Neutral citation: [2003] CAT 5

IN THE COMPETITION

APPEAL TRIBUNAL Case No. 1007/2/3/02

New Court
Carey Street
London WC2A 2JT 16 April 2003

Before:

SIR CHRISTOPHER BELLAMY
(President)
PROFESSOR JOHN PICKERING
DR ARTHUR PRYOR CB

Sitting as a tribunal in England and Wales

BETWEEN:

FREESERVE.COM PLC

Applicant

-v.-

DIRECTOR GENERAL OF TELECOMMUNICATIONS

Respondent

supported by

BT GROUP PLC

Intervener

Mr Nicholas Green QC and Mr James Flynn (instructed by Messrs Baker & McKenzie) appeared for the applicant.

Mr Jon Turner and Ms Jennifer Skilbeck (instructed by The Director of Legal Services (Competition), Office of Telecommunications) appeared for the respondent.

Mr Gerald Barling QC and Ms Kelyn Bacon (instructed by the Head of Competition and Public Law, BT Retail) appeared for the intervener.

Heard at New Court, London, on 20 and 21 January 2003

JUDGMENT (Validity of the contested decision)

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I. INTRODUCTION

1. On 9 September 2002, Freeserve.com plc ("Freeserve") appealed to the Tribunal against the refusal by the Director General of Telecommunications ("the Director"), communicated in a letter of 8 July 2002, to withdraw or vary his rejection, by letter of 21 May 2002, of Freeserve's complaint to the Director dated 26 March 2002 against BT Group plc ("BT"). That complaint alleged that BT was conducting "an orchestrated campaign of anti-competitive behaviour, aimed at achieving dominance by the incumbent in the market for retail ADSL services", in certain specific respects, in breach of the prohibition of abuse of a dominant position imposed by section 18 of the Competition Act 1998 ("the 1998 Act"). That prohibition is known as the Chapter II prohibition: see section 18(4).

2. The Director argued, first, that his letters of 21 May 2002 and 8 July 2002 did not give rise to an "appealable decision" under the 1998 Act, so that the Tribunal had no jurisdiction to hear the appeal. In its preliminary judgment of 11 November 2002 [2002] CAT 8 [2003] CompAR 1, the Tribunal held that the Director's letter of 21 May 2002 constituted a decision as to whether the Chapter II prohibition had been infringed within the meaning of section 46(3)(b) of the 1998 Act, and that, by his letter of 8 July 2002, the Director had refused to withdraw or vary that decision within the meaning of section 47(1) and (4) of that Act. Accordingly, Freeserve's appeal was admissible before the Tribunal by virtue of section 47(6)[1].

3. In accordance with Schedule 8, paragraph 3(1) of the 1998 Act it is now for the Tribunal to determine the appeal "on the merits by reference to the grounds of appeal set out in the notice of appeal".

4. In that regard, Freeserve has abandoned an earlier contention that the Tribunal should itself decide that BT has infringed the Chapter II prohibition, and has also abandoned certain requests for disclosure of documents. In effect, Freeserve asks the Tribunal to set aside the Director's decisions of 21 May 2002 and 8 July 2002, and remit the matter to the Director to be reconsidered pursuant to paragraph 3(2)(a) of Schedule 8 of the 1998 Act.

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[1] By virtue of Articles 2 and 3 of The Enterprise Act 2002 (Commencement No. 2, Transitional and Transitory Provisions) Order 2002, S.I. 2003 no. 766, with effect from 1 April 2003 this appeal is deemed to be made to the Competition Appeal Tribunal established under section 12 of the Enterprise Act 2002. Both the Competition Appeal Tribunal and its predecessor, the Competition Commission Appeal Tribunals, are referred to in this judgment as "the Tribunal".

5. In support of that contention Freeserve submits, principally, that the reasons given by the Director in his letters of 21 May 2002 and 8 July 2002 are inadequate, and/or erroneous in law, and that the Director's investigation of Freeserve's complaint fell short of the standard required. The Director, supported by BT as intervener, strongly contests those submissions.

II. BACKGROUND

Internet services

6. A person wishing to access the internet does so by using a modem device which connects his personal computer to the internet via a communications link. The link is (usually) provided either via a telephone line or, where a cable television connection has been installed, via that cabling. Currently most residential internet users have "narrowband" or "dial-up" access. Characteristics of narrowband access (whether via the telephone or cable networks) are that each time the user wants to access the internet, he has to dial a particular number in order to connect to it; unless a second telephone line is installed, the telephone cannot be used whilst the internet connection is active; and once the user has finished using the internet, he must disconnect.

7. "Broadband" access is a faster link to the internet. In addition, an internet user with broadband access does not need to dial-up or disconnect, as a broadband connection is always active. Moreover, the ordinary telephone line can be used at the same time as the broadband connection – no second telephone line is necessary. The faster speed of a broadband link compared to a narrowband link means that, for example, large files can be downloaded more quickly.

8. Broadband, like narrowband, can be supplied via a telephone or cable link. To provide a broadband link over a telephone line in the United Kingdom, it is necessary for the local telephone exchange to be "broadband enabled". As part of this enabling process, BT is upgrading local exchanges with ADSL lines. "ADSL" stands for "asymmetric digital subscriber line", and is the principal technology used in transforming a normal telephone line into a high-speed digital line capable of giving broadband access. To obtain broadband access to the internet, the subscriber's line has to be "activated" as an ADSL line, and an ADSL modem has to be connected to the subscriber's computer.

9. According to *Oftel's Internet and Broadband Brief,* November 2002, supplied to us by the Director, about 13.5 million residential and small business users in the United Kingdom had

internet access in August 2002, of whom over 90 per cent were narrowband users. As at 1 November 2002, there were approximately 1.1 million subscribers who had broadband access to the internet, a figure which appears to have roughly doubled since April 2002. Of the broadband subscribers in November 2002, about 60 per cent were supplied by a cable link provided by NTL or Telewest, while almost all the remainder, about 450,000 end users, used ADSL technology via the BT network. The Director pointed out to us that, since broadband is expanding rapidly, figures for the relative shares of supply have to be treated with caution.

10. The system of distribution for narrowband and broadband services over the BT network is that BT supplies capacity on its network at wholesale level to internet service providers ("ISPs"), who then supply internet access services to business and residential customers in return for a monthly subscription. For broadband subscribers, there is usually also an activation charge, and a charge for supplying the modem.

11. BT itself has two "in house" service providers, BT Openworld and BT Retail, who are supplied by BT Wholesale at arms' length on the same terms as other ISPs.

12. According to the Director, in November 2002 BT Openworld and BT Retail together supplied over 50 per cent of ADSL broadband access services at retail level, and about 20 per cent of all broadband access services including cable and other technologies.

13. As regards residential users, if one takes all narrowband and broadband access together, the leading ISPs supplying UK residential users with internet access are Freeserve, with about 20 per cent, AOL with 19 per cent, BT Openworld with 18 per cent, and NTL with 17 per cent. (Figure 4c, *Oftel residential survey*, August 2002.)

The parties

14. Freeserve is an ISP which competes against other ISPs in the United Kingdom in the provision of internet access services at the retail level to business and (mainly) residential customers. In addition to internet access, Freeserve also provides "value-added" services such as an e-mail facility and web space. Freeserve offers internet access services for use with either narrowband or broadband connections, and is a leading supplier, particularly of narrowband services. Freeserve is part of the France Telecom group, forming part of the Wanadoo division.

15. The Director is responsible for the sectoral regulation and licensing regime for telecommunications under the Telecommunications Act 1984, as amended ("the 1984 Act"). In addition, the Director is empowered to enforce the prohibitions imposed by the 1998 Act concurrently with the Director General of Fair Trading in relation to commercial activities connected with telecommunications: see section 54 and Schedule 10, paragraph 2, of the 1998 Act, read with section 4(3) of the 1984 Act. Guidelines on how the Director proposes to apply the 1998 Act have been published in OFT 417, *The Application of the Competition Act 1998 in the Telecommunications Sector*, March 2000 ("the Guidelines"). The Director carries out his functions under the 1984 Act and the 1998 Act through the Office of Telecommunications ("Oftel").

16. BT, whose predecessor company enjoyed a statutory monopoly in telephony and related services, is a vertically integrated provider of a wide range of telecommunications services. Under section 7 of the 1984 Act, BT has a licence to operate a fixed line public telecommunications network in the United Kingdom. BT's licence includes prohibitions on undue discrimination and undue preference (Conditions 57 and 78.14), unfair cross-subsidy (Conditions 75 and 78.12), and on the internal disclosure of certain customer information between certain of its regulated businesses (Condition 79). Condition 78 also requires BT to keep separate accounts for certain of its regulated businesses.

17. There is, at least potentially, an overlap between the sectoral regulation to which BT is subject under the 1984 Act, and the provisions of Chapter II of the 1998 Act. At present, appeals against the Director's decisions under the 1984 Act lie to the High Court under section 46B of that Act inserted by the Telecommunications (Appeals) Regulations 1999 S.I. 1999 no. 3180, whereas appeals against the Director's decisions under the 1998 Act lie to the Tribunal.[2]

18. BT is divided into a number of business divisions. At the material time these included BT Wholesale, BT Retail and BT Openworld (also referred to as "BTOW").

19. BT Wholesale provides, among other things, wholesale narrowband and broadband services to ISPs. Essentially BT Wholesale sells to ISPs capacity on the BT network. ISPs such as Freeserve use the capacity obtained from BT Wholesale to sell broadband internet access to their retail customers, provided the customer has a BT line installed. BT's principal wholesale broadband products are the IPStream family of products, notably IPStream 500.

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[2] The regulatory regime under the 1984 Act will change significantly by virtue of the Communications Bill currently before Parliament. Under the proposals in that Bill, appeals against most regulatory decisions taken by the Director will lie to the Tribunal.

20. BT Retail is responsible, among other things, for BT's retail telephone network. On 24 April 2002 BT Retail commenced trials of a "no frills" broadband access service known as "BT Broadband". Neither BT Retail nor the BT Broadband service has figured in the arguments in this case, although Freeserve has made a separate complaint about BT Broadband: see paragraph 91 below.

21. BT Openworld is an ISP which provides retail narrowband and broadband internet access services to consumers in competition with Freeserve and other ISPs. Like Freeserve, BT Openworld is a "value-added" ISP, offering an internet access package which includes e-mail services and a home page with information, website links and search engine facilities. As a retail provider, BT Openworld is a customer of BT Wholesale for the wholesale supply of broadband products and services.[3]

22. Freeserve and other ISPs are thus both customers of BT Wholesale for narrowband and broadband access, and competitors of BT Openworld in the supply of both narrowband and broadband residential internet access services.

III CHRONOLOGY OF EVENTS

23. The Tribunal has had difficulty in establishing the precise chronology of events in this case. It is in principle the parties' responsibility to provide such a chronology in appropriate cases. The following chronology of events prior to Freeserve's complaint of 26 March 2002 is largely drawn from a decision of the Director dated 8 January 2001 ("the margin squeeze decision of 8 January 2001"), and two decisions of the Director dated 28 March 2002 ("the residential margin squeeze decision" and "the business margin squeeze decision" respectively).

24. Internet access using ADSL was launched in 2000. At this time, an engineer had to call at the user's premises before ADSL could be installed.

25. It appears that, at launch, BT Wholesale charged all ISPs including BT Openworld £35 per month ex VAT (+ VAT = £41.13) for its wholesale IPStream 500 product. The retail price charged by BT Openworld to residential users was £39.99 per month (including VAT). Although it would appear, at first sight, that there was then a negative margin between the

[3] We understand BT intends to restructure BT Openworld, with part of its business activity being transferred to BT Retail. This restructuring is taking place subsequently to the events of this case.

wholesale price charged by BT Wholesale and the retail price charged by BT Openworld, we understand that BT Openworld believed that its service would be supported by secondary revenues from advertising and e-commerce.

26. On 25 May 2000, the xDSL Wholesale Products Industry Group complained to the Director that BT was engaging in a "margin squeeze" by subsidising the supply of retail ADSL services by BT Openworld from the profits of its wholesale activities. The essence of this complaint was that the margin between, on the one hand, the wholesale price charged by BT to ISPs for the wholesale product IPStream 500, and, on the other hand, the retail price charged by BT Openworld to retail customers (see paragraph 25 above), was too small to enable BT Openworld to trade profitably, or to enable third-party ISPs to compete with BT Openworld.

27. Oftel reached a conclusion on that complaint in its first margin squeeze decision of 8 January 2001. According to the published summary of the decision, Oftel considered the matter on the basis of Condition 75 (prohibition on cross subsidy) of BT's Licence. However, the full unpublished copy of the decision supplied by Freeserve on 19 March 2003 in response to a question from the Tribunal indicates that the matter was also considered under Chapter II of the 1998 Act.

28. In the margin squeeze decision of 8 January 2001 Oftel considered, without deciding, whether BT might have market power in the wholesale market for ADSL services, and then went on to consider "whether BT Openworld's business case is so implausible as to suggest a margin squeeze is in operation". Oftel concluded:

> "... Oftel cannot demonstrate that the business case is implausible. ... In recognition of the uncertainties in what is very much an emerging market, Oftel will continue to monitor BT Openworld's performance against its current business case to assess whether in practice its assumptions are realistic. Any departures would need objective justification. Oftel proposes to do this on a six monthly basis over the next year. … The case has therefore been formally moved into compliance … ."

29. On 22 February 2001, the xDSL Wholesale Products Industry Group made an application to the Director that the above decision should be withdrawn or varied pursuant to section 47(1) of the 1998 Act. Annex 1 to that application lists Freeserve as one of the industry supporters of the application. As far as we are aware, that matter did not progress further.

30. Pursuant to the margin squeeze decision of 8 January 2001, in July 2001 Oftel commenced a review of the question whether BT was operating a margin squeeze between its wholesale and retail prices for ADSL services, in particular in relation to residential customers.

31. In August 2001, BT announced that its wholesale price for IPStream 500 would be reduced from £35 to £30 per month ex VAT, while the BT Openworld retail price remained at £39.99 per month including VAT. However, according to Oftel's later residential margin squeeze decision of 28 March 2002 (see paragraph 47 below), at that time Oftel took the view that even with this reduction:

> "[BT's] new business case was based on some implausible assumptions and that BT Openworld could only sustain its retail prices if it received a subsidy from other parts of BT's business",

and that

> "[BT's] margin between wholesale and retail prices … was inadequate to permit a reasonably efficient retailer a good prospect of making an adequate return on capital."

Oftel's review therefore continued, with a view to establishing whether this margin squeeze had an effect on competition. According to Oftel, by this stage, BT Openworld had abandoned the idea that its operation would be supported by secondary revenues from advertising and e-commerce.

32. In October 2001, the xDSL Wholesale Products Group and Freeserve made a further complaint to Oftel alleging that BT was engaging in a margin squeeze by subsidising the supply by BT Openworld of retail ADSL services aimed at business customers. This complaint related to a special offer whereby BT Openworld reduced the price of its installation charge for its Business 500PLUS retail service by 50 per cent for end users ordering that service between 18 September 2001 and 31 December 2001. Since no corresponding price reduction was made by BT Wholesale, the complainants alleged that their margin was being squeezed, making it difficult for them to compete with BT Openworld in the business retail market.

33. Meanwhile, during the latter part of 2001, BT Wholesale had begun to work with ISPs to develop new "self install" broadband products. These products allow consumers to install an ADSL line themselves, without the need for an engineer's visit. It appears BT Wholesale commenced a formal trial of these new products in December 2001, in which both Freeserve and BT Openworld participated, amongst other ISPs.

34. The commercial launch by BT Wholesale of its self install broadband product IPStream Home took place on 15 January 2002. At this time, the price charged by BT Wholesale to all ISPs for IPStream Home was £25 per month ex VAT, i.e. £5 lower than the price for the engineer-installed product.

35. According to a press release supplied to us by the Director, on 4 February 2002 Pipex, another ISP, announced a price of £24.95 per month ex VAT for its home user broadband service. This was accompanied by special offers of free line activation for the first 40,000 customers and free modems for orders placed before 13 June 2002.

36. On 6 February 2002, Freeserve told Oftel in an e-mail message that they were expecting BT to announce a wholesale broadband price cut the following day, 7 February.

37. On 7 February 2002, BT announced its third-quarter results. At the accompanying presentation to the results announcement BT's Chief Executive stated that, in a couple of weeks:

> "we will substantially cut our cost on a (sic) wholesale level ... that will allow providers of broadband to be very competitive on pricing in the market"

38. On 26 February 2002, BT's Chief Executive announced that the prices of BT Wholesale's main wholesale broadband products IPStream 500 and IPStream Home would be reduced from £30 and £25 per month respectively ex VAT to £14.75 per month ex VAT for both products from 1 April 2002. On the same day, BT Wholesale launched an advertising campaign called "Broadband Briton".

39. On the same day, 26 February 2002, Freeserve announced a reduction from £39.99 to £29.99 per month for its residential broadband services from 1 April 2002.

40. According to BT, also on 26 February 2002 BT Openworld finalised the new retail price for its self install broadband product Home 500 "Plug & Go" following the wholesale price reduction announcement earlier that day. BT Openworld also finalised its budget for a marketing campaign to accompany the launch of this product. A copy of the new BT Openworld business case was, we are told, sent to Oftel that evening.

41. The next day, 27 February 2002, BT Openworld announced that its new retail broadband Home 500 "Plug & Go" self install product, would be available to residential and business broadband customers from 5 March 2002, with a special offer to waive the £65 activation

charge for orders received up to 31 May. The monthly rental was £29.99, with an equipment charge (for the modem) of £85.

42. On 5 March 2002, BT Openworld's self install product Home 500 "Plug & Go" duly became available.

43. On 6 March 2002, Freeserve booked a television advertising campaign for its residential broadband services, which was first broadcast on 15 May 2002.

44. On 8 March 2002, it was reported that BT Openworld had announced a major £10 million broadband advertising campaign including television advertising, press advertisements and the distribution of 2 million CD-ROMs.

45. In the early Spring of 2002, BT sent a "Telephone Census" to its residential retail voice telephony customers, in some cases including the census in the envelope with the ordinary regular telephone bill (known as the "blue bill"). The census included a section entitled "C. You and the Internet". One question in this section asked:

> "Who is your main Internet Service Provider (ISP) for your home Internet use?",

which was followed by the options "BT/BT Openworld", "AOL", "Freeserve", "ntl/ Telewest", "Work provided" or "Other/Don't know". One other question (in section F) asked: "Would you be interested in any of the following services? Broadband …"

46. On 26 March 2002 Freeserve lodged the complaint with which this appeal is concerned (see Section IV below).

47. On 28 March 2002, Oftel adopted a decision under Condition 78.12 of BT's licence on the alleged residential margin squeeze referred to at paragraphs 23 and 31 above ("the residential margin squeeze decision"). That decision completed Oftel's review of BT's wholesale and retail margins (see paragraphs 26 to 31 above) and took into account BT's recently announced price reductions. It appears from information provided to the Tribunal by Oftel in a letter of 26 March 2003 that the Director consulted with ISPs, including Freeserve, in the course of his review. Paragraph 5 of the residential margin squeeze decision reads:

> "5. This [wholesale] price, effective from 1 April 2002, is £14.75 a month, which is 50% less than the current price. In response to this reduction BT Openworld has drawn up another business case and reduced its retail price by 25% to £29.99. The Openworld business case incorporates a number of important forward looking assumptions, in terms of market share and cost structures, and is sensitive to volumes and input price. Having analysed BT

> Openworld's new business case, Oftel believes that no cross subsidy or margin squeeze exists at the new wholesale and retail prices. The current retail business case and the assumptions on which it is based are not implausible in the light of current market information. Oftel believes that the new margin between the wholesale price of IPStream 500 and BT Openworld's retail price is sufficient to allow service providers to compete. Indeed there are numerous service providers offering ASDL services to residential consumers at prices below BT Openworld's. There is therefore no evidence to justify any enforcement action under the Telecommunications Act. Accordingly, Oftel has closed the case."

48. Also on 28 March 2002, Oftel took a decision under Condition 78.12 of BT's licence on the complaint made in October 2001 about a margin squeeze in the business sector (see paragraph 32 above). At paragraphs 4 to 8 of this decision ("the business margin squeeze decision"), Oftel said:

> 4. Oftel considers that BT Openworld's special offer on its installation charge for Business 500PLUS was a legitimate commercial practice aimed at stimulating demand. Further, given that the special offer was for only 3.5 months, Oftel does not consider that it had a material effect on competition in this particular instance. However, Oftel agreed with the complainants that the pricing of the Business Services (and the question of whether there might be an unfair cross subsidy in operation) required further investigation.
>
> 5. Oftel was already investigating a similar complaint [i.e. the complaint which led to the residential margin squeeze decision of 28 March 2002] concerning BT Openworld's "residential" retail service (using BT Wholesale's IPStream 500 product as its wholesale input) when it received this complaint. Much of the relevant information had therefore already been requested from BT in the context of that investigation. In February 2002, during the time in which Oftel was considering whether there was any margin squeeze on the Business Services, BT Wholesale announced significant price cuts to its IPStream products.
>
> 6. In response to these cuts, BT Openworld generated another business case and reduced its retail prices. … The business case incorporates a number of important forward-looking assumptions, in terms of market share and cost structures, and is sensitive to volumes and input price.
>
> 7. Oftel has reviewed BT Openworld's business case, including as part of this process an analysis of the key sensitivities and assumptions. In any business plan that looks forward by a number of years, particularly in the case of new and emerging markets, there is always a degree of uncertainty. However, based on the information currently available, Oftel does not consider BT Openworld's business case for the Business Services to be implausible.
>
> 8. Oftel believes that the margins between the Business Services and their respective wholesale inputs are sufficient to allow service providers to compete. Oftel does not consider that any margin squeeze or cross subsidy is in operation. In these circumstances, enforcement action under the Telecommunications Act is not justified in this case, and so Oftel has closed the case."

49. On 28 March 2002 the Director also adopted a third decision ("the *Bulldog* decision"), this time under the 1998 Act. That decision related notably to a complaint by Bulldog

Communications Ltd that BT was engaged in predatory pricing in relation to its pricing of certain DSL products (IPStream and another product called Datastream) at the wholesale level. The allegation was that these products were being sold below cost to the detriment of local loop unbundling operators seeking to establish themselves as suppliers of network capacity to ISPs, in competition with BT Wholesale. In this decision the Director rejected Bulldog's complaint but set out his approach under the 1998 Act to the issues of predatory pricing and unfair cross subsidy alleged to arise in that case. In paragraphs 12 to 17 of the *Bulldog* decision, the Director refers, on the issue of predatory pricing, to paragraphs 7.13 et seq of the Guidelines, cited above at paragraph 15. At paragraphs 18 to 23 of that decision the Director refers "additionally or alternatively" to the issue of cross subsidy dealt with at paragraphs 7.20 et seq of the Guidelines.

50. On 1 April 2002, BT Wholesale's price reductions came into effect. BT Openworld's television advertising campaign also commenced on 1 April 2002.

51. On 16 April 2002, a meeting took place between Freeserve's representatives and Oftel staff about Freeserve's complaint. On 17 April, the Director wrote to Freeserve indicating that he had opened a preliminary investigation into the complaint.

52. On 22 April 2002, BT replied to certain questions that Oftel had put to BT on 17 April in connection with Freeserve's complaint.

53. On 13 May 2002, Freeserve announced its own broadband advertising campaign. The accompanying television campaign commenced on 15 May 2002.

54. Also on 13 May 2002, three companies active in the broadband sector, Thus, Freeserve and Energis, applied to the Director requesting him to vary the residential margin squeeze decision of 28 March 2002 under section 47 of the 1998 Act. Their request was that the decision should be varied so as to find that BT was in breach of the Chapter II prohibition in maintaining a margin squeeze in respect of its residential ADSL services for the period between May 2000 and August 2001. This request was apparently made so as to lay the foundation for a civil claim in damages against BT. The letter of 13 May 2002 suggests that the Director had denied that either the first margin squeeze decision of 8 January 2001, or the residential margin squeeze decision of 28 March 2002, was made under the 1998 Act.

55. On 19 May 2002, the Director published a policy statement entitled "Statement on BT's Marketing of Internet Services and the use of Joint Billing": see paragraph 82 below.

56. On 21 May 2002, the Director adopted the decision contested in this case ("the contested decision"): see paragraph 83 below. It appears that a copy was sent by e-mail by Mr Russell, the Oftel case officer, to Freeserve at 4.57 pm on that date.

57. It appears that in the afternoon of 21 May 2002 Naaz Rashid, the Oftel case officer who had been concerned with the residential margin squeeze decision, was contacted by a journalist about a possible extension of the BT offer to waive the activation charge. Ms Rashid contacted Theresa Brown, Head of Regulation at BT Openworld, who confirmed that the offer was to be extended. Ms Rashid e-mailed this information to Mr Russell at 5.36 pm on 21 May 2002. At 6.05 pm Ms Brown sent an e-mail to Ms Rashid. This e-mail states:

> "As discussed please find a couple of slides on what offers we believe to be in the marketplace. You'll note our offer in the table still states 31 May, when we are now extending to 31 August.
>
> I hope this is helpful. Do let me know if you need any further information or if you would like to take up my offer for us to come and see Oftel to discuss the offer."

According to the table attached to this document certain other suppliers such as One.Tel (£27.99), Freedom2Surf (£22.50) and Pipex (£23.44) were then offering lower monthly charges than BT Openworld or Freeserve.

58. Counsel for BT told us at the oral hearing that Oftel was first told of the extension of the offer to waive the activation charge by a telephone call from BT Openworld as early as 15 May 2002 (transcript Day 2, p. 58). BT subsequently indicated that a voicemail message was left by Ms Brown with Mr Russell, probably not later than 16 May 2002. Mr Russell then rang back, and suggested that Ms Brown speak to Ms Rashid. Ms Brown's subsequent conversation with Ms Rashid led to Ms Brown's e-mail of 21 May 2002 (BT's letter to the Tribunal of 28 January 2003). This timing is disputed by Oftel, whose case officers, we are told, do not recall the sequence of events described by BT (Oftel's letter to the Tribunal of 30 January 2003).

59. On 22 May 2002, BT duly announced that its special offer of a waiver of the £65 activation charge would be extended from 31 May 2002 to 31 August 2002. A document relied on by Freeserve to show that this announcement was made on 5 May 2002 appears to the Tribunal to contain a mistake as to the date.

60. On 26 May 2002, Freeserve's own special offer to waive the £65 activation charge terminated.

61. On 27 May 2002, Mr Persoff of Freeserve sent an e-mail to Oftel inquiring whether and when the extension of BT's special offer was known to Oftel, and asking a number of questions as to what Oftel considered to be the impact of this extension on its previous decisions on margin squeeze, and on competition.

62. On 14 June 2002, Ms Rashid replied that Oftel had been informed of the extension at the same time as BT Openworld announced it was extending the offer. According to Ms Rashid:

> "Oftel did not have any prior knowledge of the extension of the special offer when closing the margin squeeze investigation."

and that Oftel:

> "has [since] considered the impact of that extension and has concluded that it would not affect the decision of 28 March 2002".

Ms Rashid added:

> "Oftel has no evidence to suggest that there has been a material effect on competition as a result of Openworld's special offer. We would be interested in any evidence you have which suggests otherwise."

63. On 20 June 2002, Freeserve's solicitors requested the Director to withdraw or vary his decision of 21 May 2002 under section 47 of the 1998 Act, giving reasons and promising to send the Director further material and evidence. As far as we are aware, no such material was submitted prior to the lodging of this appeal.

64. On 5 July 2002, Freeserve reintroduced its special offer to waive the £65 activation charge, having noted that its sales had dropped substantially in June 2002.

65. By letter of 8 July 2002, the Director declined to withdraw or vary the letter of 21 May 2002 on the ground that he had taken no decision, or even offered an opinion, on whether the 1998 Act had been infringed.

66. On 22 July 2002, Freeserve's solicitors intimated to the Director that further material would be submitted to him by 29 July 2002. Again, no such further material was submitted prior to the lodging of this appeal, as far as we are aware.

67. This appeal was lodged on 9 September 2002.

68. On 22 October 2002, Freeserve submitted a further complaint to the Director, which is not the subject of these proceedings.

IV FREESERVE'S COMPLAINT AND THE DIRECTOR'S INVESTIGATION AND DECISIONS

Freeserve's complaint

69. On 26 March 2002 – that is to say some two days before the Director's decisions of 28 March 2002 closing his investigations into the complaints of residential and business margin squeezes referred to at paragraphs 47 and 48 above – Freeserve's Chief Executive Officer sent a letter to the Director attaching a complaint in relation to BT's activities in relation to its broadband internet access activities. The covering letter of 26 March 2002 states as follows:

> "Urgent action is needed now, if your stated ambition of achieving "effective and sustainable competition" in the provision of broadband internet access in the UK is to be achieved.
>
> Following the announcement of wholesale price reductions by BT on 26th February, Freeserve has been working hard to develop a credible retail offer which we intend bringing to market shortly after the wholesale price reductions take effect, on 1st April of this year.
>
> We find however, that BT's own ISP, BT Openworld, by their own public admission, are already signing up "8,000-10,000 customers per week" (comments from the BTOW Chief Executive, Alison Ritchie to the BBC on 20th March) and we fundamentally believe that this is the direct result of an orchestrated campaign of anti-competitive behaviour, aimed at achieving dominance by the incumbent in the market for retail ADSL services.
>
> Attached to this letter is a paper outlining the basis for our claim and the action needed to ensure that this position is not allowed to happen. The issues raised will require urgent investigation by Oftel if the market for ADSL services is not to be effectively "handed over" to BT, a position which would have significant long-term consequences for the health, vibrancy and competitive nature of the market as a whole.
>
> I look forward to your urgent confirmation that Oftel will exercise both its regulatory powers and its powers under the Competition Act to prevent this situation from arising."

70. The paper accompanying Freeserve's letter of 26 March 2002 states as follows:

> "**Examples of Anti-competitive behaviour by BT**
>
> 1. Cross marketing activity between BT and BT Openworld
>
> Immediately following the wholesale price reduction by BT, BT began a series of ostensible "broadband britain campaigns". Whilst these purport to demonstrate the wider benefits of a broadband connection, they are presented as adverts from BT, targeted directly at the consumer (i.e. not BT Wholesale's ISP customer base) and refer the reader to BT.com/broadband. The positioning of the BT ads is grossly misleading when one considers that BT.com provides a direct link to BTOW with no reference to other competing ISPs whatsoever. Examples of the advertisements referred to are attached together with "screen grabs" which show the BT.com homepage, and the link from that page to BT Openworld. The effect

of this advertising is to make BT synonymous with ADSL to the exclusion of other Service Providers.

These cross-marketing activities ensure BTOW benefits from BT's name, reputation and brand awareness. The European Commission has recently claimed in a case in France that an ISP's ability to benefit from the incumbent's reputation and brand awareness is evidence of abuse of a dominant position.

Action required

Oftel should require BT to immediately cease all ADSL cross-marketing activity, and ensure that BTOW are not unduly preferred in the market for the supply of ADSL internet access to the consumer by leveraging corporate campaigns by BT Group. In addition, to ensure equal treatment, BT should be required to notify Oftel and all ISPs of any material product changes or announcements at least 30 days prior to their introduction (we estimate that BTOW are informed well in advance of this timing). Oftel should also as a minimum require BT.com to link to the BT/Broadband site, thereby ensuring even distribution of all competing Service Providers, not just BTOW.

2. Advance Notification of wholesale price reductions

BTOW have reported (see copy of "Revolution" magazine dated 13th March attached) that BTOW will shortly launch a £10m advertising campaign, including TV advertising. In addition, BTOW are arranging for the distribution of some 2 million access disks via a variety of retail outlets including BP petrol stations and we understand that that activity is taking place at the moment (see announcement from BTOW's Chief Executive Officer dated 21st March attached). In addition, affiliate partners of BTOW are being positioned to provide links through to the BTOW sign-up page.

These comments and activities demonstrate that BTOW must have received advanced notification of the wholesale price cuts with a view to positioning themselves within the market, ahead of the competition.

We would remind you of similar allegations raised by Freeserve on the introduction of ADSL in the UK. Last year, Oftel determined that "sufficient safeguards" were in place to ensure that BT's legal, data protection, and unfair trading obligations were being met. That now appears manifestly, not to be the case.

Action required

We ask that Oftel immediately investigate:-

i. The timing of the TV campaign about to be launched by BTOW – when and by whom was the TV campaign booked with the TV companies concerned? When was the campaign conceived within BTOW and when did the agency concerned receive instructions to commence work on the campaign? If prima facie evidence suggests that this campaign was planned before the wholesale price announcement on 26th February, (as we believe it must have been) Oftel should insist that it is deferred, and only allowed to be broadcast in a timescale consistent with that available to the rest of the industry.

ii. Oftel should investigate the order placement process between BTOW and its modem supplier. Our own experience suggests that modems are in relatively short supply, we therefore require Oftel to analyse the dates when orders for modems were placed by BTOW, the call off arrangements between BTOW and their modem suppliers and the stocks of modems presently available to BTOW in order to meet their current demand.

iii. Our experience as one of the largest purchasers of CD access disks, again suggests long lead times and careful planning is required in order to fulfil the manufacturing and logistical requirements to distribute circa 2 million access disks across a variety of different retail outlets. We ask Oftel to investigate the order placement process behind this promotion in order to determine when CD access disks were first ordered by BTOW.

In summary, our experience suggests that it is inconceivable for BTOW to be in the position they now enjoy in relation to TV advertising, CD access distribution, and modem provisioning, unless they received clear notification of the wholesale price reduction prior to 26th February.

3. Cross subsidy

In January last year, Oftel determined that a cross subsidy would be unfair, in circumstances where a margin squeeze was taking place and it was having a material effect on competition. That determination was in response to complaints relating to the alleged existence of cross subsidies within the BT group which were allowing BTOW to provide short term promotions, subsidized connection fees, and in some instances zero cost connection, to the consumer. At that time, given the uncertainty of the emerging broadband market, Oftel was unable to demonstrate that BTOW's business case in such circumstances was implausible, and no action was taken.

Attached on a strictly confidential basis, is our own analysis of the BTOW business case which (1) reflects their position in the market for DSL products at the present time, and (2) assumes a £10m advertising commitment from the second quarter of this year. You will see that this results in a circa £9m loss for the company which has already posted a £100m loss for the nine months ending December 2001.

We believe there to be a prima facia case of unlawful cross subsidy in this instance, on the basis that the business case (insofar as we have been able to interpret it) is not sustainable. We believe BTOW cannot be generating sufficient revenues to cover its variable and incremental costs – prima facie evidence of predatory pricing pursuant to the principles laid down in the AKZO case. As such, we believe this constitutes abuse of a dominant position. This is entirely consistent with BT's published aim of reaching 1 million DSL customers by the end of the first quarter next year.

Action required

Oftel should immediately investigate and challenge the viability of the business case behind BTOW's current offers, in particular their waiver of the ADSL connection charge, (itself an administration charge imposed by BT) and payable by all other internet service providers. In this regard, we believe the matter to be so critical that Oftel should consider drawing on its powers under the Competition Act to conduct an immediate cross subsidy/predatory pricing investigation in order to prevent BT securing an unassailable position in the marketplace. In addition, we believe that given the prima facia evidence of abuse set forth herein, until the conclusion of such investigation, BTOW should be prevented from introducing any promotions unless Oftel and other ISPs are given sufficient advance notice.

4. BT's "Telephone Census"

We attach a copy of the BT census which we understand has been issued by BT Retail to their entire customer base. We draw your attention to Section C "You and the Internet" where you will see in section 5 the reference to BT/BTOW,

further eroding the distinction in the customers mind between BT and BTOW. We believe that the internet questions raised in the Census will provide market information which results solely from BT Retail's dominance within the market for retail telephony, and will prove invaluable in developing targeted offers to potential customers of BT/BTOW. This represents an abuse of BT's dominant position in the market for retail telephony.

Action required

Oftel should immediately require BT to withdraw the census, in order to clarify the distinction between BT and BT Openworld. BT should ensure that any subsequent census which will allow BT to achieve a significant competitive advantage over its competitors within the internet access market, should only be allowed to the extent that such information is made available generically, and without cost to all internet service providers, not just BT Openworld.

Freeserve.com plc
Ref: DCM
26th March 2002"

71. The attachments to Freeserve's complaint included:

(i) some examples of the Broadband Briton advertising campaign;

(ii) Freeserve's analysis for the year April 2002 to March 2003 of what is described as the "BT modem pack business case"; and

(iii) a copy of BT's Telephone Census.

The meeting of 16 April 2002

72. On 16 April 2002, representatives of Freeserve attended a meeting with Oftel officials to discuss the complaint of 16 March 2002. Freeserve and the Director have produced their respective notes of the meeting to the Tribunal.

— The Director's note

73. Relevant extracts from the Director's note are set out below:

"**Advanced notification of price changes**
Freeserve identified its main concern being that BTOpenworld (BTOW) had advanced notification of BT's broadband wholesale price drops. Freeserve believes that there is no way that BT could have launched its advertising campaign and distribution arrangement for cd-roms in BP garages at such short notice after the announcement of wholesale price cuts. Freeserve estimated that it would take approximately 3 months to put together such distribution arrangements.

Cross marketing
Freeserve believes that BT's "Broadband Briton" newspaper adverts are aimed at generating customers for BTOW and therefore BTOW should pay for them.

Alternatively any generic broadband advertising should not be specifically branded with the BT logo or linked to BT web sites. OFTEL pointed out that BT was entitled to advertise its services as was Freeserve and that the adverts in question linked to a web site which listed all ADSL SPs including Freeserve. In these circumstances it could be argued that Freeserve benefited from that advertising.

Freeserve referred to the European Commission's statement of objections in the Wanadoo case. Freeserve claimed that the Commission has argued that an ISP's ability to benefit from an incumbent's brand awareness could constitute an abuse of a dominant position. Oftel has not been able to obtain that statement of objections and asked if Freeserve could provide a copy.

Action point: Freeserve agreed that it would ask its parent company, Wanadoo, whether it could disclose the Commission statement of objections to Oftel.

Cross subsidy
Freeserve also believes that BTOW is currently being cross subsidised by other parts of BT's business. Freeserve pointed to its analysis of the BTOW business case it provided with its complaint which showed BTOW making a loss in year 02-03. Oftel pointed out that it was normal for a new service to make a loss in the first year. Oftel also made it clear that as it had just closed its margin squeeze and predatory pricing investigations it would be unlikely to reinvestigate these issues at the current time without strong evidence to indicate anti-competitive behaviour.

Action point: Freeserve agreed to provide a new analysis of BTOW's business case covering 3 years so that Oftel could compare with the actual BT business case.

Freeserve stated that though it had now launched its broadband campaign it had not signed off its own broadband business case. Freeserve had decided to go ahead with its campaign before the business case was completed because it felt it had to meet the competition from other broadband SPs.

Action point: Freeserve agreed to provide Oftel with its own business case when it is completed in order to compare with BTOW's.

BT's use of the Blue Bill
Oftel asked whether Freeserve had particular concerns about BT using the Blue Bill when charging for its new broadband retail product. Freeserve did not want to have access to the Blue Bill itself as it felt this would dilute its customer relationship. However Freeserve believes that use of the Blue Bill would give BT an unfair advantage against other Service Providers. …

Freeserve's complaint
Oftel confirmed that its analysis of Freeserve's complaint was in its preliminary phase, and that it would contact Freeserve shortly with a view on whether it would take the issues raised forward to a full investigation."

— *Freeserve's note*

74. Freeserve's note of the meeting does not record the three action points set out above, (which were not in fact followed up by Freeserve). Freeserve told us that, in relation to the request that it should provide an expanded three year estimated business plan for BT Openworld, the

staff who attended the meeting did recall a comment along those lines being made by Oftel as they left the meeting, but had not considered it to amount to an agreed action point.

75. Relevant extracts from Freeserve's note of the meeting of 16 April 2002 are set out below:

> "1. Freeserve reiterated the concerns expressed in our letter to OFTEL dated 20th March (sic), that effective competition in the market for broadband services in the UK was being stifled by anti-competitive behaviour on the part of BT.
>
> 2. Specifically:
>
> 2.1 BT Openworld (BTOW) must have received advance notification of the whole price (sic) reductions announced by BT on 26th February, for it to have been in the position to bring its own offer to the market so soon after that price announcement. We challenged OFTEL to seek specific information from BTOW regarding the replacement of orders for TV advertising (notwithstanding the fact that TV ads may comprise re-cut versions of earlier ads, space still needs to be booked in advance), CD access discs ("millions" according to the BTOW CEO on 20th March), plus modems and other equipment, all needed to support an on-line offer that is apparently leading to sign-ups in excess of 10,000 per week.
>
> OFTEL's initial response was that other ISPs appear to have been able to come to market with the same speed as BTOW – specifically PIPEX, and that the likelihood of a significant price reduction had been flagged for some time, before the actual price announcement of 26th February. Our response was that in a market as price sensitive as internet access, you cannot plan a promotional campaign of the scale announced and put into practice by BTOW without clear and precise knowledge of the price structure being applied.
>
> 2.2 Freeserve also expressed concern at the brand leverage available to BT/BTOW; specifically we argued that Adverts paid for by BT Wholesale, ostensibly aimed at Wholesale (ISP) clients, were in fact aimed at the consumer, and the traffic driven to BT.com leads at present, only to BTOW.
>
> We argued that generic campaigns, advocating the benefits of "Broadband Britain" carrying strong BT branding, with minimal reference to the ISP/reseller market were unfair. Either such ads should be from BTOW (in fact BT confuse the marketing position by running "generic" and BTOW campaigns at the same time), or BT.com should provide a direct link to their "Broadband" site where the full range of competing ISPs are given equal prominence. We asked OFTEL to ask BT for their traffic data, which we believe will support our argument that so-called "Broadband Britain" adverts are highly effective in promoting BTOW as the preferred supplier.
>
> 2.3 Freeserve also queried the financial viability of BTOW's business case; in particular the fact that their revenues were not capable of covering their long-run incremental costs, arguing that their position could only be supported on the basis of cross-subsidies, and that they were engaged in predatory pricing, aimed at driving out any effective competition.

OFTEL's Response

1. Re advance notification;
   CK indicated that OFTEL were mid-way through their 6-week preliminary investigation phase, it was therefore too early to give a view as to the likelihood of this complaint proceeding to full investigation.

2. Re Cross Marketing / Brand Leverage
   OFTEL believe that BT must be free to utilize its brand, (almost) as they see fit. They appeared to recognize however, that the effects of BT's brand advertising could be anti-competitive – arguments that are being developed by the European Commission to control incumbent brand leverage in France.

3. Re Predatory Pricing
   OFTEL reviewed BT/BTOW's business case in the context of approving the wholesale price reductions in February. They believe their business case to be viable and absent any further information, are unlikely to re-open this debate.

Conclusion

1. Any other ISPs who share Freeserve's concern regarding their ability to bring their own broadband product to market, so soon after the price announcement in February, need to express those concerns urgently to OFTEL, if they are to press forward with a full investigation.

2. Complaints relating to cross-marketing, brand leverage, cross-subsidy and predation, need greater articulation and more stringent legal analysis if they are to be picked up by OFTEL and form the basis for an investigation – whether on the basis of undue preference (Breach of Licence), Competition Law (abuse of a dominant position) or both.

3. There is a clear risk that BT will continue to operate in such a way as to restrict or prevent other entrants to the market and the likelihood of Regulatory intervention to prevent that situation from arising appears slim.

4. The introduction of a new DSL product from BT Retail (1) creates a further barrier to unbundling by lowering the cost of access and (2) presents new opportunities for BT to exploit its dominance in voice telephony, in particular its billing relationship with the end user. OFTEL have no powers to prevent this product from coming to market and appear to have little concern or understanding of its potential impact on competition."

Oftel's letter of 17 April 2002

76. On 17 April 2002, the responsible Competition Case Manager at Oftel wrote to Freeserve, stating that:

"… Oftel normally adopts a two-phase approach:

- The preliminary investigation phase when initial consideration is given to decide whether there is a case to answer which requires further investigation.
- The full investigation phase when further information is gathered and assessed to decide whether there has been a breach of obligations under telecommunications or competition laws. If a breach has occurred

consideration will be given to the appropriate action needed to rectify the breach and if necessary the appropriate penalties for the breach.

…

I hope to inform you of the conclusions of our preliminary investigation by 28 May, at the latest.

…"

Oftel's investigation of Freeserve's complaint and BT's letter of 22 April 2002

77. The Director has voluntarily disclosed certain documents to the Tribunal showing the steps Oftel took to follow up the complaint made by Freeserve. We regard that as an entirely proper course for the Director to have taken.

78. It appears that BT was first contacted by Oftel about the complaint on 15 April 2002, the day before the meeting with Freeserve on 16 April. An internal Oftel e-mail of 15 April 2002 from Mr Stroud to Mr Russell (the case officer) states:

> "I've spoken to Theresa Brown in the regulatory affairs section of BTOW. The cinema campaign was launched November 2001 and the tv campaign, based on a cut down version of the cinema ad, was launched 1 April 2002."

79. An internal Oftel e-mail of 17 April from Mr Russell to Mr Wood states as follows:

> "Just to let you know that I spoke to Theresa Brown at BT Openworld today (17 April) and explained that we had received a complaint from Freeserve which was now in the preliminary investigation phase. In order to progress this case quickly I asked her if she could provide the following information as soon as possible:
>
> When did BTOW place orders for its broadband cd-rom access disk[s] which are being distributed through retail channels such as BP garages?
> When did BTOW agree its current advertising spend?
> When were the slots for the current BTOW TV ads booked?
> When were current stocks of self install broadband modems ordered?
>
> Theresa agreed to get this information to me by next Monday 22 April. She also pointed out that a lot of BTOW's current advertising was planned for the launch of self install rather than the wholesale price cut. I'll provide her with a copy of the Freeserve complaint shortly and will ask for a BT response to the points made."

80. The responses were received in a letter from Ms Brown, of 22 April 2002 which reads as follows:

> "Thank you for sending me a copy of the Freeserve complaint. As discussed, I am replying to your specific questions on modems, CDs and advertising. However, firstly I wanted to put on record the background to the launch of our Plug & Go product:

- BTOW took part, along with other ISPs (including Freeserve) in the trial of the Plug & Go product in December. As Oftel is aware, we always intended to launch this product, and were gearing up to do so well in advance of the Wholesale price reduction announcement. Those working on the BT Openworld Plug & Go launch after the trial had no prior knowledge of the price changes, nor did we need it to prepare ourselves.
- Indeed, some competitors, including Pipex, launched their products very shortly after the BTWholesale product was launched on Jan 15 2002. It may be worth noting that Freeserve themselves announced that they were going to keep their trial of the self-install product going for twelve months, and had set the price at £29.99 per month, so long as customers signed up by 11 January (when the trial officially ended). (source: http://www.theregister.co.uk/content/archive/23475.html) Having taken part in this trial enabled those involved to be ready to run with the new prices when they were announced. Freeserve announced their new price immediately – a day before BTopenworld.
- Ben Verwaayen, speaking publicly on the occasion of BT's quarterly results on 7th February, stated that there would be "substantial" cuts in the wholesale price of Broadband within two to three weeks. All ISPs had the opportunity to consider what this might mean for them at that time. There was also considerable speculation in the media. (For example: http://theregister.co.uk/content/archive/23972.html)
- I attach with this letter a quote from Pipex, an ISP in the same competitive position as Freeserve in relation to BTopenworld, which would appear to support our view.

In answer to your specific questions:

1. Modems

In September 2001 BTopenworld attended an industry forum, at which Freeserve were also represented. The forum discussed issues around self-install, including modem compatibility and supply. BTWholesale announced their intention to trial the self-install product very shortly afterwards and BTopenworld replied formally with a request to join the trial.

Following this, BTopenworld published a formal ITT, inviting DSL Modem suppliers to present their proposals for providing equipment, including the ability to support BTOW's projected volumes for the full launch of the product in due course. We chose two suppliers from over 16 who could meet the demand we forecast as well as our other requirements, and the trial began in December. It is simply not the case that BTopenworld knew in advance the details of the price changes which came months after this exercise was carried out; we had always planned to launch this product. BTopenworld places orders with its supplier 1 month in advance in line with forecast demand.

2. CDs

BTopenworld's generic broadband CD has been available since late last year. We had no need to design a new CD to act quickly, as it contains no detail of the Plug & Go product or its prices.

We briefed the agency on new CD covers and point of sale material, to cover the new prices, on 27th February. We ordered more CDs to be pressed ready for distribution on that same day. Copy CDs were pressed between 5th and 7th March. They were shipped to the stores from 15th March, the last being delivered in the first week in April.

3. When was advertising spend decided
We finally decided the marketing budget, which includes advertising expenditure, in the late afternoon of 26th February when we decided our retail price, after the BTWholesale announcement earlier in the day. Oftel was given a copy of our business case later that evening, when we had finalised all the figures.

4. When were our advertising slots booked
We began talking to our media strategy agency about television advertising on 29 January. The successful trial of Plug & Go came to an end in mid-January and it is therefore entirely appropriate, contrary to Freeserve's assertions, that we would begin our discussions then. It was not, however, until 20 March that we finally confirmed our bookings with the agency for Q1.

Our first TV ad appeared on 1 April and, as I have already advised Duncan Stroud at Oftel, the advertisement itself was a cut-down version of our generic broadband cinema advertisements first aired in November 2001. We therefore did not need to commission a new advertisement, simply to alter an existing one.

In closing, I hope that this information is helpful. Good planning and swift response on BTopenworld's part should not be confused with anti-competitive behaviour.

Please let me know if you have any further questions, or require more detail on these points."

81. The facts set out in the letter of 22 April 2002 concerning BT's actions were not substantiated by supporting documents, and none were requested by Oftel.

Oftel's Statement of 19 May 2002

82. Oftel's Statement of 19 May 2002 on BT's Marketing of Internet Services and the Use of Joint Billing ("Oftel's Statement of 19 May 2002) appears to be largely concerned with BT's use of its residential "blue bill" for billing its "BT Broadband" service (see paragraph 20 above). In the press release accompanying that statement Oftel summarised its policy as follows:

> "BT cannot use detailed information contained in residential customers' bills in order to target its internet access services to particular customers, as no other operator has access to this information. Oftel is likely to view use of this information as anti-competitive.
>
> BT sales staff will be subject to strict procedures to ensure that they comply with these rules. Oftel will closely monitor BT's compliance, and will review the situation after six months.
>
> BT is also allowed to use its residential 'blue bill' to charge for its new 'BT Broadband' service."

The Director's decision of 21 May 2002 ("the contested decision")

83. On 21 May 2002, Oftel rejected Freeserve's complaint of 26 March 2002 in a letter which enclosed a memorandum referred to as "a case closure summary". It appears from the

documents before the Tribunal that the letter and case closure summary were sent by e-mail to Freeserve at 4.57 pm. We set out in full the text of the case closure summary:

"**Case closure summary**

Case number	CW/00518/04/02
Case title	BT's Broadband Marketing
Case opened	16 April 2002
Case closed	21 May 2002
Complainant	Freeserve.com PLC
Target of Complaint	BT

Issue

1. Freeserve has written to Oftel requesting that it take action under the Telecommunications Act and Competition Act against BT's "orchestrated campaign of anti-competitive behaviour aimed at achieving dominance by the incumbent in the market for retail ADSL services". Summaries of the different sections of Freeserve's complaint and Oftel's findings are set out below.

Oftel's findings

Cross marketing activity between BT and BT Openworld

Freeserve's complaint

2. BT's 'Broadband Briton' newspaper adverts were targeted at consumers and designed specifically to benefit its own ISP, BT Openworld (BTOW). Freeserve also claims that the hyperlink on the adverts for 'bt.com/broadband' advantaged BTOW as the website 'bt.com' has a direct link to BTOW. In summary, Freeserve believes that BT is using its corporate brand to cross market BTOW and make BT synonymous with ADSL to the exclusion of other Service Providers. It argues that this behaviour constitutes abuse of dominance. Freeserve has asked Oftel to require BT to immediately cease all ADSL cross marketing activity. It also believes that BT should be required to notify Oftel and all ISPs of any material product changes or announcements at least 30 days prior to their introduction. In addition Freeserve believes that Oftel should require 'bt.com' to link to the BT/broadband website "thereby ensuring even distribution of all competing Service Providers, not just BTOW".

Oftel's view

3. There is no prohibition on BT advertising its brand and services collectively or individually. BT is entitled to trade on its brand awareness and use that to promote its Internet services. Other service providers including Freeserve can also advertise their services in order to create brand awareness of themselves as broadband service providers. Many ISPs such as Freeserve already undertake substantial mass media campaigns for their narrowband products and are beginning to do this for broadband.

4. BT's 'Broadband Briton' newspaper adverts make no reference to Openworld and the Internet address they contain refers consumers to the BT.com/broadband website and not to the general BT.com website. The BT.com/broadband website has no links to BT.com and lists all service providers using BT's wholesale products, including Freeserve. The list of service providers also gives links to further information on their services and their own websites. It is likely that Openworld derives benefit from the general BT

broadband adverts. However, it is Oftel's view that all SPs benefit from this advertising through specific links to their own services.

5. Freeserve requests a 30 days notice for BT product changes. In the case of wholesale price changes there is already a 28 day notice period for material changes. The recent wholesale price drops only came into force on 1 April after a 28 [day] notice period. Oftel does not believe that the addition of 2 more days to this notification period would be materially different to the existing regime. In relation to notification of price changes to BT retail products (whether or not they are also sold to resellers) Oftel has recently concluded a public consultation on this issue. Oftel's statement can be found on its website at: http://www.oftel.gov.uk/publications/licensing/2002/noti0302.htm

6. Freeserve states that in a recent case the European Commission claimed that an "ISP's ability to benefit from the incumbent's reputation and brand awareness is evidence of abuse of a dominant position". This is a reference to the Commission investigation into predatory pricing by the France Telecom ISP Wanadoo. From the information Oftel currently has the Commission has concentrated on France Telecom's pricing practices and not its use of its brand for marketing purposes.

7. In conclusion the information supplied by Freeserve for this portion of the complaint does not provide evidence of anti-competitive behaviour by BT and the Director does not consider that this issue warrants further investigation.

Advance Notification of wholesale price reductions

Freeserve's complaint

8. Freeserve alleges that the speed with which BTOW began marketing its reduced price broadband service meant that it must have had advanced notice from BT of wholesale price cuts. Freeserve has asked that Oftel investigate the timing of BTOW's recent marketing campaign to determine: when it had developed and booked tv adverts, when it had ordered broadband modems and when it had ordered CD access disks to be distributed through retail outlets. Freeserve's overall view is that, "it is inconceivable for BTOW to be in the position they now enjoy in relation to TV advertising, CD access distribution, and modem provisioning, unless they received clear notification on the wholesale price reduction prior to 26th February". As part of its preliminary investigation Oftel has obtained information on these issues from BT.

Oftel's view

9. Oftel considers that BT Openworld (BTOW) could have moved quickly once BT's pricing announcement was made to agree an advertising spend to promote its broadband services. BTOW has confirmed to Oftel that it decided its marketing budget for promoting its retail price reduction on 26 February after the wholesale announcement earlier that day. It should be noted that Freeserve announced price reductions for its broadband retail products on the same day as BT's wholesale price reductions and a day before BTOW's own announcement.

10. BT's pricing announcement was made on the 26 February and heavily trailed by BT's chief executive, Ben Verwaayen, at BT's 3rd quarter results announcement on 7 February. Oftel has confirmed that BTOW's recent tv adverts were first broadcast on 1 April and that they are re-edited versions of old cinema adverts shown last year. BTOW has stated that slots for these adverts were booked on 20 March. Oftel considers this to be a reasonable timetable to prepare and launch this campaign given that the adverts effectively pre-dated any announcement of wholesale price cuts.

11. It should also be recognised that the price reductions announced on 26 February were just that and did not involve the introduction of a new product. BT Wholesale launched its self install broadband service on 15 January 2002 with a number of ISPs launching their own retail services on the same day. The trial of the self install wholesale products was originally announced by BT to industry on 17 October 2001 with the trial starting on 3 December 2001. It would have been possible for Freeserve to bring a product to market at any stage after that date. BTOW has told Oftel that it began to plan for its increase in the supply of modems once it applied to join the trial. BTOW did not fully launch its self install retail product until after the 26 February price reductions. This means BT had a period of over 3 months to order modems in preparation for its launch of self install. Oftel accepts BT's contention that it was the development of self install and not the wholesale price cuts which caused it to begin ordering modems.

12. BTOW's promotional cd roms have been available since last year. Oftel has confirmed that content of these cd roms is generic to BTOW's broadband service and has no specific reference to self install or a reduced price. BTOW has stated that it instructed its advertising agency to amend the sleeves and point of sale material to reflect the new self install prices on 27 February. Copy cds were pressed between 5-7 March and shipped to shops on 15 March. Oftel accepts that BTOW could have moved quickly following the announcement of wholesale price reductions to amend existing cd-roms and place them in shops to a short timetable.

13. In summary, given BT's existing broadband marketing activities Oftel considers that it could have moved quickly after 26 February to promote the new price point for BTOW making some adaptions to its existing adverts and promotional cd roms. In addition, Oftel also believes that ordering of modems was based on preparation for the launch of a self install service. In conclusion, the information supplied by Freeserve for this portion of the complaint does not provide evidence of anti-competitive behaviour by BT and the Director does not consider that this issue warrants further investigation.

Cross subsidy

Freeserve's complaint

14. Freeserve has presented Oftel with a hypothetical business case for BTOW. This claims that up to March 2003 BTOW makes a loss. Freeserve believes that this shows that BT is unfairly cross subsidising BTOW. Freeserve also believes that BT's current special offer of a reduced connection and set up charge for its Home 500 product is anti-competitive.

Oftel's view

15. Oftel has recently (28 March 2002) closed detailed investigations into cross subsidy and margin squeeze by BTOW. Oftel looked at whether the margin between the wholesale price of IPStream 500 and the retail price charged by BTOW for its At Home product was insufficient to allow other service providers to compete effectively with BT Openworld. Oftel considered the impact of the latest reduction in the wholesale price of IPStream 500 as part of its investigation into these allegations and concluded that there was no evidence to suggest a margin squeeze was currently in operation.

16. Several SPs are undercutting BTOW's new monthly rental price (£29.99) indicating that there is a sufficient retail margin to allow competition with BTOW. Freeserve's own price for its residential broadband product is the same

as BTOW's. The business case Freeserve has presented only covers 1 year, 02-03. It is perfectly possible for a service to make a loss in the first year without the pricing being judged predatory in competition law terms, provided that the product shows a positive return in a reasonable period. BTOW's own business case presented to Oftel shows payback will occur over a longer period than one year. Oftel has accepted that BTOW's business case is not implausible in its recent margin squeeze investigations.

17. BTOW's £65 reduction on its connection and set up charges is a 3 month special offer which was announced on 27 February 2002 and finishes on 31 May 2002. As part of its business margin squeeze investigation, which was closed on 28 March 2002, Oftel has already investigated a complaint from Freeserve that a previous 3.5 months half price connection offer by BTOW was anti-competitive. In that specific case Oftel considered that the special offer was a legitimate commercial practice aimed at stimulating demand. Also, as the offer only lasted 3.5 months, Oftel did not consider that it had a material effect on competition. Oftel also notes that a number of ISPs that are using BT's wholesale broadband products have special offers on connection and set up charges. Freeserve currently has a special offer which exactly matches the reduction in set up charges in the BTOW offer. In conclusion the information supplied by Freeserve for this portion of the complaint does not provide evidence of anti-competitive behaviour by BT and the Director does not consider that this issue warrants further investigation.

BT's "Telephone Census"

Freeserve's complaint

18. BT has sent a questionnaire to a large amount of its customer base called a 'telephone census' which asks for information on their use of telephony, tv and Internet services. Freeserve believes that questions in the census on Internet use, "will provide market information which results solely from BT Retail's dominance within the market for retail telephony, and will prove invaluable in developing targeted offers to potential customers of BT/BTOW." Freeserve believes that this represents an abuse of BT's dominant position in the market for retail telephony. There are further concerns from Freeserve that the wording of questions in the census refer to 'BT/BT Openworld' together and that this erodes the distinction for customers between BT and BTOW.

Oftel's view

19. Oftel is aware that BT is conducting the 'telephone census' to gather information on its customer base. These questionnaires are generic and have been sent to the majority of BT's residential customers. There is no specific targeting to customers on the basis of customer billing information which only BT has access to. There is no prohibition on BT gathering information on its customers in this way in order to market services to them in the future. Other companies can undertake similar exercises using their customer address lists or by buying in such information. Many SPs already have extensive consumer address lists in order to send out marketing information.

20. The one question in the census which refers to BT Openworld asks "who is your main ISP for home Internet use?", then gives 'BT/BT Openworld' as one of the options to tick. There is no specific obligation for BT to maintain a marketing distinction between BTOW and other parts of its business. BT is entitled to exploit the brand awareness it enjoys as a horizontally and vertically integrated company. It is important to note that costs of advertising and marketing activities must be correctly apportioned between different parts of

> BT's business to ensure that anti-competitive cross subsidy does not take place. However, Oftel has already examined BTOW's costs in its margin squeeze investigations which, as mentioned above, it has recently closed.
>
> 21. In conclusion, the information supplied by Freeserve for this portion of the complaint does not provide evidence of anti-competitive behaviour by BT and the Director does not consider that this issue warrants further investigation.
>
> ***Overall recommendations***
>
> 22. In conclusion, the information supplied by Freeserve for the complaint does not provide evidence of anti-competitive behaviour by BT and the Director does not consider that these issues warrant further investigation. Therefore Oftel has closed this case."

84. The case closure summary was copied to BT by Oftel under cover of a letter also dated 21 May 2002. It was subsequently published in the June 2002 edition of Oftel's "Competition Bulletin".

Freeserve's letter of 20 June 2002

85. On 20 June 2002, Messrs. Baker & McKenzie, Freeserve's solicitors, wrote to the Director asking for the decision of 21 May 2002 to be withdrawn or varied pursuant to section 47 of the 1998 Act.

86. The letter of 20 June 2002 attached a document setting out the reasons why Freeserve considered that the decision should be withdrawn or varied, but stated that:

> "At the same time as providing the more detailed description of the reasons in support of this application, Freeserve.com will submit a new complaint that will raise additional concerns in relation to BT's behaviour regarding broadband products and services.
>
> In support of the new complaint and the more detailed description of the reasons for this section 47 application, Freeserve.com has instructed an economist to prepare a report addressing the issue of abuse of dominance by BT in relation to broadband products and services and, in particular, issues relating to the new BT Broadband "no-frills" product. We anticipate that we will be in a position to send you this report within 6 to 8 weeks.
>
> We would suggest that you decide on the merits of this section 47 application at the same time as taking a decision regarding the new complaint we will submit. We consider that this would be the most efficient and convenient way to deal with the matter. It follows, therefore, that we will not be asking you for an early determination of this section 47 application (in order to avoid it becoming divorced from the new complaint)."

87. The document enclosed with the letter of 20 June 2002 in support of Freeserve's request that the Director withdraw or vary his decision of 21 May 2002 states as follows:

"BT'S BROADBAND MARKETING

REASONS WHY THE DECISION OF 21 MAY 2002 SHOULD BE VARIED OR WITHDRAWN

BT is dominant in a number of relevant markets with a position approaching monopoly in certain markets

[Oftel's Statement of 19 May 2002] assumes that BT is dominant in a number of relevant markets (see, for example, paragraph 2.2 of [that statement]) Freeserve.com agrees with the conclusion of the Director General in this regard. In this document, we refer to BT's dominant position in a number of relevant markets, in particular residential access lines, residential voice telephony, (narrowband) dial up internet access services, asymmetric broadband residential access services and wholesale broadband services.

The Director General will no doubt bear in mind that BT has a position approaching monopoly (also referred to as "superdominance") in certain of these markets and so has a heightened special responsibility not to undermine competition. This legal principle is highly relevant in assessing BT's behaviour, in particular where BT possesses advantages which are unmatchable (i.e. cannot be replicated) by competitors.

The reasoning of the Director General, which underlies [Oftel's Statement of 19 May 2002] and the case closure summary, is that where BT exploits those advantages which cannot be matched by third parties, this not only entrenches BT's dominant position but also gives rise to an anti-competitive abuse of that dominant position (see in particular paragraph 2.3 of [Oftel's Statement of 19 May 2002]).

Cross marketing activity between BT and BT Openworld

- The Director General has concluded that BT has not abused its dominant position as a result of the cross marketing activity between BT and BTOW. Freeserve.com disagrees with this conclusion and requests the Director General to vary or withdraw that decision.
- The decision should be withdrawn or varied as the Director General has misinterpreted, at paragraphs 2 and 3 of the case closure summary, Freeserve.com's argument on cross marketing. The Director General states that "Freeserve believes that BT is using its corporate brand to cross market BTOW and make BT synonymous with ADSL" continuing "BT is entitled to trade on its brand awareness and use that to promote its Internet services".
- The Director General's interpretation is incorrect because the argument is not that the BT brand should not be used by all BT businesses, but that advertising tailored specifically to broadband should be paid for by the businesses which benefit, and in particular by BT Openworld ("BTOW"). BT is effectively cross subsidising BTOW's marketing in order to make it synonymous with ADSL to the exclusion of other service providers. In other words, BT is leveraging its dominant position in one market into another, related market. Further evidence on this will follow.

Cross subsidy

- the Director General has concluded, at paragraphs 15 to 17 of the case closure summary, that BT has not abused its dominant position through its pricing practices relating to BTOW stating, "Oftel has accepted that BTOW's business case is not implausible in its recent margin squeeze investigation".

Freeserve.com disagrees with this conclusion and requests the Director General to withdraw or vary his decision.

- The Director General bases his conclusion in part on the fact that other ISPs have matched (or even undercut) BT's prices stating, inter alia, "Several ISPs are undercutting BTOW's new monthly rental price ... indicating that there is a sufficient retail margin to allow competition with BTOW. Freeserve's own price for its residential broadband product is the same as BT's". The Director General's conclusion is incorrect in that it is based on this reasoning.

- Service providers other than BT may choose to price at a level (even one below cost) in order to counteract the inherent advantages of the BT group company. Where BT prices below cost (including through funding its downstream business in order to price at such a level) or introduces offers that may foreclose the market, this constitutes an abuse of its dominant (or at least superdominant) position.

- The Director General is incorrect to conclude that the £65 reduction on BT's connection and set-up charges offer did not result in an infringement as it only lasted 3 months. The offer constitutes free activation of the broadband line. The period after a significant wholesale price reduction is critical for the establishment of a developing retail service such as asymmetric broadband residential access services. A dominant position may be abused through an action occurring over such a timescale in particular by a superdominant undertaking. In addition, the Director General should withdraw or vary its decision as the 3 month period has now been extended.

- In sum, Freeserve.com considers BT is abusing its dominant position in one market by cross subsidising BTOW in order effectively to foreclose a related market and/or carry out predatory pricing in order to establish a dominant position in that related market. Further evidence on this will follow.

BT's "Telephone Census"

- The Director General has concluded, at paragraph 19 of the case closure summary, that BT has not abused its dominant position through strengthening its existing dominant position and facilitating the leveraging of that dominant position as a result of the "telephone census".

- Freeserve.com disagrees with this conclusion and requests the Director General to withdraw or vary his decision. Freeserve.com considers that BT is abusing its dominant position in residential access lines, residential voice telephony, dial up internet access services and/or asymmetric broadband residential access services by way of its "telephone census".

- The Director General's decision should be varied or withdrawn as, in particular, the Director General has, at the very least, misapplied the test of (what may be termed) "matchability". This test is applied by the Director General throughout [Oftel's Statement of 19 May 2002], for example at paragraph 2.3. It underlies the reasoning in paragraphs 19 of the case closure summary where it is stated "[o]ther companies can undertake similar exercises [i.e. gathering information on customers in order to market to them in the future] using their customer address lists or by buying in such information."

- Freeserve.com considers that the Director General has wholly failed to apply the matchability test with sufficient rigour and has concluded without

justification that certain advantages enjoyed by BT are matchable. The evidence will show, in particular, that competitors cannot obtain or develop a database and customer relationships of a similar size and quality to BT's, given that BT has a superdominant position in the retail voice telephony market as a result of being a former State monopolist and currently billing such customers for telephony services. The reasons given by the Director General for concluding that competitors could indeed match/replicate BT's advantages are wholly inadequate and insufficient. If the Director General had applied the test correctly, he would have concluded that BT's inherent advantages could not be replicated by its competitors.

- This misapplication of the test has adverse consequences. As a result of a detailed census of BT's customers, BT will be able to carry out more targeted marketing of its services in the future. Questions in the census on internet use will, for example, provide market information which results only from BT's dominance in residential voice telephony market. This will prove invaluable in developing targeted offers to potential customers of BT. Correspondingly, competitors will be at a significant disadvantage in seeking to market their services to BT's residential customers.

- Hence BT will have strengthened and protected its existing dominant position and will facilitate the leveraging of that position into a related market. This is exacerbated to the extent the census erodes the distinction between BT and BTOW. Further evidence on this will follow.

Advance notification of wholesale price reductions

- The Director General has concluded, at paragraph 13 of the case closure summary, that BT has not abused its dominant position through discriminating in favour of its downstream business through the advance notification of wholesale price reductions. Freeserve.com disagrees with this conclusion and requests the Director General to vary or withdraw his decision.

- The Director General has failed to examine rigorously BT's assertions that form the basis for the Director General's conclusion.

- The Director General is incorrect to have concluded that BTOW could have implemented its marketing arrangements in the time it did once BT's pricing announcement was made without prior announcement of the detail of the price reductions.

- The Director General states, at paragraph 9 of the case closure summary, that "Oftel considers that BT Openworld (BTOW) could have moved quickly once BT's pricing announcement was made to agree an advertising spend to promote its broadband services." This reasoning is wholly inadequate, as the Director General is required to determine what actually happened, not what could have happened.

- The Director General has not adequately investigated BT's assertion that it was the self install model and not the forthcoming wholesale price reductions which led BTOW to begin to order modems (at paragraph 11 of the case closure summary). The Director General does not, for example, address the question of why BTOW did not order additional modems following the announcement of wholesale price reductions.

- In addition, the Director General should not have accepted BT's assertion that BTOW could have moved quickly following the announcement of

wholesale price reductions to amend existing CD-ROMs and place them in shops within such a short timetable (see paragraph 12 of the case closure summary). Again, the Director General should have investigated this assertion more rigorously in terms of analysing the underlying merits and evidence.

- Advertising and strategic behaviour in the period following such wholesale price reduction is a key driver of competition. After a due and proper investigation, Freeserve.com considers that the Director General will conclude that BT abused its dominant position at the wholesale level through providing advance notification to its downstream business of wholesale price reductions. This enabled BTOW to organise and commence marketing activities immediately following the public announcement of such price reductions. Such behaviour amounts to discrimination by BT and constitutes part of its strategic attempt to leverage its dominant position. "

The Director's letter of 8 July 2002 and subsequent correspondence

88. On 8 July 2002, Mr Niblett, the Director of Broadband at Oftel, wrote to Baker & McKenzie in these terms:

> "Thank you for your letter of 20 June 2002 addressed to the Director General requesting that he withdraws or varies the "decision" set out in the case closure summary attached to Trevor Wood's letter of 21 May 2002 to David Melville at Freeserve.com.
>
> The contents of the above documents to which you refer in your application do not constitute an appealable decision under the Competition Act 1998. The Director General's consideration of the Freeserve complaint of 26 March 2002 was not conducted using his powers under the Competition Act and the closure documents do not offer any opinion of the Director General "as to whether the Competition Act has been infringed" as set out in s. 46(3).
>
> As the closure documents do not constitute a "decision" for the purposes of s 46, s. 47(1) does not apply. We will of course carefully consider on its merits any fresh complaint that Freeserve.com wishes to make."

89. In the course of the proceedings for the determination of the preliminary issue of the admissibility of Freeserve's appeal, the Director conceded that the case closure letter of 21 May 2002 did, in fact, close the matter for the purposes of the 1998 Act, contrary to the impression given by the letter of 8 July 2002: see paragraphs 76 to 88 of the Tribunal's judgment on admissibility in this case: [2002] CAT 8 [2003] CompAR 1. The Tribunal also held, in its judgment on admissibility, that the letter of 21 May 2002 constituted an appealable decision within the meaning of section 46(3) and section 47(1) of the 1998 Act, contrary to the statements made in the letter of 8 July 2002.

90. On 22 July 2002, Baker & McKenzie sent a letter to the Director stating as follows:

> "Further to our letter on behalf of Freeserve.com plc ("Freeserve") dated 20 June 2002, and the letter of acknowledgement from Mr Keith Loader dated 27 June 2002, we write to update you on timing.
>
> We plan to send to you in the week beginning 29 July 2002 the additional material referred to in our letter in relation to BT's behaviour regarding broadband products and services. You will then be in a position to consider the merits under the Competition Act 1998. We look forward to discussing our significant substantive competition concerns once you have had the opportunity to review the additional material.
>
> In addition, we acknowledge receipt of the letter of Jim Niblett, Director of Broadband, dated 8 July, the content of which we are considering with Freeserve. For the avoidance of doubt, Freeserve reserves its rights in relation to this matter."

No further material was in fact submitted to the Director prior to the lodging of this appeal with the Tribunal on 9 September 2002.

91. Freeserve eventually submitted a second complaint to Oftel on 22 October 2002, a copy of which is annexed to the Director's defence. As far as we can see, that complaint relates mainly to the use of the "blue bill" for billing "BT Broadband" services (see paragraph 20 above) and the use of the 150 telephone service, and does not overlap significantly with the four areas of alleged abuse which are the subject of the present proceedings. We therefore say no more about it.

V SOME PRELIMINARY QUESTIONS OF APPROACH

(1) General issues

92. Since this is the first complainant's appeal to reach the Tribunal involving, in effect, a challenge to the Director's conclusion that certain conduct has not been shown to be an "abuse" for the purposes of the Chapter II prohibition on the facts, we invited argument on what the Tribunal's general approach to such an appeal should be.

Submissions of the parties

93. Freeserve submits, first, that the Tribunal must decide this appeal, like any other, "on the merits" in accordance with Schedule 8, paragraph 3(1) of the 1998 Act. The Tribunal should therefore consider the adequacy of the reasons given by the Director, whether he has found the facts correctly, whether his investigation has been adequate, and any issues of law arising. In particular, the Director's reasons should be sufficient to enable a complainant to determine whether the decision is well founded, to enable the Tribunal to exercise its control, and to enable interested third parties to know the Director's approach on particular issues. According

to Freeserve, the reasons in the decision cannot be supplemented or reformulated in the course of proceedings before the Tribunal, nor inferred from other documents; they must be clearly and adequately stated in the decision.

94. According to Freeserve, an appeal by a complainant is not limited in scope to the ambit of the original complaint, nor is such an appellant before the Tribunal restricted to the material he has submitted to the Director. Having regard to section 58 of the 1998 Act, the Tribunal should be able to review fully the findings of the Director, so that subsequent civil proceedings are not distorted by a defective administrative procedure. In a case such as the present, there is no basis for limiting the Tribunal's jurisdiction to a "manifest" error of fact or appreciation.

95. In the present case, however, Freeserve does not now invite the Tribunal to make original findings of fact or undertake its own appreciation of the economic issues arising. Freeserve's position is that the contested decision should be set aside and the matter remitted to the Director under Schedule 8, paragraph 3(2)(a) of the 1998 Act, on the grounds that the Director's reasons in the decision are inadequate and that he has failed to use proper care and diligence in evaluating Freeserve's complaint.

96. The Director, for his part, submits that the Tribunal should first ask itself three main questions: (i) what was the gist of the case that Freeserve actually put to the Director in its complaint in March 2002? (ii) was the rejection of that case justifiable? and (iii) was the basis of the rejection adequately communicated to Freeserve, so it knew why the Director had reached his conclusions and so that it could exercise its right of appeal? The Tribunal should not, however, make original findings of fact.

97. Although the appeal to the Tribunal is "on the merits", the Director submits that many competition law issues such as market definition require the exercise of judgment or appraisal. The Tribunal should not interfere with the Director's rejection of a complaint unless satisfied that the Director has made a manifest error in his factual or economic appraisal of the evidence before him, or if the Director has made an error of law. That is consistent with the approach adopted by the Court of First Instance of the European Communities, and reflects the approach of the Court of Appeal in civil appeals: see CPR 52.10, 52.11 and 52.11.9. According to the Director, he has made no error in the present case, manifest or otherwise.

98. The Director accepts that he has an obligation to include sufficient reasons for the rejection of a complaint to permit the complainant, and on appeal the Tribunal, to understand his reasons

for rejecting the complaint. However, the extent of the duty to give reasons will depend on the nature of the decision, the context in which it was adopted and the seriousness of the potential consequences for the persons affected. In the present case, submits the Director, the complaint was poorly argued, and requests for further information were not followed up. Freeserve had heard the views of Oftel at the meeting of 16 April 2002. The Director was therefore entitled to give only brief reasons for rejecting the complaint (see the Tribunal's judgment on admissibility in this case, at paragraph [124]). Moreover, the Director does not consider that the rejection of the complaint had serious consequences for Freeserve, which has since submitted a further complaint. Section 58 of the 1998 Act is not, according to the Director, relevant to the contested decision as there was no section 25 investigation and no finding of infringement.

99. In addition, the Director submits that complainants should not be permitted to appeal to the Tribunal on the basis of new material that was not before the Director. In the present case, Freeserve has impermissibly introduced new heads of complaint and new factual allegations before the Tribunal. The appeal process should not become a springboard for a full hearing of a new infringement claim (see the admissibility judgment in *Bettercare v Director General of Fair Trading* [2002] CAT 6 [2002] CompAR 226, at [96]). Since the appeal is against the decision of the Director, it is the correctness of that decision, taken on the material before the Director, which is in issue.

100. BT's submissions largely support those of the Director.

The Tribunal's views

101. In our view, at this early stage in the development of the 1998 Act, it is neither desirable nor possible to lay down hard and fast rules as to the Tribunal's approach in appeals brought by complainants in a case where the Director has declined to find that the conduct in question amounts to an abuse of a dominant position within the meaning of the Chapter II prohibition. Apart from anything else, there is an infinite variety of circumstances in which such appeals may arise in future cases. We think, however, it is useful to clarify certain matters, in deference to the submissions that have been made, even though it is not strictly necessary for us to do so in order to reach a decision in this particular case.

102. First, the statutory starting point for the exercise of the Tribunal's jurisdiction is paragraph 3(1) of Schedule 8 of the 1998 Act, which provides:

"3.–(1) The tribunal must determine the appeal on the merits by reference to the grounds of appeal set out in the notice of appeal."

103. Paragraph 3(2) of Schedule 8 provides:

"(2) The tribunal may confirm or set aside the decision which is the subject of the appeal, or any part of it, and may–

(a) remit the matter to the Director,

(b) impose or revoke, or vary the amount of, a penalty,

(c) grant or cancel an individual exemption or vary any conditions or obligations imposed in relation to the exemption by the Director,

(d) give such directions, or take such other steps, as the Director could himself have given or taken, or

(e) make any other decision which the Director could himself have made."

104. Paragraph 2(2) of Schedule 8 provides:

"(2) The notice of appeal must set out the grounds of appeal in sufficient detail to indicate–

(a) under which provision of this Act the appeal is brought;

(b) to what extent (if any) the appellant contends that the decision against, or with respect to which, the appeal is brought was based on an error of fact or was wrong in law; and

(c) to what extent (if any) the appellant is appealing against the Director's exercise of his discretion in making the disputed decision."

105. The Tribunal's powers are implemented by the Competition Commission Appeal Tribunal Rules 2000 S.I. no. 261, made under section 48 of the 1998 Act ("the Tribunal Rules"). The Tribunal Rules confer on the Tribunal wide powers to order disclosure of documents, hear witnesses, including expert witnesses, and so on.

106. It seems to us that the reference to an appeal "on the merits" in paragraph 3(1) of Schedule 8 means, first, that the Tribunal's function is not limited to the judicial review of administrative action according to the principles of judicial review applied in the civil courts of the United Kingdom: contrast, in this respect, sections 120 and 179 of the Enterprise Act 2002. Nor is the Tribunal limited to the heads of review set out in Article 230 of the EC Treaty, which are applicable to the Court of First Instance. Nor do we see, in a case such as the present, more than a distant analogy between the functions of the Court of Appeal under CPR 52.11 and those of the Tribunal under the 1998 Act. In our view, the position of the Tribunal is as follows.

107. In appeals where there has been a finding of infringement, it is clear that the Tribunal has a full jurisdiction to find facts, make its own appraisals of economic issues, apply the law to those facts and appraisals, and determine the amount of any penalty. The Tribunal exercised such a jurisdiction in *Napp Pharmaceuticals v Director General of Fair Trading* [2002] CAT 1, [2002] CompAR 13. Where, however, the justice of the case so requires, the Tribunal will not determine the matter of infringement itself, but remit to the Director: see *Aberdeen Journals v Director General of Fair Trading* [2002] CAT 4, [2002] CompAR 167, at [177].

108. The 1998 Act does not distinguish between an "infringement" and a "non-infringement" decision. The Tribunal's powers in Schedule 8, paragraphs 3(1) and 3(2) of the 1998 Act apply equally, whether it is a decision of non-infringement, or a decision of infringement. Similarly, the Tribunal's powers under its Rules, for example to order disclosure of documents or examine witnesses, do not distinguish between "infringement" and "non-infringement" decisions. Indeed, in some cases, a decision by the Director of "non-infringement" may well be as lengthy and detailed, and may have involved as complex an investigation, as a decision of infringement.

109. For these reasons, we do not think that, as a matter of law, the legal scope of the Tribunal's statutory jurisdiction under the 1998 Act differs according to whether the decision in question is one of "infringement" or "non-infringement". To give one example, even where the Director has taken a decision of "non-infringement", it may be open to the Tribunal in an appropriate case to substitute a decision of "infringement", rather than remit the matter to the Director, provided that the Tribunal has all the necessary material before it, and the rights to be heard of all parties have been fully respected: that was the course followed by the Tribunal in *IIB and ABTA v Director General of Fair Trading* ("the *GISC* case") [2001] CAT 4, [2001] CompAR 62.

110. It follows, in our view, that whether it is an infringement or a non-infringement decision, the Tribunal has, in principle, jurisdiction to hear an appeal on the merits, that is to say to decide whether the Director has made an error of fact or law, or an error of appraisal or of procedure, or whether the matter has been sufficiently investigated. That conclusion is not, it seems to us affected by section 58 of the Act: see *Claymore Dairies Limited v Director General of Fair Trading*, [2003] CAT 3, at [176].

111. However, *the way in which* the Tribunal exercises its jurisdiction is, in our view, likely to be affected by the particular circumstances. As the Tribunal said in its judgment on admissibility in *Bettercare*, cited above, at [96].

> "Nonetheless, in our view this Tribunal is essentially an appellate tribunal, not a tribunal of first instance. In complainants' appeals (as distinct, for example, from appeals against penalties) it seems to us that the primary task of the Tribunal will usually be to decide whether, on the material put before him by the complainant, the Director was correct in arriving at the conclusion that he did. If it turns out, in the course of the appeal, that the Director was insufficiently informed, in our view the appropriate course will usually be for the Tribunal to remit, rather than to attempt to investigate the merits for the first time."

112. Similarly, in *Aberdeen Journals*, cited above, the Tribunal said at [177], in relation to a suggestion that it should admit as evidence material not put to the defendant in the course of the administrative procedure:

> "Perhaps more importantly, such an approach could give rise to a tendency to transform this Tribunal from an essentially appellate Tribunal to a court of trial where matters of fact, or the meaning to be attributed to particular documents, are canvassed for the first time at the level of the Tribunal when they could and should have been raised in the administrative procedure and dealt with in the decision. We do not think that such a development would be conducive to appropriate rigour in administrative decision making, or to a healthy and fair system of appeals under the Act."

113. Thus both *Aberdeen Journals* and *Bettercare* take the view that where the Tribunal would risk converting itself from an appellate tribunal to a court of first instance, the appropriate course of action may well be to remit the matter to the Director, although of course the Tribunal retains a discretion not to do so. Everything will depend on what is necessary to meet the justice of the individual case, bearing in mind both the overriding need for fairness, and the need for expedition and saving costs. In some complainants' cases – of which, as will be seen, the present case is one example – the Tribunal's appellate control will, in practice, largely focus on the adequacy of the Director's reasons and the investigation he undertook. In other cases, as in *Bettercare* and *GISC*, cited above, the issue will be largely one of law.

114. We add that, in our view, in accordance with general principles, in complainants' appeals the onus is on the complainant to persuade the Tribunal that the relevant decision should be set aside. In that respect, we recognise that many complainants will face the difficulty that the Director will normally have much greater access to the facts than they do. That is particularly true of the specialist regulators, such as the Director in this case. In addition, some complainants may be small- and medium-sized enterprises, without access to legal advice and

only a rudimentary knowledge of the sometimes complex issues of competition law. What, it seems to us, a complainant needs to do is to persuade the Tribunal that the decision is incorrect or, at the least, insufficient, from the point of view of (i) the reasons given; (ii) the facts and analysis relied on; (iii) the law applied; (iv) the investigation undertaken; or (v) the procedure followed.

115. In order to persuade the Tribunal that the decision is incorrect or insufficient on an issue of fact or appraisal, complainants should normally seek to produce evidence, rather than relying on unsupported assertion. This applies particularly to sophisticated complainants with the resources to present a properly supported case. For a complainant who lacks resources, it should normally be possible at least to explain in plain business terms how a particular course of conduct adversely affects the complainant's own ability to compete in the market, with supporting information about its own business, without necessarily embarking on any complex legal analysis.

116. It seems to us difficult to justify a rule of law to the effect that a complainant may not submit new material to the Tribunal that was not before the Director. Apart from the lack of a legal basis for any such rule, there is the practical difficulty that, until he sees the decision, the complainant does not know what grounds he has for an appeal, nor will he necessarily know what steps the Director has or has not taken in the course of his investigation. In the nature of the appellate process, certain points raised by the complainant before the Director are likely to become more fully developed, as indeed may the arguments of the Director. We accept, however, the Director's basic argument that, in principle, the original complaint sets the framework within which the correctness of the Director's decision is to be judged, taking account of the material that he had or ought reasonably to have obtained. An appeal is not an occasion to launch what is in effect a new complaint and then expect the Director and the Tribunal to deal with the matter on an entirely new basis.

117. We accept the Director's submission that, in considering the sufficiency of the decision in a complainant's case, the starting point will normally be to consider the essence of the complaint made and then go on to see whether the reasons given in the Director's decision constitute a sufficient answer to that complaint, taking account of all the circumstances.

118. The Director's reasons should enable the addressee of the decision to know what the Director in fact did, and enable him to assess whether the decision is well-founded or not, notably with a view to deciding whether to appeal. In addition the Director's reasons should enable the Tribunal to determine whether or not the decision is correct. If essential elements are not set

out in the reasons, it is difficult for the parties or the Tribunal to determine with any degree of certainty what the Director took into account, and what principles he applied at the time the decision was taken.

119. While in some cases the sensible course may be for the Director to elaborate his reasons before the Tribunal, the addressee of a decision is in principle entitled to know the reasons for the decision. If the reasons are in the decision, that avoids any doubt as to whether the reasons later put forward are, or are not, rationalisation after the event.

120. However, as we said in our judgment on admissibility in this case [2002] CAT 8 [2003] CompAR 1, at [124], brief reasons may be sufficient when the Director is dealing with a poorly argued or manifestly unfounded complaint. That is particularly so, in our view, if a weak complaint is presented by a substantial enterprise which has the resources to prepare a properly argued complaint, but has chosen not to do so. On the other hand, if it is a question of a genuinely arguable complaint made by a small- or medium-sized enterprise, without large resources, the fact that the complaint is of the "home made" variety would not in our view absolve the Director from dealing with the complaint in a proper way, and we are sure that the Director would not suggest otherwise. It will all depend on what it was reasonable to expect of the Director in the circumstances of any given case, bearing in mind both the position of the complainant, and the fact that the Director does not have unlimited resources.

121. There is no dispute that, in examining the Director's reasons, the Tribunal has jurisdiction to determine whether the Director has made an error of law. As far as matters of fact are concerned, in our view the Tribunal has jurisdiction to determine whether there is an error of fact. The word "manifest" does not figure in the Act, for example in paragraph 2(2) of Schedule 8. Where it is a question of economic appraisal, for example on an issue such as market definition, it is in principle for the complainant to persuade the Tribunal that the Director's analysis is inadequately supported by his reasoning or the facts upon which he relies. Whether and to what extent the Director may reasonably enjoy a certain "margin of appreciation" on issues of economic assessment in cases where no penalty is involved will depend on the particular facts with which the Tribunal is confronted in a particular case, bearing in mind both that this is a specialist tribunal and that the appeal is on the merits.

122. The working out of these general, and at this stage, preliminary, indications will depend on the circumstances arising in future cases. In section VI below, we apply those principles in the present case.

(2) The issue of dominance

123. In the contested decision, the Director does not deal with the issue of dominance, nor the related issue of the relevant market(s). However, Freeserve has advanced arguments on both issues in its application to the Tribunal. The Director and BT have both made submissions as to how this issue should be dealt with.

Submissions of the parties

124. Freeserve submits that there are four groups of relevant markets in this case: (a) the markets for each of local and national retail voice calls by residential customers on fixed telecommunications networks (referred to together as "the residential retail voice telephony markets"); (b) the wholesale markets, namely the market for wholesale call origination on fixed telecommunications networks in the United Kingdom ("wholesale call origination market"), which relates to residential narrowband services, and the wholesale broadband asymmetric origination market ("the wholesale broadband access market") which relates to residential broadband services; (c) the residential broadband market; and (d) the residential narrowband market. According to Freeserve, these markets are "closely related markets" within the meaning of *Tetra Pak II*, [1994] ECR II-755 at paragraphs 112 to 122 and [1996] ECR I-5951 at paragraphs 21 to 31, and the EC Commission's *Notice on the Application of the Competition Rules to Access Agreements in the Telecommunications Sector* OJ 1998 C265/2, at paragraphs 65 to 67. In particular, these markets are part of the same sector, have a shared customer base, use the same infrastructure, exist in close proximity, and interact in various ways as far as competition is concerned, both "upstream" and "downstream".

125. Furthermore, says Freeserve, many factors support the view that BT has a dominant position in the residential retail voice telephony markets, (see notably the Director's decision in *BT Surf Together*, 4 May 2001, and Oftel's Statement of 19 May 2002, cited at paragraph 82 above); in the wholesale call origination market (see *BT Surf Together*); and in the wholesale broadband access market (see the *Direction to resolve a dispute between BT, Energis, and Thus concerning xDSL interconnection at the ATM Switch*, 21 June 2002, ("the *ATM Direction*" case)). In particular, according to Freeserve, ISPs wishing to compete with BT Openworld can currently obtain wholesale broadband access only from BT. As we understand it Freeserve's case is that there is a significant risk that BT will attain a position where it can restrict competition in the residential broadband market by abusing its dominant position in the closely related markets of residential retail voice telephony and wholesale broadband

access. According to Freeserve, BT's actions amount to "leveraging" its dominance in those 'upstream' or neighbouring markets into the 'downstream' market of residential broadband.

126. Freeserve, however, no longer invites the Tribunal to make a finding on dominance in this case. Freeserve submits that the Tribunal should now proceed on the assumption that BT is dominant, without it being necessary to make a finding to that effect. However, says Freeserve, the Director should, at least, have set out his working assumptions as regards dominance, in order to lay a proper foundation for his analysis on the issues of abuse.

127. The Director has not made submissions to the Tribunal on the question whether BT is or is not dominant in any relevant market. According to the Director, he made no assumptions in the contested decision on the issue of dominance, nor was it necessary for him to do so: see e.g. the Director's *Bulldog* decision of 28 March 2002 under the 1998 Act (cited at paragraph 49 above). The Tribunal should make no findings on the issue of dominance either. An appeal against a decision such as the present should not be used as a springboard for inviting the Tribunal to determine an issue which the Director has not considered. In any event, the material produced by Freeserve, referring to past decisions of the Director, would be an inadequate basis for making any such determination: a new analysis is needed in each new case: see Cases T-125 and 127/97 *Coca-Cola v Commission* [2000] ECR II-1733, at 82.

128. BT denies that it has any relevant dominant position and supports the Director's view that it is unnecessary to address that issue in this appeal. In any event, it would be inappropriate for the Tribunal to rule on that issue, which has not been investigated by the Director. Previous decisions under the 1984 Act cannot be read as deciding the issue of dominance under the 1998 Act (see also the decision of the Irish High Court in *Meridian Communications Limited v Eircell* [2001] IEHC 195).

The Tribunal's view

129. Freeserve has put before the Tribunal submissions tending to show that BT has a dominant position in one or more of the markets alleged. In the Tribunal's view those are not frivolous submissions. Similarly, in the Tribunal's view, Freeserve's argument that BT's alleged activities in relation to the residential broadband sector could, in law, amount to an abuse of its alleged dominant position in one or other of the, closely related, markets identified (wholesale broadband access and retail residential voice telephony), is not, at first sight, a frivolous argument either. This is not, therefore, a case where Freeserve's complaint could have been

dismissed out of hand on the ground that there was, manifestly, no dominant position held by BT that was capable of being abused in the manner suggested.

130. The Tribunal notes the Director's arguments that in this case it was unnecessary for him to make any definitive findings about the issue of dominance, or relevant market, or any link between BT's alleged dominance in certain markets and its alleged activities in the residential broadband sector, in circumstances where he considered, after a preliminary investigation, that there was no issue as to abuse.

131. The Tribunal observes, however, that conduct capable of constituting an "abuse" is not unlawful under the 1998 Act unless it is carried out by a dominant undertaking. In those circumstances it seems to us that, for clarity of analysis, it will often be appropriate for the Director, in rejecting a complaint on the grounds that there is no abuse, to indicate, at least briefly, which market or markets appear to him, at first sight, to be potentially relevant to his investigation, and whether or not he has made any assumption on the issue of dominance in those markets. Such a practice would, in our view, lay a firmer foundation for the analysis of the alleged abuse, and clarify for the parties concerned the starting point of the Director's reasoning. That is likely to be particularly so in complex sectors such as telecommunications where the alleged dominance may be alleged to exist in one market, and the alleged abuse allegedly takes place in a neighbouring market, whether upstream, downstream or otherwise related. We emphasise, however, that the Director is not required to decide issues which it is unnecessary for him to decide in order to reach a concluded view on a complaint. How far, in any given case, the Director sets out the assumptions he has made on relevant market and dominance, will be largely a matter for him, subject of course to the need for the Director to give adequate reasons for his decision. In this case, the Tribunal makes no findings on the issue of dominance.

VI THE ISSUES OF ABUSE

132. In its complaint, Freeserve alleged an "orchestrated campaign" of abuse of dominance on the part of BT, supported by four specific examples. In our view, each of the examples given by Freeserve needs to be examined individually, as the Director did in the contested decision.

(1) The "Broadband Briton" advertising campaign

Freeserve's complaint

133. Paragraph 1 of Freeserve's complaint of 26 March 2002 reads as follows:

"1. Cross marketing activity between BT and BT Openworld

Immediately following the wholesale price reduction by BT, BT began a series of ostensible "broadband britain campaigns". Whilst these purport to demonstrate the wider benefits of a broadband connection, they are presented as adverts from BT, targeted directly at the consumer (i.e. not BT Wholesale's ISP customer base) and refer the reader to BT.com/broadband. The positioning of the BT ads is grossly misleading when one considers that BT.com provides a direct link to BTOW with no reference to other competing ISPs whatsoever. Examples of the advertisements referred to are attached together with "screen grabs" which show the BT.com homepage, and the link from that page to BT Openworld. The effect of this advertising is to make BT synonymous with ADSL to the exclusion of other Service Providers.

These cross-marketing activities ensure BTOW benefits from BT's name, reputation and brand awareness. The European Commission has recently claimed in a case in France that an ISP's ability to benefit from the incumbent's reputation and brand awareness is evidence of abuse of a dominant position."

134. Freeserve asked that BT should be required "to immediately cease all ADSL cross-marketing activity" and that the Director should take certain specific steps to ensure "equal treatment" between BT Openworld and other ISPs

The contested decision

135. Paragraphs 3 to 6 of the contested decision state:

"3. There is no prohibition on BT advertising its brand and services collectively or individually. BT is entitled to trade on its brand awareness and use that to promote its Internet services. Other service providers including Freeserve can also advertise their services in order to create brand awareness of themselves as broadband service providers. Many ISPs such as Freeserve already undertake substantial mass media campaigns for their narrowband products and are beginning to do this for broadband.

4. BT's 'Broadband Briton' newspaper adverts make no reference to Openworld and the Internet address they contain refers consumers to the BT.com/broadband website and not to the general BT.com website. The BT.com/broadband website has no links to BT.com and lists all service providers using BT's wholesale products, including Freeserve. The list of service providers also gives links to further information on their services and their own websites. It is likely that Openworld derives benefit from the general BT broadband adverts. However, it is Oftel's view that all SPs benefit from this advertising through specific links to their own services.

5. Freeserve requests a 30 days notice for BT product changes. In the case of wholesale price changes there is already a 28 day notice period for material changes. The recent wholesale price drops only came into force on 1 April after a 28 [day] notice period. Oftel does not believe that the addition of 2 more days to this notification period would be materially different to the existing regime. In relation to notification of price changes to BT retail products (whether or not they are also sold to resellers) Oftel has recently concluded a public consultation on this issue. Oftel's Statement can be found on its website at: http://www.oftel.gov.uk/publications/licensing/2002/noti0302.htm

> 6. Freeserve states that in a recent case the European Commission claimed that an "ISP's ability to benefit from the incumbent's reputation and brand awareness is evidence of abuse of a dominant position". This is a reference to the Commission investigation into predatory pricing by the France Telecom ISP Wanadoo. From the information Oftel currently has the Commission has concentrated on France Telecom's pricing practices and not its use of its brand for marketing purposes."

Freeserve's letter of 20 June 2002

136. In its letter of 20 June 2002, Freeserve contended that the Director, in paragraphs 2 and 3 of the contested decision, had misunderstood Freeserve's argument. That argument was not that the BT brand should not be used by all BT's business, but that "advertising specifically tailored to broadband should be paid for by the businesses that benefit, specifically BT Openworld. According to Freeserve, BT was "effectively cross subsidising BTOW's marketing in order to make it synonymous with ADSL to the exclusion of other service providers".

Submissions of the parties

137. At paragraphs 1(a), 1.10(a) and 7.28 of the application, under the heading "Cross subsidy", Freeserve submits that the Director erred in failing to find that the Broadband Briton advertising campaign constituted a breach of the Chapter II prohibition, failed to give adequate reasons for his conclusion, and failed to investigate the matter properly.

138. According to Freeserve, a cross-subsidy in one market operated by an undertaking which is dominant in another market may constitute an abuse of dominance. That is the case here. The BT marketing in question benefited BT Openworld, but the latter did not contribute to the cost. The Director did not address whether this constituted an abusive cross subsidy from the wholesale broadband access market to the residential broadband market, either in his investigation or in his reasons. No basis is stated for the Director's view that all ISPs benefited from the marketing in question, or that they did so in equal measure, a conclusion which is counter-intuitive. Advertising tailored specifically to benefit the retail business should be paid for by that business. The fact that other ISPs can carry out mass marketing campaigns is irrelevant. Contrary to the Director's position, BT's use of its brand would be constrained if there was an unlawful cross-subsidy.

139. In the Director's view, the decision deals adequately with the allegations made by Freeserve in the complaint, particularly the allegation that the advertisements in question were aimed at

generating customers for BT Openworld. There was no allegation of cross-subsidy in the complaint, and the suggestion of a cross-subsidy is unsupported by evidence. In any event, the factual basis for Freeserve's argument is sufficiently answered by the Director's finding that all ISPs benefited from the advertising in question.

140. BT, supporting the Director, argues that there was no basis for any further investigation on the part of the Director.

The Tribunal's findings

141. In our view, Freeserve's original complaint was primarily directed to "cross marketing", i.e. the use of the BT brand in a manner which would, according to Freeserve, have the effect of "[making] BT synonymous with ADSL to the exclusion of other service providers", and confer on BT Openworld the benefits of "BT's name, reputation and brand awareness". Freeserve drew attention to a case apparently brought by the European Commission against Freeserve's parent company in France, Wanadoo. Freeserve asked the Director to take action to ensure that BT Openworld was "not unduly preferred in the market … by leveraging campaigns by BT Group", and to ensure that all ISPs received equal treatment. In particular, BT should give advance notice of product changes, and any BT websites referred to in the advertisements should show, or have clear links to, sites showing competing ISPs. According to the note of the meeting of 16 April 2002, Freeserve went so far as to suggest that BT should be prohibited from using its logo on generic advertising for broadband (see paragraph 75 above).

142. In its application before the Tribunal, Freeserve did not contest Oftel's view that BT is not prohibited from advertising its brand, and that BT is entitled to trade on its brand awareness and use that brand to promote its internet services. Nor does Freeserve contest that the 'Broadband Briton' newspaper advertisements make no reference to BT Openworld, and refer consumers to the BT.com/broadband website, which has no links to BT.com and in fact lists all ISPs, including Freeserve, with onward links to the websites of those ISPs. Freeserve's contrary suggestion in its complaint was apparently mistaken. No point is any longer taken as regards the notice period for product changes, and the point about the case that the European Commission was apparently bringing against Wanadoo has not been pursued.

143. As regards these points, it seems to us that Freeserve's complaint was inadequately developed and that the Director properly set out the facts in the contested decision. Freeserve has, however, maintained at paragraph 7.28(vi) of its application the assertion in its original

complaint that the advertising in question had a foreclosure effect as regards other ISPs, notably on the basis that such advertising was "specifically tailored to benefit the retail business".

144. In this regard, Freeserve has not supported its case by any specific evidence, other than by producing copies of the advertisements themselves. However, as we have said above, the advertisements in question do not refer to BT Openworld, and take the reader to the BT.com/broadband site which lists all other service providers. Apart from the BT logo, the only reference to BT in the advertisements which the Tribunal has seen is a reference, in small type at the bottom of the page, to the fact that "You will need a BT phone line". In addition one of the advertisements states "BT Wholesale provides wholesale service to Internet Service Providers (ISPs)". That reference, by referring generally to ISPs, does not seem to us to be exclusionary in character. On the contrary, the advertising material which we have seen seems, on its face, to be primarily generic material, designed to promote "broadband" as a product, rather than BT Openworld, nor was the advertising we have seen "specially tailored to benefit the retail business". In these circumstances, the foreclosure effect alleged by Freeserve does not seem to us to be substantiated. Freeserve's letter of 20 June 2002 indicated that additional evidence would be supplied to the Director in support of this point, but none was forthcoming.

145. The main, indeed virtually the only, point pursued by Freeserve before the Tribunal is that the Broadband Briton campaign in fact benefited BT Openworld more than other ISPs. From this premise Freeserve argues before the Tribunal that BT Openworld should be required to carry in its budget some allocation of the cost of that campaign, otherwise BT Openworld would be benefiting from a cross-subsidy from other parts of BT's business which, says Freeserve, would be an unlawful abuse. This contention is also relevant, says Freeserve, to its allegation of predatory pricing.

146. It is true that the notes of the meeting of 16 April 2002 suggest that Freeserve argued to the Director that BT Openworld should pay for the advertisements since those advertisements were aimed at generating customers for BT Openworld. It is not satisfactory that, in a case such as the present, the only record of the point now pursued should be in notes of a meeting unsupported by other material. Since, however, the point is raised in Freeserve's letter of 20 June 2002, and since it is reasonably related to at least some of the matters raised in the original complaint, we do not feel justified in excluding this "cross subsidy" argument advanced by Freeserve from the scope of this appeal.

147. The Director's answer to the allegation of "cross subsidy" is that he found, in paragraph 4 of the contested decision, that the advertisements in question were not aimed at generating customers for BT Openworld and "that all SPs benefit from this advertising through specific links to their own services". Hence the factual basis for Freeserve's cross-subsidy argument is unsound.

148. Freeserve has not produced any concrete evidence before the Tribunal to substantiate its allegation that BT Openworld benefited from the Broadband Briton campaign to the exclusion of other ISPs, or that BT Openworld benefited, to a material degree, more than other ISPs from that campaign. As we have already said, in our view, in the absence of any evidence to the contrary, it seems to us that the campaign in question was primarily aimed at benefiting "broadband" as a product, to the ultimate benefit, notably, of BT Wholesale, rather than specifically to the benefit of BT Openworld. Even if it were shown that the use of the BT logo in the advertisement was advantageous to BT Openworld, we see nothing to contradict the Director's argument that other ISPs, including Freeserve itself, also have strong brand names and/or the capacity to undertake major marketing campaigns.

149. We conclude that the material placed before the Tribunal by Freeserve falls short of establishing that the Director dealt inadequately with Freeserve's suggestion that the Broadband Briton advertising campaign constituted an abuse of a dominant position contrary to the Chapter II prohibition.

150. On the particular facts before the Tribunal, we are not satisfied that we should set aside paragraphs 2 to 7 of the contested decision.

(2) Advance notification of wholesale price reductions

Freeserve's complaint

151. Paragraph 2 of Freeserve's complaint of 26 March 2002 reads as follows:

> "BTOW have reported (see copy of "Revolution" magazine dated 13th March attached) that BTOW will shortly launch a £10m advertising campaign, including TV advertising. In addition, BTOW are arranging for the distribution of some 2 million access disks via a variety of retail outlets including BP petrol stations and we understand that that activity is taking place at the moment (see announcement from BTOW's Chief Executive Officer dated 21st March attached). In addition, affiliate partners of BTOW are being positioned to provide links through to the BTOW sign-up page.

These comments and activities demonstrate that BTOW must have received advanced notification of the wholesale price cuts with a view to positioning themselves within the market, ahead of the competition.

We would remind you of similar allegations raised by Freeserve on the introduction of ADSL in the UK. Last year, Oftel determined that "sufficient safeguards" were in place to ensure that BT's legal, data protection, and unfair trading obligations were being met. That now appears manifestly, not to be the case."

152. Freeserve asked that the Director should immediately investigate the timing of the TV campaign about to be launched by BT Openworld, the placement process between BT and its modem supplier, and the order placement process for CD access disks, in order to determine whether BT Openworld in fact had advance notice of the wholesale price changes announced on 26 February 2002. According to Freeserve's complaint:

"… it is inconceivable for BTOW to be in the position they now enjoy in relation to TV advertising, CD access distribution, and modem provisioning, unless they received clear notification of the wholesale price reduction prior to 26th February."

The contested decision

153. Paragraphs 9 to 13 of the contested decision state:

"9. Oftel considers that BT Openworld (BTOW) could have moved quickly once BT's pricing announcement was made to agree an advertising spend to promote its broadband services. BTOW has confirmed to Oftel that it decided its marketing budget for promoting its retail price reduction on 26 February after the wholesale announcement earlier that day. It should be noted that Freeserve announced price reductions for its broadband retail products on the same day as BT's wholesale price reductions and a day before BTOW's own announcement.

10. BT's pricing announcement was made on the 26 February and heavily trailed by BT's chief executive, Ben Verwaayen, at BT's 3rd quarter results announcement on 7 February. Oftel has confirmed that BTOW's recent tv adverts were first broadcast on 1 April and that they are re-edited versions of old cinema adverts shown last year. BTOW has stated that slots for these adverts were booked on 20 March. Oftel considers this to be a reasonable timetable to prepare and launch this campaign given that the adverts effectively pre-dated any announcement of wholesale price cuts.

11. It should also be recognised that the price reductions announced on 26 February were just that and did not involve the introduction of a new product. BT Wholesale launched its self install broadband service on 15 January 2002 with a number of ISPs launching their own retail services on the same day. The trial of the self install wholesale products was originally announced by BT to industry on 17 October 2001 with the trial starting on 3 December 2001. It would have been possible for Freeserve to bring a product to market at any stage after that date. BTOW has told Oftel that it began to plan for its increase in the supply of modems once it applied to join the trial. BTOW did not fully launch its self install retail product until after the 26 February price reductions. This means

BT had a period of over 3 months to order modems in preparation for its launch of self install. Oftel accepts BT's contention that it was the development of self install and not the wholesale price cuts which caused it to begin ordering modems.

12. BTOW's promotional cd roms have been available since last year. Oftel has confirmed that content of these cd roms is generic to BTOW's broadband service and has no specific reference to self install or a reduced price. BTOW has stated that it instructed its advertising agency to amend the sleeves and point of sale material to reflect the new self install prices on 27 February. Copy cds were pressed between 5-7 March and shipped to shops on 15 March. Oftel accepts that BTOW could have moved quickly following the announcement of wholesale price reductions to amend existing cd-roms and place them in shops to a short timetable.

13. In summary, given BT's existing broadband marketing activities Oftel considers that it could have moved quickly after 26 February to promote the new price point for BTOW making some adaptions to its existing adverts and promotional cd roms. In addition, Oftel also believes that ordering of modems was based on preparation for the launch of a self install service. In conclusion, the information supplied by Freeserve for this portion of the complaint does not provide evidence of anti-competitive behaviour by BT and the Director does not consider that this issue warrants further investigation."

Freeserve's letter of 20 June 2002

154. In its solicitors' letter of 20 June 2002, Freeserve argued that the Director had failed rigorously to investigate the matter, and should have determined what in fact happened rather than what "could" have happened, particularly as regards the ordering of modems and the supply of the CD-ROMS within such a short time.

Submissions of the parties

155. In paragraphs 1.4(b), 1.10(b) and 7.29 of its application, Freeserve submits that it presented the Director with strong prima facie evidence that BT Wholesale had discriminated in favour of BT Openworld by giving BT Openworld advance notice of the wholesale price reduction announced on 26 February 2002. Such discrimination, says Freeserve, is an abuse by BT Wholesale of its dominant position in the wholesale broadband access market.

156. According to Freeserve, the launch of BT Openworld's £10 million advertising campaign on 1 April 2002 could not have occurred without such advance notice being given, since there is a two-month advance booking period for such advertisements. If BT had booked its advertising slots on 20 March, as alleged in the decision, substantial financial penalties would have had to be paid. Freeserve's own advertising campaign was launched on 15 May 2002, following booking on 6 March. In addition, according to Freeserve, BT would not, within the

time available, have been able to arrange for around 2 million CD-ROMs to be distributed via a variety of outlets following repackaging. According to Freeserve, it would take approximately four weeks to produce ½ million CD-ROMs, with an additional week for each extra ¼ million required, in addition to the period necessary for distribution and repackaging. That could not have been done by 7 March, as the decision claims. Moreover, according to Freeserve, modems, necessary for the consumer to obtain broadband access, were in short supply at the material time. The fact that BT Openworld apparently had no difficulty in obtaining modems to meet the increased demand following the price reduction announced on 26 February strongly suggests that BT's order for modems was placed with the benefit of advance knowledge of the forthcoming price reduction. It is unlikely to be explicable by pre-ordering to meet demand following the introduction of "Plug & Go", as BT claims.

157. In those circumstances, submits Freeserve, the Director erred on the facts in concluding that BT Openworld could have implemented its marketing arrangements in the time available without prior knowledge of the details of the impending price announcement. Furthermore, the Director should have investigated the matter more thoroughly (e.g. by consulting specialists as to cinema advertisement booking times), and determined what actually happened, rather than finding what "could" have happened: that finding does not enable third parties or the Tribunal to determine what actually happened. In addition, contrary to what is said in the decision, there is no evidence, other than general press speculation, that BT had trailed the fact that the price cuts were imminent when BT's third quarter results were announced. Freeserve could not have planned its competitive response on the basis of such speculation.

158. The Director submits that he promptly took up Freeserve's complaints with BT, and received BT's reply in Ms Brown's letter of 22 April 2002. The contested decision summarises the information given by BT and other points in support of the Director's conclusion that Freeserve's complaint did not provide evidence of anti-competitive behaviour by BT. In Freeserve's solicitors' letter of 20 June 2002 the only point made was that the Director had not considered why BT had not ordered additional modems following the price announcements. In fact, however, the Director concluded that BT had planned ahead to increase the supply of modems, and this was sufficient to deal with Freeserve's complaint. There is no absolute obligation on the Director to seek verification of everything that he is told.

159. Moreover, the Director emphasises that Freeserve raises a number of factual allegations (e.g. the lead time for booking TV advertisements, and penalties for non compliance; the timing of

Freeserve's own marketing campaign; the lead time for producing CD-ROMs etc) as well as certain arguments (e.g. relating to BT's third-quarter results, the need to consult specialists on advertising lead times and the Director's acceptance of BT's statements at 'face value') which have not previously been raised. The Director opposes the introduction of new factual material at this stage, unsupported by evidence. In any event, Freeserve's points are without substance. In particular, the forthcoming price reduction was trailed by BT's Chief Executive, Mr Verwaayen on 7 February 2002. An internal Oftel e-mail also indicates that Freeserve expected BT to announce a wholesale price reduction on 7 February. Moreover, the launch of a marketing campaign does not necessarily depend on the precise timing and amount of a price reduction. Other ISPs such as Pipex launched marketing campaigns before the amount of BT's price reduction had been announced.

160. BT submits, in addition, that the Director acted entirely properly in investigating the matter as far as he did, and acted fully within his discretion in deciding to proceed no further. It is not an error of assessment for the Director to accept plausible explanations: see Case T-115/99 *SEP v Commission* [2001] ECR II-691, at paragraph 56.

161. In addition, BT expressly confirms that those working on BT Openworld's new Plug & Go self-install product did not have advance notification of the price which BT Wholesale was preparing to announce. BT Openworld had trialled the self install product between December 2001 and January 2002, as did other ISPs. BT Openworld's competitors were ahead of it or in a similar state of preparedness: on 26 February 2002, a day before BT Openworld's announcement, Freeserve, Pipex and Freedom2Surf all announced price reductions. BT further confirms the accuracy of the information given to the Director in Ms Brown's letter of 22 April 2002. The forecast order for modems was slightly increased after the wholesale price reductions of 26 February 2002, but BT had the option to do this under its existing arrangements. As to the CDs, BT's existing contractor was able to produce the CDs required and to supply them between mid-March and 1 April 2002, contrary to Freeserve's assertion.

The Tribunal's findings

162. It is apparent that the Director investigated this aspect of Freeserve's complaint by asking BT for an explanation. As appears above, BT informed the Director in Ms Brown's letter of 22 April 2002, in particular that (i) the modems had been ordered well in advance of the wholesale price change, in anticipation of the launch of the self-install retail broadband product Plug & Go; (ii) BT's agency was briefed on new CD covers on 27 February, the extra CDs were pressed between 5 and 7 March, and shipped to stores between 15 March and

1 April; (iii) discussions about television advertising were commenced with BT's agency on 29 January in anticipation of the launch of Plug & Go, but bookings were not finally confirmed until 20 March; (iv) the advertisements which first appeared on 1 April were altered versions of existing cinema advertisements, rather than new advertisements; and (v) BT Openworld's marketing budget was finally decided in the late afternoon of 26 February, after the price announcement and Oftel was given a copy of BT Openworld's business case that evening.

163. Ms Brown's letter of 22 April 2002 further states that those working on the Plug & Go launch "had no prior knowledge of the price changes, nor did we need it to prepare ourselves"; that BT Openworld was anyway gearing up for the launch of Plug & Go, so that preparatory steps had already been taken prior to the price reductions announced on 26 February 2002; that Mr Verwaayen of BT had indicated on 7 February 2002 that price cuts would be made within two or three weeks; and that Freeserve had already set its price of £29.99 and had announced it before BT Openworld, as did Pipex.

164. At paragraphs 9 to 13 of his decision, the Director sets out his assessment of the information supplied to him by BT. He accepts as plausible the contention that BT Openworld finalised its advertising spend on 26 February after the wholesale price announcement (paragraphs 9 and 13). He considers that BT Openworld had followed a reasonable timetable in booking the television advertisements in question (paragraph 10). He accepts that it was the development of the self install product rather than the wholesale price cuts which caused BT to order modems when it did (paragraphs 11 and 13). As regards the CD-ROMs, he finds that these were generic and had no specific reference to self-install or a reduced price. He accepts as plausible BT's explanation of the timetable regarding the supply of CD-ROMs (paragraph 12).

165. In the absence of any concrete elements suggesting the contrary, it seems to us that the view of facts taken by the Director was a reasonable view for him to take on the evidence before him. In addition the Director's conclusion that the matter did not merit further investigation was, it seems to us, a reasonable view of the facts for him to take.

166. Before the Tribunal, Freeserve has made a number of factual assertions, notably that BT would have incurred a substantial penalty if the television advertisements had been booked on 20 March 2002, that it would have taken longer to produce the CD-ROMs, and that, had it not had advance notice, BT Openworld would have had to order additional modems. However,

Freeserve has not placed before the Tribunal any evidence to substantiate these factual allegations.

167. BT has confirmed to the Tribunal that those working on BT Openworld's new Plug & Go self-install product did not have advance notification of the price that BT Wholesale was preparing to announce. BT has also assured us of the correctness of the facts set out in the Director's decision (Statement of Intervention, paragraphs 36 to 39). BT has further explained to the Tribunal BT's internal procedures for complying with requests for information from Oftel, and how the information set out in Ms Brown's letter of 22 April 2002 was assembled and verified before despatch (BT's answers to the Tribunal's questions, 7 January 2003).

168. As already pointed out, the Tribunal has wide powers under the Tribunal Rules to order disclosure of documents, hear witnesses (if necessary on oath) and appoint experts: see Rule 17(2)(d), (e), (f), (g), (k) and (l), Rule 17(3), Rule 20 and Rule 21. The Tribunal is quite prepared to use these powers, if necessary, to verify issues of fact that arise in proceedings before it. That possibility will no doubt reinforce the need for all concerned to ensure that information submitted to the Director or to the Tribunal is accurate and complete.

169. In this case, the Tribunal does not consider it necessary to use its powers to investigate this matter further. In the absence of any concrete evidence to the contrary, the Tribunal has no reason to doubt the factual conclusions of the Director and the facts put forward by BT. In particular, in the context of the preparations for the launch of Plug & Go, it does not seem to the Tribunal necessary to presuppose some illicit advance knowledge on the part of BT Openworld of the price cut planned by BT Wholesale in order to explain the preparatory steps taken by BT Openworld to launch its marketing campaign. Freeserve's contention that it is "inconceivable" that BT Openworld did not have such advance notice is not in our view substantiated.

170. In these circumstances the Tribunal is not satisfied that it should set aside paragraphs 9 to 13 of the contested decision.

(3) Cross subsidy and predatory pricing

Introduction

171. It is convenient to deal with this aspect of the appeal by setting out some introductory matters and then dealing with: (a) paragraphs 15 and 16 of the decision; and (b) paragraph 17 of the decision.

— Freeserve's complaint

172. Paragraph 3 of Freeserve's complaint reads:

> "In January last year, Oftel determined that a cross subsidy would be unfair, in circumstances where a margin squeeze was taking place and it was having a material effect on competition. That determination was in response to complaints relating to the alleged existence of cross subsidies within the BT group which were allowing BTOW to provide short term promotions, subsidized connection fees, and in some instances zero cost connection, to the consumer. At that time, given the uncertainty of the emerging broadband market, Oftel was unable to demonstrate that BTOW's business case in such circumstances was implausible, and no action was taken.
>
> Attached on a strictly confidential basis, is our own analysis of the BTOW business case which (1) reflects their position in the market for DSL products at the present time, and (2) assumes a £10m advertising commitment from the second quarter of this year. You will see that this results in a circa £9m loss for the company which has already posted a £100m loss for the nine months ending December 2001.
>
> We believe there to be a prima facia case of unlawful cross subsidy in this instance, on the basis that the business case (insofar as we have been able to interpret it) is not sustainable. We believe BTOW cannot be generating sufficient revenues to cover its variable and incremental costs – prima facie evidence of predatory pricing pursuant to the principles laid down in the AKZO case. As such, we believe this constitutes abuse of a dominant position. This is entirely consistent with BT's published aim of reaching 1 million DSL customers by the end of the first quarter next year."

173. Freeserve's analysis of BT Openworld's broadband business case, on a one year basis, was supplied to the Director with the complaint. As we read that document, it forecasts an alleged £24 million loss on that activity in the year to 31 March 2003. Such a loss would appear to represent a substantial proportion of BT Openworld's broadband turnover.

174. Under the heading "Action required" Freeserve requested that:

> "Oftel should immediately investigate and challenge the viability of the business case behind BTOW's current offers, in particular their waiver of the ADSL connection charge, (itself an administration charge imposed by BT) and payable by all other internet service providers. In this regard, we believe the matter to be

so critical that Oftel should consider drawing on its powers under the Competition Act to conduct an immediate cross subsidy/predatory pricing investigation in order to prevent BT securing an unassailable position in the marketplace. In addition, we believe that given the prima facia evidence of abuse set forth herein, until the conclusion of such investigation, BTOW should be prevented from introducing any promotions unless Oftel and other ISPs are given sufficient advance notice."

—The contested decision

175. Paragraphs 15 to 17 of the contested decision read, under the heading "Cross Subsidy":

"15. Oftel has recently (28 March 2002) closed detailed investigations into cross subsidy and margin squeeze by BTOW. Oftel looked at whether the margin between the wholesale price of IPStream 500 and the retail price charged by BTOW for its At Home product was insufficient to allow other service providers to compete effectively with BT Openworld. Oftel considered the impact of the latest reduction in the wholesale price of IPStream 500 as part of its investigation into these allegations and concluded that there was no evidence to suggest a margin squeeze was currently in operation.

16. Several SPs are undercutting BTOW's new monthly rental price (£29.99) indicating that there is a sufficient retail margin to allow competition with BTOW. Freeserve's own price for its residential broadband product is the same as BTOW's. The business case Freeserve has presented only covers 1 year, 02-03. It is perfectly possible for a service to make a loss in the first year without the pricing being judged predatory in competition law terms, provided that the product shows a positive return in a reasonable period. BTOW's own business case presented to Oftel shows payback will occur over a longer period than one year. Oftel has accepted that BTOW's business case is not implausible in its recent margin squeeze investigations.

17. BTOW's £65 reduction on its connection and set up charges is a 3 month special offer which was announced on 27 February 2002 and finishes on 31 May 2002. As part of its business margin squeeze investigation, which was closed on 28 March 2002, Oftel has already investigated a complaint from Freeserve that a previous 3.5 months half price connection offer by BTOW was anti-competitive. In that specific case Oftel considered that the special offer was a legitimate commercial practice aimed at stimulating demand. Also, as the offer only lasted 3.5 months, Oftel did not consider that it had a material effect on competition. Oftel also notes that a number of ISPs that are using BT's wholesale broadband products have special offers on connection and set up charges. Freeserve currently has a special offer which exactly matches the reduction in set up charges in the BTOW offer. In conclusion the information supplied by Freeserve for this portion of the complaint does not provide evidence of anti-competitive behaviour by BT and the Director does not consider that this issue warrants further investigation."

— Freeserve's letter of 20 June 2002

176. In the letter of 20 June 2002 under the heading "Cross Subsidy", Freeserve's solicitors made the following main points: (i) the Director was wrong to infer that there was a sufficient retail

margin from the fact that other ISPs were following BT Openworld's prices, since they had to do so in order to counteract the advantages of the BT Group; (ii) pricing below cost, or the introduction of offers which would foreclose the market, would constitute an abuse of dominance by BT; (iii) the Director's view that the £65 reduction on BT's connection and set-up charges for a three month period did not have a significant effect on competition was incorrect; (iv) in any event, the Director should withdraw or vary his decision now that the three month period of the offer had been extended. The letter of 20 June 2002 concluded on this aspect:

> "In sum, Freeserve.com considers BT is abusing its dominant position in one market by cross subsidising BTOW in order effectively to foreclose a related market and/or carry out predatory pricing in order to establish a dominant position in that related market. Further evidence on this will follow."

(a) Paragraphs 15 and 16 of the contested decision

177. Paragraphs 15 and 16 of the contested decision set out the Director's answer to Freeserve's complaint about the allegedly loss-making activities of BT Openworld.

Submissions of the parties

178. At paragraphs 1.5(c), 1.10(c), and 7.30 of its application, Freeserve contends, under the heading "Predatory pricing", that it had provided strong prima facie evidence that BT Openworld was running at a loss. Freeserve's mock business model for BT Openworld's broadband business showed a loss of £24 million in the year ended 31 March 2003. BT Openworld had reported an operating loss of £125 million for the year ended 31 March 2002, and a further loss of £292 million in the previous year. These figures, say Freeserve, point overwhelmingly to the view that BT is pricing below cost and, hence, engaging in predatory pricing. Revised mock figures submitted by Freeserve on 7 January 2003, in response to the Tribunal's questions, still show a predicted loss for BT Openworld's broadband business of £18 million in the year to 31 March 2003, with a deficit each month.

179. According to Freeserve, the Director erred in failing to treat the material presented by Freeserve as prima facie evidence of predatory pricing, and in failing to investigate the matter and give sufficient reasons. He also failed to give sufficient reasons for his conclusion that the business case presented by BT was plausible, and erred in relying on the prices charged by other ISPs who are necessarily constrained to follow BT. The Director also erred in relying on the two margin squeeze decisions of 28 March 2000, which were not material to the 1998 Act.

180. Elaborating its arguments before the Tribunal, Freeserve submitted, notably, that the Director had not included in the contested decision any statement of the legal principles which he was applying. According to Freeserve, he should have applied the test for predatory pricing set out in Case 62/86 *Akzo Chemie v Commission* [1991] ECR I-3359 ("*Akzo*"), but wrongly seems to have treated the matter as an allegation of margin squeeze under the 1984 Act. According to Freeserve, the Director's letter of 8 July 2002 strongly suggests that he did not consider that he was applying the 1998 Act at all.

181. Furthermore, submits Freeserve, the Director wrongly failed to recognise that the gravamen of its complaint was predatory pricing, and he used the expressions "margin squeeze" and "cross subsidy" in the contested decision without defining them, and in a confusing way. Moreover, according to Freeserve, the contested decision does not set out why the Director considered the *Akzo* test to be inappropriate, and does not explain the relevance of the margin squeeze decisions adopted under Condition 78.12 of BT's licence. In the contested decision the Director does not explain how he treated BT Openworld's accumulated losses, nor does he indicate the time frame over which he has assessed BT Openworld's conduct, merely saying that BT Openworld will suffer losses "over a longer period than one year". In addition, the contested decision fails to define what is meant by "payback", and incorrectly relies on the reactions of rivals to show that "there is a sufficient retail margin to allow competition with BTOW". In fact, rivals are simply forced to match BT's prices, even if they incur losses, as a result of BT's dominance.

182. In so far as reliance is placed by the Director on the residential and business margin squeeze decisions of 28 March 2002, Freeserve points out that the Director contends in his skeleton argument (paragraph 36) that the reasoning in those decisions was not incorporated by reference into the contested decision. In any event, the margin squeeze decisions did not address the principles to be applied to a dominant undertaking in accordance with *Akzo*, and used a vague "plausibility" test which is unexplained. What investigation the Director undertook in arriving at those decisions is also unexplained. The margin squeeze decisions apparently assume that the prices of BT Openworld cover its costs, which is not the case.

183. If and insofar as the Director now contends that he has applied the test of the "economic life cycle of the activity" based on long run incremental costs ("LRIC"), Freeserve submits that there is nothing in the contested decision to that effect. The period of the economic life cycle is not defined, and nothing is said about LRIC, nor about the discounted cash flow (DCF) calculations mentioned in the Director's answers to the Tribunal's questions. Even on these

points, the Director's position is not, however, clear because he states in the defence (at paragraph 66) that in relation to a margin squeeze the relevant period is that "over which a business case is reasonable", or in the case of a new service "whether the relevant service has a realistic commercial case at the time of launch". Those tests may be different from a test based on the economic life cycle of the activity based on LRIC.

184. In any event, Freeserve criticises the adequacy of a test based on the economic life cycle of the activity, and points out that there are other tests, such as the length of a subscriber contract (as e.g. in Oftel's Consultative Document *Competition in the Mobile Market* February 1999) or the recovery of costs in the medium term: see *Deutsche Post*, OJ 2001 L125/27. Nor is it self-evident that LRIC is an appropriate benchmark in the context of retail broadband where fixed costs are less likely to constitute a high proportion of total costs.

185. Freeserve accepts that the question of a three year business plan was mentioned at the end of the meeting of 16 April 2002 but denies that this was an 'action point'. The Director's letter of 17 April 2002 effectively closed the dialogue. Freeserve denies that it was a party to the residential margin complaint.

186. The Director submits, first, that Freeserve's complaint referred expressly to the Director's margin squeeze decision of January 2001, and to the Director's view that a cross subsidy would be unfair in circumstances where a margin squeeze was taking place and having a material effect on competition. However, the Director had recently closed his two margin squeeze investigations of 28 March 2000, which considered the sustainability of BT Openworld's business case, the very subject of Freeserve's complaint. The residential market squeeze investigation had covered both BT's special offer up to 31 May 2002 and BT's advertising spend. In those circumstances, it was perfectly reasonable for the Director to refuse to reopen his investigation in the absence of strong evidence. Freeserve's one-year business case did not provide such evidence, since it is normal for a new service to make a loss in the first year. Freeserve was informed of the Director's position during the meeting of 16 April 2002 and invited to resubmit a three-year business case, but did not do so. Freeserve's own note of that meeting indicates that its complaint lacked articulation and proper legal analysis. Moreover, Freeserve was associated with the residential cross subsidy complaint and could have challenged the Director's residential cross subsidy decision had it wished to do so.

187. According to the Director, when approaching the issue of cross subsidy, it is appropriate to consider whether a new service is viable over its economic lifetime: see the Director's Guidelines (cited above at paragraph 15) at paragraph 7.21. In the *ATM Direction* case (cited above at paragraph 125) the Director had indicated that, in the case of a margin squeeze, the relevant time period is that over which the business case is reasonable; for new services the test is whether the relevant service has a realistic commercial case at the time of the launch.

188. In these circumstances, submits the Director, Freeserve's hypothetical one-year business case for BT Openworld provides no significant evidence of margin squeeze, cross subsidy or predatory pricing. Figures from BT's Annual Report for 2002 add nothing because those figures refer to a range of businesses. There is no evidence of exclusionary intent. The fact that other ISPs are selling at or below BT Openworld's prices may not be decisive, but it is relevant to assessing Freeserve's complaint. Freeserve has provided no evidence that its own retail pricing has been forced down to unsustainable levels.

189. In answer to the Tribunal's questions submitted on 7 January 2003, the Director explained that, in assessing the sustainability of the business case for BT Openworld's new broadband service, the Director was concerned to ensure that the net present value of future cash flows was expected to be positive, providing a reasonable return on the overall investment. In such an investment appraisal, it was unsurprising that cash flows should be negative in the early period: what was important was that the positive cash flows in the later period were large enough to outweigh the initial losses and provide a reasonable return over the life of the investment.

190. In submissions to the Tribunal, the Director submitted that Freeserve's complaint was not based on "*Akzo* predatory pricing" but on an allegedly unlawful cross subsidy: the complaint was effectively a continuation of the dialogue, in which Freeserve had been involved, as to whether BT was engaged in a margin squeeze. In any event, submitted the Director, when the contested decision referred to "predatory" conduct, the test being applied was whether a reasonable return was being shown in a reasonable period. The methodology for such a calculation, namely whether the revenue over the lifetime of the service would exceed LRIC, is set out in the Guidelines at paragraph 7.21. To determine the length of the period in question it is necessary, submitted the Director, to take a range of periods, in this case between three and eight years, taking a reasonable view of the economic lifetime of the activity from the point of view of a hypothetical investor. The Guidelines, notably at paragraphs 7.6 to 7.24, make it perfectly clear that the test the Director will apply, in both cross subsidy and

predatory pricing cases, is a test based on LRIC, rather than an *Akzo* test. Those principles also appear from the *Bulldog* decision taken by the Director on 28 March 2002. Freeserve must be taken to have been aware of the Guidelines, especially since Freeserve referred to long run incremental costs during the meeting of 16 April 2002. Whatever test is to be applied, the one-year hypothetical case presented by Freeserve was plainly insufficient. In the circumstances it was for Freeserve to produce further material, as it had been invited, but failed, to do.

191. BT supports the Director, and emphasises that the one-year analysis submitted by Freeserve to the Director was unrealistic and proved nothing, since any allegation of cross subsidy or predatory pricing needs to be evaluated over the economic lifetime of the activity, in accordance with the Guidelines. Moreover, the Director was correct to refer to the pricing of other ISPs, since BT Openworld is not the price leader in this sector, having announced its price of £29.99 a day after Freeserve (£29.99), Pipex (£23.44) and Freedom2Surf (£22.50): see *Akzo*, (cited above), at paragraph 72. It is perfectly plausible to assume that BT's initial losses would be recovered during the lifetime of the activity, as the Director did in the margin squeeze decisions. Freeserve has never produced any evidence to show that it is unable to operate profitably at the price which Freeserve itself announced the day before BT Openworld.

The Director's Guidelines

192. In order to analyse the above arguments of the parties, it is first necessary to set the scene, by clarifying the terms used and setting out relevant material from the Guidelines, cited above at paragraph 15, to which the parties have referred. Those Guidelines set out, in particular, the Director's approach under the Chapter II prohibition as regards certain pricing abuses under the headings "predatory pricing", "cross subsidy", and "price squeezing". In his answers to the Tribunal's questions served on 7 January 2003, the Director confirmed that he used the terms "predatory pricing" and "cross subsidy" in the sense indicated in the Guidelines, and the term "margin squeeze" in the sense discussed under the heading "price squeezing" in the Guidelines.

— *The Director's approach to cost assessment*

193. It appears from the Guidelines that, in assessing whether there is a pricing abuse contrary to the Chapter II prohibition the Director uses an approach tailored to what he sees as the specific features of the telecommunications industry. In particular, according to the Guidelines,

telecommunications networks have large elements of fixed costs that do not vary with the number of customers or calls, and very low marginal costs. In addition, there is a large element of cost which is common to all the services provided. To reflect this specific situation, the Director considers that costs should be measured for the purpose of Chapter II cases on the basis of long run incremental costs ("LRIC"), rather than on the more conventional basis of marginal or average variable costs ("AVC"). According to the Director, measures of LRIC take into account both capital and operating costs, whereas short run marginal costs or AVC do not take account of the capital element (see paragraphs 7.6 to 7.10 of the Guidelines). In these circumstances, says the Director in the Guidelines, it will normally be appropriate in pricing cases under Chapter II of the 1998 Act to examine whether the undertaking's prices are at or above LRIC in each market concerned, as well as the question whether common costs are covered (paragraph 7.11 of the Guidelines).

— Predatory pricing

194. "Predatory pricing" is defined in the Guidelines at paragraph 7.13 as "a strategy whereby an undertaking deliberately incurs short term losses so as to eliminate a competitor and be able to charge excessive prices in the future." In the Tribunal's view, that shorthand definition of the concept of "predatory pricing" may need some elaboration in the future (particularly as regards the notion of "deliberately") but it encapsulates the basic idea, namely that the abuse of predatory pricing occurs where a dominant undertaking charges a price below cost with the likely effect of eliminating competition, and without objective justification. Paragraphs 7.14 to 7.18 of the Guidelines state (footnotes omitted):

> "7.14 In assessing whether an undertaking is engaging in predatory pricing the Director General will consider whether:
>
> - in the short run the undertaking will make an incremental profit, which will enable it to cover its costs;
> - it is the undertaking's intention to eliminate a competitor;
> - it would be feasible for the undertaking to recover its losses.
>
> Further details are given in the Competition Act guideline ***Assessment of Individual Agreements and Conduct***.
>
> 7.15 For the Director General to examine whether an undertaking is covering its LRIC is consistent with the approach set out in the EC Access Notice, which recognises that cost structures in network industries tend to be different from most other industries and that a straightforward application of the test established by the European Court of Justice in the *AKZO* case (using average variable cost as the cost floor) is inappropriate. Further details of the *AKZO* case and the costs tests the Court established are given in the Competition Act guideline ***Assessment of Individual Agreements and Conduct***. If a dominant undertaking is pricing below LRIC the Director General will therefore presume that it is

intending to engage in predatory pricing. It will be for the undertaking in question to rebut this presumption, which, the Director General recognises, will be possible in certain circumstances. It may, for example, be rational to price below LRIC where an operator has excess capacity and this has not been reflected in existing prices.

7.16 If an undertaking's individual prices are above LRIC but revenue overall fails to cover total costs, it will be regarded as intending to engage in predatory pricing if it can be established that the purpose of the conduct is to eliminate a competitor. The existence of common costs will also mean that it will be appropriate to undertake the tests outlined in paragraph 7.11 above, to establish whether total revenue covers total costs.

7.17 An undertaking may seek to justify its pricing strategy by arguing that it will result in an incremental profit that will enable it to cover its costs. As stated in the EC Access Notice, however, pricing below average total costs would not be justified if a dominant operator would benefit only if one or more of its competitors were weakened.

7.18 In assessing whether an undertaking's pricing strategy would result in an incremental profit that would enable it to cover its costs, it will often be appropriate to use a net revenue test, which compares the profitability of a particular decision (for example, to adopt a lower price) with the alternative 'benchmark' strategy (for example, to maintain prices at their existing level). If profitability were not adversely affected by the reduction in price because the demand increased sufficiently to offset the price reduction and at the same time, the price remained sufficiently high to cover the incremental costs of the increase in output, the price reduction might be viewed as legitimate competitive behaviour. If, however, an undertaking had no realistic expectation that a profit would be made or had made no attempt to assess the impact on profitability that the pricing strategy would have, the price reduction is likely to be taken as evidence of an intention to eliminate a competitor."

195. In the *Akzo* case, cited above at paragraph 180, the Court of Justice held that a price below average variable costs (AVC) by means of which a dominant undertaking seeks to eliminate a competitor must be regarded as abusive, whereas prices above AVC but below average total costs may be regarded as abusive if they are part of a plan to eliminate a competitor (see paragraphs 70 to 72 of that judgment, and the discussion in *Napp Pharmaceuticals v Director General of Fair Trading* [2002] CompAR 13, at paragraphs 207 et seq). It seems to us that the principles set out in paragraphs 7.15 and 7.16 of the Guidelines essentially follow the same approach as *Akzo*, but use LRIC as the benchmark rather than AVC.

196. In the *Notice on the application of the competition rules to access agreements in the telecommunications sector* published by the European Commission OJ 1998 C265/2, which is referred to in the Guidelines as "the EC Access Notice", the Commission sets out certain views on "predatory pricing" (paragraphs 110 to 115) and "Price Squeeze" (paragraphs 117 to 119).

197. However, neither party has referred the Tribunal to the EC Access Notice, even though, by virtue of section 60(1) of the Act, the Tribunal has a duty to deal with issues arising under the Chapter II prohibition "in a manner which is consistent with the treatment of corresponding questions arising in Community law in relation to competition within the Community".

— *Cross subsidy*

198. As far as "cross subsidy" is concerned, paragraphs 7.20 to 7.22 of the Guidelines state:

> "7.20 A cross subsidy occurs where an undertaking uses revenues from one market to subsidise losses in another market. Where the undertaking uses revenues from a market where it is dominant there may be a breach of the Chapter II prohibition.
>
> 7.21 A cross-subsidy will normally be judged to occur where an undertaking's revenues from an activity (for example, a new service) may be expected to fail to cover the costs associated with that activity over its *economic lifetime*. The Director General will consider whether the revenue over the lifetime of a service would exceed the LRIC, including the cost of capital. If the revenue would exceed the LRIC, the service would be sustainable in the long term, that is, providing the service would not require a cross-subsidy.
>
> 7.22 A group of services may share common costs which, although the services are individually priced above LRIC, are not covered. A combinatorial test would establish whether the prices of services in groups that share common costs cover both the incremental and common costs of supplying those services. If they did not, this would indicate that the group of services is being cross-subsidised."

199. Paragraph 7.23 of the Guidelines states:

> "7.23 In assessing whether the revenue from providing a service would exceed the LRIC it may be useful to perform a Discounted Cash Flow ('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 an undertaking's 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 the 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."

200. The EC Access Notice does not appear to refer specifically to the question of cross-subsidy.

— Margin squeeze

201. According to the Director, a "margin squeeze" can occur where a firm which has market power in an upstream market uses profits from its activities in that market to subsidise losses in a downstream market, with the result that the margins of its competitors in that downstream market are "squeezed" and competition is adversely affected. Such a margin squeeze does not necessarily entail pricing below costs in the downstream market, but it does entail a situation in which competitors in the downstream market cannot earn a reasonable margin, either because the "wholesale" prices are excessively high or because the "retail" prices are excessively low. An abuse of this kind is dealt with in paragraph 7.26 of the Guidelines, under the heading "Price Squeezing":

> "7.26 Where 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 (see paragraphs 7.32 to 7.37 below on excessive pricing) 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. 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 cost allocation where he believes that it may be being used to aid anti-competitive behaviour."

202. Thus a "margin squeeze" may involve a particular kind of cross subsidy, e.g. where profits from the "upstream" market are used to fund losses in the "downstream" market. That may result in an abuse, if the undertaking is dominant and if there is a material effect on competition.

203. It can be seen, therefore, that although the three concepts of "margin squeeze", "cross subsidy" and "predatory pricing" may to some extent overlap, they are not identical. In particular, the concept of "predatory pricing" seems to us to be quite separate from the concepts of "margin squeeze" and "cross subsidy", and subject to different tests. The concepts are treated separately in the Guidelines, and in the EC Access Notice. The concepts were also treated separately in the Director's *Bulldog* decision of 28 March 2002, cited above at paragraph 49.

The Tribunal's findings

— Preliminary

204. In the contested decision, the Director concluded that the information supplied by Freeserve as to BT Openworld's alleged losses "does not provide evidence of anti-competitive behaviour by BT". His reasons for that view are set out in paragraphs 15 and 16 of the decision. At paragraph 15, the Director pointed out that he had recently closed his margin squeeze investigations of 28 March 2002 and had concluded that there was no evidence that the margin between BT's wholesale price for IPStream 500 and BT Openworld's retail price was insufficient to allow other ISPs to compete effectively with BT Openworld. The core of the Director's reasoning is, however, at paragraph 16:

> "16. Several SPs are undercutting BTOW's new monthly rental price (£29.99) indicating that there is a sufficient retail margin to allow competition with BTOW. Freeserve's own price for its residential broadband product is the same as BTOW's. The business case Freeserve has presented only covers 1 year, 02-03. It is perfectly possible for a service to make a loss in the first year without the pricing being judged predatory in competition law terms, provided that the product shows a positive return in a reasonable period. BTOW's own business case presented to Oftel shows payback will occur over a longer period than one year. Oftel has accepted that BTOW's business case is not implausible in its recent margin squeeze investigations."

205. Looking at the matter from the Director's point of view, paragraph 3 of Freeserve's complaint of 26 March 2002 begins by referring to Oftel's decision of "January last year" – i.e. Oftel's decision of 8 January 2001 on the question of unlawful cross subsidy or margin squeeze. Freeserve then goes on to say, on the basis of a mock one-year business case for BT Openworld's broadband business, that it believes there to be "a prima facie case of unlawful cross-subsidy … on the basis that … the business case is not sustainable". However, on 28 March 2002 – two days after the complaint was lodged – Oftel adopted the residential and business margin squeeze decisions. Those decisions were adopted under Condition 78.12 of BT's licence which, in effect, prohibits BT from "unfairly subsidising or unfairly cross subsidising" certain of its "Businesses" as defined in the licence. In those two margin squeeze decisions Oftel held that "having analysed BT's new business case" – apparently that submitted on 26 February 2002 – "Oftel believes that no cross subsidy or margin squeeze exists at the new wholesale and retail prices" (the residential margin squeeze decision) and that "Oftel does not consider that any margin squeeze or cross subsidy is in operation" (the business margin squeeze decision). Freeserve, it appears, could have challenged either or both of those decisions in the High Court under the 1984 Act, but did not do so.

206. In those circumstances, we can well understand Oftel's position that, having just adopted the margin squeeze decisions of 28 March 2002, it was unwilling to reopen any issue of cross subsidy or margin squeeze without convincing additional information. It is apparent from the notes of both Freeserve and the Director that Freeserve was expressly informed, at the meeting of 16 April 2002, that Oftel was not going to reinvestigate matters it had just decided in the decisions of 28 March 2002 without good reason to do so. Moreover, we see no reason to doubt, on this point, the accuracy of the Director's rather fuller note of that meeting, which records that Freeserve was told that in the Director's view "it was normal for a new service to make a loss in the first year", and that Freeserve was invited to provide (i) a new analysis of BT Openworld's case over three years; and (ii) its own business case, for comparative purposes. Freeserve did not supply any further information, as in our view they could have done.

207. Moreover, and still looking at the matter from the Director's point of view, we consider that the Director could reasonably assume that a company as substantial and active in the telecommunications sector as Freeserve would be aware, at least in general terms, of the Director's Guidelines. A cursory reading of paragraphs 7.20 to 7.23 of the Guidelines would, in our view have indicated to Freeserve that the Director would have been unlikely to accept a one-year analysis of the kind submitted by Freeserve as strong evidence of an unlawful cross subsidy in the circumstances of this case. Freeserve's own note of the meeting of 16 April concedes that complaints "need greater articulation and more stringent legal analysis if they are to be picked up by Oftel". Moreover, despite the indication in Freeserve's later letter of 20 June 2002 that "further evidence will follow", no relevant new evidence was submitted by Freeserve to the Director or, indeed, to the Tribunal.

208. However, it seems to us that although Freeserve's complaint raised the issue of cross-subsidy, it also contained an allegation of predatory pricing. Thus the third sub-paragraph of paragraph 3 of the complaint said:

> "We believe BTOW cannot be generating sufficient revenue to cover its variable and incremental costs – prima facie evidence of predatory pricing pursuant to the principles laid down in the *Akzo* case. As such we believe this constitutes abuse of a dominant position."

209. Paragraph 2.3 of Freeserve's note of that meeting refers to Freeserve's argument that BT Openworld:

> "were not covering their long run incremental costs, … that their position could only be supported on the basis of cross-subsidies and that they were engaged in predatory pricing, aimed at driving out any effective competition."

Later in the note the heading "Re Predatory Pricing" appears.

210. In our view, the Director must have understood that Freeserve's complaint included an allegation of predatory pricing because he dealt with that allegation in paragraph 16 of the decision:

> "It is perfectly possible for a service to make a loss in the first year without the pricing being judged predatory in competition law terms, provided the product shows a positive return in a reasonable period."

211. In those circumstances it is convenient to consider the question of the adequacy of the reasoning in paragraphs 15 and 16 of the decision, bearing in mind that Freeserve's complaint included a distinct allegation of predatory pricing contrary to the Chapter II prohibition, in addition to an allegation of cross subsidy.

— The Director's reasoning

212. In our view, the Director's reasoning is open to criticism in three respects. First, the contested decision does not sufficiently describe the analytical approach which we are told the Director undertook. Secondly, even in the light of the Director's elaboration of his reasons before the Tribunal, that analysis remains unclear in important respects. Thirdly, the Director has not in our view sufficiently explained why the principles applicable in his view to a case of cross subsidy are transposable to the issue of predatory pricing raised by Freeserve.

213. On the issue of lack of reasoning in the decision, we note, first, that, in his letter of 8 July 2002, the Director denied that he had taken any decision as to whether the Chapter II prohibition had been infringed, or that the Director had "offered any opinion" as to whether that was the case. Despite the extensive explanations since offered as to how the 1998 Act is to be applied to a case such as the present, the contested decision does not state under which statutory provision the Director was in fact proceeding.

214. As we have said, the earlier margin squeeze decisions, to which the Director refers in paragraphs 15 and 16 of the contested decision, were adopted under Condition 78.12 of BT's licence under the 1984 Act, which prohibits cross subsidy. In our view, having referred to the margin squeeze decisions adopted under Condition 78.12 of BT's licence, the Director needed to explain, in the contested decision, why those earlier margin squeeze decisions were also effectively conclusive of the matter as regards *both* the alleged cross subsidy *and* the alleged predatory pricing abuses under the 1998 Act. That, in our view, was particularly important since, as the Director confirmed to the Tribunal, neither Condition 78.12 nor any other

provision of BT's licence makes specific reference to either predatory pricing or, at least expressly, price/margin squeezing. If, in arriving at his conclusion, the Director relied on the Guidelines issued under the 1998 Act, in our view that fact also needed to be set out in the decision, with paragraph references and a short summary of the principles considered to be applicable.

215. Moreover, as we have already indicated, the Guidelines treat the concepts of predatory pricing, cross subsidy and margin squeeze as quite distinct abuses. The test for predatory pricing is set out at paragraphs 7.13 to 7.19, the test for cross subsidy is set out at paragraphs 7.20 to 7.24, and the test for margin squeeze is set out at 7.26 of the Guidelines. There does not appear to be any material before the Tribunal to show that in relation to predatory pricing, the Director applied paragraphs 7.13 to 7.19 of the Guidelines. In particular the two-part test set out in paragraphs 7.15 and 7.16 of the Guidelines required the Director to ask himself whether BT Openworld was pricing below LRIC, and/or whether BT Openworld's prices were above LRIC but below average total costs. The Director did not, however, refer in the contested decision to paragraphs 7.13 to 7.19 of the Guidelines.

216. Indeed, we understood the Director to submit to the Tribunal that what he in fact did was to apply the principles of assessing a "cross subsidy" set out in paragraphs 7.20 to 7.24 of the Guidelines to both the allegation of "predation" and the allegation of "cross subsidy" made by Freeserve. According to the Director, his essential approach was to assume a period for "the economic lifetime of the activity", and then to make DCF calculations on various assumptions in order to determine whether the return on investment was positive over that period. The costs taken into account in that regard were, as we understood it, LRIC, i.e. long run incremental costs. The calculations were carried out with different variables: for example, on the question of the "economic life of the activity" varying periods of between three and eight years were assumed. Our understanding is that such calculations were carried out for the purposes of the margin squeeze investigations, and that the Director considered that those calculations were sufficient to dispose of Freeserve's complaint for the purposes of the 1998 Act.

217. In our view, if such was the Director's line of reasoning, that should have been stated explicitly in the decision. The decision does not state that the key concept is "the economic lifetime of the activity", nor what that economic lifetime is considered to be, nor how the concept of the economic lifetime of the activity relates to the Guidelines on predatory pricing set out at paragraphs 7.13 to 7.19 of the Guidelines. No reference is made to the need to make

DCF calculations. No mention is made of LRIC, or why and in what way LRIC would be an appropriate basis for the assessment of BT Openworld's retail broadband business. Nor are those matters expressly mentioned in the margin squeeze decisions either.

218. In addition, it is not, even at this stage, wholly clear to us what principles the Director did in fact apply in this case. Although the contested decision refers to the margin squeeze decisions, the Director has submitted (at paragraph 36 of his skeleton argument) that the reasoning of those decisions is not incorporated into the decision contested in this case. Paragraph 16 of the contested decision states that a price will not be predatory if "the product" – not "the activity" – "shows a positive return in a reasonable period", but there is no indication in the decision of what is meant by "a reasonable period". It is not clear to us whether "the reasonable period" here referred to is "the economic lifetime of the activity", apparently assumed to be between three and eight years, or some other period, e.g. the period over which a reasonable investor would wish to see a return, as paragraph 66 of the defence may suggest. These two possibilities are not in our view necessarily the same. In any event, there is no indication of what is meant by a "positive" return, e.g. does this mean a return that is not negative, or a return that would be acceptable to a prudent third party investor having regard to the cost of capital. It is not clear what role LRIC would play, or did play, in the calculations. The word "payback" referred to in the last sentence of paragraph 16 may in our experience imply a different method of investment appraisal from a classic DCF analysis. Finally, in indicating that it is perfectly normal for a new service to make a loss in its "first year", it is not clear how, for the purposes of the 1998 Act, BT Openworld's losses in previous years were to be treated for the purpose of the analysis.

219. Moreover, the contested decision does not explain why the Director's test for "cross subsidy" applies to an allegation of predatory pricing. In our view, it is far from clear that the tests for abusive "predatory pricing", an abusive "margin squeeze" or an abusive "cross subsidy" are the same, either under the Chapter II prohibition or in Community law. Both the Guidelines and the EC Access Notice set out different tests, and the Director seems to have applied different tests in his *Bulldog* decision, cited at paragraph 49 above.

220. Predatory pricing does not necessarily involve a "cross subsidy" from one business to another, since the business concerned may simply finance its losses internally or by borrowings, or look to recoup the losses from the market place at some later stage. In this case, Freeserve, in its complaint, argued that BT Openworld was not covering its average variable or incremental costs. The contested decision assumes that BT Openworld is currently making losses. There

are as yet no decided cases as to whether a dominant undertaking may price below LRIC or AVC for a period on the grounds that it is launching a new product, and if so what that period might be. Nor is there any decision on whether LRIC would be the correct basis for deciding an issue of predatory pricing in the case of retail broadband services.

221. More specifically, the Director's observation in paragraph 16 of the decision that "it is perfectly possible for a service to make a loss in the first year without the pricing being judged predatory in competition law terms, provided the product shows a positive return in a reasonable period" does not indicate whether the Director has considered whether "the losses" arise (i) because the costs are below LRIC (or even AVC) or (ii) the costs are above LRIC (or AVC) but below average total costs. On either hypothesis, there is as far as we know little or no guidance in decided cases as to whether pricing below LRIC/AVC, or between LRIC/AVC and average total costs, could be "objectively justified" on the grounds that it is a new service which is incurring start-up losses. The issue is not, as far as we can see, dealt with in paragraphs 7.15 to 7.19 of the Guidelines. In particular, it is not clear to us that an "assessment of the business case" along the lines set out at paragraphs 7.23 of the Guidelines under the heading of "cross subsidy" is the decisive consideration when it comes to an allegation of predatory pricing.

222. In all those circumstances, it seems to us that fuller reasoning on the issue of predatory pricing was required in the contested decision. Notwithstanding that Freeserve could have been expected to put in a better argued complaint, in our view the complaint on the predatory pricing issue was at least supported by some material, which required an answer. We accept that BT is entitled, in principle, to business confidentiality, but that in our view would not prevent the principles applied by the Director being set out in more detail than was the case here.

223. We add, finally, that paragraph 16 of the contested decision also relies on the fact that Freeserve's price was the same as BT Openworld's, and that other ISPs were undercutting BT Openworld, in order to establish that the retail margin was sufficient. We would observe that such a conclusion cannot, in our view, necessarily be drawn. The alternative possibility is that, in effect, other ISPs were constrained to set prices within the parameters set by BT Openworld's pricing policy, given notably that BT Openworld seems to be the largest supplier of retail broadband. In our view, the Director should have given consideration to that alternative hypothesis.

224. We stress that, in finding in the particular circumstances of this case that paragraphs 15 and 16 were insufficiently reasoned, we are not making a finding as to whether or not the Director's conclusion was correct on its merits, and still less as to whether or not BT was or may have been in breach of the Chapter II prohibition. We can see that, in the early stages of the introduction of a new technology such as broadband, it may take some time for the service to reach full profitability. At what point, however, the scale or duration of any initial losses in one market is to be judged to be an abuse of a dominant position held in an upstream or neighbouring market, or even in the market concerned, and on what criteria, is a matter of general importance which would need to be fully argued. We are not deciding that issue in this case: all we are deciding is that, in our view, paragraphs 15 and 16 of the contested decision did not spell out in sufficient detail what the Director's reasoning was.

225. It follows from the above that paragraphs 15 and 16 of the contested decision fall to be set aside.

(b) Paragraph 17 of the contested decision

226. Paragraph 17 of the contested decision deals specifically with BT Openworld's special offer to waive the activation charge which was originally announced on 27 February 2002 (paragraph 41 above).

Submissions of the parties

227. As regards BT Openworld's special offer to waive the activation charge, Freeserve advances a number of additional arguments. First, Freeserve contends that the offer to waive the activation charge had a material impact on competition. The period after the wholesale price cut was critical for the development of competition. ISPs such as Freeserve were forced to match or undercut BT's offer. Freeserve terminated its special offer at the end of May 2002, but BT's offer was extended for three months. After the end of May, Freeserve's rate of signing new subscribers dropped dramatically. Freeserve was forced to reintroduce the offer on 5 July 2002. Moreover, the Director erred (i) in failing to take account of the offer to waive the activation fee in his assessment of BT's business case; (ii) in concluding that there was no material effect on competition because the offer lasted only three months; and (iii) in failing to take account of the fact that the offer in fact lasted for six months, and had a material adverse effect on competition (see paragraph 7.30 (vii) to (x) of Freeserve's application). According to Freeserve, the Director should have considered whether this offer was below

cost; whether or how far it stimulated demand; how it related to BT Openworld's existing losses; and what the likely effect on rivals would be.

228. Furthermore, the Director should have been aware of the extension of the offer, and should have enquired of BT about it. The ex post facto justification advanced with reference to Ms Rashid's e-mail of 14 June 2002 is insufficient. The reference in the contested decision to the business margin squeeze decision of 28 March 2002 was inadequate, not least because the special offer considered in that case was different: business customers are a small proportion of the ADSL broadband market, and are likely to be less price sensitive; and the reduction in that case was 50 per cent, not 100 per cent.

229. In its answer to the Tribunal's questions of 7 January 2003, Freeserve estimated that BT Openworld would forego revenue of some £3.7 million by virtue of the special offer, and make a net loss on the occasion of each new connection. To recoup those losses, BT Openworld would have to gain extra customer revenues, taking market share from rivals, or reduce its costs. According to Freeserve, BT could not recoup the losses on the activation charge, even over a two or three year period, because its monthly margin per customer remains negative. Freeserve also informed the Tribunal that it was unable to make a margin on residential broadband under the present pricing structure, but provided no supporting information to that effect.

230. The Director, however argues that he was fully entitled to treat BT's special offer to waive the activation charge, as normal competition, as paragraph 17 of the decision indicates. This offer had also been considered in the assessment of BT Openworld's business case leading up to the residential margin squeeze decision, and a similar offer was considered in the business margin squeeze decision. The Director did not learn of the extension in time to take account of it in the decision of 21 May 2002. However, it was subsequently considered, and the Director's conclusion is set out in Ms Rashid's e-mail of 14 June 2002. As explained in answer to the Tribunal's questions, this extension of the offer was factored into the DCF calculation of BT's business plan, deducting the loss of revenue but assuming no corresponding increase in income.

231. According to BT, the fact that the special offer aimed to increase customer volumes simply reflects normal commercial activity. It does not follow that any increase in volume would be at the expense of competitors, since the overall market is growing.

The Tribunal's findings

232. The Director said at paragraph 17 of the decision:

> "17. BTOW's £65 reduction on its connection and set up charges is a 3 month special offer which was announced on 27 February 2002 and finishes on 31 May 2002. As part of its business margin squeeze investigation, which was closed on 28 March 2002, Oftel has already investigated a complaint from Freeserve that a previous 3.5 months half price connection offer by BTOW was anti-competitive. In that specific case Oftel considered that the special offer was a legitimate commercial practice aimed at stimulating demand. Also, as the offer only lasted 3.5 months, Oftel did not consider that it had a material effect on competition. Oftel also notes that a number of ISPs that are using BT's wholesale broadband products have special offers on connection and set up charges. Freeserve currently has a special offer which exactly matches the reduction in set up charges in the BTOW offer. In conclusion the information supplied by Freeserve for this portion of the complaint does not provide evidence of anti-competitive behaviour by BT and the Director does not consider that this issue warrants further investigation."

233. It seems to us that paragraph 17 of the contested decision should be read together with paragraphs 15 and 16. To the extent that paragraphs 15 and 16 fall to be set aside for the reasons we have already given, in our view the same applies to paragraph 17.

234. In addition, the following further specific points arise as regards paragraph 17.

235. The first matter that arises is whether the Director was correct to treat BT's offer as an offer limited to three months' duration. BT's evidence to the Tribunal is that Oftel was told a few days before 21 May that the offer was to be extended, but Oftel denies this (paragraph 58 above). It is plainly unsatisfactory that BT has not been able to produce documentary evidence about the communication of information highly relevant to Freeserve's complaint. It is equally unsatisfactory if, for whatever reason, the Director was unaware of the imminent extension of the offer.

236. In any event, however, it does seem established that the Oftel case officer sent Freeserve a copy of the decision at 4.57 pm on 21 May 2002 and that the case officer was at least informed of the extension of its offer by BT at 5.36 pm on that day (paragraph 57 above). In our view, if new and relevant information comes to light so soon after a case closure letter has been despatched, the proper course to follow is to reopen the case and/or issue an addendum dealing with the new information. Oftel, however, left it to Freeserve to pursue the matter. It is not clear to us that Oftel's response, of 14 June 2002 was made in the context of Freeserve's original complaint of 26 March. In any event, Freeserve was in our view entitled, and did,

raise the matter of the extension of the offer in its request to withdraw or vary the contested decision in its solicitors' letter of 20 June 2002. The Director did not, however, respond to that point in his letter of 8 July 2002.

237. The Tribunal therefore starts from the unsatisfactory position that the Director has dealt with the issue as if it was a three-month offer whereas he could, and in the Tribunal's view should, have dealt with it on the basis that it was a six-month offer, either by issuing a short addendum to the decision of 21 May 2002, or in response to Freeserve's solicitors' letter of 20 June 2002.

238. In the contested decision, the Director relies principally on the fact that a similar offer had been previously investigated in the context of the business margin squeeze investigation and there found to be a legitimate commercial practice aimed at stimulating demand and having no material effect on competition. The implication is, although it is not quite stated, that similar considerations applied to the offer which Freeserve was complaining about.

239. It does not seem to us that a cross reference to the business margin squeeze decision was a sufficient answer on the part of the Director. It does not seem to us necessarily to follow that the business sector would be as price sensitive as the residential sector. As we understand it, the previous business offer had been a reduction of 50 per cent, not 100 per cent. Moreover, the business sector's use of ADSL services is, as we understand it, smaller than that of the residential sector. More fundamentally, the residential offer could, and in our view should, have been examined on the basis of a six-month rather than a three-month period. The circumstances of the offer complained of by Freeserve seem, therefore, to be rather different from the circumstances of the offer which was considered in the business margin squeeze decision.

240. If and in so far as the Director relies before the Tribunal on the fact that the original three-month offer was included in BT Openworld's business case submitted to Oftel, and therefore had already formed part of the Director's examination of BT's business case in the context of the residential margin squeeze investigation, that fact is not stated in the contested decision. Nor is anything said about that matter in the residential margin squeeze decision. There is therefore a deficiency of reasoning on this point.

241. In so far as the Director relies on the fact that a calculation was subsequently carried out in relation to BT's business case in order to take account of the extension of the offer, the

principles being applied were not addressed at all in the Director's letter of 8 July 2002, and were in our view not sufficiently explained in Ms Rashid's e-mail of 14 June 2002. There is no evidence that that unpublished e-mail was considered by the Director to be an addendum to the decision of 21 May 2002. In any event, in so far as the Director's apparent consideration, in June 2002, of the extension of the offer, is a specific example of the general approach which the Director tells us he followed in this case, we have already held that that general approach was insufficiently explained in the decision.

242. In paragraph 17 of the contested decision, the Director further considers that the offer in question did not have a material effect on competition. He relies on the fact that other ISPs had special offers and on the fact that Freeserve had made a competing offer in the same terms. However, Freeserve has placed before the Tribunal evidence – coming to light subsequently to its complaint – that BT Openworld's offer, or more precisely the extension of the offer, did have a material effect on competition. Freeserve's evidence is that when it failed to follow BT Openworld in extending its offer after 31 May, Freeserve's rate of new registrations dropped dramatically, so that Freeserve was compelled to reintroduce its offer on 5 July 2002. At least at first sight, this evidence indicates, in our view, the difficulty of relying on the fact that some other ISPs may have made similar offers to demonstrate that BT Openworld's offer had no material effect on competition. Such offers by BT Openworld are likely to have a material effect on competition if other ISPs are constrained to follow them, as it appears may well have been the situation here. In our view the Director could not, without further analysis, safely draw the conclusion that BT Openworld's special offer had no material effect on competition.

243. We fully recognise that BT Openworld is in principle entitled to stimulate demand by making special offers. The issue, it seems to us, is how far the suggestion of BT's "dominance" in a related market may be a constraint on that freedom. That, in turn, is part of the general issue we have already discussed, namely how far a firm allegedly dominant in one market may incur "start-up losses" or losses resulting from measures to "stimulate demand" when entering a neighbouring market, without infringing the Chapter II prohibition. To the extent that we have already held that the reasoning in paragraph 16 of the decision does not sufficiently explain the steps in the Director's analysis, the same must apply to paragraph 17 of the decision which depends upon essentially the same analysis. In addition, the specific points we have mentioned above reinforce our conclusion that the reasons given in paragraph 17 of the contested decision do not meet the standard required.

244. It follows that paragraph 17 of the contested decision falls to be set aside.

(4) The telephone census issue

Freeserve's complaint

245. In paragraph 4 of its complaint Freeserve alleged:

> "… We believe that the internet questions raised in the Census will provide market information which results solely from BT Retail's dominance within the market for retail telephony, and will prove invaluable in developing targeted offers to potential customers of BT/BTOW. This represents an abuse of BT's dominant position in the market for retail telephony."

Freeserve asked Oftel to require the census to be withdrawn.

The contested decision

246. At paragraphs 19 and 20 of the contested decision the Director said:

> "19. Oftel is aware that BT is conducting the 'telephone census' to gather information on its customer base. These questionnaires are generic and have been sent to the majority of BT's residential customers. There is no specific targeting to customers on the basis of customer billing information which only BT has access to. There is no prohibition on BT gathering information on its customers in this way in order to market services to them in the future. Other companies can undertake similar exercises using their customer address lists or by buying in such information. Many SPs already have extensive consumer address lists in order to send out marketing information.
>
> 20. The one question in the census which refers to BT Openworld asks "who is your main ISP for home Internet use?", then gives 'BT/BT Openworld' as one of the options to tick. There is no specific obligation for BT to maintain a marketing distinction between BTOW and other parts of its business. BT is entitled to exploit the brand awareness it enjoys as a horizontally and vertically integrated company. It is important to note that costs of advertising and marketing activities must be correctly apportioned between different parts of BT's business to ensure that anti-competitive cross subsidy does not take place. However, Oftel has already examined BTOW's costs in its margin squeeze investigations which, as mentioned above, it has recently closed."

Freeserve's letter of 20 June 2002

247. In Freeserve's solicitors' letter of 20 June 2002, Freeserve contended, essentially, that the Director had failed to apply the "matchability" test set out in Oftel's Statement of 19 May 2002, cited at paragraph 82 above, with sufficient rigour. BT's use of its dominance in retail voice telephony could enable it to target customers or potential customers of ISPs, who would

be significantly disadvantaged in the market. Freeserve indicated that further evidence would be submitted.

Submissions of the parties

248. Freeserve submits in paragraphs 1.5(d), 1.10(d) and 7.31 of the application that the Director erred in fact and/or law or failed to give adequate reasons for his conclusion that BT had not abused its dominant position as a result of the "Telephone Census" questionnaire.

249. Freeserve submits, notably that BT would abuse its dominant position in the residential retail voice telephony market if it used that dominant position to obtain a significant advantage for its entry or expansion in a closely related market that cannot be matched by competitors. In the present case, the seeking by BT of information in the Telephone Census questionnaire amounted to the abusive "leveraging" by BT of its dominance in the residential voice telephony markets into the residential broadband market, as well as a strengthening of its dominance in the former market. By this means, BT will obtain information which is not available to its competitors. Such competitors do not, submits Freeserve, have a database which enables them to access the key 'decision maker' in the household, nor are they likely to obtain as good a response rate. Moreover, the telephone census enables BT to identify which of its 18 million residential voice telephony customers use a competing ISP, thus giving BT the opportunity to target such customers with exclusionary effect. BT's database, inherited from its days as a State monopoly, is not replicable by its competitors at any acceptable cost.

250. In purporting, apparently, to apply the test of "matchability" set out in Oftel's Statement of 19 May 2002, two days before the contested decision, the Director has not duly set out the legal basis of his approach. In addition, the Director erred by failing to investigate with sufficient rigour whether the telephone census would strengthen BT's existing position, and by concluding without sufficient evidence that certain advantages enjoyed by BT were matchable. No basis is given for the conclusion that BT will not engage in targeted marketing. In any event, the Director made a clear error of fact by stating that the questionnaires are generic, which they are not as they contain specific questions, including asking who the customer uses as its ISP.

251. The Director notes the absence of any supporting detail or evidence in the original complaint and accepts that the Oftel's Statement of 19 May 2002 is relevant when considering the contested decision on this point. The Director rejects Freeserve's argument that BT has unmatchable access to "key decision makers". The census was sent to BT's customer base,

which can be gathered from sources such as the telephone directory. Freeserve's contention that customers are more likely to open correspondence from BT is unsupported, as is its claim that BT enjoys a better response rate than other operators. There is no evidence to support Freeserve's claim that it would be costly to replicate BT's customer list or that its quality is difficult to match. The claim that the concept of matchability is inadequately explained in Oftel's Statement of 19 May 2002 is not itself explained. In the absence of evidence, the Director was entitled to conclude that there was no targeting. Freeserve has misinterpreted the reference to the census as "generic" to refer to the specificity of the questions: the comment actually refers to the absence of targeting of its recipients: see paragraphs 2.7 and 2.8 of Oftel's Statement of 19 May 2002.

252. BT argues that Freeserve's complaint was more narrowly focused than the broad claims it now makes in its application. Freeserve's specific allegations have been properly addressed in the contested decision. The Director reasoned that the questionnaires did not exploit any advantage which was specific to BT. Freeserve has not produced any evidence to undermine that conclusion. The question whether to accept BT's response on these issues was a matter of appraisal for the Director. According to BT, several other databases would be available to Freeserve if it wished to carry out a similar customer survey. BT rejects as incorrect Freeserve's unsubstantiated assertions that BT has access to the "key decision maker" in a household and that it has a better response rate for its correspondence. Indeed, BT contends that it was advised by its research agency that the survey would get a lower response rate if it was included in a bill and the census envelope was specifically designed not to resemble one.

The Tribunal's findings

253. This part of Freeserve's complaint relates to a questionnaire sent by BT to its residential voice telephony customers in the spring of 2002, asking a number of questions under the headings: A. Your satisfaction as a BT customer; B. You and your home telephone; C. You and the Internet; D. You and your mobile phone; E. You and your TV; F. You and the future. The questionnaire seeks general factual information, and information about the services the customer would be interested in obtaining. One question (in section C5) asks "Who is your Internet Service Provider?" and asks the customer to tick a box identifying BT/BT Openworld, AOL, Freeserve, ntl/Telewest, Work Provided or Other/Don't know. One other question (in section F1) asks "In the future, would you be interested in any of the following services? … Broadband …" At the end of the survey there is a footnote which states:

> "To use this data effectively to plan future services from the BT Group, BT will need to tie this data into their customer database. Please tick this box if you do not wish your data to be used in this way. □
>
> As a result of the information you have given to us in this survey, BT Group plc may wish to tell you about products and services we think may be of interest to you. Please tick this box if you do not wish to be contacted by BT Group plc in any way, as a result of this communication. □"

254. Freeserve's principal complaint was that it was an abuse of BT's dominant position in retail voice telephony for BT to use its retail telephone customer database to seek marketing information of the kind identified in the questionnaire. According to Freeserve, BT's customer database cannot be 'matched' by its competitors, and the questionnaire would enable BT to engage in targeted marketing. The Director's main response is that BT's customer database does not constitute an unmatchable advantage, since its competitors could gain access to similar databases, and that there is no evidence of targeting.

255. In our view there is no rule of law to the effect that a dominant undertaking may not conduct a market survey of its customers with a view to seeking general information about the services they use or might be interested in using in the future. Despite suggestions in its letter of 20 June 2002 that further evidence would be forthcoming, Freeserve has not produced any evidence to establish that other ISPs, or at least the larger ones, would be unable to conduct market surveys of a similar kind on the basis of mailing lists which they already have access to or could buy in. In this respect, it has not been established before the Tribunal that there is any error in the Director's conclusion in paragraph 19 of the contested decision that:

> "There is no prohibition on BT gathering information on its customers in this way in order to market services to them in the future. Other companies can undertake similar exercises using their customer address lists or by buying in such information"

256. As regards the Director's finding that "these questionnaires are generic and have been sent to the majority of BT's residential customers", we have no reason to doubt that the questionnaire was sent out to BT's customers generally, rather than to customers chosen on the basis of billing information specific to certain classes of customer (e.g. customers whose bills indicated lines used for internet access).

257. In so far as the nature of the questions in the survey is concerned, as far as relevant to the present case, most of those questions are rather general in nature, with the exception of one question (in section C5) which asks the customer to identify their main ISP for "home Internet use". This question does not, however, seem to be particularly directed towards broadband,

nor does it ask the customer to indicate whether he/she is a broadband or narrowband user. It seems likely that the vast majority of those who received the questionnaire would have been narrowband users, if they were users of the internet at all.

258. Even assuming, without deciding, that BT has a dominant position in residential retail voice telephony, no convincing argument or evidence has been put forward to persuade us that it would or might be an abuse of that dominant position for BT to send out a marketing survey asking the customer to indicate who is its current ISP for "home Internet use".

259. There is no evidence before us that BT has used the information obtained in response to the survey for targeted marketing, for example to persuade a Freeserve broadband customer to switch to BT Openworld. Moreover, Freeserve's complaint related to BT's activity in relation to broadband ADSL services, and the questionnaire does not seem to be primarily orientated towards some kind of targeted marketing in the ADSL broadband sector. If there had been evidence of "targeted marketing", it may be that the Tribunal would have had to address the Director's approach to that issue as set out in Oftel's Statement of 19 May 2002. Since, however, there is no concrete evidence of such targeted marketing having occurred on the facts of this case, it does not seem to us appropriate to address the matter further in this judgment.

260. It follows that the Tribunal is not satisfied that paragraphs 19 to 21 of the contested decision should be set aside.

VII CONCLUSION

261. It follows that paragraphs 15 to 17 of the contested decision of 21 May 2002 are to be set aside on grounds of lack of reasoning. The remainder of the appeal is dismissed as regards the decision of 21 May 2002. As at present advised, it does not seem to us necessary to make any separate order in respect of the decision of 8 July 2002.

262. On the question whether "the matter" should be remitted to the Director under paragraph 3(2)(a) of Schedule 8 of the 1998 Act, we are aware that there have been developments in this new, expanding market since the Director took the contested decision. It is also open to Freeserve to submit a new and, if so advised, more fully supported complaint. We will hear further argument on whether there should be any order under paragraph 3(2)(a) of Schedule 8 of the 1998 Act in the specific circumstances of this case.

263. On those grounds, the Tribunal holds:

(1) Paragraphs 15 to 17 of the Director's decision on 21 May 2002 rejecting Freeserve's complaint of 26 March 2002 are set aside.

(2) The remainder of the appeal is dismissed.

(3) The question of whether the Tribunal should make any consequential orders is reserved for further argument.

Christopher Bellamy John Pickering Arthur Pryor

Charles Dhanowa 16 April 2003
Registrar