

Competition Act 1998

Decision of the Office of Fair Trading  
No. CA 98/07/2004

TM Property Services Limited's complaint against MacDonald  
Dettwiler (Hub) Limited and MacDonald Dettwiler (Channel) Ltd  
(trading as Transaction Online)

18 August 2004  
(Case CE-2941/03)

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**SUMMARY**

The OFT has concluded that MacDonald Dettwiler (Hub) Limited (MDHL) and MacDonald Dettwiler (Channel) Limited (trading as Transaction Online) (TOL), both wholly owned subsidiaries of MacDonald Dettwiler Ltd, have not infringed the prohibition imposed by section 18 of the Competition Act 1998 (the Act).

The OFT's investigation was initiated by a complaint made by TM Property Services Limited (TM), which alleged that MDHL and TOL were abusing a dominant position in the market for property searches by: adopting a pricing policy which results in a margin squeeze; pricing at predatory levels; and charging excessive prices.

The relevant product market in this case is the market for the delivery of LLC1 and Con29 property searches. The OFT has concluded that MDHL and TOL do not hold a dominant position in this market. The OFT has therefore decided that MDHL and TOL have not infringed the prohibition imposed by section 18 of the Act.

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# **I THE FACTS**

## **A The parties**

### **TM**

1. TM was incorporated in 1999. In October 2000 TM was awarded one of three licences by the Local Government Information House ('LGIH') to act as a channel operator for the National Land Information Service ('NLIS') on-line conveyancing service. The role of channel operators and other suppliers in this sector is explained in section D, paragraphs 14 to 43 below. TM is a joint venture between KPMG, Intergraph (UK) Ltd, Countrywide Assured plc and a number of private equity investors and venture capitalists.

### **MDHL**

2. MDHL ('the Hub') was incorporated on 2 October 2000 and after an award of a licence to operate the NLIS Hub commenced trading in April 2001. The principal activity of the company is to develop and operate the NLIS Hub, an internet based system which provides electronic access to data relating to land and property in England and Wales. MDHL is a wholly owned subsidiary of MacDonald Dettwiler Ltd, incorporated in England and Wales. The ultimate parent company of MDHL is MacDonald Dettwiler and Associates, a company incorporated in Canada.<sup>1</sup> This relationship is illustrated in Figure 1 below.

### **TOL**

3. TOL was incorporated on 2 October 2000 and, after the award of an NLIS licence, commenced trading as an NLIS retail channel operator, under the name Transaction Online in April 2001. The principal activity of TOL is to develop and operate an on-line retail channel which provides property search information to conveyancers who subscribe to its service. As with MDHL, TOL is a wholly owned subsidiary of MacDonald Dettwiler Ltd (MDL), incorporated in England and Wales, and its ultimate parent company is MacDonald Dettwiler and Associates.<sup>2</sup> This relationship is also illustrated in Figure 1 below.

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<sup>1</sup> Source: MacDonald Dettwiler (Hub) Limited, annual report and accounts for the period ended 31 December 2001.

<sup>2</sup> Source: MacDonald Dettwiler (Channel) Limited, annual report and accounts for the period ended 31 December 2001.

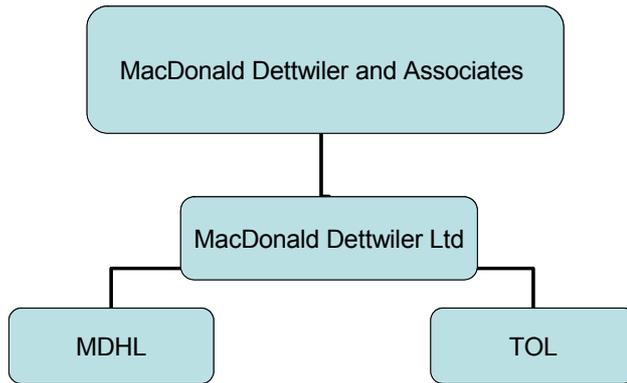


Figure 1

## LGIH

4. The LGIH is the Government body responsible for implementing NLIS. The LGIH is a subsidiary of the Improvement and Development Agency (IDeA). IDeA is owned by the Local Government Association (LGA). The LGA is a representative body for local authorities in England and Wales.

## Searchflow

5. Searchflow is the trading name of The Conveyancing Channel Limited. Searchflow is the third of the three retail channel operators licensed by the LGIH in April 2001. It is a joint venture between the Property Search Agency (PSA), a UK conveyancing search consultancy, and ESRI (Products) Limited,<sup>3</sup> a supplier of local authority search processing systems. ESRI (Products) Limited has a controlling interest in Searchflow.<sup>4</sup>

## B The complaint

6. TM approached the OFT in January 2003 to request interim measures under section 35 of the Act. TM complained that MDHL was trying to impose an increase to the wholesale price for searches (called the service provider charge – SPC) of 12 per cent across all searches. Up until this point MDHL had imposed no SPC, but had instead, according to TM, received funding via a subsidy from the LGIH. This arrangement ended in October 2002. TM believed that the

<sup>3</sup> ESRI stands for Environmental Systems Research Institute. ESRI was founded as a consulting firm in 1969.

<sup>4</sup> Source: The Conveyancing Channel Limited, abbreviated accounts for the period ended 31 December 2001.

imposition of such a high SPC, which would result in higher prices, would undermine its ability to compete effectively within the property search market. This concern was compounded by the fact that TOL had adopted an aggressive pricing policy at the retail level, as discussed below in paragraph 43. As a result TM believed, *inter alia*, that it was the victim of three anti-competitive abuses:

- **Predatory pricing:** TOL was pricing Con29 searches below average variable costs;
- **Margin squeeze:** The level of SPC charged by MDHL and TOL's aggressive pricing strategy would mean that the other channel operators would be unable to make a reasonable return;and
- **Excessive pricing:** Even if the NLIS Hub could justify the SPC on the basis of its cost base, that cost base was inflated to an unacceptable level, which meant that the resulting SPC charged to channel operators was excessive.

7. In essence TM alleges that MDHL and TOL, as a single undertaking (see paragraphs 46 to 49 below), together operate as a vertically integrated operator with the intention of forcing TM out of the on-line market for property searches.

## **C The OFT investigation**

8. In February 2003 the OFT undertook a review of TM's complaint under section 35 of the Act. Additional information was requested from TM such as its management accounts and long range strategic plans. This information was analysed in detail. Information was also requested from other relevant parties, such as the LGIH. TM's concern over the proposed level of the SPC increase was endorsed by the LGIH, which refused to sanction the increase: such a sanction, pursuant to the Hub Services Agreement,<sup>5</sup> was necessary before the SPC increase could become effective. As the price increase at the centre of TM's complaint was withdrawn by MDHL after only a few weeks, TM's request for interim measures was rejected by the OFT.
9. After an unsuccessful mediation process between the channel operators, MDHL and the LGIH, MDHL sought to impose a new SPC on 16 April 2003.<sup>6</sup> Again, the

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<sup>5</sup> See paragraph 40 below.

<sup>6</sup> The SPC for Con29 searches was to be set according to the status of a particular Local Authority. For Local Authorities not offering differential pricing the SPC was £0, for Level 1 authorities, £3 for Level 2 authorities, and £12 for Level 3 authorities respectively. For Local Authorities offering differential pricing the SPC was to remain unchanged at 12% of the respective OTC.

LGIH did not sanction this price increase. As a result MDHL sought an injunction from the High Court<sup>7</sup> against the LGIH's refusal to approve the new SPC.

10. Although it rejected TM's application for interim measures, after further consideration the OFT commenced an investigation under section 25 of the Act on 12 June 2003. The OFT subsequently used its powers under section 26 of the Act to request a range of detailed information from the LGIH and TOL. When the OFT was informed that MDHL had sought an injunction against the LGIH in the High Court, the OFT decided to put its investigation on hold to see whether, as a result of the civil proceedings, agreement on an appropriate SPC could be reached between the various parties.
11. The attempt to seek an injunction ended in September 2003, when the LGIH and MDHL signed an agreement (the September Agreement). The September Agreement sets out new terms for the Hub's SPC relating to Con29, LLC1 and other NLIS searches.<sup>8</sup> The September Agreement is discussed in paragraph 36 below.
12. The OFT requested and obtained relevant documents from LGIH relating to the injunction proceedings such as the various parties' witness statements. In addition the OFT obtained a copy of the September Agreement and the financial models used to derive the prices in that agreement. All this information was analysed in detail by the OFT. The OFT used its powers under section 26 of the Act to obtain further detailed information from TOL, including its management accounts, financial accounts and business plans.
13. Subsequently, on 29 September 2003, TM made a further request for interim measures under section 35 of the Act, to the OFT. This request was rejected by the OFT on 22 December 2003.

## **D Products and market structure**

14. When land or property is sold, it is standard practice for the purchaser's conveyancer to obtain information relating to that land or property. This information is held by a number of different public bodies. This process is usually called a property search. The conveyancer will pass on the cost of these searches to the purchaser or seller in the form of a disbursement.

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<sup>7</sup> High Court of Justice: Chancery Division: Claim No, HC 03103848.

<sup>8</sup> Paragraph 2.d of the September Agreement prohibits the Hub from making further requests for implementation of revised SPCs before 1 January 2006.

15. The conveyancer acts on behalf of the house seller or buyer for the purchase of property search information, and it is generally the conveyancer who exercises choice over how the search should be made. Therefore, the conveyancer is, for the purpose of the following analysis, the relevant consumer.
16. When a conveyancer undertakes a property search on behalf of a client, key information is obtained from the local authority ('LA') within whose area the property is located. This information is applied for, and provided by the LA, in what are known as the LLC1 and Con29 forms.
17. The LLC1 form constitutes a formal request for information held on a Local Land Charges Register ('LLCR'). The LLCR is maintained by a particular LA and holds details of all charges over land or property in that LA area.
18. The Con29 form is a non-statutory form used to request other relevant information not held on the LLCR. The content of the Con29 form is determined by consultation between several interested parties including the Local Government Association, the Law Society and the Department for Constitutional Affairs.
19. The Con29 form is divided into two parts. Part I contains standard enquiries whilst Part II contains supplementary questions relevant to particular circumstances only.<sup>9</sup>
20. The information requested using the Con29 form can be broken down into three broad categories:
  - Information held on public registers other than that held on the LLCR;
  - Information not held on public registers but for which there is a specific statutory entitlement to access by the public; and
  - Information not held as part of any statutory entitlement but generally held by an LA and included on the Con29 form with the consent of that LA.
21. There are currently three ways for a conveyancer to obtain this core information:
  - An official postal search directly from the Information holder;
  - Using a personal search company (a PSC); and

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<sup>9</sup> Such as noise abatement, hazardous substance consents and public paths.

- On-line, via NLIS.

These are explained in more detail below.

22. In addition to this information obtained from an LA, additional information is obtained from other information holders ('non core' search information). Some of this additional information is a requirement of mortgage lenders and therefore is necessary for a complete search to satisfy those requirements. An example of such information is land registration details from Her Majesty's Land Registry (Land Registry). Other search information, such as environmental searches, can be obtained on an 'as needed' basis, at the discretion of the conveyancer. An example of this additional information is an environmental search obtained from the Environment Agency. Details of the portfolio of core and non-core search information which can be requested as part of a search is attached in Appendix 1.
23. This non-core search information can be obtained via NLIS, PSCs and, in some cases, directly from the information holder.

### *An official search*

24. This is the traditional method of obtaining searches. To obtain an 'official search', a conveyancer writes to the relevant LA enclosing the LLC1 and Con29 forms. This postal application requires the payment of the relevant information holder's over-the-counter (OTC) price and the cost of postage.
25. A postal application creates internal costs for the conveyancer, such as the preparation of an application and the payment per search to the relevant information holder. These costs multiply in proportion to the number of searches required for the particular application.
26. For an LLC1 information request the LA has no discretion over the fee it can charge. The pricing of access to the information provided on the LLC1 form by an LA is set by statute.<sup>10</sup> Until 2003 the price charged by an LA was £5 for all search requests. From that date the price charged by an LA varies according to how that LA supplies the relevant search information. For a postal request, the price charged by LAs for the LLC1 is £6, whilst for an electronic search by NLIS the price is £4.

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<sup>10</sup> The Local Land Charges Act 1975.

27. However, LAs have some discretion over the level of the Con29 fees. An LA is obliged, by statute<sup>11</sup> to set the OTC price for Con29 search information at a level sufficient for that LA to cover its costs. However, each LA has a very different cost base. Therefore there is considerable variation in the OTC price level charged by LAs for their Con29 searches.
28. LAs are required to indemnify against any errors or omissions in the information they provide on the completed LLC1 form.<sup>12</sup> LAs are also liable in contract or negligence as regards any errors or omissions in the information provided on the completed Con29 form, and carry indemnity insurance to cover this.

### *Personal searches*

29. Property Searches are also provided by PSCs. PSCs utilise the fact that LAs have, on payment of an £11 fee,<sup>13</sup> a statutory obligation to allow an individual access to the LLCR at their offices. The LLCR is the source of all information contained on the LLC1 form. PSCs then attempt to replicate the requirements of the Con29 elements of an official search.
30. However, the right to access relevant information does not extend to all categories of information required to replicate a Con29. The ability of a PSC to access certain information is at the discretion of the LA. Some LAs refuse access to certain additional information categories, some LAs provide access for a charge, whilst other LAs provide free access.
31. In the past, many mortgage companies were reluctant to accept searches obtained by PSCs. This was because the search obtained direct from the LA was deemed 'official' and carried with it an indemnity given by the LA against errors. However, most mortgage lenders now accept personal searches. The main reasons for this change, given to the OFT, seem to be that PSCs now carry their own indemnity insurance and have improved their reputation for reliability. Since the 1990s the volume of searches undertaken by PSCs has grown rapidly. Estimates of the proportion of all searches that are personal searches vary but it is likely that this figure is more than 20 per cent of all Con29 equivalent searches.

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<sup>11</sup> Statutory Instrument 1994 No 1885, the Local Authorities (Charges for Land Searches) Regulations 1994.

<sup>12</sup> Section 10 of the Local Land Charges Act 1975. This indemnity only partially covers personal searches.

<sup>13</sup> Rule 14 and Schedule 3 of Statutory Instrument 1977 No 985, the Local Land Charges Rules 1977, as amended.

## *NLIS*

32. NLIS is an on-line service which allows subscribers to conduct on-line property related searches of information held by a number of public and private bodies.<sup>14</sup> NLIS was created as part of a public policy to facilitate electronic access to public records relating to land and property. Information held by LAs, is accessed through the same standard forms (LLC1 and Con29) as obtained using a postal application.
33. The NLIS service is set up as a hub and channel model: this is depicted in Figure 2. A conveyancer requests search information from one of the three channel operators. The channel operator then requests search information from the Hub, which then obtains the necessary information from information holders. The Hub then sells on this information to the three channel operators.
34. The Hub is owned by MDHL. MDHL won a seven-year licence to operate the Hub after a public private partnership tendering process in July 2000<sup>15</sup> run by the LGIH. The LGIH also granted seven-year licences, via open tender, to three channel operators: TM; Searchflow; and TOL.

### *The NLIS Business Model*

35. The OTC fee charged for a Con29 postal search varies between LAs. The average OTC fee for a Con29 search is approximately £135.<sup>16</sup> The Hub also has to pay a wholesale price equivalent to the OTC fee to run an on-line Con29 search. The Hub then charges the channel operator a wholesale price (the OTC fee plus a mark up).<sup>17</sup> The Hub's mark up is the SPC. Channel operators then charge conveyancers their retail price, which includes the OTC fee, the SPC and the channel operator's fee.<sup>18</sup>

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<sup>14</sup> It is currently possible to obtain searches directly from all LAs, the Coal Authority, the Land Registry and Land Charges Registry. A list of the different searches available through NLIS can be found in Appendix 1. NLIS channel operators also provide other search services, such as the provision of environmental searches, which are not required currently to be sourced through the NLIS service.

<sup>15</sup> With an option for a three year extension.

<sup>16</sup> Estimate provided by LGIH for the fourth quarter 2003.

<sup>17</sup> See paragraphs 141-144 for a discussion of the impact of differential pricing.

<sup>18</sup> Some of the NLIS channel operators have adopted a transparent pricing structure for their customers which breaks down their total retail price into the relevant LA's OTC fee, the SPC and their own mark up.

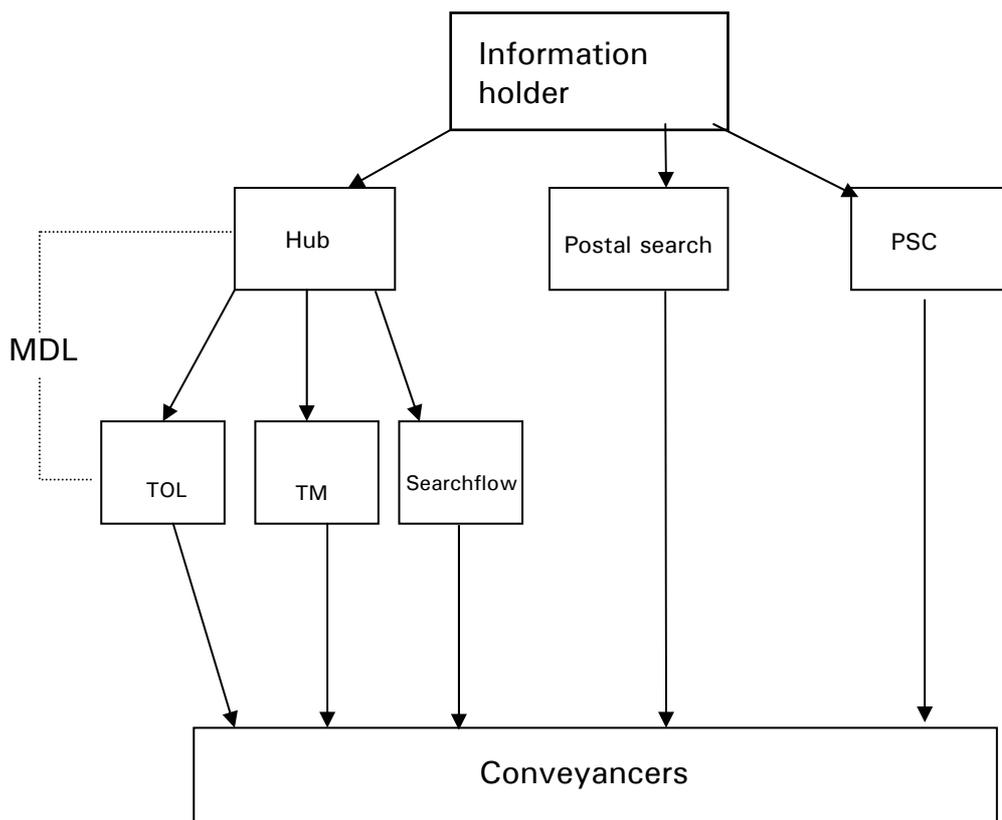


Figure 2: The NLIS model

36. Some LAs have adopted differential pricing for the OTC fee for Con29 searches. These LAs provide NLIS with a discount on the OTC fee for Con29 searches paid by postal applicants. The level of discount has varied by LA but has been on average approximately 18 per cent. As a result of the September Agreement, the SPC for Con29 searches was set at a fixed price rather than as a percentage of the OTC fee. For discounted searches the September Agreement did not effect a significant change in the level of price. For non-discounted searches, the fee for the Con29 search was set at £7.65 per search.
37. The NLIS model is intended to allow full electronic searches of LA databases without manual intervention. To achieve such a level of functionality, LAs need to make substantial investments in their IT capability. In practice, not all LAs offer a full electronic service at present: LAs provide a diverse range of capabilities to deliver NLIS searches. However, three broad groups, defined by capability, have been identified by the LGIH.

**Level 1: Low capability:** The LA maintains manual records. Once the Hub receives a search request from the channel operator, it sends a postal application to the LA. The LA sends the search back by post or DX;<sup>19</sup>

Level 2: Intermediate capability: The LA can receive a search request from the Hub electronically but generally searches are sent out by post or by DX;and

**Level 3: High capability:** The LA can provide a full NLIS service –searches are received, processed and sent out electronically.

38. As of June 2004 there were 274 electronic connections to LAs; with 53 level 3 LAs and 221 level 2 LAs. The remaining 103 LAs signed up to NLIS are at level 1. There is a target that all LAs should achieve level 3 status by December 2005 although it cannot be guaranteed that this target will be met.<sup>20</sup> For an LA to achieve Level 3 status it needs to make significant investment in its IT infrastructure.
39. The LGIH acts as the regulator of NLIS. The powers of the LGIH are not statutory but are derived from the triangular contractual relationship between the LGIH, the Hub and the three channel operators.
40. The Hub and channel operators are licensed by the LGIH, and these licences take the form of contractual agreements between:
- (1) the Hub and the LGIH (Hub Services Agreement);
  - (2) The Hub and each channel operator (Hub/Channel Agreement); and
  - (3) The LGIH and each channel operator (Channel Service Agreement).
41. The three channel operators are tied contractually to sourcing core search information through the Hub.<sup>21</sup> However, some of the channel operators have

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<sup>19</sup> DX is a courier service.

<sup>20</sup> The achievement of this target will involve considerable additional expenditure on IT by LAs. In 2000 the central IT unit of the Cabinet Office, the Department of Transport, Environment and the Regions and the Local Government Association signed a concordat saying that they would meet the Government target of having all services provided electronically.

<sup>21</sup> The channel operators are obliged to source all on-line searches relating to 'Core Data Sets' and 'Associated Data Sets' through the Hub. These categories include data from LAs, and the Coal Authority.

been, at the discretion of the LGIH, sourcing some of the complementary search information, such as environmental searches, via alternative routes.<sup>22</sup>

42. The Hub Services Agreement states that MDHL must notify and seek the 'prior approval' of the LGIH for the level of SPC charged to the channel operators.<sup>23</sup> In addition, the Hub/Channel Agreement provides that no variation in the level of Hub charges can take place without the formal approval of the LGIH.
43. The three NLIS channel operators have adopted different retail pricing strategies. TM and Searchflow pass on to their customers the Hub's SPC as well as their respective retail margin. Until the implementation of the September Agreement in October 2003, TOL charged its customers a price equivalent to the relevant LA's postal OTC fee. This means that, when retailing a Con29 search, TOL did not charge a margin or pass on, where relevant, any SPC to its customers. Since the implementation of the September Agreement,<sup>24</sup> TOL has amended its published retail prices to include, where relevant, the SPC.<sup>25</sup> All channel operators accrue additional revenues from the sale of both compulsory additional services (such as on-line mapping) and optional searches, such as the environmental searches.

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<sup>22</sup>This includes the obtaining of information either directly from the information holder or indirectly via third parties.

<sup>23</sup>Clause 12 of the Hub Services Agreement.

<sup>24</sup> See paragraph 11 above.

<sup>25</sup> TOL informed the OFT in October 2003 that it would charge all its customers a price at least equivalent to the OTC fee and SPC. In March 2004 TOL confirmed that it was covering the wholesale cost of all Con29 or LLC1 searches.

## II ECONOMIC AND LEGAL ASSESSMENT

### A Introduction

44. The Chapter II prohibition is set out in section 18(1) of the Act, which states that:

*'any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.'*

Under section 60 of the Act, the OFT is required, in applying the Chapter II prohibition, to ensure that there is no inconsistency with either the principles laid down by the EC Treaty and the European Court or any relevant decisions of the European Court. The OFT must also have regard to any relevant decision or statement of the European Commission.

45. In order to establish that an infringement of the Chapter II prohibition has occurred, it is necessary to show that the entity concerned:

- is an undertaking;
- holds a dominant position in a relevant market;
- has abused that dominant position;

and that the abusive conduct may affect trade within the UK.

### B Undertaking

46. The word 'undertaking' is not defined in the Act or the EC Treaty. It is a wide term that the European Court of Justice (ECJ) has stated covers 'every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed'.<sup>26</sup>
47. Companies which are members of the same group of companies will be regarded as forming part of the same economic unit (and therefore regarded as a single undertaking) where, for example, they are subsidiaries of a single parent company and, although they have a separate legal personality, they have no real

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<sup>26</sup> Case C-41/90 *Hofner and Elser v. Macrotron GmbH* [1991] ECR I-1979, at paragraph 21.

freedom to determine their course of action in the market or do not have economic independence.<sup>27</sup>

48. For the purposes of the Act, MDHL and TOL, as they are both wholly owned subsidiaries of MDL and form part of a single economic unit controlled by MDL, constitute a single undertaking.
49. However, in the interest of clarity, reference will be made to MDHL or TOL (or both) as appropriate when referring to up-stream activities (MDHL) or down-stream activities (TOL).

## **C Dominance**

50. The ECJ has defined a dominant position as:

*'a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers'*<sup>28</sup>

51. For the purpose of the Chapter II prohibition, dominance is assessed within a relevant economic market. The relevant market has two dimensions: the relevant goods or services (the product market) and the geographic extent of the market (the geographic market).
52. In assessing dominance, the OFT considers whether and to what extent an undertaking faces constraints on its ability to behave independently of competitors, customers or consumers. These constraints might, for example, be existing or potential competitors, or other constraints such as buyer power. As noted above, one of the first stages in analysing whether MDHL or TOL have abused a dominant position is to identify the relevant market(s) within which they operate.

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<sup>27</sup> Case 22/71 *Béguelin Import v. GL Import Export* [1971] ECR 949.

<sup>28</sup> Case 27/76 *United Brands v Commission* [1978] ECR 207, at paragraph 65.

## D The relevant product market

53. The relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer by reason of the products' characteristics, their prices and their intended use.<sup>29</sup>

### *Market for the delivery of information rather than underlying information*

54. In terms of the underlying information, each property search is a unique end to end transaction between the information holder and the purchaser. The information holder is the statutory body relevant to the particular information required and is the sole provider of that information. In terms of the underlying information, there is no possibility of supply side substitution: the information holder is the monopoly provider of that information. Similarly, there is no demand side substitution in relation to the underlying information: each search requires a discrete piece of information, which cannot be replicated or substituted from other sources. Therefore, while the conveyancer seeks the information held by the relevant LA (or other information holder), the property search market will be defined by the conveyancer's willingness to substitute between the alternative search routes to this information.
55. A conveyancer can choose to obtain a search from three routes: via NLIS, an official postal search via a direct application to the information holder or via a PSC (see paragraphs 24-34). A broad market definition for the supply of property searches would comprises all these three possible routes to the information holder. However, there are two questions which need to be answered before a final conclusion can be reached in this context:
- Can the relevant product market be restricted to search routes for Con29/LLC1 searches or should it include all categories of property searches undertaken on a complementary basis to these core searches?
  - Is information provision via the NLIS on-line route in a separate product market from information either via the direct application route or the PSC route, or both?

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<sup>29</sup>Notice of the European Commission on the Definition of the Relevant Market for the purposes of Community Competition Law, OJ 1997 C372/5, [1998] 4 CMLR 177, paragraph 7. Also, chapter 3, OFT Guideline 403, *Market definition* (March 1999)

### *Limiting the relevant market to search routes for Con29/LLC1 searches only*

56. The focus of the complaint to the OFT has been in relation to the provision of Con29 and LLC1 search services by LAs. However, the key 'selling point' of the NLIS business model is that it provides a one-stop-shop able to deliver a broad range of property related searches from different information holders, such as the Land Registry or the Coal Authority. A conveyancer will demand a set of different searches depending on the particular circumstances of the property. Therefore, arguably, the market should be defined to include all categories of searches.
57. Against this, without the ability to provide these Con29 and LLC1 searches it is unlikely that the NLIS channel operators (or indeed any provider of a route to the information provider) would receive any significant demand for other complementary searches. For this reason, when considering the issue of dominance it is possible to focus on the narrower market for Con29 and LLC1 searches. This then allows consideration of the ability of a hypothetical monopolist NLIS channel operator to increase the price of these searches. This approach is justified if it is concluded that an undertaking does not hold a position of dominance in the narrow market for LA property searches, since the undertaking is then extremely unlikely to have a dominant position in the wider market for property information held by all information holders, including LAs.

### *Does a separate relevant on-line market exist?*

58. Here the relevant question is whether there is a separate market for on-line searches or, alternatively, whether on-line providers compete in a wider market that includes direct application (whether by post or other means) and/or searches carried out by PSCs. To determine whether information provision via the NLIS on-line route can be viewed as a separate market, it is necessary to assess the possibility of demand side and supply side substitutability. This assessment can be made by undertaking a quantitative analysis of demand and supply side substitution (using the hypothetical monopolist test) and a qualitative assessment of demand and supply side substitution (using a comparison of product characteristics).

### *Demand side substitution – a quantitative approach*

59. The hypothetical monopolist test (also called the SSNIP test) can be used to assess whether a small but significant increase in price above competitive levels could be sustained by the Hub, or whether such a price increase would result in

sufficient numbers of conveyancers switching to other search routes so that the price rise is unprofitable. The OFT will typically consider a price increase of between 5 and 10 per cent to be small but significant.<sup>30</sup>

60. The question of whether or not the Hub is dominant depends on its ability to raise its price above the competitive level. The Hub has a contract based monopoly over the on-line provision of Con29/LLC1 searches. The Hub faces no competition at the on-line wholesale level. However, a price rise at the wholesale level will only be profitable for the Hub if it can also be sustained by a channel operator at the on-line retail level. Therefore, in this case, it would be necessary to assess whether a hypothetical monopolist channel operator at the retail level could raise prices above the competitive level.
61. Problems arising from applying the SSNIP test in this case include:
- Establishing whether the 5-10 per cent price increase should be applied to the full retail price charged by NLIS channel operators to conveyancers or to the cost of the NLIS service (i.e. the difference between the NLIS retail price and the wholesale price paid by the NLIS Hub to the LA for a Con29/LLC1 search<sup>31</sup>);and
  - Establishing what is the competitive retail price which should provide a basis for the application of the SSNIP test.
62. Generally when the OFT applies the SSNIP test it is necessary to assess how consumers would react to a 5-10 percent increase in the retail price. However, when considering a market such as this, where a large component of the retail price is the input price and the 'value added' component of the price is small, using a SSNIP test based on an overall retail price may not always adequately reflect the scope for substitution.<sup>32</sup>

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<sup>30</sup> Paragraph 3.2, OFT Guideline 403: *Market Definition* (March 1999)

<sup>31</sup>Typically the OTC fee.

<sup>32</sup> This is best explained with an example. Assume the product price is £100 and the service price is £5 (so the retail price is £105). Also assume that the adopted threshold for the SSNIP test is 10% and that the service provider cannot profitably increase the retail price by 10% of the total retail price of £105 (£10.50). However, the service provider can profitably increase the price by £10.50 - X (where X is some small number) but no further. In this scenario the service provider might not have significant market power. This is the case even though its own service price may have increased by up to (£10.50-X)/5 per cent. Now assume that the product price is £200 and the service price is again £5. A 10% increase in the total retail price of £205 would be £20.50. Applying the same SSNIP test shows that being profitably able to impose a price increase of up to £20.50 - X would not indicate market power. Now the service provider can increase the service price by a factor of four, without being considered to have market power. This seems anomalous. Examples of such markets include auctioneering services for fine art or for certain financial services products.

63. As a result, basing a SSNIP test on the full retail price charged by an NLIS channel operator might not produce robust results.<sup>33</sup>
64. It may be appropriate to look only at the price setting power of the channel operators in relation to the value added service rather than allow the distorting effects of the input price to be included. However, undertaking a SSNIP test on this value added increment might, in this case, overstate the market power of an NLIS channel operator and again not produce robust results.<sup>34</sup> In addition, basing the SSNIP test on the NLIS service element alone would ignore the fact that conveyancers will typically select between the three search routes on the basis of the full cost of using those routes.<sup>35</sup>
65. Whichever approach is adopted, the results obtained will depend to a large extent on the relative proportion of the value added increment (contained in the service fee) to the total selling price.
66. Irrespective of the choice of base price for the application of a SSNIP test, the use of that test is compromised in this case by the difficulty in establishing the competitive price for the value added service provided by NLIS channel operators.
67. The starting point for the application of the hypothetical monopolist test when assessing dominance should be the competitive prices charged by the three competing channel operators. However, there are several problems with basing a SSNIP test on these prices. These include:
- the NLIS business model is still new and has not reached a steady state in terms of the range of services it can and will offer or the wholesale and retail prices for those services;
  - the fact that each channel operator has adopted a different pricing strategy means that current NLIS retail prices cannot be relied on to be at a long term competitive level; and

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<sup>33</sup> OFT Guideline 403, *Market definition* (March 1999) states at footnote 7, '*arguably, the test should be applied to the value added by the undertaking, not its selling price. In practice, selling prices are more easily seen and are usually the price which will be considered. This is one reason why some flexibility in the size of price differential considered must be retained.*'

<sup>34</sup> An NLIS channel might be able to profitably increase its service fee by a given percentage rate but not its overall retail price by an equivalent percentage rate. See footnote 32 above for a fuller explanation.

<sup>35</sup> This is particularly true where the price of a personal search is typically cheaper than an official search.

- the SPC is set using estimates of both the future volume of searches and the Hub's cost or providing those searches. The OFT is no better placed than the LGIH to assess the accuracy of the projections.

These points are discussed in more detail below.

68. Basing a hypothetical monopolist test on an incorrect start point could generate incorrect conclusions. For example, if the channel operator's price was below the competitive level then any analysis would risk falling foul of the reverse cellophane fallacy.<sup>36</sup>
69. The three channel operators and the Hub are all currently, in a financial accounting sense, loss making. If, as a result of the September Agreement, it could be imputed that the Hub was now making a competitive return<sup>37</sup> then, using the SPC in the September Agreement combined with the channel operators' own costs, the OFT could estimate what the competitive return for the channel operators would be in the absence of the alleged predatory pricing by TOL. This could, in this case, provide the relevant starting point for the SSNIP test.
70. However, given the low internal marginal cost to channel operators in providing additional search volume, such an analysis is highly sensitive to the current and future volume of searches. In addition, imputing a competitive price for a monopoly channel operator which includes an appropriate rate of return not only requires an ex ante assessment of what constitutes a reasonable return in this situation but also necessitates a decision on precisely which retail services the OFT would rely on to assess margins (i.e. whether the Con29 and LLC1 searches alone should earn a competitive return or whether other searches, which have historically delivered the higher margins to channel operators, should be included in assessing the appropriate return).

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<sup>36</sup> The 'cellophane fallacy' arises when a dominant undertaking has already raised its current price above the competitive level. If this undertaking was constrained from profitably raising its price further, due to consumers switching to available substitutes, then this might be taken as evidence that this undertaking is not dominant. This inference would be incorrect. The undertaking has already exercised its market power by raising its price above the competitive level (see paragraph 5.13 of OFT Guideline 403, *Market Definition, March 1999*). The 'reverse cellophane fallacy' arises when the current price is below the competitive level. If an increase in the prevailing price of a good by an undertaking does not lead to sufficient substitution away to the good's closest substitutes, then it could be inferred that the undertaking has market power. However, this inference would be incorrect if the starting price was below the competitive price level.

<sup>37</sup> Such an imputation would have to be based on an assessment of the Hub's projected revenues and costs over the life of the project. Such an analysis would require a careful assessment of the modelling used to support the September Agreement.

71. The problem of being able to undertake a robust quantitative analysis has been addressed by the Competition Appeals Tribunal (CAT) in *Aberdeen Journals v. Director General of Fair Trading*<sup>38</sup>, where it found that:

*'economic or econometric techniques... may in particular circumstances be of limited value, for example, because the conditions of competition in the particular market place may already be atypical (see the Commission's Notice on Market Definition, paragraph 19) or because no or insufficient reliable data is available.'*

72. Provided that the OFT is able to make a robust assessment of demand and supply side substitutability there is no particular preference for basing this assessment on either a quantitative or qualitative analysis. In *Aberdeen Journals v. Office of Fair Trading II*<sup>39</sup>, the CAT affirmed the European Commission's view that there is no hierarchy of evidence:

*'In our view, there is no set 'hierarchy' of evidence in Community law on issues such as market definition. As the European Commission puts it at paragraph 25 of its Notice on Market Definition OJ (1997) C272/5:*

*'There is a range of evidence permitting an assessment of the extent to which substitution would take place ... The Commission does not follow a rigid hierarchy of different sources of information or types of evidence.'*<sup>40</sup>

73. Given the difficulties in applying the SSNIP test, in this case, in such a way that it would yield useful results the OFT has not undertaken a quantitative SSNIP test in this case. Instead, it has based its assessment on the qualitative evidence available.

### *Demand side substitution – a qualitative approach*

74. Several factors need to be considered in assessing whether postal searches and searches provided by PSCs are potential substitutes for NLIS searches:

- (i) **Equivalent information:** Can the postal searches or PSC searches provide equivalent information to both a Con29 and LLC1 search?

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<sup>38</sup> Case No.1005/1/1/01 [2002] CAT 4, at paragraph 102.

<sup>39</sup>Case No 1009/1/1/02 [2003] CAT 11.

<sup>40</sup>paragraph 127.

- (ii) **Value added service:** To what extent can the postal service or PSC searches replicate the value added services offered by NLIS on-line searches? and
- (iii) **Speed of search:** Does the relative speed of search mean that other search routes are poor substitutes for NLIS on-line searches?

75. With respect to each of these factors it is important to examine not only the existing capability but also the potential capability of NLIS. A static analysis of market power would require an assessment of the existing capability of NLIS. However, if potential capability can be shown to affect the current take up of NLIS then it may be necessary to base the assessment of market power on its potential as well as its current capability.

(i) Can PSCs or searches by post provide equivalent information to NLIS?

76. Under the terms of its licence, the Hub is able to access all relevant search information required to complete a Con29 search form.
77. Search information obtained by post is the same as that provided by NLIS. In particular LAs provide Con29 and LLC1 information in the same format regardless of whether the request is received via NLIS or via the post.
78. The ability of PSCs to replicate Con29 searches to a large extent depends on the attitude of the relevant LA. Some LAs allow PSCs access to all relevant information. This is either provided for free or for an additional fee, set locally. Other LAs deny PSCs access to certain categories of information.
79. It is not clear to what extent PSCs need access to all the information available in an official Con29 search in order to provide a competitive constraint on providers of on-line searches. The fact that the volume of searches (and share of the market for all searches) undertaken by PSCs has been growing in recent years suggests that such access has not, as yet, restricted the growth of the PSCs.<sup>41</sup> To counter any competitive disadvantage resulting from lack of access to certain information, a number of the larger PSCs have taken out substantial indemnity insurance. This serves two purposes. It replicates the coverage provided by LAs for damages arising from incorrect information provided in a Con29 or LLC1 search. It also means that, where a PSC has been denied information and cannot therefore provide all the information contained in an 'official search', by insuring conveyancers against damages claims arising from the absence of the

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<sup>41</sup> Aggregate figures for the volume of personal searches are not available. However, the OFT has obtained data from several PSCs showing rapid volume growth in recent years.

information, PSCs are still in a position to provide a service which satisfies the demands of their consumers.

(ii) Can LAs or PSCs deliver the value added services provided by NLIS?

80. NLIS has the capability to deliver considerable value added services to conveyancers. For example, NLIS allows for searches to be paid for electronically and provides invoices by email within twenty four hours, leading to reduced costs of administering payment for searches. NLIS also validates the property details on-line and attaches a map to the property details as part of the service. These value added service are examined below.
81. *On-line validation and administration:* As stated, NLIS validates the property details on-line and attaches a map to the property details as part of the service. This capability is available for searches undertaken in all LA areas. As a result, the OFT has been informed that error rates for submitted search requests in these areas are considerably lower for NLIS searches than for postal searches.
82. Postal searches are slower. Also, if a mistake is made in a postal application it can take several weeks to correct. A postal search requires searching a registry to find the relevant LA and the relevant charge. The correct search form must be filled out, a cheque needs to be requisitioned and then the search request posted. Incorrect payments are not uncommon: cheques are rejected in about 15 per cent of cases.<sup>42</sup>
83. PSCs can check that details of the search request are correct, but this will probably be at a later time, at the premises of the information holder.<sup>43</sup> Hence, validation by the PSC may be slower and more costly than validation by the NLIS service.
84. *Payment by direct debit:* There is no reason to suppose that larger PSCs could not provide a direct debit service for searches.
85. *On-line maps and further functionality:* The channel operators sell their service as being able to dovetail with conveyancer's case management needs. Some channel operators provide extensive mapping capabilities which allow them to advise conveyancers on whether they may need to undertake additional searches (e.g. Coal Authority or environmental searches). Such functionality is not available through postal searches. Although PSCs do not currently provide this

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<sup>42</sup> Estimate provided by the LGIH.

<sup>43</sup> OneSearch Direct, which collects data directly from LAs and holds it in electronic form, may be able to check the accuracy of data immediately. However, the accuracy of these will depend on whether the data have been updated since OneSearch collected them.

service larger PSCs, using a web based service, might be able to replicate this functionality in the future.

86. *One-stop-shop for a portfolio of searches:* This is a key driver of take up of NLIS. Conveyancers can use NLIS as a one-stop-shop search resource for a number of different databases such as the LLCR, Coal Authority and the Land Registry. Solicitors contacted by the OFT mentioned this as being one of the major advantages of NLIS which saved search time and provided convenience.<sup>44</sup> Conveyancers using the postal route for searches would have to make separate searches for each information type for each property. The availability of NLIS on-line, with telephone helpdesk support, should make searching via NLIS easier and more convenient.
87. However, larger PSCs have also developed the ability to offer a broad portfolio of searches. PSCs such as PSG, OneSearch Direct and Richards Gray now allow property, environmental and drainage searches to be ordered on line or by phone. This is also indicative of the fact that searches undertaken by PSCs can be considered close substitutes to on-line searches via NLIS.<sup>45</sup>
88. In addition, it has been possible for PSCs to attempt to replicate the information held by LAs. For example, OneSearch Direct, has constructed a database from a variety of sources, such as Council minutes, to obtain the property search information required for the completion of Con29 forms. OneSearch Direct then holds the necessary information in electronic format. Manual collection of information is only necessary for the completed LLC1 form from the relevant LA. While OneSearch Direct may face difficulties in procuring all the necessary information and securing the LLC1, it appears able to provide quick automated searches for a variety of property information.

### (iii) Can other search routes deliver searches as fast as NLIS?

89. One of the main expected advantages of the NLIS model is its potential speed. In theory, NLIS can deliver a seamless and extremely fast turnaround for search data. However, the speed that searches are currently delivered at is dependent on the level of functionality adopted by the relevant LA. At best, in tests a level

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<sup>44</sup> The OFT surveyed a number of solicitors firm's considerations of the relative advantages of NLIS.

<sup>45</sup> According to the website of Richards Gray, another PSC, all that is required from conveyancers is the address of the property, a contact name and a client reference. In some cases a site plan is required and Richards Gray will request the conveyancer to fax or post one through to them.

3 LA could return a search within 15 minutes.<sup>46</sup> However, most level 3 LAs take considerably longer to deliver a search. level 2 searches usually take as long to process as a postal search with any speed advantage limited to the inbound post delivery period. Level 1 searches take as long as a postal application. Approximately twenty seven per cent of LAs are still at Level 1 status.<sup>47</sup>

90. In recent years there has been a downward trend in average postal search turnaround times for LA sourced searches. In 2003 it took LAs in England and Wales an average of nine working days to process postal searches. However, periods of in excess of three working weeks are not uncommon.<sup>48</sup> The OFT has been informed by several sources that many level 3 authorities have also significantly improved the turnaround time for their postal service. This, according to these sources, has tended to diminish any competitive advantage, based on speed, held by NLIS.
91. PSCs such as PSG claim that they can match or beat the search times offered by NLIS except for those searches provided by level 3 LAs. PSCs are reliant on being allocated time slots by the relevant LA and so are sometimes restricted in their ability to provide a fast turnaround. Their competitive advantage in terms of speed might also be reduced when the end user (for example, a conveyancer) requests a portfolio of searches.<sup>49</sup>
92. When questioned about the relative speed of the various search routes many conveyancers argued that because it took on average eight weeks to complete a house purchase, a turnaround time of less than a few days, whilst useful, was not critical to their ability to compete in the conveyancing market. Interestingly, when a particularly fast turnaround was required most conveyancers the OFT spoke to, stated that they would use a personal search company.

### *Conclusions on demand side substitution*

93. The level of functionality supplied by NLIS could in the future delineate the on-line market from postal searches and personal searches. There is no doubt that NLIS is capable of delivering a higher level of functionality than the postal service and many conveyancers will pay a premium for this functionality. However, the NLIS service envisaged in the future is not reflected in the service delivered at present and, in any event, it appears that PSCs are capable of

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<sup>46</sup> According to the LGIH this fast turnaround time was part of a special trial rather than a normal transaction.

<sup>47</sup> See paragraph 38.

<sup>48</sup> Paragraph 4.77 of the 'Report on the Transfer of Security' published in March 2003. See [http://www.bba.org.uk/pdf/Report\\_Transfer\\_Security.pdf](http://www.bba.org.uk/pdf/Report_Transfer_Security.pdf).

<sup>49</sup> The PSC will need to conduct a personal search at the premises of each information holder.

replicating that functionality (and have begun to do so). In terms of speed, NLIS performance is currently patchy and not always significantly quicker than the postal service.<sup>50</sup> PSCs can usually obtain LA search information faster than NLIS. An analysis of demand side substitution therefore leads to the conclusion that, at present, the relevant product market is that for the supply of LA core search services and includes the postal, PSC and NLIS search routes.

### *Supply side substitution*

94. Under the terms of the licences awarded by the LGIH in 2000, NLIS has an exclusive arrangement with the LGIH to supply LA property searches on-line and LA searches by NLIS channel operators must be routed through the Hub. Supply side substitution in direct competition with NLIS is therefore not possible.
95. There is little incentive for LAs to develop their own alternative off-line routes to market in reaction to an NLIS search price increase. LA revenues for 'official' searches are protected by the fact that NLIS pays the equivalent of the OTC fee to the LA.<sup>51</sup> Indeed the main competitive threat to LAs comes from PSCs who can often obtain the required information at a lower fee than the OTC fee charged by a particular LA.
96. Other information holders such as the Land Registry and the Environment Agency have developed their own routes to market, both on-line and off-line.

### *Conclusion on relevant product market*

97. On the basis of the above analysis the OFT has concluded that the relevant product market in this case is the market for the delivery of LLC1 and Con29 property searches provided by all available distribution channels, be it NLIS, PSCs or the LA itself.

## **E The relevant geographic market**

98. The broadest possible geographic market is that for LLC1 and Con29 searches in England and Wales. NLIS channel operators and some PSCs retail their service using prices set nationally.<sup>52</sup> The OFT considered whether a relevant geographic

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<sup>50</sup> In addition the OFT has not been provided with any evidence that any significant changes in NLIS performance levels are imminent.

<sup>51</sup> Unless the LA decides, at its discretion, to offer a discount.

<sup>52</sup> For NLIS channel operators the channel operator's fee and Hub fee do not vary by LA, but the OTC element of their full retail price will reflect the OTC prices (and any discounts provided) set by each LA.

market could exist at a more local level, such as an individual LA area or a group of several LA areas with which a conveyancer deals. Arguably, for a conveyancer operating in a limited geographic area, the willingness to switch between search routes available in that area will depend on the particular characteristics of those search routes in that limited area.<sup>53</sup>

99. The relevant geographic market is determined by how conveyancers substitute between different search routes. OFT research has found that for some conveyancers the choice of search route will be determined by the particular features of those search routes in a particular LA area. For these conveyancers the relevant geographic market might be the main LA area within which they transact. For other conveyancers the choice of search routes will be determined by the characteristics of those search routes across a number of LA areas. For these conveyancers the relevant geographic market might be the set of LAs within which they transact. However, for many conveyancers the choice of search route will be made from a national perspective. Larger conveyancers tend to use one search route either exclusively or for the majority of their searches.<sup>54</sup>
100. Because of this variation in purchasing patterns it has not been possible for the OFT to come to a definitive conclusion as to the relevant geographic market.
101. However, it is important to note that the complaint by TM is against NLIS as a national operator. The level of SPC is set nationally. Therefore, the Hub does not vary the level of SPC between different LA areas.<sup>55</sup> Similarly TM's complaint against TOL relates to the level of TOL's nationally set retail fees and not the underlying OTC fee. Therefore it would be more appropriate to conduct any assessment of those prices from a national perspective.
102. Therefore, for the purposes of this investigation, the OFT regards the relevant geographic market as national. In any event, the OFT's conclusions on dominance as discussed in paragraphs 114-117 would be the same irrespective of whether a national or local market definition is adopted, as the same competitive constraints operate whichever definition of the market is adopted.

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<sup>53</sup>Some conveyancers who request search information from a sub set of all LAs will not necessarily be influenced by the pricing of postal searches in LAs with which they do not transact.

<sup>54</sup> The OFT undertook a poll of a random sample of conveyancers as well as the three largest customers of TOL. The results showed that most conveyancing firms polled had a preference for using one form of search route for all their clients, irrespective of location.

<sup>55</sup> While two different levels of SPC are available depending on whether the LA offers a discount on the OTC price or not, the Hub does not control this.

## F Assessment of dominance

103. In assessing dominance, the OFT considers whether and to what extent an undertaking faces constraints on its ability to behave independently. Those constraints may be:

- competitors, according to their strength in the market, which may be shown by market shares;
- potential competitors, which may be shown by a lack of significant entry barriers and the existence of other undertakings which might easily enter the market; and
- other constraints, such as strong buyer power.

### *The position of MDHL at the wholesale level*

104. Market shares, although not conclusive, provide some insight into the level of existing competition in a market. Current estimated market shares in the Con29 search market are detailed in table 1 below.<sup>56</sup>

Table 1

Search route	Postal	NLIS	PSCs
Market share (%)	48	32	20

105. Given that MDHL only provides searches via the NLIS route then its market share at the wholesale level is equivalent to the total NLIS market share.

<sup>56</sup> Figures for NLIS are based on data provided by the LGIH. While we have been able to obtain accurate data for total NLIS Con29 searches from the LGIH, estimates of total house sales vary widely depending on the source used. Therefore, the OFT has used the lowest available estimate of total house sales sourced, via the LGIH, from the Land Registry's databases. Using this data, for the last Quarter of 2003, the NLIS share of the Con29 market can be reliably estimated at approximately 25%. By June 2003, using the same data sources the NLIS market share could be as high as 32%, but a final figure is dependent on obtaining accurate estimates of house sales. Other estimates of monthly or annual house sales, made by the ODPM, are higher than the one we have used. As a result for the actual volume of NLIS searches provided, NLIS would have a lower market share for Con 29 searches. The OFT has no means of undertaking a more rigorous breakdown of the market share split between post and personal searches. However, this has no impact on the OFT's conclusions

106. As regards NLIS, while it has been difficult to obtain precise estimates for the market shares of each of the channel operators, any variation the OFT has found would not change the conclusions reached.
107. Expectations of future growth in NLIS's share of the relevant market vary. In MDHL's original Baseline Business Case it was forecasted that NLIS market share would be 89 per cent of all Con29 searches by the end of the licence period in 2007.<sup>57</sup> MDHL, as part of its civil proceedings against the LGIH, has since produced a 'best-case' forecast of a market share of 62 percent by the end of the licence period. For the OFT's purposes, there is no certainty over the trend growth for NLIS relative to other search routes such that the OFT could infer from such data that MDHL has a dominant position at the wholesale level at present.<sup>58</sup>
108. Therefore, based on the above analysis, MDHL does not hold a dominant position in the market for the delivery of LLC1 and Con29 property searches.

### *The position of TOL at the retail level*

109. NLIS channel operators face existing competition from both direct application and personal searches. As discussed in paragraph 31, PSCs have also been growing rapidly in the last few years. NLIS channel operators not only face competition from PSCs with a national presence, such as PSG, but also from small PSCs which mainly operate at a local level.
110. NLIS channel operators also face potential competition from market entry by new PSCs. For PSCs operating at a local or regional level the barriers to entry are low. For PSCs operating at a national level, barriers to entry are more significant due to the cost of setting up a national operation. However, the recent national expansion of OneSearchDirect shows that large scale market entry or expansion is possible.
111. The conveyancing market is not particularly concentrated. This would suggest buyer power is weak.
112. Given the above, the OFT does not believe that TOL has established a dominant position at the retail level. In particular, it is not clear that even if the relevant product market were restricted to NLIS, TOL could be regarded as having a

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<sup>57</sup> See page 10, *MacDonald Dettwiler, NLIS – Hub Services Baseline Business Case version 1.2*, 13 July 2000, provided to the OFT by the LGIH in an attachment to its letter of 21 July 2003.

<sup>58</sup> In any event, note that high market shares are not necessarily determinative of dominance; see paragraph 3.13, OFT Guideline 402, *The Chapter II Prohibition* (March 1999).

dominant position. TOL is estimated to be retailing approximately (...) per cent<sup>59</sup> of the market volume of searches sourced via the NLIS Hub. The remaining 58 per cent of searches is split between the other two channel operators. Even if NLIS could be deemed a separate relevant market, TOL's market share would not necessarily lead to the conclusion that TOL was dominant in that market. The fact that the NLIS market is new and that TOL's share of supply of the NLIS market has not been sustained for a significant period of time suggests that evidence that TOL has achieved a position of dominance in a hypothetical NLIS market is inconclusive. In any event, given that it has not been possible to define a separate relevant on-line market, it has not been necessary to reach a final conclusion on TOL's position in a hypothetical NLIS market.

113. In addition, there is the possibility of market entry by new channel operators. The LGIH has the power to license new channel operators at any time.<sup>60</sup>

*Conclusion on dominance*

114. For the reasons set out at paragraphs 53-96 above, it has not been possible to define a separate relevant on-line market for property searches. If it was possible to define a separate on-line market then MDHL could be considered to be dominant in that market. However, MDHL could not currently be considered to be dominant in the wider market for LA property search services.
115. Nevertheless, if, in time, the greater functionality of NLIS reduces the competitive constraint placed on it by the other search routes, then there may be grounds for defining a separate relevant market as the market for on-line LA property searches.
116. Equally, if in the future, NLIS achieved a sustained high market share within the broader property search market then MDHL could be considered to be dominant.
117. As stated at 45 above, in order to establish that an infringement of the Chapter II prohibition has occurred, it is necessary to show that the undertaking concerned holds a dominant position in a relevant market. In this case, there is insufficient evidence to show that either MDHL, at the wholesale level, or TOL, at the retail level, have a dominant position in the market for the delivery of property searches.

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<sup>59</sup>For the first six months of 2004, the three channel operators had an average share of all NLIS Con29 searches as follows: TOL (...)%; TM (...)% and Searchflow (...)%.

<sup>60</sup> Clause 3.6 of the Channel Services Agreement between each channel operator and the LGIH allows the LGIH to appoint one more channel operator at any time and more channel operators three years after the NLIS Hub commenced operations.

## G Assessment of abuse

### *Introduction*

118. Given the OFT's findings on the issue of dominance, it is not necessary to reach a conclusion on the abuses of a dominant position alleged in this case (i.e. predation, margin squeeze and excessive pricing). However, as part of its investigation the OFT has undertaken a preliminary analysis of the alleged abuses, the results of which suggest that even if there were to be a finding of dominance, it is unlikely that the conduct complained of would constitute an abuse, although no final views have been reached on these issues.
119. The European Court of Justice has defined the concept of an abuse as:

*'...an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition'.<sup>61</sup>*

In *AKZO*<sup>62</sup> the ECJ stated:

*'...Article [82] prohibits a dominant undertaking from eliminating a competitor and thereby strengthening its position by using methods other than those which come within the scope of competition on the basis of quality. From that point of view, however, not all competition by means of price can be regarded as legitimate.'*

120. The question of whether or not the pricing practices complained of can be regarded as abusive is an issue which must be looked at 'in the round'.<sup>63</sup>
121. The OFT's analysis of potential abuse must be placed within the context of how the NLIS model has been set up and regulated. NLIS retail prices, which take account of Hub and channel operator costs in addition to an input price

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<sup>61</sup> Case 85/76, *Hoffman-La Roche v Commission* [1979] ECR 461.

<sup>62</sup> Case C-62/86, *AKZO Chemie BV v Commission* [1991] ECR I-3359.

<sup>63</sup> See *Aberdeen Journals Limited v The Office of Fair Trading II* [2003] CAT 11 at paragraph 350.

equivalent to the OTC fee, will be higher than those paid for a direct application or a personal search.<sup>64</sup> The NLIS model was established on the assumption that most, if not all, LAs would quickly achieve level 3 status. This would allow NLIS to deliver all its searches electronically. The fact that, as discussed in paragraph 38 above, such a capability for many LAs has not, as yet, been realised means that this price premium (i.e. SPC plus a channel operator fee) charged by NLIS channel operators is harder to justify in the market place.<sup>65</sup>

122. The LGIH has attempted to remedy this problem in several ways. Most importantly, LAs have been encouraged to adopt differential pricing. This has been achieved through the use of a discounted pricing policy (DPP). DPP involves an LA providing a discount on its postal OTC fee to search requests it receives via NLIS. The amount of the discount varies but has been, on average, approximately 18 per cent of the LA's OTC fee (see paragraph 36).<sup>66</sup>
123. Differential pricing, when offered by an LA, has enabled the NLIS channel operators to offer lower retail prices than would otherwise have been the case. While, in practice, the Hub has retained most of the discount,<sup>67</sup> the channel operators still benefit from the fact that for their customers the only charge payable over and above the OTC fee for a postal search, is their channel operator fee. The impact of DPP on an assessment of potential abuse by MDHL is discussed in more detail below.

### *Predation*

124. TM alleged that TOL was engaged in predatory pricing by retailing Con29 searches below average variable cost.
125. Predation is an abuse which may constitute an infringement of the Chapter II prohibition. It comprises strategic behaviour whereby a dominant undertaking deliberately incurs losses in order to eliminate a competitor, or deter market entry by potential competitors, so as to be able to charge excessive prices in the future. In *AKZO*<sup>68</sup>, the ECJ established certain criteria to assess predation. Pricing above average total cost is not predatory. Pricing between average total cost and average variable cost would be predatory if it forms part of a plan to

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<sup>64</sup> For a search through TM, if TM passed on the SPC, the difference would be typically about £21, or about 18% of the average OTC fee.

<sup>65</sup> It has been put to the OFT that a poorly specified trial in Bristol led to an overestimation of the willingness of consumers to pay a premium for the NLIS service relative to the postal service.

<sup>66</sup> In April 2004, 176 LAs charged DPP adjusted prices for an official search. This was approximately 46% of all LAs.

<sup>67</sup> Before the September Agreement the Hub retained the first 18% of the discount. Since the September Agreement this 18% has been crystallised into a fixed fee.

<sup>68</sup> Case C62/86 *AKZO Chemie BV v Commission* [1991] ECR 1-3359, paragraphs 71-72.

eliminate a competitor.<sup>69</sup> Pricing below average variable cost should be presumed to be predatory.<sup>70</sup>

126. However, if a pricing policy adopted can be objectively justified, then even pricing below average variable cost might not infringe the Chapter II prohibition. For example, pricing below average variable costs in the context of a policy of loss leading may be objectively justified.<sup>71</sup>
127. The OFT has obtained information from TOL in relation to its pricing strategy and internal costs. It would appear that, until recently, TOL has been retailing Con29 searches at the OTC fee. This has meant that TOL was not charging its customers a channel operator fee or, where applicable, the SPC. This means that TOL was pricing both Con29 and LLC1 searches below the average variable cost of delivering those searches alone.
128. However, while it is clear that TOL has been aggressively pricing its Con29 and LLC1 service, this could be objectively justified. TOL has been using sales of Con29/LLC1 searches as loss leaders in order to obtain higher revenues from the sale of complementary services, such as the provision of environment searches and on-line maps. This marketing strategy, which is available to each of the channel operators, does appear to be able to generate total revenues which exceed total costs.<sup>72</sup> Such behaviour will not be regarded as being predatory unless it is clear that the real intention was to eliminate a competitor.<sup>73</sup> The OFT has not seen any evidence to suggest that TOL's strategy of using Con29 and LLC1 searches as loss leaders was intended to eliminate competition.
129. Therefore, based on an assessment of the information provided, the OFT believes that, to the extent that TOL did price below average variable cost, such conduct could be objectively justified. However, given the OFT's conclusion on the question of dominance, it does not reach a final view on this issue.

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<sup>69</sup> *Ibid*, paragraph 72.

<sup>70</sup> *Ibid*, paragraph 71.

<sup>71</sup> See OFT Guideline 414 *Assessment of Individual Agreements and Conduct* (September 1999), at paragraph 4.8.

<sup>72</sup> The OFT has analysed TOL's management accounts and business plans. Over the year to March 2004, there has been a downward trend in the trading losses made by TOL and for the month of March 2004 total revenues exceeded total costs for the first time. Therefore TOL's use of sales of Con29/LLC1 searches as loss leaders would *prima facie* appear to be a credible and potentially profitable business plan, which each of the channel operators is capable of adopting. The continued successful implementation of that plan will be determined by whether or not TOL can meet its targets for the volume of searches it supplies. While the OFT cannot form a definitive view as to the future profitability of TOL's business plan, from the evidence given to the OFT there is no reason to suggest that TOL will not, in the future, be a profitable operation.

<sup>73</sup> C-62/86 *AKZO Chemie BV v Commission* [1991] ECR I-3359 at paragraph 72.

## *Margin Squeeze*

130. A margin squeeze arises when a vertically integrated firm sets a margin between its wholesale and retail prices which is insufficient for an efficient firm competing downstream buying in 'raw material' at the wholesale price to make a reasonable return when setting prices which compete with the vertically integrated firm's downstream retail prices.<sup>74</sup> The European Commission found a margin squeeze to be an abuse of a dominant position in *Napier Brown/British Sugar*,<sup>75</sup> stating that:

*'The maintaining, by a dominant company, which is dominant in the markets for both a raw material and a corresponding derived product, of a margin between the price which it charges for a raw material to the companies which compete with the dominant company in the production of the derived product and the price which it charges for the derived product, which is insufficient to reflect that dominant company's own costs of transformation (in this case the margin maintained by Napier Brown between its industrial and retail sugar prices compared to its own repackaging costs) with the result that competition in the derived product is restricted, is an abuse of a dominant position.'*<sup>76</sup>

131. The Commission's Telecommunications Access Notice<sup>77</sup> sets out methods of demonstrating a price squeeze, which is the same as that set out in *Napier Brown/British Sugar*:

*'A price squeeze could be demonstrated by showing that the dominant company's own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant company.'*<sup>78</sup>

132. To conduct a margin squeeze analysis it is therefore necessary to establish the wholesale price, i.e. the price of the service supplied by the vertically integrated undertaking holding a dominant position in the upstream market, to the firms competing with it downstream.

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<sup>74</sup> See OFT Guideline 414, *Assessment of Individual Agreements and Conduct*, (September 1999) at paragraph 3.12.

<sup>75</sup> Case IV/30.178 [1988] OJ L284/41.

<sup>76</sup> *Ibid*, paragraph 66.

<sup>77</sup> Notice on the application of the competition rules to access agreements in the telecommunications sector, OJ C265, 22/08/1998.

<sup>78</sup> *Ibid*, paragraph 117.

133. TM has alleged that MDHL and TOL are jointly engaged in a margin squeeze against both TM and Searchflow. More specifically TM made three claims to support its allegation of margin squeeze:
- The proposed SPC increase is at a rate which is more than channel operators and ultimately consumers can bear;
  - TOL does not pass on the SPC to its own consumers in the downstream market;
  - TOL maintains a negligible mark up on its retail services.
134. While TM first complained to the OFT in January 2003, a permanent increase in the SPC was not implemented until October 2003. This means that there was no potential margin squeeze until October 2003 at the earliest.
135. As has been discussed above in paragraph 36, since the September Agreement, TOL has passed on the SPC to its customers and does make an overall margin from its sale of a portfolio of searches.
136. To find that a margin squeeze has taken place it would be necessary to show that the downstream operator, TOL, could not trade profitably on the basis of the wholesale price and the prices it charges to its customers, as set out in paragraph 36 above. However, it appears that TOL can make a profit whilst paying the post September Agreement SPC (which it passes on to its customers). Nevertheless, it is too early to assess definitively whether this strategy will be viable in the long run.
137. Therefore, based on an initial assessment of the information provided, the OFT has reached the view that MDL and TOL were not engaged in an abusive margin squeeze. However, given the OFT's conclusion on the question of dominance, it does not reach a final view on this issue.

### *Excessive pricing*

138. The OFT considers that a price might be excessive if it is above that which would be expected in a competitive market and therefore has no reasonable relation to the economic costs of the product supplied<sup>79</sup> because there is no

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<sup>79</sup>Case 27/76 *United Brands v. Commission* [1978] ECR 207)),

effective competitive pressure to bring prices down to competitive levels, nor is there likely to be.<sup>80</sup>

139. TM allege that MDHL is engaged in excessive pricing. MDHL is allowed, contractually, to recover its costs plus a fixed percentage return on that cost base. TM alleges that this provides MDHL with an incentive to inflate its cost base above that needed to set up and operate the Hub. As a result, this inflated cost base and excessive return has enabled MDHL to charge an excessive SPC. In effect, TM argues that MDHL has set the SPC at a level far in excess of that needed to make a rate of return, which would be expected in a competitive market.
140. Given its findings on dominance, the OFT has not made a detailed analysis of the MDHL's cost base in order to determine whether MDHL has inflated its costs above their actual levels. However, the OFT has reviewed the LGIH's analysis of MDHL's cost base. The results at this review did not support the view that MDHL has inflated its costs.
141. In any event, there are several factors which suggest that MDHL has not been engaged in excessive pricing. Primarily, the level of SPCs set by the September Agreement, the result of negotiations between MDHL and the LGIH, are based on agreed financial projections of the MDHL's expected costs and the expected volume of searches processed by the Hub. The OFT has reviewed these financial projections and the resulting SPCs and does not believe these SPCs to be excessive.<sup>81</sup>
142. An allegation of excessive pricing should be based on the total wholesale price paid by channel operators for a search. In the present case the total wholesale price is made up of the OTC fee plus the relevant SPC. The September Agreement allows the Hub to charge a higher SPC for searches obtained from LAs which offer a discount on the OTC fee. For these LAs the wholesale price payable by channel operators is the discounted OTC fee plus the SPC. When this discount on the OTC price is greater than the SPC charged by MDHL, the net direct wholesale cost to the channel operator for the search is lower than the OTC fee paid by a postal applicant for an equivalent search.

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<sup>80</sup> OFT Guideline 402, *The Chapter II Prohibition* (March 1999) further states at paragraph 4.8 that 'in general to be excessively high the price must be higher than it would normally be in a competitive market'.

<sup>81</sup> Prices might be higher than they could be but this is probably the result of factors other than activity by MDHL which might constitute an abuse. For example, the regulatory framework of the NLIS model has had a significant impact on the level of SPC. A considerable percentage of the cost base of the Hub is made up of licence fee payments to the LGIH. MDHL has no direct control over these costs.

143. When NLIS was established it was not envisaged that the OTC fee paid by the NLIS Hub to LAs would be lower than the OTC fee payable by direct applicants to LAs. Therefore, in this context, it would be difficult to establish that the wholesale prices charged by LAs offering discounts exceed those which would be expected in a competitive market.
144. Furthermore, if the average wholesale price payable to the Hub for all Con29 searches is calculated taking into account any discounts available, then the effective wholesale rate net of discounts paid by channel operators for Con29 searches is lower than the headline prices set out in the September Agreement.<sup>82</sup> Again, in this context, it would be harder to establish that the wholesale prices charged exceed those which would be expected in a competitive market.
145. The trend towards an increased number of LAs offering differential pricing would suggest that the offsetting impact of LA discounts will probably increase over the life of the September Agreement.<sup>83</sup>
146. Therefore, based on an assessment of the information provided, the OFT does not believe that the SPC is excessive. However, given the OFT's conclusion on the question of dominance, it does not reach a final view on this issue.

### *Conclusion on abuse*

147. Because of its conclusions on the question of a position of dominance, it has not been necessary for the OFT to undertake a detailed analysis of the relevant data to form a definitive opinion as to whether MDHL has been engaged in the alleged anti-competitive practices. However, analysis suggests that even if there were to be a finding of dominance, it is unlikely that the conduct complained of would constitute an abuse, although no final views have been reached on these issues.

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<sup>82</sup> As discussed in paragraph 36, the September Agreement sets out two SPC rates: a higher rate for LAs offering discounts on the full OTC fee and a lower rate for those which do not. When an LA offers a discount to the NLIS channel, the discount generally covers the SPC charge. This means that channel operators only have to make an overall net wholesale payment to the Hub for searches obtained from LAs not offering discounts. As a result the average SPC for all searches is lower than the headline rate for these non discounted searches.

<sup>83</sup> It could be argued that the retention of all or part of the discount by the Hub has a detrimental impact on the channel operators' competitive position. However, while such retention does prevent channel operators potentially obtaining margin from this source, such discounting was not envisaged at the commencement of NLIS.

### **III Decision**

148. Neither MDHL nor TOL hold a dominant position in the market for the distribution of property searches. Therefore, on the basis of the information in the OFT's possession, the conditions to establish an infringement of the Chapter II prohibition are not met and therefore there are no grounds for action in this case.

**Justin Coombs**  
**Director, Service Industries**  
**Competition Enforcement Division**

## Appendix 1

### Searches made through NLIS channel operators

<b>Local Authority</b>
Con 29, Standard and Optional Enquiries of Local Authority (2002 Edition) <ul style="list-style-type: none"> <li>• DPP Con29</li> <li>• Non-DPP Con29</li> <li>• Optional Enquiries</li> </ul>
LLC1, Register of Local Land Charges requisition for search and official certificate of search
CR Form 21, Commons Registration Search
<b>Coal Authority</b>
Con 29M, Coal Mining Search
<b>Drainage and Water</b>
Con 29DW, Standard Drainage & Water Enquiries
<b>Land Registry</b>
96, Application for official search of the index map
109, Application for office copies of the register/title plan; a certificate in Form 102
110, Application for office copies of documents only
MH3, Application for official search by mortgagee in respect of Matrimonial Home Rights
94A, Application by purchaser for official search with priority of the whole of the land in either a registered title or a pending first registration application
94B, Application by purchaser for official search with priority of part of the land in either a registered title or a pending first registration application
94C, Application for official search without priority of land in a registered title
Title number enquiry
Day list enquiry
ENDs enquiry
Filed plan view
Register View
<b>Land Charges Registry</b>
K15, Application for an official search
K16, Application for an official search (bankruptcy)

only)
K19, Application for an office copy of an entry in the register
MH3, Matrimonial Home Rights (Electronic and Paper)
<b>Environmental Searches</b>
Residential Property (Electronic)
Commercial Property (Electronic)
Commercial Property Report with RPS Risk Assessment (Paper)
<b>Maps</b>
Production of an electronic OS Map
Print of an electronic OS Map (200m x 200m)

Note: not all services offered by NLIS channel operators are routed through the NLIS Hub. In particular, environmental and OS maps searches have usually been routed via private search firms specialising in this area.