

## How to define a market: Lessons from the UK Competition Appeal Tribunal

- **Ofcom's Business Connectivity Market Review was overturned by the Competition Appeal Tribunal**
- **The CAT gave detailed reasons why it rejected Ofcom's market product and definitions...**
- **... and with one eye to the future set out the market definition process that should be followed.**

Ofcom's Statement following its Business Connectivity Market Review in 2016 was appealed to the Competition Appeal Tribunal whose judgement was published in November 2017<sup>i</sup>. This edition of Hexagon highlights some of the key findings of the CAT and why the Ofcom Statement was overturned and remitted back to the regulator. It also explains why the CAT may have had an eye to the future when setting the market definition process.

Market definition, and particularly geographic market definition, is often seen as the less glamorous end of competition cases. Its purpose is simply to set the boundaries of the case to be reviewed and so is a necessary, if somewhat tiresome, step on the way to assessing dominance and potentially imposing remedies. However, the judgement by the Competition Appeal Tribunal (CAT), published on 10<sup>th</sup> November 2017, on the appeal by British Telecommunications plc against UK communications markets regulator Ofcom's Business Connectivity Market Review (BCMR) shows the importance of market definition. The CAT upheld BT's appeal and remitted the

market review back to Ofcom on the basis that it erred in both its product and geographic market definitions<sup>ii</sup>.

This appeal was the last to be held under the Communications Act 2003, which allowed Ofcom's decisions to be appealed "on the merits". In future, appeals will be under the Digital Economy Act 2017 and will be equivalent to a Judicial Review, i.e. on the process. An interesting dimension to the CAT's judgement, therefore, is the extent to which it sets out the proper process for conducting a market definition exercise. The judgement appears to give some guidance on the proper process of market definition that may have implications for future reviews.

First, the CAT makes it clear that the Hypothetical Monopolists Test (HMT) is about the *profitability* or otherwise of a SSNIP<sup>iii</sup>. This may, perhaps, be a restatement of the obvious, but it is nonetheless important. At Para. 162 the CAT says: "... the critical question in conducting the HMT remains the same: whether or not a SSNIP in relation to the focal

product would be unprofitable” (emphasis added).

The CAT refers to the usefulness, in some cases, of a Critical Loss Analysis, which it describes as a numerical analysis that seeks to estimate whether a SSNIP would be unprofitable based on estimates of the hypothetical monopolist’s gross margin and consumers’ likely level of switching. Regulators have tended to avoid use of this analysis, largely because of the informational requirements to do it properly. The CAT does not say it needs to be performed but does make the point that it is useful in determining if a SSNIP would be unprofitable.

A second issue is the chain of substitution. Ofcom’s argument was that there was a single product market for all bandwidths of Contemporary Interface Symmetric Broadband Origination (CISBO) leased lines due to a chain of substitution that links the slowest to the fastest bandwidth. BT contested this and argued that there is a break in the chain between 1 Gigabit per second (G) and 10G and so two separate product markets.

Two questions of process are highlighted in the CAT’s judgement. First, Ofcom took the view that there would be as much upward migration in the event of a SSNIP by a monopolist of 1G lines as there would downward migration in the event of a SSNIP by a monopolist of 10G. The CAT rejects this conclusion at Para. 248. It states “Overall, therefore, we do not find any error on the part of Ofcom in considering that 1G users exhibit a degree of price sensitivity as regards an upgrade to a 10G services. We do not, however, find any support for the proposition that many 10G users would consider switching down to a 1G service in response to a 10G SSNIP”.

Secondly, Ofcom’s consideration of the chain of substitution only examines one potential break, between 1G and 10G. The judgement makes it clear that neighbouring products on *both sides of the focal product* must be considered, not just on one side (Paragraphs 323 – 329).

Turning to the question of geographic market definition, Ofcom defined geographic markets

based on *prima facie* competitive conditions and used a “Boundary Test” to determine whether a geographic area was likely to be competitive or not. The boundary was set as BT plus an average of four or five other operators in a post code sector, dependent on businesses’ proximity to connection points. Ofcom also considered contiguity of postcode sectors such that there needed to be a reasonable number of postcodes next to each other that passed the Boundary Test. Again, two process issues stand out from the CAT’s findings.

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*Geographic markets must be defined using the same products as product markets*

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First, Ofcom attempted to use only Very High Bandwidth ( $\geq 1G$ ) circuits when defining geographic markets despite including all bandwidths in the product market. It also excluded Ethernet in the First Mile (EFM) from the geographic market definition despite including it in the product market definition. In other words Ofcom defined geographic

markets using a subset of the product market definition.

The CAT rejected Ofcom's use of a subset of products. It stated: "there was no logical justification for having regard to only a selected part of that product market (VHB) when examining the question of competitive conditions for the purpose of defining the geographic market" (Para. 373).

Secondly, BT claimed that Ofcom had designed the Boundary Test such that only the Central London Area (CLA) would be found competitive. The CAT seemed frustrated that Ofcom could not prove it had not done so or that BT could prove it had done so: referring to a "rather confused factual background" (Para. 418).

However, it concludes on this point by saying "...that if it were to transpire that the Boundary Test had simply been fixed to define the CLA boundary by reference to the historic [Central and East London Area] boundary, rather than as a result of some appropriate review of the

requirements for effective competition in 2016, it would obviously not have been correct for Ofcom simply to conclude that no other area in the UK could be effectively competitive unless it was as competitive as the CLA" (419).

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*Defining markets correctly is important: an incorrect market definition invalidates the whole market review*

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Getting product and geographic market definitions correct and following the correct procedure for coming to such definitions were clearly important in this case. Three key lessons come from the analysis above. First, the HMT concerns the profitability or otherwise of SSNIP. For products to be in the same market it must be shown that a SSNIP on the focal product would unprofitable. Demonstrating there would be some level of switching is not enough. Secondly, when considering the chain of substitution, alternative variants on both sides of the focal product must be considered as well as both upward and downward

substitution. Finally, geographic markets must be defined on the same basis as product markets and boundaries should be set between competitive areas and the rest of the country, not between the most competitive area and the rest.

As a result of rejecting the market definition, the CAT has remitted the review back to Ofcom without finding it necessary to hear the issues related to dominance and remedies. For the future, it seems that it will not be enough for regulators just to go through the process of defining markets: they must go through the *correct* process. This judgement indicates some aspects of the correct process.

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<sup>i</sup> Richard Cadman, Director of SPC Network, acted as an expert witness in this case on behalf of CityFibre. Views expressed in this edition of Hexagon are those of the author and not necessarily of CityFibre.

<sup>ii</sup> Ofcom has issued temporary Significant Market Power (SMP) conditions that, according to Ofcom, largely implement the parts of its original Statement that were not contested.

<sup>iii</sup> Small but Significant Non-transitory Increase in Price.