

**CENTRE FOR COMPETITION &
REGULATORY POLICY (CCRP)
DEPARTMENT OF ECONOMICS**

**Competition Policy Roundtable:
Market Inquiries and their Future**

Summary Report

**January 25th 2013
City University London**

1. Introduction

On 25 January 2013, a CCRP Round Table with a distinguished panel of speakers discussed the future of Market Inquiries (MIs) within the UK's Competition regime, both currently and under the CMA (Competition Markets Authority) from 2014 onwards. The initial presentations were followed by an extensive discussion where the panellists and audience members discussed the strengths and weaknesses of the existing system as well as the MI arrangements proposed for the new CMA. The latter will take over functions carried out currently by both the OFT and the Competition Commission.

The panel members included current and past Chairs of the Competition Commission, the designated Chair of the CMA, an OFT Director and senior academics and consultants expert in competition policy issues. The Round Table was introduced by Xenia Dassiou, Director of the CCRP and chaired by Jon Stern, Senior Visiting Fellow at CCRP, standing in for Emeritus Professor Jon Cubbin).

The full list of Panel Members is at Annex 1 and the list of Topics covered is at Annex 2. The main issues discussed were as follows:

2. Overview and CMA Development of a Market Investigation Strategy

Prior to the implementation of the Enterprise Act (EA 1998) in 2002 the competition regime structure was lacking in rigour and this particularly

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affected the investigation of ‘complex monopolies’ (as pre-1998 market inquiries were known). Unlike today, ensuring effective competition in markets of interest was just one component of the investigations and the competition agencies only made recommendations to the Secretary of State who had the final decision. Hence, before 2002, the remedies within published reports could be affected by non-competition concerns and/or political pressures. In consequence, before the implementation of EA 2002, investigations like those into the beer market sometimes resulted in the application of remedies which lacked a strong economic and competition basis. Further, the Ministerial decisions on these issues were taken in a highly opaque manner behind closed doors.

Following the launch of the Enterprise Act in 2002 the competition policy regime benefited from a significant overhaul and detachment from ministerial involvement as the CC, in particular, was given the responsibility for competition *decision making* and ministers were excluded from the process. In addition, the role of OFT and the CC was focused strongly on ensuring effective competition and appropriate remedies and this has been reflected in the market investigation regime that has developed since.

Market studies by the OFT and market investigations by the CC are a distinctive and unique tool. It has been argued that they are the ‘jewel in the crown’ of the UK’s competition regime. Certainly, some of the most important recent competition cases have been MIs (e.g. the case of BAA with the recent sale of Stansted in addition to the divestment of Gatwick). However, the *purpose* of market inquiries has never been specified - nor have their relationships with other aspects of CC work, such as mergers. Hence, there has been no coherent *strategy* yet developed over what sectors should be subject to MIs or why. It is hoped that the creation of the CMA with the merger of the OFT and the CC will provide a way by which such a strategy can be developed. (See Section 2 below for further discussion.)

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Since 2002, the CC has been commissioned to carry out 15 MIs with the number, complexity and range having significantly increased after 2005. MIs in general are very time and resource intensive, particularly some of the larger ones of recent years. However, there was a 3-year period (after the ROSCOs¹ MI in 2007 and before the local buses MI in 2010) during which none were commissioned, with the result that, in one particular year, the CC was not working on any MI. This 3 year gap may have been a factor in the government's decision to bring the OFT and the CC together.

In recent years, the CC has become heavily stretched with up to 5 on-going market investigations at any given time. Specifically, since 2010, the CC has carried out the local buses MI, followed by pay TV movies. While some of the earlier investigations were not very important for the economy as a whole, others clearly were (namely, groceries, PPI² and airports) and, at times, they have stretched CC resources.

It is generally agreed that market investigations are a crucial and, in general, very successful feature of the UK competition system and it is critical that the new regime ensures that this will continue to be the case. The transition team of the CMA faces an organizational challenge that will require the authority to maintain or improve upon the current high standard of functioning.

While at the initial stages of formation, the CMA has a number of potential options for improving the competition regime in general and the MI process in particular. The new organisation provides an opportunity to have an integrated perspective for and, in particular, to internalize incentives for full MI market referrals on a more consistent basis. For market studies, the CMA will enjoy greater powers than OFT but with a more demanding time-scale for both market studies and full (stage II) MIs.

¹ Rolling stock companies. They own the trains which they lease to train operating companies.

² Payment protection insurance

For full (2nd Stage) MIs the Board of the CMA will have to ensure a sensible flow of work rather than the previous feast and famine cycle. There will need to be a focus on strategic management at the CMA both in general and, in particular, for Stage II MIs. However, as discussed below, this raises the issue of how to keep Stage I market studies fully separate from Stage II MIs.

Minimizing uncertainty over the timeliness of the procedures will be good both for companies and for the credibility of the Authority itself. In addition, the formation of the new Authority also provides the opportunity to consider the role of competition policy within government sponsored quasi-markets, e.g. for education and healthcare.

3. Stage I and Stage II for Market Investigations under the CMA

The creation of the CMA presents a major opportunity to strengthen the regime and its strategic focus regarding MIs. More dialogue should be possible on policy regarding choice of cases, general approach and reference to Stage II investigation while preserving the Stage I and Stage II distinction. In consequence, the transition team will need to reflect carefully on how to best to use the CMA's new powers and what the scope of the MI regime should be.

OFT's current role in the MI process is essentially one of "triage" - it carries out 6-7 market studies per year, chosen from many hundreds of issues raised by individual and groups (including super-complaints). Of the studies carried out, about 1-2 per year are referred to the CC. In making the decision as to whether or not to refer cases to the CC, the OFT places considerable weight on how likely it is that the CC will be able to find suitable and effective remedies to the problems identified.

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Under the current regime, the OFT faces no time restrictions in its market study phase (Stage I) investigations - apart from responses to super-complaints which must be completed within 90 days. To some extent this is the counterpart of the fact that, unlike the CC, its information gathering powers are quite limited. In its investigations, the OFT looks for evidence that indicates harm inflicted to consumers. Sometimes the OFT investigates after a super-complaint as in the case of petrol prices. Recent OFT market studies include drip pricing, consumer contracts and price comparison websites.

The market study phase is critical as it allows the OFT to explore more areas of interest than narrowly defined competition concerns. However uncertainty over the complexity and hence timeliness of a possible MI minimizes the number of referrals put forward for an in depth investigation by the CC.

The current competition regime does not outline a ‘reference threshold’ nor does it describe the conditions for a good referral. The OFT expects that forming a new competition authority provides the possibility to improve upon current guidelines. The CMA is well placed - all evidence under one roof will enrich the dialogue between the OFT and the CC on what needs to be referred, i.e. “good” cases for a market investigation. An appropriate structure for the referrals process is crucial, through clearer criteria and an improvement of the flow between Stage I & II investigations. The new regime imposes statutory deadlines for Stage I which will be met by the strengthened information gathering powers of the CMA at this Stage.

There is however an institutional challenge ahead: namely, of how to combine effectively two different cultures operating under a single regime. It is of critical importance to ensure that a merged competition authority does not compromise the separation between Stage I & II in the market investigation. To maintain credibility the CMA must show that Stage II will retain its “second pair of eyes” identity and retain flexibility, namely a readiness to alter a decision on any given case. A good example of this

flexibility and independence in the current regime is the pay TV movies MI, where the final conclusions of the Stage II process reversed previous decisions - for very good reasons given that conditions in that market had changed significantly since the initial market study and even since the provisional conclusions of the Stage II process.

The fact that that CC's decisions (and those of the CAT) have stood up well on appeal in terms of the final outcome is a testament to the good general performance of the previous MI regime. Will that continue within the current legal framework? The new system will be legally sustainable only if it ensures the continuation of the existing genuinely independent second stage to investigations. The case of avoiding a confirmation bias will need to be considered carefully - and not least for legal reasons since the investigation regime can be challenged on the basis of a 'no-independence' challenge by companies. The legitimacy of the CMA crucially depends on this. Ultimately the credibility and strength of the reformed regime will depend on the preservation of independence between the two Stages.

4. Concurrency and CMA's Relationship with Sectoral Regulators

While the UK competition regime has grown to be of high repute in EU and world rankings, important powers have been underutilized. The Competition Commission's (CC) dependence on sectoral regulators (its "clients") for proposing investigations to be launched for the regulated infrastructure industries has created considerable concern.

We observe a limitation of the types of issues that are being investigated by the competition agencies in this area because the sectoral regulators perform under different incentives. Market investigations are seen by the

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regulators as a last resort solution. (The exception to the general reluctance to use competition powers by the regulators has been OFCOM, but arguably it was easier for them given network competition in telecoms networks.)

In addition, the CC has not been asked to undertake general enquires of significant markets of concern such as media and banking. This may be justified when the remit is far broader than just assessing competition in the market (e.g. financial stability [prudence] concerns). Similar concerns arise where general public interest issues are the prime concern rather than an adjunct to competition issues (as with newspapers or defence).

It is therefore important that the CMA retains the ability to maintain and use the full toolkit of all possible remedies as it is imperative to achieve the relevant solution to a given case. This involves both structural and behavioural remedies including the need for licences (e.g. as, in the past, with Yellow Pages). For example, in the case of the rolling stock reference by the ORR the answer was in a change in the franchise system rules, not a typical market remedy of the type the CC would most often choose.

It will be difficult to implement the new competition act if sectoral regulators continue to be hesitant to refer cases - particularly MI cases - to competition agencies. Their reluctance is understandable given that sector regulators face significant uncertainty over the outcome and losing control of their sector for up to two years. Uncertainty is an additional reason for sectoral regulators reluctance, especially in cases where government and taxpayer money is at stake as with ORR (the rail regulator).

Guidance must be provided to sectoral regulators and the authority must appreciate the strong connection to political influences in such cases. Some sectoral regulators have recently experienced substantial changes concerning their objectives and powers (e.g. Ofgem).

The goal for the new regime is to facilitate concurrency and combine the expertise of regulators from various sectors to enhance the ability to decide

when to use competition policy or regulatory powers (ex post versus ex ante regulation). An annual report will evaluate the concurrency between regulatory bodies to ensure greater cooperation. In addition - and importantly - the government has agreed an amendment to the new Competition Act which allows the government to suspend concurrency for all sectoral regulators except the health economic regulator.

More demanding deadlines would improve the level of referrals by regulators by reducing uncertainty. Currently, the CC does not have formal discussions with sectoral regulators. The new system should increase incentives to improve communication, thus making concurrency work better. The intention is that the CMA will have the resources and incentives to encourage regulators to “go for it” i.e. more Stage I investigations and the likelihood of less infrequent Stage II MIs.

The trade-off arising from that increase in communication is the danger of a confirmation bias occurring between sectoral regulators and the CMA. Another issue may be that concurrency is concerned with anti-trust (e.g. dominant incumbents) and therefore has little to do with the CC and rather more with the OFT under the current regime. But this divide disappears where the CMA raises the major issues in Stage I market studies.

5. Market Failures, Public Policy Concerns and other Non-Competition Issues

The UK is better positioned than the European Commission to probe oligopolies, collusive behaviour and mergers among other areas of concern. More specifically there are gap the EU competition law regarding cases of “tacit collusion” (e.g. co-ordinated effects), whereas UK has had a system that does this effectively.

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There may be issues that arise from more complex investigations where the public sector plays a greater role, as in the local buses case. The OFT looked at the need for reform in that market; the remedies took the form of changes which the Department of Transport was asked to make rather than any structural/ behavioural remedies in the market itself. Hence, *policy changes* may be in some cases more suitable than competition remedies, as they also were in the case of the ROSCOs. Similar public policy issues arose in the 2007 groceries MI e.g. of the treatment of farmer suppliers and local high streets. These had to be addressed along with pure competition issues. The remedy was the creation of an ombudsman for the farmers in their dealings with supermarkets.

This case also illustrates that players in the market - and those involved in MIs- should have reasonable expectations on the aims of the investigation. For example in the groceries case, many small businesses and their representatives had expectations that the inquiry had been commissioned to safeguard the number of competitors by protecting them against the supermarkets.

Today, market investigations cover a variety of issues and, in general, these are dealt with relatively successfully. As mentioned before tacit collusion is difficult to deal with but this is in the mainstream of what is considered as a competitive market failure. However there are market failures that are essentially *government* failures, as for example in the case of BAA, which was privatised as a monopoly.

One important weakness of the current MI system is that there can be a lack of focus due to an overly broad remit so that identifying the source of market failure can be a challenge. This seems to be the case for the CC in the ongoing car insurance market investigation. This case is complicated by the fact that the non-fault party's insurer has an incentive to raise the at-fault insurer's costs - creating a principal-agent problem - and there have been claims that people were crashing cars intentionally to gain insurance money.

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These types of market failure are frequent. The Competition Commission looks at adverse effects on competition and this test is broad enough to include many types of market failures even if these arise from consumer behaviour. Effective use of the competition test is required to identify the relevant issue and determine the magnitude of the investigation required. However it is hardly rational to expect that the CMA can or should correct all market failures. Hence it is important to manage expectations by clarifying the aims of the MI as mentioned above.

It was suggested that the exclusive focus on the theory of harm is in some cases pointless as well as resource and time consuming. If there are “other market failures” then perhaps there should be a distinct set of remedies for such cases rather than a market investigation. This would reduce the time and resources required to deal adequately with the case. As the creation of the CMA broadens the remit of the regime, the procedures must ensure that there are different instruments for different types of market failures to avoid the analysis of the obvious.

In conclusion, the new Authority must appreciate that effective competition will not always be the main area of concern for issues raised in market studies. There are various other factors that create market distortions unrelated to the level of competition within a market. The label of 'effective competition' can distort the regulatory process if appropriate market failures are not assessed alongside competition issues. The regime's instruments must be efficiently focused on defining the key issues and true characteristics linked with market failures where a competition policy response is the most appropriate.

6 Public Interest Issues, Competition Policy and Market Investigations

The current process can study public *policy* issues however public *interest* issues are not related to the core of the investigations. There will be a new clause in the upcoming competition legislation whereby ministers will only be able to intervene in the remedy stage i.e. after the investigation has analysed multiple areas of concern. Regardless of one's position on public interest these issues need to be well defined if the new regime is to avoid the problems of the pre-1998 arrangements.

Market investigations can now have in their terms of reference to deal with public issues - but with limitations as for example in the context of plurality, (media), financial stability etc. It would be advisable to specify sectors where this might apply to avoid making the regime messy (as it is in the case of mergers as set out in EA1998; defence and media).

One argument offered for the proposed change is that it did not make sense to have as in the current regime, the ability to look at public interest issues in the case of merger investigations, but not in the case of market investigations (where public interest issues can only be introduced at the remedies stage and then only by ministerial intervention).

Hence, it may be better to restore symmetry by allowing under the new competition regime that such public interest considerations can be included in the terms of reference for a MI if one of the reasons discussed above applies to the relevant case. This, however, does not necessarily mean - and should not imply - a return to the old pre-EA period of MMC investigations using the public interest criterion.

As the proposed public interest treatment for MIs is complex, it may be hard to implement; care should be taken that it does not create uncertainty and that it is used sparingly.

7. Miscellaneous Issues and Concluding Comments

(i) Expectations, Uncertainties and Fears over Referrals

There is a fear of a CC referral as the start of a “big change” that in some cases leads to a self fulfilling prophesy. It was agreed that the new regime should try to puncture the myths regarding the investigatory process, particularly the Stage II process.

The authority does not know what it will uncover during an investigation. The competition agencies have to look at all the angles of a case and there is always uncertainty over the outcomes. If you knew the answer you would not need to investigate! But as in the case of the recent OFT investigation of petrol prices, the outcome can also be as simple as a decision that the market is competitive.

The agencies are feared by some companies and uncertainty over final decisions can affect share prices during the process and after. The admin timetable is published at the start of the inquiry, but nobody (in the CC/CMA) can say what will be found.

(ii) Consistency

It was suggested that the CC panel members selected for a particular case can be something of a lottery and this creates further uncertainties surrounding the investigations. It implies that the CMA will need to take a strategic approach. The CMA must ensure confidence in the consistency of different panel members across investigations. The new regime’s ability to achieve independence within their procedures is still uncertain and thus this area remains a work-in- progress. It is crucial to ensure a separation between the investigators and the decision maker.

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However, it was strongly argued that, at the CC, every investigation looks at the facts and there is no inconsistency between differently composed panels. Indeed, it was argued that the CC makes great efforts to avoid inconsistencies in approach and decisions across investigations. Ex post evaluation helps and shows that there is institutional consistency across investigations and how decisions are reached.

(iii) The CMA and the Future of Market Inquiries

It was generally agreed that we must make the CMA work: the exercise is clear and the consequences of bad work will be costly. The MI process is a unique instrument not found elsewhere in the world. It should be viewed as a viable part of the toolkit of promoting competition together with mergers and abuse investigations, not just as an academic exercise. The CMA will ensure legal robustness by providing an independent Stage II procedure.

ANNEX 1

Organiser

Xeni Dassiou (Director, CCRP)

List of Panel Members

Roundtable Chairman

John Cubbin (Emeritus Professor, City University London and Competition Commission member), represented on the day by:

Jon Stern, Senior Visiting Fellow, CCRP

Panel Members

Lord Currie (Chair Designate, Competition and Markets Authority)

Peter Freeman CBE, QC (Chairman, CAT and previous Chairman of Competition Commission)

Thomas Hoehn (Visiting Professor, Imperial College London & Competition Commission Panel Member)

Derek Ridyard (Partner, RBB Economics)

Mary Starks (Senior Director, OFT)

Roger Witcomb (Chairman, Competition Commission)

ANNEX 2

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