although these may have been added to or otherwise amended orally at the Inquiry. Annexes D and E contain the parties' legal submissions as to matters of Dominance and Competition. Annex F contains DHB's view as to the powers of the SoS to make directions under the provisions of the Act and Annex G contains the Operators' response to the Board's submissions.

11. Annexes D, E and G stem from the argument in the Operators' opening submissions that DHB is an undertaking which occupies a dominant position in the relevant market in which it provides port services and which has infringed and continues to infringe the prohibition in Article 102 of the Treaty on the Functioning of the European Union (TFEU) and Chapter II of the UK Competition Act 1998 insofar as the dues charged by it are excessive in comparison to the Board's relevant costs.

[3] CD/01/07,08,09,10 & CD/01/13
[4] CD/03/04
[5] CD/03/05
[6] INQ/46/OBJ & INQ/47/DHB

12. The Operators sought to argue their case in this respect by reference to a range of judgements from the European Court of Justice (ECJ) as well as by reference to the evidence to be heard by the Inquiry. The Operators concluded that the SoS, when reviewing a s31 objection, must ensure that any determination is not contrary to applicable EU and UK competition law.

13. I considered a determination as to the applicability of and compliance with EU and UK competition law to be beyond the scope of the Inquiry and therefore requested that this element of the Operators' case be presented as separate legal submissions. These are given at Annex D. DHB's response to the Operators' submissions was presented during the course of the Inquiry and is attached at Annex E.

14. However, notwithstanding the material referred to above, the Operators in closing presented a further submission on competition and dominance which sought to address matters raised in DHB's initial response. These further submissions are given at Annex G. Given the substantial nature of these submissions I considered it reasonable to allow DHB the opportunity to properly consider them and, if it so wished, to submit a final response. However, given that I considered any determination under EU and UK competition law beyond the scope of the Inquiry, I saw no merit in prolonging the Inquiry for this to take place. I therefore acceded to DHB's request to make any final response in writing directly to the SoS. It was agreed that any such response should be with the SoS by the end of November 2011 and therefore forms no part of this report.

Background to the Port, its operations and its users

15. The Port of Dover ('the Port') is described in its Annual Report and Accounts for 2010[7] as "…..a significant local asset of national and international importance and home to one of the world's busiest roll-on roll-off ferry ports, handling more than 13 million passengers and around 5 million vehicles every year. It is also the UK's second busiest cruise port and the fourth largest UK port for fresh produce imports."

16. Dover is a trust port, an independent statutory body governed and controlled by its board and run for the benefit of stakeholders with no shareholders or owners. Stakeholders include users of the Port, employees of the Port and its users and those individuals, organisations and groups having an interest in the operation of the port - including the local community.

17. Physically, the Port comprises an area of some 845 acres including breakwaters and piers, ship manoeuvring areas, a ferry terminal, a general cargo terminal, two cruise terminals, an aggregate terminal, a former hoverport, a marina, port control and navigational facilities, workshops, offices and a seafront promenade and beach with adjacent residential and hotel properties. The assets of the Port include a range of operational and commercial buildings together with a variety of plant and machinery such as cranes, tugs, weighbridges and a dredger. There are a number of listed buildings and structures. The Port is more particularly described in the evidence of Mr Krayenbrink.[8] Plans of the Port are given in the core documents.[9]

[7] CD/08/04
[8] Mr Krayenbrink PoE INQ/02/P §3.1-3.8
[9] CD/04/01-03

18. Notwithstanding the cruise ship, marina and cargo operations, the commercial ferry companies are clearly key elements of the Port's business. Three major ferry companies currently utilise the Port in order to provide high frequency, high capacity and fast turnaround services to the continent. DFDS operates three vessels between Dover and Dunkerque, P&O operates up to six vessels between Dover and Calais, and SeaFrance operates four ferries between Dover and Calais - SeaFrance operating exclusively on this route. Because of the berthing system at Dover it is likely that vessels transferred to other routes and ports would require substantial modifications.

19. Shore based operations at the Port are shared between the Operators and DHB. For instance, P&O controls the marshalling of its traffic from the assembly lanes onto its ships as well as the discharge of traffic from its ships across the link span whereas marshalling in the rest of the port is provided by DHB. In 2009 DHB ceased to provide a number of shore based services including the mooring and unmooring of vessels and the operation of ramps and passenger walkways. These services, known as Integrated Landside Operations (ILO), are now provided directly by the Operators or are outsourced by them. Of the 130 DHB staff involved in the provision of ILO services only some 88 staff were transferred under TUPE to the new providers and in consequence DHB funded a number of redundancies. In 2009 the cost of ILO services was assessed as c£4.2m. As the transfer took place part way through the year the Operators received a pro-rata rebate on their dues.

20. Operation of the Port clearly demands a high degree of liaison at both day to day and strategic levels. To that end the Port has a number of communication channels including a range of structured meetings. The most formal and regular of these is the Port Consultative Committee (PCC) which involves a wide range of stakeholder groups. The Ferry Port Users Group (FPUG) appears to be the main vehicle for consultation between the Operators and DHB. It is a regular, normally quarterly, meeting between the Operators (at MD and CEO level) and DHB senior management. The FPUG has commercial and technical and operational sub groups.

The Case for the Operators[10]

21. The Operators' case is set out at paragraphs 40 to 69 of the opening written submissions.[11] In summary, it is that each of the ship, passenger and goods dues levied by DHB ["the Board"] in respect of 2010 and 2011 should be levied at a rate lower than that at which each has been levied in respect of those years respectively, on the basis that:

    (a) the dues are excessive in that they generate an excessive profit per se for the Board;

    (b) the dues are excessive in that they generate an excessive profit by market comparison;

    (c) the dues are excessive in that they constitute an abuse of a dominant position held by the Board;

    (d) the dues are excessive in that the Board has taken into account matters it should not have when setting the rates – i.e. Terminal 2 (T2) development costs and privatisation costs;

    (e) the dues are excessive in that the Board has failed to take into account the reduced integrated landside operation ["ILO"] costs, which reduction arose from the Board's outsourcing decision in their regard; and

    (f) the dues are excessive in that they are unreasonable as they do not take into account or in any way acknowledge the current commercial environment, the commercial pressures on the Operators or the significant financial effect of the (increases in) the dues on the Operators.

22. Taken together, it is respectfully submitted that the opening and closing submissions of the Operators present an overwhelming case that the harbour dues levied by the Board in 2010 and 2011 were excessive and unreasonable, or, in the words of the Department for Transport ["DfT"], the dues were "too high" for the reasons set out above.[12]

23. The Operators have set out in Annex 1 to their Closing Submissions[13] a summary of the evidence given during the Inquiry by their witnesses of fact. The following key points arose in the course of the evidence:

    (a) The admission by Mr Goldfield that the dues set by the Board have to be reasonable;[14]

    (b) The admission by Mr Goldfield that in reality there was no alternative to Dover on the short sea route to the Continent;[15]

[10] The material points based on the Operators' closing submissions
[11] INQ/22/OBJ
[12] See Note on role of Secretary of State in reaching decisions under section 31 of the Harbours Act 1964 dated June 2011 (document CD/06/10)
[13] INQ/46/OBJ
[14] Day 1, p. 118, l. 22 – 24 (NB All such references are to Inquiry transcripts at INQ/48/OBJ)
[15] Day 1, p. 128

(c) The admission of Mr Goldfield that the Board had unlimited borrowing powers;[16]

(d) The captive nature of the market, evidenced by (inter alia) the Board's "take it or leave it" attitude;[17]

(e) The marked increase in dues despite (a) the worst recession in living memory and (b) the position of other ports that froze or reduced their dues;

(f) The ever-increasing market share of Eurotunnel and the contrasting decreasing market share of the Operators;[18]

(g) The cash surplus of some £60 million, originally accumulated on the condition that it would be used for T2;

(h) The Board's volte-face of using that cash surplus for filling the pension deficit and privatisation costs, as well as T1 improvements;

(i) The vast increase in the cost of those T1 improvements, despite the admission that the requisite improvements needed for traffic management would be modest;[19]

(j) The Board's admission that there is no guarantee that any eventual private owner of the port of Dover will actually progress T2;[20]

(k) The fact that one Operator, P&O, was able to borrow 80% of the costs of building two new vessels, to be contrasted with the Board's present position which is that it can only raise 25% from the capital markets;

(l) The extraordinarily short period Mr Waggott defined as the "foreseeable future" – some two years, which period is shorter than the Board's present medium term capital expenditure plan;[21]

(m) The entirely hypothetic nature of the Board's expert's proof, who admitted that his approach led to the conclusion that the dues imposed in 2010 and 2011 were neither commercial nor competitive;

(n) The absence from the said proof of the cash surplus of £60 million;

(o) The difference in treatment between the Operators and other users of the port, including cruise ship operators;[22]

(p) The fact that the re-weighting of the tariff in 2010 meant that the Board was insulated against the economic downturn, whilst the Operators were penalised by fixed rates;

[16] Day 1, p. 157, line 20
[17] Evidence of Mr Waggott – Day 3, p. 100 - 102 – *"ferry operators come, ferry operators go …"*
[18] INQ/46/OBJ and the evidence of Mr Chadney. Transcript: Day 9, p. 71, 76 – 77
[19] Evidence of Mr Krayenbrink. Transcript: Day 2, p. 108
[20] Evidence of Mr Waggott. Transcript: Day 3, p. 95 - 96
[21] Day 3, page 130 - 131
[22] Evidence of Mr Waggott. Transcript: Day 3, p. 187 - 188

(q) Calais was more expensive because of its own structural differences and higher local social costs, and was not acquiring a cash surplus;

(r) The Board is budgeting on the basis that T2 could be required at very short notice, for instance, in the event that the freight market increased unexpectedly due to another fire in Eurotunnel or a volcanic ash cloud;[23]

(s) The Board's understanding that the ultimate stakeholder is the future generation, rather than its existing users[24] and its disregard for the interests of present user-stakeholders;[25] and

(t) The Board had resolved that it would not decrease the tariff in 2011 as to do so would show "weakness" to the Operators. Mr Waggott was unable to explain why the Board considered that it must hold any position, be it of strength or of weakness to its customers.[26]

24. As will be seen further below, these factors help to demonstrate that the objections made by the Operators to the 2010 and 2011 tariffs are well-founded. The Operators have also produced a summary of the detailed economic evidence heard by the Inquiry which is set out in Annex 2 of the Operators' closing submissions.[27] *(Inspector's note: DHB agreed that, provided that Annex 2 was treated solely as the Operators' perspective on the evidence, it was not necessary for it to be read out in closing. In coming to my recommendations I have taken Annex 2 as representing solely the Operators' view of the evidence.)*

25. The conclusion that the objections are well founded is based on the relevant facts, the economic evidence and also on the legal submissions on competition law. *(Inspector's note: for convenience the competition law submissions made by the Operators[28] are reproduced at Annexes D and G and the initial submissions made by DHB are given at Annex E).*

Reductions Sought

26. Insofar as concerns the Operators' suggested tariff reductions, they are set out in the documents already received by the Inquiry.[29] The Operators have sought to engage with the Board to assist in determining the operation of such proposals, which mirrors the wish by the Operators to work constructively with the Board on a general basis. As noted in the opening oral submissions made on behalf of the Operators, they did not wish to become embroiled in this long and expensive Inquiry; however, they felt that they had little option but to pursue the objections because of the intransigence of the Board up to that time. As can be seen from the modelling exercise carried out by the Board in relation to the Operators' suggested tariff reductions,[30] each of those suggested reductions result in a positive cash balance for the Board at the end of 2012, i.e. after substantial works have been

[23] Evidence of Mr Waggott. Transcript: Day 3, p. 92
[24] Evidence of Mr Waggott. Transcript: Day 3, p. 103, lines 11 - 16
[25] Evidence of Mr Waggott – Day 3, p. 100 - 102 – *"ferry operators come, ferry operators go ..."*
[26] Transcript, Day 3, p.174 lines 16 – 23, p. 175 (all lines) and p.176, lines 1 – 12
[27] INQ/46/OBJ.
[28] INQ/21/OBJ and INQ/46/OBJ Annex 3
[29] DFDS: INQ/11/OBJ, INQ/11A/OBJ, INQ/18/OBJ and INQ/18A/OBJ, SeaFrance, INQ/12/OBJ, INQ/20/OBJ and INQ/20A/OBJ, P&O: INQ/13/OBJ, INQ/13A/OBJ, INQ/19/OBJ, INQ/19A/OBJ.
[30] The modelling exercise document is at INQ/41/DHB

carried out and paid for in relation to the upgrade for T1. It will be recalled in this regard that the Board's projected cashflow[31] shows a Capex spend of some £38 million on steady state renewals and T1 upgrades between 2011 and 2012.

27. In passing, it should be noted that the Board's suggestion in its modelling exercise (INQ/41/DHB) that such cash balances would be adversely affected by the fact that the reductions would have to be given to the non-ferry operators as well is completely misconceived. The only tariffs subject to the Inquiry are those paid by the Operators. There is a completely separate tariff for non-ferry operators, including cruise ships. There is no evidence before the Inquiry that such tariffs are excessive or as to what matters the Board has or has not taken into account in setting those tariffs, in particular whether tariffs applicable to cruise ships and other non-ferry operators had also been surcharged to pre-fund T2. Even if there were, this Inquiry would not have the jurisdiction to make any finding in relation to the tariff applicable to non-ferry operators. In the circumstances, the Board does not need to take into account non-ferry operators in any determination of the impact of any reduction in the Operators' tariff on the Board.

28. The choice of type of reduction is clearly a matter for recommendation by the Inspector and subsequently determination by the Secretary of State.

Powers of the Secretary of State

29. The Harbours Act 1964 provides that if the Secretary of State is satisfied that an objection to ship, passenger or goods dues is made out, she shall:

> "give to the authority such direction with respect to the charge as would meet objection thereto made on any of the grounds specified in subsection (2) above (whether that is or is not the ground, or is or is not included amongst the grounds, on which the objection whose lodging gives rise to the proceedings is expressed to be made)." (s31(6)(b))

30. Of the grounds set out in subsection (2), the Ferry Operators have objected to the charges on the basis that the dues ought to be imposed at a rate lower than that at which they have been imposed for 2010 and 2011. However, as is clear from s31(6)(b), it is open to the SoS to make a direction on one of the other grounds, for example, that a particular due ought not to be imposed at all or that particular classes of ships, passengers or goods should be excluded from a charge.

31. A direction made by the SoS must be in writing and must specify a date for its coming into operation and the period from that date (which shall not exceed twelve months) during which it is to have effect (s31(7) of the Act).

32. The Ferry Operators have made objections to all the dues levied on ferries for 2010 and for 2011. The year 2010 has now completely passed. By the time of any decision by the SoS, most of 2011 will also have elapsed. The appropriate course for the SoS, if she is of the view that the objections are made out, would be to make 2 directions:

    (a) a direction in respect of 2010 coming into force on 1 January 2010 and lasting for a period of 12 months; and

[31] INQ/29/DHB

(b) a direction in respect of 2011 coming into force on 1 January 2011 and lasting for a period of 12 months.

33. It is submitted that this must be the correct construction of the Act. It cannot be construed in a way that would prevent it from giving an effective remedy as intended by the provisions of s31 of the Act. There are no relevant regulations or guidance to s31 of the Act made under that Act or under the Tribunals and Inquiries Act 1992 and the decisions in relation to Bembridge Harbour Board and Langstone Harbour Board[32] are not helpful on this point, as in those decisions the SoS upheld the dues in question and there was accordingly no direction to lower any dues.

34. At the Inspector's request, P&O Ferries, DFDS and SeaFrance have each given estimates as to what they believe the overall position on dues should be.[33] The estimates are expressed as a percentage reduction.

35. As further requested, the Ferry Operators have further made estimates about what each of the component charges should be[34] to achieve the overall position on dues (i.e. the percentage reduction) set out in the documents referred to in the preceding paragraph. However, it should be noted that the Ferry Operators' primary cases are that the dues should be imposed at a rate lower than that at which they are currently imposed. That is all that the Ferry Operators are required by the Act to make out. The various extents of the reductions that the Ferry Operators are seeking are set out in documents INQ/11/OBJ, INQ/11A/OBJ, INQ/12/OBJ and INQ13/OBJ. Documents INQ/18/OBJ, INQ/18A/OBJ, INQ/19/OBJ and INQ/20/OBJ are then only illustrative of the way in which Dover Harbour Board ("DHB") could structure such a reduction. As objectors under s31 of the Act, there is no onus on the Ferry Operators to supplant the function of the harbour authority in determining its particular tariff structure, particularly given that the Ferry Operators do not have access to DHB's management accounts.

36. If the SoS is of the view that the objections of the Ferry Operators are made out, it is open to her to determine that those objections would be 'met' (to use the language of s31(6)) by directing either:

(a) that DHB reduce its dues as it sees fit to achieve an overall reduction in the dues payable by the Ferry Operators according to the tariff in the relevant year of a proportion or percentage reduction as against the dues originally paid ("the percentage reduction") that the SoS in her discretion sees fit in light of documents INQ/11/OBJ, INQ/11A/OBJ, INQ/12/OBJ, INQ13/OBJ, INQ13A/OBJ and the evidence heard at the Inquiry;

(b) that DHB reduce its dues by applying the percentage reduction to each due in the tariff; or

(c) that DHB substitute the rate of each due in the tariff with a revised rate as determined by the SoS in her discretion, so as to achieve the percentage reduction overall.

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[32] CD/06/11, CD/06/12 and CD/06/13, CD/06/14
[33] INQ/11/OBJ, INQ/11A/OBJ, INQ/12/OBJ INQ13/OBJ and INQ13A/OBJ
[34] INQ/18/OBJ, INQ/18A/OBJ, INQ/19/OBJ and INQ/20/OBJ

37. The Operators are of course aware of the position as set out by the Department for Transport in its note of June 2011 that

> *"[w]here an objection is made under section 31(2)(ii) and an Inquiry is held, its role is to investigate, evaluate and make findings upon the relevant facts and the parties' arguments in order to assist the Secretary of State in deciding upon the objection. This will involve an assessment by the Inquiry of whether the charges are too high* ***and, if so, what reduction should be made****." – emphasis added.*

38. The Operators are content for any one of their suggestions (or part or parts thereof) to be adopted by the Inquiry for recommendation to the Secretary of State.

39. As to the position of the power of the Secretary of State to order a rebate, the Operators do not accept the Board's submission as set out in INQ/45/OBJ. The Operators contend that the Secretary of State need not purport to order a separate rebate. Rather, if the Secretary of State is of the view, following the Inspector's recommendations, that it is not commercial or competitive, or fair or equitable, for the Board in levying dues in 2010 and 2011 to seek to retain cash reserves in the region of £60 million (and further to seek to maintain a return of 12% on those cash reserves), the Secretary of State may, and in the Operators' submissions, should, set the dues for those years at such lower level that would cause the Board to defray some part of that cash reserve and, in so doing, to indirectly return to the Operators part of their contributions to that reserve.

40. The Operators have set out in their submissions[35] the reductions in the levels of dues that they believe should be made. Further they have set out the extent to which the cash reserves should be defrayed (expressed as a rebate) - £19million according to DFDS and £40million according to P&O Ferries. Document INQ/41/DHB prepared by DHB shows that any of those suggested 'rebates' could be borne by DHB without balance sheet difficulties. As such, the Secretary of State may simply apply the tariffs set out in INQ/18A/OBJ, INQ/19/OBJ, INQ/19A/OBJ and INQ/20/OBJ to deliver the reductions sought in INQ/11/OBJ, INQ/12/OBJ, INQ/13/OBJ and/or may further reduce those suggested tariffs to deliver the rebates sought in INQ/11/OBJ or INQ/13/OBJ.

The Inquiry

41. The Inquiry has been constituted pursuant to the Harbours Act 1964 to determine the lawfulness of the dues imposed by the Board on the Operators pursuant to the years 2010 and 2011.[36]

42. It is common ground between the parties that the harbour dues subject to this Inquiry comprise the following elements of the above-mentioned tariffs:

    (a) Conservancy fee;

    (b) Harbour dues;

    (c) Passenger dues;

    (d) Wharfage;

[35] INQ/11/OBJ, INQ/11A/OBJ, INQ/12/OBJ, INQ13/OBJ, INQ13A/OBJ
[36] CD/03/4 and CD/03/5

(e) Security.

43. The objections of the Operators all seek a determination that the relevant harbour dues are excessive and ought to be imposed at a lower rate pursuant to s31(2)(ii) of the Act.[37]

44. By letters dated 14 July 2011, the Operators' legal representatives were informed of the decision of the Parliamentary Under-Secretary of State for Transport that an Inquiry should be held into the objections in relation to both the 2010 and 2011 dues.[38]

The appropriate legal framework

45. It is common ground between the parties that there is no statutory provision in the Act which defines the test to be applied by an Inspector or subsequently by the Secretary of State when determining whether an objection made pursuant to section 31(2)(ii) of the said Act is made out.

46. Section 31(2)(ii) of the Harbours Act 1964 relates to objections, such as those made in the present matter, which assert that the dues ought to be imposed at a lower rate than that at which it was imposed.

47. Despite the lack of statutory provision, and as noted in the Operators' opening written submissions, the DfT has very recently set out its position with regard to the legal process and it is clear therefrom that the process is not restricted to an administrative law style review but rather is to examine the merits of the dues imposed. To that end, the remit of the process is extremely broad.

48. It is noted that the Board seeks to rely strongly on the findings in the *Langstone Harbour* decision. No reference is made to the subsequent decision in *Bembridge Harbour* or to the above-mentioned very recent guidance note from the DfT. The Operators suggest this omission is telling.

49. Despite the lack of statutory provision, the Inquiry will doubtless be assisted by two other sources – the governmental guidance and the two Inquiries mentioned above.

50. As to the former, the following points can be taken from their contents:

(a) Dues should not be imposed for services that port users do not need;[39]

(b) Dues must be seen to be fair and equitable;[40]

(c) Dues must be set at a level that allows for proper maintenance of the trust's harbour or conservancy duties;[41]

(d) Access to ports is open, subject to payment of reasonable port tariffs;[42]

(e) The Government and the devolved administrations retain powers to set dues when port users appeal against them. This is because the public

[37] CD/01/01, CD/01/02, CD/01/08, CD/01/11, CD/01/14, CD/01/15
[38] Appendix 1/R to Mr Goldfield's rebuttal proof: INQ/01/R
[39] Modernising Trust Ports (2000) ["MTP1"]: CD/06/1 at paragraph 112
[40] Ibid at paragraph 114
[41] Ibid at paragraph 114
[42] Modern Ports – a UK policy (2000) ["MPUK"]: CD/06/3 at paragraph 1.1.6

right to use a harbour depends on payment of dues – that right could be practically extinguished if the dues were unfair or unreasonable;[43]

(f) Dues must be fair and equitable – it is wrong for some users to have special treatment;[44]

(g) It is the duty of trust port boards to strike a balance that fully respects the interests of all stakeholders in the light of the objectives of the port, including commercial considerations, and what constitutes the 'common good' for all stakeholders (current and future) and the port itself;[45]

(h) In pursuing its target rate of return, it is in the interests of all stakeholders that a trust port should set its dues at commercial and competitive rates, neither exploiting its status as a trust port to undercut the market, nor abusing a dominant position in that market;[46]

(i) Harbour dues must be set at a level that allows for proper maintenance of the trust port's harbour and/or conservancy duties, and geared to attaining the target level of return;[47]

(j) Users are first and foremost customers of the port and the proceeds from their custom should be utilised prudently to maximise benefit to all stakeholders and in the best and most effective interest of the future of the trust port.[48]

51. Although the various guidance documents all make clear that they do not have the force of law, they are clearly of relevance and importance to the Inquiry. This is confirmed by the two main Inquiry reports in this area, mentioned above, and the subsequent Ministerial decisions in relation thereto. The key points arising from those Inquiry reports, both of which were followed by the Minister, in relation to the relevant legal framework, can be summarised as follows:

(a) As a matter of policy and commonsense, charges levied in the exercise of public functions should be reasonable;[49]

(b) The principle of reasonableness is reflected in the MTP (2000) guidance that dues must be seen to be fair and equitable;[50]

(c) Dues should be set at commercial and competitive rates, neither exploiting trust port status to undercut the market nor abusing a dominant position in the market.[51]

52. The Inspectors in the above-mentioned Inquiries sought to apply these general principles to the factual positions before them in the light of the parties' submissions in those cases. By definition, those factual positions will not be

[43] Ibid at paragraph 2.1.12
[44] Ibid at paragraph 2.1.12
[45] Modernising Trust Ports (Second Edition) ["MTP2"]: CD/06/6 at paragraph 1.1.5
[46] Ibid at paragraph 1.2.3
[47] Ibid at paragraph 1.2.4
[48] Ibid at paragraph 1.2.5
[49] Bembridge Harbour Report at paragraph 3.5
[50] Ibid at paragraph 7.16
[51] Langstone Harbour Report at paragraph 5.32

replicated in the present position, not least because of the publicly-noted "unique" position of the port of Dover. In the circumstances, the guidance and reports will only be of assistance to this Inquiry in setting out the general applicable framework. The application of that framework to the determination of the Operators' objections will be predicated on the factual matrix present in this Inquiry.

53. To that end, the evidence given by the parties as to their understanding of the concepts of "reasonableness", "fair and equitable" and "commercial and competitive" will obviously be of interest.

Reasonable

54. As noted above, Mr Goldfield admitted that the level of the harbour dues had to be reasonable.[52] Mr Christensen suggested in this context that the Board should be entitled to charge dues that provided a reasonable rate of return, covering costs and taxation.[53] He continued, when answering the Inspector's question on the point, stating he was of the view that it would not be reasonable to impose dues in order to assist with the Board's pension deficit because, in essence, it was simply seeking to pass on costs arising from its pension difficulties on to its customers, the Operators. To that end, it was important when determining whether the dues imposed were reasonable to analyse whether the costs to both the Board and the Operators had been spread equally and in this regard, the fact that the Operators "brought home the bacon" in relation to the Board's revenue was not to be discounted.[54]

55. Mr Wilkins' evidence on the issue was also of interest: "the Harbour Board tends to invest to a very high standard, and what the ferry operators are asking for is not that investments, such as the list as has been produced, that those not be done, but that they exercise restraint, because what we're looking at is a rate of increase in port taxes which the ferry operators object to… I would highlight the Port of Dunkerque, which accommodates about a quarter of the freight traffic that Dover does, directly from Dover, and just under a third of the tourism business, and yet the facilities there are rudimentary, they are quite capable of handling the traffic and the port functions perfectly adequately, but the level of investment is significantly lower".[55]

Fair and equitable

56. The Board made the following suggestions in relation to this criterion:

    (a) "Fair" could be seen in terms of delivering a fair rate of return in line with what has been set across the organisation;[56]

    (b) "Equitable" could be seen in terms of trying to treat all stakeholders equally;[57]

[52] Transcript, Day 1, p. 118, line 20 – 22
[53] Transcript, Day 6, p. 86
[54] Transcript, Day 6, p. 116, line 18
[55] Transcript, day 5, p. 157
[56] Transcript, Day 4, p.45, lines 21-23
[57] Transcript, Day 4, pp.45-46, lines 23-2

(c) It was fair to look at discounts for cruise ships, given that their business had a significant impact on the Board's bottom line and rate of return and is capable of generating additional income for the future delivery of infrastructure;[58]

(d) In terms of ferries, there was some difficulty with discounts in terms of market position and commitment.[59]

57. The Operators and Mr Harman made the following suggestions in relation to this criterion:

(a) The costs incurred by the Board should be split equally across the Operators;[60]

(b) The lack of a volume discount for the Operators was not fair and equitable when such discounts were available to cruise vessel operators;[61]

(c) MTP1 suggested that ports should compete fairly and not abuse any dominant position they might have. Fair and equitable also appeared to relate to setting dues that allow for proper harbour maintenance and do not exempt some users from paying dues when other users pay the market rate. It also appeared that the investment policy had to be fair and equitable;[62]

(d) Fair and equitable appeared to relate to the cross-subsidisation of a port, the analysis of which would require a rigorous and transparent analysis of actual cash costs and their allocation, which information was not available to the Operators.[63]

Commercial and competitive

58. When reviewing this criterion, Mr Christensen suggested that the position of the market should be at the forefront of the Inspector's mind – to that end, the fact that Eurotunnel was a very aggressive market participant, which behaviour impacted on the Operators' business, was relevant. That impact should also have been felt by the Board but thanks to the increased dues, the Board had, during this period of intense competition from Eurotunnel, been able through revenue from dues to accumulate a surplus of £60 million. In addition, the dire economic position was relevant. In a recession it was simply not commercial to impose such high dues, which failed to take account of customers tied to the port.[64]

59. Ms. Deeble's evidence on this issue was that the tariffs were not negotiated – there was in her words "no discussion, no negotiation, no phasing in ... it is a very frustrating and atypical commercial relationship."[65] She also made clear that the

[58] Transcript, Day 4, p.47, lines 8-16
[59] Transcript, Day 4, p.47, lines 19-21
[60] Transcript Day 6, p.116, lines 9-11
[61] Transcript Day 7, p. 65, lines 10-21
[62] Transcript Day 8, pp. 46 - 47, lines 25 - 6
[63] Transcript Day 8, pp. 48 – 49, lines 19 – 25; 1- 2
[64] Transcript, Day 6, p. 117
[65] Transcript, Day 7, p. 67, lines 2-11

fact that Eurotunnel competed head to head with P&O was relevant in this context where the increased tariffs put more pressure on the Operators.[66]

60. The Board's evidence on this was of interest. Mr Waggott gave the following answers to questions from the Inspector:

(a) If Dover were run as a commercial business, it would seek to deliver a commercial rate of return and pay a dividend;[67]

(b) "Commerciality" was not about the simple passing through of costs; rather it was about generating what should be generated by a commercial operator;[68]

(c) Rate of return and acting commercially is not obviously the sole determinant of everything that a trust port should do and its board would take into account, rather, it is just one of the factors;[69]

(d) Any future investment in T2 would not deliver in the short term a 12% rate of return, as currently stated in the Board's minutes;[70]

(e) "Commercial" in the context of the 2010 tariff setting was to be viewed in terms of delivering a fair balance of risk and reward between the parties;[71]

(f) "Commercial" also meant asking whether the dues would allow the customer base to compete, and whether they would allow the customers to choose Dover and remain here rather than move to say Portsmouth or Ramsgate;[72]

(g) "Competitive" could be seen in terms of allowing the Board to develop for the long term.[73]

The setting of the 2010 tariff

61. The manner in which the 2010 tariff was set by the Board was clearly described by the Inspector, as confirmed by Mr Waggott.[74]

62. The dues in 2010 were set on the following basis so as to cover and deal with:

(a) Operational costs;

(b) Short-term capital costs;

(c) The re-balancing of the risk with regard to volumes;

(d) The aim of increasing the cash balance with a view to longer-term custodianship of the port.

[66] Transcript, Day 7, p. 67, lines 12-24
[67] Transcript Day 4, p.34, lines 10-12
[68] Transcript Day 4, p.35, lines 5-9
[69] Transcript Day 4, p.41, lines 13-16
[70] Transcript Day 4, p.42, lines 6-9
[71] Transcript, Day 4, p.44, lines 24-25
[72] Transcript, Day 4, p.45, lines 13-18
[73] Transcript, Day 4, p.45, lines 18-20
[74] Transcript, Day 4, p.52, lines 16-25

63. Mr Waggott confirmed that the 2010 tariff was set on the basis that the Board knew the figure it wanted at the end of the day, in order to cover the matters set out in the preceding paragraph.

The setting of the 2011 tariff

64. The manner in which the 2011 tariff was set by the Board was clearly described by the Inspector, as confirmed by Mr Waggott.[75]

65. The dues in 2011 were set on the basis of July 2010 RPI and was at a figure that the Board thought it could get, bearing in mind the Board's understanding of the difficult trading conditions suffered by the Operators and the fact that objections had been made in relation to the 2010 tariffs.[76]

The impact of the 2010 and 2011 tariffs on the Operators

66. It is the Operators' case that Mr Waggott's evidence stating that the Operators paid less in actual and percentage terms in 2010 than 2009 is, with respect, disingenuous.[77] Mr Christensen's evidence details DHB global revenues to have increased by 9.13% from 2009 to 2010 if proper account is given to the ILO savings and a uniform level of traffic is applied across the board (Mr Christensen has applied the 2009 traffic volumes).[78]

67. The impact on SeaFrance, applying the 2010 traffic volumes to 2009, 2010 and 2011 and taking into account the ILO savings sees an increase of 12.95% in SeaFrance's dues from 2009 to 2010 and an increase of 4.75% from 2010 to 2011.

68. P&O Ferries similarly incurred an increase in dues from 2009 to 2010 when those years are compared on a like-for-like basis and the ILO savings (and associated costs) are taken into account, although the increased cost was minimised by action on P&O Ferries' part to decrease those costs, as set out in Ms Deeble's evidence. DHB submitted that ILO costs to P&O Ferries would be in the region of £1.1million, if the numbers of ILO staff reduced at P&O's initiative are taken into account. P&O Ferries would estimate that the true number is in the region of £1.4million when redundancy costs are included. This represents an increase of 2.24% from 2010 to 2011.

Excessive nature of the 2010 tariff

The 2010 tariff was unreasonable

69. The Board has unreasonably set the 2010 tariff in shifting its structure away from a variable charge based on the loading of vessels to a more fixed 'per-vessel' charge in order to (unreasonably) maintain and continue to accrue excessive surplus cash. That cash was ostensibly being assembled to fund the T2 development which the Board knew at the time of setting the 2010 tariff had been delayed; might not be viable in the light of the economic downturn; and could not in any event be delivered by the Board on the basis of its assumptions as to borrowing.

[75] Transcript, Day 4, p.53, lines 13-23
[76] Transcript, Day 4, p.53, lines 18-25
[77] INQ/03/P, para 17.7
[78] INQ/05/P, para. 26(a)

70. In the 2010 tariff, in terms of ship dues, the Board increased harbour dues by 48.9% and introduced a new fixed conservancy charge of £190 per vessel. For a 50,000 GT vessel, that represents an increase in ship dues in 2010 of 39.5% against dues imposed in 2009.[79]

71. This increase reflected the fact that the Board had decided to change the structure of the tariff fundamentally.

72. Prior to the change, the ratio of fixed rate to variable rate was struck so as to ensure that in times of high volumes through the port, the amount of dues paid increased. Correspondingly, when volumes reduced, so too did the amount of dues paid. This was seen as reasonable for both the Board and the Operators.

73. However, the change implemented by the Board in the 2010 tariff meant that the above-mentioned ratio became strongly skewed in favour of fixed rates – as well as the conservancy fee, the harbour dues are also effectively fixed (as the size of the Operators' vessels does not alter). Although the Board had reduced passenger dues (adults were reduced by 29p (49%)) and goods dues (wharfage charges were reduced by variable amounts ranging from 53% for smaller motor vehicles but only 6.7% for larger freight vehicles and 3.4% for accompanied trailers), this had the direct consequence of shielding the Board from the effects of the economic downturn whilst exposing the Operators to its full force. It will also be recalled that because of the aggressive competition from Eurotunnel, the Operators had to bear those added costs as they were unable to pass them on to their customers. Some might describe this as a perfect storm, others a "double whammy" - either way, the effect of the change, which in effect comprised a one-way risk hedge for the Board, was unreasonable in the circumstances. It should always be borne in mind that these figures do not include the additional saving to the Board and the additional cost to the Operators of shifting the ILO burden to the Operators.

74. The Inspector will note that the Board does not deny that it knew how tough market conditions would be in the relevant period. In February 2009, Mr Waggott confirmed that *"... 2009 would be a very difficult year in the current economic climate ..."*.[80] In June 2009, Mr Waggot stated that *"the current short sea freight market as a whole was down around 15-20% ..."*.[81]

75. Mr Chadney's evidence was that the structure of a high element of fixed to variable charges is not suitable for a "*footloose*" market such as freight taken through Dover which experiences volatile freight volumes. Indeed, even though comparator ports may have a similar or even higher element of fixed to variable charges, this structure is more suited to ports subject to long term contracts, or those that do not rely on cargo.[82] Mr Chadney suggested that the increase of the fixed element of the charges, in the middle of an economic downturn accompanied with severe austerity measures, leaves the Operators in a particularly vulnerable position.[83]

[79] Mr Waggott's rebuttal proof at Table 4, p. 18
[80] Minutes of FPUG Commercial Sub-Group meeting of 27 February 2009 at paragraph 4: CD/11/1
[81] Minutes of FPUG Commercial Sub-Group meeting of 24 June 2009 at paragraph 3: CD/11/3
[82] Evidence of Mr Chadney, Day 9, p. 53 – 56
[83] Evidence of Mr Chadney, Day 9, p. 147

76. During 2009, the Board sought to rationalise the fundamental re-weighting of the tariff on the ground that there was a need to protect against risk for future investment if volumes fell. Moving to a fixed charge per vessel was in the circumstances an important strategy change due to the long-term investment needs of the business.[84] It is clear that at that time, the long term investment envisaged was the building of T2. In the same meeting in which the Board sought to rationalise the fundamental re-structuring of the tariff, Mr Waggott told the Operators that the earliest time that T2 would be available would be 2015, and more likely 2017, after a 3 to 4 year build, which would mean starting work sometime between 2011 and 2013. It can therefore be seen that the said restructuring of the tariff was heavily dependent on the T2 build.

77. However, as has emerged during the Inquiry process, the Board decided to remove T2 from its 2010 – 2012 Capex plan in 2009. The evidence now before the Inquiry is that T2 will not be required before 2019 to 2022.

78. In the circumstances, there was no need to re-structure the 2010 tariff. As we now know, the Board's projected Capex spend for 2010 was some £11.97 million. The Board's existing surplus as of 2009, taken together with the fact that it had outsourced ILO services to the Operators, meant that existing and realistic future capital expenditure could have been met without the re-structuring of the 2010 tariff, which directly led to the substantial increase in the amount of dues to be paid to the Board by the Operators.

79. The Board's position that it had to increase the cash surplus because it could not access more than £100 million on the capital markets has to be viewed with some scepticism. First, the evidence from P&O was that it was able to fund 80% of its capital expenditure through the capital markets.[85] Secondly, the Board confirmed that the last time it had asked the Department for Transport about the position of State funding was in 2009. Thirdly, the evidence in the form of Mr Pusey's supplemental proof[86] was that three other trust ports had substantial loans approved by the Department for Transport.

80. The unreasonableness of the Board's approach was exacerbated by the fact that far from using the cash surplus to fund capital investment projects, it was going to spend 50% of it – some £30 million – on filling the deficit in its pension fund. The Operators' position with regard to this is succinctly summarised in their joint letter of 10 March 2010:

> *"... it is not acceptable or permissible that funds built up from excess dues charged to the operators to pre-fund Terminal 2 should now be used to pay a very significant amount into the DHB pension fund. We must query the basis for the calculation of this pension fund deficit and whether it is reasonable or necessary now to fully fund it, given that deficit payments are normally paid over many years. This funding appears designed simply to enable a smooth transition process. As such it is a direct cost of the privatisation and should be paid for from the funds raised in the privatisation process."* [87]

[84] Ibid at paragraph 5, p.5
[85] Transcript, Day 6, p. 130, line 16
[86] INQ/31/OBJ/P
[87] Appendix 2 to Helen Deeble's proof of evidence: INQ/07/A

81. As Ms. Deeble made clear in her proof, P&O has reduced its pension scheme in the face of current conditions, in line with many other organisations.[88] The Board appears to have taken the view, unreasonably in the Operators' eyes, that it could immunise itself against the real world by funding its pension deficit from its captive customers' dues.

82. Further, the imposition of the Board's new tariff regime has clearly had a detrimental impact on the Operators' commercial performance during the present economic downturn. As can be seen from SeaFrance's figures, the percentage of its dues to turnover amounted to just over 7% of its turnover. In terms of the effect of the 2010 tariff on the Operators' profit, this is likely to have been much higher, as can be seen from Mr Howarth's evidence, in which he mentioned the figure of 125%.[89]

83. In all the circumstances, the Operators contend that the setting of the 2010 tariff insofar as it related to harbour dues was unreasonable.

The 2010 tariff was not fair or equitable

84. It is clear from the evidence and the obvious difference in the ferry and cruise ship tariffs that the Operators were not treated in the same or similar fashion to the cruise ship operators who were given volume rebates and loyalty discounts.

85. Mr Goldfield made the point succinctly – the cruise ship market is more volatile and the Board needed to offer incentives to retain their custom.[90] However, as is clear from the guidance and the decisions referred to above, trust ports are not allowed to treat users differently. This, the Operators would contend, is even more important when the class of user being discriminated against is captive, as the Operators are – Dover is the only game in town.[91]

86. Additionally, as was clear from the evidence of Mr Harman and Mr Waggott, there is no guarantee that the present ferry operators at Dover will continue to be present in the future. It is not fair or equitable to prefer the future interests of future stakeholders of Dover Harbour who will be the users of T2 over the present interests of the current stakeholders of the harbour, i.e. the Operators, by seeking to require those Operators to pay for T2, potentially twice over. The evidence heard how the cash reserve originally accrued for T2 was now being applied to other matters and the Board may then seek to accrue further cash to pay for T2.[92]

87. Further, the evidence of Ms Deeble, Mr Christensen and Mr Wilkins shows that it was not fair or equitable for the Board to seek to insulate itself from commercial risk in times of economic hardship by switching its approach from a variable charge to a fixed per-vessel charge.

88. Further, the evidence of the Operators is that a 12% rate of return is not fair or equitable in the current climate, but that a lower rate of return, one in the region of 7% would be appropriate. (see, e.g. INQ/13A/OBJ)

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[88] Helen Deeble's proof of evidence at paragraph 5.6.4(f): INQ/07/P
[89] Transcript, Day 6, p. 143, line 7 - 17.
[90] Transcript, Day 1, p. 106, line 19 - 25
[91] Evidence of Mr Wilkins, Transcript, Day 6, p. 62
[92] Transcript, Day 7, p. 36

89. In all the circumstances, the Operators contend that the setting of the 2010 tariff insofar as it related to harbour dues was neither fair nor equitable.

The 2010 tariff was not commercial or competitive

90. The 2010 tariff representing a nearly 40% increase on the tariffs levels set for 2009 and which prioritised the fixed fee element (ship dues comprising harbour dues and conservancy fees) over the variable (goods and passenger dues) was not commercial, particularly given the poor economic climate. A trust port acting commercially and in an ordinary competitive environment would not set those tariffs as it would lead to a loss of custom. The Board was only able to set those tariffs because the Operators were captive customers of the Board and could not transfer their business to another port easily or at all.

91. In this regard, the Inspector will note that although MTP2 specifically states that trust ports should set themselves a target rate of return, that task is not without limits. Those limits are clearly set out at paragraph 1.2.3 of MTP2 which provides as follows:

> *In pursuing that target level of return, it is in the interests of all stakeholders that a trust port should set its dues, evaluate its investments and* ***charge for its services****, at commercial and competitive rates, neither exploiting its status as a trust port to undercut the market, nor abusing its dominant position in that market. [emphasis added]*

92. Mr Waggott suggested that the Operators could leave the port if they so wished. The Operators made clear that (a) his suggestion was wrong and (b) it demonstrated a complete disregard for the Board's most important customers. Essentially the Board's approach in the setting of the 2010 tariffs was to disregard the interests of the Operators and profit from their captive status to increase the large cash surplus it already had. The Inspector will recall in this regard that prior to the implementation of the 2010 tariffs the Board had already decided to postpone works on T2.

93. The evidence of Mr Waggott also showed that it was the intention of the Board in setting the 2010 tariff to fund the T2 investment by accruing from dues the entire costs of the project bar a minority amount of borrowing (Mr Waggott suggested an amount in the region of £100million). It is submitted and was the evidence of Mr Harman, that pre-funding from existing customers in that way is simply not a commercial approach. The *commercial* approach would be to fund through debt markets. The Board have agreed that there is no legal restriction on their power to borrow. If there came to be a *commercial* case for T2 with a clear *commercial* return any apparent reluctance on the part of the DfT to borrowing by the Board might be overcome.

94. Mr Harman was equally clear that his view was that T2 could not be funded by increasing dues to meet the funding requirements as this would lead to an anti-competitive outcome (i.e. tariffs would have to increase by too much, leading to a loss of demand due to competition from Eurotunnel, which would result in T2 not being required). Equally, maintaining and increasing the size of the cash surplus to be used for any purposes the Board sees fit is neither reasonable nor commercial, and certainly not competitive.

95. It will be recalled that in the context of the prohibition of setting charges in an abusive fashion, as noted above, Mr Chadney's evidence was that the increase in ships dues by some nearly 40% between 2009 and 2010 supported the contention that the Board was abusing its dominant position.[93]

The 2010 tariff constituted and was set as an abuse of a dominant position

96. The Operators' response to document INQ/44/DHB is contained in Annex G.

97. In summary and without prejudice to the detail set out in Annex G, where arguments based on competition law are put to the SoS within the context of a s31 Inquiry, she is acting as a representative of the State and/or is susceptible of review by the courts and is thus required to apply EU law in addition to any national law. Moreover, if the Board is held to have abused its dominant position in relation to the setting of dues in 2010 and 2011 then the SoS would, in making directions in the exercise of her powers under s31 Harbours Act 1964, in addition be required to give effect to those provisions and provide the Operators with the corresponding remedies, as otherwise she would be acting contrary to the above-mentioned provisions in the relevant European treaties.

98. The Operators contend that the SoS has the power and indeed the duty to apply competition law where this falls within the scope of the exercise of her powers under s31 Harbours Act 1964. Any contrary interpretation would deprive the Operators of an effective remedy under EU law and be contrary to the fundamental principle of cooperation enshrined in the European treaties.

99. As to dominance, the location of Dover is acknowledged by Mr Goldfield as a facet of Dover's "*unique position*"[94] and the assertion by Mr Goldfield that the Operators could run out of the Thames, Harwich, or East Anglia or even from the North of England is misconceived. The operators cannot operate out of these ports (as is clear from the evidence of the Operators, in particular Ms Deeble) and Mr Goldfield's evidence was not supported. As noted in the Operators' opening submissions, ports within the EU have been found to hold dominant positions in their relevant markets and no evidence has been produced by the Board to counter those points as applied to the Port of Dover. In the premises, the Operators maintain their contention that the Board was at all material times – i.e. when it set the 2010 and 2011 tariffs applicable to the Operators – in a dominant position in the relevant market.

100. As to abuse of that dominance, it is admitted by the Board[95] that "the imposition of unfair or excessive prices can constitute an abuse of a dominant position." The Operators submit that the tariffs charged by the Board in 2010 and 2011 exceeded their economic value and were untenable, for the reasons set out in Annex G, and accordingly were abusive. In particular, following the readjustment in the tariff structure in 2009 the failure to account for the saving in ILO costs in 2010 and 2011 by reducing the charges more than the Board did do, led to an excess margin of revenue over costs that the Board has not been able to justify and which the Operators contend is evidence of abusive pricing.

[93] Transcript: Day 9, p 148 - 149
[94] Goldfield, Day 2, page 28, line 11
[95] para. 16, INQ/44/DHB

Inappropriateness of the 2011 tariff

101. The Operators repeat their submissions *mutatis mutandis* in respect of the 2010 tariffs in support of their contention that the 2011 tariff was inappropriate. The Operators submit that it was further not fair or equitable or in accordance with the Board's duties to stakeholders for it to simply set the 2011 tariff on the basis of an RPI index increase on the 2010 tariff in order "*not to show weakness*".[96]

102. In addition, the Operators contend that the use of the RPI rather than the CPI was in all the circumstances unreasonable given that that index is increasingly viewed as volatile [see the evidence of Mr Howarth and Mr Christensen].

Conclusion

103. In the premises, the Operators contend that each of the dues charged in the tariffs for 2010 and 2011 were excessive. They accordingly respectfully submit that a recommendation to that effect be made to the Secretary of State.

104. In addition, they seek a further recommendation that the tariffs should be reduced by any other reductions put forward by the Operators.

105. To that end, a draft Order is appended to INQ/46/OBJ at Annex 4.

[96] Appendix 11 to Mr Waggott's proof.

The Case for Dover Harbour Board[97]

Introduction

106. This Inquiry concerns the setting of harbour dues by DHB for the years 2010 and 2011. Objections and representations have variously been made by the three operators which presently operate ferry services from the Port of Dover ("the Objectors").

107. The evidence before the Inquiry is extensive and, inevitably, it is not possible in closing submissions to address it fully. These submissions therefore focus on the proper approach to be adopted in the Inspector's consideration of the objections and the making of recommendations to the Secretary of State before reviewing the key evidential outcomes of the Inquiry and drawing conclusions.

108. The submissions therefore proceed to address the following matters:

i. The role of DHB

ii. The relevant statutory provisions pursuant to which the dues were set

iii. The process of setting the tariff in 2010 and 2011

iv. The actual dues levied in 2010 and 2011 and their impact

v. A review of the tariffs against the "commercial, competitive, fair and equitable" test

vi. PwC's (PricewaterhouseCooper's) economic review and Mr Harman's attempt to undermine it

vii. Conclusions on the question: "Were the dues set appropriately?"

viii. The Operators' various alternative proposals

ix. Final conclusions.

The Role of DHB

109. DHB is a trust port. It is an independent statutory body governed and controlled by an independent board, which is charged inter alia with the administration, maintenance and improvement of the Port[98]. There are no shareholders or owners, but there are a significant number of stakeholders and stakeholder groupings. As a trust port, all surplus funds are reinvested into the Port for the benefit of stakeholders. These stakeholders are those using the Port, employees of the Port and its users and all those individuals, organisations and groups which have an interest in the operation of the Port including the local community[99].

110. Whilst the ferry operators, as one grouping of customers of the Port, are important and valued stakeholders, they have no exclusive claims upon DHB and their interests must be balanced by the Board along with those of other stakeholders. Of course, the Objectors have no interests other than their own (ie that of their Boards

[97] Based on the closing submissions of DHB: INQ/47/DHB
[98] Proof of Mr Goldfield: INQ/01/P, section 4
[99] Ibid, para.4.4.1 et seq

and shareholders)[100] to pursue and it is not surprising that they should fight hard to protect their commercial interests. However, whilst DHB has disclosed a great deal of information about its financial performance, the Objectors have revealed virtually nothing which is not available from their statutory accounts. In particular, they have not revealed information which allows the role played by the tariff to be seen alongside other elements of their overall cost base, which itself is subject to significant fluctuation as a result of external factors such as fuel costs[101].

111. DHB is not a "regulated business" and is not subject to the type of regulation which Parliament has put in place for many of the privatised industries, where pricing is subject to an extensive system of controls.

112. By contrast, DHB is governed by the Harbours Act 1964 ("the 1964 Act") in setting the dues which it charges its ferry operator stakeholders. The relevant provisions are considered below.

The Statutory Context

113. The starting point is section 26 of the 1964 Act. This is entitled "Repeal of provisions limiting discretion of certain harbour authorities as to ship, passenger and goods dues charged by them". Parliament thus set about expressly *removing limits* on discretion which previously constrained harbour authorities.

114. Section 26(2) goes on to provide that "Subject to the following provisions of this Act.....a harbour authority shall have power to demand, take and recover such ship, passenger and goods dues *as they think fit* at such a harbour as aforesaid" (emphasis added). Parliament thus conferred an extremely broad discretion on DHB and expressly intended to do so.

115. The following section is also of interest. Section 27 expressly provides that certain charges of certain harbour authorities are "to be reasonable", but expressly excludes from the ambit of this limitation "ship, passenger and goods dues": see subsection (2)(a).

116. Section 31 of the 1964 Act provides a "right of objection to ship, passenger and goods dues". This requires the Secretary of State to consider whether to approve the charge or direct the harbour board to meet the objection. It is clear from subsections (6)(a), (7) and (10) that the objection process could be used annually.

117. There is no further elaboration of the statutory objection process and, so far as I am aware, no further relevant primary or secondary legislation which sets out expressly the considerations which the Secretary of State should have in mind when considering an objection. Again, I submit that this must have been deliberate. It would have been perverse for Parliament to enact legislation expressly establishing a wide and unfettered discretion for harbour boards in setting dues and then to establish a prescriptive approach for the consideration of objections to those dues by the Secretary of State.

118. Thus the Inspector at the Langstone Harbour Board section 31 Inquiry concluded, having considered submissions on this issue:

[100] Confirmed in XX by Mr Wilkins and Ms Deeble
[101] See K.Howarth INQ/08/P, para.3.6

> "...in statutory terms, harbour authorities have specifically been given an extremely broad discretion in this respect which does appear to be largely unfettered despite the provision for objections..."[102]

119. Consequently and against this background, it is submitted that the onus lies on an objector to demonstrate that the harbour board's very broad discretion has been improperly exercised such that (in this case) dues should be lower.

120. This is *not* to say that this Inquiry is limited to consider only those matters which might form the basis of an administrative law challenge (ie Wednesbury grounds). However there must be a limit to the exercise upon which the Inspector and SoS are now embarked and it is not accepted that their role is to revisit and "second guess" every decision which DHB have taken in recent years which might have an impact upon the level at which dues have been set.

121. In their representations of 12th November, 2010[103], P&O states its position in these terms:

> "Clearly, it was not intended for all dues to be routinely determined by the Secretary of State – it is the relevant harbour authority who has primary responsibility for the setting of dues. As such, the Secretary of State will defer to an appropriate extent to the assessment of dues by the harbour authority and will only seek to vary the dues they have imposed where she has good reason to do so." (emphasis added)

122. It follows that, merely because another party might have chosen to set the dues differently, is no reason to disturb the exercise of its broad discretion by DHB. In the words of P&O, there must be "good reason to do so".

123. It is submitted that this is the correct analysis. Thus the merits of the dues may be considered by the Secretary of State pursuant to section 31, but this exercise must defer appropriately to DHB, in the exercise of its broad discretionary powers. This approach is no more than a recognition of the impossibility of a short Inquiry putting the Inspector "into the shoes" of a large organisation such as DHB over a lengthy period of time - such that each and every underlying decision about the running of the port with any impact on dues can be revisited. It is submitted that this cannot have been the intention of Parliament in enacting the section 31 process. Nothing said in these submissions conflicts with the note on the role of the SoS in reaching decisions under s31 of The Act issued by DfT in June 2011.

124. Finally, it will be seen that the Objectors are and have been pursuing their interests on a variety of fronts: for example, extensive representations are being made to the DfT on the issue of privatisation. It is submitted that the Objectors opposition to the possible privatisation of the Port of Dover is a wholly separate issue, and one which must not be allowed to interfere with DHB's ongoing statutory responsibilities to set dues as a trust port. It is clear that DfT's view is that "possible future changes in the status of DHB..... have no bearing on the appropriateness of harbour dues levied before the change"[104]. DHB respectfully concurs with that

[102] CD/06/12, para.5.31
[103] CD/01/10
[104] Letter: DfT (Matthew Brown) to BDB (Francis Tyrell) 14th July, 2011 at INQ/01/R, Appendix BG/1/R

approach and takes the view that, whilst the Objectors plainly have a significant interest in the principle of privatisation and the terms upon which any privatisation may take place, the section 31 process for the 2010 and 2011 calendar years is not the appropriate forum in which to pursue those interests.

The Approach of DHB to the Setting of Dues in 2010 and 2011

125. The task of setting dues has been undertaken by DHB with regard to a wide variety of material considerations. Central to this exercise has been the advice of the Secretary of State in the document "Modernising Trust Ports"[105]. This document requires an accountable – and more commercial – approach to the activities of trust ports. In particular, trust ports should set dues at a level "that allows for proper maintenance of the trust's harbour or conservancy duties"[106].

126. Mr Goldfield has addressed, inter alia, this broad context for the exercise of DHB's discretion and explained some of the financial and other constraints within which DHB must operate which bear upon the setting of the dues.

127. Against this background, Mr Waggott has described the process by which DHB set the relevant (and immediately preceding) tariffs. In so doing, he has reviewed both the guidance in MTP and the specific factors operating at Dover.

128. It is clear from MTP1 and 2 (and the Port Marine Safety Code - PMSC) that dues are not required to be set in proportion to the services received by users of the harbour. It is submitted that this is a sensible and pragmatic approach, reflecting the inherent difficulties in balancing the interests of a diverse group of stakeholders – as DHB is required to do - and the injunction to use proceeds from customers "prudently to maximise benefit to all stakeholders and in the best and most effective interest of the future of the port"[107]. It hardly needs to be restated that the Objectors' aims and objectives are inevitably very different and are commercially driven by their Boards and shareholders.

129. Mr Waggott sets out in detail the considerations which directly informed DHB in the setting of its dues in 2010 and 2011[108]: what guidance in MTP1 and MTP2 allows and requires in relation to financial performance; the restriction on borrowing; the capital and maintenance requirements for the existing port; the financial implications of the Master Plan including the proposals for T2 and the need to accrue and maintain a cash surplus; financial targets set by the Board and commercial pricing and the lack of true comparators. In 2010 these factors were supplemented by the introduction of proposals for a long term price path, the intention of DHB to rebalance the fixed and variable elements of the tariff and the cessation of DHB's ILO function during 2009.

130. These considerations were clarified and summarised in a consolidated form by the Inspector in the course of questions to Mr Waggott on Day 4: "the tariffs as set in 2010 essentially reflected the need to recover operational costs, to recover short-term capital costs, to rebalance the Board's risk and to increase DHB's cash balance with a view to the longer term custodianship of the port..... In 2011, the long term

[105] CD/06/6
[106] Para.1.2.4
[107] MTP2, para.1.2.5
[108] See in particular INQ/03/P, section 4.

price path was not pursued and the increase was limited to RPI, reflecting the Board's recognition of the operators' likely difficult trading conditions". Mr Waggott affirmed this summary of the considerations which had influenced the process of setting the 2010 and 2011 tariffs.

131. It is now necessary to consider these factors in more detail, as their legitimacy has been attacked during the course of the Inquiry.

Recovery of Operating Costs

132. In fact, there has been very little dispute about operating costs. Moreover, there has been no dissent from the proposition set out in my Short Opening Submissions that running a harbour of the size and with the annual throughput of Dover is a complex and demanding operation.

133. I have asked each company witness for the Objectors in turn whether specific inefficiencies have been or are alleged. None has suggested that there is evidence of such inefficiencies and none has been able to point to an instance in the past when a matter has been drawn to DHB's attention and no action has been taken.

134. On the contrary, the evidence of Mr Krayenbrink[109] reveals a methodical and robust approach to operational issues, supported by a proper programme of inspection and systematic advance planning to ensure that port capacity is available and functioning effectively to meet the needs of its various users. The minutes of the Technical and Operational Sub-Group[110] support this submission.

135. Indeed none of the Objectors has made any allegation that the port is other than well run. This is highly significant, as the Objectors number users of many other ports with a broad experience of operating conditions in the industry and P&O is itself a port operator in other locations[111].

136. The sole reference to operational inefficiency in the material before the Inquiry relates to the ILO function. In relation to ILO, DHB itself realised that it could not provide these services optimally and, after concluding that it was not best placed to effect rationalisation of this function internally, moved to a system whereby operators themselves contracted for these services directly. There is absolutely no evidence whatsoever that the ILO issue is symptomatic of wider inefficiency within DHB and any attempt to draw such an inference would be entirely unsupported. Indeed, the reverse is true as DHB identified this issue itself, acted to address it and the subsequent experience of the operators has shown that this was the correct course.

137. The Secretary of State may therefore conclude on the evidence that DHB runs the port efficiently and incurs operating costs which are consistent with such a conclusion.

[109] INQ/02 series and oral evidence on Day 2
[110] INQ/02/R Appendix 2
[111] Ms Deeble's evidence

Recovery of short-term capital expenditure

138. Messrs Goldfield and Krayenbrink have explained DHB's ongoing responsibilities to maintain and improve the existing port infrastructure, as well as to plan for the future.

139. Short to medium term Capex plans have for many years been shared in advance with the operators prior to being finalised. This applies both to the range of works set out in the Capital Expenditure Plan 2010-2012[112] and that for 2011-2015[113].

140. Notwithstanding the discussion at Technical and Operational Sub-Group and detailed justification which underpinned the inclusion of the individual Capex items in these plans, Mr Wilkins in various purple passages in his colourful (and frankly ill-considered) Proof of Evidence thought it appropriate to suggest that these Plans were excessive and the expenditure unwarranted. He even goes so far as to suggest that much of the current Capex is "gold plating" to make the Port more attractive for privatisation[114] or "a list of items thrown together to try and justify rate increases"[115].

141. Mr Krayenbrink has thoroughly rebutted these allegations[116] and shown that Mr Wilkin's colleague, Mr Kevin Root, was in fact in attendance at numerous meetings of the Sub-Group when these items were discussed and raised no questions about the appropriateness of the Capex plans. He has also produced samples of the Capital Works Updates[117] which are regularly provided to members of the Sub-Group.

142. No points of objection to individual elements of the Capex plans were pursued in cross-examination of Mr Krayenbrink. Accordingly, the Inspector and the Secretary of State are invited to conclude that DHB's short term Capex plans are (and have been) soundly based and appropriate.

Rebalancing the tariff

143. Mr Waggott explains at section 12 of his main proof of evidence[118] the structural changes to the tariff which were introduced in 2010. In particular, he explains DHB's view that it was disproportionately exposed to risks by the pre-existing fixed to variable weighting of the tariff at 25:75. This concern was exacerbated by DHB's high level of fixed costs, a point which Mr Chadney readily accepted in XX[119], commenting that this was even more pronounced with the transfer of the ILO function away from DHB.

144. The rebalancing introduced in 2010 moved the fixed to variable weighting from 25:75 to a more reasonable 40:60. Mr Waggott's Rebuttal Proof[120] compares this

[112] INQ/02/A, MK10
[113] Ibid, MK3
[114] INQ/06/P, para.48
[115] ibid
[116] INQ/02/R
[117] INQ/25
[118] INQ/03/P
[119] Day 9
[120] INQ/03/R

weighting to a range of other UK ports and finds that DHB still has the lowest (fixed) proportion of ships dues of all its peers even after a major realignment[121].

145. No evidence has been produced by any of the Objectors' witnesses to suggest that the reweighting undertaken by DHB was unreasonable or out of line with practice elsewhere, nor has any rationale been advanced for returning to the former or an alternative balance. In their Alternative Proposals, SeaFrance alone suggests reweighting the tariff with 27% ships dues, although this figure is not explicitly justified. DHB has commented[122] that this proposal is likely to favour SeaFrance more than the other operators.

146. In summary, this reweighting has been undertaken to reflect more appropriately the high fixed costs which DHB bears in administering and maintaining the Port of Dover. It represents a re-structuring, but one which leaves DHB still charging fixed dues which are significantly lower as a proportion of SPG dues than other UK ports. There is no basis for attacking this reweighting as excessive.

147. What the Objectors have done has been to attack as "excessive" and use as "sound bites" in their case the proportionate *increase* in ships dues in 2010 when compared with 2009[123]. This exercise is, of course, no more than cherry-picking, as it fails to acknowledge the substantial proportionate *decrease* in the levels of variable dues. As Mr Chadney agreed in XX[124], "it is important to look at the *aggregate* effects of the changes in the tariff". The effects of changes in individual components can only be assessed in the context of the overall composition of the tariff. To close your eyes to half of the tariff and cry foul on the basis of the other half is farcical. This is considered further below.

Accrual of cash for the longer-term custodianship of the port

148. There appears to be agreement between the parties that a port such as Dover needs to take a long term approach to new infrastructure and Messrs Chadney and Pusey readily acknowledge that "it takes years to plan, fund, build and deliver port capacity"[125].

149. For DHB, the critical issue was the realisation that, for significant periods during 2007 and 2008, the port was "getting close to the point of reaching its limit of reasonable utilisation"[126], with routine overflow of road freight vehicles on to the highway network at peak times and major consequential effects for the Town of Dover. This led DHB to advance plans for T2, a new ferry terminal focussed on the Western Docks. After extensive public consultation and engagement with stakeholders, an application for an HRO (Harbour Revision Order) to enable the development of T2 and associated works was made.

150. As of today, all outstanding objections to the HRO have been withdrawn. No party is pursuing a case that the development is unnecessary, nor that it should be constructed at a different location, nor that other measures can be undertaken which will solve the capacity constraints at the existing terminal.

[121] Ibid para.3.44
[122] INQ/41/DHB, page 3
[123] INQ/46/OBJ para 50
[124] Day 9
[125] INQ/09/P, para.7.15
[126] INQ/02/P, para.7.4

151. Thus the Secretary of State may and should conclude that T2 - as conceived and planned by DHB - is the likely solution to the Port's capacity problems and that, on the available evidence, T2 has the potential to be implemented without unacceptable environmental impacts.

152. As Mr Chadney recognises, there remains the problem of funding. The working figures for the complete T2 development are in the range £380-£400m, with Phase 1 costed at approximately £200m. These are, of course, very substantial sums for DHB, which has a total annual turnover of £57m. The position is further complicated by the inability of DHB to borrow, which arises from the trust port status of DH and the fact that its debt is classed as government debt. DfT confirmed in January 2009 that "no provision has been made in the Department's budgets, which have been fixed until 2014, for the new borrowing which would be required to finance your Western Dock development"[127]. This position will apply at least until 2014, with (unsurprisingly) no commitment from the government either way as what will happen thereafter.

153. However, even if borrowing can take place – either as a result of a change of position from the government or as a result of a change in the status of DHB – Mr Goldfield is clear that there would still be a requirement for cash to fund the T2 project. He considers that the limit on borrowing would be at £80-100m[128]. Ms Deeble valiantly sought to suggest in oral supplementary evidence that much higher ratio of debt to cash could be secured based upon her experience in financing two new ships in summer 2008. However, she candidly admitted in XX, first, that she had no experience of raising finance for £200-400m of (fixed) port infrastructure and had not investigated the options open to DHB and, second, that the loan agreement for the P&O ships was agreed in Spring 2008 and executed in Summer 2008, ie prior to the Lehman's collapse in September 2008 and the debt crisis which has followed.

154. Mr Goldfield also made clear in oral evidence his abiding concern that DHB would find itself in a situation where additional capacity was urgently needed and DHB was simply unable - for financial reasons - to provide it.

155. The current best evidence before the Inquiry and the Secretary of State from DHB is that a start on T2 Phase 1 might be required as early 2016, in order to deliver capacity in 2019-2022. This is based upon the forecasting work undertaken by DHB, updated to take account of minor T1 improvements[129].

156. It is highly significant that none of the Objectors has commissioned or proffered any alternative forecasting work to that spoken to by the DHB witnesses. The only noises which the Objectors have made about demand have been generalised assertions about issues such as low sulphur fuels. However no attempt has been made to model the alleged effects of such factors on demand/capacity at Dover in the medium to long term.

157. 2016 is only 4 years from the likely date of the Ministerial decision on these objections. At the Inspector's request, Mr Waggott has produced a high level cash flow for 2011-2021 on the assumption that work on T2 Phase 1 commences in

[127] INQ/01/A, Appendix 4
[128] INQ/01/P, para.9.8
[129] Evidence of Messrs Krayenbrink and Waggott

2016[130]. This demonstrates that DHB will have to borrow close to Mr Goldfield's maximum serviceable borrowing (£80m) in the latter part of the period, even with the retention of its present cash balance.

158. The above are the circumstances which have led DHB to seek to accumulate reserves to enable it to embark upon T2 within a timeframe which would allow new capacity to be delivered as closely as possible to the time when it is needed. It is submitted that this is a reasonable, prudent and entirely proper approach for a body which is most conscious of its responsibilities to a broad class of stakeholders (including, for example, the inhabitants of the Town of Dover) and its duty to provide stewardship of the trust port for future generations.

159. It must be emphasised at this stage that the concept of using the tariff to accrue cash for future major infrastructure investment was transparently explained to and clearly accepted in principle by the Objectors from 2007, when the issue first arose. In the years 2007-2009, DHB accrued a cash surplus of £57m. In none of these years was a section 31 objection lodged in respect of the tariff as set by DHB. As Mr Waggott emphasises[131], in 2010 the cash accrual target was much reduced from previous years to take account of "both the anticipated difficult trading conditions and also the delay in the anticipated date by which T2 was likely to be required". In the event, the cash balance at year end 2010 was increased by only £3m to £60m. Note that there has been no significant impact on this cash balance arising from pension fund issues which are provided for in a separate plan.

160. It is necessary at this stage to pause and observe that these cash balances do not derive solely from ferry tariffs. They represent the cash balance of DHB *as a whole*, following a number of strong years across the port's various income generating streams and include the proceeds of asset disposal. There is no sense in which the funds are directly "traceable" to the ferry operators.

161. However, it is clear from the way in which the Objectors' evidence is couched - and the £40m and £19m suggested "rebates" sought by P&O and DFDS respectively - that they are in effect seeking to unravel the effects of earlier, closed years. It is submitted that this is not a legitimate purpose for a section 31 objection, which should be directed at the tariff set for the year in question and the circumstances surrounding the setting of that tariff.

162. As discussed above, what lies at the heart of the objections would appear to be anxiety on the part of the Objectors that DHB's cash reserves will be "swallowed up" in any privatisation and not ultimately used for investment in port infrastructure. Mr Goldfield has sought to make it clear, as do these submissions, that DHB wishes to see a major part of its cash reserves ring-fenced for investment in the Port *if* any privatisation is authorised by the government. As Mr Goldfield explained in evidence, DHB has been advised that ring-fencing is legally possible (if technically complex), but has held off commissioning the legal work which would be required until there is greater clarity as to the prospects of any privatisation.

[130] INQ/29
[131] INQ/03/P, para.17.2

163. In summary, given that:

i. the purpose of accruing of cash springs directly from DHB's desire to fulfil its statutory obligations (by ensuring that it is able so far as is practicable to provide additional port capacity as and when it is required);

ii. there is no challenge to the forecasting work relied upon by DHB, which suggests that a start on T2 Phase 1 could be required as early as 2016;

iii. there is no evidence which suggests that T2 Phase 1 could be provided without reliance upon substantial cash reserves; and

iv. £57m of the current £60m cash balance was accrued in years when no objections were lodged to the tariff,

it is submitted that DHB acted entirely properly in 2010 and 2011 in seeking to sustain and (within the limitations imposed by the economic climate) enhance its cash reserves.

164. Accordingly the Secretary of State may be invited to conclude that there is no basis upon which to disturb DHB's balancing of the complex issues which faced it in 2010 in respect of its future investment needs and the accumulation of funds to support such investment timeously.

RPI - 2011

165. For 2011, the suite of factors taken into account by DHB is rather more straightforward, as the decision was taken not to pursue the 2010-2012 price path but simply to increase the tariffs by RPI for July 2010, RPI having been the measure conventionally used by DHB prior to the cash accrual exercise.

166. RPI is a measure in use in a variety of contexts by government and is one of a number of measures of inflation which are publicly available. When P&O produced INQ/37/OBJ to demonstrate the "impact of 2010 tariff change on P&O Ferries", the measure of inflation which it used to make its point was RPI, rather than CPI, which would have produced a lower output for this exercise in 2010.

167. The Objectors have accused DHB of choosing the month in 2010 with the highest figure for RPI[132]. However this accusation is completely misconceived and again calls into question the amount of analysis which preceded the making of the objections. In fact, RPI for July 2010 was lower than the figures for each of the preceding 3 months[133].

Summary of factors affecting DHB's approach to tariff setting

168. In summary, DHB's approach was entirely proper and relied upon considerations which were both legitimate and material. There is simply no basis for interfering with the way in which DHB weighed the issues before it in setting SPG dues in 2010 and 2011.

[132] Wilkins proof, INQ/06/P, para.144.
[133] INQ/03/R, Appendix 2

Impact of the Dues Set for 2010 and 2011

169. DHB's evidence considers *ex post facto*, by reference to a variety of metrics, the *actual* impacts of the dues imposed for the years in question. No part of this analysis supports the proposition that the dues set for these years were excessive.

Impact on DHB's financial performance

170. This exercise commences in section 17 of Mr Waggott's Proof of Evidence[134], where EBITDA (Earnings before Interest, Taxes, Depreciation and Amortisation), ferry turnover/total turnover and ROCE (Return On capital Employed) are all examined by reference to preceding years. These are all standard measures of financial performance.

171. The tables on pages 26-28 of INQ/03/P reveal nothing startling or excessive about the effects of the tariffs set in 2010 and 2011.

172. Additionally, Mr Pusey (whose evidence was not summarised) has also undertaken a comparative assessment of DHB's financial performance measured against a suite of other UK Trust Ports and has sought in section 2 (sic; now 3) of INQ/09/P to suggest that DHB's profits are excessive. Unfortunately, due perhaps to the very short time in which he was instructed (in August 2011 prior to submission of proofs towards the end of the month) his Table 2 contained multiple errors.

173. His Table 2 has now been corrected and augmented with the addition of one further UK Trust Port (Belfast) by Mr Waggott[135]. As explored in XX of Mr Pusey, the outcome is that DHB is *within a range* for each and every one of the metrics examined. It is submitted that there is absolutely nothing arising from this exercise (when undertaken accurately) which supports the Objectors' claims that DHB is generating excessive profits.

174. As a footnote, it may be suggested that Belfast's cash balance is only greater than Dover's because it generates income from a variety of non-port activities. Whilst that may be the case, Dover's cash balance cannot be viewed out of context: it only stands at its present level because of the need to accumulate funds which are required to undertake a major new item of port infrastructure.

Impact on ferry operators

175. It is instructive that Mr Chadney sought himself to undertake a comparison between 2009 and 2010 for the dues charged on a representative vessel. This vessel was defined by him and "based on typical assumptions for ferries currently in service"[136]. His exercise examines each element of the tariff in turn and is sensitive to the rebalancing exercise which DHB undertook in 2010. However, notwithstanding Mr Chadney's agreement in XX[137] as to the importance of the aggregate effect of the changes, this "aggregate effect" is not tabulated in the same way as the changes in the ships dues, nor is it discussed in Mr Chadney's text. It is submitted that this is rather an extraordinary omission, although again it may be

[134] INQ/03/P
[135] INQ/03/R, page 14, para.3.35
[136] INQ/09/P, para.5.8
[137] Day 9

explained by Mr Chadney's instruction less than two weeks before the exchange of evidence, and in circumstances where the Objectors had not previously been in receipt of any expert advice of this nature.

176. As Mr Waggott's Rebuttal proof reveals, when this exercise is carried out properly, Mr Chadney's representative vessel would see a *reduction* in dues by -7.8%.[138] This is hardly an impressive platform for advancing allegations that DHB's dues are "excessive" and Mr Chadney expressly agreed in XX that his exercise did not amount to evidence of abuse of a dominant position. Taking Mr Chadney back to the ship dues only element of the tariff in RX and inviting him to categorise the % increase in ships dues only as abusive was a pointless exercise when the key issue is agreed to be the aggregate effect of the tariff changes.

177. During the Inquiry, Mr Chadney's representative vessel exercise was supplemented by INQ/37/OBJ, which examines the effect of the 2010 tariff on P&O. This exercise has been controlled for volume changes as between 2009 and 2010 and also seeks to factor in the outsourcing of the ILO function to ferry operators. Even on the basis of the figures as presented, the "actual" increase on cost to P&O is stated to be 3.55%. As Ms Deeble agreed, given that the DHB tariff represents 7.4% of P&O's turnover on the Short Sea Route, a 3.5% increase in 2010 would (if the figure were correct) amount to an increase of 0.26% or one quarter of one percent as an impact on turnover.

178. In fact, as Ms Deeble agreed in XX, the 2010 ILO figure in INQ/37/OBJ <u>does not</u> represent P&O's <u>actual</u> ILO costs in 2010, notwithstanding that this document is intended to consider the <u>actual</u> impact of the tariff changes. Ms Deeble agreed that the figure of £1,673,892 is simply a pro rata figure based upon the 59 employees previously allocated to P&O. The number actually transferred to P&O was 34, with DHB bearing the redundancy costs of the balance. [NB. Although P&O subsequently reduced the numbers to 24, this generated a one off payment of a year's salary – so the effect of making a further deduction is neutral for 2010.] The figure of £1.4m referred to in the Operators' closing submissions (INQ/46/OBJ paragraph 48) is not recognised.

179. Thus, if the actual numbers transferred are used, Ms Deeble agreed that the correct pro rata figure to use would be £1.1m. If this is substituted into calculation for the £1,673, 892 which represented previous 59 ILO employees, then Ms Deeble agreed that this would represent an increase of 0.8% over the amounts paid by P&O to DHB in 2009, when controlled for volume.

180. When this 0.8% increase is considered by reference to the 7.4% of turnover which is represented by tariff payments to DHB, the impact on P&O for 2010 is an increase of 0.06%. As Ms Deeble observed somewhat defensively in XX, this is indeed "more than previously" (ie an increase over 2009). That cannot be denied. However, once again, this analysis does call into question why the P&O objections and evidence are laced with hyperbole and allegations of "excess" and "abuse" - which are simply not borne out by any objective analysis of the facts. Mr Chadney expressly agreed in XX that these figures did not support the allegations made against DHB.

[138] INQ/03/R, para.3.56

Commercial, Competitive, Fair and Equitable

181. DHB has made clear that it has had proper regard to MTP2[139] in setting its dues. MTP2 contains general advice to trust ports to "set its dues... at commercial and competitive rates...."[140]. It is also stated that "investment policies too should be fair and equitable"[141].

182. The four adjectives deployed in these two sentences have been combined to provide a means of reviewing the harbour dues set in this and other cases[142]. However there is no clear explanation of what these terms are intended to mean in this particular context and certainly no basis for ascribing any prescriptive meaning or effect to their use in MTP2.

183. I proceed to assess the DHB dues briefly by reference to these terms.

Commercial ...rates

184. This provision must also be considered in the light of para.1.2.1 of MTP2, which states that "the Government expects trust ports to.... generate a commercially acceptable rate of return". This (together with para.1.2.2 read as a whole) indicates that trust ports should be run as if they were "fully commercial" businesses. There is absolutely no suggestion that they should operate effectively to subsidise their users and insulate them from the levels of dues which would be chargeable by a PLC port. As Mr Ogier explained, once having generated a "commercially acceptable" rate of return, it is open to the trust port to decide how any funds accumulated should be deployed: the options would range from investment in facilities or services for stakeholders to returning an element to customers by way of rebate.

185. As Mr Harman agreed in XX, it is also clear that MTP2 intends to give trust ports considerable autonomy in setting target rates of return "for existing activities and new projects". Mr Waggott explained in evidence that DHB has set a target rate of return for new projects of 12%.

186. The previous version of MTP referred to "publicly provided commercial services" as setting a target level of return of 8%. This 8% is expressed to be a "real" figure[143], which is agreed by Mr Howarth to equate to a "nominal" return of 10.7%. This is virtually identical to the DHB return, which is expressed for statutory accounting purposes as a nominal return of 10.9%. There is certainly no basis for viewing DHB's return as other than "commercial".

187. Mr Waggott's evidence[144] also considers DHB's rate of return by reference to a range of returns earned by other UK trust ports, which are also subject to MTP2 guidance. His table shows that DHB's return is not dissimilar to that earned by Shoreham and some way below that earned by Milford Haven. It is within the range for its peer trust ports.

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[139] CD/06/6
[140] Ibid, para 1.2.3
[141] Ibid, para 1.2.6
[142] See, for example, the Langstone Harbour case.
[143] See "the old 6 and 8 % real figures": MTP2 para,1.2.2 ...
[144] INQ/03/R, page 14, para.3.35

Competitive

188. It is accepted that analysing the competitiveness of DHB's dues is not a straightforward exercise, as there is no UK port sharing identical characteristics with the Port of Dover, with a directly overlapping market.

189. However, the Port of Calais is described by P&O as "the closest port by way of size and type of operation" to Dover and as Dover's "most comparable competitor"[145] (emphasis added). Ms Deeble expressly agreed in XX that she stood by these judgments.

190. Ms Deeble also indicated in XX that she expected the Calais tariff to be set as a competitive port acting inter alia in the interests of its business partners, the ferry operators. Likewise, she drew attention to the competitive environment in which Calais operated, with Boulogne and Dunkerque as direct competitors for business. Mr Harman, by contrast, had not considered these matters[146].

191. In this context, Mr Ogier has undertaken a benchmarking exercise to compare DHB's dues against those of the Port of Calais. PwC's exercise reveals that, following appropriate adjustments for ILO and security, Dover's charges are in the range 55-75% (ie significantly) below those of Calais.

192. It is notable that the Objectors do not suggest a different conclusion in their evidence. They present no alternative analysis of the Calais tariff. Indeed, both Mr Wilkins and Ms Deeble agreed in XX that "it is materially more expensive to call at Calais than at Dover". Ms Deeble also agreed that the "economic value" to the ferry operators of the service provided at Calais (ie as a port where passengers and cargo on the Short Sea Route can be embarked and disembarked) is *the same* as the economic value of the service provided at Dover.

193. Somewhat bizarrely, Ms Deeble was left trying to explain away the very large disparity between the dues charged at Calais and the much lower dues charged at Dover on the basis of French social and labour laws. However, she was constrained to agree that the sizeable disparity was unlikely to be entirely explicable on this basis.

194. The Inspector and the Secretary of State are invited to conclude on the evidence before them that the Objectors' "most closely comparable competitor" (as defined by them) charges "materially more" for a service of the same economic value to that provided to the Objectors by DHB. It is not plausible to suggest that DHB's dues are other than competitive in this context.

195. The other issue which has arisen in this context is the role played by Eurotunnel in the provision of cross-channel services. As discussed by Mr Ogier, it is not accepted that Eurotunnel can be compared directly with DHB, due to its vertical integration and very different financial structure. However the market performance of Eurotunnel has been relied upon by the Objectors allegedly as evidence of the deleterious effects upon their performance of changes to the DHB tariff in 2010 and 2011.

[145] CD/01/02
[146] Day 7-8 XX'd

196. Here it is necessary to put to one side the claims made in the Objectors' evidence - such as Mr Wilkins' assertion that Eurotunnel were now back at in excess of 40% market share and above the market share they enjoyed prior to the fire – and have regard to the facts.

197. Mr Chadney's evidence[147] - as now supplemented by INQ/43/OBJ - reveals that the market share profiles of Eurotunnel and Dover have remained generally flat over the past 8 years or so, when exceptional events (such as the tunnel fire) are discounted. In particular, Eurotunnel's share of the freight market is now:

    i. well below its historic peak levels (in 2005);

    ii. not surging ahead to > 40% in Q2 of 2011 (as Mr Wilkins alleged) but arriving at more of a plateau of c. 37% according to INQ/43/OBJ;

    iii. only showing relatively strong apparent "year on year" growth because it is still in the process of recovering its market share (to take it back towards "normal" pre-fire levels), having lost a very significant part of its market share during and after the fire. The annualised figures need to be approached with caution in these circumstances.

198. Thus there is absolutely no evidence that the DHB tariff is distorting the cross-channel market.

Fair and equitable

199. These adjectives as deployed in MTP2 (without further guidance as to their application) are difficult to apply beyond the obvious context of investment policy. However, these submissions assume that the guidance may be intended to encourage fair and equitable behaviour by trust ports in their dealings with different classes of users or stakeholders.

200. However, it is also important to note that para.1.2.5 of MTP2 expressly rejects the presumption that "dues levied on a specific group or type of user should be exclusively reinvested in improving services and facilities on offer to that user".

201. DHB considers that its dues are fair and equitable for the reasons set out above. However, one instance in which this issue has arisen has been in relation to the availability of discounts to the cruise trade at DHB. It has been suggested that DHB's cruise customers receive preferential treatment by virtue of the availability of discounts to that sector of the market.

202. In response, DHB witnesses have sought to explain the differences between the ferry and cruise market and the high risks of losing cruise trade, with a consequential impact upon total DHB revenues.

203. However, more importantly, DHB witnesses have emphasised that they have never been able to introduce a volume discount in the tariff, because the smaller operators have always objected to this - on the basis that it will entrench the position of the dominant carrier (ie P&O). The company witnesses for the Objectors each confirmed in XX that this was, indeed, the case and Mr Chadney agreed that his points on this subject were empty in the circumstances. He suggested "banging

[147] INQ/09/P, section 7

the operators' heads together", but had obviously not attempted this task himself nor gauged its prospects of producing a favourable outcome.

204. The other area in which the issue of discounting arose was in the context of a loyalty or commitment discount. DHB's Policy Statement[148] has, since 2004, offered a long term berth allocation option to ferry operators on terms which would reflect that commitment. None of the Objectors had chosen to take advantage of this option – even for the new P&O ships. Indeed, Ms Deeble indicated that she had been happy with the annual tariff until 2010.

205. None of the above suggests structural or other unfairness in DHB tariff setting. Once again, allegations have been made against DHB without the Objectors giving proper consideration to their implications and/or the absence of evidence to support them.

The PwC Review and Mr Harman's attempts to undermine it

206. It is clear that DHB did not use and never has used a "cost allocation" model to set its tariff. Indeed, as has already been discussed, para.1.2.5 of MTP2 does not promote a proportionate relationship in trust ports between revenues and expenditure for specific groups or types of user.

207. However, in response to the issues being raised by operators surrounding the dues, DHB commissioned PwC to consider the relationship between revenue arising from and costs associated with DHB's ferry operations.

208. Mr Ogier, a Partner at PwC, has concluded that, on this basis, for both 2010 and 2011, DHB's ferry dues were beneath those which would have reflected the economic cost of the services provided to the ferry operators in those years. Mr Ogier has had to make use of commercially sensitive information to perform his task, but has done so in full knowledge of his overriding duty to assist the Inquiry on matters within his expertise.

209. There has been and can be no doubt that this has been an *ex post facto* review, undertaken as a cross-check on the appropriateness of the tariffs. Mr Ogier has compared it with the type of exercise undertaken by the Competition Commission when investigating allegations of anti-competitive behaviour.

210. After receiving Mr Ogier's evidence, the Objectors appointed Mr Harman with the purpose, it would seem, of attacking the PwC conclusions. Certainly, Mr Harman does not state in his proof (per contra Mr Ogier) that he has regarded his duty to the Inquiry as overriding his duty to his clients.

211. Much of Mr Harman's attack has focussed upon achieving substitution of an historic cost asset base for the replacement cost asset base used by Mr Ogier. One of the consequences of so doing is to reduce substantially the asset base figure in the economic costs analysis (from Mr Ogier's £243.9m to £99.4m in 2010)[149]. When this is, in turn, used by applying a WACC (as a proxy for a rate of return) to derive an actual figure for Return on Capital, this figure is depressed by over £10m as a result of the substitution of the asset value.

[148] INQ/03/A, Appendix TW12
[149] INQ/10/R, Table 2.1

212. Mr Ogier's use of a replacement cost approach is fully justified in his proof[150]. Moreover, he has been conservative by excluding all gifted assets (notwithstanding that the costs of their replacement would fall to DHB) and intangible assets and has also carried out a robust sense check by reference to the expected costs of T2.

213. He also draws support from the Competition Commission's account of its "normal" approach to investigations into allegations of excessive profit[151]. Furthermore, Mr Harman confirmed in XX[152] that all the charging reviews for regulated industries he lists at page 47 of his proof proceed on the basis of real rates of return and an inflated – and not historic cost – asset base. These are documented at INQ/39/DHB.

214. Mr Ogier explained that one of the principal reasons for using an inflated (replacement costs) asset base was that the profile remained flatter over time compared with an historic costs approach and thus the outcome of economic analyses was more consistent. This point is well illustrated by the figures at INQ/42/DHB, especially for current rates of inflation.

215. It is submitted that Mr Ogier's approach should be preferred for all the reasons set out above and given by him in evidence.

216. However, this issue is not as fundamental as it might at first seem. Even if Mr Harman's approach is taken – as per his Tables 2.1 and 2.2 – the difference between the total revenue and total economic cost is £40m versus £43.5m for 2010 and £43.5m versus £44.5m for 2011. Given the number of assumptions and roundings involved in these exercises, these figures are plainly no basis for an allegation of excessive profits – as Mr Ogier stated. Moreover, Mr Harman expressly agreed in XX[153] that the differences were "small figures".

217. The different approaches to the asset base account for the greatest difference between the parties. The other issue (and sensitivity) considered in some detail by Mr Harman was the rate of return which DHB could legitimately expect to earn. The only Table exploring this is Mr Harman's Table 2.4[154], which tests for a zero return on capital. However in XX he confirmed that it was not his case that DHB should be earning a zero return and he accepted that MTP2 requires a "commercially acceptable return". He does not, however, specify what that return should be nor does he present a sensitivity test to show its implications.

218. There is, in fact, little to be gained by exploring the debate between Mr Ogier and Mr Harman further, as Mr Harman expressly eschews the question of what level of charges would be deemed to be reasonable[155] and the only results which he does present at Table 2.1 and 2.2 – even if they were accepted to be correct (which they are not) – do not support an allegation of excessive profits. Additionally, Mr Harman's assessment of DHB's funding needs stops dead at 2015 and he does not suggest an alternative structure which would fund a step change in capacity shortly after 2015. This is a critical omission.

[150] See paras 3.24 to 3.28.
[151] INQ/27/DHB, footnote 22
[152] Day 8
[153] Day 7
[154] INQ/10/R p.24
[155] Ibid, para.1.10

Conclusions on the Proper Exercise of Discretion and Appropriateness of the Dues as set

219. It is submitted that DHB's evidence successfully meets and refutes the objections and demonstrates that there is no good reason to interfere with the tariffs as set. Accordingly, there is no requirement for the Secretary of State to consider the Objector's various alternative proposals. In the alternative, I set out brief submissions on the alternatives below.

Objectors' Alternative Proposed Tariffs

220. DHB's main response to these proposals in their various forms is set out in INQ/41/DHB and I will not repeat that analysis in these submissions. Needless to say, these proposals will dramatically deplete DHB's balance sheet (if any is adopted) and put at grave risk DHB's ability to respond timeously to increased demand triggering the commencement of work on T2 Phase 1.

221. Additionally, in separate legal submissions[156], DHB disputes the existence of a power to order a rebate as sought by P&O and DFDS.

222. The principal additional submission which it is necessary to make at this stage is simply to note the extraordinarily divergent outcomes which the three Objectors seek from this process. They have made one case evidentially, but that apparently supports three very different outcomes.

223. The underlying rationale for what is proposed in each case is far from clear, but the key response is that these disparate proposals emphasise the importance of the role performed by DHB in striking a balance between the interests of various stakeholders and user groups. Thus consideration of the Alternative Proposals reinforces the submissions made above that DHB's discretion has been exercised appropriately and there is no good reason in this case to interfere with the tariffs as set.

224. DHB has set out its response to the Operators' submissions as to dominance and competition.[157] However, in light of the Operators' further submissions at Annex 3 to their closing submissions (*Inspector's note: Annex G to this report*) DHB wishes to reserve the right to make a further and final submission in reply, if necessary directly to the SoS. Notwithstanding the prospect of further submissions, DHB makes two observations; firstly there appears to be little between the parties as to the applicable legal framework and secondly, should the s31 objection fail, then any claim of abuse should also fail.

Final Conclusions

225. It is, of course, a matter of great regret to DHB that these objections have been made and that this Inquiry has taken place. However, at the close of the evidence, it is submitted that DHB has demonstrated that it has conducted itself entirely appropriately, both in accordance with its governing statutes and with guidance from the Secretary of State.

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[156] INQ/45/DHB
[157] INQ/44/DHB

226. Indeed, what is remarkable is not the dues set by DHB, but the excessive language in which both the original objections and the evidence of the Objectors has been couched. It is almost as if the Objectors had not troubled to consider the *actual* effects on the amounts to be paid under the new tariff before lodging their objections and peppering them with allegations of abuse of dominant position and excessive profits.

227. In fact, when considered by reference to virtually any objective measure or benchmark, the dues set are within a reasonable range and far from excessive.

228. It is difficult to avoid the conclusion that these objections have been motivated largely by opposition to privatisation of the Port and, in particular, concerns as to the extent to which the cash accrued by DHB will be ring-fenced for expenditure on the Port. It is agreed that the terms of any privatisation in this regard will be important and DHB is alive to the Objectors concerns in this regard - but this is for another day and another process.

229. It is submitted that the evidence before the Inquiry firmly supports the dismissal of the objections and upholding of the dues as set by DHB.

Written Representations[158]

Board of Trustees of DHB Pension and Life Assurance Scheme[159]

230. The Scheme has over 1,500 members, comprising in excess of 300 active members (current DHB employees), around 800 pensioner members and over 400 deferred members (previous employees who have not yet drawn their pension benefits). At 30 September 2009, its investments amounted to £1053 million. The Scheme is managed by an independent Board of Trustees, half of whom are nominated by DHB, and half elected by the members of the Scheme.

231. The most recent actuarial valuation of the Scheme was undertaken as at 30 September 2009. Following the advice of the Scheme Actuary, based on the assumptions used by the Trustees to estimate the net present value of the Scheme's liabilities at that date (which took into account the financial strength of DHB) this valuation revealed that the Scheme had a deficit of £22.4 million at that date.

232. In July 2010, with advice from the Scheme Actuary, the Trustees and DHB reached agreement in respect of a Recovery Plan under which, in addition to its regular contributions, DHB will make additional contributions into the Scheme over the period to 2017 in order to extinguish the deficit shown by the September 2009 valuation by mid 2017. In agreeing to this Recovery Plan, the Trustees were again mindful of DHB's financial strength and its ability to meet these additional contributions from its operating cash flow.

Impact of Upholding the Objections on the Scheme

233. The Trustees have been informed by DHB that, in making the Objections, the ferry operators are seeking a reduction in dues of between 25% and 30% from their present level. They note that any reduction that might result from the Objections being upheld would apply not just to the dues levied on the ferry operators who made the Objections, but to the dues paid by all ferry operators in view of the common charging structure applied by DHB. DHB has told the Trustees that its operating cash flow would reduce by approximately £10 million to £12 million per annum in such circumstances, thereby eliminating the net cash surplus it has experienced in recent years.

234. The Trustees therefore note that the DHB's financial position would be materially weakened if the Objections were to be upheld. This would have a significant impact on the funding of the Scheme in two respects.

235. Firstly, the Trustees would need to reconsider the assumptions they have adopted in arriving at the deficit in the Scheme. In particular, based on their assessment of DHB's present financial strength, they have adopted an investment strategy that seeks to achieve a superior return compared with a risk-free strategy. If the DHB's financial strength were to weaken, in order to comply with their legal obligations, the Trustees would need to further review their investment strategy. We anticipate that this would result in a more prudent investment strategy being adopted. Whilst such a strategy would increase members' security, it would be expected to deliver a

[158] Extract of the material points
[159] Full text at CD/01/03 (2010) and CD/01/12 (2011)

lower investment return with less volatility. It is very likely that this would feed through to a lower discount rate being used for any actuarial valuation. The net present value of the Scheme's liabilities would increase accordingly, thereby resulting in an increase in the deficit.

236. It is not possible to quantify precisely at this time how much the deficit would increase as a result of adopting a more prudent investment strategy. However an upper limit can be set by noting that, had a risk-free discount rate been used for the actuarial valuation as at 30 September 2009, (implying a fully risk-free investment strategy) the Scheme's deficit would have been £58.9 million, £36.5 million more than the deficit on which the Recovery Plan is based.

237. The second impact of a worsening of DHB's financial position would be on the Recovery Plan. If DHB's operating cash flow was to reduce, its ability to make additional contributions to the Scheme in respect of the Recovery Plan would be undermined or possibly eliminated entirely. In such circumstances the Trustees would seek to have the (recalculated) deficit repaired as quickly as possible by a cash injection into the Scheme. Although DHB presently holds substantial cash balances, it is not clear to the Trustees to what extent DHB would be able to meet in full the demand of the Trustees to repair the deficit. This depends in part on how much the deficit will have increased as a result of adopting a more prudent investment strategy, as discussed above. However, the Trustees fear that in an extreme case, DHB could have difficulty in meeting a recovery plan that fully clears the revised deficit.

Conclusion

238. The Trustees consider that if the Objections were to be upheld, there would be a material adverse change to the financial strength of DHB. It is likely that this would result in an increase in the deficit in the Scheme and a demand by the Trustees on DHB to repair this larger deficit out of its cash resources, which DHB may not be able to meet.

239. The Trustees have therefore concluded that it is not in the interests of the members of the Scheme for the Objections to be upheld and request that the Secretary of State should reject them accordingly.

Mr Kevin Richardson (General Manager, Port Operations/Harbour Master)[160]

240. Mr Richardson has been an employee of DHB for nearly 23 years. With respect to the recent challenge launched by two of the Dover Ferry Operators under section 31 of the Harbours Act he is sure that the Board will vigorously and robustly defend its position on pricing which he believes has always been fair and reasonable both in the past and present. He sees the s31 challenge as a delaying tactic on the part of the ferry operators in response to the very difficult trading climate and whilst accepting that the process must take its course, he hopes that it is not a prolonged process and that any decisions are binding going forward.

241. He considers the section 31 challenge to be an obstacle to moving the privatisation process forward and strongly urges the SoS and other Government departments to do all in their power to expedite the section 31 process. A prolonged and drawn out

[160] Full text at CD/01/04

Inquiry is seen to benefit only the ferry operators whilst prolonging the uncertainty for Port of Dover staff.

Mr William Read (DHB employee)[161]

242. Mr Read is an employee and a stake holder of the DHB and an active member of the Pension Scheme. He urges the Department to uphold the Board's position in their pricing conflict with the Operators and considers that the Board has made huge efforts to keep the prices to the operators low, often at the cost of staff numbers.

243. He believes it has now come to a point where cost savings will be very difficult to achieve and that the Board has no other choice but to put prices up. However, he considers that the prices will still be very competitive and it is very noticeable that two out of the four operators have not lodged any complaints regarding prices. Dover's charges are still very much lower than those that operators pay for the same services in France.

National Union of Rail, Maritime & Transport Workers[162]

244. The RMT believes that the port user-tariffs being charged to ferry companies at Dover are unacceptable and that increases in the tariffs could threaten job security for employees of the ferry operators at the port. Normally such matters would principally be ones between the ferry companies and DHB; however it is fairly clear that an increase in charges of 33% by 2012, compared with 2009, is not reasonable, especially in the current economic climate.

245. The operators are not in a position to go elsewhere. Nevertheless, and despite protests from the operators against the charges, DHB has maintained their existing stance for 2010 tariffs. The RMT also believes that revenue from these charges should not be used for privatising the port but that the money should instead fund investment in Dover Port. Dover should retain its existing status as a Trust Port to serve the local community. The UK Shipping Industry is facing a tough climate at the present time and the proposed increases in tariffs are therefore not helpful. Indeed, LD Lines have recently withdrawn services from Dover Port.

246. The RMT therefore supports the objections of the companies made under section 31 of the 1964 Harbours Act and request that the SoS gives this matter her full consideration.

[161] Full text at CD/01/05
[162] Full text at CD/01/06

Inspector's Conclusions

247. The following conclusions are based on the submissions and representations put before the Inquiry. Where appropriate, references are given to earlier paragraphs [in square brackets]. In considering the statutory and policy framework and the criteria for assessing objections I draw where appropriate on the reports of the Inspectors dealing with the Inquiries into objections to the harbour dues at Langstone and Bembridge harbours[163].

The Statutory Framework

248. The statutory basis for the setting of harbour charges is found in Sections 26 to 39 of the Harbours Act 1964 ("the Act"). Section 26 deals with the "Repeal of provisions limiting discretion of certain harbour authorities as to ship, passenger and goods dues charged by them" and Section 26(1) states that:

> *"Subject to the following provisions of this Act, any statutory provision made with respect to a particular harbour authority shall cease to have effect in so far as (otherwise than by way of expressly providing for freedom from dues or in any other manner prohibiting the levying of a due) it limits the discretion of the authority as to the ship, passenger and goods dues chargeable by them at a harbour which…….they are engaged in improving, maintaining or managing……..."*

249. Having expressly removed any statutory provision limiting the discretion of an authority as to the ship, passenger and goods dues chargeable by them, the power for a harbour authority to make ship, passenger and goods dues is then derived from Section 26(2). This provides that:

> *"Subject to the following provisions of this Act ..... a harbour authority shall have power to demand, take and recover such ship, passenger and goods dues as they think fit ....."*

Section 26 of the Act therefore gives harbour authorities considerable discretion as to the ship, passenger and goods dues to be charged.

250. Although Section 27(1) provides that certain charges of harbour authorities *"…….shall be such as may be reasonable",* Section 27(2) excepts certain charges, including ship, passenger and goods dues, from the provisions of Section 27(1).

251. Section 31 of the Act does, however, give a right of objection to ship, passenger and goods dues. Section 31(2) requires such objection to be in writing and lodged with the SoS by:

> *"(a) a person appearing to him to have a substantial interest; or*
>
> *(b) a body representative of persons so appearing;*

and the objection is expressed to be made on all or any of the following grounds, namely,-

> *(i) that the charge ought not to be imposed at all;*

[163] CD/06/12 and 14

(ii) that the charge ought to be imposed at a rate lower than that at which it is imposed;

(iii) that, according to the circumstances of the case, ships, passengers or goods of a class specified in the objection ought to be excluded from the scope of the charge either generally or in circumstances so specified.

(iv) that, according to the circumstances of the case, the charge ought to be imposed, either generally, or in circumstances specified in the objection, on ships, passengers or goods of a class so specified at a rate lower than that at which it is imposed on others."

252. Section 31(4) of the Act authorises the SoS to "*proceed to consideration of the charge and any representations made and, unless he is satisfied that he can properly proceed to a decision in the matter without causing an Inquiry to be held with respect to it, shall cause an Inquiry to be so held*."

253. Section 31(6)(a) of the Act gives authority to the SoS to approve the charge but set a limit to the period during which the approval is to have effect. This period must not be longer than 12 months from the date of approval.

254. Section 31(6)(b) of the Act gives the SoS the power to give to the harbour authority *"... such direction with respect to the charge as would meet objection thereto..."*. This section also provides that the SoS's direction can be on any of the grounds set out in Section 31(2) "... *whether that is or is not the ground, or is or is not included amongst the grounds, on which the objection whose lodging gives rise to the proceedings is expressed to be made.*" Such a direction must specify a date from which it operates and the period (not exceeding 12 months) during which it is to have effect.

255. No further amplification of the statutory objection process has been suggested by the Operators or DHB and neither puts forward any other relevant legislation which sets out expressly the considerations which the Secretary of State should have in mind when considering such an objection.

256. The Operators did, however, draw the Inquiry's attention to both EU and UK competition law, particularly in respect of dominance and competition. I address this separately later.

Policy and Guidance

257. A number of government policy and guidance documents were referred to throughout the course of the Inquiry. Like the Inspector in the Langstone Harbour case[164] I recognise that these documents are non-statutory and generally take the form of a best practice approach. They do, however, reflect government policy and guidance on harbour undertakings and have formed a substantial part of the decision making framework underpinning the earlier determinations by the SoS following Inquiries into harbour dues at Bembridge and Langstone.

258. None of the parties to the Inquiry raised any substantive objection to their use in this case and I shall therefore attach substantial weight to them in my considerations and recommendations. Key guidance includes;

[164] CD/06/12 para 5.28

Modernising Trust Ports: A Guide to Good Governance (DETR, January 2000)(MTP1)[165]

259. MTP1 was produced following review of trust ports by DETR in 1998 and involved a detailed scrutiny of the trust sector with specific regard to standards of corporate governance and the accountability of its operations. MTP1 provides guidance to assist all trust port boards to meet standards of independence, openness and accountability.

Modernising Trust Ports (second edition)(DETR, August 2009)(MTP2)[166]

260. This is essentially a restatement of MTP1 brought up to date and supplemented with new guidance on, amongst other matters, reporting, KPIs and stakeholder policy.

Modern Ports: A UK Policy (DfT, November 2000)(MPUK)[167]

261. MPUK recognises that the UK's ports are vital gateways for trade and travel and sets out the broad policy aims of government for the UK's ports. These reflect an integrated approach to transport and recognise the relationship between transport and other important policies.

The Green Book (Appraisal and Evaluation in Central Government)(2003)[168]

262. As part of Government's commitment to continued improvement in the delivery of public services the Green Book contains guidance to encourage a thorough, long term and analytically robust approach to the appraisal and evaluation of proposals before committing significant funds.

Note on role of Secretary of State in reaching decisions under section 31 of the Harbours Act 1964 (DfT, June 2011)[169]

263. A note written to assist an Inspector appointed by the SoS to hold an Inquiry under Section 31(4) of the Act as well as the parties to a Section 31 objection procedure. The note sets out the DfT's understanding of the functions of the SoS under Section 31 when deciding upon objections lodged against harbour dues imposed by a harbour authority.

Legal submissions as to matters of Dominance and Competition

264. The Operators have put forward submissions that DHB is an undertaking which occupies a dominant position in the relevant market in which it provides port services and which has infringed and continues to infringe the prohibition in Article 102 of the Treaty on the Functioning of the European Union (TFEU) and Chapter II of the UK Competition Act 1998 (CA) insofar as the dues charged by it are excessive in comparison to the Board's relevant costs.

265. The Operators further submit that the Secretary of State, when reviewing Section 31 objections, must ensure that:

[165] CD/06/01
[166] CD/06/06
[167] CD/06/03
[168] CD/06/04
[169] CD/06/10

any decision is not contrary to applicable EU and UK competition law, namely in this case the rules set out in Article 102 TFEU and/or chapter II CA 1998;

when setting its tariffs the Board complies with the UK and European law special obligations on it as a dominant undertaking controlling an essential facility; and

the Board has complied with the requirement in the Secretary of State's own guidance to this Inquiry not to abuse its dominant position.[170]

266. DHB's counter submissions state that Section 31 of the Harbours Act 1964 does not expressly require the Secretary of State to determine whether the 2010 and 2011 tariffs constitute an abuse by DHB of a dominant position but accept that the Secretary of State is required to have regard to Article 106(1) TFEU and is required to consider if it has application in this instance. However, it is also DHB's submission that there is no competent authority which has determined that DHB holds a dominant position, or is an essential facility in relation to any market relevant to the consideration of the 2010 or 2011 tariffs, or that DHB's tariffs in 2010 or 2011 constitute an abuse of a dominant position.[171]

267. There is no doubt that the SoS should have regard to the submissions of the main parties on this matter. However, I accept DHB's submission that there is no competent authority which has yet made the necessary determinations as to the applicability of and compliance or otherwise with EU and UK competition law. The Operators note that they *"……are aware that the Inspector does not have the power to make recommendations to the SoS on purely legal arguments….."*[172] but suggest that she is *"…..entitled to take note of such legal arguments and this is what the Operators consider she is entitled to and ought to do."*

268. Notwithstanding the Operators' views it seems to me that in order to give any material force to the legal arguments being put forward would require judgements to be made as to the applicability of and compliance with EU and UK competition law; I consider this to be beyond the scope of an Inquiry under Section 31(4) of the Act. That is not to say that matters of competition and dominance should be ignored in a Section 31 Inquiry; indeed, the guidance in para. 1.2.3 of MTP2 specifically requires trust ports to avoid abusing a dominant position and the Inquiry heard evidence on just that matter.

269. Some of that evidence has been referred to in the particular submissions of the parties as to dominance and competition and I shall take that evidence into account. However, in the absence of any determination by a competent authority I shall, in arriving at my recommendations, give little weight to the legal arguments dealing with the applicability of and compliance with competition law.

The powers of the Secretary of State

270. The note on the role of Secretary of State in reaching decisions under Section 31 of the Harbours Act 1964 (issued by the DfT in June 2011) states at para 6) that "*The legislation does not explain how the Secretary of State should approach the consideration of a section 31 objection*". However, having considered a number of

[170] Annex D para. 63
[171] Annex E paras. 28-33
[172] Annex G para 1

factors, the note concludes that the SoS has an appellate role in determining objections made under Section 31, thus requiring consideration of the appropriateness of the charge(s) to which objection is made. Para 9) of the note makes it clear that this will involve an assessment of whether the charges are too high and, if so, what reduction should be made. No substantive objections were raised to the principle of this approach.

271. DHB accepts that Sections 31(6)(a), (7) and (10) of the Act mean that the objection process could be used annually and I agree with the Operators that the Act cannot be construed in a way that would prevent it from giving an effective remedy as intended by the provisions of Section 31. Therefore, whilst both the 2010 and 2011 charging years are likely to have passed by the time any decision is made, if the SoS is of the view that the objections are made out then the appropriate course of action would be to make 2 directions:

(a) a direction in respect of 2010 coming into force on 1 January 2010 and lasting for a period of 12 months; and

(b) a direction in respect of 2011 coming into force on 1 January 2011 and lasting for a period of 12 months. [32, 33, 116]

272. The Operators' primary case is that the dues should be imposed at rates lower than those at which they are currently imposed. In the Operators' view, that is all they are required by the Act to make out. However, to help inform the Inquiry and the SoS in making an assessment of whether the charges are too high and, if so, what reduction should be made, the Operators were asked to put forward their assessment of what the dues should be. In the event, each Operator put forward differing views as to the appropriate overall level of reduction as well as to the charging structure underlying any such reduction. Notwithstanding these submissions, the Operators confirm that if the objections are accepted as being made out then they are content for any of the suggestions (or part or parts thereof) to be adopted. [35, 38]

273. In putting forward their views as to what the dues should be, both DFDS and P&O included proposals to reduce the Board's accumulated cash reserves. DFDS proposed[173] that with respect to 2010 some £8m be rebated retrospectively to the Operators in 2011 and with respect to 2011, a further £5m be rebated retrospectively in 2012. A further £6m rebate is sought between 2013 and 2016. P&O[174] suggested that a significant proportion of the surplus (at least £40m) be returned to the Operators or that some of the surplus be used to pay for capital and revenue expenditure over the next five years - thereby reducing the tariff.

274. In response to these proposals DHB notes that the Secretary of State is empowered by section 31(6)(b) of the Harbours Act 1964 *"…….to give to the authority "such direction* with *respect to the charge as would meet the objection thereto..."(emphasis added)"* and further submits that *"…..an order to make a rebate of cash accrued as a result of dues collected in earlier, "closed" years would not be a "direction with respect to the charges" which are the subject of the*

[173] INQ/11/OBJ
[174] INQ/13/OBJ

objections herein. Accordingly, there is no power to order a rebate in the form proposed by P&O and DFDS". [175]

275. Notwithstanding the proposals put forward by DFDS and P&O nothing has been drawn to my attention that would empower the SoS to make a direction with respect to anything other than the charges being objected to, in this case 2010 and 2011. The Operators nevertheless argue[176] that in making a direction in respect of the 2010 and 2011 charges, these could be set at a level below that at which DHB would cover its costs - thus resulting in DHB having to defray some of its established cash reserve and thereby indirectly returning it to the Operators.

276. I do not consider this a reasonable argument. DHB sets its dues annually and its cash reserves have been accumulated over a number of years. If the SoS were to make a direction setting the 2010 and 2011 charges at a level below that at which DHB would cover its costs then some of the cash reserves accrued in earlier years would need to be defrayed. Such an approach would, in effect, mean that the SoS had determined that the dues set in earlier years were themselves too high.

277. Although DHB accepts that Sections 31(6)(a), (7) and (10) of the Act mean that the objection process could be used annually the Inquiry was held solely in order to consider the objections into the 2010 and 2011 dues. If the SoS were to make a direction that, in effect, determined that the dues in earlier years were too high this would, in my view, exceed the remit of the Inquiry and the powers of the SoS. In particular it would mean that those having a right to make representations in respect of the charges imposed in those earlier years would be deprived of the opportunity so to do. [1, 116]

278. The Operators have raised matters relating to interest payments and the effect that any direction on the charges might have in future years[177], matters which have also been responded to by DHB[178]. However, having had regard to the submissions it seems to me that these are matters that should, if necessary, rightly be addressed elsewhere and I see no need to consider them further in the context of this Inquiry.

Criteria for assessing the objections

279. The starting point for any assessment of the objections must be the statutory framework set out above. [248-255] This makes it clear that, subject to a right of objection by a person appearing to the SoS to have a substantial interest (or a body representative of such persons), harbour authorities have considerable discretion as to the ship, passenger and goods dues to be charged. It is common ground between the parties that there is no statutory provision in the Act which defines the test to be applied by an Inspector or subsequently by the Secretary of State when determining whether an objection made pursuant to section 31(2)(ii) of the said Act is made out. [45]

280. Although Section 27(1) of the Act does impose the limitation that certain charges of certain harbour authorities shall be such as may be 'reasonable', Section 27(2) identifies ship, passenger and goods dues as being excepted charges for the

[175] Annex F para. 2
[176] INQ/38/OBJ paras. 15 and 16
[177] INQ/38/OBJ paras 13 and 16
[178] Annex F paras 5 & 6

purposes of Section 27(1). To my mind that does not, however, imply that harbour authorities have carte blanche to charge ship, passenger and goods at levels which, under normal circumstances, would be regarded as 'unreasonable'. Instead it seems to me that identifying ship, passenger and goods dues as excepted charges is simply an acknowledgement that Section 31 confers a very specific right of objection to such dues – a remedy not available in respect of other charges.

281. Mr Goldfield accepted in evidence for DHB that charges should be reasonable and the Inspector reporting into the Objections to Harbour Dues at Bembridge Harbour[179] concurred with the parties to that Inquiry that, "……*despite the 'as they see fit' clause in s26(2) and the lack of a statutory requirement for harbour dues to be reasonable, as a matter of policy and commonsense dues should nevertheless be reasonable*".

282. Against this background I am clear that when considering an objection under Section 31 an assessment should be made as to whether the charges are, in all the circumstances, 'reasonable'. Although that, in itself, allows considerable scope for interpretation regard must also be had to applicable government policy and guidance. This is identified above [257-263] and contains a range of other helpful assessment criteria including;

- Dues should be set at commercial and competitive rates neither exploiting trust port status to undercut the market, nor abusing a dominant position in that market (MTP2 para 1.2.3)
- Dues must be seen to be fair and equitable - it is wrong for some users to have special treatment (MPUK para 2.1.12, MTP1 para 114)
- Dues must be set at a level that allows for proper maintenance of the trust's harbour or conservancy duties (MTP1 para. 114, MTP2 para 1.2.4)
- All trust ports should set themselves a target rate of return for existing activities and new projects, determined by the board (MTP2 1.2.2)
- Port developments and port operations should not in general need public subsidy (MPUK para. 2.1.13)
- There should be no presumption that dues levied on a specific group or type of user should be exclusively reinvested in improving services and facilities on offer to that user (MTP1 para 113, MTP2 para 1.2.5)
- Investment policies should be fair and equitable. A board should act not only to protect the commercial position of the port, but also to take investment opportunities which offer maximum benefit across the whole stakeholder group. Having regard to such wider stakeholder benefit may legitimately result in longer term investment planning. (MTP2 para 1.2.6)
- Dues should not be imposed for services that port users do not need (MTP1 para 112)
- It is the duty of the boards, at all times, to strike a balance that fully respects the interests of all stakeholders, not just one group, in the light of objectives of the port, including commercial considerations, and what constitutes the

[179] CD/06/14 para 7.16

'common good' for all stakeholders (current and future) and the port itself (MTP2 para 1.1.5)

Privatisation

283. Privatisation of the port is an option which is being pursued by the Board and which it is envisaged would, by facilitating access to capital markets, enable the Board to fund its longer term investment requirements. It is clearly a matter of some import to the Operators who have expressed concerns over the potential impacts of privatisation on future tariffs, the delivery of T2, the future of the £60m cash surplus, the use of that surplus to fund privatisation costs and the perceived impact of potential privatisation on the Board's behaviours.

284. Notwithstanding that the Operators hold genuine concerns over privatisation and its effects, privatisation is by no means certain. DHB confirmed to the Inquiry that whilst it was pursuing privatisation it was nevertheless continuing to operate Dover within its current trust port status.

285. The view of the DfT[180] is that no change to the status of DHB could in practice be made before the end of 2011 - in other words, not before the end of the period covered by the objections – and therefore the possibility of change is not relevant to decisions on the objections. I agree. Even if it could be successfully argued that the prospect of privatisation has influenced the Board's behaviours and its approach to tariff setting - and that safeguards will be needed in respect of the cash surplus – the dues must be assessed in the context of Dover's current trust port status. I have made my considerations on that basis.

The objections

286. It is undisputed that those making objections have right to do so. In summary, the objections are that the charges in respect of 2010 and 2011 ought to be imposed at rates lower than those at which they have been imposed (Section 31(2)(ii)). The Operators' basis for considering the charges too high is that:

(a) the dues are excessive in that they generate an excessive profit per se for the Board;

(b) the dues are excessive in that they generate an excessive profit by market comparison;

(c) the dues are excessive in that they constitute an abuse of a dominant position held by the Board;

(d) the dues are excessive in that the Board has taken into account matters it should not have when setting the rates – i.e. T2 development costs and privatisation costs;

(e) the dues are excessive in that the Board has failed to take into account the reduced integrated landside operation (ILO) costs, which reduction arose from the Board's outsourcing decision in their regard; and

(f) the dues are excessive in that they are unreasonable as they do not take into account or in any way acknowledge the current commercial

[180] INQ/01/R Appendix 1 - Letter from DfT to Bircham Dyson Bell dated 14 July 2011

environment, the commercial pressures on the Operators or the significant financial effect of the (increases in) the dues on the Operators.

287. Although Section 31 confers a right of objection to 'ship, passenger and goods dues' it was accepted by all parties that the manner in which DHB publishes its Ferry Tariff booklets means that 'ship, passenger and goods dues' comprise 'Conservancy Charge', 'Harbour Dues', 'Passenger Dues', 'Wharfage' and 'Security'. [6]

Assessment of the dues

288. Having regard to the range of criteria identified above, the Operators' reasoning for considering the charges to be too high and the approaches of the Inspectors considering the objections at Bembridge and Langstone harbours I consider that there are three key, overarching, issues to be addressed: whether the dues are commercial and competitive, whether they are fair and equitable and, in all respects, whether they are reasonable.

289. However, before moving on to directly address the key issues it would be helpful to examine a range of preliminary matters including;

- The competitive position of DHB in the market place
- Comparator ports
- Theoretical pricing models
- Re-balancing the tariff
- Integrated Landside Operations (ILO)
- The economic and commercial climate
- Effect of the 2010 tariff changes on the Operators and DHB
- Operating costs and short term capital costs
- The Board's attitude
- T2 and the Board's cash surplus
- Cruise operations
- Operators' proposed tariffs

290. The 2011 dues were set by applying a percentage uplift to the 2010 dues. Many of the underlying arguments are therefore common to both 2010 and 2011. To avoid duplication I shall focus on the 2010 dues before dealing separately with the uplift applied to derive the 2011 dues.

The competitive position of DHB

291. Mr Goldfield accepted for DHB that the port of Dover occupies a unique position in geographic terms. However, that is true for any port. Indeed, in Dover's case it could be argued that the proximity of Ramsgate and Folkestone make Dover's location less of a distinguishing feature than for other, more isolated, ports and thereby potentially less of an advantage in commercial terms.

292. That would, however, be to ignore Dover's geographic position in relation to the particular markets that it serves. It is clear that in terms of the short sea route to the continent, Dover is particularly well located. Its proximity to Calais means that Dover not only provides the shortest sea crossing (bringing advantages in such matters as fuel consumption) but also means that the ferry operators can achieve a greater number of daily round trips than would be possible at even the nearest of the potential alternatives. Dover is also well connected to the UK's transport infrastructure. For the Operators there are clearly both efficiency and marketing advantages in sailing out of Dover.

293. In addition to the geographic advantages of Dover the Inquiry heard that the Operators would face considerable difficulties in transferring their operations to other ports. The Operators' ships are, in general, configured specifically for berthing at Dover and the depths of water at the nearby ports are less than at Dover; both factors that would need to be overcome. The Operators also point out that a proportion of their business is 'turn up and go' where customers arrive at Dover without a booking in the knowledge that there will be ferries running to the continent. If an operator moved away from Dover it is likely to miss out on an appreciable proportion of this 'turn up and go' business.

294. Whilst it may be that some of these issues could be addressed through investment in infrastructure or marketing this is likely to involve a very significant cost outlay.

295. Despite suggestions that Eurotunnel is a competing force in the cross channel market and may act as some kind of restraining force on the setting of dues at Dover it seems to me that as Eurotunnel is not an alternative to Dover as far as the berthing of ferries is concerned. Rather Eurotunnel is in competition with the Operators.

296. It could be argued, in extremis, that if Dover's charging policy restricted the ferry operators' ability to compete with Eurotunnel then the Operators might lose traffic and be forced to cut the number of services on offer. This in turn could impact on DHB's revenue forcing it to consider alternative pricing strategies. However, Dover's charges represent only one element of the Operators' overall costs. Increases to Dover's charges of the orders of magnitude seen in 2010 and 2011 are, in my view, unlikely to have a significant impact on the prices being charged by the Operators or on their traffic levels. In consequence the competition offered by Eurotunnel is unlikely to have more than a weak influence on the setting of dues at Dover.

297. The Operators face considerable barriers to exit and, for the reasons above, I see only limited market constraints influencing Dover's approach to the setting of dues. DHB confirmed that its approach to the 2010 dues was to set them at levels that would cover the Board's operational and short-term capital costs whilst simultaneously delivering a targeted increase in the accumulated cash balance. Although the Board discussed its approach with the Operators prior to the 2010 tariff being confirmed,[181] and some changes resulted, the evidence suggests that DHB did not perceive itself as being particularly constrained by market forces in its setting of the 2010 tariff.

[181] eg INQ/03/P Schedule 2

298. Taking account of all these matters I conclude that Dover occupies a dominant market position in terms of the short sea route to the continent. However, in contrast to the short sea crossing ferry operators, cruise ship operators are far less constrained in their choice of ports. Indeed, the cruise ship operators were described during the Inquiry as 'footloose'. Consequently I do not see Dover as occupying a dominant position in the cruise market.

Comparator ports

299. One indicator as to whether or not dues have been set at commercial and competitive rates is to compare them with dues at similar ports. However, as noted above Dover is unique in terms of its geographical location and the main parties agree that there is no directly comparable port. DHB considers the best comparator to be the port of Calais[182] and notwithstanding the Operators' reservations as to the usefulness of Calais in this role[183] it was nevertheless conceded that Calais is likely to be the most comparable port to Dover. [189]

300. DHB suggests that, following adjustments aimed at putting both Dover and Calais on a similar footing in terms of the services provided, charges at Calais "……appear to be very substantially higher than those at Dover"[184] - a finding said to be applicable to both the 2010 and 2011 charges. The Operators agree that "it is materially more expensive to call at Calais than at Dover" [192]. Dependent on the assumptions used with respect to exchange rates and security services, Dover's charges (on a revenue yield per PCU (passenger car unit) equivalent basis) appear to be between 55 and 74% of the charges at Calais.[185]

301. The Operators suggest that Calais' higher charges may be reflective of a higher labour charge and a greater social cost burden. They also point out that even though Calais' charges may be higher than those of Dover, both may be charging excessive prices. However, the Operators accepted both that Calais was in competition with Dunkerque and Boulogne and that it was unlikely that the whole of the charging disparity could be explained on the basis of French social cost burdens and different labour laws. [190-193]

302. Calais is said to provide a service of similar 'economic value' to that at Dover (ie both ports facilitate the boarding and discharge of passengers and cargo on the short sea route) and there are some similarities in their operations. Nevertheless it is clear that Calais and Dover cannot be compared directly. Even after making adjustments to compensate for some of the differences (such as the range of services provided and exchange rates) it is highly likely that differences will remain and the difficulties in finding true comparator ports is accepted by DHB[186].

303. Nevertheless, the evidence before the Inquiry is that:

- Calais is the most comparable port to Dover;
- Calais is subject to competitive pressures; and

[182] INQ/04/P 7.23
[183] INQ/10/RP 4.6
[184] INQ/04/P 7.27
[185] INQ/04/P Table 24
[186] INQ/04/P Para 7.22

- the charges at Calais appreciably exceed those at Dover

Although the evidence before the Inquiry was based on Calais' revenue information and not on its costs information, Calais has been in existence for some considerable time. It is therefore likely to be in a reasonably steady state. The Inquiry heard no cogent evidence to suggest that Calais was incurring any significant and unusual costs (such as seeking to fund an equivalent to T2). Therefore, notwithstanding the considerable caveats and difficulties applicable to any 'comparator' port, I consider that, having regard to the factors above, the charges at Calais are at least an indication that Dover's charges can be regarded as commercial and competitive.

304. Information comparing Dover's 2010 finances to that from a number of other UK ports was also put before the Inquiry.[187] Whilst this showed that Dover had the largest turnover of all the ports analysed it also showed that on a suite of other measures, Dover's performance fell within the overall range for each category. For instance, the ROCE at Dover was 10.87% in a range of 2.23% (Aberdeen) to 14.48% (Milford Haven), its EBIT margin was 20.98% in a range of -2.21% (Aberdeen) to 47.84% (Belfast) and its cash balance of £56.8m, whilst high compared to most of the ports analysed, was exceeded by that at Belfast (£60.7m).

305. Although the comparator ports selected all have trust status there are some fundamental differences between the markets they serve and their business models. This again makes direct comparisons difficult and less valuable. Nevertheless, the figures indicate that Dover is not significantly out of line with other ports in terms of its financial performance indicators.

Theoretical pricing models

306. DHB's actual method of price setting is to use what is, in effect, a cost plus basis. In order to provide what has since been described as an 'ex post facto' justification of its pricing, DHB commissioned PwC to provide a theoretical evaluation of its dues[188]. The evaluation is said to be akin to the type of investigation undertaken by the Competition Commission in investigating allegations of anti competitive behaviour. The Operators commissioned FTI Consulting to review and comment on PwC's theoretical evaluation[189]. For simplicity I shall hereafter simply refer to the evaluations in terms of DHB or the Operators.

307. According to DHB's evaluation, revenue from ferry charges in 2010 amounted to £43.5m, some £11.8m less than the theoretical evaluation of total economic costs. For 2011, ferry revenues are anticipated to be £44.5m, around £11.5m less than the theoretical economic costs. Non-ferry charges in 2010 gave revenues of £12.6m, some £3.8m less than the total economic costs and for 2011 non-ferry revenues are expected to be £11.2m, around £4.9m less than the expected total economic costs.

308. Based on these figures DHB concluded that;

- dues have been set at levels below those consistent with being commercial and competitive

[187] INQ/09/P updated by INQ/03/R Para 3.35 Table 2
[188] INQ/04/P Proof of Mr Tim Ogier, Partner PwC
[189] INQ/10/P Rebuttal proof of Mr Greg Harman, Senior Managing Director FTI Consulting

- there is no material cross-subsidisation between the ferry/non ferry businesses

309. In contrast to DHB's findings the Operators' concluded that revenues exceeded costs (including making allowance for a full commercial return) by £3.5m in 2010 and by £1.0m in 2011. The Operators consider that this implies that prices are excessive per se. Clearly both of the theoretical analyses are based on differing assumptions and, to a certain extent, differing methodologies. I address two of the key factors below.

Commercial rate of return

310. MTP2 makes it clear at para. 1.2.1 that trust ports should be run as commercial businesses and should generate a commercially acceptable rate of return. Although para. 1.2.2 refers to Green Book guidance (both historic and recent) on target rates of return there is an acknowledgement that the Green Book recommendations are primarily aimed at public sector investment in public sector owned businesses rather than commercial operators in a competitive open market. MTP2 goes on to say that all trust ports should set themselves a target level of return for existing activities and new projects, determined by the board. The target level of return should reflect the need to provide a contingency and, in addition, make optimism bias adjustments commensurate with the perceived level of risks associated with any particular activity or investment.

311. MTP2 para. 1.2.3. states that in pursuing that target level of return it is in the interests of all stakeholders that a trust port should set its dues, evaluate its investments and charge for its services at commercial and competitive rates, neither exploiting its status as a trust port to undercut the market, nor abusing a dominant position in that market.

312. DHB's theoretical analysis uses a real pre-tax Weighted Average Cost of Capital (WACC) of 9% for 2010. This is intended to reflect the risks involved in Dover's underlying business and is derived from an assessment as to the likely cost of capital and an estimate as to the cost of debt - both being adjusted to take account of the fact that DHB is a small company. 9% was selected as the mid point of a range extending between 7.2% and 10.8%. DHB points out[190] that the 9% chosen is not far away from the 8% figure referred to in the Green Book guidance current at the time of MTP1.

313. In contrast, the Operators suggest that it is unclear as to whether a target rate of return or a full commercial rate of return is required - pointing out that MTP2 seeks for trust ports to generate a "*……commercially acceptable rate of return*." Indeed, the Operators read MPT2 as appearing to suggest that a trust port is not required to earn a purely (and hence full) commercial rate of return but rather should seek to generate a target level of profit commensurate with its investment needs. Setting a full commercial rate of return may generate cash reserves for which there is no immediately obvious outlet. Bearing this in mind the Operators consider that it would be appropriate to take an approach to setting charges that directly links to the actual cash requirements of DHB over a period of time (including the need to retain a cash reserve).

[190] INQ/26/DHB p5

314. However, it seems to me that the accumulation of surpluses is something very clearly envisaged by MTP2 - which acknowledges at 1.4.1 that "*Trust ports can expect to generate a significant return*". Although one approach to such surpluses might be to return them to users in the form of rebates or lower charges, this does not appear to accord with the guidance in MTP2 which at Para. 1.4.2 says that "*The Department does not…..recommend the distribution of a 'dividend' among trust port stakeholders*" - MTP2 also noting that a trust port's stakeholder group is varied and indirect and a simple dividend payment is not possible.

315. An alternative approach suggested to the Inquiry is that any surpluses could be used to accumulate cash for reinvestment in the port. This does appear to accord with MTP2 which, at Para 1.4.3, identifies a range of ways in which a trust port's surpluses may be justifiably employed - including investing in infrastructure with a longer term view than might be expected of a private company port and investing in infrastructure to a higher standard than might maximise profits but where this brings direct quantifiable benefits to stakeholders.

316. The Operators do not argue that DHB should be prevented from earning a return; rather it is the size of the return that is at issue. In this respect I have some sympathy with the thrust of the Operators' view that returns earned by trust ports should be commensurate with their investment needs. However this approach is likely to give rise to difficulties in respect of choosing the appropriate time frame for the assessment of investment needs, raises questions as to the appropriate levels of contingency and could lead to fluctuating charges. In any event, I return to the fact that MTP2 clearly sets an expectation that trust ports will generate significant returns. Indeed, in the absence of such an approach trust ports may well be in position to undercut the market - contrary to MTP2 Para 1.2.3. Whilst this may not be directly relevant to Dover (given its unique characteristics) the concept nevertheless helps to appreciate the approach outlined in MTP2.

317. In light of the arguments above and the guidance in MTP2 I consider that trust ports should set their pricing based on a commercial rate of return - even though that is likely to mean that a trust port will accumulate cash reserves over time. In a commercial company these reserves could be distributed to shareholders; in a trust port they would need to be used in other ways.

318. Having established that trust ports should adopt a commercial rate of return, the question is one of establishing the appropriate rate. In this respect the issue at most contention between the main parties is the inclusion by DHB of the small company risk premium. Indeed, the Operators consider that there may be good arguments for DHB to have a lower cost of capital.

319. DHB has estimated the pre tax real cost of capital to be 9%. In contrast, converting the Operators' adopted pre tax nominal WACC of 9.6% would give a pre tax real WACC of 6.9%. The Operators have referred to a number of charging reviews in respect of various regulated industries noting that these reviews all used rates of return below that adopted by DHB. However I note that none of the reviews is particularly recent and all concerned large scale industries. As such I do not consider this a particularly strong argument that the WACC adopted by DHB is overstated.

320. I note that use of the Operators' suggested WACC in DHB's assessment would reduce the total economic cost by some £5m[191]. Notwithstanding the parties' agreement that the difference in the assessment of the cost of capital would not have a material impact on the relative conclusions, the cost of capital is clearly a consideration to be borne in mind.

The asset base

321. If a return on capital is to be included in consideration of the appropriate dues then the parties agree that the assumptions made in respect of the asset base are likely to have the most material impact.

322. In essence the two main approaches to dealing with inflation in terms of capital expenditure are to allow depreciation and return on an index-linked asset base using a real WACC (the 'replacement cost approach') or to apply a nominal WACC to the historical book value of the assets (the 'historical cost approach'). The parties agree that, *over the life of the asset*, both approaches would give the same result. However, the profile of returns would be different and the graphs at INQ/42/DHB show that over a range of inflation rates the use of a replacement cost/real return produces a generally flatter profile in terms of annual revenue compared to the use of an historic cost/nominal return approach.

323. DHB argues that the replacement cost approach is preferred by Regulators because its flatter profile is considered fairer to users of the asset at different points in its economic life and because it gives the right economic incentive price signals to both customers and competitors. The Operators consider that the historical cost approach is consistent with the expected returns in the debt markets and is more reflective of the way in which DHB sets its rate of return and the return DHB has actually earned historically. Switching to a replacement cost approach halfway through an asset's life could produce a windfall gain. The Operators also take issue with a number of the adjustments and assumptions adopted by DHB in its use of the replacement cost approach.

324. It is clear that, in this case, the replacement cost approach and the historical cost approach would each produce a markedly different result in terms of economic cost. INQ/36/DHB demonstrates that the Operators' approach of applying a nominal WACC to the historical book value of the assets results in a return on capital and thus a total economic cost which is some £12m less than that derived from DHB's approach of applying a real WACC to an index-linked asset base. The choice of approach is therefore of some import.

Summary

325. In seeking a realistic theoretical benchmark it may be argued that using the historical cost approach favoured by the Operators would give the best comparator as it is grounded more in 'real' figures and contains fewer assumptions. However, it seems to me that it could also be argued that in using the port's capital expenditure (Capex), as opposed to an economic depreciation, the approach becomes in part a circular argument and loses some of its value as a benchmark. It is also likely that the historical cost approach would produce more variable results than a long term steady state approach and consequently may be less reliable as a means of

[191] INQ/36/DHB Change (D)

benchmarking. Whilst this can in part be overcome by extending the analysis over a number of years[192] this introduces forecasting uncertainties.

326. In contrast, the replacement cost approach is likely to give more stable results but brings with it the possibility of windfall gains. It also requires some significant assumptions to be made. Nevertheless, it is obviously an oft used approach. Indeed, all the charging reviews referred to in the Operators' submissions (across a range of regulated industries) were undertaken on the basis of real rates of return and an inflated asset base. [213]

327. INQ/36/DHB shows that in respect of 2010 the two approaches produce widely differing results. The economic cost under the historic costs approach is £40m compared to that under the replacement costs approach of just over £55m. The difference of some £15m when set against revenues of £43.5m is significant.

328. The approach adopted by DHB is an accepted means of assessing competitive prices in a competitive market. Use of this approach suggests that economic costs exceeded revenue by £11.8m in 2010 and are likely to exceed revenue by £11.5m in 2011 - leading to the conclusion that the dues are set considerably below the appropriate levels. In contrast, the Operators' approach is said to be consistent with much of UK utility regulation. This tends to set prices by reference to a cost of assets which is substantially less than their replacement cost (eg by reference to privatisation proceeds). This method indicates that revenue exceeded economic costs by £3.5m in 2010 and is likely to exceed economic costs by £1m in 2011[193] leading the Operators to conclude that because the revenues exceed the economic costs, the dues are excessive per se. However, the calculated exceedances are fairly small compared to the turnover, particularly in 2011. To my mind this is more indicative that the dues may be set marginally too high.

329. Given such a wide disparity between the two analyses, the number of assumptions underlying the calculations and the limitations of time and scope in putting together the submissions I regard neither approach as being a good basis on which to approach the setting of dues. Instead it is more likely that the two approaches indicate a range within which, theoretically, it is likely that the dues should sit.

330. However, for a number of reasons I favour DHB's theoretical conclusion that the dues are not excessive. Firstly, given the relatively small exceedances of revenue over cost demonstrated by using the historical cost approach it is likely that the Operators' conclusions are more sensitive to variations in the input assumptions than DHB's conclusions. Secondly, the approach adopted by DHB is an accepted means of assessing competitive prices in a competitive market; DHB is not a regulated industry and one aim of the Inquiry is to assess whether the dues are commercial and competitive. Thirdly, DHB's approach leads to more stable results; whilst a switch in the charging approach part way through an asset's life could give windfall gains, there is no convincing evidence to show that this is what has happened here. Indeed the 'ex post facto' approach to the theoretical pricing model was necessary because DHB has actually been charging on what is effectively a 'cost plus' basis. In consequence it seems to me that the replacement costs approach is more robust and, on balance should be accorded greater weight - lending support to the view that the dues are not excessive.

[192] INQ/10/P Mr Harman's rebuttal proof Table 2.6
[193] Ibid Tables 2.1 and 2.2

Re-balancing the tariff

331. In setting its 2010 dues DHB did not simply add an inflationary percentage increase to its 2009 dues but instead chose to rebase its tariff structure. This rebasing included shifting the emphasis away from variable charges which are dependent on the loading of vessels towards a more fixed 'per vessel' charge. The Operators view this change as unreasonable considering that it had the direct consequence of shielding DHB from the effects of the economic downturn whilst exposing the Operators to its full force. DHB readily admits that one of its intentions in setting the dues was to rebalance its risk profile in respect of volumes. [146]

332. Prior to the tariff changes DHB had a fixed/variable tariff ratio around 25:75. Following rebasing this ratio has moved closer to 40:60. Comparison with a range of other ports shows that Dover has, despite the rebasing, retained the largest proportion of variable charges - although it is unclear from the information before the Inquiry as to the considerations taken into account when setting the dues at the comparator ports or indeed whether they are truly comparable. In this respect the Operators point out that even though comparator ports may have a similar or even higher ratio of fixed to variable charges this structure is more suited to ports subject to long term contracts, or those that do not rely on cargo. [75]

333. Nevertheless, whilst SeaFrance have expressed dissatisfaction with the fixed/variable tariff ratio and are seeking a rebalancing of the tariff, the Inquiry heard no persuasive evidence showing that the ratio of fixed/variable charges is unreasonable or that DHB's rebalancing exercise ran contrary to any of the accepted guidance. The Operators accept that Dover has a high proportion of fixed charges and I have no doubt that the Operators are better able to influence the load factors of their vessels than is DHB. To me it does not seem unreasonable that risk is born where it can best be managed. In any event it is clear that DHB retains a significant interest in the Operators' business as 60% of the tariff is still seen as variable.

Integrated Landside Operations (ILO)

334. In 2008 DHB took the decision to withdraw from the provision of Integrated Landside Operations (ILO) services to the Operators. That decision was implemented during 2009 and meant that the Operators then became responsible for the provision of a number of functions such as unaccompanied freight handling, mooring and unmooring and link span operations. The 2009 tariff had been set to include provision of these services and their withdrawal by DHB in March 2009 led to a rebate being given to the Operators against the 2009 tariff.

335. No rebates were given in 2010. The Operators consider the 2010 and 2011 dues excessive in that DHB has failed to take into account the reduction in its costs resulting from transferring the responsibility for the provision of ILO services.[21]

336. For its part, DHB is clear that when setting the 2010 tariff it did not take into account any costs associated with the provision of ILO services. I have been given no reason to take a different view particularly as the 2010 tariff involved a complete rebasing. Whilst I therefore acknowledge the Operators' concerns and accept that the ILO transfer increased their base costs I do not accept that DHB has failed to take account of the ILO transfer in setting its tariff. However, it is clear that when comparing year on year costs between 2009 and 2010, allowance must be made for

the transfer of ILO responsibilities; to do otherwise would mean that any comparisons would be distorted.

The economic and commercial climate

337. The Operators suggest that the economic and commercial climate should be at the forefront of any considerations as to the objections. In particular they point to what they describe as the 'dire economic position' and to Eurotunnel as being 'a very aggressive market participant' [58].

338. There is no doubt that the economic position is, and has been, difficult. DHB accepted early in 2009 that it would be a very difficult year in the economic climate pertaining at that time and later that same year acknowledged that the short sea freight market was down around 15-20%. DHB also acknowledged that in setting the 2011 dues it was aware of both the difficult trading conditions and the objections to the 2010 dues [65, 74].

339. In addition to more general economic matters, SeaFrance highlighted that Eurotunnel had publicly announced its intention to increase its market share[194]. P&O confirmed that competition from Eurotunnel was likely to be persistent and also noted that there were poor prospects for growth in both Europe and the UK; that fuel costs in general would be a significant cost challenge; and that new low sulphur regulations would result in yet further cost challenges to the Operators.[195]

340. In contrast to the Operators' concerns, DHB points out that the market share profiles of Eurotunnel and Dover have remained generally flat over the last 8 years or so and that Eurotunnel is only showing relatively strong apparent 'year on year' growth because it is still in the process of recovering market share to take it back to 'pre-fire' levels. Notwithstanding this view it seems to me that the combination of economic and competitive factors is likely to produce very difficult trading conditions for the Operators. [197]

Effect of the 2010 tariff changes on the Operators and DHB

341. In considering the effect of the tariff changes on the Operators it is instructive to look at the effect on a hypothetical vessel - an approach taken in the Operators' submissions.[196] The Operators chose to undertake these calculations on a vessel of 50,000 GT (Gross Tonne) - said to be representative of the larger vessels operated by the current stakeholders.

342. The Operators point out that, compared to 2009, the changes made to the 2010 tariff resulted in an increase in harbour dues of some 48.9%. This increase, together with the new fixed conservancy fee for 2010 of £190 (an increase of some 5.6%), led to an overall increase in ship dues of some 39.5% compared to 2009. [70].

343. However, whilst there has clearly been an increase in ship dues this is only part of the picture. To appreciate the overall effect of the 2010 tariff changes on the hypothetical vessel it is also necessary to look at the other changes to the tariff. In particular the increase in ship dues must be viewed alongside the reduction in

[194] Mr Wilkins Day 5, p189
[195] Ms Deeble Day 7 p82-83
[196] PoE Mr Chadney/Mr Pusey Pages 17 & 18

passenger and non freight dues (-47.3%), the reduction in freight dues (-11.1%) and the increase in the security charge (+2.0%). The net effect of all these changes is that the total cost of the hypothetical vessel berthing at Dover has been reduced by some -7.8% when comparing 2010 to 2009.[197]

344. But even this analysis does not yet tell the whole story. Firstly, whilst it shows that the cost of berthing a hypothetical vessel has fallen between 2009 and 2010 it makes no allowance for the transfer of ILO responsibilities. Secondly, the analysis is only applicable to the hypothetical vessel; in reality, even if volumes had stayed constant, the impact of the tariff changes would have been different for each operator as any changes are dependent on their fleets and loadings.

345. INQ/37/OBJ seeks to show what the overall effect of the changes would have been for P&O assuming constant volumes. It does this by applying the 2010 tariff to the 2009 volumes and by seeking to put the ILO costs on an equivalent basis for each year – in effect, nullifying them for comparison purposes. The net result is an overall increase in P&O's costs of some 3.55% - said to be equivalent to around 5% when an allowance is made for RPI (-1.43%).

346. DHB argues [179] that the 3.55% overstates the situation and that if the actual numbers transferred across in respect of the ILO function are substituted for the pro rata figure used in INQ/37/OBJ, then the actual increase in charges experienced by P&O would equate to around 0.8%. I have no reason to doubt this calculation. However, it could be argued that it represents a conflation of two issues; the Inquiry heard no cogent evidence to suggest that securing the ILO efficiencies was dependent on the 2010 tariff changes or that it represented any kind of justification for increasing the remainder of the charges.

347. Nevertheless, I understand that DHB bore the redundancy costs of those personnel who did not transfer to the Operators and I can appreciate that DHB might expect to realise the benefits of that investment and gain from the efficiencies so created. Similarly, the Operators might legitimately expect to benefit from the further efficiencies that they made following completion of the transfer.

348. The overall effect of the ILO transfer was to reduce the cost of running the port although within that overall reduction the cost base of DHB fell whereas that of the Operators rose. All other things being equal, it therefore does not seem unreasonable for the Operators to expect that the transfer would lead to a lowering of the dues. However, as DHB explained to the Inquiry, setting the 2010 dues involved a complete rebasing exercise - the aim of which was for DHB to cover its operational and short term capital costs, re-balance its risk with regard to volume fluctuations and increase its cash balance by a targeted amount.[62] An increase in the Operators' cost base was therefore, in one sense at least, irrelevant to DHB's setting of the 2010 dues.

349. DHB's figures show that, in reality, falling volumes meant that the Operators actually paid less in 2010 compared to 2009. Although the Operators describe this presentation as disingenuous, [66] I note that had volumes stayed constant from 2009 and had the *actual* effects of the ILO transfer been taken into account, the effect on P&O would have been a 0.8% increase in charges. Even if ILO costs are, in effect, removed from the comparison (as presented by P&O in INQ/37/OBJ) the

[197] Mr Waggott's Rebuttal proof Table F p 22

theoretical like for like cost increase experienced by P&O would have been just over 3.5%. Notwithstanding that negative inflation also increased the impact of the tariff change it does not seem to me that, of themselves, these figures justify calling the increase 'excessive'.

350. However, as noted earlier, the effect of tariff changes is not the same on each of the Operators - as each operates a different fleet. The Operators' closing submissions suggest that, on a constant volume basis and taking into account the ILO savings, SeaFrance experienced a much more significant increase in its dues between 2009 and 2010 than did P&O. Although the source for this suggestion is not referenced or recognised, SeaFrance did tell the Inquiry[198] that "….the total amounts that we paid were in fact an increase." Whilst INQ/33/OBJ shows that SeaFrance's traffic and ship dues fell by some £0.5m in 2010 compared to 2009 regard must also be had to the effect of the ILO transfer and the fact that volumes also fell. Without accounting for the effect of the ILO transfer, INQ/33/OBJ illustrates that for SeaFrance dues at Dover as a percentage of turnover rose from 7.1% in 2009 to 7.9% in 2010. [67].

351. DFDS approached the matter in a different way and looked instead at the global cost to all Operators based on the new tariff and assuming constant volumes and an adjustment for ILO. On this basis DFDS concluded that if "…..one applies the 2010 tariffs to 2009 volumes, DHB's revenue would appear not to have changed. However, if proper account is taken of the savings they made from not providing mooring and stevedoring, they would come out 9.1% better off"[199].

352. DFDS goes on to suggest that "If one applies 2010 tariffs to 2010 volumes, DHB's revenue would appear to have dropped by 7.7%. However, if proper account is taken of the £4 million saving in mooring and stevedoring costs, DHB comes out 2.2% better off, despite falling volumes."[200]

353. It is also worth noting that DHB's budget for 2010 originally targeted an EBITDA of some £24.37m - higher than in any year since 2007 when the port was experiencing capacity issues. Although the actual EBITDA turned out to be some £20.25m, this lower figure can largely be explained by the undertaking of significant harbour maintenance works to a blockship in the Western harbour. This amounted to some £3m, a figure charged to the profit and loss account.[201]

354. In the Operators' view the blockship works were not necessary at this time. If this view is accepted and the EBITDA 'normalised' by adding back the cost of the blockship, earnings would have been higher in 2010 than in 2009 - despite falls in both ferry related and total turnover. In the event, despite a fall in revenue and paying for the blockship works the 2010 tariff delivered an increase in cash and investments of some £3.06m - taking the total cash and investments to £60.285m at the end of 2010. A further accrual of some £2.6m is currently anticipated during 2011.[202]

[198] Day 6 p15 lines 21-22
[199] PoE Mr Christensen para 26
[200] ibid
[201] PoE Mr Waggott pp 25-28
[202] Ibid paras 17.2 & 17.3

355. It is clear from this background that the restructuring of the tariff and the outsourcing of the ILO services has made it somewhat complicated to draw year on year comparisons. However it can be seen that;

- the Operators actually paid lower dues in 2010 compared to 2009
- the ILO transfer increased the cost base of the Operators and reduced that of DHB
- on a 'like for like' basis the Operators would have paid out higher amounts for the same service levels
- efficiencies in the provision of ILO services (funded both by DHB and the Operators) had the effect of suppressing any cost increases that would have otherwise arisen from the 2010 tariff
- if 'normalised' for the blockship DHB's earnings would have been higher in 2010 than in 2009 despite falls in both ferry related and total turnover
- the 2010 tariff led to DHB's cash and investments increasing by some £3.06m despite falls in both ferry related and total turnover

Operating and short term capital costs

356. The Operators accept that government guidance encourages trust ports to set harbour dues at a level that, as well as being geared to attaining a target level of return, allows for proper maintenance of the trust port's harbour and/or conservancy duties. Operating and short term capital costs are therefore an important consideration when setting dues.

357. Although DHB suggests that there is very little dispute about operating costs [132] the Operators have expressed dissatisfaction over matters such as the 'gold plating' of investments, the transfer of ILO charges and the levels of contributions to the pension fund. P&O also suggests that the absence of competitive pressures on Dover means that there is little incentive to drive out efficiencies.

358. According to SeaFrance the port of Dunkerque is somewhat rudimentary but nevertheless manages to provide a very efficient service to its customers and users. [55] In contrast Dover is said to 'gold plate' its investments and the Inquiry heard that a number of SeaFrance requests to delay projects and exercise restraint during the economic downturn have gone unheeded by DHB. However, SeaFrance put forward little substantive evidence in support of their concerns. Whilst evidence of 'gold plating' may be difficult to obtain I note that the Operators have the opportunity to discuss the short term capital programme with DHB at regular meetings. According to DHB, SeaFrance representatives at these meetings have not previously questioned the appropriateness of the Capex plans.

359. The Operators also raise concerns over the amount of work now said to be required to T1. However, DHB explained that as a result of the extended timescales for T2, additional works were required to T1 in order to maintain operational availability and improve operational efficiency. Despite the Operators' concerns I see no reason to doubt DHB's assessment and I saw on my site visit that at least one of the link spans had restrictions placed on it as a result of structural failure.

360. The transfer of ILO responsibilities resulted in significant efficiencies both through the transfer process itself (and the funding by DHB of a number of redundancies) as

well as by the subsequent actions of the Operators. Clearly this area was being operated inefficiently. However, the Inquiry was told that the potential for efficiencies was identified by DHB itself and despite the Operators' genuine concerns over efficiency in general I do not accept that the ILO situation can, itself, be regarded as proof of port wide inefficiencies.

361. In respect of pension fund payments, DHB has agreed a long-term recovery plan. The deficit recovery payments currently proposed amount to some £2.15 million per annum. As DHB has only one 'pot' to cover all its expenditure these payments could result in the cash reserves being reduced.[203] However, I see no reason to doubt that proper stewardship of a pension scheme is a legitimate part of running a business. In this case it has been identified that the pension fund is in deficit and it seems to me that DHB is obliged, in some manner, to address that deficit. I accept that the reality of DHB's business is that there is only one 'pot' of money and therefore any additional pension contributions are bound to reduce DHB's cash surplus below what it might otherwise be. Whilst P&O point out that DHB has not, unlike many other commercial organisations, amended its pension scheme benefits and contribution arrangements, no convincing evidence was put to the Inquiry to show that the Board's pension scheme was excessive. [81]

362. PwC accepted that its work on the theoretical costs benchmark would, ideally, have looked at the question of whether or not the port's operating costs were efficiently incurred. However, PwC also noted that matters of efficiency did not feature strongly in the Operators' objections and, as a full efficiency study was seen as being beyond the scope of the analysis,[204] no such study was carried out.

363. In reality, little cogent evidence was put before the Inquiry on matters of efficiency; although the Operators' concerns in this matter are no doubt genuinely expressed there is little to support them.

The Board's approach

364. The Operators expressed considerable dissatisfaction over the Board's perceived attitude, its approach to tariff setting and to their commercial relationships in general. In describing the approach to the tariffs P&O note that there was "*….no discussion, no negotiation, no phasing in……it is a very frustrating and atypical commercial relationship*".

365. The Inquiry heard that relationships between the port and the Operators worked well at an operational level. However it is clear that tensions exist at both strategic and commercial levels. I have no doubt that these arise largely from the atypical commercial arrangement described by P&O in which the dominant position of the Board and the captive nature of the Operators is likely to make any 'negotiation' unbalanced. [23, 59, 92]

366. However, to my mind whether or not the Board has been insensitive in its dealings with the Operators is of only limited relevance to a s31 Inquiry. Whilst the Board's attitude may afford some insight into its approach to tariff setting, the assessment of those tariffs is better undertaken by reference to more objective measures. Consequently I do not propose to look further at this issue.

[203] Mr Waggott Day 3 pp 147-150
[204] Mr Ogier Day 5 p 53 lines 8-12

T2 and the Board's cash surplus

367. There is no dispute between the parties that, in addition to discharging their day to day management responsibilities, trust ports need to take a longer term view. The Operators also acknowledge that port capacity takes time to plan, fund, build and deliver. [148]

368. According to DHB, for significant periods in 2007 and 2008 the port was "getting close to the point of reaching its limit of reasonable utilisation", a situation involving routine peak time overflows of road freight vehicles onto the highway network. This had major consequential effects for the town of Dover. DHB thus put forward plans for T2, a new ferry terminal focussed on the Western Docks. After public consultation and engagement with stakeholders of the port an application was made for a Harbour Revision Order (HRO) in order to enable the development to take place. There are no outstanding objections to the HRO. [149, 150]

369. However, notwithstanding the Operators' acknowledgement of the potential need at some stage for capacity improvements they do not consider that costs associated with T2 should have been taken into account in setting the rates for 2010 and 2011. [21] The Operators particular concerns include;

- that the Board is budgeting on the basis that T2 could be required at very short notice despite it being delayed, potentially unviable in light of the economic downturn and potentially undeliverable on the basis of the Board's assumptions as to borrowing [69]
- that the £60m cash surplus accumulated by the Board, which in the Operators' view has been built up on the basis that it would be used for T2, is now being spent on other matters (such as pension costs)
- the lack of any guarantees that a future private owner of the port would progress T2. [23]
- that investment in T2 would not deliver in the short term a 12% rate of return - as stated in the Board's minutes [60]
- that the Operators may be forced to pay twice over for T2 [86]
- the Board's approach to funding [79, 80, 93, 94]

370. T2 is anticipated to cost around £380-£400m. DHB's current philosophy is to deliver T2 in two phases with Phase 1 costing approximately £200m. Given DHB's turnover the construction of Phase 1 is, of itself, likely to require substantial borrowings.

371. In terms of timing, it was originally anticipated that T2 would need to be available between 2015 and 2017 which, after taking account of a 3 to 4 year build period would have meant commencing work between 2011 and 2013. Based on the forecasting work undertaken by DHB and accounting for minor capacity improvements in T1 the latest predictions are that T2 will be required sometime around 2019 to 2022 – potentially necessitating a start on Phase 1 in 2016. No other cogent forecasting work was put before the Inquiry. [76, 77, 155]

372. DHB acknowledges that it has unlimited borrowing powers and evidence was placed before the Inquiry to show that other trust ports have borrowings. However, despite its unlimited borrowing powers DHB's view is that, in reality, its ability to

borrow is very restricted. As a public corporation, DHB's borrowings would be reflected in the Public Sector Borrowing Requirement (PSBR) and would be part of the overall borrowing of the DfT. As such DHB would be required to seek the DfT's permission before borrowing.[205]

373. Informal discussions with banks have indicated to DHB that "…….any reputable lender would require a letter of comfort as security from the Department before agreeing to lend"[206]. The Department has said that it would not be prepared to provide any such security to a lender on the basis that the security would be classed as government debt. Despite its unlimited borrowing powers DHB told the Inquiry that it is in any case unwilling to act against the wishes of the Department. In January 2009 the Department confirmed that it had no provision in its budgets (which had been fixed until 2014) for new borrowing to fund the western docks development. [152]

374. The Operators point out that it has been some time since DHB approached the DfT to seek funding for T2. In light of the fact that timescales for T2 have slipped the Operators' point does not seem unreasonable. However, given the current economic climate I consider that the prospects of securing the DfT's commitment to funding T2 are unlikely to be significantly greater now than they were in 2009. [79]

375. I understand that DHB took the view as early as 2006 that the prospects of getting the DfT's permission to introduce the level of debt into the organisation necessary to fund the T2 development were remote. In the face of rising traffic and a port likely to be operating at or near its capacity the Board decided that it had to seek other means of funding T2 and, in order to be able to access the capital markets, determined that full privatisation of the port would be the preferred option.

376. DHB also took the view that the size of the business meant that any borrowing over £80m would be a considerable risk and any borrowing over £100m impossible to service. Given that £80-100m was seen by DHB as the maximum it could borrow and the cost of Phase 1 was predicted as being some £200m DHB began to build up a cash surplus - of which some £57m was accrued between 2007 and 2009. During this period the Operators raised no formal objections to the tariffs then in force. Although P&O told the Inquiry that it had been able to fund 80% of its own capital expenditure through the markets, DHB and P&O are two very different businesses. Consequently I do not regard P&O's experiences as being a reliable indicator of DHB's ability to borrow. [79, 158, 159]

377. At my request DHB provided a high level cash flow[207] covering the period 2011 to 2021. This suggests that in order to fund T2 (assuming a start in 2016), even if DHB retained and built on the current cash balance it would also have to borrow significant sums in 2019 to 2021 - close to what it regards as the maximum serviceable borrowing. [157]

378. Looking at this background it seems that the Board has been faced with a number of significant and difficult decisions. In light of the projected growth in traffic and the likelihood that the port's capacity would be exceeded (with significant consequences for the town of Dover) I accept that 'do nothing' would not have been

[205] Mr Goldfield PoE para 9.1, 9.2
[206] Mr Goldfield PoE para 9.6
[207] INQ/29/DHB

a sensible position for the Board to adopt - indeed, it would have failed to "….strike a balance that fully respects the interests of all stakeholders". The Board's decision to address the issues facing the port by planning an increase in capacity is therefore understandable.

379. The usual commercial approach would have been to fund such an investment through borrowings before recovering the interest and capital over a number of years through the tariff. However, DHB took the view that it could not follow the normal financing route as its ability to borrow was severely constrained. It chose instead to accumulate cash 'up front' through the tariff structure but it is clear that this would never be sufficient of itself to fund capacity improvements of the scale envisaged within the required timescales. The Board therefore determined that some borrowings would also be required. In the Board's view the only way it could secure these borrowings would be through privatisation. MPUK says at 2.1.13 that port developments and port operations should not in general need public subsidy.

380. There is a clear logic to the Board's approach. Although the Operators point out that T2 would not deliver the target 12% rate of return currently stated in the Board's accounts (a point accepted by DHB) and MTP2 is clear that all trust ports should set themselves a target rate of return for existing activities and new projects, MTP2 also recognises at 1.4.3 that a trust port's surpluses may be justifiably employed in undertaking activities that have a lower commercial return than might be acceptable to a company port, but which have other benefits for stakeholders – eg for the local community. In any case I do not see it as the role of the Inquiry to try and 'second guess' the Board as to whether or not T2 is the right option for the port. That is a matter for discussion between the Board and its stakeholders. [60]

381. It has already been noted that the Operators did not formally object to the dues imposed in earlier years when the majority of the existing cash surplus was accumulated. The evidence shows that the Operators were acting under the clear impression that the cash surplus was being accumulated in order to fund T2 and thus in paying tariffs which led to an increased cash surplus the Operators were not only accepting of the need for T2 but also the Board's approach to funding it.

382. The key question is not therefore, whether T2 is the right option or whether it needs to be pre-funded but whether, in light of the commercial and economic climate and the current growth forecasts, DHB should be seeking to accumulate further cash through the 2010 and 2011 dues.

383. Dealing first with the matter of timescales it is obvious that the urgent need for T2 experienced during 2007/2008 is no longer the key factor it once was. Indeed, I note that lower growth has already led to a change in DHB's approach and it is now undertaking T1 refurbishment and capacity works in advance of T2. The capital plan approved at the end of 2010 is founded on this approach.[208]

384. Nevertheless, the best forecasting information available to the Inquiry shows that a start on T2 may still be needed as early as 2016. Were that to be the case, INQ/29/DHB shows that DHB would need to borrow a maximum of some £72m in 2020 in order to fund Phase 1. This is close to, but not at, DHB's anticipated

[208] INQ/02/S Summary PoE Mr Krayenbrink para 11.2

maximum borrowings - although the predicted cash flow is clearly dependent on a range of assumptions.

385. With respect to the commercial and economic climate, trading conditions are demonstrably difficult for the Operators and it is understandable that they should seek to reduce their costs wherever possible. However, it is less clear as to whether setting the 2010 and 2011 tariffs at levels intended to deliver increases in the Board's cash surplus would have had any material impact on the Operators' pricing policies or their competitive positions against Eurotunnel. To gain some further understanding it is worth looking at P&O costs as an example.

386. INQ/37/OBJ shows that P&O's cost in relation to its use of Dover has been around £20m - or around half that of Dover's total s31 ferry related turnover (which is in the order of £40m[209]). If it is assumed that the ferry operators contributed the majority of the cash surplus accrued in 2010[210] (not subject to further substantiation but a useful working assumption), said to be just over £3m, and that the cash surplus is accrued in proportion to the dues paid, then it follows that P&O is likely to have contributed around half of that increased cash surplus - or some £1.5m. DHB charges as a whole represent some 7.4% of P&O's turnover on the short sea route [177] and therefore £1.5m would represent rather less than 1% of P&O's turnover.

387. Notwithstanding that there are a number of broad brush assumptions in the figures above I consider it likely that the ferry operators would have contributed towards the increases in DHB's cash surplus during 2010 and 2011 by what are, in their own rights, substantial sums of money. As such I accept that these sums could have had potentially significant impacts on the profit lines of the Operators. [82]

388. However, on the further assumption that the contributions of all the Operators to DHB's cash accumulation would be in similar proportions to that of P&O, their contributions are likely to represent only very small proportions of their turnovers. In my view it is unlikely that sums representing less than 1% of turnover would be sufficient to materially distort competition between the Operators and Eurotunnel. Nevertheless, and irrespective of the particular focus brought about by the current economic climate, I can understand the Operators' reluctance to pay over such sums unless they are demonstrably necessary.

389. I am in no doubt that for a number of years the Operators have been working under the impression that the Board's cash fund was being accrued for the specific purpose of funding T2. However, DHB maintains that its resources remain to be dealt with in whatever manner the Board decides is appropriate.[211] Whatever the reasons, there have clearly been significant misunderstandings between the parties.

390. DHB told the Inquiry that its overriding issue in setting the 2010 and 2011 tariffs was the requirement for capital investment in the future - whilst at the same time having enough funds to be able to run the business.[212] Government guidance supports these objectives. MTP1 para. 114 and MTP2 para 1.2.4 note that the

[209] INQ/03/P Mr Waggott PoE para 17.7
[210] Mr Goldfield acknowledged that the cash surplus arose predominantly from the tariffs imposed on the Operators (Day 1 p105 line 23)
[211] Mr Goldfield rebuttal evidence para 2.5
[212] Mr Goldfield Day 1 p114 lines 14-25

Board has obligations to set dues at a level that allows for proper maintenance of the trust's harbour or conservancy duties. MTP2 para 1.2.6 notes that a board should also act not only to protect the commercial position of the port, but also to take investment opportunities which offer maximum benefit across the whole stakeholder group. Having regard to such wider stakeholder benefit may legitimately result in longer term investment planning.

391. However, the Board should also strike a balance that fully respects the interests of all stakeholders, not just one group. This should be done in light of the objectives of the port, including commercial considerations, and what constitutes the 'common good' for all stakeholders (current and future) and the port itself (MTP2 para 1.1.5). Having regard to the need to strike a balance, MTP1 is clear at para. 112 that dues should not be imposed for services that port users do not need. Whilst T2 is probably going to be required at some time in the future, it is clearly not needed in the short term.

392. INQ/29/DHB shows that DHB has sufficient funds to cover its short term costs. It also suggests that even if the 2010 and 2011 tariffs were to be lowered to the point at which there would be no increase in DHB's cash balance, then even if T2 was to start in 2016 the port would still be able to borrow within the limits that it considers realistic.

393. However, INQ/29/DHB is clearly predicated on a range of assumptions which must include, amongst others, assumptions about income and the cost of 'steady state renewals'. It could be argued that DHB should have the experience to predict these with some accuracy. Nevertheless, the figures must be subject to some uncertainty and whilst INQ/29/DHB shows that the port should be able to remain within its borrowing limits it also shows that the port might come close to those borrowing limits - particularly if they turn out to be nearer to £80m than £100m. Were DHB not to retain the predicted combined total of £6m of cash accruals for 2010 and 2011, then the Board's needs in 2020 would, at some £78m, appear to come very close to what could be the maximum borrowings of £80m.

394. The Operators generally accept that the holding by DHB of some form of contingency (ie a cash balance) is an appropriate means of coping with unforeseen issues.[213] Whilst the Operators contend that DHB's current holdings are excessive, INQ/29/DHB shows that in the latter part of the period being considered the Board could well end up in a position where it is unable, even through borrowing, to deal with any unforeseen issues.

395. The Operators have raised a number of other concerns in respect of the cash surplus and T2. These include the absence of anything guaranteeing that T2 would actually be constructed should privatisation proceed. DHB accepted that this may be the case. However DHB also stated that it is the Board's intention to find a legal mechanism to ensure that whatever surplus exists at the point of privatisation (should it occur) is ringfenced for the benefit of the Operators in terms of future capital expenditure.[214] Whether or not this proves to be possible I have already

[213] Eg DFDS INQ/11/OBJ p2 "……it would be prudent to hold up to three years' worth of planned expenditure in cash at any point in time", P&O INQ/13/OBJ p1 "Some level of surplus is always required for emergency maintenance."
[214] Mr Goldfield Day 1 p148 lines 7-16

noted that my considerations should be based on the assumption that Dover retains its current trust port status. I have therefore not considered this matter further.

396. Further concerns are that the surplus will be used for things other than T2 (eg pensions) - and in consequence the Operators would end up paying twice for T2 - and that the Operators are paying for something that may benefit future users of the port rather than them. [80, 86]

397. Irrespective of any misunderstanding that may have existed over the use of the cash surplus it is clear that the ferry tariffs comprise a very significant part of Dover's income. Consequently, even if the cash surplus had been ringfenced for the purposes of T2 it is very likely that the Board would have had to increase its ferry tariffs in order to accrue additional funds to deal with matters such as the pension deficit. As such it does not seem critical as to whether or not funds are ringfenced for T2 and although the Operators may feel as though they might pay twice for T2, it is likely that the demands placed on them through the tariffs would be similar whether or not T2 funds were ringfenced.

398. With respect to the matter of contributing towards assets that may benefit future users of the port rather than the Operators, unless DHB was able to borrow the whole cost of the asset this seems to me inevitable. In any event, the Inquiry heard that even in PwC's theoretical analysis some of the assets were treated as 'gifted' and it is therefore likely that the Operators currently enjoy assets to which they do not and have not contributed anything in the way of capital cost.

Cruise operations

399. DHB confirmed that its approach to the use of the port by cruise ships is very different to that adopted in relation to the ferry companies. In particular, incentives such as volume discounts are on offer. The Operators note that no such volume discounts are on offer to them and point out that both MTP1 (para 114) and MPUK (para 2.1.12) state that dues must be seen to be fair and equitable as well as noting that it is wrong for some users to have special treatment. [23(o)]

400. The Inquiry heard that the cruise ship business is considerably more volatile than the ferry business and the fact that the cruise operators are more able to choose from a range of ports means that, compared to the ferry operators, they have only limited ties to Dover. Indeed, it was suggested to the Inquiry that they were 'footloose'.

401. Consequently, the commercial dynamics of the cruise operations are different to those of the ferry operations and the services required by each type of operation are very different - a simple example being turn around times. In these circumstances it would be strange if the ferry operators and the cruise operators had similar tariffs - or indeed similar tariff structures.

402. As to the matter of volume discounts DHB told the Inquiry that it took the view that the cruise business was more marginal than the ferry business and that even a small number of incremental cruise vessels could make a big difference to the port's bottom line. In DHB's view, using volume discounts to attract further cruise ships to the port is entirely laudable commercial behaviour and could defray future costs levied on ferry operators. [215] In contrast, DHB does not believe that it can deliver

[215] Mr Waggott Day 3 p189- 192

incremental gains in terms of the existing ferry tariff considering that that the offer of volume discounts to the ferry operators would simply mean that in order to maintain the overall level of revenue required by the port, the tariff per ship would have to increase.

403. The Inquiry heard no substantive evidence to show that offering volume discounts to the ferry operators was likely to result in overall growth. The application of volume discounts to the ferry operators is therefore likely to mean that DHB's overall revenue would fall or, if DHB increased its base price levels in order to maintain the same revenue stream, then assuming constant volumes the bigger operators would pay less whilst the smaller operators would pay more. For this reason it is not surprising that discussions between DHB and the Operators have failed to agree on volume based discounts. It could also be argued that, in this scenario, the use of volume based discounts would itself not be fair and equitable.

404. There was very little evidence before the Inquiry dealing with the proportions of cost being born by the various stakeholder groups. Although DHB concluded that there was a lack of material cross subsidy between the ferry and non ferry parts of the business [216] the Operators point out that this conclusion is at best limited by the amount of information available at a disaggregated level and in any event does not consider whether individual ferry dues are themselves cost reflective[217]. However, nor was there any evidence before the Inquiry to suggest that the dues charged to the cruise operators were at levels below a commercially sustainable rate or that they had been calculated to win traffic at any cost.

405. MTP1 says at para 114 that discounts should be calculated and awarded on an equitable basis that bears comparison across the stakeholder group and that Boards have a responsibility to operate in the interest of all of their stakeholders. However it concludes by noting that "This requires equitable treatment of all businesses within the port and appropriate pricing of the services provided to them." Para 112 notes that "Boards should recognise that different users have different service level requirements. This should be recognised in levying charges." This does not suggest to me that all users should be subject to either the same tariff or the same discounts. MPUK says at 2.1.12 that "It is wrong for some users to have special treatment, and even be exempt from dues altogether, when *their competitors* (my emphasis) are paying the going rate".

406. Against this background it is my view that although the cruise operators are subject to a different tariff and are offered volume discounts, this is not itself reason to conclude that the ferry tariffs are unfair or inequitable - particularly given that the evidence suggests that there is no material cross subsidy between the ferry operators and other users.

Operators' proposed tariffs

407. Section 31(6)(b) of the Act gives the SoS the power to give to the harbour authority *"... such direction with respect to the charge as would meet objection thereto..."*. In order to inform and assist the Inquiry and the SoS's further considerations the Operators were asked to present their proposals as to what the tariffs ought to be if the SoS determined to make a direction under

[216] INQ/04/P PoE Mr Ogier para 7.11(b)
[217] INQ/10/P Rebuttal proof Mr Harman paras 2.16 to 2.20

Section 31(6)(b). The Operators' proposed tariffs are laid out in a series of documents presented to the Inquiry.[218] The effects of these tariffs on the finances of the port have been modelled by DHB and are presented in INQ/41/DHB.

408. Although the Operators' aim was to present a common case in objecting to the 2010 and 2011 dues it is obvious from the range of tariffs now proposed that the Operators hold differing views as to the type and quantum of the alleged inequity. It is particularly noticeable in the structuring of the proposed tariffs that SeaFrance does not, unlike DFDS and P&O, seek a cash rebate. However, SeaFrance is the only operator to seek a material re-weighting of the tariff such that DHB would carry a greater proportion of variable risk and P&O is the only operator to propose an explicit efficiency factor. All the Operators look to use CPI rather than RPI as the inflationary measure.

409. The modelling in INQ/41/DHB applies the suggested 2010 tariffs to the 2010 volumes and the proposed 2011 tariffs to the forecast 2011 and 2012 volumes. Where the Operators seek cash rebates extending beyond 2012 these are aggregated and shown as a single rebate in 2012.

410. DHB experienced some difficulties in reconciling the Operators' proposals into a common format and the range of proposals meant that it was necessary to make certain assumptions, particularly as to the manner in which the rebates would be presented. Nevertheless, INQ/41/DHB was produced following a number of clarifications from the Operators and I consider that it does present a reasonable overview, at least in terms of scale, as to the likely impact of the proposed tariffs on DHB's finances. None of the Operators raised any significant objections to the presentation.

411. The modelling shows that against DHB's actual 2010 ferry revenue of approximately £38.7m the Operators' proposals would produce ferry revenues ranging between circa £31m (P&O) and circa £33.8m (DFDSv2 – in looking at the effects of the proposals I have ignored the original DFDS proposal and used that reflecting the inclusion of security charges). Even if the highest of the Operators' proposals was to be adopted, this would lead to a reduction in DHB's 2010 ferry revenue of around £4.9m. This compares to the actual increase in DHB's cash and investments in 2010 of just over £3m.

412. Whilst this comparison may not be absolutely correct if tax effects were to be taken into account it is nevertheless suggestive that DHB's cash balance (as accumulated prior to 2010) would decrease even if the highest of the Operator proposals was to be adopted. I have already explained my view [276] that if the SoS was to make a direction which led to a defrayal of the cash reserves accrued in previous years then this would indicate that, in effect, the SoS had determined that the dues set in earlier years were themselves too high - and as such is likely to exceed both the remit of the Inquiry and the powers of the SoS.

413. INQ/41/DHB Table B shows the effect of the Operators' proposed tariffs and rebates applied to the years between 2010 and 2012 including an assessment of the likely tax effects. Whilst not an entirely accurate reflection of the proposals (DFDS and P&O both envisaged the rebates being paid over a longer period) it nevertheless

[218] DFDS: INQ/11/OBJ, INQ/11A/OBJ, INQ/18/OBJ and INQ/18A/OBJ, SeaFrance, INQ/12, INQ/20/OBJ and INQ/20A/OBJ, P&O: INQ/13/OBJ, INQ/13A/OBJ, INQ/19/OBJ, INQ/19A/OBJ.

serves to suggest that the proposals would all lead to a significant diminution in the Board's accumulated cash reserves.

414. DHB argues that if any cash balance is to be returned to the Operators it should be returned to all users of the port, all of whom have contributed to the accumulation of the cash balance. DHB's view is that to do otherwise would be to distort the balance between ferry and non-ferry users and be potentially discriminatory. In contrast the Operators argue that the only tariffs before the Inquiry are those relating to the ferries and there is no evidence that the cruise tariffs are excessive, no evidence as to the considerations taken into account when the cruise tariffs were set and nothing to say whether the non-ferry operators had been surcharged to fund T2. As such the Operators maintain that there is no need to take account of non-ferry operators in any determination of the impact of any reduction in the Operators' tariff. [27]

415. I have already accepted that there is only one cash balance and that it is not specifically for T2. However, it is less clear as to whether or not all users of the port have contributed to the accumulation of that cash balance – and even if they have, in what proportion - as there is very little evidence that deals with cost allocation between the various stakeholder groups. Perhaps the only indicator before the Inquiry is DHB's own conclusion that there is a lack of material cross subsidy between the ferry and non ferry parts of the business. On this basis it could be argued that the cash balance has been accumulated in proportion to the revenues derived from the ferry and non-ferry parts of the business - although this would appear to be at odds with DHB's view that the majority of the cash accruals derive from the ferry tariff.

416. It seems to me that it would be unreasonable to argue that a lack of detailed cost allocations in DHB's accounting practices should be regarded as sufficient reason to prevent the SoS from giving the harbour authority *"... such direction with respect to the charge as would meet objection thereto..."*. It also seems to me that DHB's arguments are, in one sense at least, of limited relevance; no objections have been raised to the non-ferry tariffs and I see no reason to believe that a direction should, or indeed could, be made requiring changes to those tariffs. It is therefore my view that, should the SoS wish to make a direction involving a reduction in the cash surplus accrued during the year in question, then such direction would be demonstrably reasonable, at the very least to a level proportionate with the ferry revenues to the port's overall revenues.

Are the 2010 dues commercial and competitive?

417. One way of seeking to answer this question is to look at the dues charged by similar ports. According to the evidence before the Inquiry, Calais is the most comparable port to Dover. The Inquiry heard that whilst Calais is subject to competitive pressures, its charges materially exceed those at Dover. Clearly there are considerable difficulties in finding a directly comparable port and the comparison with Calais is subject to a number of caveats - not least that the comparison is based on Calais' revenue information not, its costs information. Nevertheless, I consider that the charges at Calais are an indicator that Dover's charges are commercial and competitive. [303]

418. A second approach is to look at a range of KPIs from other trust ports. Once again difficulties arise in finding true comparators and any comparisons must be subject to caveats. Nevertheless, the analysis before the Inquiry shows that on a suite of

measures, including ROCE and EBIT margins, Dover's performance in 2010 fell within the overall range for each category. This is a further indicator that Dover's charges can be regarded as commercial and competitive [304, 305]

419. A third approach is to look at a theoretical pricing model. According to the replacement cost approach presented by DHB, the port's dues have been set at levels below those consistent with being commercial and competitive. In contrast the Operators alternative historical cost approach concludes that DHB's dues are "excessive per se". [327]

420. Both theoretical pricing approaches have track records in the competition and regulation arenas. However, given the number of assumptions underlying the calculations and the limitations of time and scope in putting them together I regard neither as a sound basis on which to reach a definitive determination as to whether the dues are commercial and competitive. Instead it is more likely that the two approaches provide a range within which the dues should sit.

421. Nevertheless, for a number of reasons I favour DHB's conclusion that the dues are not excessive. Firstly, given that the Operators' conclusions are more marginal than those of DHB they may be more sensitive to the input assumptions. Secondly, the approach adopted by DHB is an accepted means of assessing competitive prices in a competitive market and DHB is not in a regulated industry. Thirdly, DHB's approach is likely to lead to more stable results over time. Whilst DHB's approach could result in windfall gains, there is no evidence to show that has, or would, happen here. It is therefore my view that, on balance, more weight should be accorded to DHB's view that the dues are not excessive. [328 - 330]

422. Applying the 2010 tariff to 2009 volumes and making an adjustment for the ILO transfer suggests that DHB would have been some 9% better off in 2010 compared to 2009. Even taking account of falling volumes and applying the 2010 tariff to 2010 volumes, DHB would have been some 2.2% better off. Whilst this shows that DHB has improved its financial position in the face of difficult economic conditions and as such the Operators' concerns are wholly understandable, it does not, in my view, demonstrate that DHB's dues are excessive. Indeed it may simply show that DHB's dues have historically been too low. [351, 352]

423. Taking all of these matters into account I reach the view that the 2010 dues can be regarded as being commercial and competitive.

Are the 2010 dues fair and equitable?

424. MTP1 says at para. 114 that dues must be seen to be fair and equitable if they are not to be open to challenge. Para. 116 says that investment policies too should be fair and equitable although MTP2 at 1.2.5 is clear that there should be no presumption that dues levied on a specific group or type of user should be exclusively reinvested in improving services and facilities on offer to that user. MTP2 para. 1.2.7 notes that charges should not be imposed for services that port users do not need and Boards should recognise that different users have different service level requirements. This should be recognised in levying charges.

425. DHB told the Inquiry that its overriding issue in setting the 2010 and 2011 tariffs was the requirement for capital investment in the future - whilst at the same time having enough funds to be able to run the business. [390]

426. Turning first to the operating and short term capital expenditure, MTP1 para 114 also says that dues must be set at a level that allows for proper maintenance of the trust's harbour or conservancy duties. Notwithstanding the Operators acceptance of the Board's need to discharge these duties they raise a number of concerns over the way in which these duties have been approached pointing to such matters as the 'gold plating' of investments and the lack of incentives for the Board to drive out cost efficiencies. However, whilst I have no doubt that the Operators' concerns as to the efficiency of the port's operations are genuine, the Inquiry was given no persuasive evidence in support of these concerns. I give them little weight. [356-363]

427. With respect to significant future capital investment the Board is seeking to use its tariff structure to accumulate a cash fund of sufficient size to facilitate investment in T2 – although contrary to the Operators' historical understanding there is no ringfenced fund solely for T2. In seeking to pre-fund a large part of T2 through the port's tariffs, the Board's approach is commercially unusual. However, given the perceived need for T2 and the Board's understanding that it would not be able to borrow sufficient funds to cover the full costs of T2, the chosen approach is understandable. MPUK says at 2.1.13 that port developments and port operations should not in general need public subsidy. The Board's approach has not previously been objected to by the Operators. [367 – 381]

428. Nevertheless, the Operators believe that DHB should not be seeking to add to its cash balances through the 2010 and 2011 tariffs as the need for T2 has now receded. However, if DHB were not to retain the cash accrued in 2010 and 2011 (predicted to total some £6m) it seems likely that, even based on the latest forecasts for a delayed start to T2, the Board would need to borrow close to what it regards as its potential maximum borrowings of £80m. This would leave no room for contingencies. [381-384, 390-394]

429. Whilst DHB accepted that the ferry operators are likely to contribute the majority of any cash accrual, MTP2 is clear that there should be no presumption that dues levied on a specific group or type of user should be exclusively reinvested in improving services and facilities on offer to that user.

430. There was very little evidence before the Inquiry dealing with the proportions of cost being born by the various stakeholder groups across the port. The limited evidence that was put forward indicates that there is no material cross subsidy between the ferry operators and other users. Although I do not see this as a conclusive demonstration that the dues are equitable it is an indicator of such.

431. The Operators pointed to the volume discounts being offered to the cruise operators as evidence of inequity. However, there was nothing to show that the dues being charged to the cruise operators were at levels below a commercially sustainable rate or that they had been calculated to win traffic at any cost. Therefore, although the cruise operators are subject to a different tariff to the ferry operators and are offered volume discounts, this is not in my view reason to conclude that the ferry tariffs are unfair or inequitable. [404 -406]

432. All ferry operators are subject to the same tariff and I note that discussions between DHB and the Operators have failed to agree on volume based discounts within the ferry tariff. Indeed, depending on the particular arrangements in force it might be argued that the use of volume based discounts within the ferry tariff could themselves lead to unfairness and inequity between the Operators. [403]

433. The footnote to MTP1 para. 114 gives further insight into what may constitute fair and equitable; "If dues were to be found partial and unequal in their operation as between different classes: if they were manifestly unjust: if they disclosed bad faith: if they involved such oppressive or gratuitous interference with the rights of those subject to them as could find no justification in the minds of reasonable men, the Court might well say "Parliament never intended to give authority to make such rules: they are unreasonable and ultra vires."

434. Taking account of the background above and the further guidance in MTP1 I find no persuasive reason to consider the tariffs unfair or inequitable.

Are the 2010 dues reasonable?

435. In finding the dues to be commercial and competitive, fair and equitable it might be argued that they are bound to be reasonable. However, whether or not dues are seen to be reasonable in all respects should also involve looking at the dues from the perspective of the organisations subject to them – particularly here where Dover is in a dominant position relative to the short sea crossing ferry operators. MTP2 is clear that the interests of the stakeholders, or 'beneficiaries' in the port, must at all times be the guide by which trust port boards direct the port. (1.1.5)

436. The economic and competitive climate has made, and is likely to continue to make, trading conditions very difficult for the Operators. Taking this into account it must be asked whether or not it is reasonable for DHB to set the tariffs at a level at which DHB not only 'covers its costs' but also adds to its cash accruals and whether such an approach is in the interests of its stakeholders.

437. It seems to me reasonable for the Board to try and cover its short term costs through the imposition of tariffs. Indeed, MTP1 seeks for dues to be set at a level that allows for proper maintenance of the trust's harbour or conservancy duties. It remains to be considered as to whether the Board should have set its dues at levels which meant that it accrued around a further £3m of cash during 2010.

438. DHB dues appear to represent around 7-8% of the ferry operators' respective turnovers. If it is assumed that the majority of the cash surplus is down to the ferry tariff then contributing towards the circa £3m increase in the cash surplus would represent something like 0.5% of turnover for each operator. In my view this is unlikely to materially distort competition. Nevertheless, the sums involved are significant in their own right and would clearly impact on the profit lines of the Operators. [350, 386 - 388]

439. Weighed against the current financial and competitive situation of the Operators is the need for DHB to secure delivery of T2 at the appropriate time by the accrual of a cash surplus. I have already noted that, given the latest projections of timescales and costs, even if the Board were not to accrue any cash surpluses in 2010 and 2011 it would still be able to borrow within the limits that it considers realistic. However, the Board's borrowings would come very close to its expected limits and the Board would have little scope for any contingencies. Both the income and cost projections used to derive the long term cash flow must be subject to uncertainties. [392 - 394]

440. Clearly the matter is one of balance. The 2010 tariff has been set at a level at which the Board's cash surplus has increased - which in consequence has reduced the risk associated with the timely delivery of T2. At the same time the 2010 tariff

is unlikely to have materially distorted competition. Against that, the 2010 tariff has had a direct effect on the Operators' bottom lines and the lack of further accruals in 2010 (or indeed 2011) would not inevitably mean delays to T2.

441. I note that, when the port was running near to capacity in 2007/8, there were a number of occasions where congestion at the port led to considerable traffic congestion in the town as vehicles spilled out onto the surrounding roads. If T2 was not delivered at the time it was required, the experiences of 2007/8 suggest that the consequences for future stakeholders of the port, particularly the ferry operators and the local community, would be potentially very severe.

442. MTP2 notes at 1.1.4 that a trust port is a "*valuable asset presently safeguarded by the existing board, whose duty is to hand it on in the same or better condition to succeeding generations. This remains the ultimate responsibility of the board, and future generations remain the ultimate stakeholder*." Bearing in mind this responsibility to future generations, the development timescales involved in major infrastructure investment, the consequences of failure to deliver T2 at the required time and the government guidance that "*Trust ports can expect to generate a significant return*" MTP2 (1.4.1), I take the view that, on balance, the dues can be regarded as reasonable.

443. In the event that the SoS disagrees with this conclusion and considers it unreasonable that the Board should make further cash accruals in the prevailing economic climate it would be possible to make a direction, similar to that proposed in Annex 4 to the Operators' closing submissions, of the form that 'the Board is required to reduce the 2010 ferry tariffs by X%, the value of 'X' being such that the Board's cash accrual for 2010 is zero'.

444. Although DHB suggests in INQ/41/DHB that such an approach could be discriminatory to other users of the port, I have already noted that I do not see a lack of detailed cost allocations in DHB's accounting practices as being sufficient reason to prevent the SoS from giving the harbour authority *"... such direction with respect to the charge as would meet objection thereto..."*. DHB accepts that the majority of the cash accrual is likely to have been garnered through the ferry tariffs and as the Operators point out, no objections have been raised to the cruise or other tariffs. If, again, the SoS disagrees, an alternative would be a direction of the form "……..the value of 'X' being such that the total cash accrued in 2010 is reduced by an amount equivalent to the ferry revenues as a proportion of the port's total revenues". In other words, if the ferry revenues represent 60% of the port's total revenues, then 'X' should be set at a figure that reduces the cash surplus accrued in 2010 by 60%. [414-416]

Has the Board abused its position?

445. I have already established that the Board occupies a dominant position in respect of the ferry operators. The question is whether or not the Board has, in setting its tariffs, abused that dominant position. [100/Annex G]

446. It is agreed between the Operators and DHB that the imposition of unfair or excessive prices can constitute an abuse of a dominant position. However, I see no need for the SoS to re-run the arguments under the framework of competition law to determine whether or not the prices set by the Board are an abuse of its dominant position.

447. If the dues are adjudged to be commercial and competitive, fair and equitable and in all respects reasonable, I see no reason to believe that they should be construed as constituting an abuse of the Board's position. Conversely, if the SoS considers it necessary to make a direction in order to meet the objections then that direction would itself be likely to acknowledge abuse. However, in making the direction, the SoS would be ensuring that the charges became commercial and competitive, fair and equitable and in all respects reasonable. I therefore see no need to consider this matter further.

The 2011 tariff

448. The 2011 tariff was not derived from a rebasing exercise but was instead set by applying a percentage increase to the 2010 rates. The RPI figure chosen was that for July 2010. The Inquiry was given to understand that, prior to its cash accrual exercise DHB had conventionally used RPI in the setting of its tariffs. [165]

449. The Operators raise the same objections to the 2011 tariffs that they raise to the 2010 tariffs but in addition consider the Board's chosen inflationary increase to be too high. In this they argue not only that CPI should have been used as opposed to RPI (in that it is said to be less volatile) but also that the RPI figure chosen by DHB was itself unrepresentatively high of actual inflation. [101,102]

450. I do not propose to deal with the 2011 tariff in any depth as, other than the percentage increase the arguments would be similar to those for 2010. I shall therefore focus solely on the matter of the percentage increase applied by DHB.

451. Turning first to the matter of CPI vs RPI, although CPI is used by Government in a range of situations and may be a less volatile measure than RPI the Inquiry heard little in the way of cogent evidence to show why it was a more appropriate measure to use in this situation. Indeed the Operators' own evidence[219] shows that all of the regulated businesses referred to experience price controls based on an 'RPI-X' formula rather than a 'CPI-X' approach. Although DHB is not regulated, little other evidence was provided. With respect to the chosen figure being 'unrepresentatively high' DHB stated that it had chosen the July RPI figure as that was the month it had traditionally used in setting its tariffs. DHB also pointed out that, rather than being 'unrepresentatively high' the July RPI figure was actually lower than in any of the preceding three months. [167]

452. The Operators have questioned the Board's motivations in setting the 2011 tariff - referring particularly to the expression used in the discussion on the preliminary strategy for the 2011 tariff in which members suggest that "……..to go lower would show weakness" before agreeing that the tariff increase should be based on RPI.[220] I can understand the Operators' concerns with this comment and it could be argued to be in conflict with the fundamental principle of a trust port - which is that it is run by an independent board for the benefit of stakeholders. The ferry operators are arguably the most important of those stakeholders at Dover. [101]

453. However, MTP2 also recognises at 1.1.5 that it is the duty of the Board to strike a balance that fully respects the interests of all stakeholders, not just one group. DHB confirmed that the 2011 tariff had been set at a level that, whilst it did not

[219] INQ/10/P Rebuttal proof of Mr Harman Table 2.5 p26
[220] INQ/03/A Appendix 11 Extract from the Board's minutes dated 28 September 2010

deliver what the Board thought it needed, delivered the best that the Board thought it could get bearing in mind the difficult trading conditions for the Operators and the objections to the 2010 tariff.

454. It is understandable that the Operators would prefer to see the use of what would have been a lower CPI figure and the Board's approach could be seen as being somewhat insensitive. However, taking account of all the evidence submitted to the Inquiry I can see no cogent reason for seeking to overturn the Board's chosen inflationary figure in arriving at the 2011 tariff.

Summary of Conclusions

455. There is no legislation which expressly sets out the considerations which the Secretary of State should have in mind when considering an objection under Section 31 of the Harbours Act 1964. However, I have attached substantial weight to both government guidance and the note written by the SoS on reaching decisions under section 31 of the Harbours Act 1964 (DfT, June 2011). Although the SoS will clearly need to have regard to the legal submissions of the main parties in respect of EU and UK competition law, in the absence of any determination by a competent authority as to the applicability of and compliance with these laws I have given these arguments little weight in arriving at my recommendations. [248-256, 257-263, 269, 282]

456. The construction of the Act means that the objection process could be used annually. Therefore, whilst both the 2010 and 2011 charging years are likely to have passed by the time any decision is made, if the SoS is of the view that the objections are made out then the appropriate course of action would be to make 2 directions:

(a) a direction in respect of 2010 coming into force on 1 January 2010 and lasting for a period of 12 months; and

(b) a direction in respect of 2011 coming into force on 1 January 2011 and lasting for a period of 12 months.

However, if the SoS were to make a direction that led to the Board's cash reserves being less than at the start of 2010, this would in effect determine that the charges made in earlier years were too high. This would, in my view, exceed the remit of the Inquiry and the powers of the SoS. [271-277]

457. Despite the Operators' concerns as to the potential future privatisation of the port I have considered the objections in the context of Dover's current status as a trust port. [285]

458. In considering the dues, three key, overarching issues needed to be addressed: whether the dues are commercial and competitive, whether they are fair and equitable and whether, in all respects, they are reasonable. In order to inform my assessments in each of these areas I have examined a range of factors including the competitive position of DHB in the market place, comparator ports, theoretical pricing models, the economic and commercial climate as well as the proposals for T2 and the Board's cash surplus. [289]

459. Taking account of the charges at Calais (said to be the most comparable port to Dover), comparisons with a range of KPIs from several other trust ports and comparisons with theoretical pricing models provided by both DHB and the

Operators I have come to the view that the dues can be regarded as being both commercial and competitive. [417-423]

460. In looking at whether the dues are both fair and equitable little evidence was put forward as to the manner in which costs were allocated across the port and consequently whether the dues were reflective of the manner in which costs are incurred. However, whilst not determinative, the evidence that was put forward suggests that there is no material cross subsidy between the ferry and non-ferry operators. Although cruise operators, unlike ferry operators, are offered volume discounts this does not itself lead to the conclusion that the ferry tariffs are unfair or inequitable. No persuasive evidence was put forward to show that the port's operating and short term capital expenditure was being inefficiently incurred.

461. Although the Board has adopted a commercially unusual approach to funding the proposed significant future capital investment in T2, the Board's approach has a logical and understandable basis that has not previously been objected to by the Operators. Whilst the ferry operators are likely to contribute the majority of any cash accruals, MTP2 is clear that there should be no presumption that dues levied on a specific group or type of user should be exclusively reinvested in improving services and facilities on offer to that user. In light of the further guidance in MTP1 as to what may constitute fair and equitable I have found no reason to consider the tariffs unfair or inequitable. [424-434]

462. Although the Board's accrual of a cash balance will affect the Operators' bottom lines in what is a difficult economic and commercial climate it is unlikely to materially distort competition. Bearing in mind the Board's responsibilities to future stakeholders and the potentially severe consequences of not delivering T2 when it is needed, I conclude that the dues can, on balance, be regarded as reasonable. [435-442]

463. The Operators allege that the dues are excessive in that they generate an excessive profit per se; an excessive profit by market comparison; constitute an abuse of a dominant position; take into account matters they should not such as T2 and privatisation; fail to take account of the ILO outsourcing and fail to acknowledge the current commercial pressures on the Operators.

464. For the reasons above I do not find that these objections have been made out. Although the Operators have also raised concerns over the Board's approach, and some of the expressions put before the Inquiry could be construed as being somewhat insensitive, having found the 2010 dues to be commercial and competitive, fair and equitable and, on balance, reasonable I see no compelling reason to interfere with the 2010 dues as imposed.

465. In respect of the 2011 dues it is my view that there are no cogent reasons for seeking to overturn the Board's chosen inflationary figure used in deriving the 2011 tariff.

466. Therefore, and having had regard to all other matters before me, including the further written representations [230-246], it is my view that the SoS should approve the charges for both 2010 and 2011.

467. However, in the event that the SoS disagrees with my findings, two separate directions will be needed, one in respect of each year under consideration. [443, 444] As noted, each direction will need to specify a date for its coming into

operation and the period from that date (which shall not exceed 12 months) during which it is to have effect [456].

Recommendation

468. **I recommend** that, in accordance with section 31(6)(a) of the Harbours Act 1964, the Secretary of State should approve the charges demanded by Dover Harbour Board for both 2010 and 2011.

Lloyd Rodgers

Inspector

ANNEX A

APPEARANCES

FOR THE DOVER HARBOUR BOARD:

Mr Tom Hill QC	Instructed by Eversheds LLP
He called	
Mr Robert Goldfield	CEO & Register of the Dover Harbour Board
Mr Michael Krayenbrink	Director of Port Development, DHB
Mr Timothy Waggott	Director of Finance and Commercial, DHB
Mr Timothy Ogier	Partner, PricewaterhouseCoopers

FOR THE OPERATORS:

Mr Fergus Randolph QC	Instructed jointly by Bircham Dyson Bell LLP, Clyde & Co LLP and Hill Dickinson LLP
He called	
Mr Robin Wilkins	Managing Director, SeaFrance (UK)
Mr Jesper Christensen	Operations Director, DFDS Seaways
Mrs Helen Deeble	Chief Executive Officer, P&O Ferries
Mr Karl Howarth	Chief Financial Officer, P&O Ferries
Mr Ian Chadney	Port Operations Executive, Moffat & Nichol
Mr Nigel Pusey	Shipping Consultant, Moffat & Nichol
Mr Greg Harman	Senior Managing Director at FTI Consulting

ANNEX B

CORE DOCUMENTS

CD/01
Objections and Representations

2010

CD/01/01 Objection of DFDS to 2010 Tariff (17 June 2010)
CD/01/02 Objection of P&O Ferries to 2010 Tariff (24 June 2010)
CD/01/03 Representations on behalf of the Board of Trustees of DHB Pension and Life Assurance Scheme (18 August 2010)
CD/01/04 Representations by Kevin Richardson (20 August 2010)
CD/01/05 Representations by William Read (undated)
CD/01/06 Representations on behalf of the National Union of Rail, Maritime & Transport Workers (17 September 2010)
CD/01/07 Representations by DHB (24 August 2010)
CD/01/08 Letter from SeaFrance to the Department for Transport (12 August 2010) and Objection of SeaFrance to 2010 Tariff (3 September 2010) (allowed as a representation)
CD/01/09 Further representations by DFDS (11 November 2010)
CD/01/10 Further representations by P&O Ferries (12 November 2010)

2011

CD/01/11 Objection of P&O Ferries to 2011 Tariff (7 February 2011)
CD/01/12 Representations on behalf of the Board of Trustees of DHB Pension and Life Assurance Scheme (25 March 2011)
CD/01/13 Representations by DHB (7 April 2011)
CD/01/14 Objection of SeaFrance to 2011 Tariff (redacted version) (12 April 2011)
CD/01/15 Objection of DFDS to 2011 Tariff (13 May 2011)(allowed as a representation)

CD/02
Notices

2010

CD/02/01 Notice of P&O Ferries' objection to 2010 Tariff in Dover Express (15 July 2010)
CD/02/02 Notice of P&O Ferries' objection to 2010 Tariff in Lloyd's List (16 July 2010)
CD/02/03 Notice of P&O Ferries' objection to 2010 Tariff in Folkestone Herald (15 July 2010)
CD/02/04 Notice of DFDS's objection to 2010 Tariff in Dover Express (22 July 2010)
CD/02/05 Notice of DFDS's objection to 2010 Tariff in Lloyd's List (14 July 2010)
CD/02/06 Notice of DFDS's objection to 2010 Tariff in Folkestone Herald (undated)

2011

CD/02/07 Notice of P&O Ferries' objection to 2011 Tariff in Dover Express (25 February 2011)
CD/02/08 Notice of P&O Ferries' objection to 2011 Tariff in Lloyd's List (24 February 2011)
CD/02/09 Notice of P&O Ferries' objection to 2011 Tariff in Folkestone Herald (24 February 2011)
CD/02/10 Notice of SeaFrance's objection to 2011 Tariff in Dover Express (10 March 2011)

CD/02
Notices (Contd)

2011

CD/02/11 Notice of SeaFrance's objection to 2011 Tariff in Lloyd's List (10 March 2011)
CD/02/12 Notice of SeaFrance's objection to 2011 Tariff in Folkestone Herald (10 March 2011)
CD/02/13 Notice of DFDS's objection to 2011 Tariff in Dover Express (undated)

CD/03
Ferry Tariffs

CD/03/01 Dover Harbour Board Ferry Tariffs 2007
CD/03/02 Dover Harbour Board Ferry Tariffs 2008
CD/03/03 Dover Harbour Board Ferry Tariffs 2009
CD/03/04 Dover Harbour Board Ferry Tariffs 2010
CD/03/05 Dover Harbour Board Ferry Tariffs 2011

CD/04
Plans

CD/04/01 Plan showing Port of Dover layout
CD/04/02 Plan showing location of relevant activities at Eastern Docks
CD/04/03 Plan showing location of relevant activities at Western Docks
CD/04/04 Layout plan and computer generated image for T2

CD/05
Legislation

CD/05/01 Harbour and Passing Tolls, &c. Act 1861
CD/05/02 Dover Harbour Consolidation Act 1954
CD/05/03 Harbours Act 1964
CD/05/04 Pilotage Act 1987
CD/05/05 Ports Act 1991
CD/05/06 The Highways (Inquiries Procedure) Rules 1994
CD/05/07 Dover Harbour Board Revision Order 2006/2167

CD/06
Policy and Guidance

CD/06/01 Modernising Trust Ports: A Guide to Good Governance (DETR, January 2000)
CD/06/02 Port Marine Safety Code (DETR, March 2000)
CD/06/03 Modern Ports: A UK Policy (DfT, November 2000)
CD/06/04 The Green Book (Appraisal and Evaluation in Central Government) (2003)
CD/06/05 PPRO 4/039/0003 Trust Port Advice Final Report (DfT, May 2007)
CD/06/06 Modernising Trust Ports (second edition) (DETR, August 2009)
CD/06/07 Port Marine Safety Code (DETR, October 2009 revision)
CD/06/08 Infrastructure Ownership and Control Stock-take – Final Report: Main Findings (OFT, December 2010)
CD/06/09 Infrastructure Ownership and Control Stock-take – Final Report: Case study annexes
CD/06/10 Note on role of Secretary of State in reaching decisions under section 31 of the Harbours Act 1964 (DfT, June 2011)

CD/06
Policy and Guidance (Contd)

CD/06/11 Decision letter issued by DfT on Objection to charges levied by Langstone Harbour Board (30 June 2010)
CD/06/12 Report to the Secretary of State for Transport on Objection to Harbour Dues at Langstone Harbour (18 February 2010)
CD/06/13 Decision letter issued by DfT on Objection to charges levied by Bembridge Harbour Board (14 October 2010)
CD/06/14 Report to the Secretary of State for Transport on Objection to Harbour Dues at Bembridge Harbour (2 March 2010)

CD/07
DHB Operational Framework

CD/07/01 Dover Harbour Board Chart of Organisation & Personnel
CD/07/02 DHB Mission Statement

CD/08
Financial Information

CD/08/01 Port of Dover Annual Report & Accounts 2007
CD/08/02 Port of Dover Annual Report & Accounts 2008
CD/08/03 Port of Dover Annual Report & Accounts 2009
CD/08/04 Port of Dover Annual Report & Accounts 2010

CD/09
Port Development Documents

CD/09/01 Port of Dover 30 Year Master Plan Zoning Report (July 2005)
CD/09/02 Dover Harbour Board Planning for the Next Generation - Overview of Proposals (March 2006)
CD/09/03 Dover Harbour Board: Port of Dover Economic Impact Assessment Final Report (Ove Arup & Partners Ltd, November 2006)
CD/09/04 Dover Harbour Board: Planning for the Next Generation – Second Round Consultation Document (January 2007)
CD/09/05 Dover Harbour Board: Planning for the Next Generation – Third Round Consultation Document (May 2008)
CD/09/06 Dover Harbour Board: Development Plan – A Regeneration Opportunity for Port and Town (May 2008)
CD/09/07 Dover Terminal 2 Environmental Statement: Non Technical Summary (December 2009)
CD/09/08 Harbour Revision Order formal statutory application (December 2009)
CD/09/09 Dover Harbour Board: Our Plan for the Next Generation Ferry Terminal 2 (January 2010)
CD/09/10 Representations of SeaFrance SA, P&O Short Sea Ferries Limited and Norfolkline Shipping B.V. on the HRO application (4 March 2010)
CD/09/11 Development and Planning Performance Report (May 2011)
CD/09/12 Port of Dover Performance Report 2007 (May 2008)
CD/09/13 Port of Dover Strategic Review 2008 (May 2009)
CD/09/14 Port of Dover Strategic Review 2009 (April 2010)
CD/09/15 Port of Dover Strategic Review 2010 (May 2011)

CD/10
Corporate Restructuring of the Port of Dover

CD/10/01 Dover Harbour Board: A Change of Corporate Structure for the Port of Dover (stakeholder briefing) (January 2010)
CD/10/02 Official Details of the Dover Harbour Board Transfer Scheme (January 2010)
CD/10/03 Articles of Association of Port of Dover Limited (successor company) (January 2010)
CD/10/04 Department for Transport: Ports Act 1991 The Dover Harbour Board Transfer Scheme (public notice) (February 2010)
CD/10/05 Dover Harbour Board: The Case for a Change of Corporate Structure for the Port of Dover (February 2010)
CD/10/06 Announcement of the Parliamentary Under-Secretary of State (Mike Penning MP) regarding further consultation on Dover Harbour Board's Transfer Scheme (21 July 2010)
CD/10/07 Department for Transport: Ports Act 1991 The Dover Harbour Board Transfer Scheme (public notice) (29 July 2010)
CD/10/08 Dover Harbour Board: Introduction by the Chairman to the Board's revised and more detailed proposals for voluntary privatisation of the Port of Dover (30 July 2010)
CD/10/09 Dover Harbour Board Scheme Information Document: a new corporate structure for the Port of Dover (30 July 2010)
CD/10/10 Secretary of State for Transport's guidance note concerning procedure for sale of Trust Ports (3 August 2011)
CD/10/11 Letter from the Rt. Hon. Theresa Villiers to DHB (3 August 2011)
CD/10/12 Letter from DHB to the Rt. Hon. Theresa Villiers (13 August 2011)

CD/11
Minutes of the Port User Groups

CD/11/01 Ferry Port User Group Commercial Sub-Group of 27 February 2009
CD/11/02 Ferry Port User Group of 2 June 2009
CD/11/03 Ferry Port User Group Commercial Sub-Group of 24 June 2009
CD/11/04 Dover Port User Group of 30 July 2009
CD/11/05 Ferry Port User Group Commercial Sub-Group of 11 September 2009
CD/11/06 Ferry Port User Group of 21 September 2009
CD/11/07 Ferry Port User Group of 14 December 2009
CD/11/08 Ferry Port User Group Commercial Sub-Group of 20 April 2010
CD/11/09 Ferry Port User Group of 7 May 2010
CD/11/10 Ferry Port User Group of 29 November 2010
CD/11/11 Ferry Port User Group Commercial Sub-Group of 17 February 2011
CD/11/12 Ferry Port User Group of 12 May 2011
CD/11/13 Ferry Port User Group Commercial Sub-Group of 15 June 2011

CD/12
Notes of Port Consultative Committee Minutes (PCC)

CD/12/01 PCC of 9 June 2009
CD/12/02 PCC of 16 September 2009
CD/12/03 PCC of 3 February 2010
CD/12/04 PCC of 10 June 2010
CD/12/05 PCC of 5 January 2011
CD/12/06 PCC of 10 March 2011
CD/12/07 PCC of 9 June 2011

CD/13
Miscellaneous

CD/13/01	Memorandum to the Members of Dover Harbour Board Pension and Life Assurance Scheme (27 July 2010)
CD/13/02	Pre-Inquiry Meeting Note issued by Inspector (19 July 2011)
CD/13/03	Notes of Pre-Inquiry Meeting held on 11 August 2011

ANNEX C

INQUIRY DOCUMENTS

DOCUMENTS SUBMITTED PRIOR TO THE INQUIRY OPENING

INQ/01/P	Proof of Evidence of Mr Robert Goldfield
INQ/01/S	*Summary proof of evidence*
INQ/01/A	*Appendices*
INQ/01/R	*Rebuttal including appendices*
INQ/02/P	Proof of Evidence of Mr Michael Krayenbrink
INQ/02/S	*Summary proof of evidence*
INQ/02/A	*Appendices*
INQ/02/R	*Rebuttal including appendices*
INQ/03/P	Proof of Evidence of Mr Timothy Waggott
INQ/03/S	*Summary proof of evidence*
INQ/03/A	*Appendices*
INQ/03/R	*Rebuttal including appendices*
INQ/04/P	Proof of Evidence of Mr Timothy Ogier, including summary proof
INQ/04/A	*Appendices*
INQ/04/R	*Rebuttal*
INQ/05/P	Proof of Evidence of Mr Jesper Christensen
INQ/05/S	*Summary proof of evidence*
INQ/05/A	*Appendix*
INQ/06/P	Proof of Evidence of Mr Robin Wilkins
INQ/06/S	*Summary proof of evidence*
INQ/06/A	*Appendices*
INQ/07/P	Proof of Evidence of Ms Helen Deeble
INQ/07/S	*Summary proof of evidence*
INQ/07/A	*Appendices*
INQ/08/P	Proof of Evidence of Mr Karl Howarth
INQ/09/P	Joint Proof of Evidence of Mr Ian Chadney & Mr Nigel Pusey
INQ/09/S	*Joint Summary proof of Evidence*
INQ/09/A	*Appendices*
INQ/10/P	Rebuttal proof of Mr Greg Harman (NB. Document marked as INQ/10/R/P)
INQ/10/S	*Summary rebuttal proof (NB. Document marked as INQ/10/R/S)*
INQ/10/A	*Appendices (NB. Document marked as INQ/10/RA)*

DOCUMENTS SUBMITTED AT THE INQUIRY

INQ/11/OBJ	DFDS proposals regarding the correct level dues – 12/09/11
INQ/11A/OBJ	DFDS supplementary note regarding the correct level of dues
INQ/12/OBJ	SeaFrance position – correct dues 12/09/11
INQ/13/OBJ	P&O Ferries position – correct dues 12/09/11
INQ/13A/OBJ	P&O note – Real versus Nominal Rates of Return
INQ/14/DHB	Opening Submission of Mr Thomas Hill QC for DHB 13/09/11
INQ/15/OBJ	Opening Submission of Mr Fergus Randolph QC for the Operators 13/09/11
INQ/16/DHB	Letter - Eversheds to DfT dated 06/09/11
INQ/17/DHB	Email – DfT to Eversheds dated 08/09/11
INQ/18/OBJ	DFDS proposals regarding the correct level of dues – supplementary note 12/09/11

DOCUMENTS SUBMITTED AT THE INQUIRY (CONTD)

INQ/18A/OBJ	DFDS proposals regarding the correct level of dues – second supplementary note 26/09/11
INQ/19/OBJ	P&O proposals for the correct level of dues – 13/09/11
INQ/19A/OBJ	P&O justification for recommended 80% of CPI tariff increase for 2011
INQ/20/OBJ	SeaFrance proposed reduction of 2010 & 2011 DHB tariffs – 13/09/11
INQ/20A/OBJ	Third Supplementary Note – SeaFrance proposed reduction of the 2010 & 2011 DHB Tariffs
INQ/21/OBJ	Operators' opening submission (Part I): dominance & competition
INQ/22/OBJ	Operators' opening submission (Part II): general matters
INQ/23/DHB	Summary of operator charging proposals – DHB assumptions 2010 & 2011
INQ/24/DHB	Operator charging proposals summarised
INQ/25/DHB	Sample capital works updates at the Technical & Operational Sub-Group of the Ferry Users Group Meetings
INQ/26/DHB	Ogier/Harman – Note of common/uncommon ground
INQ/27/DHB	Market Investigation References: Competition Commission Guidelines June 2003 - extract
INQ/28/DHB	e-mail from Julian Smith of PwC ref. assessment of Dover's charges/PwC advice to DfT
INQ/29/DHB	DHB projected cashflow schedule 2011-2021
INQ/30/OBJ	Note on Ports Act 1991 & proceeds of purchase
INQ/31/OBJ/P	Supplemental proof of Mr Nigel Pusey
INQ/32/OBJ	Market Investigation References: Competition Commission Guidelines June 2003
INQ/33/OBJ	SeaFrance - Dues as a % of turnover 2009/2010
INQ/34/OBJ	Letter and attachments Bircham Dyson Bell to Eversheds dated 24 August 2011
INQ/35/DHB	Dredged level at the Port of Ramsgate
INQ/36/DHB	Expert economic witness variance – changing 3 key assumptions
INQ/37/OBJ	Impact of 2010 Tariff change on P&O Ferries
INQ/38/OBJ	Note on the form of SoS's Direction & question of rebate
INQ/39/DHB	UK regulatory precedent – weighted average cost of capital
INQ/40/OBJ	e-mail Eversheds to Operators' Solicitors dated 23/09/11 regarding DHB rate of 12% for new investments
INQ/41/DHB	DHB's analysis of operators' tariff proposals
INQ/42/DHB	Graphs showing return on replacement & historic costs at real & nominal returns; range of inflation percentages
INQ/43/OBJ	Cross Channel Statistics 2011 Quarter 1 and Quarter 2
INQ/44/DHB	DHB response on matters of dominance & competition
INQ/45/DHB	DHB note on the form of the SoS Direction & the question of a rebate
INQ/46/OBJ	Operators' closing submissions (Mr Fergus Randolph QC)
INQ/47/DHB	DHB closing submissions (Mr Thomas Hill QC)
INQ/48/OBJ	Bundle of daily transcripts

ANNEX D

LEGAL SUBMISSIONS ON BEHALF OF THE OPERATORS[1]

General

1. These written legal submissions are presented to the Inquiry on behalf of all of the Ferry Operators as to matters of dominance and competition.

Introduction

2. These submissions set out the Operators' case that the Board is an undertaking that occupies a dominant position in the relevant market in which it provides port services to the Operators and has infringed and continues to infringe the prohibition in Article 102 of the Treaty on the Functioning of the European Union ("TFEU") and the corresponding prohibition in Chapter II of the UK Competition Act 1998 insofar as the levels of dues charged by it in 2010 and 2011 respectively are excessive in comparison to the Board's relevant costs.

3. Article 102 TFEU prohibits as incompatible with the internal market the abuse by one or more undertakings of a dominant position within the internal market or in substantial part of it, insofar as it may affect trade between Member States. Such abuse may consist of "*directly or indirectly imposing unfair purchase or selling prices or unfair trading conditions*".

4. For the purposes of the application of Article 102 TFEU and Chapter II of the UK Competition Act 1998 the Board is an undertaking as held by the ECJ:

> "36. …[A]ccording to settled case-law, the concept of an undertaking covers any entity engaged in an economic activity, regardless of its legal status and the way in which it is financed[2], and that any activity consisting in offering goods and services on a given market is an economic activity […] ".[3] [4]

Key legal concepts

5. There are therefore two key legal concepts, dominance and abuse, relevant to the application of the prohibition that are defined in the relevant case law as follows:

(a) Dominance

6. In one of the leading cases on the definition of a dominant position, *Hoffmann-La Roche*[5] , the ECJ held –

> "38 Article [102] is an application of the general objective of the activities of the [European Union] laid down by Article 3(f) of the Treaty [now superseded]

[1] Submitted as INQ/21/OBJ and Annex 3 to INQ/46/OBJ
[2] Case C-41/90 Höfner and Elser [1991] ECR I-1979, paragraph 21; Case C-244/94 Fédération Française des Sociétés d'Assurances and Others v Ministère de l'Agriculture et de la Pêche [1995] ECR I-4013, paragraph 14; and Case C-55/96 Job Centre [1997] ECR I-7119, paragraph 21
[3] Case 118/85 Commission v Italy [1987] ECR 2599, paragraph 7
[4] Case C-35/96, Commission v Italian Republic, ECR [1998] I-03851
[5] Case 85/76 Hoffmann-La Roche v Commission [1979] ECR 461, paragraph 91

namely, the institution of a system ensuring that competition in the common market is not distorted.

Article [102] prohibits any abuse by an undertaking of a dominant position in a substantial part of the common market in so far as it may affect trade between Member States.

The dominant position thus referred to relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers.

39 Such a position does not preclude some competition, which it does where there is a monopoly or a quasi-monopoly, but enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the conditions under which that competition will develop, and in any case to act largely in disregard of it so long as such conduct does not operate to its detriment."

(b) Abuse

7. In *Michelin II*[6] , the ECJ held that –

"54. …[T]he Court points out that, according to a consistent line of decisions, an 'abuse' is an objective concept referring to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is already weakened and which, through recourse to methods different from those governing normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition […].[7]

55. Therefore, whilst the finding that a dominant position exists does not in itself imply any reproach to the undertaking concerned, it has a special responsibility, irrespective of the causes of that position, not to allow its conduct to impair genuine undistorted competition on the common market (Michelin v Commission, cited at paragraph 54 above, paragraph 57, and Irish Sugar v Commission, cited at paragraph 54 above, paragraph 112). Similarly, whilst the fact that an undertaking is in a dominant position cannot deprive it of its entitlement to protect its own commercial interests when they are attacked, and whilst such an undertaking must be allowed the right to take such reasonable steps as it deems appropriate to protect those interests, such behaviour cannot be allowed if its purpose is to strengthen that dominant position and thereby abuse it […]."[8]

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[6] Case T-203/01, Michelin v Commission, [2003] ECR II-4071

[7] Case 85/76 Hoffmann-La Roche v Commission [1979] ECR 461, paragraph 91; Case 322/81 Michelin v Commission [1983] ECR 3461, paragraph 70; Case C-62/86 AKZO v Commission [1991] ECR I-3359, paragraph 69; and Case T-228/97 Irish Sugar v Commission [1999] ECR II-2969, paragraph 111

[8] Case 27/76 United Brands v Commission [1978] ECR 207, paragraph 189; Case T-65/89 BPB Industries and British Gypsum v Commission [1993] ECR II-389, paragraph 69; Joined

8. And similarly at paragraph 97 –

> "…[I]t must be borne in mind that an undertaking in a dominant position has a special responsibility not to allow its conduct to impair genuine undistorted competition on the common market (*Michelin v Commission*, cited at paragraph 55 above, paragraph 57)."

9. In the leading case on pricing abuse, *United Brands*[9], the ECJ defined the necessary conditions for a finding of an excessive or unfair pricing abuse prohibited by Article 102 TFEU.

10. In paragraph 250 of its judgment the ECJ stated that "*charging a price which is excessive because it has no reasonable relation to the economic value of the product supplied would be such an abuse*".

11. The Court did not specifically set out how the "economic value" of a product should be determined, although it stated in paragraph 251 of its judgment that "*the excess could, inter alia, be determined objectively if it were possible for it to be calculated by making a comparison between the selling price of the product in question and its cost of production, which could disclose the amount of the profit margin*". The Court further stated in paragraph 252 that *"[t]he questions therefore to be determined are whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative, whether a price has been imposed which is either unfair in itself or when compared to competing products*".

12. The European Commission followed that approach in its decision in Case COMP/36.568 *Scandlines Sverige v Port of Helsingborg* (hereafter "*Helsingborg*")[10] where it held that –

> "the decisive test in *United Brands* focuses on the price charged, and its relation to the *economic value* of the product. While a comparison of prices and costs, which reveals the profit margin, of a particular company may serve as a first step in the analysis (if at all possible to calculate), this in itself cannot be conclusive as regards the existence of an abuse under Article 82."[11]

13. In paragraph 103 of its *Helsingborg* decision, the Commission stated that it would "*follow the methodology set out by the Court in paragraph 252 of the* United Brands *judgement. The Commission will therefore assess the costs actually incurred by HHAB in providing the products/services in question (the costs of production) and make a comparison with the prices actually charged (section II.B.2.1). The Commission will then assess whether the prices are unfair when compared to prices charged to other users or by other ports (section II.B.2.2), or whether the prices are unfair in themselves (section II.B.2.3)*."

14. Chapter II of the Competition Act of 1998 ("CA 1998") contains substantive provisions that correspond to the provisions of Article 102 TFEU in all material

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Cases T-24/93 to T-26/93 and T-28/93 Compagnie Maritime Belge Transports and Others v Commission [1996] ECR II-1201, paragraph 107; and Irish Sugar v Commission, cited above, paragraph 112

[9] Case 27/76, United Brands v Commission [1978] ECR 207

[10] See further note 15 and corresponding text

[11] Ibid. at paragraph 102

respects. The legal position regarding abuse of dominance by port authorities is therefore the same in the UK and under EU law.

Special or exclusive rights

15. It is settled EU law that, where Member States assign special and exclusive public rights to an undertaking, Member States are under a duty to ensure that the rules of the TFEU are not compromised. This duty extends particularly to the observance of EU competition rules.

16. Article 106(1) TFEU provides in terms that

> "... in the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 18 and Articles 101-109." [*scil*. the EU competition rules].

17. Article 106 TFEU has been interpreted by the ECJ[12] as creating special and exclusive rights where

> "protection is conferred by legislative measures on a limited number of undertakings which may substantially affect the ability of other undertakings to supervise the economic activity in question in the same geographical area under substantially equivalent conditions".

The applicability of EU/UK competition law to the Board

18. Under UK law, the provision of public harbours has been a prerogative of the Crown and some form of state authorisation has always been needed to allow persons to provide a harbour or otherwise take control of public rights of navigation and to charge for doing so. In current times that authorisation has been granted by an Act of Parliament and, most recently, by Order under s16 of the Harbours Act 1964. As such within the UK, all harbour authorities are granted exclusive rights to administer the harbours within their jurisdiction and to levy ship, passenger and/or goods dues in respect of the use of those harbours.

19. Under the Dover legislation, the Board is entrusted with the exclusive right of administering, maintaining and improving Dover Harbour. As a harbour authority, the Board has the power under s26(2) of the Harbours Act 1964 to "demand, take and recover such ship, passenger and goods dues as they think fit" at Dover Harbour in relation to the harbour functions with which it is entrusted by the Dover legislation.

20. Given its position under the Dover legislation as the exclusive provider of ferry port harbour facilities at Dover Harbour, and in particular its ability to levy ship, passenger and goods dues, the Board has the ability to, and does in fact, affect the ability of the ferry operators using Dover Harbour to exercise their own economic activities."

21. The Board should therefore be considered an undertaking to which a Member State has assigned special and exclusive public rights to which the provisions of Article 106 (1) TFEU therefore apply. However, Article 106 TFEU makes it clear that the

[12] See case C-475/99 Firma Ambulanz Glöckner v Landkreis Südwestpfalz at paragraph 24

fact that an undertaking has such a status does not derogate from its duty to comply with the competition rules, including in this particular case the duty of a dominant undertaking not to abuse that position by means of excessive or unfair pricing practices. That obligation is acknowledged and echoed in the guidance in MTP2 (para 1.2.3).

22. Thus the provision by the Board of harbour facilities at Dover Harbour and the setting by the Board of the passenger, ship and goods dues charged in respect of the provision of such facilities are fully subject to the competition rules of the TFEU and/or UK competition law. Like all other public entities in the United Kingdom, including other trust ports, the Board is thus under a duty to ensure that their actions conform to EU and UK competition legislation and the Board's statutory duties and powers under the relevant domestic legislation must be exercised in the light of its overriding Union law duties as indicated in MTP2.

23. The Secretary of State will, in making her decision in relation to the SPG dues under s31 of the Harbours Act 1964 not only take into account the guidance in MTP2 but will of course in relation to the question of any abuse by the Board of a dominant position need to ensure that her decision, and the process by which her decision is reached, ensures that both she and the Board comply with the obligations imposed on the United Kingdom Article 106 (1) TFEU not to enact or maintain in force any measure contrary to the rules contained in the TFEU.

The relevant market

24. The definition of the relevant market is of paramount importance and a prerequisite to the application of EU and UK competition rules as this sets the economic parameters within which the question of dominance has to be assessed.

25. As explained in the European Commission's ("Commission") Relevant Market Notice:

> "The main purpose of market definition is to identify in a systematic way the competitive constraints that the undertakings involved face. The objective of defining a market in both its product and geographic dimension is to identify those actual competitors of the undertakings involved that are capable of constraining those undertakings' behaviour and of preventing them from behaving independently of effective competitive pressure."[13]

26. At paragraph 13 the Commission states that –

> "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, in particular in relation to their pricing decisions. A firm or a group of firms cannot have a significant impact on the prevailing conditions of sale, such as prices, if its customers are in a position to switch easily to available substitute products or to suppliers located elsewhere. Basically, the exercise of market definition consists in identifying the effective alternative sources of supply *for the customers of the undertakings involved*, in terms both of products/services and of geographic location of suppliers." [emphasis added]

[13] Commission Notice on the definition of relevant market for the purposes of Community competition law, Official Journal C 372 , 09/12/1997 P, paragraph 2.

27. The relevant market is therefore usually to be defined from the point of view of the buyer of the goods or services in question, in this case the port services that the Board provides to the ferry operators at the Port of Dover. Where else could they buy such services from?

28. The Board is currently the exclusive provider of port facilities for ferry operators within Dover Harbour and therefore to determine the relevant geographical market there are no possible substitutes within Dover Harbour. The relevant geographical market in this case (involving as it does allegations of excessive prices charged to *ferry operators*) is thus independent of and likely to be narrower as a market than the market in which those operators themselves operate.

29. There are in fact currently no other ports offering substitutable port facilities for ferries of the types operated by the three Objectors to which they could transfer their business. See, for instance, evidence of Helen Deeble, INQ/07/P at paragraph 5.3.1 and Robin Wilkins, INQ/06/P at paragraphs 10 and 11. The geographical market is therefore limited to Dover Harbour itself. This is consistent with the analysis adopted by the Commission in a number of previous decisions in the ports sector.[14]

30. As regards the relevant service market, this is the market for the provision of port facilities in the port of Dover to the ferry operators. The Commission in the *Port of Helsingborg* decisions[15] defined the relevant market as being the "*market for the provision port services and facilities in HHAB of Helsinborg [the port of Helsingborg] to ferry operators transporting passengers and/or vehicles on the Helsinborg-Elsinore route (the HH-route)*".

31. On the basis of the above, in the present case the relevant market would be the market for the provision of port facilities in Dover Harbour to ferry operators on the so-called "short sea Cross Channel corridor", i.e. between Dover and Calais/Dunkerque in both directions.

The Board's dominant position and control of an essential facility

32. The European Courts have stated in numerous decisions that "*as far as the existence of exclusive rights is concerned, it is settled law that an undertaking having a statutory monopoly in a substantial part of the common* [now internal] *market may be regarded as having a dominant position within the meaning of Article 86* [now Article 102] *of the Treaty*".[16]

[14] Commission Decision of 11 June 1992 B& I Line v. Sealink [1992] CMLR 255 paragraphs 11 -14 ; Commission Decision of 21 December 1993 Port of Rødby, OJ No L 55, 26. 2. 1994, paragraph 7.

[15] Case COMP/36.568 Scandlines v Port of Helsingborg and Case COMP/36.570 Sundbusserne v Port of Helsingborg, both of 23 July 2004.

[16] See the European Court of Justice's rulings in Case C226/96 Corsica Ferries France SA v Gruppo Antichi Ormeggiatori del porto di Genova Coop. arl, Gruppo Ormeggiatori del Golfo di La Spezia Coop. arl and Ministero dei Trasporti e della Navigazione, [1998] ECR I-03949 paragraph 39; Case C-41/90 Höfner and Elser v Macrotron [1991] ECR I-1979, paragraph 28; Case C-260/89 ERT v DRP [1991] ECR I-2925, paragraph 31; Case C-179/90 Merci Convenzionali Porto di Genova SpA v Siderurgica Gabrieilli SpA at paragraph 14; and Raso and Others, cited above, paragraph 25.

33. In the *Helsingborg* decisions of 2004 (cited above) the Commission concluded that HHAB (the port authority) held a dominant position using the test set out in the leading judgment of the ECJ in the Hoffmann-La Roche case already cited[17]: "*The dominant position thus referred to relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers."*

34. In the *Helsingborg* decision the Commission relied on the standard test of dominance under Article 102 TFEU, and it concluded that the port of Helsingborg held a dominant position since:

    (1) it was a sole provider of portside facilities and services to ferry operators transporting passengers and vehicles on the relevant route, and

    (2) there was no possibility for any other undertaking to enter the upstream market as regard the provision of portside facilities and services at Helsingborg.

35. The same test should be applied to the Board. As the current exclusive provider of port facilities at Dover Harbour, the Board is in a *de facto* if not *de jure* dominant position as regards the provision of port facilities in Dover Harbour and it has a dominant position within the meaning of Article 102 TFEU and/or Chapter II CA 1998.

36. Also, the port of Dover, by virtue of its strategic location and role on the Dover-Calais/Dunkerque route, constitutes an essential facility within the meaning of the jurisprudence of the EU courts on this concept. The relevant EU case law clearly holds that an essential facility is a facility or infrastructure without access to which competitors cannot provide services to their customers and the Commission has clearly identified port infrastructure as an essential facility.[18]

37. This fact was indeed recognised by the Office of Fair Trading in its Working Paper on draft ownership of mapping entitled '*Infrastructure Ownership and Control stock-take*' of December 2010 (OFT1290). The OFT has noted –

    "Demand-side substitution might also be limited not just by geography but because not all assets are able to provide substitutes for one another. Infrastructure assets often have specialist facilities which prevent even local sites from offering a demand-side substitute for some users. In other words, assets may be operating in distinct product markets. There was evidence of this across the case studies.

    For example:

    …..

[17] Case 85/76 Hoffmann-La Roche & Co. AG v Commission of the European Communities, [1979] ECR – 00461, paragraph 38

[18] See Commission Decision of 11 June 1992 B& I Line v. Sealink [1992] CMLR 255 paragraph 66; Commission Decision of 21 December 1993 Port of Rødby, OJ No L 55, 26. 2. 1994, paragraph 12

• In the ports sector there may also be a lack of substitutability for some products at some ports. The lack of demand-side switching might be constrained, for example, by the existence of specialist infrastructure at ports, or the inability of some ports to offer then deep water necessary for larger ships and so to compete to attract them. For example, we found that demand-side switching could be inhibited at Port of Dover primarily due to specialised docking equipment and the shortness of the sea crossing."[19]

38. Moreover, the Commission has specifically indicated that an undertaking occupying a dominant position in the provision of an essential facility, should not abuse that position and it has a special duty not to distort the market where it enjoys a dominant position.[20]

Abuse of dominant position and excessive pricing

39. Article 102 TFEU provides that "*any abuse by an undertaking of a dominant position within the internal market (or in a substantial part of it) which affects trade between EU Member States is prohibited."*

40. In addition, Article 102(a) TFEU clearly singles out as an abuse of a dominant position the fact of "*directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions*". Accordingly, abuse of a dominant position constitutes the direct or indirect imposition of unfair or excessive prices.

41. The Board's decisions as regards pricing and excess profits have significantly distorted competitive conditions in the market for ferry services in the Port of Dover affecting the routes connecting the port pairs of Dover and Calais and Dover and Dunkerque. Indeed since 2007 the Board has been setting its tariffs considerably above its underlying costs of operation, which allowed it to accumulate cash reserves of approximately £60 million.

42. The EU Courts have set out a definition of what may constitute an excessive or unfair pricing abuse under Article 102 TFEU in, e.g., the United Brands case[21] as follows: "*charging a price which is excessive because it has no reasonable relation to the economic value of the product supplied would be such an abuse*".

43. The issue of how to determine the economic value of the product was examined in this decision. In this regard the Court stated that:

(i) *"the excess could, inter alia, be determined objectively if it were possible for it to be calculated by making a comparison between the selling price of the product in question and its cost of production, which could disclose the amount of the profit margin";*

(ii) *"the questions therefore to be determined are whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative,*

[19] 'Infrastructure Ownership and Control stock-take' of December 2010 (OFT1290), paragraph 7.14
[20] See Commission Decision of 11 June 1992 B& I Line v. Sealink [1992] CMLR 255 paragraph 66 and paragraph 97 of Michelin II supra n.32
[21] See Case 27/76 United Brands v Commission [1978] ECR paragraph 250

whether a price has been imposed which is either unfair in itself or when compared to competing products".[22]

44. However, the Court has not defined or given detailed guidance on what constitutes excessive or unfair pricing.

45. In the *British Leyland* case the EU Courts confirmed its jurisprudence according to which "*an undertaking abuses its dominant position where it has an administrative monopoly and charges for its services fees which are disproportionate to the economic value of the service provided*".[23] It further stated that because the price of the service was "*not based on the cost but on the consideration that the trader who was carrying out a transaction for gain could be required to pay a higher fee*", then "*the fee was fixed at a level which was clearly disproportionate to the economic value of the service provided and that that practice constituted an abuse by BL of the monopoly it held by virtue of the British rules.*"[24]

46. When setting its tariffs, the Board has persistently failed to take into account the economic value of the services it provides to the ferry operators, particularly from 2007 onwards when it started imposing inflated tariffs in view of the proposed construction of T2.[25] A good example of a dominant's company behaviour is also evident in the events following the Board's outsourcing of the ILO services in 2009. The sequence is conveniently set out in Mr. Karl Howarth's evidence.[26] By outsourcing the ILO services, the Board reduced its operational costs with the transfer of the costs of the ILO services to the ferry operators. The Board itself recognised the economic benefit that it would derive from this move insofar as it agreed in its negotiations with the ferry operators for the 2009 tariffs to grant them a rebate. That was accepted by the ferry operators on the understanding that the savings in operational costs would be reflected in future tariff years (see evidence of Mr Jesper Christensen INQ/05/P, at paragraph 31). Those savings were not one-off savings limited to a single year, but the benefit of them accrued to the Board in perpetuity: once the functions of maintenance and stevedoring staff had been transferred away from the Board it no longer carried those costs.

47. However, in its 2010 tariff, the Board ignored the post-transfer reductions of its operational costs of the ILO services, and not only cancelled the rebate but also applied an increase on the tariff. Only a dominant company unmindful of any market constraints and with captive clients, such as the Board, could engage in economic behaviour that pays such scant regard to the needs of its key customers, generating substantial profits in a period of financial crisis, and moreover in a period when it reduced its own cost base.

48. Chapter II CA 1998 also establishes a prohibition of abuse of dominant position in similar terms to the Article 102 TFEU and section 18 (a) CA 1998 provides, amongst other things, that conduct "*directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions*" constitutes an abuse of a dominant position.

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[22] See Case 27/76 United Brands v Commission [1978] ECR paragraphs 251 and 252
[23] See Case 26/75 General Motors v Commission (1975) ECR 1367
[24] See Case 226/84, British Leyland v Commission of the European Communities, [1986] ECR – 03263, paragraphs 29 and 30
[25] See INQ/06/P, Proof of Evidence of Robin Wilkins, paragraphs 25 to 29
[26] INQ/08/P at paragraphs 3.2 ff.

49. As already submitted, however, the prohibition on an abuse of a dominant position may be infringed in a wide set of circumstances not limited to the specific examples given in the Treaty itself. As stated above, the concept of abuse is wide enough to cover any behaviour of an undertaking with a dominant position which has "recourse to methods different from those governing normal competition in products or services on the basis of the transactions of commercial operators" and/or "has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition."

50. The evidence put before the Inspector contains many examples of pricing behaviour which did not conform to that principle. Each of the Proofs of evidence of Helen Deeble,[27] Karl Howarth,[28] Robin Wilkins[29] and Jesper Christensen[30] contain details of the impact that the changes introduced by DHB in 2009 to its pricing methodology and the various increases in individual tariffs (dues) had on the ferry operators, initially in 2010, and continued to have in 2011. There is in particular a reference to the Board not reducing prices in recognition of the "harsh trading conditions" in the same way as had been done at other ports that P&O Ferries enter. If other ports are seen to have reduced prices and the Board does not, that provides *prima facie* evidence that the Board possesses the market power to allow it to behave in an abusive way, and the Objectors submit that this is in itself evidence of abuse.

51. The case law of the European courts makes it clear that undertakings in a dominant position have a "special duty" not to hinder the maintenance of effective competition to the detriment of their customers and ultimately consumers[31]..

52. This is also acknowledged in Modernising Trust Ports (second edition)[32] at paragraph 1.2.3

> "In pursuing that target level of return, it is in the interests of all stakeholders that a trust port should set its dues, evaluate its investments, and charge for its services, at commercial and competitive rates, neither exploiting its status as a trust port to undercut the market, nor abusing a dominant position in that market."

53. As shown by Helen Deeble's evidence,[33] the result of the Board's actions appears to be to have kept prices in the "downstream" market for freight transport services at higher levels than they would otherwise have been if the ferry operators' input costs had not been abusively raised.

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[27] INQ/07/P at paragraph 5.3.1 regarding the market vulnerability of the ferry operators in comparison with DHB's market strength
[28] INQ/08/P , generally at section 3 and in particular at paragraph 3.4
[29] INQ/06/P
[30] INQ/05/P
[31] Case 322/81, Michelin v Commission, ECR [1983] 3461, paragraph 57, Michelin II supra n.32 and Warner-Lambert/Gillette, OJ 1993 L116/21 [1993] 5 CMLR 559, paragraph 23
[32] See Modernising Trust Ports (second edition) (DETR, August 2009) - CD/06/06
[33] Cited at note 27 above and also paragraph 5.6.1

54. The UK Office of Fair Trading ("OFT") and the Monopolies and Mergers Commission ("MMC")[34] have produced helpful guidance as regards excessive pricing either by way of decisions or guidelines.

55. In the *Contact Lens Solutions* case[35], the MMC found that the two leading suppliers of contact lens solutions, with an aggregated market share of 73%, made very high profits with a return on capital over a five-year period between 86% and 120%. The MMC concluded that this was not a competitive market and concluded that the suppliers' excessive pricing policy exploited their dominant or monopoly position. In this specific instance, the MMC recommended the reform of the regulatory system or direct control of the contact lenses companies' prices.

56. In April 2004, the OFT published its guidance in relation to abuse of dominant position and excessive pricing.[36] In this guidance, the OFT indicated that in a given monopolistic market it would assess evidence that prices are substantially higher than in a competitive market.

57. To determine whether prices are excessive the OFT offered different benchmarks: comparison with prices of similar services, comparison with underlying costs, comparison with price evolution over a sufficient period of time and excessive profits.

58. The excessive profit factor is of large significance for tariff increases adopted by the Board since 2007. According to the OFT's guidance under normal competitive market conditions companies would expect to earn 'normal profits' with a rate of return proportional to its 'cost of capital'. If profitability persistently exceeds costs of capital, profits are 'supra-normal'. According to the OFT, supra-normal profits supported by other evidence could indicate that competitive pressure was not strong enough to keep prices at competitive levels and that excessive prices were being charged.

59. The OFT confirmed this position in its 2004 paper and stated that –

> "High prices or profits alone are not sufficient proof that an undertaking has market power: high profits may represent a return on previous innovation, or result from changing demand conditions. As such, they may be consistent with a competitive market, where undertakings are able to take advantage of profitable opportunities when they exist. However, persistent significantly high returns, relative to those which would prevail in a competitive market of similar risk and rate of innovation, may suggest that market power does exist. This would be especially so if those high returns did not stimulate new entry or innovation".[37]

60. Certainly the Board does not face any competitive pressure given its dominant position and for that reason alone its market power enables it:

    a. to generate significantly higher profits than if it operated in a truly competitive market;

[34] Please note that the MMC has been replaced by the Competition Commission on 1 April 1999
[35] See Contact Lens Solutions Cm. 2242 (1993)
[36] OFT "Assessment of conduct - Draft competition law guideline for consultation" (April 2004) - OFT 414a
[37] See OFT's paper "Assessment of market power" (December 2004) - oft 415 - paragraph 6.6

b. to generate higher revenues by comparison with any other trust port in the UK[38]; and

c. to accrue a cash reserve of approximately £60 million with a gross profit margin of 36% and EBIT margin of 21% according to the Board's 2010 accounts[39], which could be considered as 'supra-normal' in the 2009-2010 economic climate and thus a clear evidence of excessive pricing.

Conclusion

61. The Board is in a dominant position as regards the provision of port facilities in Dover Harbour. It is settled EU and UK competition law that a dominant undertaking which controls an essential facility has a special responsibility not to abuse its market power by imposing excessive prices to the detriment of its captive users, the Objectors.

62. As set out in detail above, it is the Objectors' position that the evidence submitted by them in their Objections and in this Inquiry clearly show that the Board has been increasing its tariffs and generating excessive profits of approximately £60 million through an abuse of its dominant position, in a manner contrary to EU and UK competition law. By contrast, a commercial port not enjoying a dominant position would have faced competitive pressure to charge lower dues from rival, substitutable ports.

63. The Secretary of State when reviewing a s31 Objection must ensure that:

a. its decision is not contrary to applicable EU and UK competition law, namely in this case the rules set out in Article 102 TFEU and/or chapter II CA 1998;

b. that when setting its tariffs the Board complies with the UK and European law special obligations on it as a dominant undertaking controlling an essential facility;

c. the Board has complied with the requirement in the Secretary of State's own guidance to this Inquiry not to abuse its dominant position.

[38] See INQ/09/P – Proof of Evidence of Moffatt & Nichol, section 6, pages 23 and 24
[39] See INQ/09/P – Proof of Evidence of Moffatt & Nichol, paragraph 3.8, page 10

ANNEX E

LEGAL SUBMISSIONS ON BEHALF OF THE DOVER HARBOUR BOARD

AS TO MATTERS OF DOMINANCE AND COMPETITION

General

1. This response is submitted to the Inquiry on behalf of Dover Harbour Board ("DHB") in response to the written legal submissions made on behalf of the ferry operators ("the Operators") by Fergus Randolph QC dated 13 September 2011 (INQ/21/OBJ).

Legal Framework

2. It is accepted that DHB is an undertaking for the purposes of the application of Article 102 of the Treaty on the Functioning of the European Union ("TFEU") and Chapter II of the UK Competition Act 1998.

3. At Paragraphs 15 to 23, the Operators argue that DHB should be considered to be an undertaking to which a Member State has assigned special or exclusive public rights to which the provisions of Article 106 (1) TFEU apply. At Paragraph 23, the Operators argue that the Secretary of State in making her decision in relation to the SPG dues under s31 Harbours Act 1964 should not only take into account the guidance in Modernising Trust Ports (second edition) 2007 ("MTP2") but will also, in relation to the question of any abuse by DHB of a dominant position need to ensure that her decision and the process by which any decision is reached, ensures that she and DHB comply with the obligations imposed on the United Kingdom by Article 106(1) TFEU not to enact or maintain in force any measure contrary to the rules contained in the TFEU.

4. It is not a matter for the Inspector or the Inquiry to determine the scope and applicability of Article 106 TFEU and its application to the Secretary of State's decision. However it is recognised that the Secretary of State may determine that DHB is an undertaking to which Member States have granted special or exclusive rights and that as a consequence of any such determination, the Secretary of State will need to consider the application of Article 106(1) in reaching her decision.

5. The measure referred to in Article 106 for these purposes is the procedure and provisions contained within s31 Harbours Act 1964. The provisions of s31 do not usurp or contravene the provisions of Article 102 and are as a consequence not contrary to the rules of the Treaty. The Secretary of State is required under s31 to consider the SPG dues and in doing so will be guided by the Inspector and have regard to guidance including the guidance contained in MTP2.

6. It should be noted that the Secretary of State's decision under s31 Harbours Act 1964 is not a decision whether DHB has or has not abused any dominant position DHB may hold. A decision on s31 Harbours Act 1964 is a decision made following an objection made on one of the following grounds namely:

   6.1 that the charge ought not to be imposed at all;

   6.2 that the charge ought to be imposed at a rate lower than that at which it is imposed;

6.3 that, according to the circumstances of the case, ships, passengers or goods of a class specified in the objection ought to be excluded from the scope of the charge either generally or in circumstances so specified;

6.4 that, according to the circumstances of the case, the charge ought to be imposed, either generally or in circumstances specified in the objection, on ships, passengers or goods of a class so specified at a rate lower than that at which it is imposed on others.

7. The Secretary of State in making her decision shall either:

7.1 approve the charge but set a limit not being later than the expiration of twelve months from the date on which she approves it to the period during which the approval is to be of effect, and give to the authority written notice that she has approved it, stating the limit set; or

7.2 give to the authority such direction with respect to the charge as would meet objection thereto made on any of the grounds specified in subsection (2) above (whether that is or is not the ground, or is or is not included amongst the grounds, on which the objection whose lodging gives rise to the proceedings is expressed to be made).

8. In making that decision, the Secretary of State is therefore not directed to consider expressly whether or not DHB has or has not abused a dominant position. The Secretary of State in making her decision is however likely to have regard to the guidance to which DHB is subject including MTP2. Paragraph 1.2.3 of MTP2 states:

"In pursuing that target level of return, it is in the interests of all stakeholders that a trust port should set its dues, evaluate its investments, and charge for its services, at commercial and competitive rates, neither exploiting its status as a trust port to undercut the market, nor abusing a dominant position in that market."

9. As the Secretary of State is not required to answer directly the question whether DHB has abused a dominant position, and in the absence of any judicial decision that the level of dues set by DHB in 2010 or 2011 constitutes an abuse of any dominant position, it is suggested that the Secretary of State needs to satisfy herself only that the tariffs she is upholding or imposing are not likely to be regarded by a court of competent jurisdiction as an abuse. In this regard the Secretary of State can take into account the views of the Inspector on the extent to which the tariffs set in 2010 and 2011 comply with guidance including MTP2.

10. In Paragraphs 6 to 14, the Operators set out some relevant case law in relation to the concepts of dominance and abuse. It is agreed that the passages cited are relevant in the assessment of whether particular pricing may constitute an abuse of a dominant position.

11. In addition, the Court of Appeal considered these issues in Attheraces v British Horseracing Board Limited 2007 EWCA Civ 38. At paragraphs 115 to 119 of its judgment, the Court of Appeal, commenting on the passages referred to in United Brands by the Operators, states;

"115 Although it would be wrong to read this passage too literally, it must, in our judgement, be read and applied with care. We make the following points.

116 First, the judgment in fact poses two questions. The first is whether the difference between the costs actually incurred and the price actually charged is excessive. The second question is whether, if the first question is answered affirmatively, a price has been imposed which is either unfair in itself or when compared to competing products. BHB contends that the judge wrongly conflated the two questions into a single question, namely whether the charges specified by BHB were excessive.

117 Secondly, the central concept in abuse of dominant position by excessive and unfair pricing is not identified as the cost of producing the product or the profit made in selling it, but as the "economic value of the product supplied." The selling price of a product is excessive and an abuse "if it has no reasonable relation to its economic value."

118 Thirdly, the court did not say that the economic value of a product is always ascertained by reference to the cost of producing it plus a reasonable profit (cost +), or that a higher price than cost + is necessarily an excessive price and an abuse of a dominant position. The court was indicating that one possible way ("inter alia") of objectively determining whether the price is excessive and an abuse is to determine, if the calculation were possible, the profit margin by reference to the selling price and the cost of production.

119 Fourthly, it has to be borne in mind that, as stated in Bronner, the law on abuse of dominant position is about distortion of competition and safeguarding the interests of consumers in the relevant market. It is not a law against suppliers making "excessive profits" by selling their products to other producers at prices yielding more than a reasonable return on the cost of production, i.e. at more than what the judge described as the "competitive price level". Still less is it a law under which the courts can regulate prices by fixing the fair price for a product on the application of the purchaser who complains that he is being overcharged for an essential facility by the sole supplier of it.

12. In Attheraces, the Court of Appeal concluded on excessive pricing at Paragraphs 203 to 215, material extracts from which are as follows:

"203…

204 The judge correctly stated the law as laid down in United Brands (cited above) that a fair price is one which represents or reflects the economic value of the product supplied. A price which significantly exceeds that will be prima facie excessive and unfair. But the formulation begs a fundamental question: what constitutes economic value?

205 On the one hand, the economic value of a product in market terms is what it will fetch. This cannot, however, be what Article [102] and section 18 envisage, because the premise is that the seller has a dominant position enabling it to distort the market in which it operates.

206 On the other hand, it does not follow that whatever price a seller in a dominant position exacts or seeks to exact is an abuse of his dominant position.

207 How is the critical judgment of the economic value of the pre-race data to be made? That has to be determined before deciding whether BHB is seeking to charge ATR a price which abuses its dominant position by trying to obtain substantially more than the economic value of the pre-race data. There is nothing

in the Article or its jurisprudence to suggest that the index of abuse is the extent of departure from a cost + criterion. It seems to us that, in general, cost + has two other roles: one is as a baseline, below which no price can ordinarily be regarded as abusive: the other is as a default calculation, where market abuse makes the existing price untenable.

208 …… It seems to us that the most that a successful challenge under Article [102] can achieve in a case like this is a re-negotiation, not a cost + limit on prices, for whatever else Article [102] does it does not create a European system for determining prices.

209 …

210 …

211 …

212 Mr Roth's central contention is that there is no reason why the economic value of the product should not be its value to the purchaser rather than cost +, as held by the judge. He instanced the high franchise fees paid by broadcasters for what is no more than permission to operate their equipment from cricket grounds and football stadiums — in other words a simple licence to enter the property and view a sporting spectacle. If it were, as arguably it should be, for the purchaser to show that he cannot make a reasonable return because of the price exacted by the seller, failure would mean that the product was of economic value to the purchaser at the material price, and ATR would fail.

213 As already noted, the Commission's decision in Scandlines[1] supports the view that the exercise under Article [102], while it starts from a comparison of the cost of production with the price charged, is not determined by the comparison. This in itself is sufficient to exclude a cost + test as definitive of abuse. …

214 …

215 This said, we accept that there is moral force in ATR's position. ATR adds value (in the form of pictures of the races) to the pre-race data and has the task of collecting overseas bookmakers' payments. It is taking all the risks and, as the judge found, will have to absorb most or all of the costs, while BHB seeks to take half of what they make. This may be thought to be unfair, but it cannot alone make it an abuse of BHB's dominant position. As Jacobs A-G said in Bronner[2] (cited above), the principal object of Article [102] of the Treaty is the protection of consumers, … , not of business competitors. In our judgment, this is correct, even if it is the competitors and not the consumers who are alleging abuse of dominant position. We need to look beyond ATR's immediate interests to the market served by ATR. There is little, if any, evidence that competition in the market is being distorted by the demands made by BHB upon ATR."

Market, Dominant Position and Essential Facility

13. As identified by the Operators at Paragraphs 24 to 31, any consideration of abuse of dominance requires the relevant market to be defined. Evidence was produced to

[1] Scandlines [2006] 4 CMLR 23
[2] Bronner v. Mediaprint [1998] ECR 1–7791

the Inquiry which indicated the ability of ferries to be utilised elsewhere than Dover, albeit that modification would in most cases be required[3]. Evidence was also provided of (i) the ferry operators seeking the use of alternative ports for the same or similar customers and (ii) alternative ports being used by businesses and consumers to travel and/or transport goods. Evidence was also provided that indicated that both DHB and the ferry operators regard Eurotunnel as a competitor both in relation to the provision of alternative infrastructure and in relation to competing for customers i.e. passengers, vehicles and freight[4]. DHB does not therefore accept the Operators' conclusion that the relevant market is necessarily narrowly defined to be the market for the provision of port facilities in Dover Harbour to ferry operators on the so-called "short sea Cross Channel corridor".

14. It is important to note that no consequence whatsoever flows from any finding that DHB has a dominant position in any given market or comprises an essential facility. Consequences only flow if a finding of abuse is also made - a proposition which is firmly rejected in this case for the reasons set out below.

Abuse of Dominant Position and Excessive Pricing

15. The Operators consider abuse of dominance and excessive pricing at Paragraphs 39 to 60 of their written submission.

16. It is agreed that the imposition of unfair or excessive prices can constitute an abuse of a dominant position.

17. It is not accepted, as the Operators state in Paragraph 41, that DHB's decisions as regards pricing and excess profits have significantly distorted competitive conditions in the market for ferry services in the Port of Dover. The evidence of Mr. Waggott and Mr. Ogier[5] demonstrates that pricing by DHB of the SPG dues has been undertaken and set on a proper basis in accordance with DHB's statutory duties and guidance and that the pricing is not unreasonable, nor the profits excessive. The evidence demonstrated that the pricing level was justifiable and below an assessment of DHB's economic costs, and that the accumulated cash reserves were generated for the benefit of DHB's stakeholders and in anticipation of future capital requirements. There is no evidence that the SPG dues levied by DHB in 2010 or 2011 have significantly distorted competitive conditions in the market. The evidence of the Operators' own experts[6] is that the market share of Eurotunnel compared with the Operators remains at or below long term historic trends, with Eurotunnel's market share recovering from the effects of the 2008 Eurotunnel fire but not going above the pre fire level. This will be considered further in DHB's Closing Submissions to the Inquiry.

18. The Operators identify the link between the cost of the product or service supplied and its selling price. It is DHB's position that whether a price is excessive is not determined by the link between the cost of the product or service and its selling price. It is also DHB's position that in any event its SPG dues bear reasonable and

[3] Mr Wilkins' oral evidence, 21 September 2011.
[4] Mr Ogier's oral evidence, 20 September 2011. Ms Deeble's Proof at para 5.1.6 and also in her oral evidence, 27 September 2011. Mr Wilkins' oral evidence, 20 September 2011.
[5] Mr Waggott's Proof at Section 5 and at para 20.1 to 20.2. Mr Ogier's Proof at para 7.15 (a).
[6] Mr Chadney and Mr Pusey at para 7.6 to 7.12 of their Proof, and in Mr Chadney's oral evidence, 29 September 2011.

proper relation to the costs incurred by DHB in operating the Port including the operation of the infrastructure utilised by the Operators. Mr. Waggott's evidence demonstrates that DHB's margins in relation to the ferry operation and the Port as a whole are reasonable in comparison to other Ports[7].

19. In any event, the Operators at paragraphs 43-46 also correctly identify the importance of assessing the economic value of the product or service supplied. Ms. Deeble for P&O expressly referred to Calais as a port operating with a customer focus and in a competitive environment and expressly acknowledged that the economic value to P&O of the use of Calais was the same as the economic value to P&O of using Dover[8]. Each of the Operators (aside from DFDS which do not operate out of Calais) agreed that tariffs at Calais are materially higher than at Dover[9] and no evidence was produced which disputed Mr. Ogier's conclusions that the tariff at Calais is approximately 43% to 74% higher than at Dover[10].

20. The market share evidence of the Operators' own experts[11] indicate that the Operators continue to be able to compete effectively with Eurotunnel and that the Operators in 2010 and 2011 continue to be able to secure market shares at around historic levels and at or above those levels which applied prior to the Eurotunnel fire in 2008. Evidence from the Operators has indicated Eurotunnel are charging low tariffs in a bid to gain greater market share[12] and that Eurotunnel is very aggressive in trying to regain its market share[13] but the Operators' own evidence suggests that other factors such as fuel price increases have had a significantly larger impact upon the Operators than the level of the tariffs[14].

21. At Paragraphs 46 and 47, the Operators discuss the ILO outsourcing. DHB in its evidence[15] demonstrates that the rebate in 2009 reflected a proper reimbursement of costs included in the tariff which were not subsequently expended by DHB due to the outsourcing. DHB's evidence also demonstrates that no ILO costs were included in future years so no further rebate was appropriate or required[16]. P&O's own evidence also demonstrates that the Operators paid less for equivalent ILO services in 2010 and 2011 compared with the cost incurred by DHB in 2009[17]. In addition P&O's own evidence[18] indicates that P&O paid only approximately 3.5% more for use of the port on a like for like basis in 2010 compared with 2009[19]. When actual costs are used, this reduced to an additional 0.8%. Mr Chadney, in his oral

[7] Mr Waggott's Proof, Section 17 and Rebuttal Proof at paras 3.25 to 3.42. as well as in his oral evidence, 15 September 2011.
[8] Ms Deeble's oral evidence, 27 September 2011.
[9] Mr Wilkins' oral evidence, 20 September 2011. Ms Deeble's oral evidence, 21 September 2011.
[10] Mr Ogier's Proof at para 5.33.
[11] Mr Chadney and Mr Pusey's Proof, Figures 11 to 15 at pages 28 to 30 as well as in Mr Chadney's oral evidence, 29 September 2011.
[12] Mr Wilkins' oral evidence, 20 September 2011.
[13] Mr Chrstensen's oral evidence, 21 September 2011.
[14] Mr Howarth's Proof at para 2.3.
[15] Mr Waggott's Proof at paras 13.1 to 13.3.
[16] Mr Waggott's Proof, Section 13 and Rebuttal Proof at para 2.13 as well as in his oral evidence, 16 September 2011.
[17] Ms Deeble's oral evidence, 27 September 2011.
[18] INQ/37
[19] Ms Deeble's oral evidence, 27 September 2011.

evidence for the Operators, agreed that these figures were not indicative of excessive pricing or abuse of dominant position. This evidence is directly contrary to the Operators' assertions in Paragraph 47 and in particular their allegation that DHB paid scant regard to the needs of its customers.

22. At Paragraph 49, the Operators refer to the concept of abuse being wide enough to cover behaviour which has "recourse to methods different from those governing normal competition in products or services on the basis of the transactions of commercial operators" and/or "has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition". At Paragraph 50 the Operators then refer to various evidence submitted by the Operators which they allege supports their argument of abuse on this basis. This allegation is refuted. The evidence demonstrates that other ports increased prices over the period, though the Operators declined to disclose details due to commercial confidentiality[20]. The evidence also indicates that over the period the Operators have maintained their market share against Eurotunnel at or above historic levels and at or above levels which pertained prior to the Eurotunnel fire in 2008[21]. P&O confirmed that the tariff increases constituted a very small proportion of the Operators' cost base[22] and demonstrably a much smaller impact than other Operator costs such as fuel[23]. The evidence further suggests that the Operators would not have necessarily passed any lower tariffs through to customers and Mr. Christensen expressly stated that the benefit of any lower tariffs in future were not guaranteed to be passed on to customers[24].

23. At Paragraph 53, the Operators refer to Ms. Deeble's evidence suggesting that Eurotunnel have maintained prices at a higher level than would otherwise be the case because DHB introduced the tariffs which it did. There is no evidence that the Operators would have lowered prices had the tariffs been lower in 2010 or 2011 and there is other evidence that Eurotunnel have been lowering prices to attempt to increase market share[25].

24. At Paragraph 55, the Operators refer to a 1993 market investigation into Contact Lens Solutions in which the suppliers had a 73% market share and a return on capital of between 86% and 120%. DHB's return on capital (including cash) in 2010 was 6.8% and in 2011 is forecast to be 6.8%. The relevance of the Contact Lens Solutions case is not understood and the circumstances in that case were plainly wholly different from those arising here.

25. In Paragraph 57, the Operators refer to benchmarking prices to help to determine excessive pricing. N The evidence of Mr. Ogier in relation to benchmarking[26] supports DHB's pricing as reasonable and his conclusions in relation to Calais' prices being materially higher than Dover were not refuted by any of the Operators in their evidence.

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[20] Ms Deeble's oral evidence, 27 September 2011.
[21] Mr Christensen's oral evidence, 21 September 2011. Mr Chadney's oral evidence, 29 September 2011.
[22] Ms Deeble's oral evidence, 27 September 2011.
[23] Mr Howarth's Proof para 2.3.2.
[24] Mr Christensen's oral evidence, 21 September 2011.
[25] Mr Wilkins' oral evidence, 20 September 2011.
[26] Mr Ogier's Proof, Section 6.

26. In Paragraph 60, the Operators assert that DHB is able to generate significantly higher profits than in a truly competitive market. The evidence of Mr Ogier refutes this assertion and demonstrates that DHB's profits are not higher than in a competitive market[27]. Mr. Wilkins in his evidence also suggested that prices would be higher in the event of DHB being privatised[28]. The Operators further assert that DHB generates higher revenues by comparison with any other trust port in the UK. The evidence of the Operators' experts Mr Chadney and Mr Pusey as corrected by Mr. Waggott in his proof, demonstrates that DHB is within a range on a variety of metrics when compared with other UK ports[29].

27. The Operators then suggest that DHB's gross profit margin and EBIT margin are supra normal. The Operators' own expert evidence suggests that DHB's tariffs are not in themselves excessive, and the evidence has shown that DHB's financial performance is within a range when compared with other trust ports[30]. The Operators further suggest the cash reserve of approximately £60 million with a gross profit margin of 36% and an EBIT margin of 21% in 2010 is supranormal. This is denied and the evidence does not support such a position. The evidence demonstrates that the cash accumulated is anticipated to be used to fund a new terminal development when required and is justifiable on that basis. Mr Ogier's evidence further supports the accumulation of this cash reserve for such purpose as consistent with guidance and a legitimate use for the surplus generated[31].

Conclusion

28. Section 31 of the Harbours Act 1964 does not expressly require the Secretary of State to determine whether the 2010 and 2011 tariffs constitute an abuse by DHB of a dominant position.

29. The Secretary of State is required to have regard to Article 106(1) TFEU and is required to consider if it has application in this instance.

30. There is no competent authority which has determined that DHB's tariffs in 2010 or 2011 constitute an abuse of a dominant position.

31. There is no competent authority which has determined that DHB holds a dominant position or is an essential facility in relation to any market relevant to the consideration of the 2010 or 2011 tariffs.

32. If DHB is in a dominant position or is an essential facility in relation to any relevant market, the evidence does not support a finding that DHB is likely to have abused such a dominant position. The tariff increases have not significantly increased the Operators' costs, the market shares of the Operators' have remained at or above the historic level compared with Eurotunnel, and the Operators have acknowledged in evidence that the tariffs paid at Dover relate to a service which has the same economic value to the Operators as that received at Calais, where tariffs are accepted to be at a materially higher level.

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[27] Mr Ogier's Proof, para 7.11 and 7.15. In addition please see Mr Ogier's oral evidence, 16 September 2011.
[28] Mr Wilkins' Proof, para 57.
[29] Mr Waggott's Rebuttal Proof, paras 3.25 to 3.42.
[30] Mr Waggott's Rebuttal evidence, para 3.27.
[31] Mr Ogier's oral evidence, 16 September 2011.

33. DHB has set its tariffs in 2010 and 2011 in accordance with its statutory duties and in accordance with guidance. The cash reserve accumulated has been raised for the legitimate purpose of prefunding future anticipated capital projects and the retention of such balances and the setting of tariffs accordingly is proper and legitimate and is not an abuse of any dominant position DHB may hold.

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ANNEX F

DHB's NOTE AS TO THE FORM OF THE SECRETARY OF STATE'S DIRECTION AND THE QUESTION OF REBATE

1. This Note responds to INQ/38/OBJ.

2. By section 31(6)(b) of the Harbours Act 1964, the Secretary of State is empowered to give to the authority "such direction *with respect to the charge* as would meet the objection thereto..."(emphasis added). It is submitted that an order to make a rebate of cash accrued as a result of dues collected in earlier, "closed" years would not be a "direction with respect to the charges" which are the subject of the objections herein.

3. Accordingly, there is no power to order a rebate in the form proposed by P&O and DFDS.

4. It is submitted that paragraph 15 of INQ/38/OBJ impliedly concedes this.

5. Paragraph 16 of INQ/38/OBJ is not accepted. DHB sets its dues annually having regard to all relevant matters. The objections which are the subject of this Inquiry relate solely to the calendar years 2010 and 2011. For the avoidance of doubt, it is not accepted that the Secretary of State's determination of these objections will have application in succeeding years in respect of which tariffs have yet to be set.

6. Finally, should the Secretary of State (contrary to DHB's case) make any direction which necessitates the repayment funds by DHB to the Operators, then it is not accepted that such repayment will be subject to compound interest.

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ANNEX G

OPERATORS' RESPONSE TO DHB'S LEGAL SUBMISSIONS

The role of the Secretary of State

1. In their Opening Submissions, the Operators included, for the benefit of the Secretary of State ["SoS"], their arguments in support of the third ground of objection, namely that "the dues are excessive in that they constitute an abuse of a dominant position held by the Board." The Operators are aware that the Inspector does not have the power to make recommendations to the SoS on purely legal arguments but on the other hand she is entitled to take note of such legal arguments and this is what the Operators consider she is entitled to and ought to do.

2. In this connexion, the Operators note that the Board accepts[1] that the Board is an undertaking for the purposes of the application of Article 102 of the Treaty on the Functioning of the European Union ("TFEU") and Chapter II of the UK Competition Act 1998.

3. The Board also accepts[2] that the SoS may determine that the Board is an undertaking to which a Member State has granted special or exclusive rights within the meaning of Article 106 TFEU.

4. The Board submits[3] that the SoS may not "expressly" consider whether or not the Board has abused a dominant position, but concedes that she may have regard to the guidance to which the Board is subject, including the guidance in para. 1.2.3 of MTP2 that specifically requires trust ports to avoid abusing a dominant position.

5. The Board further submits[4] that the SoS may take account of the views of the Inspector as to the existence or otherwise of an abuse of a dominant position insofar as the Inspector is considering the extent to which the tariffs set in 2010 and 2011 comply with guidance including MTP2. The Operators would not dispute either submission so far it goes.

6. But the implication is that beyond that the SoS has no powers to apply Article 102 TFEU. This is wrong as a matter of law.

7. First, the SoS has a duty to apply the Treaty, including all its competition provisions, by virtue of the principle of sincere cooperation enshrined in Article 4(3) of the Treaty of the European Union (TEU). Moreover, Article 3 of Council Regulation 1/2003 specifically provides as follows:

> "1. Where the competition authorities of the Member States or national courts apply national competition law to any abuse prohibited by Article [102] of the Treaty, they shall also apply Article [102] of the Treaty.

[1] INQ/44/DHB, para 2
[2] INQ/44/DHB, para 4
[3] INQ/44/DHB, para 8
[4] INQ/44/DHB, para 9

> 2. Member States shall not under this Regulation be precluded from adopting and applying on their territory stricter national laws which prohibit or sanction unilateral conduct engaged in by undertakings.
>
> 3. Without prejudice to general principles and other provisions of Community law, paragraphs 1 and 2 … [do not] preclude the application of provisions of national law that predominantly pursue an objective different from that pursued by Articles [101] and [102] of the Treaty."

8. The effect of these provisions is that where arguments based on competition law are put to the SoS within the context of a s31 Inquiry, she is acting as a representative of the State and/or susceptible of review by the courts and is thus required to apply Article 102 TFEU in addition to any national law. Moreover, if under Article 102, read with Article 106 TFEU, the Board is held to have abused its dominant position in relation to the setting of dues in 2010 and 2011 then the SoS would in making directions in the exercise of her powers under s31 Harbours Act 1964 in addition be required to give effect to those provisions and provide the Operators with the corresponding remedies, as otherwise she would be acting contrary to the relevant above-mentioned provisions in the TEU and the TFEU.

9. The Operators also dispute the submission of the Board at para. 9 of INQ/44 that in the absence of a judicial finding of abuse of dominant position the SoS does not have the power to determine the issue beyond satisfying herself that that the tariffs she is upholding or imposing are not likely to be regarded by a court of competent jurisdiction as an abuse: the SoS has the power and indeed the duty to apply competition law where this falls within the scope of the exercise of her powers under s31 Harbours Act 1964. Any contrary interpretation would have deprive the Operators of an effective remedy under EU law and be contrary to the fundamental principle of sincere cooperation enshrined in Article 4(3) TEU.

10. To the extent that s31 Harbours Act 1964 pursues objectives different from Article 102 TFEU and national competition law (as argued by the Board in INQ/44/DHB, paragraphs 5 and 6.), the SoS's powers are unfettered by Article 102 (see Article 3(3) of Regulation 1/2003) and the Operators are entitled to their full remedies under the 1964 Act regardless of any findings under Article 102.

Dominant position

11. In their Opening Submissions, the Operators have relied on the extensive case law and decisional practice of the European Commission to show why the dues set by the Board in 2010 and 2011 constituted abuses of a dominant position. In particular, they relied for the finding of a dominant position on *Hoffmann-La Roche*[5] , in which the ECJ held that –

> "38… Article [102] prohibits any abuse by an undertaking of a dominant position in a substantial part of the common market in so far as it may affect trade between Member States.
>
> The dominant position thus referred to relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power

[5] Case 85/76 Hoffmann-La Roche v Commission [1979] ECR 461, paragraph 91

to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers."

12. At paragraph 13 of INQ/44/DHB the Board submits that ferries can be utilised elsewhere than Dover, although it is recognised that Mr Wilkins in his evidence had stated that extensive modifications would be required.

13. The paragraph goes on to suggest that alternative ports could be used by businesses and consumers to travel and/or transport goods and that there was evidence that Eurotunnel was regarded as a competitor by DHB and the Operators both in relation to the provision of alternative infrastructure and in relation to competing for customers, i.e. passengers, vehicles and freight.

14. It is, however, a matter of basic competition economics that the relevant market has to be viewed from the standpoint of the party that demands the product in dispute (port services for the berthing of their ferries)[6] and so the fact that ferry customers can use alternative ports for their transport needs or the comparison with Eurotunnel as an alternative infrastructure are both flawed as (a) none of the other ports is substitutable as none is capable of meeting demand from the ferry operators operating their particular ferries at Dover and (b) the Channel tunnel cannot be viewed as a substitute for Dover as again it is by definition not capable of meeting demand from ferry operators operating their ferries. To suggest otherwise is simply wrong..

15. On the contrary, the Operators submit that Dover's "unique" position offering the only berthing facilities for the ferries of the Operators operating ferry services on the short sea Channel crossings to France cannot be replicated by other UK ports. The geographical location of Dover to Calais offers a high level of trippage across the Channel and Mr Goldfield acknowledged that if the operators wanted to do 5 or 6 rotations a day, then "*you couldn't do it anywhere apart from Dover*"[7].

16. The location of Dover is also acknowledged by Mr Goldfield as a facet of Dover's "*unique position*"[8].

17. The assertion by Mr Goldfield that the operators could run out of the Thames, Harwich, or East Anglia or even from North England, is misconceived. The operators cannot operate out of these Ports and his evidence was not supported.

18. In addition, it will be recalled that Mr Goldfield gave evidence that the cruise ships were treated more favourably by DHB in order to attract the cruise ship business. Unlike the business of the Operators, the cruise ships have a number of ports available to them. In this regard, DHB acknowledge that it must be competitive[9]. Mr Waggott highlighted the captive nature of the Ferry Operators when explaining that an overall reduction in tariff would simply result in a blanket reduction[10]. Unlike the cruise liners, the Operators cannot move. As captives, the Operators have no other choice but to use Dover and DHB is therefore in a dominant position.

[6] Cf. UK Competition Commission (2007) Svitzer / Wijsmuller A/S and Adsteam Marine Ltd., final report, February, in which the Competition Commission defined the relevant geographical market for towage service as being restricted to individual ports.
[7] Goldfield, Day 1, page 128
[8] Goldfield, Day 1, page 128, line 11
[9] Transcript Day 1, Page 106, lines 19 -25
[10] Transcript Day 3, Pages 189 - 191

19. The Port of Ramsgate was also proffered as an alternative port. However, the Inquiry was provided with evidence that the maximum draft of Ramsgate was 6.5 metres, compared to Dover's maximum draft of 8.5 metres[11]. Ms. Deeble, in answering questions from the Inspector, stated as follows in relation to Ramsgate:

> *"it would need to be very extensively dredged. The turning circle that the ships need to berth and move off berth is also very narrow. There are currently two berths there. I believe that both of those berths are much shorter than our existing ships, including our new ships, and of course there is an existing operator in there. The port is owned by the local authority. I think it would need very extensive redevelopment from capital dredging, new berths, etcetera, to be able to function as an effective alternative to Dover. We would then have to look at the crossing time, which I am not aware exactly what it would be if you are going say from Calais, but it is likely to be longer. That would reduce the number of rotations you would get with each of your vessels. That in turn reduces the frequency and increases the dwell time for our freight customers, which is so important to them in the sort of "just in time" premium segment on the short sea."* – Transcript, Day 7, pp.157-158.

20. As noted in the Operators' opening submissions, ports within the EU have been found to hold dominant positions in their relevant markets – e.g. in the *Helsinborg* cases, the Court concluded that the port of Helsingborg held a dominant position since:

    (a) it was a sole provider of portside facilities and services to ferry operators transporting passengers and vehicles on the relevant route, and

    (b) there was no possibility for any other undertaking to enter the upstream market as regard the provision of portside facilities and services at Helsingborg.

21. No evidence has been produced by the Board to counter those points as applied to the Port of Dover. In the premises, the Operators maintain their contention that the Board was at all material times – i.e. when it set the 2010 and 2011 tariffs applicable to the Operators – in a dominant position on the relevant market.

Abuse

22. Regarding abuse, the Operators relied on the classic formulation in *Michelin II*[12] to the effect that -

> "54. …according to a consistent line of decisions, an 'abuse' is an objective concept referring to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is already weakened and which, through recourse to methods different from those governing normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition…

[11] INQ/35/DHB
[12] Case T-203/01, Michelin v Commission, [2003] ECR II-4071

> "55.... whilst the fact that an undertaking is in a dominant position cannot deprive it of its entitlement to protect its own commercial interests when they are attacked, and whilst such an undertaking must be allowed the right to take such reasonable steps as it deems appropriate to protect those interests, such behaviour cannot be allowed if its purpose is to strengthen that dominant position and thereby abuse it..."

23. The Operators also maintain that the correct test for excessive pricing is that set out in the Union case law commencing with *United Brands* in the following terms:

> *"an undertaking abuses its dominant position where it has an administrative monopoly and charges for its services fees which are disproportionate to the economic value of the service provided"*[13].

24. The Board has agreed[14] that the passages cited are relevant in the assessment of whether particular pricing may constitute an abuse of a dominant position.

25. It is also admitted by the Board[15] that "the imposition of unfair or excessive prices can constitute an abuse of a dominant position."

26. The case law of the European courts makes it clear that undertakings in a dominant position have a "special duty" not to hinder the maintenance of effective competition to the detriment of their customers and ultimately consumers[16]. The Operators are customers for this purpose.

27. Furthermore, any "recourse to methods different from those governing normal competition in products or services on the basis of the transactions of commercial operators, [that] has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition" can be abusive.

28. These passages show that the concept of abuse in Union law is a very broad one and that the class of abuses is not closed.

29. The same applies to abuse arising from excessive pricing. There is no single formula for measuring what is excessive and different approaches may be justified in different cases.

30. The Board has cited[17] the judgment in *Attheraces v BHB* [2007] EWCA Civ 38 in which Court of Appeal reviewed the relevant Union case law. The references at paragraphs 119 and 215 therein to the remarks made in the *Bronner* case – to the effect that Article 102 was not a charter for unhappy business competitors to complain about the behaviour of fellow competitors – are not relevant in the present matter where the Operators are the captive customers of the Board.

31. While there is no dispute that the basic definition is that of a "price which significantly exceeds [the economic value of the product supplied]", the Court of

[13] See Case 26/75 General Motors v Commission (1975) ECR 1367
[14] at INQ/44/DHB, para. 10
[15] at INQ/44/DHB, para. 16
[16] Case 322/81, Michelin v Commission, ECR [1983] 3461, paragraph 57, Michelin II supra n.32 and Warner-Lambert/Gillette, OJ 1993 L116/21 [1993] 5 CMLR 559, paragraph 23
[17] INQ/44/DHB, paras. 11ff.]

Appeal in its comments on the relevant passages in *United Brands*[18] expressed the opinion that the "[European] court did not say that the economic value of a product is always ascertained by reference to the cost of producing it plus a reasonable profit (cost +), or that a higher price than cost + is necessarily an excessive price and an abuse of a dominant position. The court was indicating one possible way ("inter alia" of objectively determining whether the price is excessive and an abuse is to determine, if the calculation were possible, the profit margin by reference to the selling price and the cost of production." Nothing in that finding, however, precludes using cost + as a measure of excessive pricing in appropriate cases.

32. In its conclusions on excessive pricing at paragraphs 203 to 215 the Court of Appeal proceeded to consider in some detail what is meant by "economic value". The Court was prepared to accept that the cost + criterion has two roles: to act as a baseline below which there can be no finding of abuse and as a default calculation where market abuse "makes the existing price untenable".

33. The Court of Appeal has sought to limit the scope of the economic value test in the specific context of the *Attheraces* case but the Operators submit that (a) unless confirmed by the General Court or the Court of Justice this is not authoritative of what Union law is; and (b) in any event the dues set by the Board satisfy at least one of the twin criteria of the Court of Appeal and would permit the cost + rule to be applied. EU law overrides UK law where the context requires.

34. As stated in the Opening Submissions, the Board has persistently failed to take into account the economic value of the services it provides to the ferry operators, particularly from 2007 onwards when it started imposing inflated tariffs in view of the proposed construction of T2.[19] A good example of a dominant's company behaviour is also evident in the events following the Board's outsourcing of the ILO services in 2009.

35. Thus the Operators submit that even if the cost + criterion is limited in the way suggested by the Court of Appeal the tariffs charged by the Board in 2010 and 2011 exceeded their economic value.

36. First, the evidence of Mr Ogier sought to show that the 2010 and 2011 dues were below cost but this was comprehensively rebutted by Mr Harman in his rebuttal evidence and in oral examination, as can be seen from the synopsis of the same in Annex 2 to these Closing Submissions. By way of non-exhaustive examples:

    (a) Mr Hill QC clarified that Mr Ogier's report was not based on DHB's accounting practice or its conduct in setting the tariffs: "it's no part of our case that the exercise Mr Ogier has carried out was, in fact, undertaken prior to the setting of the tariffs for 2010 and 2011…" (Day 2, page 147, line 1 - 5).

    (b) Mr Ogier did not look at the tariffs at a disaggregated level but in the round;

    (c) Mr Ogier's report is produced on the basis of a Competition Commission assessment when there is no guidance to support this approach;

[18] Case 27/76 United Brands v Commission [1978] ECR 207
[19] See INQ/06/P, Proof of Evidence of Robin Wilkins, paragraphs 25 to 29

(d) Mr Ogier was assessing DHB's [revenue] on a maximised or "full commercial rate of return", rather than an acceptable rate of return;

(e) Mr Ogier's assessment inexplicably did not account for DHB's £60m cash surplus;

(f) Mr Ogier admitted that there was a link between the level of return and future investments but failed to take into account the future investment plans of DHB.

37. Secondly, it is precisely the Operators' case that the Board's prices were "untenable" and that the only explanation for the level of dues which the Board has sought to extract from its captive users can only have resulted from an abuse of a dominant position. In particular the Operators rely on the basing of the 2010 tariffs on a cost base that included ILO costs (when all the ILO functions had been transferred to the Operators and were no longer a cost to the Board) and the basing of the 2010 tariffs on a baseline that was hugely inflated by the cash surplus of £60 million (the sole justification for which is a highly improbable contingency of a sudden rise in demand for ferry services such as another Eurotunnel fire or volcanic ash cloud [Evidence of Mr Waggott, Day 3, p. 103, lines 11-16]). It is untenable for the Board not to give credit for the removal of those costs as once the functions of maintenance and stevedoring staff had been transferred away from the Board it no longer carried those costs. If it was prepared to give a rebate in 2009, why not in subsequent years? The abuse speaks for itself.

38. It is also untenable for the Board to keep the cash surplus it had built up for T2 for a remote contingency. That it can do so and (absent the intervention of the SoS) it would be able to is itself *prima facie* evidence of it being in a dominant position and of abusing it.

39. It is refuted that Calais' tariffs are *materially higher* than Dover on the basis that the services and facilities offered at Dover are not comparable. In relation to Mr Waggott's evidence that Calais' charges are "materially more expensive" than those of Dover, Mr Waggott acknowledged that he has not taken into account Calais' costs information and has based his assessment purely on Calais' publicly available revenue information[20]. Without such information, Mr Waggott's assumptions are unsubstantiated.

40. It is further submitted that the Operators clearly distinguished between the services and facilities offered by DHB and those at Calais. It is therefore not the case that the economic value of Calais is materially the same to that of Dover or that the tariffs can be reliably compared.

41. The Operators have further submitted[21] that the Board should be considered an undertaking to which a Member State has assigned special and exclusive public rights to which the provisions of Article 106 (1) TFEU therefore apply. However, Article 106 TFEU makes it clear that the fact that an undertaking has such a status does not derogate from its duty to comply with the competition rules, including in this particular case the duty of a dominant undertaking not to abuse that position by means of excessive or unfair pricing practices. That obligation is acknowledged

[20] Waggott, Day 3, page 154, lines 17 - 18
[21] Opening Submissions. Para. 69

and echoed in the guidance in MTP2 (para 1.2.3) and accepted by the Board in INQ/44/DHB.

42. There is therefore no bar to the application of Article 102 TFEU whether by virtue of Article 106, Article 3 of Regulation 1/2003 or s31 Harbours Act 1964 itself.

43. As for the application of the cost + criterion, the Operators rely on the evidence of the experts, which shows that the dues charged by the Board in its 2010 and 2011 tariffs were unfair and/or excessive within the meaning of Article 102 TFEU.

44. Mr Ogier reached the conclusion that the Board's prices were justifiable and below an assessment of DHB's economic costs. The Operators however maintain that the analysis is flawed as it fails to take account of the removal of ILO costs as from 2010: if the Board's costs are re-adjusted to take account of the savings, then it is clear that the tariffs in both 2010 and 2011 are well above costs. Mr Chadney was pressed in cross-examination to state that on the basis of a hypothetical vessel the dues were not excessive but he had immediately before made it clear that this was only on the basis that one left ILO costs out of account. In addition, his answers in cross-examination on the subject only touched on his analysis of the hypothetical vessel, which by definition was not used by any Operator in 2010 or 2011.

45. The readjustment of the tariff structure that the Board carried out between 2009 and 2010 disguises the true position and should not be taken at face value. It is not disputed that certain SPG dues apparently went down on a per item basis, but the overall effect of the readjustment all things being equal was to increase the dues, not decrease them. When Mr Chadney was asked about the real increases in relation to the 2010 and 2011 tariffs as impacting on the Operators' vessels, his evidence was clear: those rises "supported the argument that there may be an abuse of a dominant position in respect of this."[22]. It will be recalled that in his proof of evidence, he stated inter alia as follows, which statement was not challenged in cross-examination:

> *"DHB benefits from a largely unique situation where it is by far the dominant UK supplier of cross-Channel ferry services. Their ferry operating stakeholders are captive to DHB and have no sensible alternative options. The tariff charges imposed on the Objectors is indicative of this dominant position and may be considered to be an abuse of it. The ferry operators contribute three quarters of DHB income and as such may be considered easy targets from whom to raise funding and through whom to satisfy other stakeholder needs, many of which do not contribute significantly to DHB earnings".* – paragraph 5.21

46. Mr Ogier's evidence must consequently be used with great caution as it is based on only part of the picture.

47. It is central to the Operators' cases that following the readjustment in the tariff structure in 2009 the failure to account for the saving in ILO costs in subsequent years by reducing the charges more than the Board did do led to an excess margin of revenue over costs that the Board has not been able to justify and which the Operators contend is evidence of abusive pricing .

[22] Transcript Day 9, p.149

48. It is also irrelevant that certain Operators such as P&O[23] paid less for ILO than what they would have paid on the basis of the charges as they were before the transfer. Without a corresponding rebate after 2009 they have been paying (in both tariff years 2010 and 2011) the ILO costs twice over, once to the Board through the levying of unadjusted SPG dues and again for their own ILO services: those own ILO costs are either incurred as own expenses in the case of P&O or as third party costs in the case of DFDS and SeaFrance who have outsourced the relevant ILO services.

49. With regard to the impact of Eurotunnel referred to at paragraph 23 of the Board's submissions[24], the Operators gave evidence that the Chairman of Eurotunnel has publicised that it intends to aggressively pursue market share. Evidence was provided by Mr Wilkins that the Operators are concerned that the increase in tariffs do not allow them to be as competitive as they would wish, or otherwise be, which will have an impact on its ability to retain their market share[25] which was acknowledged by Mr Ogier[26]. In any event, it is not the Operators' position that market share is an accurate reflection of revenue. Therefore, even if Eurotunnel market share stays relatively stable (which the Operators contend will not), Eurotunnel has more disposable revenue to be flexible in the prices it offers to its customers and compete with the Operators[27]. The Operators do not enjoy the same flexibility.

50. With regard to paragraph 24 of the Board's submissions[28], the Operators contend that the Board's estimate ROC of some 12% taken together with its actual cash surplus of over £60 million demonstrates that the prices charged by the Board were excessive. The fact that the Competition Commission found that the companies in the contact lens investigation had higher ROC is nothing to the point. Any unjustified excess will be abusive.

51. The Board refers at paragraph 25 to Mr. Ogier's benchmarking exercise. However, that is fundamentally flawed as it does not take into account how DHB's costs are actually constructed[29]. It is therefore not possible to determine that DHB's pricing is reasonable from Mr Ogier's analysis. In relation to Calais' prices being materially higher than those of Dover, Mr Ogier has not taken into account that the services and facilities of Calais cannot be compared to those of Dover.

52. The Board then seeks to rely, at paragraph 26, on the evidence of Mr. Ogier. However, such reliance is misconceived as he admitted that his report was predicated on a hypothesis and not the real situation as it existed in Dover.

53. Whether a new owner would increase the tariffs is not relevant. A private owner is not subject to the same restrictions to those of a trust port. If the new owner does increase its tariffs, that does not mean that DHB's current level of tariffs is not excessive. The same is true of the position of other trust ports – Mr. Chadney's evidence was clear – the other trust ports could be operating excessive tariffs as

[23] INQ/44/DHB
[24] INQ/44/DHB
[25] Robin Wilkins, Day 5, page 182, line 16 – 23
[26] Day 5, page 37, 18 - 25
[27] Robin Wilkins, Day 6, page 59
[28] INQ/44/DHB
[29] Ogier, Day 5, page 44

well. That does not mean that the 2010 and 2011 tariffs were not excessive. The Board say that Mr Pusey and Mr Chadney's own evidence (corrected by Mr Waggott) shows that DHB's profit is within a range of metrics. The metric which Mr. Pusey and Mr. Chadney sought to rely upon at paragraph 3.18 of INQ/09/P, was the excessive cash balance. The cash balance figures, which were accepted by Mr. Waggott show DHB were not within any kind of range when compared with any of the other UK trust ports.

54. Finally, the Board is simply wrong to suggest that the Operators' own expert evidence suggested that the Board's tariffs were not in themselves excessive. As can be seen from paragraph 45 above, Mr. Chadney's evidence was clear – the dues imposed could be considered to be abusive.

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