Is the new defence to the cartel offence odd enough to be circumvented by the courts?

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Is the new defence to the cartel offence odd enough to be circumvented by the courts?

Andreas Stephan, Professor of Competition Law

It is argued that the courts should take a purposive interpretation of the new defence to the UK’s cartel offence, so that defendants cannot escape criminal liability simply because they took reasonable steps to seek legal advice before entering into a cartel and regardless of whether that advice was followed.

The Enterprise and Regulatory Reform Act 2013 removed the requirement of dishonesty from the UK Cartel Offence. It was thought this had posed a significant obstacle to effective enforcement, as only one original prosecution reached trial during the period 2003-2012. Dishonesty was replaced with a carve-out: the offence is not committed where the arrangement is entered into openly – meaning that customers (including a person requesting bids) are given relevant information or that information is ‘published’ prior to its implementation.

To address concerns raised by the Confederation of British Industry (CBI) that the revised offence would risk criminalising legitimate business arrangements (in the absence of dishonesty), three defences were also introduced at a late stage. These apply where the defendant can show:

1. At the time of making the arrangement she did not intend the nature of the arrangements would be concealed from customers; OR
2. She did not intend the nature of the arrangements would be concealed from the competition authority; OR
3. Where she “…took reasonable steps to ensure that the nature of the arrangements would be disclosed to professional legal advisers for the purposes of obtaining advice about them before their making…”

Read literally, this final defence allows cartelists to escape criminal liability by simply showing they took reasonable steps to seek legal advice prior to entering into a cartel arrangement. This is regardless of whether the legal advice was followed and can be relied upon even where the defendant made sophisticated efforts to hide the arrangement. It does not constitute a defence to an infringement decision (and any subsequent fines on an undertaking) under the Competition Act 1998, but this is likely to have a far weaker deterrent effect on individual decision makers; one of the key reasons why the UK adopted a criminal offence in the first place.

The question arising is whether the courts have any choice but to apply a literal interpretation of this defence. Under the rules of statutory interpretation endorsed in the work of Francis Bennion, a purposive interpretation is possible even where the enactment is only capable of one meaning. This is especially the case where a literal interpretation creates an absurdity that could not have been intended by Parliament. However, the factors supporting a purposive construction must be especially powerful if they are to justify a departure from a clear and unambiguous literal meaning.

Defeating the Purpose of the Act

The clear purpose of the 2013 Act was to improve the effectiveness of the cartel offence, as reflected in the Government’s consultation on reform and all other supporting material. Far from furthering this objective, the present defence makes prosecutions even less likely. This is because it excuses all cartel arrangements where legal advice was previously sought, even those entered into dishonestly, where the individuals deliberately ignore the legal advice and go to great lengths to hide the arrangement from customers and the competition authority. Ironically, the increasing proliferation of competition law compliance training actually makes it more likely that would-be cartelists are aware of the availability of this defence. To assume that individuals will always make an honest attempt to follow legal advice would be to grossly underestimate the secretive and devious nature of hard core cartel conduct. What is more, the guidance on the revised offence, published by the
Competition and Markets Authority, has indicated that the term ‘professional legal advisers’ must cover both external and in-house legal advisers, as well as those qualified in foreign jurisdictions.

The defence is also inconsistent with the other defences and carve outs which basically exclude arrangements made (or intended to be made) openly. We know from debates in the House of Lords that the defences were meant to separate ‘legitimate behaviour’ from behaviour that is ‘clandestine to a high degree’. Obtaining legal advice prior to the implementation of cartel arrangements cannot be construed as equivalent to entering into the arrangements openly. The advice sought will be subject to legal privilege and details will not therefore be disclosed to customers or the competition authority. This is significant because the original rationale for excluding arrangements made openly was that customers could then choose to contract elsewhere. Arrangements made openly could also attract administrative fines under the Competition Act 1998 and Article 101 TFEU and the possibility of actions for damages. The defence is not even consistent with the concerns raised by the CBI, which apparently led to the introduction of the defences. Behaviour that benefits from the third defence cannot be regarded as a “standard commercial transaction” or the “normal business activity” that the CBI sought to protect. Indeed, Parliament cannot have intended the obtaining of legal advice (even if in good faith) to be capable of being immediately followed by deliberate wrongdoing.

Manifest absurdity that runs counter to effective legal policy

The courts may further choose to justify departing from a literal meaning of the defence by drawing on considerations such as the public interest, the need for the law to be consistent and coherent, fairness and the assumption that Parliament intends to further the ends of justice. A defence of seeking legal advice risks making a mockery of the criminal justice system and would be inconceivable in relation to more conventional crimes such as burglary, assault or theft. The defence in fact amounts to a manifest absurdity, as it allows legal advice to absolve criminal liability, regardless of the defendant’s intentions or actions in the commissioning or implementing of the offence. An individual who has been advised their actions will be illegal but, nevertheless, goes on to engage in wrongdoing is arguably more deserving of punishment than an individual who engaged in those practices purely out of ignorance. Yet in the context of the cartel offence, the former category can enjoy an absolute defence where there was no intention to enter into the arrangements openly, while the latter category cannot.

A Purposive Construction of the Defence

What is missing from the defence is an extra sentence along the lines of "...and must have intended to take reasonable steps to comply with that advice". This would alleviate the concerns outlined above and it is argued the interpretative factors favouring such a purposive approach are strong enough to justify a challenge to the literal meaning of the enactment. However, the courts may nevertheless be reluctant to read such a substantial extra obligation into the defence. If this is the case, then there will be an urgent need for legislative change.

1: This article is based on a forthcoming article: A Stephan, ‘The UK Cartel Offence: A Purposive Interpretation?’ (2014) Crim. L. R. 877.
2: There was a second case (Marine Hoses), but the defendants had been arrested in the US and agreed to plead guilty under a plea bargain.
7: Memorandum submitted by CBI on Enterprise and Regulatory Reform Bill to the Public Bill Committee, June 2012.
8: It is also notable that the defence is at odds with the ECJ ruling in Schenker (C-681/11) [2013] Bus. L.R. 1176, where it was held that ‘legal advice... cannot form the basis of a legitimate expectation on the part of an undertaking that its conduct does not infringe Article 101 TFEU nor will not give rise to the imposition of a fine’. 

This allows cartelists to escape criminal liability... even where the defendant made efforts to hide the arrangement...
We made these agencies independent – and didn’t they do well?

Chris Hanretty and Christel Koop
Reader in Politics, CCP/UEA and Lecturer in Political Economy, Kings College London

A large body of literature has investigated the determinants of the independence of regulatory agencies. Few have investigated the effects of independence. A new working paper finds it has the expected positive impact.

Independence independent independence, independently independent independence, independence.

This is a not completely unfair summary of much of the political science, economics, and public administration literature on regulatory agencies, including competition authorities. Independence has been a tremendously fecund organising concept and has spawned a large literature on the meaning and measurement of independence, its relationship with other concepts (such as accountability), and its antecedents.

But this literature has sometimes seemed a bit solipsistic -- concerned only with the interrelationships of concepts.¹ That solipsism is particularly disappointing given that independence has often been sold as a way of liberating regulatory agencies from the kind of political control that might lead to suboptimal decisions (due, for example, to politicians behaving inconsistently between election periods and all other times). Few have examined the link between independence and better outcomes - outcomes that people might actually care about. Fewer still have examined the contribution made by independence as compared to other factors which might conceivably affect the quality of the work done by competition authorities - factors like staffing, resourcing, and broader issues of accountability and government capacity.

In a working paper, Christel Koop and I have tried to examine whether independence does in fact lead to better outcomes - or, at least, better perceived quality. Quality is a difficult concept to measure and, rather than create a new measure of quality out of whole cloth, we decided to borrow an existing non-academic measure. Since 2005, the Global Competition Review has been giving competition authorities around the world star ratings from one to five. (There are some ratings before 2005, but these sometimes rated agencies, and sometimes competition regimes. We’re only interested in the quality of agencies). These star ratings are compiled on the basis of summary statistics, and surveys and interviews with competition policy ‘users’ - everyone from academic economists to companies affected by competition policy - and are available for 36 agencies operating in 34 countries.

The top ratings are often won by the ‘usual suspects’ - the Bundeskartellamt, the Competition Commission (as was),
the Federal Trade Commission - but there’s interesting variation in the middle and the bottom. For instance, it’s unusual to see a country ranking which places Italy and Mexico ahead of Sweden and Denmark, as the GCR does in some years.

For each agency with a ranking, we also measured the agency’s degree of formal independence and accountability. For each agency, we look at several legislative provisions and produce a single overall score for these two concepts. For independence, we look at features like the tenure of agency heads, security of funding, and the possibility of legislative override. For accountability, we look at features like the obligation to report to the parliament (and to the executive), and whether items like annual activity reports must be filed. We only ever look at the legislative provision, rather than actual practice. We realise that practice can diverge from what’s written in the text of the law - but we’re interested in design, and it’s only legislative provisions that can be designed.

When we throw these variables (alongside other controls) into a regression predicting quality, we do find a statistically significant link between independence and perceived quality - but no statistically significant link between accountability and perceived quality.

But the effect is not huge. If we set all of the variables in our model to their mean, then the predicted (most probable) rating is 3 stars.

What then would it take to move to a rating of 3 1/2 or four stars? We estimate it would take:-

1. Quite a large change in independence, equal to the difference in independence between the US Federal Trade Commission and the former Competition Commission in the UK (which by our measure did not have an exceptionally high degree of formal independence)

2. A small change in staffing, or a change of slightly less than seven FTE staff members, equal to the difference between the Japanese Fair Trade Commission between 2009 and 2010, when it had precisely seven more staff members.

3. A small change in general government effectiveness, equal to the difference between Belgium and (slightly more effective) Great Britain.

The benefit from increased independence is quite slight compared to other determinants of quality: but it’s (usually) much cheaper to make a change to agency’s level of independence, and much easier than changing the general level of government effectiveness in a country.

1: I say this despite having written a detailed paper on how exactly formal independence should be measured: Hanretty and Koop, 2012.


Competition in the UK postal sector: Universal service on the rocks?

Antje Kreutzmann-Gallasch, PhD Student in Law

In September, the Business, Innovation and Skills (BIS) Select Committee launched an inquiry into competition and universal service in the postal sector. This inquiry is a renewed attempt to discuss long-standing issues concerning the feasibility of universal postal service and to find solutions in order to safeguard this vital service in the future. In addition to considering a compensation fund for the Royal Mail, should we actually consider the scope of universal service as well?

Since the full opening of the UK postal market to competition in 2006, new entrants have been able to enter the market. One particular concern was that new entrants only target the most profitable consumers (consumers in urban areas), while access to the service for those living in less populated areas would no longer be guaranteed. To avoid social exclusion and to achieve a good quality of basic postal services, the obligation to provide universal service to all users at affordable prices was normally imposed on the incumbent, without it being compensated.1

In the UK, Royal Mail (RM) is the designated single universal service provider (USP) until 2021. While Royal Mail is fully responsible for the provision of Universal Service Obligations (USOs), no obligations have been placed on new entrants. In the UK, as well as in other EU Member States, this has been regarded as the best solution, at least until new entrants have established their position in the market. Since establishing a nationwide delivery network is cost-intensive, new entrants have chosen selective entry and offer their services in profitable urban areas only.

Currently, only RM provides nationwide collection and delivery of letters six days a week. Alternative providers offer direct delivery only in profitable parts of the country and less frequently. Often their service is further restricted to certain groups of users such as ‘business to business’ customers. In areas where competitive providers do not wish to provide direct delivery, they choose downstream access.2 Seeking downstream access is more feasible for a firm than setting up its own nationwide delivery network.3 Hence, in many areas of the UK, the ‘final mile’ delivery is still a natural monopoly in the technical sense, and the costs of the ‘final mile’ remain a large percentage of the RM’s total costs.

So far, no external funding mechanism has been established in the UK to reimburse RM whenever the net costs of the USO provision generate an unfair burden on it. In the past the lack of a compensation fund did not pose a major problem for the USP as USOs were usually cross-subsidised by other segments. However, when competition in the market increases, cross-subsidies will be eroded, which creates a challenging situation for the USP. Since demand in the letter market is also declining, it becomes even more difficult for RM to cover the costs of universal service. Less revenue from the mail market means more cross-subsidies are necessary to cover the increasing costs of USOs.

The current conditions may create a cherry-picking situation, placing the USP at a competitive disadvantage. For
that reason, RM submitted a report to Ofcom earlier this year arguing that competition in the direct delivery market poses a threat to the universal service provision. RM requested, firstly, a full review of direct delivery and, secondly, adjustments of the regulatory access policy to protect universal service. After the latest assessment of postal users’ needs in 2012, the regulator chose not to propose any changes to the scope of universal service and Ofcom announced it would not launch the next review before the end of 2015. In the meantime, the BIS Select Committee has launched an inquiry into competition and universal service in the postal sector with an emphasis on access, direct letter delivery and delivery of parcels.

Since demand in the letter market is also declining, it becomes even more difficult for RM to cover the costs of universal service.

The call for a revision of the universal postal service is not new. Since the first Hooper Report was published in 2008, the contestability of USOs has been under discussion. This Report acknowledged that the universal postal service was under threat mainly because of the declining letter market. Two years later, the Report was updated by Hooper and he came to the conclusion that the situation had worsened. Both reports found that RM would have to increase its efficiency and called for a change of the regulatory framework.

The 2008 Report, the updated version concluded that the creation of a compensation fund should not be excluded per se.

Neither of these consultations touched upon the scope of universal service. There are reasons for this. The concept of universal service is not just a competition problem but affects important social policy considerations – narrowing the scope of universal service may increase the risk of social exclusion. Even though the letter market has declined, users still value and appreciate a six days a week delivery/collection and the uniform pricing system. Nonetheless, the experience of the last few years has demonstrated that, without a major reform, USOs will become financially unviable and the sustainability of universal service cannot be guaranteed in the long run.

Whether imposing USOs on more than one operator is the right way forward to protect universal service is debatable. In many areas, direct delivery will remain a natural monopoly in the technical sense. A legal requirement that more than one firm has to provide USOs may create a barrier to entry, and consequently have an adverse effect on competition. As Hooper found, the establishment of a compensation scheme and an appropriate access price scheme are ideas that will have to be given serious consideration, at the very least. The compensation fund may only be a temporary solution to protect universal service until RM has increased its efficiency further and is in a position to compete with additional providers without external subsidies.

These reforms will most likely not be enough. The reduction of universal service appears to be a further necessary step owing to the growing e-substitution of letters. Thus it might be necessary to reduce the scope of direct delivery of mail from six to five days. This would be in line with the existing legal framework. The UK postal legislation exceeds the five days a week requirement set out in the European Postal Directive (Article 3(3) of Directive 2008/6/EC). In the long term, it may even be necessary to move from uniform pricing to a cost-reflective pricing approach. Again, this would be in line with the European Postal Directive as long as prices remain affordable.

It remains to be seen which actions the Select Committee will recommend in order to protect universal postal services.

This article is based on a CCP Consultation response on competition in the UK postal sector by Harker M, Hviid M, Kreutzmann-Gallasch A and Waddams C <http://competitionpolicy.ac.uk/documents/107435/7614683/ CCP+Response+-+BIS+-+Competition+for+UK+Postal+Sector. pdf/c0441d33-1551-467c-b4e7-ed314a1a0605>

2: Downstream access describes the process whereby alternative firms hand over their collected mail to RM at an inward mail centre for direct delivery.
3: RM increased its access prices at the beginning of the year. Following a complaint by TNT Post, Ofcom is currently investigating the new access price regime. Ofcom, Case CW/01122/01/14 <http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01122/> accessed 28 October 2014.
8: ibid (para 38).
10: For a discussion see Booth L & Hough D, ‘TNT Post and Royal Mail: end-to-end competition in postal service’ (Note, SN/EPT06935).
11: For more information see Harker M, Hviid M, Kreutzmann-Gallasch A & Waddams C (Consultation Response, 2014).
Is there or has there ever been a 40% market share threshold for merger control in Brussels?

Bruce Lyons, Professor of Economics

It used to be said that the key to avoiding intervention by Brussels in a European merger was to persuade the authorities of a market definition that leaves the merged firm with a combined market share of less than 40%. If such a rule ever existed, it would imply little regulatory attention was being placed on the economic effects of a merger. However, recent CCP research reveals a much more nuanced approach to the use of market share in the Commission’s merger analysis.

It used to be said that the key to avoiding intervention by Brussels in a European merger was to persuade the authorities of a market definition that leaves the merged firm with a combined market share of less than 40%. If such a rule ever existed, it would imply little regulatory attention was being placed on the economic effects of a merger.\(^1\) Modes of competition differ considerably across industries and markets. No formulaic market share rule could be efficient across markets where firms are producing a bulk commodity in capacity constrained facilities, or differentiated consumer products, or auction markets.

It is very likely that the Commissioner, Chief Competition Economist and others at DG Competition would deny this formulaic characterisation of merger interventions. They would point to the considerable amount of careful work they undertake in understanding the industry and its modes of competition, in developing appropriate theories of harm and testing them against the available evidence. They might invite you to look at their published decisions for confirmation that they focus on the expected effects of a merger and not simply on market shares.

We did not receive such an explicit invitation but, nevertheless, this is what Luke Garrod and I have done in a paper forthcoming in the Journal of Industrial Economics.\(^2\)

The main focus of our paper is on the early settlement of mergers (i.e. remedies agreed in Phase I) as compared with referral to Phase II. However, we needed to model the determinants of intervention (in either Phase I or Phase II) as part of an econometric methodology designed to control for potential statistical bias. This brief article draws on only that subsidiary part of our paper.

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\(^1\) We define an ‘intervention’ as a Phase I decision that either requires remedy (typically divestiture) before being allowed to proceed, or a referral to an in-depth Phase II investigation. There were 167 such interventions decided by the Commission between 1999-2006. We collected data from all of these and added a 10% sample of all Phase I clearance decisions (206 such mergers) so we could understand the difference between intervention and non-intervention decisions.

Many of these mergers affected a large number of markets in both geographic and product dimensions, so we focused on the largest combined market share in each merger (‘maxshare’).\(^3\) We also collected a large amount of other data...
from each merger decision, including on the theories of harm that were seriously considered by DG Comp – for example, nearly every merger considers unilateral effects, but some also consider coordinated, vertical or conglomerate effects.

So, what did we find? Figure 1 plots the predicted probability of DG Comp intervening in a merger against the largest combined market share of a merger. First, focus on the black dots. Each dot represents a merger in which the Commission considered only the unilateral effects of a merger (i.e. additional independent market power). The dots show that an increase in the maximum combined market share has little effect on the probability of intervention when maxshare is less than 40%, but the probability of intervention rises substantially for marginal increases in maxshare between 40% and 60%. The probability of intervention is close to one when maxshare exceeds 70%, so higher values have little additional effect. The point of inflection (i.e. the point of greatest sensitivity to maxshare) is at 47% and it is at approximately this level that the probability of intervention is 0.5.4

Next, consider the crosses. These illustrate the extent to which alternative theories of harm increase the probability of intervention. The vertical dispersion between the dots and the crosses is particularly large for maxshare between 35% and 45%. In this range, mergers with only unilateral effects are cleared more likely than not, whereas an intervention is more likely if additional theories of harm are assessed.

In 2013-2014, a year's worth of interventions, market share certainly mattered in these cases, but there is no simple threshold. Where unilateral effects were the only concern, there was no evidence of a 40% market share threshold, but we do identify a substantial difference above and below 45%-50% market share. The simple market share ‘rule’ is an even less reliable predictor of intervention decisions in the presence of alternative theories of harm for consideration.

These results do not draw on more recent data. The period covers the millennium ‘dotcom’ merger boom (and bust), and most of the boom leading into the financial crisis. It also covers the period in which the Commission was heavily criticised by the European Court, and the subsequent period in which the revised Merger Regulation was adopted and Commissioner Monti introduced some major internal reforms. The full effect of these reforms, including the new organisation of merger control in DG Comp and the introduction of a Chief Economist with a highly qualified economics team, was only felt from 2004 and may have taken a few years to bed down. Is there any evidence that the role of market share has changed?

We have not had the time to fully update our work, but I have looked at all merger intervention cases both decided and published in the 16 months between July 2013 and October 2014. Because of delays in publishing decisions, this is roughly a year’s worth of interventions. After eliminating failing firm cases and a Phase II outright clearance, this left 13 decisions and I identified the largest combined market share in each case. The exact market share is confidential, so the following shares are midpoints in published ranges so always approximate and rounded.

This small sample is not directly comparable to the 373 mergers included in our earlier database, not least because it does not include a sample of non-interventions, so caution is required before drawing strong conclusions. Nevertheless, this glimpse into recent practice is suggestive. In over half of the cases (i.e. seven), maxshare was at least 75%; in three cases it was 60%-65%; in one case 55%; and the remaining two cases 40%-45%. The 55% share case found concerns about vertical effects, the 45% case found evidence of severe long run capacity constraints of rivals who could not therefore respond to any output restriction by the merged firm, and the 40% case revealed serious concerns about coordinated effects (tacit collusion). Overall, we can conclude that DG Comp practice has now progressed far from using any market share threshold, let alone a 40% rule.

1: Steve Davies and I found something close to a 40% rule in some complex pharmaceuticals mergers around the millennium settled in Phase I (see Mergers and Merger Remedies in the EU: assessing the consequences for competition, 2007, Edward Elgar).
3: We also checked for incremental market share and the share of the largest rival, but do not report these results.
4: The vertical spread of the dots is mainly due to the caseload on DG Comp – it is less likely to clear a merger without requiring a divestiture if its resources are under greater pressure.
This year the CCP 10th Annual Conference focused on the topic of ‘Problem Markets’. Insights and debates were offered by the 25 speakers from the UK, EU and the US who ranged from academics to those in the public, private and third sectors. The conference attracted over 120 delegates belonging to the worlds of both academia and practice which gave us our best attendance to date and ensured a lively discussion throughout.

A problem market might be defined as one in which there are no issues clearly breaching standard antitrust law, but it is often clear they are not working well for the consumer. These markets can seem difficult for the regulators to handle because there is no obvious contravention of competition or antitrust law. However, although it is not clear if illegal activity is taking place, these markets often attract widespread attention and concern from the public, politicians, academics and the media, thereby putting pressure on competition agencies to act.

Through examining this key theme from a variety of multi-disciplinary perspectives, the conference identified potential factors that created these problems markets. These included economic factors, both on the demand and supply-side, as well as wider social and political factors. Discussion was also based around potential interventions which could help matters, and reflection was given on the legal framework and past case experience in the UK, EU and US, as well as on a number of specific problem sectors such as financial services, health, energy and air transport.

Full presentations can be downloaded here.
Digital technology has created new ways of marketing old products as well as creating completely new products from smart phones and tablet computers to apps and social networking. It has also resulted in many new firms, some of which have rapidly become global giants such as Google, Amazon and Facebook to name but a few.

Each of these developments raises fascinating and unresolved competition issues, for example e-book marketing. The challenge this represents for competition policy is recognised by the fact that the CMA has selected e-commerce as its first self-chosen market inquiry.

The CCP conference will present new research that helps to answer a wide range of relevant questions:

- As Internet platforms account for an increasing fraction of retail sales, providing intermediation between producers and consumers, what are the roles, market structures and competitive effects of these platforms?
- What possible abusive practices, such as imposing most favoured nation clauses, can platforms engage in?
- What are the implications for evidence gathering in competition cases?
- The internet and social media can enhance the consumers’ ability to share information and to become better informed. When does this raise competition concerns?
- Social websites may affect consumer search behaviour and efficiency. What does that imply about firm behaviour and the assessment of behavioural and structural remedies in competition cases?
- Websites collecting reviews of goods and services potentially enable better matches between these and a consumer’s preference, but poor matching and negative reviews could prove costly for firms. What effect does this have on firm and user behaviour?

More details will be circulated soon.
If you wish to keep up to date with news on the 2015 Annual Conference click here to join our mailing list.
Keep it simple, stupid? Tariffs in regulated industries

Catherine Waddams Price, Professor of Regulation

Regulators have recently become increasingly concerned about the number and structure of tariffs being offered by companies in their sector. Simplification of tariffs is an attractive policy response to complaints that companies are deliberately imposing complex tariffs to confuse consumers. Consumers play an important role in well-functioning markets - if consumers do not respond to better offers by taking advantage of them, there is little incentive for companies to make those offers, or for suppliers to try and retain consumers through counter-offers. The issues over simpler tariffs, in particular the tension between perceived fairness and the lowest costs and average prices for all consumers, highlights the underlying tension in markets which are seen as particularly important to consumers. The question then arises as to whether competition is the best process for such markets, or whether the importance of public confidence and preferences for equality suggest that regulation is a better approach. Ultimately, the decision must be political, but this is probably an area where mixed strategies are likely to result in the worst rather than the best of both worlds.

Regulators have recently become increasingly concerned about the number and structure of tariffs being offered by companies in their sector. The energy regulator, Ofgem, had imposed a limit of four tariffs per payment type on each company, and specified that this should take the form of a standing charge and a running rate under its Retail Market Review; the Office of the Rail Regulator has considered these issues as part of its own Retail Market Review; and the financial regulator has encouraged banks to streamline their accounts, leading to the withdrawal of high interest savings deals.

Consumers play an important role in well-functioning markets - if consumers do not respond to better offers by taking advantage of them, there is little incentive for companies to make those offers, or for suppliers to try and retain consumers through counter-offers. The Competition and Markets Authority has identified weak consumer response as a potential theory of harm in its current investigation into the energy market. How far do complex tariffs contribute to such weak response, and what are the likely effects of imposing simpler price structures?

The new understanding of consumers as ‘behavioural’ is one of the intuitions which lie behind the proposals. In the energy market, for example, analysis of consumer activity in the fifteen years since choice of supplier became available indicates that many households do not switch supplier (regularly, or at all), even though there are substantial gains available, around £350, or 30% of the bill, for those who have never switched supplier and are willing to change from ‘traditional’ payment methods. Some of this ‘inertia’ can be explained by preference for a particular supplier or payment method or high costs of searching and switching. But there is particular focus on the energy sector because of its rising cost and price (for environmental and security of supply reasons), and the affordability problems which face many low income households. Moreover, the fact that delivered energy is by definition the same whoever supplies it (since it is delivered through the same pipes and wires) highlights the money left ‘lying on the table’ by inactive consumers. In this sector, too, the suppliers have followed the longer established practice of banks in offering good temporary deals to those who will switch to them, and ‘defaulting’ consumers onto higher tariffs after the initial deal ends. Such a ‘bait and switch’ policy is a common marketing practice, and it is often difficult to identify
the ongoing cost of, for example, a new phone contract, since the headline price refers to the temporary introductory offer.

**Consumer demand**

On the demand side, the simplification of tariffs may reduce the barriers which consumers perceive, and encourage more activity, particularly among those who were previously reluctant to change because of tariff confusion. However, three factors may limit this increase. The first is that while consumers may say that complex tariffs deter them from switching, their removal will have little effect if there are other barriers such as inattention or lack of confidence. Ofgem’s own evidence indicates that few consumers volunteer complex tariffs as a factor preventing switching, and experimental evidence suggests that simplifying tariffs may have limited effect. The second reason is that, although prices may fall through fiercer competition, the ‘levelling’ of prices will mean that there are fewer good deals available, and so fewer gains available from switching. Since the activity of all groups, including the most active, is strongly affected by the gains to be made, consumer switching is likely to be deterred. It is interesting to note that switching rates fell from the time that potential gains fell in response to the non-discrimination clauses, except for the period of intense political exposure of the sector in Autumn 2013. Thirdly, it is not clear in the energy case that reducing the number of choices from around 500 to, say, 100 for each consumer (four tariffs over 25 suppliers) is going to increase activity significantly. If it is the number of possible tariffs which deter consumers, more competitors offering additional options would be seen as detrimental.

Surveys of consumer behaviour undertaken by CCP indicate that while consumers may say they are deterred by complex tariffs, their activity is far more likely to be curtailed by lengthier switching time than longer search time. Indeed there is little evidence that shortening search time through simpler tariffs would encourage more switching. However, this evidence is from a relatively active group who are able to provide estimates for potential gains and potential search time - those who are not able to do so might be more engaged by simplification. Nevertheless, it is important not to underestimate inherent switching barriers. Even among a particularly active group of well-informed consumers who opted into a major switching auction and invested a considerable amount of time in providing the necessary information, fewer than one third of those offered a positive saving accepted the offer, even though median savings were around 10% of the average bill and the switching process was extremely simple.

**Supplier response**

To respond to demand concerns, tariffs may be simplified without considering the likely supply response. If a range of tariffs is offered, which is then restricted, it is clearly unrealistic to expect the companies to retain only their least expensive tariff, given that this will sacrifice all the revenue they have previously collected from other consumers. To the question - “why can’t everyone have it this cheaply?” the response is that this may provide insufficient profits for sustaining the businesses and future investment; and that those who get it cheaply on a short term basis may pay more over a longer period. If concerns arise about the level of profits which companies are making, tariff restrictions are an inappropriate tool which carries potentially adverse consequences to address this issue – removing entry barriers so incumbents can be challenged directly by other companies offering cheaper tariffs is preferable.

Simple tariffs may themselves be a means to attract consumers, and some newer energy companies have made this their own marketing strategy, with some success. They are not keen to find that their own special offer is now mandated to be part of every tariff on the market.

Restricting the number of tariffs has a similar effect to the non-discrimination clauses, in the sense that it restricts the extent that the companies can separate consumers by charging them different prices (see Hviid and Waddams Price,
Fairness is a great concern to policy makers and commentators in markets for essential products. One relevant factor is the extent to which one consumer may gain in one time period, but lose in another. This depends partly on whether they continue to be active, and find another good deal when the temporary ‘bait’ rate expires. But even if they are not, and pay the higher rate for some time, the relevant net costs or gains are appropriately measured over several time periods, including that in which the lower rate was paid. There are many products and services consumed over time, classically capital equipment and later materials or servicing (for example, coffee machines and ‘pods’, photocopiers and servicing), where both theory and legal judgments have recognised the importance of evaluating the whole package, not merely any ‘overpayment’ of the ongoing element. Bait and switch offers could be presented as an introductory offer to overcome consumer switching costs, with the company recouping these legitimately in later higher payments. Of course, it is not acceptable for prices to be misleading or deceptive; such behaviour is illegal under consumer protection law, and these laws should be enforced if there is concern that they are being violated.

While the argument above suggests that those who have switched have at least received some benefits from their initial offer, those who have never switched are likely to be on higher tariffs than those who have been active. This is a natural consequence of incentivising people to change suppliers through lower offers – arguably, as suggested above, to overcome natural inertia and ‘switching costs’. Indeed, consumers are broadly ‘rational’ in the sense that, as a group, they are more likely to change suppliers when they expect higher gains from doing so. It is difficult to see how competitive markets could operate without this effect, and an alternative interpretation of fairness might be that those who make the effort to change supplier should reap more rewards.

Fairness concerns from different bills for different consumers (receiving essentially the same service) are particularly salient in industries which are seen as essential to life or social and economic participation. Those whose demand is least responsive to price changes may well be those who are already minimising their use of the product, or lower demand may have adverse health consequences. Regulators and policy makers are sensitive to these concerns (and may have specific social duties) and so find it difficult to tolerate the tariff differentiation which companies themselves may want to introduce.

In terms of winners and losers from tariff simplification, the ‘levelling’ of prices will mean that switchers are less well off than they previously were, while those who do not switch should see lower prices, depending on how fiercely companies compete with each other. To the extent that non switchers are predominantly groups who are deemed
vulnerable, this will benefit more of them than consumers on average. However, these are relative figures and it is worth noting that, though fewer in the vulnerable groups may have switched, within each group a majority may have done so. Thus, if the prices for switchers rise, as is likely, a majority of vulnerable consumers may pay more as a result.

There are several cases which illustrate the withdrawal of the best offers when companies are restricted in their pricing policy. In the energy sector itself, most of the largest companies have responded to the RMR constraints by maintaining a standard tariff which can be varied (with appropriate notice) as costs change, and two or three tariffs which maintain fixed prices over a pre-specified period of one to three years. As noted above, special high interest payments have been withdrawn in banking, which will reduce the potential gains and switching rates. One form of innovation, tailored tariffs for different preferences and needs, are an obvious direct casualty of such regulatory rulings. However, simpler tariffs may improve the quality of consumer decisions, which is also an important motivation for companies to offer better deals.

**Policy implications**

Simplification of tariffs is an attractive policy response to complaints that companies are deliberately imposing complex tariffs to confuse consumers, a so-called confusionopoly. In energy, this has a high profile antecedent in the promise of the Prime Minister in 2012 that “energy companies [will] have to give the lowest tariff to their customers”. Ironically, in energy the complex tariffs were a direct response to another regulatory intervention, the non-discrimination clauses, which forbade differentiation between regions in the standard tariffs, and so companies were allowed, indeed encouraged, by the regulator to offer special deals. In other markets, complex tariffs seem to have developed independently of regulatory intervention.

The issues over simpler tariffs, in particular the tension between perceived fairness and the lowest costs and average prices for all consumers, highlights the underlying tension in markets which are seen as particularly important to consumers, often with a history of state ownership and regulation, so that the competitive process is both the ‘new kid on the block’ but is also a change which can be blamed for any adverse changes. If the most important aspect of energy or telecoms prices or bank charges is that everyone should pay the same, even if this is at a higher level, then tariff constraints may be justified. However, the question then arises as to whether competition is the best process for such markets, or whether the importance of public confidence and preferences for equality suggests that regulation is a better approach.

If, however, efficiency, lower costs and innovation are the most important aspects of the market, competition should be allowed to operate with as few restrictions as possible, beyond those which are designed to enhance the competitive process itself (i.e. avoiding market power and its exploitation). Ultimately the decision must be political, and this is probably an area where mixed strategies are likely to result in the worst rather than the best of both worlds. Policy makers need to decide whether they want to pursue competitive strategies, which are distributionally ‘blind’ and will almost certainly result in some winners and some losers. In this case, the policy effort should be to make the market work as well as possible, by encouraging activities which limit market power, and ensuring that consumers have the means of making the best decisions for themselves, which may include use of intermediaries such as brokers or web comparison sites. Distributional objectives should be met using better instruments, such as the tax and benefit system. Restricting tariffs, while it may not have the adverse effects experienced through the non-discrimination clauses, will result in lower potential gains for active consumers, which may reduce competitive pressures in the industry. If, on the other hand, sectors such as energy and banking are expected to provide particular distributional outcomes, better focused regulation may be a more appropriate framework, despite its well-known costs and limitations.
The hidden perils of levelling the playing field in a competition

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Is levelling the playing field for the competitors good for the outcome of the competition itself? Recent research by CCP members shows that this might not always be the case. A close competition due to such levelling may result in destructive activities among the competitors who are desperate to win.

A main feature of competition policy is to level the playing field for the competitors with an objective of improving the competition. This goes within and beyond the standard competition policy related to markets. There are various other competitions, ubiquitous in day to day life, in which people make costly investments to win something. Examples include promotion tournaments, political races, rent-seeking, elections, sports, and also various market competitions such as advertising or patent races.

The potential participants of a competition do not necessarily have even abilities or resources. A sufficiently uneven competition, however, has several disadvantages. It may fail to give a level playing field to a historically disadvantaged or minority group. As a result, competitors from a minority group may decide not to participate in the competition. It can also fail to elicit significant efforts from weaker participants if they perceive their likelihood of winning to be too small. Knowing this, a stronger participant also has limited incentives to exert high effort, and the overall effort exerted in a sufficiently uneven competition is usually low.

A competition designer is usually concerned about both the ethical issue, as well as the level of effort the competitors exert in the competition. It would be natural, therefore, to conclude that a competition designer should aim to level the playing field, since it will provide some support to the disadvantaged competitors and also make the competitors exert more effort. Handicapping – where stronger participants are a priori weakened – is one such tool that is widely used in sports, promotional tournaments and other types of competitions.

Firms that use competitions as a motivational tool often handicap those of superior ability, or give head-starts to those with inferior ability. Similarly, expenditure in political campaigns is often capped – thereby handicapping the candidate with the richest connections. It is also common to observe handicapping of an outsider in a local procurement auction, or in internal promotional tournaments. One extreme policy used to handicap the most efficient players is to exclude them altogether.

All these designs are implemented essentially to ‘level the playing field’ for all the participants, to rescale the likelihood of winning for all the participants, and to incentivise participants to exert higher levels of effort in the competition. In sports this is known as ‘competitive balance’ and is an important component when designing sports tournaments. Providing support to weaker or local firms to facilitate more market competition is also often observed.

Implementation of such policies, however, is not without danger. Competitors often exert effort to not only improve their own performance, but also to damage the performance of their rivals. Competitions between participants of comparable ability may see more effort diverted to destruction, rather than production. In a political race or market advertisement this may take the form of negative smear campaigning, rather than a positive focus on the issues or the product. In markets, this may mean negative advertising or even introducing ways to increase rivals’ costs. On a football pitch, this may mean using fouls to stop rival teams scoring.

This is an important but unexplored issue. It is not possible to collect data from firms or other parts of markets regarding the constructive or destructive effort as a result of levelling the playing field. We therefore employ data from a sport that has a structure similar to the issue concerned. To find the effects, we analyse a sports environment in which both levelling the playing field and destructive effort exists.

We examine 19,635 horse races run in the U.K. in 2011 and 2012. Of these, 11,766 (59.9%) are handicap races. In handicap races, horses within a range of abilities are permitted to take part, but superior horses are given heavier weights so that all horses have a similar probability of winning. The BHA (British Horseracing Association) Guide to Handicapping states that: “A handicap is a race for which horses are allotted weight, based on their ability on the racecourse, to try to equalize their chances of winning... The Handicapper hopes to make the race exciting and competitive for the owners and racegoers”.

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There is also a second ingredient to our data. The BHA investigates ‘interference’ between horses during each race. Interference can include one horse knocking into another horse, a horse forcing another off its racing line, and even cases of a jockey stealing another jockey’s whip during the race. While interfering with another horse, the jockey is exerting effort to reduce the likelihood of the victim winning. In 2011 and 2012 alone, there were 1,099 cases of actual (and not accidental) interference.

We find, first of all, that handicapping does its job in levelling the field: favourites (often, the best horses) are less likely to win handicap races than they are to win non-handicap races. Reflecting the uncertainty created by handicapping, overall the favourite wins 31.5% of all the races. But they win as many as 41.43% of the non-handicap races, whereas only 27.5% of the handicap races. This is summarised in Figure 1.

Second, and the key result, participants in handicap races are substantially more likely to commit interference than those competing in non-handicap races. In 2011 and 2012 there were 1,099 cases of interference, of which 787 occurred in handicap races and only 312 occurred in non-handicap races. In terms of proportion, 4.0% of non-handicap races observed destructive interference, but this rises to 6.7% for handicap races (see Figure 2). In other words, levelling off the playing field helps the weaker competitors but it also appears to increase the likelihood of destruction in competition environments. Further rigorous statistical tests support this result.

Finally, we investigate the reason for which this phenomenon is observed. It is one thing to establish that levelled competitions are more susceptible to destructive effort, but whether this practice actually works in the interferer’s favour is still not clear. We find that there are strong incentives for jockeys to employ destructive strategies because it helps the interferer to improve his/her final rank and to win the race. Interference gains the saboteur 1.43 places, on average, relative to the betting market’s pre-race expectations of their finishing position.

Combining these results, we conclude that, if not taken care of, interference may partially offset the benefits in terms of positive effort inducement and equality that arise with tools such as handicapping.

So, whereas levelling the playing field has several positive aspects in a competition (such as providing better opportunities for the weaker competitor or increasing effort spent), our results show that, as a by-product, incidences of destructive effort may also increase. This happens since, with a levelled playing field, the competitors have similar likelihood of winning. Hence, they employ any possible measure to outdo others.

Our results are of particular interest in settings such as workplaces, political campaigns, advertising and sports, in which it is possible for players to interfere with rivals (competitions in which players cannot access their rivals – e.g. applications to colleges, innovation tournaments, etc. – will be safe from the implications of our results). We suggest that the designer should weigh different options, including surveillance and punishment, against destructive efforts before implementing measures of levelling the playing field.

The last six months have seen CCP organise a successful summer conference on “Problem Markets” and attract the highest number of delegates in the series’ ten year history. We have also hosted an exciting workshop for new researchers in the Competition, Law and Economics European Network (CLEEN), and introduced a well-attended course on competition economics for practitioners.

Centre members have been awarded new research grants, including a grant to study affordability, and we continue to work closely with other research centres, including the RCUK Centre for Copyright and New Business Models in the Creative Economy (CREATe), the Centre on Regulation in Europe (CERRE) and the new ESRC Business & Local Government Data Research Centre.

Over the next six months, CCP will be organising a workshop on the media under the CREATe umbrella, providing further bespoke knowledge exchange on competition policy aimed at practitioners and putting together the programme for the next annual summer conference, this time focusing on “Competition in the Digital Age” – more information can be found in this issue.

The Centre has seen a large turnover in research staff resulting from changes in our funding. We have said goodbye to our Research Coordinator Judith Mehta who has retired; and our Post-Doctoral Research Fellows Miguel Flores, Anna Bennato, Despoina Mantzari; our Research Associates Martin Graffenberger, Antony Karatzas, Minyan Zhu, Joo Young Jeon, Antje Kreutzmann-Gallasch and Francesca Vantaggiato. All have left to pursue their academic careers at UEA or elsewhere, of which further details can be found here. Many of them have retained CCP associate membership and we look forward to continuing to work with them.

We have since welcomed Dave Reader and Sofia Izquierdo Sanchez who have joined David Deller in our team of Research Associates. Two of our affiliated PhD students have submitted their thesis, Saeed Alkatheeri and Frederick Wandschneider, while Elliott Boardman, Ioannis Pappous, Wejie Yan, Shaun Bradshaw, Natalia Borzino, Mengjie Wang and Natalya Mosunova have started their studies, ensuring that CCP continues to support the next generation of researchers.

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