

Undue discrimination by SMP providers

Consideration of responses to a proposal for
investigating potential contraventions on competition
grounds of *Requirements not to unduly discriminate*
imposed on SMP providers

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Consideration of responses

Introduction

- 1.1 In June 2005, Ofcom consulted on an approach to investigating potential contraventions on competition grounds of *Requirements not to unduly discriminate* that have been placed on SMP providers. The proposal was made up of two parts.
- 1.2 Firstly, Ofcom proposed that in all such investigations it should ask two questions:
 - 1.2.1 Do any differences (or similarities) between transaction conditions offered by an SMP provider to two customers reflect relevant differences (or similarities) in the customers' circumstances?
 - 1.2.2 Whether any such differences (or similarities) that are not objectively justified by relevant differences (or similarities) in the customers' circumstances had, have or will have the capability to harm competition?
- 1.3 Secondly, Ofcom proposed a special case. Ofcom proposed that when an SMP provider offers differences in non-price transaction conditions in favour of its own downstream business, then Ofcom should presume undue discrimination, and invite the SMP provider to rebut this presumption.
- 1.4 These proposals represented two changes to the existing guidelines issued by Oftel¹. The first change is a move away from a 'material adverse effect to competition' test to a 'capable of harm to competition' test. The second change is to the scope of the rebuttable presumption.
- 1.5 Ofcom received 15 responses to the consultation. All of the respondents supported Ofcom's proposals to some degree, and the majority of respondents supported most of the positions outlined.
- 1.6 In this document, we set out how Ofcom has taken account of questions raised by respondents. We are simultaneously publishing final guidelines that illustrate Ofcom's new approach to investigating potential contraventions of requirements placed on SMP providers not to discriminate unduly.
- 1.7 The main issues raised by respondents to the consultation were:
 - requests for a comparison of *Requirements not to unduly discriminate* and non-discrimination obligations,
 - the treatment of efficiencies from vertical integration in comparison to the benefits of competition,
 - the scope of the rebuttable presumption, and
 - Ofcom's approach to determining harm to competition.

¹ *Imposing access obligations under the new EU Directives*, September 2002.

Requirements not to unduly discriminate and non-discrimination obligations

- 1.8 The first issue raised during the consultation was the comparison between non-discrimination and undue discrimination.
- 1.9 Some respondents, including Cable & Wireless, UKCTA and Centrica asked Ofcom to confirm whether there are any differences between the obligation of 'non-discrimination' described in the Access Directive (the Directive)² and the *Requirement not to unduly discriminate* deriving from the Communications Act 2003 (the Act). Other respondents submitted that, in their view, *Requirements not to unduly discriminate* are less onerous than non-discrimination obligations, with some believing that the term 'unduly' introduces a triviality or materiality test.
- 1.10 In contrast, Ofcom considers that in wholesale markets *Requirements not to unduly discriminate* (under the Act) have the same meaning, and describes the same concept, as an obligation of non-discrimination (under the Directive). As stated in the consultation, the phrase 'not to discriminate unduly' reflects the transposition into the Act of the concept of non-discrimination under the Directive. In retail markets, Ofcom considers that these requirements have a similar meaning to the obligation of non-discrimination set out in the Directive. However, the obligation is not restricted to customers providing 'equivalent services'³, because in retail markets customers are end users of services.
- 1.11 In particular, in both wholesale and retail markets, Ofcom considers that 'undue discrimination' is a single concept. We do not consider that the terms 'undue' or 'unduly' can be taken separately, or that they imply a materiality or triviality threshold. Given this position, Ofcom believes that the proposals contained in the consultation already enable Ofcom to consider cumulative effects of otherwise minor contraventions, as requested by Scottish and Southern Energy and MCI among others.
- 1.12 Following on from this point, MCI questioned whether Ofcom's proposal to consider harm to competition is necessary. Ofcom does consider that the test is necessary because we do not want to ban commercial behaviour that would benefit consumers. We acknowledge that in some cases customers can be treated differently, independently of their circumstances, in a manner that is consistent with effective competition and that benefits consumers. For example, pricing based on a customer's willingness to pay might help to generate greater demand or help to stimulate a new market sector.
- 1.13 Ofcom's position is reflected in the European Regulators Group (ERG) Common Position on Remedies⁴

In some cases, price discrimination may increase welfare compared to situations without price discrimination, especially when total output rises.

² *Access Directive* (2002/21/EC).

³ Article 10(2) of the Access Directive.

⁴ Paragraph 2.3.3.2, *ERG Common position on the approach to appropriate remedies in the new regulatory framework*, ERG (03)30.

Potential efficiencies from vertical integration

- 1.14 The second group of issues, raised by respondents, concern benefits that derive from vertical integration of an upstream and downstream business.
- 1.15 In relation to fixed telecoms markets in particular, a number of respondents including UKCTA asked how the guidelines relate to the concept of equivalence of outcomes⁵ that Ofcom described within the Strategic Review of Telecoms – Phase 2⁶.
- 1.16 Ofcom considers that this new approach to investigating potential contraventions of *Requirements not to unduly discriminate* will contribute to achieving equivalence of outcomes. However, to be clear, Ofcom does not consider that equivalence of outcomes is the right benchmark in all cases. Specifically, we do not consider that equivalence of outcomes is a test to assess whether or not a firm has complied with a *Requirement not to unduly discriminate*. In response to the first phase of the strategic review many of BT's competitors suggested that, despite existing *Requirements not to unduly discriminate*, there remained a number of differences between the wholesale products they are able to purchase from BT and the products that BT supplies to itself to compete in downstream markets. Ofcom considers that many of the examples highlighted, such as timing of product releases, sharing of information and speed of response to faults will be addressed by the approach set out in these guidelines, as the differences in products offered may not reflect differences in the circumstances of the customers and are capable of harm to competition. Going forward, Ofcom does not intend to pursue equivalence of outcomes as a general concept.
- 1.17 Cable & Wireless went on to ask that Ofcom consider the harm to competition in all cases, even when differences in conditions offered to two customers reflect differences in their circumstances. Similarly, Wanadoo considers that *Requirements not to unduly discriminate* under the Act should be more onerous than the similarly worded test under competition law.
- 1.18 Ofcom considers that it is appropriate to reflect the potential to generate efficiencies from vertical integration in the new guidelines, given the general nature of the guidelines, covering many providers and many markets. This approach is also consistent with competition law and is consistent with the ERG Common Position on Remedies. However, Ofcom recognises that in some markets where competition is less well developed, it may be appropriate to take a different approach, as Ofcom has done recently to CPS calls to the same and adjacent digital local exchanges⁷. Ofcom will consider the need for such arrangements on a case-by-case basis.
- 1.19 Cable & Wireless raised another concern about Ofcom's approach to vertical efficiencies. They suggested that Ofcom's approach creates a perverse incentive for SMP providers to design their organisations and internal systems in such a way that internal supply is always cheaper. Ofcom does not consider that the proposals will create this incentive, because Ofcom will take account of choices made by an SMP provider to introduce such costs. Therefore, Ofcom's most likely response to an SMP provider who has artificially created circumstances providing a cost advantage to an

⁵ Equivalence of outcome implies that the wholesale products that BT offers to its wholesale customers should be comparable to those that it offers to its own retail activities, but the product and processes need not be exactly the same so long as any differences are not material. Paragraph 6.10, *Strategic Review of Telecoms - Phase 2*, November 2004.

⁶ http://www.ofcom.org.uk/static/telecoms_review/condoc_phase2.htm.

⁷ *Addressing the local call disadvantage*, July 2004.

internal customer would be to require the same conditions be offered to all customers. The risks to an SMP provider of engaging in such a strategy would therefore be high, and Ofcom's explicit recognition of that risk from the outset raises those risks. Ofcom will be particularly concerned about any such decisions taken since the *Requirement not to unduly discriminate* has been in place.

Rebuttable presumption

- 1.20 The third group of points raised related to Ofcom's proposal to apply a rebuttable presumption in some cases.
- 1.21 Some SMP providers are concerned that the rebuttable presumption should not extend to them. Vodafone and Kingston suggested that, in their cases, the presumption would be disproportionate because any differences in treatment between internal and external customers that do not reflect differences in customer's circumstances would not cause material harm to competition.
- 1.22 In each of these cases, Ofcom (or Oftel) considered the proportionality of the obligations within the relevant market reviews. In mobile call termination, in particular, Ofcom noted that undue discrimination between the SMP provider and a wholesale customer would be of concern and that leverage of a dominant position has the potential to raise barriers to market entry, and stifle the growth of new competitors.
- 1.23 Vodafone suggested that the presumption threatened to introduce non-trivial compliance costs. Similarly, BT expressed concern that the effect of the rebuttable presumption is to invite numerous, spurious investigations that would demand resources from SMP providers and Ofcom alike. Ofcom considers this unlikely, particularly given that the scope of the rebuttable presumption no longer includes differences in price behaviours. In any event, Ofcom has amended the guidelines to make plain that Ofcom's existing guidelines governing the handling of complaints and disputes will continue to cover these categories of investigation or dispute resolution⁸. Therefore, complainants or disputants will continue to be required to substantiate any claims, before Ofcom will open an investigation.
- 1.24 BT also suggested that the rebuttable presumption amounts to a transfer in the burden of proof, contrary to the fundamental rights of defence and general principles of public law and competition law. Ofcom disagrees that a rebuttable presumption can be characterised in this way. The effect of the rebuttable presumption is to set a framework within which the investigation of possible misconduct can occur. Ofcom will continue to have a duty to find evidence to support any finding of a contravention.
- 1.25 Responding to a question raised by MCI, Ofcom confirms that the standard of proof required to rebut a presumption will be no different to the standard required in other investigations carried out by Ofcom.
- 1.26 A number of respondents thought that Ofcom's proposed approach was not onerous enough. A number called for the rebuttable presumption to continue to cover price differences as well as non-price behaviours. Vodafone added that limiting the presumption to non-price behaviours creates an incentive to discriminate unduly using price. As stated above, Ofcom considers there are a number of pricing policies that are not dependent on customers' circumstances that can be good for consumers in some cases. Ofcom does not want to discourage this sort of behaviour. We believe

⁸ http://www.ofcom.org.uk/bulletins/eu_directives/guidelines.pdf.

that any incentive to discriminate unduly using price created by this approach is countered by the potential cost and relative ease of identification of undue discrimination using price.

- 1.27 The last issue raised in relation to the rebuttable presumption came from MCI, who questioned whether the presumption was that non-price differences in transaction conditions offered by a vertically integrated SMP provider favouring an internal customer would be presumed not justified by differences between customers' circumstances, or would be presumed to harm competition.
- 1.28 Ofcom confirms that the rebuttable presumption applies to both questions. , In the consultation document, Ofcom set out that differences in customers' circumstances are most likely to be relevant if they influence the cost of supplying to them. The document went on to note, often the cost of supplying many non-price transaction conditions need not vary substantially between customers. Secondly, Ofcom also noted in the consultation that differences in non-price conditions rarely benefit competition; that such differences are unlikely to lead to new market segments or a significant increase in overall demand.
- 1.29 Accordingly, Ofcom has made clear in the guidelines that the presumption is of undue discrimination; therefore, there is a presumption that differences are not justified by customers' circumstance and there is a presumption that such differences harm competition.
- 1.30 However, as noted above, as Ofcom's guidelines on submitting complaints and disputes will continue to apply to this type of investigation. Therefore, before Ofcom will open an investigation in response to a complaint or dispute, complainants and disputants will need to demonstrate evidence that any differences are not justified by either, differences between the customers' circumstances, or by absence of harm to competition.

Determining harm to competition

- 1.31 The final issue raised by respondents concerns the test used in the guidelines for considering harm to competition.
- 1.32 O2 disagreed that the relevant test should be 'capable of harm to competition'. BT proposed instead 'likely to harm competition' and Crown Castle among others believes that the test should remain 'material adverse effect on competition'.
- 1.33 However, the test that Ofcom is adopting is consistent with and follows the test established in the context of competition law enforcement in the judgement of the European Court of First Instance in *Michelin II*⁹:

"...it is sufficient to show that the abusive conduct of the undertaking in a dominant position *tends to restrict competition* or, in other words, that the conduct is *capable of having that effect*."

⁹ Case T-203/01, *Manufacture française des pneumatiques Michelin v Commission of the European Communities*, paragraph 239.