

## UK Competition

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For further information on any UK or EU Competition related matter, please contact your usual Slaughter and May contact, or:

**Lindsay Draffan**  
One Bunhill Row  
London  
EC1Y 8YY  
United Kingdom  
T: +44 (0)20 7090 4373

**Ingrid Lauwers**  
Square de Meeûs 40  
1000 Brussels  
Belgium  
T: +32 (0)2 737 94 21

### ARTICLE

## ORR clears rail freight company of abuse of dominance

The Office of Rail Regulation (**ORR**) has published its decision clearing DB Schenker Rail (**DBS**), the UK's leading rail freight operating company, of alleged breaches of Article 102 TFEU and Chapter II Competition Act 1998, prohibiting the abuse of a dominant position. The ORR found that the prices charged by DBS in relation to its contract with ConocoPhillips (**CP**) were not predatory because they covered DBS's average avoidable costs and made a contribution to fixed costs and overheads.

### BACKGROUND

Freightliner Heavy Haul (**FHH**), a competing haulage company, as well as certain other parties complained to the ORR that DBS had used aggressive pricing to win a number of contracts within the industry. In particular, the contract with CP (**the Contract**) was allegedly priced so low as to be evidence of predatory behaviour. Following a short review of the cost information and possible relevant markets, the ORR decided that it had reasonable grounds to suspect that the Chapter II prohibition had been infringed and therefore started an investigation under s.25 Competition Act 1998.

### THE CONTRACT

The Contract, a "hook and haul" service<sup>1</sup>, was entered into by DBS in November 2009. It concerned the haulage of petroleum products between CP's Humber Refinery at South Killingholme, near Immingham, and the Kingsbury Oil Terminal in Kingsbury, Warwickshire. The Contract was due to run until October 2012.

<sup>1</sup> This meant that DBS provided the locomotives, while the wagons were provided by CP.

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## THE INVESTIGATION

### Scope

The ORR's investigation focussed on whether the Contract constituted predatory pricing by DBS. The ORR decided not to carry out a full market definition or dominance assessment but stated that while the evidence it had gathered suggested a rail-only product market, it was not possible to conclude on the precise boundaries without such a full assessment.

### Abusive pricing

The principles followed by the ORR in relation to abusive pricing are set out in the European Commission's "Guidance on the Commission's enforcement priorities in applying article 82 of the EC Treaty (now 102 TFEU) to abusive exclusionary conduct by dominant undertakings"<sup>2</sup>. This sets out two tests, namely:

1. If a dominant firm is failing to cover Average Avoidable Costs (AAC)<sup>3</sup>, this may indicate it is forgoing short term profits and that an equally efficient competitor cannot serve the relevant customer(s) without incurring a loss; and
2. If a firm fails to cover Long Run Average Incremental Cost (LRAIC)<sup>4</sup>, this may indicate that an equally efficient competitor could be foreclosed from the market<sup>5</sup>.

In its assessment of DBS's pricing of the Contract, the ORR decided to use the AAC measure which was also used by the Office of Fair Trading in its *Cardiff Bus* Chapter II investigation.

### DBS's rationale for the pricing

Having scrutinised the contemporaneous documents in relation to DBS's pricing of the Contract, the ORR found that DBS did not demonstrate any indication of a "plan to eliminate a competitor". In fact, the documents suggested that DBS's main intention was to maximise revenue (and therefore profit) – a motive which, according to the ORR, is illustrative of a rational interpretation of normal competition on the merits.

### Financial Analysis

The ORR therefore conducted a financial analysis of DBS's revenues and costs in order to assess to a "reasonable degree of certainty" the relationship between DBS's price and the costs it incurred in fulfilling the Contract.

The ORR compared the costs and revenues over the first year of the three year contract as it considered that focussing on one year would not omit any important insights regarding the profitability of the Contract. The review

<sup>2</sup> This builds on the principles established in the Commission decision of *AKZO v Commission* [1991] ECR I-3359 and supported by the European Court in *Tetra Pak II – OJ* [1992] L72/1 that if a firm that holds a dominant position: (a) prices below Average Variable Costs, it will often be presumed to be anti-competitive, and (b) prices above Average Variable Cost but below Average Total Cost, it may be abusive where such pricing is part of a plan to eliminate a competitor.

<sup>3</sup> Which is the cost that would have been avoided had the firm not produced the extra output relating to the alleged abusive activities (in this case the Contract).

<sup>4</sup> Which is usually higher than the AAC as it includes product-specific fixed costs pre-dating the alleged abusive behaviour.

<sup>5</sup> As the dominant firm is not recovering all the (attributable) fixed costs of producing the good or service in question.

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was also based on certain central assumptions in relation to volume i.e. the number of wagons per train, and railcar “payloads”<sup>6</sup>.

The starting point of the financial analysis was DBS’s own contemporaneous analysis of the various costs<sup>7</sup>. The ORR scrutinised this for reasonableness, using its own knowledge of freight costs and its models, cost estimates provided by FHH, and further clarifications and cost information provided by DBS in responses to information notices.

Having then carried out further analysis, the ORR arrived at a “central estimate” of the cost of fulfilling the Contract which it considered would represent, as accurately as possible, the reasonable expectation of future costs which DBS could be expected to have held at the time of preparing its bid for the Contract. Where there was ambiguity in the calculations, the ORR opted to use the higher cost estimate, thus subjecting DBS to a more rigorous analysis.

The costs measured included: non-capital (i.e. maintenance) costs of locomotives; fuel cost; track access charges by Network Rail; driver costs; groundstaff costs; foregone revenue in relation to access to DBS’s Kingsbury facilities which it would have earned had any other company won the Contract; and a small contract-specific investment of the purchase of a small van used to transport train drivers between the Immingham and Kingsbury sites. The ORR did not measure the capital costs of the locomotives as these were fixed costs not specific to the Contract.

## FINDINGS

The ORR found the Contract price was higher than the “central estimate” of costs arrived at by the ORR (i.e. the AAC). The ORR also considered that the difference between the AAC for the Contract and the Contract price was enough to contribute a certain, relatively modest, amount towards fixed costs and overheads.

## CONCLUSION

The ORR concluded that on the basis of this evidence, there was no breach by DBS of either Article 102 TFEU or Chapter II Competition Act 1998. The Contract price was sufficiently greater than the ORR’s chosen test measure for such a breach, the AAC. Although the difference was modest, the ORR considered that this may be attributable to its policy of erring on the higher side of the cost estimates, as well as the impact of the recent economic climate on freight operating companies.

## SOURCE

Decision of the Office of Rail Regulation – DB Schenker Rail (UK) Limited ([18.08.2010](#))

<sup>6</sup> The capacity of each railcar measured in tonnes.

<sup>7</sup> The source of this was a document prepared by DBS at the time of preparing a bid for the tender, which the ORR obtained during the unannounced site visit it conducted at the beginning of the investigation.

## Mergers

### COMPETITION COMMISSION (CC) REFERENCES

1. ***OFT refers Zipcar/Streetcar merger to the CC*** – The OFT has referred the completed acquisition by Zipcar Inc of Streetcar Limited to the CC. Both companies run car clubs in London, with Streetcar being the largest and Zipcar the second largest. The OFT's investigation highlighted advantages of scale for the merged entity from combined customer networks, cars and parking spaces. However, difficulty of further entry and expansion in London was also identified by the OFT, potentially making it difficult to replace the competition constraint lost through the merger ([10.08.2010](#)).

## Antitrust

### COMPETITION APPEAL TRIBUNAL (CAT)

2. ***CAT publishes transcripts of hearings in construction recruitment agencies appeals*** – The Competition Appeal Tribunal has published the transcripts of the joint hearings held in the appeals by Eden Brown Limited, CDI AndersElite Limited and CDI Corp, and Hays PLC, Hays Specialist Recruitment Limited and Hays Specialist Recruitment (Holdings) Limited against the OFT prohibition decision under Chapter I Competition Act 1998. The transcripts are available on the CAT website ([09.08.2010](#)).

### OTHER

3. ***Competition Commission makes new Groceries Market Investigation (Controlled Land) Order*** – the CC has published the final version of the Groceries Market Investigation (Controlled Land) Order 2010. The order is a part of the package of remedies which, following the CC's investigation into the supply of groceries by retailers, are being put in place in order to address the competition

concerns found. This Order was originally published on 30 April 2010 but was subsequently revised ([12.08.2010](#)).

## Regulatory

### ENERGY

4. ***Ofgem publishes guidance on launch and conduct of Significant Code Reviews*** – Ofgem has published guidance on the launch and conduct of Significant Code Reviews. The guidance explains the processes that Ofgem will follow prior to, during and after a review ([12.08.2010](#)).
5. ***Ofgem publishes interim guidance on consumer protection issues relating to smart meters*** – Ofgem has published a letter setting out guidance for suppliers on the application of the standard licence conditions for the supply of gas and electricity relating to disconnection and prepayment meters. The guidance applies where supplier has installed a smart meter and has the capability to disconnect the premises remotely or switch the customer to prepayment terms ([16.08.2010](#)).

### TELECOMMUNICATIONS/MEDIA/TECHNOLOGY

6. ***CAT publishes order staying appeal by Top Up TV against Ofcom's decision*** – The CAT has ordered a stay on the appeal by Top Up TV against Ofcom's decision in relation to Sky's proposed digital terrestrial pay TV services. Top Up TV requested the stay based on the grounds that there may not be, as yet, an appealable decision under section 317 of the Communications Act. The stay will be lifted by further order or if a relevant appealable decision under the Broadcasting Act 1996 is taken by Ofcom which would enable Sky to broadcast and retail certain pay TV services on digital terrestrial television ([06.08.2010](#)).

7. ***Ofcom publishes report on local cross-media media ownership rules*** – Ofcom has published a report on the cross-media ownership rules for local media companies. This report updates the evidence from Ofcom's earlier report in this area, published in November 2009. In particular, the report is in response to the Secretary of State (Culture, Olympics, Media and Sport) having asked Ofcom to consider the implications of removing the rule that no one person may hold, at the same time, a local analogue radio licence, a regional Channel 3 licence whose potential audience includes at least 50% of that radio station's potential audience, and one or more local newspapers which have a local market share of 50% or more in the coverage area. The report suggests that while there are a number of factors in favour of removing the rule e.g. economic pressures on local media and the increasing use of non-traditional media such as the internet, the rule does provide some protection for the plurality of local commercial news provision which remains a relevant consideration (09.08.2010).
8. ***Ofcom publishes final determination in BT's 0845 and 0870 charges dispute*** – Ofcom has published its final determination in a dispute between BT and mobile operators in relation to the introduction by BT of new termination charges for 0845 and 0870 calls. Ofcom has reached a final decision that BT's new termination charges for calls to 0845 and 0870 numbers hosted on its network are not fair and reasonable. Ofcom has also decided that BT must repay any additional amounts paid to it already (11.08.2010).
9. ***Ofcom decides on complaint by Top Up TV alleging breach by Sky of licence conditions for Sky Sports 1 and 2*** – Ofcom has published its decision in relation to a complaint by Top Up TV Europe Limited alleging that British Sky Broadcasting Limited (Sky) has breached licence condition 14A of its Television Licensable Content Service licences for Sky Sports 1 and 2 (Channels). This licence condition places an obligation on Sky to offer the Channels wholesale. Ofcom has found that Sky has breached the condition by placing a restriction relating to the retail distribution of the Channels and has ordered Sky to remove the restriction (18.08.2010).
10. ***CAT publishes details of appeal against Ofcom's Stour Marine and O2 determination*** – The CAT has published details of an appeal brought by Everything Everywhere Limited against Ofcom's determination in the dispute between Stour Marine and O2 in relation to the termination rates payable for voice calls that originate on O2's network and terminate on Stour Marine's network. The appellant claims that Ofcom made an error of fact and/or law in its characterisation of the service(s) provided by Stour Marine and therefore incorrectly assessed the termination rate (20.08.2010).
11. ***Ofcom publishes statement on review of retail and wholesale ISDN30 markets*** – Ofcom has found that there are distinct product markets at both the retail and wholesale level for ISDN30 services. Whereas there is no undertaking with significant market power (outside the Hull area) in the retail market, Openreach has significant market power in the wholesale market throughout the UK (excluding the Hull area) in the wholesale market. KCOM has significant market power in both the retail and wholesale markets in the Hull area. Ofcom has decided to impose a number of remedies including conditions on KCOM, and conditions, price control, and accounting remedies on Openreach (20.08.2010).
12. ***Ofwat publishes statement on statutory reporting on adapting to climate change*** – Ofwat has published a statement in relation to the requirement for organisations with functions "of a public nature" to report on progress on adapting to climate change, which the Secretary of State can impose under the Climate Change Act 2008.

## WATER

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All 19 water and sewerage companies have been asked to report by 31 January 2011. Ofwat has also been asked to report on the impact of climate change on its functions by 31 May 2011 ([20.08.2010](#)).

#### OTHER

13. *National Audit Office (NAO) publishes report on electricity generation* – The NAO has published a briefing paper for the Energy and Climate Change Select Committee which briefly outlines the key policy features and regulatory framework for electricity generation and the nature of the transition required over the next ten years to meet carbon reduction and renewable energy targets ([10.08.2010](#)).

## Consultations

14. *Ofgem publishes open letter consultation on Potential Significant Code Reviews* ([12.08.2010](#)).
15. *Ofwat consults on regulatory issues arising from change of control of Bournemouth and West Hampshire Water* ([16.08.2010](#)).
16. *Ofgem consults on approach to LNG facilities price control* ([17.08.2010](#)).
17. *Ofgem consults on minded to position on gas distribution network capacity outputs incentive 2013/14 and 2014/15* ([19.08.2010](#)).
18. *OFT consults on draft guidance on Competition Act investigation procedures* ([20.08.2010](#)).
19. *Ofcom issues second consultation on wholesale broadband access market* ([20.08.2010](#)).

#### London

T +44 (0)20 7600 1200  
F +44 (0)20 7090 5000

#### Brussels

T +32 (0)2 737 94 00  
F +32 (0)2 737 94 01

#### Hong Kong

T +852 2521 0551  
F +852 2845 2125

#### Beijing

T +86 10 5965 0600  
F +86 10 5965 0650