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Transport

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Letter sent via e-mail to:
P&O Ferries Holding Ltd – c/o Mr Francis Tyrrell Bircham Dyson Bell LLP;
DFDS Seaways BV (formerly Norfolkline Shipping BV) Mr Edmund Wollam c/o Hill Dickinson LLP;
Sea France SA c/o Mr Philippe Ruttley Clyde & Co LLP;
Dover Harbour Board c/o Mr Richard Prowse Eversheds LLP

Dear Sirs,

HARBOURS ACT 1964 - SECTION 31

Objections to the harbour dues charged by Dover Harbour Board for the year 2010

Objectors: P&O Ferries Holding Ltd, DFDS Seaways BV (formerly Norfolkline Shipping BV) and (late objection) SeaFrance SA ("the objectors")

1. I am authorised by Mr Norman Baker, Parliamentary under Secretary (the Minister), on behalf of the Secretary of State for Transport (the Secretary of State) to inform you that consideration has been given to the report of the Inspector, Mr Lloyd Rodgers, BEng (Hons), CEng, MICE, MBA who held a public inquiry on 11 sitting days, between 13 September and 14 October 2011, into objections lodged with the Secretary of State under section 31 of the Harbours Act 1964 against harbour dues charged by Dover Harbour Board (DHB).

2. DFDS Seaways BV (formerly Norfolkline Shipping BV) and P&O Ferries Holdings Limited lodged objections to the harbour dues charged by DHB from 1 January to 31 December 2010 (the 2010 harbour dues). Their objections were lodged on 17 June 2010 and 24 June 2010 respectively. A late objection was received from SeaFrance SA. Objections were also lodged by P&O Ferries Holdings Limited and SeaFrance SA to the harbour dues charged by DHB from 1 January to 31

December 2011 (the 2011 harbour dues). Their objections were lodged on 7 February 2011 and 8 February 2011 respectively. A late objection was received from DFDS Seaways BV.

3. The objectors and DHB agreed at the public inquiry that the 2010 harbour dues comprised the charges in the Ferry Tariff booklet published by DHB for 2010 contained in the sections identified as Conservancy Charge, Harbour Dues, Passenger Dues, Wharfage and Security (IR 6).

4. This letter conveys the Minister's decision taken in pursuance of section 31(6) in relation to the 2010 harbour dues. Although the report and public inquiry referred to in paragraph 1 considered objections in relation to both the 2010 and 2011 harbour dues jointly, a separate letter will be sent to all parties to convey the Minister's decision in relation to the 2011 harbour dues.

5. The Secretary of State has not been personally involved in the making of the Minister's decision. References to the Secretary of State in this letter in relation to the making of the decision mean the Minister acting on behalf of the Secretary of State.

The Inspector's Report

6. A copy of the Inspector's report is enclosed. In this letter, references to paragraph numbers in the Inspector's report are indicated by the abbreviation "IR".

7. The Inspector has considered all of the objections to, and representations about, the harbour due charges made in writing and orally at the Inquiry and has submitted his report to the Secretary of State. His conclusions are at IR 247 to IR 467 and his recommendation is at IR 468. The Inspector recommended that, in accordance with section 31(6)(a) of the Harbours Act 1964, the Secretary of State should approve the 2010 harbour dues.

The Secretary of State's Decision

8. The Secretary of State has carefully considered the Inspector's report, and for the reasons set out below, accepts the recommendation of the Inspector that the 2010 harbour dues should be approved. The Secretary of State approves the charges in accordance with section 31(6)(a) of the Harbours Act 1964 subject to a limit on the period during which the approval is to be of effect of 12 months from 1 January 2010.

The Secretary of State's Reasoning

9. The Secretary of State in considering the Inspector's report makes the following comments on matters raised in the report.

Procedural Matters

10. The Secretary of State notes that the Inspector sets out a number of procedural matters at IR 1 to IR 14. In particular, it is noted he recorded that only P&O Ferries Holdings Limited (P&O) and DFDS Seaways BV (DFDS) had made timely objections to the 2010 harbour dues, whereas SeaFrance SA (SeaFrance) had made a late objection. In relation to the 2011 harbour dues, only P&O and SeaFrance had made timely objections and DFDS had made a late objection. In each case the Department for Transport had accepted the late objection as a valid representation.

11. The Secretary of State also notes that the three ferry operators intended to present a common case to the inquiry and that DHB accepted that, in the interests of expediency and efficiency, all three of the ferry operators should be regarded as having objected to the 2010 and 2011 harbour dues. This was accepted by all parties involved. The Secretary of State further notes that only DHB and the ferry operators gave evidence at the Inquiry, but that written representations were also received from other persons and were taken into account by the Inspector. These are detailed at IR 5 and IR 230 to IR 246.

12. The Secretary of State is satisfied with the way the Inspector dealt with this matter in IR 4. The Secretary of State accepts that no one was prejudiced or prevented from putting forward their case at the time, and that the Inspector took into account all relevant evidence.

13. It has come to the attention of the Secretary of State that since the close of the inquiry, SeaFrance has been the subject of corporate liquidation proceedings in France. SeaFrance's UK solicitors, Clyde & Co, have informed the Department that SeaFrance was placed under judicial liquidation by order of the Tribunal de Commerce of 16 November and this took effect on 9 January 2012. Clyde & Co have also explained that SeaFrance has ceased trading but the company remains in existence at the present time. At the time when its objections were made to the Secretary of State SeaFrance was operating four ferries between Dover and Calais. As such SeaFrance had a substantial interest in the 2010 and 2011 harbour dues, satisfying the requirement for objections under section 31(2) of the Harbours Act and for representations under section 31(4). The Secretary of State takes the view that the subsequent liquidation proceedings do not impact on the decision making process or affect the Secretary of State's decision.

The objectors' case

14. The objections lodged against the 2010 harbour dues were expressed to be made on the ground that the charge ought to be imposed at a rate lower than that at which it was imposed.

15. The objectors' case is set out in IR 21 to IR 105 and Annexes D and G of the Inspector's report. The Secretary of State has given full consideration to the points raised by the objectors.

DHB's case

16. The case for DHB that the 2010 harbour dues should be approved by the Secretary of State is set out in IR 106 to IR 229 and Annex E of the Inspector's report. The Secretary of State has given full consideration to the points raised by DHB.

17. After the inquiry finished sitting, DHB, on 9 December 2011, submitted a representation consequent upon the Secretary of State's decision to make a Harbour Revision Order for a new Terminal 2 at Dover Harbour. At the same time DHB submitted a response to the objectors' closing submissions on competition law issues.

18. The Secretary of State was informed by DHB's solicitors (Eversheds) that the representations submitted on 9 December 2011 had not been forwarded to the objectors. For completeness the Department wrote to the objectors enclosing DHB's representations. No further representations were received by the Secretary of State in response to that letter. The Secretary of State considers that the representation concerning Terminal 2 would add nothing of significance to the consideration of the issue by the Inspector at IR 367– IR 398 and has therefore disregarded the representation made by DHB on 9 December 2011 concerning Terminal 2.

19. The treatment of DHB's representation in response to the objectors' closing submission on competition law issues is subject to the following considerations. The representation was made with the consent of the Inspector and the knowledge of the other parties. A copy of the representation is enclosed. The representation contained argument on three issues: the role of the Secretary of State, dominant position and abuse. These issues are relevant to the applicability of and compliance with EU and UK competition law, a matter which the Inspector determined to be outside the scope of his inquiry. The representation does not attempt to introduce any new evidence. Although the representation was submitted after the end of November 2011, which was the timing agreed at the inquiry, the

delay has not caused any prejudice or other adverse effects. Having regard to these circumstances the Secretary of State considers that it is fair and reasonable to take the representation made by DHB on 9 December 2011 concerning competition law issues into account and has done so.

The Statutory Framework

20. The Secretary of State notes that the Inspector set out at IR 248 to IR 251 the statutory basis for the setting of harbour dues under the Harbour Act 1964 and for the lodging of objections to harbour dues. IR 252 to IR 255 describes the powers and duties of the Secretary of State when considering objections. The Secretary of State is satisfied that the Inspector correctly identified and summarised the relevant provisions.

21. The Secretary of State notes that prior to the Inquiry officials at the Department for Transport published guidance on the role of the Secretary of State in reaching decisions under Section 31 of the Harbours Act 1964. This was available to all the parties before the Inquiry took place and was taken into account by the Inspector when holding the inquiry (IR 263 and IR 270).

22. The Secretary of State notes that the Inspector heard arguments as to whether section 31 enabled the Secretary of State to issue a direction requiring a rebate of harbour dues collected in previous years or reducing the harbour dues so that they did not cover DHB's costs. The Secretary of State accepts the Inspector's analysis and conclusions on this issue set out in IR 272 to IR 277.

Policy and Guidance

23. The Secretary of State notes that the Inspector at IR 257 to IR 262 identified government policy and guidance documents to which he attached substantial weight. None of the parties to the Inquiry raised any substantive objection to their use. These documents included *Modernising Trust Ports: A Guide to Good*

Governance published by DETR in 2000 (MTP1) and *Modernising Trust Ports* (second edition) published by the Department for Transport in 2009 (MTP2).

24. MTP2 was intended to update and replace MTP1, which is no longer current in England (and Wales). The Secretary of State notes that the assessment criteria which the Inspector derived from the policy and guidance documents as set out in IR 282 includes criteria ascribed to MTP1. However, each of these criteria can be found in MTP 2 or another cited document, as well as in MTP1. Whilst the criterion that dues should not be imposed for services that port users do not need is expressed by the Inspector to be found only in MTP1, in fact it also appears in MTP2 paragraph 1.2.7. Accordingly the Secretary of State considers that the Inspector's reliance on MTP1 has not materially affected his conclusions on the criteria to apply in considering the objections (IR 279 to IR 282) and the Secretary of State accepts the criteria identified in IR 282.

Privatisation

25. The Secretary of State notes the Inspector's remarks about the objectors' concerns over DHB's voluntary privatisation proposals (IR 283 to IR 284). As referred to by the Inspector at IR 285, officials at the Department indicated before the inquiry that any possible future change of status of DHB could not be made before the end of 2011 and therefore did not have any bearing on the decision in relation to the harbour dues charged for 2010 or 2011. The Inspector agreed and concluded that the harbour dues must be assessed in the context of DHB's current trust port status. This remains the view of the Secretary of State. Any representations relating to the potential impact of the proposed sale of DHB should be made in relation to those proposals at the appropriate time. Although not relevant to this decision, the Secretary of State notes that DHB told the inquiry that it is its intention to find a legal mechanism to ensure that whatever cash surplus exists at the point of privatisation (should it occur) is ring-fenced for the benefit of the objectors in terms of future capital expenditure (IR 395).

The Inspector's consideration

26. The Secretary of State notes that the Inspector identified at IR 288 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. The Secretary of State agrees with this approach.

27. Before directly addressing the key issues, the Inspector examined a range of preliminary matters, listed in IR 289. These were as follows.

The competitive position of DHB

28. This is dealt with in the section of this letter below dealing with the competition law arguments (paragraphs 46 to 129).

Comparator ports

29. At IR 299 the Inspector observed that one indicator as to whether or not dues have been set at commercial or competitive rates is to compare them with dues at similar ports. The Secretary of State agrees with this approach and notes the Inspector's analysis of the parties' evidence (IR 300 to IR 302). The Secretary of State accepts the Inspector's finding that although Calais and Dover cannot be compared directly, the evidence showed that Calais is the most comparable port, Calais is subject to commercial pressure and the charges at Calais appreciably exceed those at Dover, and also accepts the Inspector's conclusion that the charges at Calais are at least an indication that Dover's charges can be regarded as commercial and competitive (IR 303). At IR 304 and IR 305 the Inspector considered information comparing Dover's 2010 financial performance indicators with the equivalent indicators of a number of other UK trust ports and concluded that although differences between them made direct comparisons difficult and less valuable, Dover was not significantly out of line. The Secretary of State agrees with the Inspector's view.

Theoretical pricing models

30. The Secretary of State notes that DHB used an expert (Mr Tim Ogier, partner PwC) to provide a theoretical evaluation of its dues and the objectors also relied on an expert (Mr Harman, Senior Managing Director FTI Consulting) to review and comment upon that evaluation (IR 306 to IR 309). The theoretical analyses put forward at the Inquiry by DHB and by the objectors were, the Inspector observed at IR 309, based on differing assumptions and, to a certain extent, differing methodologies and they produced different results (IR 308 to IR 309). The Inspector identified two key factors: commercial rate of return (IR 310 to IR 320) and the asset base (IR 321 to IR 330). In considering what an appropriate rate of return should be, the Inspector had regard to the parties' arguments about the interpretation of the guidance set out in MTP 2. The Inspector accepted DHB's view that a trust port such as DHB should set its pricing based on a commercial rate of return even though this is likely to mean that it will accumulate cash reserves over time. He went on to consider what would be a commercial rate of return and in particular the cost of capital and concluded that the objectors had not made out a particularly strong argument that the WACC (weighted average cost of capital) adopted by DHB was overstated.

31. The second key factor considered by the Inspector was what assumptions should be made about the asset base, if a return on capital were to be included in consideration of the appropriate dues (IR 321 to IR 330). He identified two main approaches to dealing with inflation in terms of capital expenditure, namely 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 Inspector considered each of these approaches, which produced markedly different results in terms of economic cost, and concluded that neither was a good basis on which to approach the setting of harbour dues. He found it more likely that the two approaches indicated a range within which, theoretically, it was likely that the dues should sit. Nevertheless he stated that, for reasons he set out at IR 330, he favoured DHB's theoretical conclusion that the dues were not excessive. The Secretary of State's consideration of these issues and the Inspector's analysis and conclusions is set out in paragraphs 99 to 111 below. The

Secretary of State’s conclusion is that the expert evidence before the Inspector does not show that the 2010 harbour dues were in excess of cost by a significant amount or a significant margin.

Re-balancing the tariff

32. The Secretary of State notes the Inspector’s findings that DHB’s rebasing of its tariff structure in 2010 changed its fixed/variable tariff ratio from around 25:75 to closer to 40:60 (IR 332). The Secretary of State accepts the Inspector’s analysis of this change in IR 331 to 333 and his conclusion that no persuasive evidence had been presented to the inquiry that the new ratio of fixed/variable charges was unreasonable or that DHB’s rebasing exercise ran contrary to any of the accepted guidance.

Integrated Landside Operations (ILO)

33. The Inspector at IR 334 to IR 336 considered DHB’s decision in 2008 to withdraw from providing ILO services. DHB gave a rebate to the objectors in 2009, to reflect the resulting reduction in its costs, but did not give a rebate in 2010 or 2011. The Inspector acknowledged the objector’s concerns and accepted that the ILO transfer increased their base cost but did not accept that DHB had failed to take account of the ILO transfer when setting the 2010 harbour dues. The Secretary of State concurs with the Inspector’s assessment. (See also paragraph 115 below).

The economic and commercial climate

34. The Secretary of State notes the Inspector’s observations, at IR 337 to IR 340, about the prevailing economic and commercial climate and the Inspector’s acknowledgement that the combination of economic and competitive factors is likely to produce very difficult trading conditions for the objectors.

Effect of the 2010 tariff changes on the objectors (Operators) and DHB

35. The Secretary of State notes the Inspector's analysis of the figures and arguments presented by the parties concerning the effect of the changes to the 2010 harbour dues (IR 341 to IR 354). The Secretary of State accepts the Inspector's conclusions as set out in IR 355.

Operating costs and short term capital costs

36. The Inspector at IR 356 observed that the objectors 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. At IR 356 to IR 363 the Inspector examined the objectors' concerns about DHB's operating and short term capital costs, in particular concerns about 'gold plating' of investments, the transfer of ILO charges, the levels of contribution to the pension fund and whether operating costs were efficiently incurred. The Secretary of State accepts the Inspector's analysis and conclusions.

The Board's approach

37. The Secretary of State notes the Inspector's remarks, at IR 364 to IR 366, about the objectors' considerable dissatisfaction over DHB's perceived attitude and its approach to tariff setting and to their commercial relationships in general. The Inspector found that tensions existed at strategic and commercial levels and was in no doubt that these arose largely from the atypical commercial arrangement in which the powerful position of DHB and the captive nature of the objectors was likely to make any 'negotiation' unbalanced. Nevertheless the Inspector took the view that while the Board's attitude might afford some insight into its approach to tariff setting, the assessment of those tariffs was better undertaken by reference to more objective measures. The Secretary of State concurs with the Inspector's view on the appropriate measures for assessment and accepts that it was reasonable for the Inspector not to look further into this issue.

T2 and the Board's cash surplus

38. Since the close of the inquiry, the Secretary of State published on 28 November 2011 a decision to make a Harbour Revision Order to authorise DHB to carry out works at Western Docks to provide a new Terminal 2 (T2) (a decision in which Mr Norman Baker was not involved). The Secretary of State notes that the objectors argued that the costs associated with T2 should not have been taken into account by DHB in setting the 2010 and 2011 harbour dues (IR 69, IR 76, IR 86 and IR 92 to IR 94, and summarised by the Inspector at IR 369). The Secretary of State notes the Inspector's analysis of the approach DHB took towards T2 and its financing (IR 370 to IR 380). The references to DfT policy in IR 372 to IR 374 are substantially correct except that it is not the case that DHB are legally required to seek the DfT's permission before borrowing (by virtue of section 3 of the Ports Finance Act 1985). However, the Secretary of State notes that DHB gave evidence that it would require a letter of comfort as security from the DfT in order to secure a loan from a reputable lender. It is the case that the DfT does not generally provide letters of comfort. Accordingly the Secretary of State accepts the Inspector's conclusion that there is a clear logic to DHB's approach and accepts the remainder of IR 380. The Inspector observes at IR 382 that the key question to consider was 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 harbour dues. The Secretary of State agrees with the Inspector's analysis of the objectors' concerns and his conclusions in IR 381 to IR 398. (See also paragraphs 112 to 114 below).

Cruise operations

39. The Secretary of State notes that DHB confirmed that its approach to the use of the port by cruise ships is very different to that adopted in relation to the objectors, and that in particular incentives such as volume discounts are on offer to cruise ships (IR 399). The Inspector summarises the evidence heard at the inquiry at IR 400 to IR 404, including the reasons for DHB not offering volume discounts to the objectors. The Secretary of State notes that there was very little evidence before the inquiry dealing with the proportions of cost being borne by the various stakeholder groups, or whether

individual ferry dues were themselves cost reflective (IR 404), but that the limited evidence put forward suggested that there was no material cross subsidy between the objectors and other users.

40. At IR 405, the Inspector refers to paragraph 114 of MTP1 which stated 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 interests of all their stakeholders, and that this requires equitable treatment of all businesses within the port and appropriate pricing of the services provided to them. Paragraph 112 of MTP1 noted that Boards should recognise that different users have different service level requirements and this should be recognised in levying charges. As mentioned above, MTP1 is no longer current in England (and Wales) and has been replaced by MTP2. Paragraph 1.2.7 of MTP2 states that '*Boards should recognise that different users have different service level requirements. This should be recognised in levying charges. Where it is practical and cost effective, ports should offer a service tailored to the individual user's needs*'. The Secretary of State considers that the replacement of MTP1 with MTP2 does not require any material change to the criteria which the Inspector applied to the issue of cruise operations and that the Inspector's conclusions on the issue can stand. The Secretary of State accepts the Inspector's conclusions at IR 406.

Objectors' (Operators') proposed tariffs

41. The Inspector asked the objectors to present their proposals as to what the harbour dues ought to be if the Secretary of State determined to make a direction under section 31(6)(b) that the charge ought to be imposed at a rate lower than that at which it was imposed (IR 407). Because the Secretary of State has decided not to give such direction, it is not necessary to consider IR 408 to IR 416.

Key Issues

Are the 2010 dues commercial and competitive?

42. At IR 417 to IR 423 the Inspector identified the factors which he considered relevant to the question of whether the 2010 dues were commercial and competitive, and summarised the arguments and his analysis in relation to each of those factors, as set out in preceding paragraphs of his report. The Secretary of State agrees with the criteria applied by the Inspector at IR 417 to IR 423 and with the conclusions drawn by the Inspector as a result of applying those criteria, and concurs with the finding that the 2010 dues can be regarded as being commercial and competitive.

Are the 2010 dues fair and equitable?

43. The Secretary of State notes that the Inspector refers, at IR 424, to the Department's guidance, including the statement in paragraph 114 of MTP1 that dues must be seen to be fair and equitable if they are not to be open to challenge. Whilst MTP1 is no longer current in England (and Wales), the Secretary of State accepts that it is appropriate to apply the principle that the dues should be fair and equitable. At IR 433 the Inspector sets out a footnote to paragraph 114 of MTP1. The Secretary of State does not consider that it is necessary to rely upon the contents of the footnote in order to form a conclusion as to whether the 2010 dues are fair and equitable, and has not done so. At IR 425 to IR 432, the Inspector identified the factors which he considered relevant to the question of whether the 2010 dues were fair and equitable, and summarised the arguments and his analysis in relation to each of those factors, as set out in preceding paragraphs of his report. The Secretary of State agrees with the Inspector's reasoning and with the Inspector's finding that there was no persuasive reason to consider the harbour dues unfair or inequitable.

Are the 2010 dues reasonable?

44. The Inspector at IR 435 to IR 437 sets out his understanding of the additional criteria to apply to determine whether harbour dues are reasonable and the Secretary

of State agrees with that approach. At IR 437 the Inspector refers to a statement in MTP1 that also appears in MTP2. The Secretary of State accepts the Inspector's summary of the arguments and his analysis of the relevant factors at IR 438 to IR 442 and agrees with the Inspector's conclusion that, on balance, the dues can be regarded as reasonable. The Inspector at IR 443 to IR 444 considers the possible form of a direction under section 31(6)(b) of the Harbours Act 1964, in the event that the Secretary of State disagrees with the Inspector's conclusion. It is not necessary for the Secretary of State to form a view upon IR 443 to IR 444.

Has the Board abused its position?

45. This is dealt with in the section of this letter below dealing with the competition law arguments (paragraphs 46 to 129).

Dominant position and abuse under competition law and the Secretary of State's role

46. There was one line of argument presented to the inquiry that the Inspector considered to be beyond the scope of the inquiry (IR 13). This was an allegation introduced by the objectors in their opening submissions that DHB had abused a dominant position in breach of EU and UK law. The Inspector decided that a determination as to the applicability of and compliance with EU and UK competition law would be beyond the scope of the inquiry (IR 13) and accepted DHB's submission that no competent authority had yet made the necessary determinations on those issues (IR 267). As a consequence he would give little weight to the legal arguments put forward on the issues (IR 269), although in his view there was no doubt that the Secretary of State should have regard to the submissions of the parties (IR 267). He nevertheless considered that matters of competition and dominance should not be ignored in a section 31 inquiry. He noted that the guidance in paragraph 1.2.3 of MTP2 specifically requires trust ports to avoid abusing a dominant position and that the Inquiry had heard evidence on the matter which he would take into account (IR 269). He went on to examine at IR 291 to IR 297 the competitive position of DHB and concluded (IR 298) that DHB occupies a dominant position in terms of the short sea route to the continent, but

not in the cruise market. At IR 445 to IR 447 he considered whether DHB had abused its dominant position. He saw no need for the Secretary of State to re-run the arguments made by the parties under the framework of competition law to determine whether or not the prices set by DHB are an abuse of its dominant position. His reasoning was that if the dues were adjudged to be commercial and competitive, fair and equitable and in all respects reasonable, there was no reason to believe that they should be construed as constituting an abuse of DHB's position. On the other hand, if the Secretary of State considered it necessary to make a direction to meet the objections, the direction was likely to acknowledge abuse and would ensure that the charges became commercial and competitive, fair and equitable and in all respects reasonable.

Parties' submissions

47. The objectors submitted 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 (IR 11). The objectors were asked by the Inspector to present their arguments in separate legal submission, which they did, and these are attached to the Inspector's report at Annex D. DHB's response is attached to the Inspector's report at Annex E. DHB did not accept that the relevant market was such that it was dominant and denied that there was evidence of abuse (Annex E paragraphs 13 and14). Both parties relied upon an analysis of EU and UK case law to support their respective positions.

48. The objectors also included in Annex D submissions about the role and duty of the Secretary of State in dealing with the allegations of infringement of EU and UK competition law. They asserted (Annex D paragraph 63) that the Secretary of State when reviewing a section 31 objection must ensure (a) that her decision is not contrary to applicable EU and UK competition law, namely Article 102 TFEU and Chapter II of the UK Competition Act; (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; and (c) that DHB complies with the guidance in MTP2 paragraph 1.2.3 that it should not abuse its dominant position. According to the objectors' argument, DHB is an undertaking to which a Member State has assigned special and exclusive public rights to which Article 106.1 TFEU therefore applies, but remains under a duty to comply with the competition rules (Annex D paragraph 21). The wording in MTP2 paragraph 1.2.3 that 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, indicate the overriding EU duties placed upon DHB by Article 102 (Annex D paragraph 5). Thus, the objectors argue, the Secretary of State will need to ensure that the section 31 decision and the process by which the decision is reached, ensures that both the Secretary of State and DHB comply with the obligations imposed on the UK by Article 106.1 TFEU not to enact or maintain in force any measure contrary to the rules contained in the TFEU (Annex D paragraph 23).

49. DHB responded to the objectors' written submissions upon the role and duty of the Secretary of State in Annex D as follows. It recognised that the Secretary of State may determine that DHB is an undertaking to which a Member State has 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 (Annex E, paragraph 4). The measure referred to in Article 106 for these purposes is the procedure and provisions contained within section 31, and these do not usurp or contravene the provisions of Article 102 and therefore are not contrary to the rules of the Treaty (Annex E paragraph 5). In reaching a decision under section 31 the Secretary of State is not directly required to determine whether DHB has abused a dominant position (Annex E paragraph 8). There has been no determination by a competent authority that DHB holds a dominant position or is an essential facility in relation to any relevant market, or that there has been an abuse of a dominant position by DHB (Annex E paragraphs 30 and 31). In the absence of any judicial decision that the level of dues set by DHB constitutes an abuse of a dominant position, it is suggested that the Secretary of State needs to be satisfied only that the charges that the Secretary of State 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 charges comply with guidance including paragraph 1.2.3 of MTP2 (Annex E paragraph 9).

50. In closing the objectors produced a second written submission that developed their argument as to the duty of the Secretary of State and is attached to the Inspector's report at Annex G. The principle of sincere co-operation enshrined in Article 4(3) of the Treaty of the European Union (TEU) and Article 3 of Council Regulation 1/2003 is relied upon by the objectors to support the proposition that the Secretary of State has the power and a duty to apply the TFEU, including Article 102 (Annex G paragraph 7). They argued that where competition law arguments are raised in the context of a section 31 inquiry, the Secretary of State acts as a representative of the State and/or is susceptible of review by the courts, and therefore must apply Article 102 in addition to any national law. Moreover, they submit, 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 Secretary of State would in making directions in exercise of her powers under section 31 Harbours Act 1964 in addition be required to give effect to those provisions and provide the objectors with the corresponding remedies. Otherwise the Secretary of State would be acting contrary to the relevant above mentioned provisions in the TEU and TFEU (Annex G paragraph 8). Any contrary interpretation would deprive the objectors of an effective remedy under EU law and be contrary to the fundamental principle of sincere cooperation enshrined in Article 4(3) TEU (Annex G paragraph 9). However, if and to the extent that section 31 pursues objectives different from Article 102 TFEU and national competition law, the Secretary of State's powers are unfettered by Article 102 (Annex G paragraph 10).

51. The second submission by the objectors was submitted late in the inquiry and the Inspector agreed to give DHB time to consider it and to allow DHB to submit a final written response directly to the Secretary of State by the end of November 2011. DHB's final submission was sent to DfT under cover of a letter dated 9 December

2011. For the reasons explained in paragraph 19 of this letter, the Secretary of State accepts that the submission should be taken into account. The submission contended that the objectors' conclusion, based on Article 3 of Council Regulation 1/2003, that the Secretary of State is required to apply Article 102 TFEU, is wrong because the Secretary of State is not a competition authority of a Member State or a national court, and in reaching her decision under section 31, the Secretary of State is not applying national competition law (DHB response of 9.12.2011, paragraph 3). According to DHB, the Secretary of State has no jurisdiction or standing to determine whether Article 102 has been infringed. It is sufficient for the Secretary of State to decide that, if she correctly exercises her powers pursuant to section 31, then ipso facto her decision will not infringe competition rules. Moreover if she decides that the charges subject to objection are commercial and competitive, fair and equitable, she can be satisfied that the charges would not be abusive of any dominant position (DHB response of 9.12.2011, paragraph 4). A contrary interpretation to that of the objectors would not deprive them of an effective remedy under EU law because any decision of the Secretary of State is without prejudice to their rights to pursue any other available legal remedy including a claim for abuse of dominant position before a competent body (DHB response of 9.12.2011, paragraph 5). The reference in paragraph 1.2.3 of MTP2 to not abusing a dominant position is a reference to what a competent authority might conclude in relation to abuse of dominant position (DHB response of 9.12.2011, paragraph 6). The evidence in relation to the reasonableness of the dues set by DHB falls so far short of established notions of 'abuse' that any further debate on competition law issues would be entirely arid (DHB response of 9.12.2011, paragraph 7).

Secretary of State's consideration: Article 4(3) TEU and Article 3 Regulation 1/2003

52. The Secretary of State has carefully considered the submissions of the parties on the Secretary of State's powers and duties with regard to determination of the issue of whether there has been a breach of EU and UK competition laws. The Secretary of State notes the approach adopted by the Inspector.

53. The essence of the objectors' arguments as developed in their second submission (Annex G, paragraphs 7and 8) is twofold. Firstly, the principle of sincere cooperation in Article 4(3) TEU taken with Article 3 of Council Regulation 1/2003 means that where competition law arguments are raised in section 31 objection proceedings, the Secretary of State acts as a representative of the State and/or is susceptible of review by the courts and is thus required to apply Article 102. Secondly, if under Article 102 TFEU, read with Article 106 TFEU, DHB is found to have abused a dominant position in setting harbour dues the Secretary of State must give effect to those Articles in framing directions under section 31.

54. The relevant provisions of the Treaties and of Council Regulation 1/2003 are set out in an appendix to this letter. Article 4(3) TEU includes a requirement that Member States shall refrain from any measure which could jeopardise the attainment of the Union's objectives. Article 3.1 of Council Regulation 1/2003 has effect where the competition authorities of Member States or national courts apply national competition law to any abuse prohibited by Article 102 TFEU and requires them to apply also Article 102. By virtue of Article 3.3 of Regulation 1/2003, that requirement does not preclude the application of provisions of national law that predominantly pursue an objective different from that pursued by Article 102.

55. The DHB argues that the Secretary of State in deciding upon objections lodged under section 31 is not a national competition authority applying national competition law, within the meaning of Article 3 of Council Regulation 1/2003, and that therefore the obligation contained in Article 3.1 of Council Regulation 1/2003 does not apply.

56. The Secretary of State has weighed up the parties' arguments. They turn upon the nature of Section 31. This is a long-standing provision which empowers the Secretary of State to review and if appropriate reduce ship, passenger or goods dues charged by a harbour authority upon the lodging of an objection by a person appearing to have a substantial interest. It does not specify the criteria to be applied by the Secretary of State in exercising that function. The provision applies to harbour dues set by any coastal harbour authority, without regard to whether the

harbour is or is not in a dominant position in a relevant market, or whether it is a public or private undertaking. It enables the Secretary of State to ensure that a harbour authority in setting harbour dues is striking an appropriate balance between the interests of all its stakeholders, taking into account its funding needs. There is nothing in section 31 which indicates that it is intended as an instrument of national competition law.

57. Nor is national (or EU) competition law ousted by section 31. Neither the lodging of an objection under section 31 nor a decision by the Secretary of State following such objection precludes the application of national and EU competition rules by a competent authority. National competition laws in the UK apply the principles of Articles 101 and 102 TFEU to activities with domestic effect, and these are contained in the Competition Act 1998. Specifically, section 18 of the Competition Act prohibits the abuse of a dominant position. The Competition Act gives the Office of Fair Trading and certain regulators specified in section 54 the power to investigate possible breaches of national competition laws, to reach determinations and to take enforcement action. The Secretary of State does not have any such powers whether under the Competition Act or the Harbours Act. The obligations of the UK under the Treaties to give effect to EU competition rules are met by the competent competition authorities and these do not include the Secretary of State.

58. The objectors place reliance upon the inclusion in MTP2 of paragraph 1.2.3 which says that dues should be set at rates which do not abuse a dominant position in the market. The Secretary of State considers that paragraph 1.2.3 was not intended to impose responsibility upon the Secretary of State, in the context of considering objections under section 31 of the Harbours Act or otherwise, to determine whether there has been an abuse of a dominant position for the purposes of A102 TFEU. The words are aimed at harbour authorities, reminding them that they should not act in a manner which breaches competition laws prohibiting abuse of a dominant position. Whether there has been such a breach remains a matter for a competent authority.

59. On the basis of the above factors and reasoning, the Secretary of State finds that the Secretary of State is not a UK competition authority and is not applying national competition law when considering objections under section 31 of the Harbours Act. Therefore the obligation to apply Article 102 contained in Article 3.1 of Regulation 1/2003 does not operate upon the Secretary of State. In the alternative, the Secretary of State finds that section 31 is a provision of national law which predominantly pursues an objective different from that pursued by Article 102.

60. In relation to Article 4(3) TEU, the Secretary of State notes that in the case of *Van Eycke v ASPA Case 267/86* the European Court of Justice laid down the principle that Article 102 TFEU, read in conjunction with Article 4(3) TEU, requires Member States not to introduce or maintain in force measures which may render ineffective the competition rules applicable to undertakings. As discussed above, a decision by the Secretary of State under section 31 is without prejudice to the application by a competent authority of the competition rules contained in the Competition Act and the TFEU.

61. The conclusion of the Secretary of State is that the Secretary of State is not obliged by Article 102 TFEU, Article 3 of Regulation 1/2003 or Article 4(3) TEU, to apply Article 102 as part of her decision under section 31 of the Harbours Act. Nor is the Secretary of State obliged or empowered by Part 1 of the Competition Act to apply the equivalent prohibition contained in section 18 of that Act.

62. The Secretary of State also notes that, to the extent that Article 4(3) TEU is engaged in the present circumstances, it would not appear to impose any obligation on the Secretary of State over and above that which might arise under Article 106 TEU (discussed immediately below).

Secretary of State's consideration: Article 106 TFEU

63. In the objectors' first submission, they argued that Article 106 applies to the Secretary of State in exercising powers under section 31 and that it requires the Secretary of State to comply with the obligation not to enact or maintain in force

any measure contrary to the rules contained in the TFEU (Annex D paragraph 23). In their second submission, however, they accepted that, to the extent that section 31 pursues objectives different from Article 102 and national competition law, the Secretary of State's powers are unfettered by Article 102. The relationship between the two, apparently contradictory, statements is unclear. However, the Secretary of State acknowledges that the question of the possible application of Article 106 arises for consideration independently from the possible application of Article 4(3) TEU and Article 3 of Regulation 1/2003.

64. The first issue for consideration is whether Article 106 TFEU applies in the present circumstances. Article 106 is set out in the appendix to this letter. Article 106.1 provides 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 those contained in the Treaties, in particular to those rules provided for in Articles 101-109 (the competition provisions).

65. Article 106.1 applies in the case of public undertakings and undertakings to which Member States grant special or exclusive rights. There was some discussion in the parties' submissions as to whether DHB was an undertaking to which the UK had granted special or exclusive rights (Annex D paragraphs 18 to 21 and Annex E paragraphs 3 and 4). DHB recognised that the Secretary of State may determine that DHB is an undertaking to which Member States have granted special or exclusive rights. No view was expressed in the submissions as to whether DHB was a public undertaking. It appears to the Secretary of State that it is likely that DHB falls within one or more of the three categories of undertakings referred to in Article 106.1, and this letter proceeds on that basis.

66. Article 106.1 prohibits Member States from enacting or maintaining in force any measure contrary to Article 102. The objectors did not address what was meant by a measure in this context, but DHB asserted that it was the procedure and provisions contained in section 31 (Annex E paragraph 5). Since these do not

usurp or contravene the rules of the Treaty, Article 106.1 is not engaged, according to DHB.

67. The Secretary of State agrees that section 31 does not offend against competition law. In this regard, the Secretary of State has considered the legal effects of a decision under section 31, particularly in regard to the application of competition law. A direction must be given by the Secretary of State to the harbour authority if a ground of objection under section 31 is made out (section 31(6)(b)). For example the Secretary of State might direct that harbour dues be reduced by say 10% or at least 10%. The legal effect of a direction is that it is an offence for the harbour authority to fail to comply with an obligation it imposes (section 31(8)). The maximum period during which the direction can have effect is 12 months. The objectors are precluded from lodging another objection within the twelve month period (section 31(10)). However there is nothing to stop the objectors bringing a complaint that the original dues or reduced dues constitute an abuse of a dominant position before a competent authority. The OFT or the European Commission would be competent to determine such a complaint, as would a UK court hearing a private law action against the harbour authority. If the Secretary of State were to approve the charge (again for a maximum of twelve months) no further objection can be brought under section 31 during the validity of the approval (section 31(10)), but the charge can at any time be the subject of a complaint to the OFT or the European Commission of abuse of a dominant position, or of a private law action against the harbour authority before the courts. The Secretary of State's direction or approval, as the case may be, would not clothe the charges with any legal protection in competition law proceedings.

68. Moreover in any case where an interested party considers that there is an abuse of a dominant position by a harbour authority in relation to the level of harbour dues, it can take action to have that abuse rectified by a competent authority before, during or after raising an objection under section 31, or instead of making such an objection.

69. Equally, the Secretary of State is aware that the term ‘measures’ in Article 106 should be given a wide interpretation and may include administrative directions, the exercise of shareholders’ rights and non-binding recommendations (see e.g. *Case C-203/96 Chemische v Minister [1998] 3 CMLR 873, Case 249/81 Commission v Ireland [1982] ECR 4005* concerning Art 28 TEC, now 34 TFEU). The Secretary of State has considered whether approval or direction given under section 31 should be construed as a measure for the purposes of Article 106.

70. It may be that the word ‘enact’ in the Article implies that a measure must be an executive act rather than a quasi-judicial decision confirming or rejecting a decision of a harbour authority such as is required by section 31. However it can also be argued that the cases support a less literal approach to interpretation. The Secretary of State accepts that there is uncertainty on the point.

71. The Secretary of State has also considered whether the setting of the dues by DHB is itself a measure which if upheld by the Secretary of State under section 31, is ‘maintained’ by the UK for the purposes of Article 106. The Secretary of State considers that such an interpretation would extend the meaning of measure beyond acts of government to include acts of the undertaking, in this case DHB, and concludes that such an interpretation is not correct.

72. In view of the quasi-judicial nature of the section 31 objection proceedings and the continued application of normal competition law remedies, the Secretary of State considers that it is at least arguable that there is no ‘measure’ in this case which engages Article 106.1.

73. The Secretary of State has not reached a conclusion on the application of term ‘measure’ in the present context, but, given the uncertainty, has decided to consider the matter on the basis that the decision on the level of dues under section 31 does constitute enacting or maintaining in force a measure for the purposes of Article 106.

74. Before examining Article 106.1, it should be noted that if Article 106.1 applies, it may be subject to Article 106.2. Article 106.2 provides a derogation from the rules

on competition for undertakings entrusted with the operation of services of general economic interest or having the character of a revenue producing monopoly, in so far as application of the rules obstructs the performance of particular tasks assigned to them. No evidence or argument has been presented on this issue and the Secretary of State has not formed a view. Therefore for the purposes of this decision the Secretary of State will consider the application of Article 106.1 without regard to the possibility that Article 106.2 applies.

75. The remaining question is what is required of the Secretary of State in the present circumstances, assuming that Article 106.1 applies. It has already been explained that any such decision by the Secretary of State gives no legal protection from competition law proceedings. A competent authority would not be bound by a finding by the Secretary of State that DHB had or had not abused a dominant position. Moreover the ruling of the European Court of Justice in *CIF (Case C-198/01 [2003] 5 CMLR 829)*, taken together with Regulation 1/2003, makes it clear that a competent competition authority can and must disapply a national measure that is contrary to Article 106.1.

76. A decision by the Secretary of State is unlikely to have any persuasive value either. Because, as previously noted, the Secretary of State has no powers to require the parties to provide information, a conclusion reached by the Secretary of State on the issue of whether there has been an abuse of a dominant position would be based only upon the information that the parties chose to provide. In this regard it is noted that there were significant limitations on the cost information before the Inquiry, as considered further below. Nor did the Inquiry have any information as to the costs incurred by Calais, which was accepted by the Inspector to be the most comparable port to Dover (IR 303). DHB further claimed that details of prices charged by other ports were not disclosed by the objectors (Annex E paragraph 22).

77. The relative lack of relevant information before the Inquiry is all the more significant given the complexity of the issues involved in cases concerning allegations of unfair pricing, and the difficulties in applying the relevant legal and

economic principles. For example, in *Case COMP/A.36.568/D3 Scandlines Sverige AB v Port of Helsingborg* (which like the present dispute involved a short-sea crossing), the Commission made clear that, even with its extensive investigatory powers, its analysis of cost was only approximate (para 117), and found that there was insufficient evidence to conclude that the prices charged were an abuse of a dominant position (para 246).

78. The Secretary of State has considered what is required by the duty on Member States under Article 106.1 in the context of considering an appeal under section 31. In doing so, it is clear that, as previously explained, the Secretary of State is not a competent competition authority and section 31 is not an instrument of competition law. The Secretary of State does not consider that the duty requires a conclusive finding as between the parties' cases on whether there has been a breach of Article 102. That is to say there is a difference between a duty to determine whether Article 102 has been infringed by DHB and a duty to not to enact or maintain in force a measure contrary to Article 102.

79. The Secretary of State nevertheless accepts that while Article 106.1 does not require a determination as the position as between the parties, it does (where it applies) require the Secretary of State not to approve harbour dues if the findings of the Inspector and/or the evidence presented by the parties at the inquiry indicate that the dues constitute an abuse of a dominant position contrary to Article 102.

80. The Secretary of State notes that the objectors' submissions relating to the issue of an abuse of dominant position have focused on the possibility that the dues constitute excessive or unfair pricing. Whilst the objectors also made submissions to the effect that the categories of abuse are not closed (Annex G, paragraph 28), the Secretary of State has not identified any other form of abuse which arises for consideration.

81. The principles to be applied in an assessment of whether there has been an abuse of a dominant position by virtue of unfair pricing are set out in a number of leading cases. The leading decision of the Court of Justice is that in *United Brands*

v Commission (Case 27/76 [1978] ECR 207). It is also important to have regard to the decision of the Commission in *Case COMP/A.36.568/D3 Scandlines Sverige AB v Port of Helsingborg,* which concerned the application of the principles of unfair pricing in the context of port charges for ferry operators. And it is relevant to have regard to the recent decision of the Court of Appeal in *Attheraces v British Horseracing Board Limited 2007 EWCA Civ 38*, which is the leading domestic case applying the above mentioned European authorities.

82. The two essential components of any abuse are (1) the existence of a dominant position in a market and (2) an abuse of that position.

83. As previously indicated the Inspector considered the evidence about the competitive position of DHB and concluded that DHB occupied a dominant market position in terms of the short sea route to the continent (IR 291 – IR 298). He also dealt briefly with the question of abuse (IR 445 - IR 447) and concluded that if the disputed harbour dues were commercial and competitive, fair and equitable and in all respects reasonable, he saw no reason to believe that they would be construed as constituting an abuse of a dominant position.

84. The Secretary of State does not regard the Inspector's findings on these issues, and in particular his views on the issue of abuse, as a proper analysis of the position under EU competition law. In deciding that harbour dues were commercial and competitive, fair and equitable and in all respects reasonable, the Inspector did not apply the principles and criteria developed by the European Court of Justice and the Commission for assessing whether DHB occupied a dominant market position and if so whether there has been an abuse of a dominant position in breach of Article 102. Although the Inspector's analysis of the issue of dominance addresses a number of the issues which arise on a proper application of competition law principles, it is not clear that the Inspector reached his conclusions within the specific framework of competition law. Moreover, although the Secretary of State agrees with the conclusion of the Inspector that the harbour dues were commercial and competitive, fair and equitable and in all respects reasonable, the Secretary of State does not consider that that conclusion is necessarily indicative

of whether the harbour dues constitute an abuse under Article 102, assuming that DHB is dominant in the relevant market.

85. The Secretary of State therefore considers below the Inspector's findings of fact (and the evidence more generally) as they bear on the proper application of competition law. The Secretary of State also has regard to the arguments relied on by the objectors as establishing an abuse of a dominant position. If the Secretary of State does not consider that those findings, arguments and evidence indicate that the prices in question are excessive or unfair, then there is no basis in Article 106 for the Secretary of State to decline to approve the dues.

Market Definition and Dominance

86. The objectors relied upon the definition of a dominant position laid down by the European Court of Justice in *Hoffman-La Roche v Commission (Case 85/76, ECR 461)* (Annex D paragraph 6). DHB accepted the relevance of the passage cited by the objectors (Annex E paragraph 10).

87. The objectors discussed the relevant market in paragraphs 24 to 31 of Annex D, relying on the European Commission's Relevant Market Notice. In particular, the objectors stated that (1) it is necessary to identify the extent to which DHB is subject to competitive constraints, and (2) the key test is one of demand substitutability. The objectors concluded that the relevant market is for the provision of port facilities in Dover Harbour to ferry operators between Dover and Calais/Dunkerque in both directions (referred to as the short sea Cross Channel corridor). DHB did not accept that definition (Annex E paragraph 13) and argued that the relevant market was broader but did not propose an alternative market definition.

88. The objectors argued that DHB was dominant in the relevant market and provided an essential facility (Annex D paragraphs 32 to 38) although DHB took issue principally on the ground that the objectors had defined the relevant market too narrowly.

89. The Inspector set out in IR 291 to IR 297 his findings that:

- Dover had an advantageous geographic location, offering the shortest sea crossing (hence fuel savings), the opportunity for higher frequency operations than any alternative port, and strong UK transport links;
- The objectors would face difficulties and disadvantages transferring their operations to other ports;
- Eurotunnel is not an alternative for the berthing of ferries, and competition between Eurotunnel and the objectors is a weak constraint on the setting of dues;
- The objectors face considerable barriers to exit;
- There are only limited constraints influencing the setting of harbour dues.

90. On that basis he concluded at IR 298 that DHB occupied a dominant market position in terms of the short sea route operated by ferries to the continent (without defining what he meant by the short sea route).

91. The Secretary of State accepts the Inspector's analysis of the factual evidence in IR 291 to IR 297.

92. The Secretary of State has further had regard to the relevant legal principles, including those relied on by the objectors and the Commission's Relevant Market Notice generally. The Secretary of State notes that it is necessary to identify the relevant product and geographic markets. The Secretary of State has considered in particular the issue of demand substitutability – that is to say, whether there are products available which are regarded by consumers as a substitute for those made available by DHB, and which place a competitive constraint on DHB. The Secretary of State notes that this is not a case in which there appears to be any constraint on DHB as a result of supply substitutability and/or potential competition.

93. On that basis, and having regard to the Inspector's findings and the available evidence, the Secretary of State thinks it more likely than not that the relevant market is the market for the provision of port facilities in Dover Harbour to ferry operators between Dover and Calais/Dunkerque in both directions, and that DHB

is dominant in that market.

94. Accordingly, it must be considered whether the Inspector's findings and/or the evidence indicate an abuse of that dominant position within the meaning of the relevant case law.

Abuse

95. Under *United Brands*, it is an abuse to charge a price which is excessive because it bears no reasonable relation to the economic value of the product being supplied (para 250). The Court of Justice stated that there are two questions to be determined (para 252):

- first, whether the difference between the costs actually incurred and the price actually charged is excessive; and

- secondly, if the answer to the first question is affirmative, whether a price has been imposed which is unfair in itself or when compared to competing products.

96. In subsequent cases, it has been emphasised that, under *United Brands*, the question is ultimately whether the price charged is unfair, and that this does not depend solely on whether the price charged exceeds the cost of supplying the product plus a reasonable margin ("cost plus"). Rather, it requires an assessment of whether the price bears a reasonable relation to the economic value of the product *to the purchaser* (*Scandlines* para 241, *Attheraces* para 218).

97. The Secretary of State notes that it is the objectors' position that, in the present case, the prices in question should be found to constitute an abuse if they exceed cost plus (Annex G, pararaph 31). Whilst the Secretary of State recognises that cost plus may, in a given case, represent an appropriate measure of economic value, the objectors do not explain why this is said to be such a case. The Secretary of State notes that in *Scandlines*, which was also concerned with port

charges, the Commission did not consider that cost plus was the appropriate measure of economic value (paras 148-151, 148, 234 ff). The Secretary of State further considers that there are good reasons why economic value may, in the context of the present case, exceed cost plus (as discussed further below).

98. The Secretary of State also notes the objectors' submission that the decision of the Court of Appeal in *Attheraces*, which is said to limit the test of economic value, is not to be regarded as authoritative of EU law (Annex G, para 33). However, the decision in *Attheraces* was explicitly an application of the decision of the European Commission in *Scandlines*. The Secretary of State does not therefore accept this argument. The Secretary of State does not in any regard see any inconsistency between *Attheraces* and any decision of the European Courts.

Analysis of Costs - 2010

99. The Secretary of State notes that the material before the Inspector indicated two possible approaches to the analysis of the relevant costs, specifically in the evidence of Mr Ogier (on behalf of DHB) and Mr Harman (on behalf of the objectors). The Inspector found that neither was a good basis for setting harbour dues, but that it was more likely that the two approaches indicated a range within which the dues should sit (IR 329).

100. The Secretary of State agrees with the Inspector's view in relation to the limitations of the cost analysis before him. Those limitations are at least if not more significant in the context of an allegation of unfair pricing. The Secretary of State notes in particular that the cost analysis was not presented by either expert at the level of the individual products or dues – the analysis was rather concerned with ferry operations at the port as a whole. This limitation of the cost analysis was emphasised by Mr Harman on behalf of the objectors (see Harman proof INQ/10/P 2.15 to 2.28).

101. Under *United Brands*, an analysis of the cost of providing the product is central to an allegation of unfair pricing. Given the Inspector's reservations concerning the cost analysis carried out, and limits of that analysis, the Secretary of State is not

satisfied that there is an adequate evidential basis for a conclusion that the prices in question are excessive having regard to cost.

102. Notwithstanding that general point, the Secretary of State has considered what conclusions may be drawn from the evidence before the Inspector as regards the costs and revenues associated with ferry operations as a whole.

103. Of the two cost analyses before the Inspector, Mr Ogier's analysis suggested that prices were below their economic cost. Only Mr Harman's analysis suggested that prices were in excess of cost.

104. Mr Harman's analysis for 2010 suggested that (assuming a commercial rate of return) revenues would exceed cost by £3.5m out of £43.5 m, or some 8% (IR 328-IR 329). The Inspector noted that this number is sensitive to input assumptions.

105. It is not clear to the Secretary of State that the excess of revenue over cost calculated by Mr Harman is outwith any potential margin of error. This is fortified by the fact that the equivalent numbers for 2011 are £1m or 2%, which would appear to be very much within the margin of error. The Secretary of State also notes that Mr Ogier made assumptions which he regarded as cautious (see Ogier proof INQ/04/P 3.48-3.51).

106. The Secretary of State does not consider that Mr Harman's analysis clearly supports the conclusion that prices for 2010 were in excess of cost by a significant amount or a significant margin.

107. The point is further illustrated by the available calculations of the relevant cost of capital ("WACC"). The Inspector found that it was reasonable for the cost analysis to proceed on the basis of a commercial WACC, and that the objectors had not made a convincing case that the commercial WACC used by Mr Ogier was overstated (IR 317 and IR 319). If Mr Ogier's WACC rate is applied to the remainder of Mr Harman's cost analysis, then (on a calculation produced by DHB) costs would exceed revenues (INQ/26/DHB).

108. The Secretary of State notes that there was significant debate between Mr Ogier and Mr Harman concerning the merits of a replacement cost approach versus an historic cost approach. The Inspector, having heard both witnesses give evidence, preferred Mr Ogier's conclusions. However, it is not necessary to prefer one approach to the other to conclude that they are both relevant to an analysis of unfair pricing (and indeed this appears to have been Mr Harman's own view – see Transcript of 28 September pp 54, 198-199 and 202-203).

109. The Secretary of State notes that the Court of Justice in *United Brands* referred to the costs "actually incurred". However, it does not appear that this passage was intended to support one particular form of cost analysis over another. Indeed, the Court of Justice went on to state at para 253 that "*Other ways may be devised – and economic theorists have not failed to think up several - of selecting the rules for determining whether the price of a product is unfair."*

110. The Secretary of State nevertheless acknowledges the fact that Dover is accumulating a cash reserve, and the Inspector's view that ferry revenues in 2010 and 2011 will have made a significant contribution to that surplus (IR 387). The Secretary of State further acknowledges that it was part of Dover's purpose in setting dues for 2010, 2011 and previous years to include an element of surplus which would be available to fund future investment (IR 129).

111. The existence of some excess of revenue over cost does not however mean that prices are necessarily "excessive", for the purposes of the test in *United Brands*. The evidence is that the total surplus for 2010 is some £3m. As has been noted above, this is a modest amount, and represents a modest percentage surplus. The Secretary of State is not satisfied that this merits the conclusion that prices are excessive having regard to cost.

112. Moreover, the Secretary of State notes that DHB is a trust port, and that its cash reserve is being used and/or is planned to be used for the purposes of continued investment in the port, including the construction and/or maintenance of infrastructure used to provide ferry services. The focus of those plans was on investment in Terminal 2 (IR 368).

113. The Inspector found that, unless DHB could borrow the whole of the cost of any new asset that may benefit future users of the port, the objectors would inevitably contribute to the cost of those assets (IR 398). He found moreover that the funding of T2 would require DHB to build on its cash balance even if it were to borrow close to the maximum serviceable borrowing (IR 377- IR 382). Making no allowance for a surplus over cost in 2010 and 2011 would leave no room in DHB's plans for contingencies (IR 428). The Inspector considered that, in the circumstances, DHB's decision to establish a cash fund was understandable (IR 427)

114. Accordingly, if one is seeking to ascertain the cost to DHB of providing the services in question in a particular year, there is an issue as to how far, *in the particular circumstances which apply to DHB*, it is appropriate to include a contribution towards the cost of future investment in the provision of those services. The Secretary of State does not regard this question as having been settled on the material before the Inspector. (This point may, in the alternative, be treated as relevant to the question of whether prices charged by DHB are unfair in themselves, as discussed further below).

115. The objectors have argued that DHB's prices are abusive because they contain no reduction to reflect the fact that ILO was (with effect from 2010) the responsibility of the objectors. However, it is not clear how the objectors' point fits within the principles established by the case law. In particular, DHB stated that the cost of providing ILO had not been included in the proposed tariffs for 2010, and there was therefore no element of cost to reduce or to rebate to the objectors. It is not therefore clear that there is any basis for expecting a reduction from the 2010 rates on account of this factor (as to which see IR 348).

116. The objectors have argued that DHB makes supra-normal profits from its ferry operations. The Secretary of State notes the Commission's observations in *Scandlines* at paras 155 to 158 on the limitations of comparative profitability analysis. In any event, the available evidence is that DHB's profitability is within a range of known values for the profitability of trust ports, and that the position was the same on a range of other metrics (IR 209 – IR 305).

Conclusion on cost analysis

117. For all of the reasons, the Secretary of State does not consider that the material before the Inspector indicates that the difference between the 2010 prices and the costs incurred is excessive. That being the case, the further question of whether the prices are unfair does not strictly arise. The Secretary of State nevertheless considers that question below.

<u>Unfairness</u>

118. Under *United Brands*, it is necessary to consider whether prices are unfair either in themselves or when compared with competing products. This involves consideration of the economic value of the services to the objectors (see *Scandlines*, para 151).

119. It is not clear that there are any relevant *competing* products with which the prices charged by DHB can be compared. However, the Secretary of State notes that prices at DHB are lower than at Calais, which the Inspector found was the best available comparator.

120. More pertinently, the Secretary of State notes moreover the evidence of P&O's Ms Deeble that P&O placed the same economic value on the services supplied by DHB as it did the services supplied by Calais (Transcript of 27 September pp 151-152). Given that charges at Calais are appreciably higher than those at Dover (IR 303), it would appear to follow that prices at Dover do not exceed their economic value, at least to P&O.

121. In that regard, the Secretary of State notes that, on the evidence, the economic value to the objectors of the services provided by DHB is likely to be high. Those reasons arise from the particular advantages of Dover for ferry operations. In *Scandlines*, the Commission said at para 242 *"The services provided by HHAB may not be superior in terms of quality or performance to ones provided elsewhere by other ports, but the fact that they are provided at this place allows both passengers and ferry-operators to cross the Øresund in an expeditious way, which*

is in itself valuable, creates and sustains demand both on the downstream and the upstream markets. In this case, the demand by customers for the provision of transport services on the downstream market to cross the Øresund between Helsingborg and Elsinore sustains the demand by the ferry-operators for the provision of port services at Helsingborg."

122. Similarly, the value of access to Dover to the objectors will reflect amongst other factors the shortness of the crossing, the resultant savings in fuel cost, the ability to offer a high frequency service, and the existence of good transport links within the UK. That being the case, there is no reason to assume that the value to the operators of access to the port should not exceed a "cost plus" measure.

123. The objectors have argued that DHB has failed to take account of the economic value to the operators by imposing inflated tariffs for the purposes of the construction of T2, against their wishes. However, any unwillingness on the part of the objectors to pay a surplus for the construction of T2 does not mean that the prices charged by DHB exceed the economic value to the objectors of access to the port, given its particular advantages.

124. The Secretary of State further notes that Mr Ogier justified his use of a replacement cost analysis on the basis that it provided a benchmark for a competitive price, and that this point was accepted by the Inspector (IR 330). Thus, whether or not one prefers Mr Harman's historic cost methodology for the purposes of an analysis of whether prices are excessive having regard to cost, the replacement cost analysis may be regarded as a relevant benchmark in considering whether prices are unfair in themselves. On that view, Mr Ogier's view (which was preferred by the Inspector in IR 330) supports the view that prices are not unfair in themselves.

125. The objectors have further relied on the extent of the year on year increase in ferry charges. It is not clear to the Secretary of State that the relationship between a particular year's charge and the previous year's charge is of itself relevant to the principles established by the case law. In any event, the Secretary of State notes the Inspector's finding that that there was evidence that the increase in dues was

in fact small (at least for certain of the objectors) (IR 349). The Secretary of State does not consider that this point warrants the conclusion that the prices charged were unfair.

126. The objectors have also relied on the impact of the fees on their businesses, particularly in the context of otherwise harsh trading conditions. However, the Secretary of State does not consider that the evidence shows that the level of the tariff had any particular or concrete effect on the objectors' businesses which itself points to the conclusion that the fees are unfair.

Competition

127. In *Attheraces*, the Court of Appeal emphasised the need to show that an alleged instance of unfair or excessive pricing has a distortive effect on competition (paras 214 and 217). The Inspector found, having heard the witnesses, that the making of a contribution towards the cash surplus by each of the objectors was unlikely to materially distort competition (IR 438). The Secretary of State sees no reason to disagree with the Inspector's conclusion.

Effect on Trade

128. An abuse of a dominant position contrary to Article 102 must have an effect on trade between Member States. No arguments or evidence have been presented on this point, which does not in any event arise. However, had the argument arisen, the Secretary of State would likely have concluded that prices charged for the use of a port used to establish cross border transport links could in principle have affected trade between Member States.

Conclusion on Abuse of Dominance

129. The conclusion of the Secretary of State is that the available evidence does not indicate that in charging the 2010 harbour dues, DHB abused a dominant position contrary to Article 102. Accordingly a decision of the Secretary of State to approve the 2010 harbour dues under section 31 of the Harbours Act is not contrary to the Secretary of State's duty under Article 106.1, if such a duty pertains.

Conclusion

130. For the reasons set out above the Secretary of State approves the 2010 harbour dues in accordance with section 31(6)(a) of the Harbours Act 1964 subject to a limit on the period during which the approval is to be of effect of 12 months from 1 January 2010.

Enclosures etc.

131. A copy of the Inspector's report is attached for information, together with the response of DHB of 9 December 2011 on competition law issues and a copy of relevant provisions of EU law. A copy of this letter is being sent to each of the parties and will be available on the Department's website in due course.

132. A notice in compliance with section 31(6)(a) of the Act is being sent to DHB and will be published in the relevant newspapers in accordance with section 31(9) as soon as practicable.

Yours faithfully

Anthony Ferguson