Research Bulletin
Multi-disciplinary Insights in Competition and Regulation

News Corporation and Sky: is this a Berlusconi moment?

Also in this issue:
Dominant buyers, media coverage of cartels and the OFT/Competition Commission merger
Two key arguments underpin Ofcom’s original recommendation that this acquisition should be referred to the Competition Commission. The first is that the shift from 39% to full ownership could materially change control of Sky. Some may be a little surprised by this given the earlier consideration of Sky/ITV which took 39% to be enough to bring News Corporation into the picture, but I set this aside. I focus instead on the second: that the associated change in cross media ownership could undermine the plurality of view in the news and current affairs market.

Within the market defined broadly by those who regularly use one or more sources for the news from TV, radio, newspapers and the internet, the BBC is the dominant player with a wholesale market share of 37%. ITN, Sky and News Corporation form a second group with a share of 10-12% each and the remaining newspapers constitute another group with notably smaller shares of 2-5% each. The proposed acquisition would, therefore, create a new player with a 22% share and reduce the numbers in that second group. Of course, one can look at the news market in a variety of ways (as Ofcom did), but they all reveal a similar change and this is why Ofcom was concerned.

Was it right in this concern? There is no well accepted plurality threshold for making a judgement. The FCC attempted in 2003 to codify a pluralism threshold in media mergers through reference to the competition one of 1800 in the HHI (i.e. anything above this and the alarms ring).
There is some sense to this in the US, even though their courts thought otherwise, because their broadcasters, like their newspapers, are lightly regulated and plausibly belong to same market. The difficulty in the UK is that broadcasters and newspapers are regulated differently in ways that complicate any such simple measure of plurality. Broadcasters have to respect the variety of views in what they produce whereas newspapers do not (and are often associated with particular viewpoints). As a result, pluralism arises both from the range of views expressed by newspapers and from each broadcaster’s requirement to generate pluralism internally. The tricky issue is how to measure pluralism overall for cross media mergers when it comes from these two forms.

A first thought is that so long as the regulation of broadcasting remains robust, such a merger will not obviously affect the extent of diversity because broadcasters do not have scope to behave differently when they team up with an opinionated newspaper. The practical worry, then, is that regulation isn’t always robust in this sense and/or that it may become less robust precisely because a cross media merger creates a politically powerful media group. The political economy of temptation may prove too strong, so to speak, if Rupert Murdoch can offer not just the support of his newspapers but also his broadcasters and this is perhaps why some have seized on this acquisition as a Berlusconi moment for the UK media. Ofcom does not spell this out but it is also not persuaded by the argument (put to it by Sky among others) that broadcasting is reliably different.

This is, perhaps, not so surprising given the evident pressure to relax these public service broadcasting restrictions. His argument echoed James Murdoch: ‘Why shouldn’t the public be able to see and hear, as well as read, a range of opinionated journalism and then make up their own mind what they think about it?’

The short answer to this question is that there is a lot of evidence that external pluralism is a poor substitute for the internal variety which comes from these broadcasting impartiality requirements. Nevertheless, if the requirements were to be relaxed such that, possibly save for the BBC, the news came from opinionated broadcasters, newspapers and websites, then the kind of exercise attempted by the FCC for the US would begin to make sense for the UK. Perhaps, then, it is no coincidence that the current HHI in the wholesale news market (using the figures above) is around the threshold figure of 1800 and if the acquisition went ahead, it would rise above 2000. If plurality can be modelled on the same basis as competition, then that is well into the region where alarm bells ring.

If Sky News is floated off as a separate company with a News Corporation stake of 39% (and the acquisition goes ahead), then in a formal sense the status quo in relation to news and current affairs is maintained. That does not mean, however, the Berlusconi moment has passed. The issue to watch is what happens to plurality requirements placed on broadcasters. If they are relaxed or disappear, then what stands between the alarm bells ringing or not, in the sense above, is whether News Corporation actually needs more than its current 39% stake for effective editorial control of Sky News.
According to a recent OFT publication, the public sector spends around £220 billion on the purchase of goods and services from the private and third sectors. Where this is the case, it is natural to want or expect these public sector buyers to use their buyer power to obtain the best deal around. Indeed, the government’s own adviser, Sir Philip Green made this clear in his Efficiency Review, reported on 11th October 2010: “Government must leverage its name, its credit rating and its buying power”. The Efficiency and Reform Group has been set up to improve the approach to procurement, allowing Government to use its scale to ensure it always gets the best value for money. This all appears uncontroversial.

Is it really always that simple? As often happens when an answer seems self-evident, unintended consequences may lurk just beneath the surface. In a number of cases the public sector, acting as an intermediary for consumers, is a dominant, but not the only, buyer of some input. One example of this is Local Authorities negotiating the price of care home places. Recent work with Professor Ruth Hancock [School of Medicine, Health Policy and Practice at UEA] on care homes provides an indication of what can go wrong and what the consequences might be.

Buyer Power and Care Homes
In the UK, over 400,000 people aged 65 and over receive long-term care in a care home; this is projected to more than double over the next 50 years. Local authorities purchase care home places on behalf of a large group of people based on a means test of their income and capital assets. People excluded by the means test are self-funding. Local Authorities, using their buyer power, may be
able to procure assisted places from these providers at a price below the market rate. Low prices paid to care homes could force other care homes out of the market, resulting in a shortfall in capacity; and care homes might have to charge higher fees to self-funders to subsidise publicly-funded residents.

Using a simple theoretical model, we show that if the local authority negotiates a price which is below average costs then, to break even and cover costs, the care home must charge all other users a higher price. The larger the discount negotiated by the local authority or the larger the number of places procured by the local authority, the higher the private sector price must be for the care home to stay in business. People who are no longer willing or able to afford a care home place in the private market, but remain ineligible for local authority support lose as a result. This is the ‘squeezed middle’ who can afford the market price (no price discrimination) but not the higher private rate that care homes charge when local authorities exercise their buyer power. Other self-funders have to pay an inflated price to keep the care homes financially viable so also lose.

Exercising their buyer power enables local authorities to spend less on care home places (and so more on other things) or buy more care home places. The cost of this is borne by self-funding care home residents. Whether they are the right group to pay for this is a policy decision which should be made in full recognition of the effects from using buyer power.

Broader perspectives
The logic extends beyond the care home example. If the public sector genuinely holds buyer power that can be exploited, it must be the case that there is little or no countervailing seller power. Put differently, the selling side must be fairly competitive, or at least fairly contestable. If that is so, any reduction in the price below the uniform “competitive” price would leave a shortfall in the funding of fixed costs and hence jeopardise the survival of some of the suppliers. Survival would require the sellers to find compensating income from elsewhere. Where the public sector purchases alongside other buyers, the latter group is an obvious target for any necessary cross subsidy. How important this distortion in the market is would have to be assessed on a case by case basis. While competition law would be able to respond to any abuse of the buyer power if the dominant buyer was a private firm, matters are more complex when it comes to the public sector in that role. The issue is whether or not the public buyer is an undertaking for the purpose of Article 101 and 102 TFEU or the English equivalent of CA98 Chapter I and II. From the ECJ decision in FENIN the answer is by no means obvious. From that decision, it is unlikely that the public sector will be found to be an undertaking if the procurement of goods or services is carried out in the fulfilment of a social function rather than for further processing or resale.

1 Commissioning and competition in the public sector, March 2011, OFT1314.
The Troubled Media Coverage of Cartel Enforcement

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Successful information dissemination is key to enhancing the deterrence and perceived legitimacy of cartel laws. Media coverage can play a powerful role in achieving this, but tends to focus on victims and harm. Cartel cases (like other forms of corporate misbehaviour) tend to be underreported or misreported because of the difficulty in identifying and communicating these focal points.

Media coverage of law enforcement has the power to educate and influence people's beliefs, values and reactions to a given behaviour. Reporting of cartel cases has the potential to expose the nature and effects of practices such as price fixing, helping to bridge the gap between how cartels are treated in law and how they are popularly perceived. If the imposition of high fines on firms and jail terms on individuals is to succeed in the long run in securing compliance, strong public support is of central importance. It lends legitimacy to these laws and strengthens government commitment to enforcement efforts, in terms of maintaining sufficient investigative resources and countering lobbying for soft enforcement. Media dissemination of the nature and effects of cartel practices can create a social stigma towards price fixing and encourage a culture of compliance within the business community.

Even the criminalising of an activity neither ensures that activity is taken more seriously, nor that the existence of a criminal offence is communicated to the wider public or business community. The UK's cartel offence is one of over 3,000 new criminal offences introduced in the UK since 1997. The tendency for 'over-criminalisation' has come about because the threat of criminal sanction is used as a quick fix in curbing behaviour seen as harmful or undesirable. It is a way for government to be seen to be doing something about a problem. Many of the young criminal offences in the UK
concern seemingly trivial or obscure behaviour, raising the criticism that the criminal law has lost its bite.\(^3\) It may also raise the danger of a defendant genuinely having no idea (and no reasonable way of knowing) that their behaviour would constitute an offence – although this would be no defence in law. This makes the need to raise the profile of cartel cases all the more pressing, especially as we are principally concerned with securing compliance and desistance.

The main way in which media reports can enhance cartel enforcement is through the dissemination of information on the infringements themselves. Survey work in the UK construction industry was commissioned by the OFT before and after fines for bid rigging were imposed in 2009.\(^4\) Of the construction firms who had heard of the OFT decision four months later, 80% cited media reports as their main source of information. This appears to have significantly exceeded traditional industry channels such as trade associations. Indeed, only 18% were aware of recently adopted codes of conduct in relation to competition, even though 30% claimed to be members of trade bodies who recently adopted such codes.

Communicating the harm of cartels is particularly important and is considered by many to constitute a central underpinning of the decision to legitimately sanction or criminalise a given activity. The problem, as noted by Steven Box is that, ‘the public understands more easily what it means for an old lady to have £5 snatched from her purse than to grasp the financial significance of corporate crime’.\(^5\)

Alleged corporate criminals – such as Ian Norris or the NatWest Three – do not fit our preconceptions of what criminals look like (young, usually wearing a hoody?), not helped by the media being invited into the homes of the NatWest Three to interview them around their children. Consequently the reporting of such cases typically gets sidelined by a more populist issue or is turned on its head entirely. Thus the Ian Norris case became more about the long and unfair reach of US law enforcement, with the Confederation of British Industry supporting a protest march of company directors to parliament. In relation to the NatWest Three (not a competition law case), Levi notes how the press even made comparisons between the three defendants and gross miscarriages of justice such as the ‘Birmingham Six’ and ‘Guilford Four’.\(^6\) In other cases of white-collar crime the media coverage becomes obsessed with the defendant’s fall from grace, turning the reporting of wrongdoing into a form of celebrity scandal. Examples of this include the reporting of Nick Leason’s £830 million fraud at Bearings Bank and more recently Bernar Madoff’s US$65 billion fraud.

So what is the problem? Crucially the media focus on the victim and the harm when reporting illegal acts, both of which are difficult to identify in cases of price fixing. It is for this reason that the media are disproportionately preoccupied by crimes of a violent, sexual or interpersonal nature – especially incidents which are apparently random. Readers and viewers immediately understand the harm involved in such cases, and feel in immediate fear of it. The typical perpetrator here also fits their preconceptions of what a wrongdoer should look like, rather than the faceless corporation or the smartly dressed businessman who perhaps looks a little too much like a ‘normal’ person. In most cartel cases the harm is remote and dispersed. Price fixing of an upstream product can cause enormous harm to the economy as a whole – as the extra cost is passed down the chain of production – but is likely to be dispersed among a large number of final consumers, each of whom may have paid only a little extra for the given product. This means there is no critical mass of harm (compare with an individual victim who has been mugged). While competition authorities and academics have sought to estimate the harm caused by cartels, this exercise always involves a set of assumptions as to the counterfactual; how prices would have behaved had a cartel not formed. Even if we were to reliably estimate cartel harm, the smoke-filled room provides journalists with a poor alternative to the sex, violence and graphic imagery of conventional crime reporting.

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Even where a cartel case is effectively reported, the objectionable nature of cartel practices can be lost in media coverage, where this is inconsistent with the statements and behaviour of politicians. When supermarkets and dairy firms were investigated by the OFT for price-fixing in 2003, the firms pointed out that they were responding to pressure from parts of the UK government to raise the price of milk and other products, in order to help farmers. The reporting of cartels as objectionable acts is also at odds with other policy areas such as trade. For example, ‘export cartels’ are generally tolerated, as are collusive agreements between governments; most notably the oil cartel, OPEC. For some, these contradictions reinforce a view that practices such as price fixing are simply part of the system; an inevitable consequence of a free market in which the pursuit of higher profits is central to everything.

All this leaves competition authorities with the unenviable task of maintaining an effective level of enforcement, while at the same time having to promote their activities through mainstream media channels. Lessons from the US (where cartel enforcement only really took off in the late 1980s) suggest that media coverage can be maximised through careful case selection; at first targeting cartels directly affecting final consumers and those involving bid-rigging in public procurement. Early cases which particularly struck a chord with the US media included the bid-rigging of contracts to supply milk to schoolchildren and equipment to the military.

4 OFT, Evaluation of the Impact of the OFT’s Investigation into Bid Rigging in the Construction Industry: A Report by Europe Economics (OFT 1240, June 2010).
The Proposed Merger of the OFT and Competition Commission*

Stephen Davies, Professor of Economics and Bruce Lyons, Professor of Economics

The government has just released a consultation document on the UK competition regime. This includes a proposal to merge the OFT and the Competition Commission into a single Competition and Markets Authority. Is this a good idea? We approach this question in the same way as such an authority would appraise a commercial merger. We argue that cost savings are trivial relative to any change in the quality of decision making. However, the OFT and CC have very different decision making structures that cannot simply be welded together. Success or failure of a single CMA will depend crucially on coherent institutional design and, in particular, on how decisions are made.

The ‘industry’ in which the firms/agencies operate
The OFT acts as a first phase review body for mergers and market investigations. If it finds a potential competition problem, it refers the merger (or market) to the CC for a detailed investigation. The CC has stronger powers to order remedies or to prohibit an anticompetitive merger. The OFT also investigates and prosecutes antitrust violations (i.e. cartels, anticompetitive agreements or abuse of a dominant position), and has a consumer protection role. The CC undertakes regulatory appeals. This division of responsibilities for each institution has evolved gradually since the Monopolies Commission was established in 1948.

Other countries have different institutions to perform similar tasks. For example, DG Competition in Brussels undertakes the entire merger review process as well as antitrust. In the USA, there are two agencies (Federal Trade Commission and Department Of Justice) but each does complete merger reviews and antitrust – cases are distributed roughly along industry lines. Other countries have other idiosyncrasies so there would seem to be an opportunity for comparative analysis to identify the best institutional design. However, it turns out that most peer reviews place the UK alongside the EC and USA as world-leading competition authorities. We believe it would be unwise to conclude that institutions do not matter.

Criteria by which to judge the proposed merger
The standard by which commercial mergers are judged is whether they substantially lessen competition. A modest lessening of competition may be balanced by efficiency gains as long as consumers do not lose out. In the current case, we need to adapt these criteria. The first priority is:
• Would the merger likely result in a less competitive economy with adverse effects on consumers? And if the answer is too close to call, we can bring in the efficiency defence:
• Would the business community receive a better service?
• Would there be cost savings to the taxpayer?

This ranking of criteria may require some justification. Annual consumer benefits attributable to competition policy in mergers, markets and antitrust are estimated at £739m. Furthermore, deterrence effects have been estimated to be at least five times as great. These benefits have to be set against combined annual costs of the OFT and CC of just £73m. Unfortunately, there is no reliable measure of business compliance costs, but it would clearly be unwise to risk even a small proportion of these benefits without huge cost savings.

Effects of the proposed merger
Cost savings on behalf of the taxpayer are easily dealt with. Potential cost savings include: rationalisation of back-of-office costs; single premises; and more effective use of staff with fluctuating work-loads. The consultation is backed by an analysis of such savings. Allowing for transition costs, the expected saving averages £1.3m pa, or a tiny 0.18% of the measured policy benefits even excluding deterrence! Clearly the merger must be judged by its likely impact on good case choice and decisions that promote competition and do not chill innovation.

1. Coordination. There are less often anticompetitive effects and more often efficiencies in a vertical merger than there are in one that is horizontal. The OFT/CC merger is essentially vertical as the first phase cases flow from the OFT to the CC for deeper investigation. This has been the position since the OFT was established 38 years ago. The CC has no powers to initiate any investigation – every merger or market inquiry must come through the OFT (or a sector regulator). Also, the CC can impose remedies but the OFT often has to monitor them. It is, perhaps, disappointing that coordination is not seamless after all these years, but it is not and there remains room for improvement. One example is that case flow is not as smooth as it might be and this compromises resource utilisation.

2. Externalities on other institutions. The OFT and CC currently each have a range of roles beyond mergers and markets. For example, the OFT is the body responsible for antitrust. Sector regulators can concurrently apply some of these provisions to their own sectors (though they rarely do). The OFT also has an important responsibility for consumer protection, which will probably be merged with other bodies responsible for representing consumers. The CC can receive market references from sector regulators and hears regulatory appeals.

The Competition Appeals Tribunal has very different roles in relation to the OFT compared to its relationship with the CC. The system is very complex and might benefit from rationalisation, but an OFT/CC merger would be only part of the jigsaw. It will have profound (and not always obvious) implications for many other institutions.

3. Decision making. This is arguably the biggest issue of all. The OFT has a model of decision making that was apparently based on the European Commission (DG Comp). Case teams investigate and this is followed by an executive decision. The identity of the decision maker has been opaque, at
least until the last couple of months when the OFT has begun naming an individual executive for each case. In contrast, the CC arose out of the Royal Commission model of decision making. This has a panel of named, part-time, non-executive experts brought together to advise the staff case team from the start and then to decide each case. In terms of corporate culture, the style of decision making could hardly be more different. We also know that many commercial mergers fail because it is impossible to weld two incompatible cultures together. Success in commercial mergers often depends on either wholesale adoption of the better approach or the careful design, bottom to top, of a rational decision making structure that is seen as such by all parties. The CMA requires the latter.

Provisional findings
The UK already has a first class competition regime, albeit with room for improvement. The creation of a single CMA has the potential to enhance quality if it is well designed. There could be a smoother flow of cases, shared expertise and a more coordinated treatment of remedies. The system could also be faster and less complex for firms. On the other hand, there would be few potential cost savings, externalities on other institutions, and possibly a loss of competition between agencies vying to be the best.

Most importantly, the decision making structure of the proposed CMA must be right. This applies to antitrust as well as mergers and markets, and it needs to be appropriate to whether decisions are final determinations or referrals for further investigation. We could only recommend clearance (or prohibition) of the merger once the proposed decision making structure has been agreed. In this short article, we do not have the space to argue our own recommendations but we can conclude that the proposed merger is referred to phase 2 for serious scrutiny.

* Stephen Davies has been academic adviser to OFT since 2001. Bruce Lyons was a reporting Member of CC 2002-11. Both write as independent academics and their views should not be attributed to the OFT or CC.
Director's Letter: News from CCP

Catherine Waddams

During the past six months, CCP highlights have included the annual conference of the Association of Competition Economics held in November at the John Innes Centre in Norwich and a mock merger analysis of the proposed merger of the UK Office of Fair Trading and Competition Commission at UEA's London offices. We are looking forward to welcoming a very interesting group of speakers to this year's annual conference tackling the topical issue of consumers, focusing on the importance of their own role in ensuring that markets work well – an area of increasing interest and action for policymakers. For more information, a list of confirmed speakers and details of how to book visit http://www.uea.ac.uk/ccp/events/annualconference2011

Assem Dandashly, who has a political science background, has joined the Centre as a research fellow. Oindrila De has returned to India, and was one of four students who successfully defended their PhDs in the last few months – Oindrila, Elizabeth Hooper and Kerry Gardner at UEA, and Peter Whelan, a lecturer in Law, at Cambridge. Two new lecturers have joined CCP – Chris Hanretty (Political Science) and Nicholas Vasilakos (Norwich Business School).

This is my last letter as Director. After ten years as Director of CCP (and its predecessor at UEA, the Centre for Competition and Regulation), this seems a good time to hand over to a successor. I will remain as a researcher in the Centre, focusing on my work on consumers and regulation. I am delighted that Morten Hviid, in whom I have every professional confidence, will take over the Directorship. Thank you to newsletter/research bulletin readers for their support over the past decade.

Recent CCP Working Papers

Non-discrimination clauses in the retail energy market
Morten Hviid and Catherine Waddams Price, CCP Working Paper 10-18

Assessing Competition Policy: Methodologies, Gaps and Agenda for Future Research
Stephen Davies and Peter Ormosi, CCP Working Paper 10-19

Three Private Firms and an Independent Regulator are Sufficient for Rapid Mobile Network Penetration
Yan Li and Bruce Lyons, CCP Working Paper 11-1

Avoidance Techniques: State Related Defences in International Antitrust Cases
Marek Martyniszyn, CCP Working Paper 11-2

Financing Renewable Energy through Household Adoption of Green Electricity Tariffs: A Diffusion Model of an Induced Environment Market
Ivan Diaz-Rainey and Dionisia Tzavara, CCP Working Paper 11-3

The Long-term Impact of Wind Power on Electricity Prices and Generating Capacity
Richard Green and Nicholas Vasilakos, CCP Working Paper 11-4

Early Settlements and Errors in Merger Control

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