

Annex B

Report by Professor Yarrow on key criteria to define geographic markets

I have been asked by BT to consider (a) whether or not there could be any sensible assessment of significant market power (SMP) without taking into account geographic criteria, (b) upon what basis a national authority may apply such criteria, and (c) whether or not economic harm might arise as a result of failure adequately to address geographic issues.

I have been Director of the Regulatory Policy Institute since 1991, and currently serve as an economic adviser to Ofgem, Postcomm and the CAA. Since around the time of BT's privatisation, I have variously conducted research, written, and advised on regulation and competition in the communications sector. I was a member of an expert panel set up to assist ministers in the development of the Communications Act, within which group I had the remit of addressing issues of economic regulation. In an earlier period I was a member of a similar expert group established to assist Commissioner Bangermann in the development of the EC Green Paper on Convergence.

At Annex 1 to this Report I attach a list of the documents to which I have referred in the course of preparing my report.

Significance of geographic factors

1. Supplies of economic commodities are distinguished by the characteristics of the relevant product/service (perceived, as well as real), by location and by time. Market definition, which involves the identification of a particular set of supplies/transactions, must therefore address (a) product/service issues, (b) spatial/geographic issues and (c) temporal issues.
2. If one or more of these areas ((a), (b), (c)) is not adequately addressed, the market will necessarily be ill defined.
3. Similar points hold in relation to the assessment of market power, the economic scope of which will vary across products/services, space and time.
4. It is therefore necessary that Ofcom include spatial/geographic criteria when defining markets and when assessing market power.
5. It may be noted that the significance of the distinguishing characteristics of commodities (product/service characteristics, space and time) can vary substantially from one economic context to another. In many cases, for example, assessment of the temporal dimension of a market can be relatively trivial – it may, for example, just be a period of years over which an infringement of competition law is alleged to have taken place. On the other hand, there may be cases where a distinction can be made between supplies in peak and in off-peak periods, or where there is some clear change in structural

conditions in a market that has occurred at a particular time. In these latter cases temporal issues will assume a greater significance.

6. Spatial and locational factors are of particular importance in network sectors. Major temporal issues are also common in these sectors. For example: peak/off-peak distinctions are potentially important in transport, energy and communications; regulatory reform (leading to structural changes/breaks in competitive conditions) has been a major influence in network sectors; and there has been, and continues to be, rapid technological change in communications.
7. The importance of spatial/geographic factors follows immediately from the nature of networks. In general, network sectors are characterised by the *transport of something* (people, cargo, gas molecules, electric power, water, signals) *from one location to another*. Networks (comprising nodes and connections between nodes) are spatially configured to serve this purpose, and such configuration is a key determinant of the patterns of economic substitutability and complementarity to be found in the supply of transport capacity (i.e. the supply of infrastructure). For example, whether a rail passenger can easily travel from A to B by alternative routes depends upon network configuration and, in Britain, that configuration remains heavily influenced by the factors of importance to the Victorian pioneers who established the first connections (rail links) and nodes (stations, depots, etc.)
8. Spatial factors such as customer or traffic density are central to the configuration and operation of networks. Historically, these factors have also been central to public policy in network industries, in that there has often existed a policy preference for geographic cross-subsidies in supply (e.g. from urban to rural services), expressed in terms of policy pressures for 'levelised' or 'postalised' prices. Broadly speaking, the effect of this preference has, until recent decades, been the suppression (by public policy) of competition in network sectors -- since competition, which introduces pressures to align prices with costs, tends to unravel cross-subsidies created by postalisation.
9. In more recent years, and particularly since the early 1980s, the economic benefits of allowing spatial variations in prices have been given much greater weight in public policy. There are two main points here. First, although competition may lead to greater spatial heterogeneity in prices and service, it has the desirable effect of promoting better performance across the board: hence, many less-favourably located customers may benefit, even though they benefit less than customers in other locations. Second, it has been increasingly recognised that, even if some support to less favourably located customers is deemed politically desirable, there are often more efficient/effective ways of achieving the policy objective than by suppressing spatial price/service differentials and by suppressing the competition that would unravel such differentials. That is, distortion of competition is *not indispensable* to the achievement of the policy goal.
10. Notwithstanding this transition in policy thinking, there remain significant policy pressures toward the suppression of spatial price differences in network

industries. Independent regulators are not immune to political influence, and politicians are not indifferent to the geographic locations of votes and (in practice, to an even greater extent) production facilities. This is a common and persistent issue (and source of tension) across network sectors, at both the national and EU levels.

11. In my view, therefore, spatial/geographic factors can be expected to be of considerable importance when defining markets and assessing market power in network industries. Indeed, the economic relevance of network configurations for regulation and competition is one of the arguments for entrusting sector-specific regulators with enforcement powers in competition policy. Such bodies can and should build up the expertise in the changing specifics of the networks covered by their powers, which knowledge is relevant in the discharge of both regulation and competition law functions.
12. On the other hand, set against this information efficiency argument is the point that sector-specific regulators may be more vulnerable to political influence and industrial lobbying than are the general competition law authorities. Given that there tends to be persistent, ‘opportunistic’ pressure (albeit of varying strength) to distort competition so as to create or sustain geographic cross-subsidisation in networks, rigorous attention to spatial issues in market definition and market power assessment can be an important line of defence against inefficient regulation.

How might geographic criteria be taken into account in the assessment of SMP?

13. In general terms, the relevant spatial factors should be taken into account by defining the geographic extent of markets following principles and procedures set out in the European Commission’s *Notice on the definition of the relevant market for the purposes of Community competition law* (the Commission Notice). Thus, a relevant geographic market comprises an area in which “*the conditions of competition are sufficiently homogeneous and...can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.*”
14. In the context of the Oftel reviews, the potential complexity of this task is greatly eased by virtue of the purposes for which the assessments are conducted. The aim is define areas of economic activity (by product/service, location and time) according to whether economic conditions suggest that these areas of activity should or should not be subject to a certain type of *ex ante* regulation. Put simply, it can be asked: what activities, in which locations and what times should be deregulated, in the sense that business conduct in these areas is governed only by general competition law?
15. The binary aspect of the question posed (is there or is there not SMP?) implies that, in practice, there should be no pressing requirement for Ofcom to engage in resource-intensive exercises so as precisely to define boundaries between (the potentially many) different possible geographic markets in which, on the wider analysis, it is clear that either (a) BT has SMP or (b) BT does not have SMP. The distinction that matters is between areas/locations where there is

and where there is not SMP (and therefore between areas where *ex ante* regulation is and is not to be imposed). Again putting matters simply, in areas where competition has developed to a sufficient degree, the policy aim is that regulation is to be rolled back.

16. It can be noted that UK and European policy explicitly recognises the process of liberalisation and deregulation to be dynamic. Progressive liberalisation can be expected to lead to the emergence of quite substantial variations in the pressure of competition in different locations and at different times, as underlying heterogeneity in network configurations and spatial variations in costs are exposed. The task for sectoral regulators is to keep pace with these developments so as to ensure that *ex ante* regulation is proportionate in its scope. Given that the scope of regulation will be determined by the relevant market definitions that are adopted, market definition must be responsive to changing conditions of competition if major regulatory policy failures are to be avoided.

Of tel's approach to geographic market definition

17. Given the significance of spatial influences on competition in networks, and given the context of the reviews (the search for proportionate public policy interventions in a sector characterised by uneven developments in competition), I would have expected the spatial market analysis to be rather more detailed and extensive than might be found in most competition law evaluations, including cases such as the CC investigations into small business banking and supermarkets. The opposite is the case, however, and the analysis falls well short of the procedures and approaches set out in the in those sections of the Commission Notice that address issues of geographic market definition.
18. The Commission notice on market definition states, amongst many other things, that:

"The Commission's approach to geographic market definition might be summarised as follows: it will take a preliminary view of the scope of the geographic market on the basis of broad indications regarding the distribution of market shares of the parties and their competitors as well as a preliminary analysis of pricing and price differences at national and EU or EEA level. This initial view is used basically as a working hypothesis to focus the Commission's enquiries for the purposes of arriving at a precise geographic market definition.

The reasons behind any particular configuration of prices and market shares need to be explored. Companies might enjoy high market shares in their domestic markets just because of the weight of the past, and conversely, a homogeneous presence of companies throughout the EEA might be consistent with national or regional geographic markets. The initial working hypothesis will therefore be checked against an analysis of demand characteristics (importance of national or local preferences, current patterns of purchases of customers, product differentiation/brands, other)

in order to establish whether companies in different areas do really constitute an actual alternative source of supply for consumers."

This approach – and considerably more detail is provided later in the Notice – can be compared with the Oftel approach.

19. So far as I can determine, the central Oftel proposition, repeated throughout the review for different products and groups of products, is that the geographic market is national (excluding Hull) *because BT sets its relevant prices on a national basis.*
20. I have not had time to assess the validity of the statement that BT's prices are nationally uniform, but it is clear that, if correct, such an observation falls well short of what the Commission Notice suggests is necessary when defining the market. Thus:
 - The Notice suggests that a preliminary view will be taken on the basis of broad indications of the geographic distributions of market shares and pricing/price differentials. In contrast, Oftel appears to: reach a final view on the basis of one aspect of pricing (BT's prices); ignore pricing evidence relating to (the now many) other telecoms competitors; and completely fail to explore geographic/spatial differences in product market shares, the lead factor in the section of the Commission Notice that is cited above.
 - The Commission Notice states that the reasons behind any particular configuration of prices and market shares need to be explored, and the subsequent statements lead back to the central question (for market definition) of substitutability ("*...in order to establish whether companies in different areas do really constitute an actual alternative source of supply for consumers.*") In relation to BT's prices -- but not other prices or market shares -- the Oftel review states for some products that uniformity is required by regulation, as a result of the interpretation of universal service obligations, and for other products (including local- and inter-tandem conveyance and transit) that geographic uniformity reflects choices made by BT. There is no attempt to examine the factors driving these 'choices'. Specifically, there is no attempt to examine whether it is the spatial pattern of demand and supply-side substitutability (the central matter in geographic market definition) that explains uniformity, or whether uniformity is better explained by one or more other factors, such as regulatory constraints arising from, say, licence conditions.
21. The absence of a (required) detailed analysis of the reasons for observed geographic patterns in prices is a particularly serious problem. *A priori*, it might be expected that, as competition develops in a network, prices in different parts of the network will start to diverge, under the interacting influences of varying levels of competition and spatial variations in costs (each of which tends to be related to locational variations in customer and traffic density). That such price differentiation has not happened, or at least

has not happened to a significant extent, is, in my view, most likely the *result of regulatory policy*. Specifically, Oftel has, for many years, sought to use provisions of the BT licence prohibiting undue price discrimination to prevent the emergence of significant price differentials.

22. The rationale for this approach to price differentials is relatively easy both to understand and to justify in the early stages of liberalisation.¹ Consider, for example, two areas of activity, A and B, such that competition can be expected to develop more quickly and more vigorously in Area A than in Area B, say because of differences in customer or traffic density. Regulatory imposition of uniform prices arguably then serves two purposes:
- It weakens the incentives of the initially 'super-dominant' incumbent to engage in targeted discounting in area A so as to impede the entry and expansion of competitors. On this basis, the restriction might be held to have pro-competitive effects in area A.
 - To the extent that the incumbent responds to emerging competition in area A by reducing prices, the benefits of emerging competition will be transmitted more quickly to customers in area B.
23. The key point I would make is that the regulatory pressure toward price uniformity, via a particular interpretation of 'no undue discrimination' provisions, is a remedy for market power problems in both area A and area B (I will here leave open the question of whether it can be expected to be the most effective remedy, but see footnote 1). This leads immediately to a question: is the remedy still likely to be appropriate in circumstances where competition has become effective in area A?
24. The difficulty when area A has become competitive is that, whilst there may continue to be benefits from price uniformity to customers in area B (where there is still, by assumption, a market power problem), this is achieved at the potential cost of distorting competition in activity A. Thus, in relation to area A, a competitive activity is distorted by the imposition of restrictions on one of the competitors. Economic analysis of the effects on competition of such a handicap is broadly similar to the analysis that would be conducted in a state aids case where one competitor is favoured relative to the rest.

¹ I note, however, that the policy of preventing significant price differentials has not been universally adopted in the network sectors. In 1997, in its 'ValuePlus Decision', on which I advised, Ofgas approved significant discounts offered by British Gas Trading (BGT) in the South West, a region that was opened up to competition in the first wave of an area-by-area roll-out of liberalisation in retail gas markets. The economic assessment was based upon an analysis of prices in relation to costs in the South West, which was recognised to be characterised, at the time, by conditions of competition that differed from other areas (although there was no formal market definition exercise, since this was not required by the licensing regime). An influential factor in the decision was the argument that allowing BGT to respond to competition in the region would, provided that the discounts were not predatory or disproportionate ('undue'), spread the benefits of competition more quickly and more widely to consumers in the area. At the same time, consumers in other areas, where competition had not yet developed, could be protected by the established price caps.

25. In the new circumstances, then, the 'no undue discrimination' remedy is, if it is interpreted as requiring uniform or near uniform prices, likely to be poorly targeted and disproportionate. While it remains true that it may provide protection to customers against abuse of market power in area B, it is difficult to envisage circumstances in which the distortion of competition in area A can be said to be *indispensable* for that purpose. For example, customers in area B could be protected by direct constraints on pricing in that area, or by constraining the differential between area B and the *market average* of area A prices (*not* the area A price of just *one* competitor).
26. One of the central aims of the European Directive is to develop better targeted regulatory interventions. To achieve this aim is necessary first to assess markets and market power, and then to apply remedial, *ex ante* regulation.
27. In my view, it is important that any reasoning does not effectively invert the analytic process. No reasoning should start with a remedy (geographically uniform pricing), and uses the remedy to define the market (the whole area over which the remedy is applied).
28. There would be no logic to this. Suppose, for example, that we are dealing with a context in which there are distinct geographic markets, in that competition is effective in some areas but not in others: in the words of the Commission's Notice, the conditions of competition are appreciably different. In such circumstances the imposition of uniform pricing can be expected to be a poorly targeted remedy, for reasons just given. If, then, observed uniform pricing is the result of poor regulation, it makes no sense to reason that there is a single geographic market on account of the existence of uniform pricing.
29. To repeat, the purpose of the market analysis is to help in the development of better regulation. Properly conducted, the process will lead to consistency between economic market assessments and remedies; but it is wrong in principle to assume that, because a particular remedy is already in place, markets should be defined in a way that is consistent with that pre-existing remedy. The legal requirements in relation to market definition serve to help ensure that the market interventions of regulatory and competition authorities are well founded. Particularly where conclusions on market definition are intimately related to the scope of regulation, as they are in the present context, the normal procedures should not be short-circuited.

Other arguments in the Oftel documents

30. A number of other points in relation to geographic market definition are made in the Oftel documents, particularly the document published in August 2003², in relation to whose purpose appears to buttress the conclusions reached by reference to geographic uniformity in existing prices. None of these adds to the substantive analysis, and some are self-contradictory. I will therefore comment on them only briefly.

² Second stage consultation document dated 26th August 2003 on the review of fixed narrowband wholesale exchange line, call origination, conveyance and transit markets.

Apparent geographic variations in competition

31. At para 5.6 of the Final Notification (28 November 2003)³, in response to BT's submissions on geographic issues, it is stated that it is not apparent (my emphasis) to the Director that there are significant geographic variations in competition. This, of course, is precisely the question that requires detailed investigation, and, according to the Commission Notice, it is not to be settled on the basis of appearances or preliminary views. I also note that:

- Elsewhere in the Oftel reviews, the existence of potential geographic variations in competition is explicitly recognised. For example, at A.III.49 of the August document we find "*Oftel recognises that in certain telecommunications (product) markets in the UK, there could be different competitive pressures in different geographic areas.*"
- On the evidence that I have seen, there are significant differences between the numbers of infrastructure competitors operating in major metropolitan areas and the numbers operating in other areas. Taken in conjunction with variations in customer and traffic densities, which in large part likely account for the differences in concentration among suppliers, there are, *prima facie*, significant geographic differences in conditions of competition linked to a simple, binary distinction between metropolitan and non-metropolitan areas.

Impracticality/complexity

32. At the same paragraph of the Final Notification, Oftel states that it would be impractical for it to examine the state of competition in each part of the network, but, given that Oftel (now Ofcom) is a specialist regulator of a network sector, my view is that this declaration of lack of competence is simply not credible. Market definition is not an exact science and, as words such as *sufficiently* and *appreciably* in the Commission's Notice (see para 13 above) make clear, much is left to judgment. Recognition that it is not sensible to evaluate every last detail of spatial variation in competition is no basis for declining to assess whether any appreciable/significant/substantial variations exist. As a first step, for services such as local- and inter-tandem conveyance and transit, market definition according to a metropolitan/non-metropolitan distinction (as a proxy for consumer or traffic density) is an obvious option that merits detailed assessment.

Proliferation and instability of geographic markets

33. In the August document it is argued by Oftel that "*...the definition of separate geographic markets using the hypothetical monopolist test as outlined above would likely lead to a proliferation of markets. This, when considered along with the dynamic nature of telecommunications markets, would likely mean*

³ Identification and analysis of markets, determination of market power and the setting of SMP conditions – Final Explanatory Statement and Notification – published on 28th November 2003

that the boundary between areas where there are different competitive pressures would be unstable and change over time, rendering the market definition obsolete. It is not clear that determining ex-ante where the boundary would be is an exercise that could be carried out with any degree of accuracy."

There are a number of points to make about this position:

- a. There is a lot of supposition in the statements. In the absence of an attempt at market definition, there is little basis for assuming that a proliferation of geographic markets would be the outcome. Factors militating against this are: (a) the binary nature of the regulatory framework (is there or is there not SMP?), which simplifies the boundaries that need to be analysed, and (b) the relative stability in patterns of traffic and consumer density (Tyne and Wear is unlikely to be depopulated overnight).
- b. Application of the hypothetical monopolist test -- which, if the arguments in some of my academic work are correct, does indeed have a bias toward over-narrow market definitions -- is not the only conceptual approach available for the purposes of identifying areas within which the conditions of competition are sufficiently homogeneous and between which these conditions are appreciably different. Even if starting bottom-up, from the narrowest possible market definition, is normally the preferred process, starting top-down, by testing progressive disaggregations of a national area, is preferable to not starting at all.
- c. It can be expected that: market boundaries will change over time as a result of liberalisation and technical change; economic assessments will tend to lag behind latest market developments; and perfect accuracy will not be feasible. Again, however, none of this is an excuse for inaction. It is a fundamental principle of good regulation that it responds to changing market circumstances. In general, the areas of economic activity where SMP exists have been contracting over time, but, whilst this certainly suggests that market boundaries will be changing over time, I can see no basis for describing any aspect of the liberalisation process as 'unstable'. Moreover, accuracy is unlikely to be improved by declining to investigate geographic variations in competition.

Effects on policy

34. In similar vein to the above, Oftel goes on to argue that: "*Because of the difficulties associated with defining separate geographic areas, there is a risk that inappropriate decisions would be made about the imposition or removal of regulations, which could be detrimental to consumers and competition. In any case, even if separate narrow local markets were to be defined, it is likely that BT would continue to have SMP in many of these markets. Therefore,*

such a detailed approach is unlikely to add significant benefit to the regulatory outcome being proposed.

As in relation to arguments concerning the implications of uniform pricing, it seems to me that Oftel has got things upside down again here. There is a requirement to define the geographic scope of the market, and Oftel has done so (it concludes that the market is national, excluding Hull). The risks referred to are risks arising from the possibility of errors in arriving at any market definition. There are no extra risks arising from, and specifically associated with, narrower market definitions. If conditions of competition vary significantly, such that more disaggregated geographic markets can be identified, then inappropriate decisions about the imposition or removal of regulations will be more likely in the event that the market is (incorrectly) defined as national.

In fact, therefore, the overall risks of policy error can be expected to be greater in the absence of a detailed investigation of spatial variations in competitive conditions, for the simple reason that, absent such investigation, decisions will be based on less information. That is why I say that the analysis is upside down.

35. The last part of the statement cited in para 34 above is a manifest *non-sequitur*. To see this, suppose that, for a particular service, ten geographic markets were identified, in six of which BT was found to have SMP. 'Deregulation' would then occur in four of the markets, and, on the relevant policy criteria, there could be said to be a significant benefit relative to an outcome in which no deregulation occurred. Oftel's conclusion could only be sustained if failure to deregulate competitive markets was, to a good approximation, costless. That is not my view, and it is not a view that is reflected in the European Directives.

Chains of substitution

36. I confess that I do not understand Oftel's reasoning concerning chains of substitution at A.I.27 of the Oftel document of 26 August 2003. BT was certainly right to argue that market definition can properly vary according to the undertaking whose potential market power is being assessed (see CA Market Definition Guideline, para 5.17). It is not clear why the response to this *general* and correct proposition should be specifically related to the properties of chains of substitution, although it is true that the *specific*, illustrative example in the CA Market Definition Guideline is based on such a chain.
37. The CA Market Definition Guideline reference to breaks in chains of substitution occurs elsewhere, at para 4.4, which is explicitly concerned with geographic market definition. In that paragraph, the Guideline explicitly recognises that chains of substitution may break down in rural areas. This is a point that depends upon spatial variations in customer density (which is lower in rural areas) and, as such, is, contrary to Oftel, relevant to the current issues. In effect, the point recognises that 'breaks' in substitutability that arise from

variations in customer density may lead to the existence of separate geographic markets. This is an issue that Oftel is apparently unwilling to explore, notwithstanding the clear prompts given in the CA Guideline; for example, “*Even if most of the United Kingdom formed a single market, areas such as the Highlands of Scotland might form separate markets ...*” (para 4.4).

The NTL/CWC merger

38. In the following paragraph of the August document (para A.I.128), Oftel claims support for its conclusion that the relevant markets are national (excluding Hull) on the basis of the Competition Commission’s reasoning and findings in the *NTL/CWC* merger investigation; but this position is unsustainable on the evidence. In its discussion of the relevant geographic market, the CC notes that “*It could be argued that, as each cable operator is involved in the supply of services only within its respective franchise areas, and as the proximity of cable networks in other areas does not impose competitive constraints on it, the relevant market for each cable operator is indeed the geographic area within which it is active.*” I would only add that, as a *general, abstract* argument, I find this compelling, and, in the absence of particular facts suggesting that an alternative definition would not be misleading, it points to the existence of a series of local markets at the *retail* level.
39. The CC goes on, however, to note that the EC Access Directive states that: “*The definition of particular product markets is best done in the light of a detailed examination of an individual case.*” It is on this basis, mapped across to geographic market definition, that the CC goes proceeds to consider the specifics of the proposed *NTL/CWC* merger.
40. The CC (and EU) approach -- each case to be decided on a detailed examination of the facts of the individual case -- therefore implies that it is wrong of Oftel to cite the conclusion from *NTL/CWC* in support of its own view of geographic market definition in a completely different factual context. Rather, the CC approach, following European norms, indicates that Oftel should have conducted a detailed examination of the individual cases, which is precisely what has not been done.
41. In relation to the specifics of the *NTL/CWC* investigation, I believe that the following points were likely to have been influential in determining the CC’s conclusion on market definition:
 - One of the major issues in the case was the potential effect of the merger on the wholesale TV ‘content’ market, in which NTL and CWC were purchasers of channel content, including from BSkyB. This wholesale market is not ‘locational’ in any meaningful sense, and is appropriately defined as national.
 - The merger was between two cable franchisees. Although each operated in distinct geographic areas, and although customers in a particular area could not substitute one cable supplier for the other,

most customers in a cable area *could* substitute BSkyB or OnDigital (or BT for relevant telecoms services) for the incumbent cable operator. Thus, the broad characteristics of demand-side substitutability (i.e. the choices of alternatives for cable customers), and the competitive pressure on the relevant cable operator from the satellite and terrestrial operators, were similar across regions, *and could be expected to remain similar after the merger*. By implication, the CC could, without risk of serious error, discount geographic heterogeneity in its analysis. I note that this situation would have been significantly different in the event that the proposed merger had been between, say, a cable franchisee and OnDigital. In that case, the expected effect of the proposed merger would have been to increase market concentration in pay-TV in some geographic areas but to leave that concentration unchanged in other areas. That is, the effects of such a merger would have been more spatially heterogeneous. This underscores the point that the appropriate definition of the market may depend upon the identities of the relevant parties in a competition case.⁴ I also note that, in the context of the telecoms markets that have been reviewed by Oftel, BT frequently faces substantially different numbers of competitors in different geographic areas, which was not the case in *NTL/CWC*, at least in relation to pay-TV services.

- The CC made explicit reference to the European Commission Decision on Bell Cablemedia/Cable & Wireless/Videotron, which deals in particular with UK cable TV networks, and which “*remarks that whether the market is defined as local, in which case there is no horizontal competition concern as there is only one franchisee in each given territory; or whether it is defined as national which means assuming that programme suppliers operating in other franchised areas are supplying programmes to the areas in question the question can be left open, because on either definition the present operation does not give rise to competition concerns.*”

42. This is all very different to the current context. Geographic market definition cannot be left open: it is required precisely in order to be able to determine the scope of appropriate regulation. The alternatives available to customers (demand substitutability) and the competition faced by BT are not similar across geographic locations. There is no equivalent to the wholesale content market issues that arose in the *NTL/CWC* case.

43. The cases are, therefore, not at all closely comparable, and, particularly given the (correct) reasoning in the EC Access Directive that “*The definition of particular product markets is best done in the light of a detailed examination*

⁴ It may also depend upon the nature of the case, for example whether it concerns a merger or an allegation of an abuse of dominance. Suppose, for example, that a hypothetical cable operator were accused of abusive conduct. It is then highly unlikely that the geographic extent of the market would be defined as any wider than the cable operator's franchised area; and such a case would be more comparable to the SMP exercise conducted by Oftel than is the *NTL/CWC* merger.

of an individual case”, the CC’s conclusions in the *NTL/CWC* case have no direct bearing on the current issues.

Harm done as a result of failures in geographic market definition

44. I am not in a position to give an opinion on the harm done as a result of failures in geographic market definition that lead to the imposition of poorly targeted regulation. Such an analysis requires a considerable amount of factual material -- so as, for example, to evaluate the effects of asymmetric regulatory constraints on the business conduct of a company such as BT operating in a competitive market – which I do not possess and would not have had time to analyse even if it had been available.
45. In general, however, it can be said that there are two types of outcome to consider:
- imposition of regulatory constraints on a company that does not enjoy SMP, and
 - absence of regulatory constraints on a company that does enjoy SMP.
46. In the first case, there will typically be a distortion of competition, since the imposition will normally be discriminatory in effect: constraints are placed on one (or more) companies that, by construction, do not enjoy, but not on other, competing companies. As noted in passing earlier, the outcome is not unlike the effect of state aid given to one, favoured company in a competitive market; the difference being, of course, that the chosen company or companies is here handicapped rather than assisted.
47. In the second case, the problem will be one of potential exploitation of market power. Speaking broadly, the harm done will arise from the increased exploitation of market power that can be associated with the absence of an *ex ante* regulatory supplement to general competition law.
48. In each case both the overall level of harm and its incidence (on consumers, companies, etc.) will depend upon the specific market context and cannot be evaluated without detailed examination of the factual circumstances.
49. What can be said, however, is that:
- Imposition of discriminatory constraints on companies operating in competitive markets would be contrary to the high-level principles of UK and EU competition policy (competition is not to be distorted, save with very good cause).
 - Failure to impose *ex ante* obligations on companies with SMP in telecoms markets would be contrary to the relevant European Directives.

I confirm that insofar as the facts stated in my report are within my own knowledge I have made clear which they are and I believe them to be true, and that the opinions I have expressed represent my true and complete professional opinion.

Signed :
Professor George Yarrow

Annex 1

Oftel, *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets*: consultation documents (17 March 2003 and 26 August 2003) and *Final Explanatory Statement and Notification* (28 November 2003).

Competition Commission, *NTL Incorporated and Cable & Wireless Communications plc: A report on the merger situation* (2000).

European Commission, *Notice on the definition of the relevant market for the purposes of Community competition law*.

OFT, *Competition Act Market Definition Guideline*

D. Beal, *UK Core Networks*, a BT presentation to Oftel on network competition, 2002.