INVESTIGATION BY THE DIRECTOR GENERAL OF TELECOMMUNICATIONS (“THE DIRECTOR”) INTO ALLEGED ANTI-COMPETITIVE PRICING BY BRITISH TELECOMMUNICATIONS PLC (“BT”) IN RELATION TO ITS UK-SPN CALLS SERVICE

NOTE: WHERE TEXT APPEARS AS […] THIS INDICATES THAT A FIGURE OR PASSAGE HAS BEEN EXCISED ON THE GROUNDS OF CONFIDENTIALITY

INTRODUCTION

1. The Director has conducted an investigation examining whether British Telecommunications plc (“BT”) has infringed Section 18(1) (“the Chapter II prohibition”) of the Competition Act 1998 (“the Act”) in relation to the pricing of its UK-SPN service.

2. The Director has concluded that BT has not infringed the Chapter II prohibition. BT has not engaged in anti-competitive practices in terms of the prices charged for its UK-SPN service.

3. BT launched its UK-SPN service in April 2002. During the Director’s investigation BT announced that the UK-SPN service would no longer be available to new customers with effect from 30 May 2003, and BT has informed the Director that the service will be withdrawn from BT’s portfolio by […].

4. BT, whose registered office is at 81 Newgate Street, London EC1A 7AJ, is the listed holding company for an integrated telecommunications group that provides voice and data services in the UK and elsewhere. Its principal activities include local, national and international telecommunications services, broadband and internet products and services, and IT solutions. BT serves approximately 21 million UK residential and business customers. In the financial year to March 2002, BT had a UK turnover (from continuing activities) of £16.7 billion.¹ BT is an undertaking for the purposes of the Chapter II prohibition. Within BT, the BT Wholesale business is responsible for the provision of the UK-SPN service.

¹ BT Annual Report 2002, pages 8 and 86.
THE UK-SPN PRODUCT

5. The investigation concerned BT’s UK-SPN calls only service (the “UK-SPN service”). The UK-SPN service is a wholesale Indirect Access (“IA”) product provided by BT using a network leased from the administrators of a failed telecommunications company (“telco”). The UK-SPN service supplies end-to-end calls to service providers for resale to end users. These service providers either do not have a telecommunications system (‘systemless service providers’), or do not wish to carry certain calls on their own telecommunications system.

6. In order to provide this service, BT purchases from itself wholesale IA call origination and when appropriate termination, in the same way as IA operators, supplying the remaining transit element of a call across the UK-SPN network.

7. The cost to BT of any call on the UK-SPN network is therefore built up from origination, conveyance over the UK-SPN network and termination. Charges for origination and termination are regulated by Oftel’s Network Charge Control regime and subject to cost-orientation obligations imposed via BT’s telecommunications licence granted under section 7 of the Telecommunications Act 1984. The charge that BT pays for call origination and termination segments of the UK-SPN service are the same charges payable by any other competing IA operator.

Cost elements of the UK-SPN service

2 Typically a telecommunications service consists of both ‘calls’ and ‘access’ elements (i.e. for a retail customer there is a charge for making individual calls and a line rental (and connection) charge for the physical provision of the network into an end-user’s premises). A calls only service is simply the supply of individual calls at a pence per minute charge - there is no ‘access’ (i.e. line rental charge) element within the package. In the case of the UK-SPN service, the reseller will simply buy and sell on BT wholesale call minutes to end-users. In most cases, the end-user will have access provided and billed by BT.

3 Indirect Access is where a customer’s call is routed and billed through operator A’s network even though the call originated from the network of operator B (in this case BT). The customer typically enters a four or five digit access code (or an auto-dialler does so automatically) and the call is routed via the alternative operator.
THE DIRECTOR’S INVESTIGATION

8. The Director had reasonable grounds for suspecting that the Chapter II prohibition had been infringed by BT in relation to the pricing of the UK-SPN service, on the basis of a complaint made by a number of BT’s competitors. The complainants were: Thus plc, Kingston Communications (Hull) plc, MCI Worldcom Ltd, Energis Communications Ltd, Omne Communications Ltd, COLT Telecommunications Group Plc, Telia International Carrier (UK) Ltd, and Cable and Wireless Plc (“the complainants”). The complainants made three allegations:

1. the UK-SPN service was being provided by BT below cost;
2. BT was using the UK-SPN service to specifically target markets to the detriment of alternative network providers;
3. BT’s pricing of the UK-SPN service may represent price discrimination at the retail level between systemless service providers and BT’s other corporate retail customers.

Allegation 1: UK-SPN service below cost

9. That complaint alleged that the UK-SPN service was being provided by BT below cost and that BT was funding the shortfall from profits on activities in other markets in which it appeared that BT was likely to hold a dominant position.

10. BT is a supplier of interconnection services to competitors in the downstream markets in which the UK-SPN service is sold. In this investigation, the Director considered that a margin squeeze was the most appropriate way to characterise the alleged abuse (see paragraphs 21 to 27). The Director confirmed this in a letter to the complainants dated 22 July 2002.

Allegation 2: Targeting competitors

11. The complainants also alleged that BT was using the UK-SPN service to specifically target markets to the detriment of alternative network providers. As part of the investigation the Director considered whether any evidence indicates that BT may have sought to engage in an anti-competitive strategy aimed at foreclosing relevant markets(s) or causing one or more competitors to exit those markets.

Allegation 3: Price discrimination

12. The allegation was also made by the complainants that BT’s pricing of the UK-SPN service represents price discrimination at the retail level between systemless service providers and BT’s other corporate retail customers, by offering lower prices to the former group.

13. The Director considers that offering different prices to service providers for resale than to other corporate customers would not of itself represent anti-competitive price discrimination. First, there are likely to be objective reasons for charging different prices, in particular, different underlying costs of supplying the two groups of customers. Such pricing could therefore represent price differentiation rather than
price discrimination. Second, even if there were price discrimination (rather than price differentiation), in the circumstances of this case, there would not be a material adverse effect on competition, as these two groups of customers do not themselves compete in the same downstream markets. BT’s business customers do not compete in the provision of retail end-to-end telephone calls (ie the markets in which resellers compete).

**SUSPECTED BREACH OF THE CHAPTER II PROHIBITION – ABUSE OF A DOMINANT POSITION**

14. The Chapter II prohibition of the Act prohibits conduct in a market by one or more undertakings which amounts to an abuse of a dominant position, if it may affect trade within the United Kingdom.

15. Section 18(2)(a) of the Act explains that conduct may amount to an abuse if it consists of “directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions”.

**Market definition**

16. The Director is satisfied that BT’s conduct in this case would not infringe the Chapter II Prohibition (his conclusions are detailed below). It is not therefore necessary, in issuing this decision, for the Director to reach any firm conclusions on the relevant market(s) and whether or not BT may be dominant within them. However, the Director’s investigation necessarily included a consideration of likely upstream and downstream market definitions; this was in order to illustrate the characterisation of the alleged abuse.

**Upstream markets**

17. The relevant upstream markets are the input markets from which a dominant position could be leveraged, in particular via an attempted margin squeeze. As part of the implementation of the new EC regulatory framework for electronic communications the Director has published his current view on market definitions for fixed telephony. For the purpose of this investigation the upstream markets would appear to be:

- fixed narrowband call origination in the UK excluding Hull (ie from the end-customer’s telephone line over the BT ‘core’ network up to the point of hand-over to the UK-SPN network (or alternatively another operator’s network))

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4 See for example, para 3.5, OFT Competition Act 1998 guideline OFT 414: Assessment of Individual Agreements and Conduct.

5 OfTEL publication: Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets, consultation - 17 March 2003

• fixed narrowband call termination on BT’s network (from the point of hand-over to the BT network to the end-customer (noting that call termination costs exclude all access network costs))

18. From previous investigations, data collected under the Director’s ongoing responsibilities as a sectoral regulator, and current market reviews, the Director has evidence to suggest that BT’s share of fixed narrowband call origination minutes has persistently exceeded 50%. The European Court has held that if an undertaking’s market share has persistently exceeded 50%, it will, unless there is evidence to the contrary, be presumed to be dominant.

19. The Director has consistently defined fixed geographic call termination on each operator’s network as constituting a separate market. Therefore, BT is also likely to hold a position of dominance in call termination on its own network.

**Downstream markets**

20. The downstream markets of relevance in this case are those in which the UK-SPN service is sold since these are the markets in which a margin squeeze would potentially have an effect on competition. The end-to-end call markets of interest therefore are likely to include local calls, national calls, international calls on a route by route basis, and calls to mobiles in the UK excluding Hull.

**The alleged abuse - Margin Squeeze**

21. As set out in Oftel’s Competition Act Guidelines (the “Competition Act Guidelines”) ‘...[w]here a vertically integrated undertaking is dominant in an upstream market and supplies a key input to undertakings that compete with it in a downstream market, there is scope for it to abuse its dominance in the upstream market. The vertically integrated undertaking could subject its competitors in the downstream market to a price or a margin squeeze by raising the cost of the key input … and/or by lowering its prices in the downstream market. The integrated undertaking’s total revenue may remain unchanged. The effect would be to reduce the gross margin available to its competitors, which might well make them unprofitable.'

22. BT is a vertically integrated supplier of calls. BT provides wholesale interconnection services (such as fixed narrowband call origination and termination), end-to-end calls to service providers and end-to-end calls to end-users (ie retail sales). Given a dominant position in interconnection services, BT would have the potential to engage in conduct which could have a material adverse effect on

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8 See footnotes 5 and 6 above
11 Ibid at paragraph 7.26.
competition in end-to-end call markets. This would be through the reduction of the margin available to competitors between the prices for end-to-end calls and the charges for interconnection services. This is known as a margin squeeze. A margin squeeze is a form of vertical leveraging by which a firm attempts to exploit a position of dominance in an upstream market to restrict or distort competition in a downstream market.

23. The European Commission found a margin squeeze to be an abuse of a dominant position in *Napier Brown/British Sugar*¹², stating that:

>'The maintaining by a dominant company, which is dominant in the markets for both a raw material and a corresponding derived product, of a margin between the price it charges for a raw material to the companies which compete with the dominant company in the production of the derived product and the price which it charges for the derived product, which is insufficient to reflect that dominant company’s own costs of transformation (in this case the margin maintained by Napier Brown between its industrial and retail sugar prices compared to its own repackaging costs) with the result that competition in the derived product is restricted, is an abuse of a dominant position.'¹³

24. The European Commission’s Telecommunications Access Notice (‘the EC Access Notice’)¹⁴ sets out the same method for demonstrating a price squeeze as that set out in *Napier Brown/British Sugar*:

>'A price squeeze could be demonstrated by showing that the dominant company’s own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant company.'¹⁵

25. The *Napier Brown* decision concerned a situation in which an undertaking was dominant in both the relevant upstream and downstream markets. The EC Commission’s Access Notice refers to a situation in which the firm is dominant in the upstream market only.

26. The Competition Act Guidelines set out Oftel’s statement of policy concerning margin squeeze:

>'In considering whether an undertaking is engaging in price squeezing in breach of the Competition Act, the Director General will consider whether the dominant undertaking would be profitable in the relevant downstream market if it had to pay the same input prices as its competitors. A dominant undertaking may try to conceal a price squeeze by allocating to its upstream activities costs that are actually incurred as a result of its downstream activities. The Director General will give close consideration to the method of

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¹² EC Commission decision 88/518.
¹⁴ Notice on the application of the competition rules to access agreements in the telecommunications sector, OJ C265, 22/08/1998.
¹⁵ See note 12 above at paragraph 117.
A margin squeeze analysis, therefore, requires an identified wholesale price, i.e. the price of the good supplied by the upstream dominant undertaking to companies competing with it in downstream markets. In the case of the UK-SPN service, the relevant wholesale price is the price set by BT for interconnection services that competitors must purchase in order to offer end-to-end calls to their customers, i.e. call origination and termination charges.

**Analysis of BT’s pricing of the UK-SPN service**

**Stack test for margin squeeze**

28. In investigating a margin squeeze allegation, the relevant cost stack\(^{17}\) is comprised of the price paid by competitors for upstream inputs and the other costs of an efficient downstream operator (typically the vertically integrated firm’s downstream costs are used, as indicated in the above citations from *Napier Brown/British Sugar*, the EC Access Notice and The Competition Act Guidelines). In this case, BT’s costs for end-to-end calls include call origination, call termination and the costs associated with supplying a calls only service via the UK-SPN network. The first two of these elements (i.e. call origination and call termination) are priced as regulated charges (see paragraph 7 above).

29. It should be noted that if a cost-stack were built up using the long-run incremental cost (LRIC) of each input the result would be lower than the relevant cost-stack for an equally efficient downstream competitor. This is because downstream competitors purchase inputs from BT (i.e. call origination and call termination) at charges which consist of LRIC plus a mark up to cover BT’s network common costs. Therefore, the pence-per-minute (ppm) cost stack for the UK-SPN service comprises:

- the relevant pence per minute (“ppm”) charges for call origination and call termination (when bought from BT) from the network charge controls, as derived in the bottom row of Tables 1A and 1B; and

- the average ppm LRIC cost attributable to the UK-SPN platform.\(^{18}\) These costs were set out in evidence submitted to the Director by BT and relate chiefly to the

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\(^{16}\) See note 10 above at paragraph 7.26.

\(^{17}\) A cost stack is a summation of the various costs involved in providing a service.

\(^{18}\) As explained in paragraph 7.8 of the Competition Act Guidelines, ‘The long run incremental cost (LRIC) measure takes into account the total long run costs (that is, both capital and operating costs) of supplying a specified additional unit of output (‘the increment’). The increment could be, for example, the provision of a new service. If the price of a service covers all its LRIC, including the costs of capital (and with any common costs being recovered through charges for the undertaking’s other services), it will be profitable for the undertaking to offer the service. As the provision of telecommunications services is characterised by high levels of capital costs it will generally be appropriate to use LRIC as the cost base.’ At paragraph 7.10 of the Competition Act Guidelines it states ‘The use of LRIC as the cost base for the supply of telecommunications services is also consistent with the view that in network industries it is generally inappropriate to measure the cost of supplying a service by reference to average variable costs’.
network lease agreement, external support contracts, switching and circuits, and labour costs. Further details on the method used by the Director to calculate an average LRIC for the UK-SPN service is discussed below.

**The Director’s Analysis of UK-SPN prices**

30. The Director has obtained detailed evidence from BT about the cost of providing end-to-end calls via the UK-SPN network. In particular, the Director has examined the nature of the original network lease agreement between BT and the administrators of the failed telco and documentation setting out a detailed description of relevant costs.

31. The Director was able to establish the cost to BT of the necessary interconnection services (ie fixed narrowband call origination and termination valued at BT’s charges for these services) based on the level of connectivity of the UK-SPN network to BT’s core network (Tables 1A and 1B)\(^{19}\). [...]% of all call origination to the UK-SPN service is single tandem, [...]% is double tandem. Similarly, [...]% of all call termination on BT’s network from the UK-SPN service is single tandem, [...]% is double tandem.

Table 1A – average UK-SPN service call origination

<table>
<thead>
<tr>
<th></th>
<th>Day</th>
<th>Eve</th>
<th>W/end</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Tandem</td>
<td>0.5267</td>
<td>0.2411</td>
<td>0.1899</td>
</tr>
<tr>
<td>Double Tandem</td>
<td>0.7924</td>
<td>0.3628</td>
<td>0.2857</td>
</tr>
<tr>
<td>Weighted average call origination charge</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
</tbody>
</table>

Table 1B - average UK-SPN service inland fixed narrowband call termination charge

<table>
<thead>
<tr>
<th></th>
<th>Day</th>
<th>Eve</th>
<th>W/end</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Tandem</td>
<td>0.5212</td>
<td>0.2386</td>
<td>0.1879</td>
</tr>
<tr>
<td>Double Tandem</td>
<td>0.7868</td>
<td>0.3603</td>
<td>0.2837</td>
</tr>
<tr>
<td>Weighted average call termination charge</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
</tbody>
</table>

\(^{19}\) Tables 1A and 1B include the regulated published price per minute charge for day, evening and weekend periods, for single and double tandem connections. The weighted average price = (single tandem price x [...] + (double tandem price x [...])}
Price-cost test using BT’s forecast total volume and distribution of volumes among call-types

32. The Director carried out a price-cost analysis on various call types. The call types used account for (on the basis of BT’s forecasts) [...]% of all traffic carried over the UK-SPN.

33. The Director performed a forward-looking Discounted Cash Flow (DCF\textsuperscript{20}) analysis of the UK-SPN platform costs expected over the lifetime of the service set out in BT’s business case (ie [...] months which reflects the length of the lease). Using this information, the Director calculated the nominal pence per minute value, which when multiplied by forecast volumes for each month would yield a stream of payments with a present value equal to the present value of platform costs over the life of the service. This figure can be regarded as an estimate of the per minute platform cost of the UK-SPN service. It is dependent, in particular, on the assumption about volume forecasts. This cost was then added to the weighted average charges for call origination and termination (based on the single tandem to double tandem ratio – see Tables 1A and 1B above) for each call-type. The resulting margins between price and the above cost-stack (both on a time of day weighted basis) are shown below in Table 2.

34. The weighted-sum of the resulting price-cost margin for each call-type was then used to give an indication of the pence per minute margin for the service as a whole. The estimated margin for the service as a whole is shown in the bottom row of Table 2. (NB This service-level margin calculation assumed that the [...]% of call-types by volume not surveyed in detail – e.g. inland non-geographic and other IDD – are all break-even, ie prices cover average origination and termination charges plus average LRIC for the UK-SPN platform.)

\textsuperscript{20} A DCF analysis is relevant in order to take account of the timing of future costs under the business plan for the UK-SPN service. This is because future cash flows are worth less than current cash flows. The weight attached to future cash flows is known as a discount factor and depends on the opportunity cost of funds to the firm, i.e. its cost of capital. As explained in paragraph 7.23 of the Competition Act Guidelines “In assessing whether the revenue from providing a service would exceed the LRIC it may be useful to perform a DCF analysis. This is a forward-looking analysis of the incremental cash flows (in terms of both costs and revenues) that are expected to arise from a service. It may be particularly useful to perform a DCF analysis in relation to new services or for a service in its start-up phase, when it is often reasonable to expect initial losses to be incurred. A DCF analysis is one of the standard methods of investment appraisal. It should be based on assumptions that are consistent with those made in a business plan in relation to, for example, the competitive conditions to be expected in the market. It will not always be possible for an undertaking to meet all targets set out in its business plan. Evidence of an abuse of dominance may be provided, however, where a business case is based on unjustified and implausible assumptions or where there has been a failure by the undertaking to take remedial action once it became apparent that it would not meet the targets”.

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Table 2. Price-cost test for the call-types analysed and for the service as a whole. (Analysis based on BT forecast usage and distribution of minutes among call-types.)

<table>
<thead>
<tr>
<th>Call-type</th>
<th>ppm margin (time of day weighted)</th>
<th>margin as a percentage of price (time of day weighted)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local/national</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>Orange</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>Vodafone</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>T-Mobile</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>O2</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>Dolphin</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>Total calls to mobiles</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>USA</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>Germany</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>France</td>
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<tr>
<td>Australia</td>
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<td>[...]</td>
</tr>
<tr>
<td>India</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>TOTAL (weighted by expected volumes per call-type)</td>
<td>[...]</td>
<td>[...]</td>
</tr>
</tbody>
</table>

* denotes not calculated

35. The results of the analysis in Table 2 indicate that certain call-types (namely local/national calls and certain IDD routes) appear to marginally fail the price-cost test, although the test is passed for the service as a whole (ie the aggregate margin of [...]ppm is positive). The Director is aware that cost calculation depends on assumptions, and considers that the margin of failure on the call-types in question is not definitive. In particular, the below cost call-types are only just below cost as a proportion of price, and the largest negative margin is smaller than [...]%. This is likely to be within the margin of error of the calculation.

36. The Director therefore considers that, looked at alone, the information available at the time the UK-SPN service was launched suggests that it would have been incrementally profitable for BT to launch this service.

**Price-cost test using revised forecasts (in the light of information on actual volumes)**

37. The conclusions in the previous section are based on traffic forecasts contained in BT’s original business plan. BT later provided the Director with data on actual traffic levels for the UK-SPN service, which showed that actual volumes were significantly lower than forecast in BT’s original business plan. For the purposes of analysis the Director therefore considered it necessary to revise traffic forecasts for the remaining period of the service. The results in Table 3 were derived using volumes based on actual data for the months available and thereafter forecast
volumes on the assumption that growth follows a similar pattern to that assumed under BT’s original forecasts (but applied to a lower starting level ie as determined by the last available actual volume figures). The pattern of usage underlying the margin calculations in Table 3 is depicted in Chart 1 as the series labelled ‘Actual and base case revised fcst’.

38. Using actual and revised forecast total usage for the UK-SPN service (rather than the original forecast total usage), the Director believes that the evidence points to each call-type failing to make a sufficient contribution to the UK-SPN platform costs in order for there to be full cost recovery. The calculation of the weighted average service margin uses the actual distribution of volumes among call-types. This distribution is assumed to remain constant over the forecast period. As can be seen from Table 3, using actual and revised forecast total usage, the forecast aggregate margin would be […]ppm.

Table 3. Price-cost test for the call-types analysed and for the service as a whole. (Analysis based on actual volumes and the Director’s revised forecasts.)

<table>
<thead>
<tr>
<th>Call-type</th>
<th>ppm margin (time of day weighted)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local/national</td>
<td>[…]</td>
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<tr>
<td>Orange</td>
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<tr>
<td>Vodafone</td>
<td>[…]</td>
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<tr>
<td>T-Mobile</td>
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<td>O2</td>
<td>[…]</td>
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<tr>
<td>Dolphin</td>
<td>[…]</td>
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<tr>
<td>Total calls to mobiles</td>
<td>[…]</td>
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<tr>
<td>USA</td>
<td>[…]</td>
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<tr>
<td>Germany</td>
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<td>France</td>
<td>[…]</td>
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<tr>
<td>Australia</td>
<td>[…]</td>
</tr>
<tr>
<td>India</td>
<td>[…]</td>
</tr>
<tr>
<td>TOTAL</td>
<td>[…]</td>
</tr>
</tbody>
</table>

39. Even if one were to make the extreme assumption that volumes were to increase linearly from their actual level to the level originally forecast by BT for the end of the business case (ie a pattern of usage corresponding to the series labelled ‘Actual and high growth revised fcst’ in chart 1 below), margins for each call-type would still be negative. Under this extreme growth scenario the aggregate margin would be […]ppm.

40. BT’s forecast total volumes for the UK-SPN service and the revised forecasts referred to above are shown in the following chart. However, in a letter dated 4 February 2003 BT informed the Director of its intention to close the UK-SPN platform within a few months, on the basis of its own analysis that showed that it would not be economic to renew property leases (due to expire on […]).
Effect of the UK-SPN service on competition

41. In light of the results set out in paragraphs 37 to 40, which indicate a margin squeeze in relation to the UK-SPN service, the Director went on to consider whether the UK-SPN service has had a material adverse effect on competition. In Michelin v Commission\(^\text{21}\) the ECJ set out that a practice may be found to be abusive where they ‘have the effect of hindering the maintenance or development of the level of competition still existing on the market’. Commercial Solvents v Commission\(^\text{22}\) set out that it can be an abuse to engage in a practice that may entail a serious risk of anti-competitive effect in the future, although it is likely that to prove an abuse it would have to be shown that the risk of such anti-competitive effect is a real one. In considering this issue, the Director looked at the volumes of calls carried by the UK-SPN network and competitor prices and how they compare with UK-SPN service prices.

Volume of Calls Carried by the UK-SPN Network

42. In considering whether there has been any material adverse effect on competition resulting from the fact that BT’s prices for the UK-SPN service have failed to recover sufficient revenue to cover costs in the initial stages of the business, it is relevant that the UK-SPN service has not met expected volumes.

43. The Director has carried out an analysis of the potential effects of the UK-SPN service upon competitors’ services. The Director has compared volumes of calls carried by the UK-SPN network with volumes of calls supplied to service providers by competitors to the UK-SPN service. On the basis of his analysis, the Director has estimated that the maximum likely impact the UK-SPN service could have had at the end of the business plan period, was to carry volumes equating to 8% of competitor volumes of end-to-end calls supplied to service providers. It should be noted that this estimate of 8% of service provider sales is very much an upper bound of the potential effect of the UK-SPN service.\(^\text{23}\) BT’s actual volumes turned out to be much lower than forecast. The maximum actual impact on competitors’ volumes for the latest complete quarter for which the Director received data was less than 1%.\(^\text{24}\) In the Director’s view the actual effect is likely to have been even lower than this as:

\[^{21}\text{Case 322/81 [1983] ECR 3461 at paragraph 70}\]
\[^{23}\text{Taking the base case assumption for volume forecasts (see Chart 1), UK-SPN traffic would have been […] minutes in the final quarter modelled. (Forecast rather than actual traffic has been used in this comparison because actual data covered only what might be considered the start-up phase of the business and a more cautious approach would point to considering the likely impact of the UK-SPN once traffic might be expected to stabilise.) Competitor traffic was […] minutes in Q2 2002/03 (comprising only traffic data received from complainants, ie not all competitors, and excluding those complainants unable to separate in-house supply of minutes from third party wholesale supply).}\]
\[^{24}\text{Actual SPN traffic for Q2 2002/03 was […]minutes. Dividing this by the figure for competitor traffic excluding those complainants unable to separate in-house supply from third party wholesale supply (see previous footnote) gives 0.4%}\]
• his estimate of the size of total sales of end-to-end calls to service providers is likely to be underestimated as it omits volumes carried by competitors not sampled (i.e., those not party to the original complaint); and

• his calculation strips out those complainants who have been unable to distinguish end-to-end calls sold to service providers from those supplied in-house (i.e., to their own retail operations).

**Competitor price comparison**

44. As another test to assess the impact on competition the Director undertook a comparison of prices for the UK-SPN service against both pre and post-launch competitor prices, comparing both the levels of individual call types and a weighted average price (based on local, national, calls-to-mobiles and selected international routes). Although the Director recognises that not all pricing is directly comparable (for example, some but not all operators price local and national calls differently or, alternatively, the structure of volume discounts and ‘best-price’ available will vary from operator to operator), he considers Table 4 below to be sufficiently indicative of price levels for the purposes of comparison.

45. Competitor prices appear broadly in line with those of the UK-SPN service. The time-of-day and call-type weighted average price for the UK-SPN service is around the average for the competitors surveyed. This is shown in Table 4.

**Table 4. UK-SPN and competitor prices**

<table>
<thead>
<tr>
<th></th>
<th>Aggregate service price (ppm)</th>
<th>Aggregate service price relative to SPN</th>
</tr>
</thead>
<tbody>
<tr>
<td>BT (UK-SPN)</td>
<td>[…]</td>
<td>[…]</td>
</tr>
<tr>
<td>KC</td>
<td>[…]</td>
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<td>Thus</td>
<td>[…]</td>
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</tr>
<tr>
<td>Colt</td>
<td>[…]</td>
<td>[…]</td>
</tr>
<tr>
<td>C&amp;W</td>
<td>[…]</td>
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</tr>
<tr>
<td>Telia</td>
<td>[…]</td>
<td>[…]</td>
</tr>
<tr>
<td>Worldcom</td>
<td>[…]</td>
<td>[…]</td>
</tr>
<tr>
<td>Pre-launch (based on KC &amp; Thus) arithmetic mean</td>
<td>[…]</td>
<td>[…]</td>
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<tr>
<td>Sample arithmetic mean with SPN included</td>
<td>[…]</td>
<td>[…]</td>
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<tr>
<td>Sample arithmetic mean with SPN excluded</td>
<td>[…]</td>
<td>[…]</td>
</tr>
</tbody>
</table>

Note: Weighting by time-of-day and across call types based on SPN weights.
46. Although not shown in Table 4, for each call type analysed (ie local, national, calls-to-mobiles (an average of calls to all mobile networks) and five selected IDD routes) there was at least one competitor to the UK-SPN service whose time-of-day weighted average prices were below that of the UK-SPN service.

47. This suggests that at the time of launch of the UK-SPN service BT did not deliberately attempt to undercut its competitors. The fact that established competitors in wholesale end-to-end calls priced at similar levels to UK-SPN prices (and for a number of individual call types priced lower) is consistent with competitors’ businesses remaining viable despite the introduction of the UK-SPN service.

48. The Director is, however, aware that careful interpretation is needed of evidence regarding comparison between an incumbent’s alleged anti-competitive price and competitors’ prices. It is possible that the competitor could be constrained to match, or even to undercut, the incumbent’s prices in order to remain effective players in the market. The relatively low volumes realised by BT’s UK-SPN service, however, does not provide support for the plausibility of this interpretation. In the circumstances of this case the Director regards the evidence of competitors’ prices as supportive of the conclusion of a lack of material anti-competitive effect, but he has not relied on this evidence.

Effect of the UK-SPN service on competition - conclusion

49. On the basis of the evidence available to the Director in terms of the effect of the UK-SPN service, the Director does not believe that the UK-SPN service has to date hindered the maintenance or development of competition in the relevant downstream markets. There is no evidence to demonstrate that the UK-SPN service has had a material adverse effect on competition.

Evidence of an Intention to Engage in Anti-Competitive Behaviour

50. The Director found evidence that BT was aware of the competitive threat posed by alternative network operators and was keen to supply systemless service providers with a competitive calls only product. Whilst BT could have sought to develop and offer a calls only service over its core network it regarded entry to the market via the UK-SPN service as a quicker, though more limited, option. Providing an equivalent product on BT’s core network would require significant work to upgrade the network.

51. As stated in the Competition Act Guidelines, “evidence of an abuse of dominance may be provided... where a business case is based on unjustified and implausible assumptions or where there has been a failure by the undertaking to take remedial action once it became apparent that it would not meet its targets.” Actual volumes carried in the first months of BT’s UK-SPN service have not been sufficient to enable BT to generate the revenue required to fully recover the anticipated costs of the UK-SPN service. However, the Director does not consider

25 See footnote 10 above  
26 Ibid at paragraph 7.23
that BT’s original business case was implausible based on BT’s forecast call volumes compared to actual call volumes of competing operators.\textsuperscript{27}

52. The Commission’s decision in Deutsche Post\textsuperscript{28} established that the dominant undertaking in that case, by remaining in the market without any foreseeable improvement in revenue, would restrict the activities of competitors that are in a position to offer this service at a price that covers their costs.\textsuperscript{29} In the case of the UK-SPN service, after several months’ actual data the Director is aware that BT has taken the decision to close the service in light of failure to achieve expected demand. The Director believes that BT has therefore satisfied the duty on dominant undertakings to exit the market where there is no foreseeable improvement in revenue, which was suggested by the Deutsche Post decision.

53. The Director therefore concludes that there is insufficient evidence to demonstrate that BT intended to engage in a practice consistent with an anti-competitive strategy.

CONCLUSION: NON-INFRINGEMENT

54. The Director has now completed his investigation. On the basis of the information available to him, the Director has concluded that:

- on BT’s original forecast volumes the UK-SPN service would have been a profitable service in aggregate and those call-types forecast to be below cost would be insignificantly so relative to price;
- on actual and revised forecast volumes carried by the UK-SPN network, prices are unlikely to cover the relevant cost floor for any call-type;
- however, BT’s original business case was not implausible and after several months’ actual data BT has taken the decision to close the business;
- there is no evidence to demonstrate that the UK-SPN service had a material adverse effect on competition; and
- there is also insufficient evidence that BT intended to pursue an anti-competitive strategy. The available evidence suggests a new business that was unsuccessful in meeting forecast demand (and as a result has been withdrawn) rather than a deliberate or negligent anti-competitive strategy.

55. For these reasons, the Director does not consider that BT’s pricing of the UK-SPN service constitutes an infringement of the Act.

\textsuperscript{27} Last quarter of BT’s business case (April to June 2003) forecasts [...] minutes, compared to actual call volumes (July to September 2002) for competing operators; Cable and Wireless: [...] minutes, Energis: [...] minutes, Kingston Communications: [...] minutes, and Worldcom: [...] minutes. While not a like for like quarterly comparison with actual volumes achieved by competitors, the last quarter figures in BT’s business case are presumed to represent a sufficiently stabilised period for the purposes of comparison.

\textsuperscript{28} OJ [2001] L125/27

\textsuperscript{29} Ibid at paragraph 36