

Competition Act 1998

Direction given pursuant to Section 35 of the Competition Act 1998

London Metal Exchange

27 February 2006

---

Please note square brackets indicated confidential information redacted.

**Direction**

1. This is an interim measures direction given by the Office of Fair Trading ('OFT') to the London Metal Exchange ('LME'), made pursuant to section 35(2) of the Competition Act 1998 ('the Act').
2. LME is directed as follows:
  1. The London Metal Exchange shall not increase the hours of trading available on its electronic trading platform, LME Select, outside of 07:00 to 19:00 (London time), as is currently its practice; and
  2. The London Metal Exchange shall confirm in writing to the OFT that it has complied with direction 1 within 5 working days of receipt of this direction.
3. This direction is effective from 27 February 2006.

## Reasons for Direction

### Background

4. Article 82 of the EC Treaty ('Article 82') prohibits the abuse by one or more undertakings of a dominant position within the common market or a substantial part of it where this may affect trade between Member States.
5. Under section 25(5) of the Act, the OFT may conduct an investigation if there are reasonable grounds for suspecting that the prohibition in Article 82 has been infringed.
6. On 1 July 2003, the OFT received a complaint from Spectron Group Plc ('Spectron') about predatory and discriminatory pricing by LME in the provision of its electronic trading platform LME Select. Spectron provides an electronic trading platform called eMetal in competition with LME Select. This platform allows traders to make a trade by placing a 'bid' or 'offer' on the eMetal screen. This bid or offer placed by a broker ('the initiator') specifies the type of metal, quantity and price that the broker wishes to trade. Interested brokers ('aggressors') execute the trade by selecting the bid or offer on screen.<sup>1</sup>
7. The OFT initially commenced an investigation pursuant to section 305 of the Financial Services and Markets Act 2000. It subsequently commenced an investigation pursuant to section 25(5) of the Act into LME's behaviour in relation to the provision of platforms for the exchange-based trading of non-ferrous base metal contracts. In the course of the investigation, a number of information requests have been sent to LME and Spectron by the OFT in relation to Spectron's allegations.<sup>2</sup>
8. On 3 August 2005, LME announced the possible extension of its trading hours on LME Select to potentially cover 'morning Asian trading'<sup>3</sup> in its electronic newsletter *e-Ringsider*.<sup>4</sup> LME also gave notice on 16 September 2005 that its intention to extend trading hours was still under discussion. According to LME documents, this extension was not formally confirmed until 23 November 2005 when an internal document circulated to limited classes of LME members stating LME's intention to extend LME Select's trading hours to cover morning Asian trading with effect from 1 March 2006. This timescale is confirmed in LME's representations.<sup>5</sup>

---

<sup>1</sup> Once the trade has been completed, on eMetal, each party then enters the details of the trade into the LME/London Clearing House (LCH) electronic processing system. The LCH matches the trades, charges a clearing fee and charges an exchange fee on behalf of the LME. Spectron recovers a commission from the aggressor of the trade.

<sup>2</sup> Information requests under section 26 of the Act and section 305 of the Financial Services and Markets Act 2000 (FSMA 2000). These were made on 10 March 2004 (section 305 only), 11 January 2005, 3 May 2005 and 19 September 2005.

<sup>3</sup> Morning Asian trading is executed by far east Asian clients during far east Asian business hours therefore occurring overnight London time.

<sup>4</sup> [www.lme.co.uk/oct05-article1.asp](http://www.lme.co.uk/oct05-article1.asp)

<sup>5</sup> See paragraph 13, LME's representations.

9. An application requesting that interim measures directions be given to LME in respect of its proposal to extend LME Select's trading hours was received from Spectron on 3 February 2006.
10. Under section 35(2) of the Act, if the OFT considers it necessary to act as a matter of urgency, for the purpose:
  - a. of preventing serious, irreparable damage to a particular person or category of persons, or
  - b. of protecting the public interest,it may give such interim measures directions as it considers appropriate for that purpose.
11. On 13 February 2006, in fulfilment of the requirements of section 35(4) of the Act, the OFT gave written notice to LME that it proposed to issue the interim measures direction set out at paragraph 2 above ('the Notice'). LME, or its authorised representative, was also invited to inspect those documents in the OFT's file relating to the proposed direction, subject only to the withholding of documents to the extent to which they contain confidential information.
12. LME was invited to make representations on the proposed direction by 5:00 PM on Monday 20 February 2006. LME subsequently requested that time for representations be extended. The OFT acceded to this request and LME submitted its representations on the Notice ('LME's representations') on Wednesday 22 February 2006. The OFT may, on its own initiative at any time or following an application by LME or Spectron, review the above interim measures direction with a view to varying, amending, replacing or removing this direction.
13. The OFT has given careful consideration to LME's representations. However, for the reasons set out below, the OFT considers that in this case it is necessary as a matter of urgency to give the above interim measures direction to LME to protect the public interest. Further, or in the alternative, the OFT considers that it is necessary as a matter of urgency for it to give the above interim measures direction to LME to prevent serious, irreparable damage to Spectron.
14. When the OFT's substantive investigation pursuant to section 25(5) of the Act is complete it may, if it decides that an infringement is established, replace the above interim measures direction with directions given pursuant to section 33 of the Act. The above interim measures direction may also be replaced, should it be appropriate, by the OFT's acceptance of binding commitments, pursuant to section 31A of the Act. Otherwise, any interim measures direction made in this case will have effect until the OFT no longer has the power under section 25 to conduct the investigation or until it has completed its substantive investigation.
15. Pursuant to section 46(2) and section 47(1)(d) and (2) of the Act, this decision to make the above interim measures direction may be appealed to the Competition Appeal Tribunal by LME or by any other person with sufficient interest. Any such appeal must be made by sending a notice of appeal to the Registrar of the Competition Appeal Tribunal so that it is received within two months of the date upon which the appellant was notified of this decision, or the date of publication of this decision, whichever is the earlier, and should be made

in accordance with the Competition Appeal Tribunal Rules 2003. The making of such an appeal will not suspend the effect of this decision.

### **The OFT's investigation and reasonable grounds for suspecting an infringement of Article 82**

16. The OFT commenced an investigation under section 25(5) of the Act because it had reasonable grounds for suspecting that LME had infringed the prohibition in Article 82 in that the LME is:
- dominant in the provision of platforms for the exchange-based trading of non-ferrous base metals contracts;<sup>6</sup> and
  - abusing this dominant position by:
    - predation through the pricing and continued operation of LME Select, whereby LME Select's revenues are below some measures of its cost; and/or
    - exclusionary price discrimination, whereby the LME offers discriminatory relative pricing of its trading platforms in a way that does not reflect the nature of the services offered and allows a zero margin for actual and potential competitors, such as Spectron.
17. More specifically, the evidence provided to the OFT indicates that for a number of years since its introduction in 2001 LME has been generating revenues from LME Select which, on the basis of the OFT's analysis, are below its cost. The case law is clear that where revenues fall below an appropriate measure of cost a rebuttable presumption of predation will exist. The OFT considers that LME Select's revenues do fall below an appropriate measure and, therefore, reasonable grounds for suspecting abusive conduct in breach of Article 82 can be established.<sup>7</sup>
18. In addition, the OFT considers the trading fees charged by LME for LME Select are set at the same level as those for telephone trades, even though LME Select provides all the services of a telephone trade along with additional services. This form of price discrimination<sup>8</sup> means that anyone trading on Spectron also incurs an LME charge equivalent to the charge incurred for use of LME Select. In other words, brokers pay the *same* level of transaction fee to LME (irrespective of whether they choose to trade on Spectron eMetal or on LME Select). Therefore, from the perspective of the broker, any fee charged by Spectron necessarily represents an additional cost over the cost of using LME Select. This pricing policy means that Spectron – or any other potential competitor trading LME contracts – has zero margin on which to operate.
19. In addition, LME Select has operated a targeted incentive scheme, which may have amplified any effect on Spectron of the predation and discriminatory relative

---

<sup>6</sup> See Annex 1.

<sup>7</sup> See Annex 1.

<sup>8</sup> Charging the same price for different services, when one set of services (telephone trade) is a subset of the other (LME Select).

pricing of LME's trading platform. Under this incentive scheme, the aggressor of a trade made via LME Select was charged an additional fee that was transferred in full to the initiator of that trade. This scheme was later modified to target specific trades upon which Spectron was offering a similar (albeit less pronounced) incentive arrangement. As a result of its need to make a margin on trades, Spectron was unable to match the terms of LME's scheme and this may have contributed to the switching of trades from Spectron's eMetal platform to LME Select.

20. Internal documents provided by LME set out a number of statements of intention by LME to protect its dominant position and to target Spectron.
21. The OFT considers that the conduct described above may prevent Spectron from competing on a viable basis as a platform for exchange-based trading of non-ferrous base metals contracts. Indeed since LME Select was established its operation has resulted in a very substantial reduction of Spectron's trading volumes in those segments where they compete in the provision of electronic trading (see paragraphs 30-32 below).
22. LME had previously considered extending trading hours on LME Select but considered this would be prohibitively expensive unless volumes were to increase substantially.<sup>9</sup> Although the volume of electronic trading on LME Select may have increased since that time, LME has produced no evidence to persuade the OFT that its understanding of LME's pricing behaviour is not correct.
23. The OFT has reasonable grounds for suspecting that the conduct in question has, or may have, an effect on trade between Member States.<sup>10</sup>
24. On the basis of this investigation and the evidence available to it, the OFT considers there are reasonable grounds for suspecting that LME has infringed the prohibition contained in Article 82 of the EC Treaty. Annex 1 sets out in further detail the evidence on which the OFT has relied in reaching this view.

### **Grounds for giving an interim measures direction**

#### *The Public Interest – section 35(2)(b)*

25. In the present case, the OFT considers that it is necessary to impose an interim measures direction as a matter of urgency to protect the public interest.

#### THE OFT'S VIEW

26. As indicated above, the OFT considers on the basis of evidence provided that there are two main public interest grounds for giving the above interim measures direction.
27. First, on the evidence available, the OFT considers that the extension of trading hours would be likely to have the effect of extending or exacerbating existing

---

<sup>9</sup> LME Board minutes of 16 November 2001, see LME letter to OFT of 4 February 2005, appendix 2A.

<sup>10</sup> See Annex 1.

abusive conduct. The OFT believes that in any extension of LME Select trading hours, LME will apply the same pricing structure as currently applies to 'European day trading'.<sup>11</sup> Accordingly, any extension of trading hours would mean that the abusive conduct which the OFT has reasonable grounds for suspecting would be applied to an additional category of transactions to which this conduct does not presently apply (due to current limits to hours of trading via LME Select).

28. The OFT has indicated in its guideline, *Enforcement*,<sup>12</sup> that it may consider that it is necessary to act urgently to protect the public interest, for example, to prevent damage being caused to a particular industry as a result of the suspected infringement, and that it may also take action to prevent damage to competition more generally. In the present case, the OFT is of the view that it is not in the public interest to allow the *extension* of behaviour, which in its preliminary view, is abusive conduct contrary to Article 82, and that in the interests of preventing damage to competition it is urgently necessary to issue the above interim measures direction.
29. Second, the OFT also considers that it is urgently necessary to issue an interim measures direction in this case to prevent damage to the market which the OFT defines, for the purposes of this decision, as the market for the provision of platforms for the exchange-based trading of non-ferrous base metals contracts ('the market'). This harm to the general competitive process and to market conditions, is distinct and considered separately from any damage that is to Spectron itself (which is considered in paragraphs 40-50 below). Any impact on Spectron is likely to have a wider impact on any other potential entrants to this sector.
30. The introduction of LME Select has resulted in significant migration of trading volume from Spectron to LME Select. While the migration of trading volumes from one platform to another is not itself evidence of a competition problem, this is not the case where such migration occurs in the context of 'below-cost pricing'. Rather, the introduction of LME Select at a below-cost price (along with the relative price charged for telephone trades and apparently exacerbated by the introduction of the LME Select incentive scheme<sup>13</sup>), appears to have led to the almost complete elimination of any trading volume on Spectron's electronic trading platform in those segments where LME Select is available (i.e. the European day trading market segment).
31. To date, LME Select has not covered morning Asian trading, which is the only segment in which Spectron continues to have any significant volume of trading on its electronic platform. In its application for interim measures directions, Spectron indicated that if LME extends the trading hours on LME Select to cover morning Asian trading, this is likely to cause a migration of a significant portion of Spectron's remaining trading volume to LME Select. Consequently, the provision by Spectron of an electronic platform in competition with LME Select will become unviable.

---

<sup>11</sup> European daytime trading is trading that occurs during typical London or European business hours. LME Select is available for European daytime trading from 07:00 to 19:00hrs London time.

<sup>12</sup> *Enforcement*, December 2004, OFT 407.

<sup>13</sup> See paragraph 19 above.

32. Information provided by Spectron in its application supports Spectron's statement that if LME Select trading hours are extended this would cause Spectron to entirely cease competing with LME Select (see Annex 2 below).
33. In circumstances where Spectron is the only operator currently competing with LME in the provision of electronic platforms for the exchange-based trading of non-ferrous base metals contracts, the OFT considers that the elimination of Spectron is not in the interests of consumers, or in the public interest more generally. Although not currently active in day trading to any significant extent, the OFT considers that Spectron is at present uniquely well placed to re-enter that market segment in the future. Were Spectron to be eliminated, the OFT considers that its re-entry would be very difficult or impossible. In addition, as stated above, the OFT considers that LME's behaviour is likely to impact on other potential entrants to this sector.
34. In this regard, Spectron has indicated in its application that if it is forced out of providing an electronic trading platform in the market, it would be extremely difficult, if not impossible, for it to re-establish a viable electronic trading platform at some point in the future. There are a number of factors to support this, including the reputational damage to Spectron, the cost and difficulty of re-introducing an additional trading screen to brokers' desks and the overall difficulty of overcoming the reputational effects of the alleged predatory behaviour. The OFT considers that these are credible concerns, and that they support the view of the OFT set out above that the elimination of Spectron is not in the interests of consumers, or in the public interest.
35. The OFT also considers that if the above interim measures direction is not given to LME, any final directions given pursuant to section 33 of the Act would likely be ineffectual and insufficient to remedy the abusive conduct which the OFT has reasonable grounds for suspecting. The European Court of Justice has been clear that in such circumstances it is appropriate to take such protective measures.<sup>14</sup> Similarly, the Court of First Instance has held that it will be appropriate to grant interim measures where there is a likelihood of damage occurring which could no longer be remedied by the decision to be adopted upon the conclusion of the investigation into the suspected abuse.<sup>15</sup> The OFT considers that, for the reasons outlined above, this is just such a case.

#### LME'S REPRESENTATIONS AND THE OFT'S RESPONSE

36. LME's response to the OFT's views on the public interest test appears to be two-fold. First, it argues that because the OFT and Spectron were aware in August 2005 of their plans to extend LME Select trading hours, any public interest ground cannot be credible. Second, it argues that there will be no grave and irreparable harm to Spectron.
37. Dealing with the latter argument first, the OFT initially notes that LME appears to have conflated the tests in section 35(2)(a) and (b) of the Act. In other words, serious, irreparable damage to Spectron and harm to the public interest are

---

<sup>14</sup> Case C-792/79 *R Camera Care v Commission* [1980] ECR 119 at paragraph 18.

<sup>15</sup> Case T-9/92 *Peugeot v Commission* [1993] ECR II-493, [1995] 5 CMLR 696.

distinct and must be considered separately – as the OFT has done. In any event, dealing with the substance of this latter argument, the OFT is not convinced by the LME's mere assertion that no 'grave and irreparable harm'<sup>16</sup> will be caused to Spectron if LME extends the trading hours of LME Select. For the reasons already given, if such an extension occurs, the OFT believes, on the basis of the evidence provided to date, that the very likely consequence of this will be the elimination of Spectron as a competitor to LME Select. LME has provided no evidence to show that this damage would not result from the extension of LME Select's trading hours or that the final elimination of Spectron from the market would not be the natural consequence of such an extension. Indeed, LME appears to accept that in the past, significant damage to Spectron has resulted from the introduction of LME Select, namely that Spectron's eMetal business has entirely ceased European day trading and only continues morning Asian trading because at present LME Select does not provide trading in this segment.<sup>17</sup>

38. As to the OFT's first ground for imposing this direction to protect the public interest, namely that it is necessary to prevent an extension of predatory conduct, LME merely asserts that the proposed extension of LME Select is 'commercially rational'. The OFT explained in its Notice of 13 February 2006 why it considers LME's pricing and operation of LME Select to be predatory conduct contrary to Article 82. LME has provided neither evidence nor reasoned argument to persuade the OFT that its understanding of LME's pricing behaviour is not correct. LME argues that its behaviour is commercially justifiable.<sup>18</sup> However, its arguments in this regard appear to amount to no more than an assertion that its members desire it to extend the trading hours of LME Select and that it has invested time and effort in obtaining the necessary regulatory approvals for this extension. Without more, neither of these factors can justify action which, in the OFT's reasoned view, would amount to an extension of the abusive conduct which the OFT has reasonable grounds for suspecting.

#### CONCLUSION

39. For the reasons given above, the OFT remains of the view that it is necessary to act as a matter of urgency, for the purpose of protecting the public interest.

#### **Serious, irreparable damage: section 35(2)(a)**

##### THE OFT'S VIEW

40. In addition to considering it necessary to impose an interim measures direction as a matter of urgency to protect the public interest, in the present case the OFT considers that it is also necessary for it to impose an interim measures direction as a matter of urgency to prevent serious and irreparable damage to Spectron.
41. As outlined above at paragraphs 30 and 32, the OFT considers that if it does not give a direction to prevent LME from extending LME Select's trading hours, the

---

<sup>16</sup> See paragraphs 22-26, LME's representations on OFT Notice under section 35 of the Act.

<sup>17</sup> See paragraphs 45, 50 and 67, LME's representations on OFT Notice under section 35 of the Act.

<sup>18</sup> See in particular paragraphs 27, 76, 134 and 135, LME's representations.

likely consequence will be the elimination of Spectron. Spectron has stated this expressly in its application to the OFT.<sup>19</sup>

42. In its guideline, *Enforcement*, the OFT has indicated its view as to what constitutes serious, irreparable damage<sup>20</sup>:

*'What constitutes damage is a question of fact and will depend on the circumstances of each case. However, damage may be serious where a particular person or category of persons may suffer considerable competitive disadvantage likely to have a lasting effect on their position. Serious damage is likely to include significant financial loss to a person (to be assessed with reference to that person's size or financial resources as well as the proportion of the loss in relation to the person's total revenue), and significant damage to the goodwill or reputation of a person might also constitute serious damage.'*

43. The OFT considers that if Spectron is forced to exit the market for the provision of platforms for the exchange-based trading of non-ferrous base metals contracts, this would constitute a considerable competitive disadvantage to Spectron. There can be no greater competitive disadvantage than being forced, by the abusive conduct of a rival, to exit the market. As outlined above at paragraph 34, the OFT considers, on the basis of the evidence before it, that this is likely to have a lasting effect on Spectron's position in that market. The OFT considers that if Spectron is forced out of providing an electronic trading platform in the metals market, it will be extremely difficult, at least, for it to re-establish a viable electronic trading platform in this area at some point in the future.
44. The OFT considers that if Spectron is forced out of the market by an extension of LME Select trading hours, there would be significant damage to the goodwill and reputation of Spectron. This reputational damage to Spectron with its customers is, in the OFT's view, likely to contribute significantly to the difficulty Spectron would face in trying to re-establish a viable electronic trading platform at some point in the future. In contrast, the proposed interim measures direction will preserve Spectron's position in extended hours trading and preserve its status as uniquely well-placed to re-enter the day trading segment, pending conclusion of the OFT's substantive investigation.
45. For all these reasons, the OFT considers that if LME extends the trading hours of LME Select, Spectron will suffer serious and irreparable damage and that therefore it is necessary to make an interim measures direction to prevent such an extension.

#### LME'S REPRESENTATIONS AND THE OFT'S RESPONSE

46. The OFT notes LME's representations that no serious and irreparable damage to Spectron will arise from the extension of LME Select's trading hours. However, for the reasons set out in paragraph 37 above, the OFT has no cause to alter the view set out in the Notice.

---

<sup>19</sup> See paragraph 2.7, Spectron's submission on application for interim measures directions.

<sup>20</sup> *Enforcement*, December 2004, OFT 407 at paragraph 3.5.

47. In addition to arguments already addressed, LME's representations suggest that the damage relied upon by the OFT as justifying the making of an interim measures direction is 'purely hypothetical'.<sup>21</sup> The OFT notes that LME has not provided the OFT with either evidence or argument for this assertion.<sup>22</sup>
48. The OFT does not accept LME's argument that the only potential damage to Spectron is purely financial loss, which ultimately could be remedied by compensation. The OFT does not consider that harm to Spectron (in the form of elimination as a competitor to LME Select) could readily be remedied by later compensation. On the evidence available, it appears to the OFT that if LME extends the trading hours of LME Select, the likely result is the elimination of Spectron as a competitor in the market. Moreover, the OFT considers that a further consequence is likely to be significantly increased difficulty for Spectron in re-entering that market. The OFT also considers that there is likely to be consequent damage to Spectron's reputation.
49. LME also asserts that it is within Spectron's power to ensure that no harm occurs to it, which is contrary to the available evidence. However, it has provided no indication stating how it is within Spectron's power to ensure that no harm occurs to it much less any evidence to support this assertion.
50. The OFT does not accept LME's argument that the damage to Spectron, which this interim measures direction seeks to prevent, has already occurred. The OFT does not believe this to be true on the basis of the evidence available. The harm that the above interim measures direction will prevent is serious, irreparable damage to Spectron via its elimination as a competitor to LME Select. This harm has not yet occurred. While it is true that in those segments where LME Select already operates Spectron has been all but eliminated, in those segments where LME Select is not currently available Spectron has retained market liquidity. It is the OFT's view, explained above, that the likely consequence of the extension of LME Select's trading hours is the migration of this remaining liquidity from Spectron to LME and the consequent total elimination of Spectron from the market. Indeed, LME appears to accept that some degree of damage has already occurred to Spectron as a result of the operation of LME Select (see paragraphs 26, 45, 50, and 67 of LME's representations). This seems consistent with the OFT's view that further extension will cause further damage to Spectron.

## CONCLUSION

51. For the reasons given above, the OFT remains of the view that it is necessary to act as a matter of urgency, for the purpose of preventing serious, irreparable damage to a particular person (specifically Spectron).

## Urgency

52. The OFT considers that it is necessary to give an interim measures direction in this case as a matter of urgency because of LME's intention to extend LME Select trading hours as of 1 March 2006. As stated above at paragraph 30, the

---

<sup>21</sup> See paragraph 23, LME's representations on OFT Notice under section 35 of the Act.

<sup>22</sup> See paragraph 37 above.

historic reaction of the market to the introduction of LME Select has been a migration of virtually all trading volumes from Spectron to LME Select.

53. There is no prospect of the OFT concluding its investigation into the suspected infringement(s) of Article 82 by LME before 1 March 2006.
54. As noted above, it is necessary to ensure that, if on conclusion of OFT's investigation a finding of infringement is made, any remedies proposed would be capable of addressing the harm to competition that has occurred. The OFT considers that if it does not act to prevent the extension of LME Select's trading hours, then those consequences identified above will result, and it will not be possible, even if the investigation concludes with a finding of infringement, at that stage to propose any remedies capable of addressing the harm which the OFT considers is likely to have occurred.
55. LME has argued that there is no urgency in the present case for the following reasons:
  - More than six months have elapsed since the LME announced its plan to extend the trading hours for LME Select, and no action was taken by either the OFT or by Spectron until Spectron applied to the OFT on 3 February 2006 for an interim measures direction to be made;
  - The damage relied upon in the present case is 'purely hypothetical';
  - Interim measures should not be awarded where the purpose is to prevent financial loss, as ultimately compensation will be a sufficient remedy in this regard;
  - It is within the applicant's (Spectron's) own power to ensure that no harm occurs to it;
  - The relevant damage to Spectron has already occurred.
56. The OFT does not consider that any of these arguments alter the balance of views. This matter is urgent as the conduct of LME, which in the view of the OFT is likely to harm the public interest and to cause serious and irreparable damage to Spectron, is due to occur on 1 March 2006.
57. Although the extension of trading hours was first proposed by LME in August 2005, it was unclear at that point whether the proposal was definitely going to be acted upon and when such an extension might occur. Indeed, the OFT did not become aware until after 23 November 2005 that LME would proceed with extending LME Select's trading hours with effect from 1 March 2006. Furthermore, until the matter was drawn to its attention by Spectron on 5 January 2006, the OFT was unable to assess the likely impact on Spectron – the only existing, direct competitor to LME Select – of the proposed extension of trading hours.
58. In addition, the full extent of the likely effect of the extension to LME Select's trading hours only became clear to the OFT when Spectron's application for interim measures was received. It is not accepted that the fact that no interim

measures direction has been given before now makes this matter less urgent. The OFT's interim measures powers are intended to ensure that the public interest is protected and irreparable damage to customers or competitors is not suffered by reason of a suspected infringement of competition law. The situation is now one of urgency and the measures in question are justified.

59. With respect to any alleged delay by Spectron in applying to the OFT to make an interim measures direction, this again does not affect the urgency of this matter. The OFT notes that Spectron delayed making an application for an interim measures direction until that application became a matter of urgency: when the extension of LME Select trading hours was imminent and it was evident that the OFT's investigation would not be concluded before that extension.

### **Balance of interests**

60. The OFT considers that the balance of interests in this case favours giving the proposed interim measures direction.
61. As noted above, the OFT considers that if no such direction is made this would be contrary to the public interest and would cause serious and irreparable damage to Spectron. In the absence of the proposed direction, it appears to be LME's intention to extend its apparently unlawful conduct. It is the OFT's view that the consequence of this is likely to be serious damage to Spectron and to the structure of the market generally. In contrast, as stated at paragraph 41 above, the proposed interim measures direction will preserve Spectron's position in extended hours trading and preserve its status as uniquely well-placed to re-enter the day trading segment, pending the conclusion of the OFT's substantive investigation.
62. In addition, there is no undue prejudice to LME if the proposed interim measures direction is given. Indeed, the evidence available to the OFT suggests that in fact expansion in the trading hours of LME Select is likely to be costly for LME. This view is supported by LME's representations.
63. In its representations, LME has argued that the making of this direction will (1) give rise to material trading uncertainty and grave practical problems and (2) negatively affect the interests of third parties. However, the OFT is not persuaded by the representations that LME has made in respect of either of these factors. None of these points has been developed or supported by evidence sufficiently to be given weight by the OFT.
64. In these circumstances, the OFT considers that giving the interim measures direction set out at paragraph 2 above is entirely justified and proportionate, and that the balance of interests favours this course.

## Annex 1

1. This annex sets out the evidence on which the OFT has concluded that there are reasonable grounds for suspecting that LME has infringed the prohibition contained in Article 82 of the EC Treaty. As the OFT has not yet concluded its investigation, the OFT is in the process of collecting further information which may cause the OFT to reconsider or reassess the evidence set out in this annex. This annex takes into account points made in LME's Representations (dated 22 February 2006) on the Notice of consultation for interim measures (dated 13 February 2006).

### Summary of case

2. In July 2003 Spectron complained to the OFT about the charging structure of LME's electronic trading platform (ETP), Select. According to Spectron, Select's charges were predatory and discriminatory, and aimed at eliminating Spectron as a competitor.
3. Since the time of the complaint, Spectron's trading volumes have declined significantly. Spectron has stated that almost all the business now done on its platform is morning Asian trading (i.e. trading between 01:00 and 07:00 hours London time), as it is the only ETP for LME contracts available to traders at this time.
4. In summary, the prima facie case against LME is that it has abused a position of dominance for the provision of platforms for the exchange-based trading of non-ferrous base metals contracts by, amongst other things:
  - predation through the pricing and continued operation of LME Select, whereby LME Select's revenues are below some measure of its cost; and/or
  - exclusionary price discrimination, whereby the LME offers discriminatory relative pricing of its trading platforms in a way that does not reflect the nature of the services offered and allows zero margin for actual and potential competitors, such as Spectron.
5. In addition, LME Select operated a targeted incentive scheme, which may have exacerbated any effect on Spectron of the predation and discriminatory relative pricing of LME's trading platform.
6. Further to this, internal documents provided by LME, such as Board minutes, set out a number of statements of intention by LME to protect its dominant position and to target Spectron.
7. Amongst other things, Article 82 prohibits imposing unfair purchase or selling prices. Such behaviour has been held by the Courts to include predation (e.g. as established in AKZO ). The Courts and national competition authorities have considered such abuses to be among the most serious.

## The Parties

8. LME is a Recognised Investment Exchange (RIE) under the Financial Services and Markets Act 2000 (FSMA 2000). LME provides the environment for exchange-based trading in non-ferrous base metals.<sup>23</sup> LME is a wholly owned subsidiary of LME Holdings Ltd and functions on a non-profit making basis. There are about 80 members of LME, mainly broker firms, who are also the main shareholders. Membership of LME is split over five categories that determine a members' access to services. For 2004, the turnover of LME Holdings Ltd was £16.3 million.
9. Spectron has provided screen-based electronic trading services to the energy market since 1988. These services mainly support over-the-counter (OTC) transactions for energy brokers that operate on a number of international exchanges (e.g. IPE, NYMEX). It also offers ancillary services such as market data and clearing services. Since 1999, Spectron has provided services to non-ferrous metal brokers and launched its electronic screen based trading system (Spectron eMetals) in June 2000. As Spectron eMetals only trades LME contracts, it is only available to users capable of trading such contracts, viz, LME brokers. Spectron eMetals' turnover for 2003 was £1.1 million, but has fallen substantially since then.

## LME services and fees

10. LME provides the environment – such as the regulation and trading platforms - for the trading of non-ferrous metals contracts. Trading takes place through the formation of a contract when two brokers agree to a trade, specifying the price, the delivery date and the quantity (number of Lots) to be traded. To check and to record the trade details, each broker must enter the details of the trade into the LME matching system (LMEMS), via a terminal provided by LCH.Clearnet, which also provides clearing and settlement.
11. LME offers three trading platforms over which brokers may trade LME contracts:
  - a. the Ring, which is a traditional open-outcry (i.e. floor-based) market;
  - b. an inter-broker market where brokers contact each other or their clients in order to trade. As this has traditionally operated mainly through the telephone, such trading has generally been referred to as 'telephone trading', though in fact it covers all trading not on the Ring or on Select; and
  - c. electronic screen-based trading through LME Select.
12. Many types of trade can be done on any of the three platforms, although certain types of trade tend to be done on particular platforms owing to the complexity of the trade and liquidity considerations. Telephone trades comprise the greatest

---

<sup>23</sup> As an RIE, LME imposes obligations on members to ensure a transparent, orderly market that provides proper protection for investors. In essence, LME regulates the market place but the Financial Services Authority regulates specific broker firms ensuring they are fit and proper to offer services to clients.

volumes of trades, followed by the Ring. Only a small (but growing) proportion of trades are conducted electronically.

13. When a trade is entered into LMEMS the broker will be charged a transaction fee (termed a 'contract levy'). Each side to a trade pays the transaction fee. The level of the transaction fee depends upon the membership category of the broker and the platform used. There are no transaction fees for using the Ring. Transaction fees for telephone trades and LME Select are the same. LME operated a revenue-neutral incentive scheme for trades on Select between June 2002 and November 2005. This scheme charged 'aggressors' of a trade an additional fee when they 'hit' a trade posted on Select. This fee was then transferred in full to 'instigators', thus altering the relative price of aggressing or instigating without accruing additional revenue to LME.
14. LME Select was launched on 9 February 2001, eight months after Spectron eMetals was introduced. Select can be used by category 1 and 2 members of LME and it currently operates between 07:00 hours and 19:00 hours London time.

#### **Spectron services and fees**

15. Spectron's eMetals platform operates in a similar manner to LME Select. Spectron also operates a form of incentive scheme. As contracts traded on Spectron eMetals are LME contracts, brokers must register their trades with LME. This requires a separate step to enter the details of the trade into LMEMS, at which point the brokers are charged the telephone trade fee. As a result, LME telephone trades are a necessary complement for brokers that use Spectron to trade LME contracts.

#### **Market definition and dominance**

##### *Market definition*

16. As discussed above, LME provides an environment where parties may enter into contracts for the payment-versus-delivery of non-ferrous metals. This allows the parties to hedge (i.e. insure against) price risk in non-ferrous metals (this is how LME generally describes its role).
17. The OFT's preliminary view is that the market may be defined as 'worldwide exchange-based trading of non-ferrous base metals'. LME argues that the OFT's uncertainty over market definition is shown by the fact it still needs to do further work here.<sup>24</sup> Having considered documents and evidence from LME, the OFT has formed a preliminary view; however, it cannot form a final view until it has consulted with customers as to their views on substitution. The OFT also notes that, despite its criticisms, LME does not offer an alternative market definition.
18. The OFT notes LME's comments in its Representations that '[t]he OFT's assessment of the relevant market is fundamentally flawed. It is entirely devoid of any assessment of competitive constraints and demand-side substitution. It is

---

<sup>24</sup> LME Representations paragraph 112.

limited and inaccurate in its assessment of supply-side substitution.<sup>125</sup>

19. On demand-side substitution, LME suggests that customers may not consider other trading platforms (such as telephone trades) as substitutable for electronic trading.<sup>26</sup> This would seem to imply that electronic trading is a separate market from other trading platforms.
20. LME has however previously indicated that it wished to charge the same for LME Select and telephone trades on the basis that it does not wish to 'steer' the market<sup>27</sup> – this clearly implies that LME considers there is a significant degree of substitutability between telephone trades and Select. LME has also previously stated that members can trade LME contracts for all metals for all prompt days using LME facilities of Select, the Ring and the telephone.<sup>28</sup> Also, the threat to the Ring that LME perceived from electronic trading would seem to suggest a competitive constraint from the latter. While it would appear that electronic trading platforms might be closer substitutes to each other, the evidence also supports the inclusion of LME's other trading platforms in the same market.<sup>29</sup>
21. Non-ferrous metal prices may also be hedged through over-the-counter (OTC) trading, where two parties enter into a contract off exchange. From the OFT's current knowledge of OTC trading, it appears that such trading in general has different characteristics from exchange-based trading, which may mean that substitutability between them is limited. Exchanges provide a liquid, transparent market in standardised contracts, while OTC contracts are 'private' trades which may well have bespoke conditions. OTC trading is therefore not included in the OFT's provisional market definition.
22. Supply-side considerations are also unlikely to widen the market definition beyond a market for exchange-based trading of non-ferrous metals contracts, as other commodity exchanges could not easily enter and offer trading in non-ferrous metals (owing, for example, to commercial and regulatory hurdles).
23. In its Representations, LME is critical of this approach. It cites statements made by Spectron in April 2000 that entry from electronic trading was a significant threat to LME. These statements were made in the context of whether an electronic platform could take business away from LME's Ring platform. The position now is one where LME operates the main electronic trading platform. Under these circumstances, it is difficult to see other existing electronic trading platforms, currently used to trade other commodity products, being easily and effectively switched to trading LME contracts.

---

<sup>25</sup> LME's Representations paragraph 113.

<sup>26</sup> LME's Representations paragraph 100.

<sup>27</sup> For example, in its response on 25 March 2004 to the OFT's request for information under section 305 of the Financial Services and Markets Act 2000 (FSMA) on 10 March 2004.

<sup>28</sup> Appendix 5 to LME letter to the OFT dated 14 October 2005 in response to OFT request for information under section 305 of FSMA and section 26 of the Competition Act 1998 on 19 September 2005.

<sup>29</sup> This appears to be recognised by LME when noting that membership fees do not vary by the type of platform used, in order to allow members to trade freely over all LME platforms (LME Representations paragraph 149).

## Dominance

24. On the basis of the OFT's provisional market definition, LME has been described as:

'the world's premier terminal market for trading non-ferrous metals, accounting for about 95% of global exchange business for the base metals it trades.'<sup>30</sup>

25. The OFT has made its own preliminary estimate of market shares based on global volumes (Lots) traded, using figures supplied by LME and by Spectron (figures relate to year 1 September 2004 to 31 August 2005):

Undertaking	Trading Platform	Percentage <sup>31</sup>
LME	Open outcry in the ring	[ < 20]
	Telephone	{ > 70]
	Electronic (Select)	[ < 10]
Spectron	Electronic	[ < 5]
Other exchanges (NYMEX etc)	Various	[ < 10]
	Total	100

26. Treating all exchange based non-ferrous metals trading, regardless of platform, as being in the same market, as indicated previously, LME has [>90 per cent] of global trading, which suggests LME might be regarded as dominant or having significant market power. Spectron eMetals was assumed to have less than [5 per cent] for this period. The analysis of barriers to entry, below, supports this provisional conclusion.
27. As set out above, the OFT does not consider that supply-side substitution could be achieved very quickly either in terms of a competing exchange or an alternative electronic trading platform. Longer term entry may be more feasible but significant difficulties still appear to remain. For example, a new entrant would need time to establish a sufficient volume of trade to attract liquidity in the first instance and then retain a sufficient volume of trade. In addition, an entrant would need to meet regulatory requirements, which in themselves constitute a not insignificant barrier to entry.
28. In Spectron's case, it appears to have benefited from being the first provider of an electronic platform for non-ferrous metals when it established eMetals. Now that LME Select is established, no such advantage is available to any further entrant at this point. This would appear to make the possibility of entry by a competing electronic platform significantly less likely. In addition, while Spectron would likely face difficulties in offering a European-trading service in the future, it is nonetheless uniquely well placed to do so.
29. In conclusion, the information available on LME's market position and barriers to entry appear sufficient to support a *prima facie* finding of dominance on a market for exchange-based trading of non-ferrous metals contracts.

<sup>30</sup> Managing Metals Price Risk With The London Metal Exchange (2001): page 33.

<sup>31</sup> Individual percentages do not add up to total because of rounding.

## The effect on trade

30. The OFT also has reasonable grounds for suspecting that the conduct in question has, or may have, an effect on trade between Member States. For this to be so, it must be possible to foresee with a sufficient degree of probability on the basis of a set of objective factors of law or fact that it may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States.<sup>32</sup>
31. In *Commercial Solvents*,<sup>33</sup> the ECJ commented that where a competitor is likely to be eliminated and this elimination has repercussions on the competitive structure within the common market, the effect on trade criteria may be fulfilled.<sup>34</sup> This condition may be fulfilled in any case with supranational markets.
32. Given LME's position as the largest exchange for non-ferrous metal trading, and the global nature of metal trading, with many brokers based outside of the UK, the OFT has formed the view that LME's conduct is likely to have at least a potential effect on trade between member states.

## The abuse

33. It would appear that the pricing of LME Select was set with little consideration of how it would contribute to covering its operating costs. LME Select's costs consist of the supply contract with an IT-contractor for the provision of the electronic trading platform, and some other direct costs (staff, etc.) to LME. As the individual IT contracts last for three years, it is possible to compare LME Select's revenues and costs over these periods.
34. As a result, it is appropriate to evaluate LME's behaviour against an avoidable cost test. In other words, LME has decided to enter into (or renew) each IT contract for a period of three years, thereby incurring a cost which may be compared to the revenues LME Select earned over that period. Had the LME not entered into or renewed each contract, these costs could have been avoided and the corresponding revenues foregone. Pricing and operating so that avoidable costs are not recovered is presumed to make no sense absent the incentive to predate. The OFT considers that, on the whole of the evidence available, this behaviour would give rise to a (rebuttable) presumption of predation.<sup>35</sup>
35. The first contract for LME Select was with OM Technology for its provision between 2001 and 2003; the second is with Cinnober for 2004 to 2006. LME has provided data on LME Select's revenues over these periods, and also estimates of the avoidable costs involved for each of the two contracts.<sup>36</sup> For the period of the first contract (2001-2003), revenues were £[ ] and avoidable costs £[ ]. LME Select continued to make a significant loss in the second

---

<sup>32</sup> Paragraph 23 of the Commission Notice.

<sup>33</sup> Joined Cases 6/73 and 7/73 *Commercial Solvents* [1974] ECR 223

<sup>34</sup> Paragraph 33. Also see paragraph 23 of the Commission Notice.

<sup>35</sup> There may be legitimate commercial reasons for pricing below AVC, these are considered at paragraph 4.12 OFT's draft guideline, *Assessment of conduct*.

<sup>36</sup> At this stage we have not accounted for cost of capital or any revenues attributable to Select from financial data sales. However, we do not expect these to significantly alter the results of our cost analysis.

contract period (2004-2006), with revenues of £[ ] and avoidable costs of £[ ].<sup>37</sup> The OFT considers that more weight should be attached to the second contract, as LME would have had some indication of LME Select's performance at this stage, having got beyond the initial 'start-up' period.

36. In addition, the OFT notes that some of the revenues attributed to LME Select are revenues that would otherwise have been received by LME, even if it did not operate LME Select (for example, telephone trade fees paid to LME by users of Spectron). As such, it might be argued that the above revenues actually overstate the financial contribution of LME Select (and therefore understate the associated losses).
37. The evidence from LME Select's revenue and avoidable costs therefore indicates sufficient losses to support a reasonable presumption (albeit rebuttable) of predation.
38. In its Representations, LME appears to reject the validity of such a test on the basis that although overall non-profit-making, there is no requirement for each platform to break even.<sup>38</sup> It also comments that any predation test should be applied to the market as a whole, since this is the OFT's definition of the relevant market.<sup>39</sup>
40. However, predation does not necessarily require that all of a dominant firm's activities within the relevant market are priced below costs, only those activities specifically targeting or competing against the prey. In *Aberdeen Journals*,<sup>40</sup> the CAT supported the OFT's view that the relevant product market for the purposes of the case was the market for advertising in local newspapers in Aberdeen (paid-for and free).<sup>41</sup> This market included two titles owned by Aberdeen Journals, the *Evening Express* and the *Herald & Post*. However, the CAT supported the OFT's conclusion that Aberdeen Journals had abused a dominant position by pricing the *Herald & Post* below average variable costs during the month of March 2000.<sup>42</sup> In other words, there may be a finding of predation where a dominant firm runs only one of its products or services below cost, even if it has other products or services in the same market (which may benefit from the predation). Regardless therefore of the position of LME's other platforms, it appears that LME Select is being run so that it is not covering avoidable cost and therefore may be presumed predatory, absent any objective justification for these continued losses.
39. LME also argues that as a not-for-profit organisation it has no incentive to eliminate Spectron in order to increase profits in the longer time-period.<sup>43</sup> This argument does not however allow for the possibility that a predatory strategy might entrench LME's existing dominant position (as indicated by the evidence of

---

<sup>37</sup> This is based on LME's forecast costs for 2006.

<sup>38</sup> LME Representations paragraph 138.

<sup>39</sup> LME Representations paragraph 140.

<sup>40</sup> Case 1009/1/1/02 *Aberdeen Journals Limited v the Office of Fair Trading* (CAT, 23 June 2003)

<sup>41</sup> *Aberdeen Journals*, paragraphs 256, 273, 301, 313.

<sup>42</sup> *Aberdeen Journals*, paragraph 452.

<sup>43</sup> LME's Representations paragraphs 141 to 143.

intention, see paragraph 43). This may have with the consequence of protecting LME's other trading platforms from competition and removing cost or other pressures, leading to increased market inefficiency.

40. Further to the finding of predation, the OFT notes that the fees for LME Select are set at the same level as those for telephone trades, even though LME Select provides all the services of a telephone trade along with additional services.
41. This form of price discrimination<sup>44</sup> means that anyone trading on Spectron also incurs an LME charge equivalent to LME's charge for LME Select. In other words, brokers pay the same level of transaction fee to LME whether they choose to trade on Spectron eMetals or on LME Select. Any fee charged by Spectron therefore necessarily represents an additional cost over using LME Select from the perspective of the broker. This pricing policy means that Spectron – or any other potential competitor trading LME contracts – has zero margin on which to operate.
42. Although LME has sought to justify its fee structure,<sup>45</sup> this does not change the fact that Spectron does not have a margin on which to operate and that this choice of fee structure may have contributed to any effect of the predatory operation of LME Select on Spectron's ability to compete effectively. This may have been further exacerbated by the targeted incentive scheme that LME operated for trades on LME Select.
43. Finally, from the contemporaneous documents gathered from LME (such as Board and committee minutes) there is evidence of intent by LME to both protect its dominant position in metals trading, and to capture volumes of trade from Spectron. In some instances, this evidence may be interpreted as a legitimate strategy to meet competition. For example, the targeting of Spectron through the incentive scheme may have been incidental, as it was the only other provider of an electronic trading platform. However, on balance, the weight of evidence on intent appears to support the view that LME followed an anti-competitive, exclusionary strategy at least with regard to its intentions towards Spectron.
44. In the circumstances and in light of the above evidence, the OFT considers that it has reasonable grounds for continuing to suspect that LME has infringed Article 82 EC.

---

<sup>44</sup> Charging the same price for different services, when one set of services (telephone trade) is a subset of the other (LME Select).

<sup>45</sup> LME's Representations paragraphs 144 to 150.

**Annex 2**