



Department for Business Innovation and Skills Streamlining Regulatory and Competition Appeals: Consultation on Options for Reform.

Consultation response from the ESRC Centre for Competition Policy

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INTRODUCTION

We welcome a review of the current complex and confusing appeal system and applaud the aim of simplification and reduction of spurious cases. However, we are concerned that the consultation document fails to take sufficient account of the essential context of how decisions are made, by whom and with what evidence base in the first instance.

Appeals are fundamental to an effective system of regulation. They provide a vital safeguard against unfair or wrongful outcomes and allow the actions of regulators to be independently scrutinised and held to account. An effective appeals system is especially important in an administrative system of regulation, where the roles of investigator and arbiter in the first instance are assumed within the same organisation - albeit often by different sets of individuals. If firms are denied the adequate capacity to challenge spurious decisions, there is a danger that legitimate business activity may be stifled. An efficient system of appeals promotes confidence in the UK's regulatory and competition regime and helps firms understand how they will be treated in the future and the boundaries of lawful conduct. Indeed, alongside good decision making and streamlined procedures, certainty is one of the most important aspects of an effective competition and regulatory regime. It avoids unnecessary transaction costs in the form of regulatory action, enforcement and appeals.

Judicial Review and Full Merits appeals are better understood as two ends of a sliding scale, rather than as distinct systems. The central question posed by this consultation is whether the UK's system of regulatory and competition appeals should move away from Full Merits and closer to Judicial Review. The assumption is that Full Merits appeals provide a greater incentive for firms to challenge regulators and are more costly.

In this response we: (1) focus on the reasons why there may be a high volume of appeals; (2) discuss whether it is acceptable to move further away from Full Merits appeals; (3) consider the incentives of regulators and firms; (4) assess the extent to which the changes will reduce the number of cases, their length and cost.

Much of this discussion is general, but where appropriate each section of this response makes reference to the relevant questions set out in the consultation document.

UNCERTAINTY AS THE UNDERLYING CAUSE OF APPEALS

For the most part, the current rate of appeals does not appear to be due to bad decisions by regulators or the competition authority. Instead they are fuelled mainly by uncertainty and the complexities inherent in many regulatory decisions. In appeals relating to the Competition Act 1998, the uncertainty mainly relates to the way in which the competition authority calculates penalties and leniency (in

the context of cartels). The absence of a clear and predictable formula for calculating fines has made appeals almost routine in such cases, both within the UK and at the Community level. The discretion retained by competition authorities in calculating fines makes it inevitable that appeals will generally result in downward adjustments in fines. The *Construction Bid-Rigging* case illustrates just how receptive an appeals body can be to various arguments for downward adjustments. The CAT reduced penalties for six firms in this case by 90%.¹

In the context of merger control, the number and length of appeals (taking into account the high number of cases compared to antitrust and regulation), are relatively low. This is partly due to the difficulty of putting a merger on hold during an appeal. However, it is also a reflection of a comparatively high level of certainty, with clear guidelines and the consistent application of merger rules, allowing firms to predict reliably whether a proposed merger is likely to raise serious competition concerns. Where issues do arise, firms are often willing to accept undertakings during Phase I, avoiding costly and unnecessary further action.

The problem of uncertainty appears to be most pronounced in the context of regulated industries. As the government acknowledges (para 1.8), regulators are tasked with making sophisticated judgements, often about how markets should operate in the future. They are faced with complex economic evidence and often have to balance conflicting policy objectives. Consequently, asking a different set of people to make the same judgement, faced with exactly the same evidence, may very well result in a different outcome. This makes a system of Full Merits appeals problematic as it will inevitably amount to a second guessing of the regulator, rather than simply a safeguard against spurious decisions.

IS A SHIFT AWAY FROM FULL MERITS TOWARDS JUDICIAL REVIEW ACCEPTABLE? (Consultation Questions 1, 2 and 6).

As the government states, “There is a balance to be struck between enabling parties to have appropriate rights of appeal and ensuring that the system as a whole functions efficiently and enables the regulator or authority to take decisions in an efficient and timely way” (para 4.3).

Any shift towards judicial review will involve reducing parties’ ability to challenge the decisions of regulators and the competition authority. If appeals are high in number and regularly enjoy some success, this suggests that there are aspects of regulatory practice that do not stand up to scrutiny. The potential cost of shifting towards judicial review is therefore a firm’s reduced ability to challenge poor or unfair decisions.

This cost of the proposed changes is significantly higher in the context of ex post infringement decisions than in ex ante regulation or merger control. Apart from

¹ *Kier Group PLC and others v Office of Fair Trading* [2011] CAT 3

there being significant implications for the firm, including loss of reputation, the penalties associated with competition powers are criminal in character if not in name. This necessitates a higher level of scrutiny and the need to comply carefully with the European Convention of Human Rights. In cartel cases, the use of leniency and settlements already risks punishing firms for exercising the right to defend themselves. Furthermore, it is not yet known how decision making in the new CMA will be taken. Indications are that the independence of decision makers in antitrust will continue to be at a lower level than that for mergers and market inquiries. Moves to reduce the scope for appeals in the context of Competition Act 1998 cases are therefore hard to justify. The solution would be to ensure much stronger independence of first instance decision making in CA98 cases, but a move towards Judicial Review cannot be supported without this.

In the context of regulation, the question is more complicated. One may query the wisdom of exercising regulatory powers where two sets of experts may arrive at very different conclusions from the same set of evidence.

However, regulation is an economic and political necessity given the various economic, social and environmental objectives at stake. The complexities involved clearly make Full Merits appeals problematic as it is undesirable that regulated firms should have an incentive to have a ‘second shot’ at appeal. If we have confidence in the expertise and decision making practice of the regulators, then it is right that any appeals system should focus only on whether the regulator erred in how it reached its decision.

The general rule in public law is that a public body’s decision can only be challenged where it is unlawful, wrongly took factors into account, failed to take relevant factors into account, or the decision was totally unreasonable.² This can be extended through a flexible system of Judicial Review, to serve as a check on the economics reasoning applied in an individual case. The question would be: could a “reasonable” economist have come to the same conclusion? The appeals body would consider whether the regulator followed the correct procedure, carried out appropriate economic analysis and came to *reasonable* conclusions. This would necessitate the presence of economists (and possibly other relevant experts, such as accountants) on appeals bodies. Indeed, given the importance of economic evidence in competition cases, it is not appropriate that appeals decisions can currently be taken by the CAT without the requirement of an economist being a member of the panel.

There are two potential problems with a “reasonable” economist approach. The first is that judgements relating to reasonableness in law - the man on the Clapham omnibus - do not necessarily lend themselves to the more complicated judgments made in analysis of economic evidence. The second problem is that while we may be confident in the regulator’s expertise and decision making

² *Associated Provincial Picture Houses Ltd. v Wednesbury Corporation* [1948] 1 KB 223 (at 229)

practice under the current regime, any relaxation of the scrutiny brought by appeals could cause a drop in quality among regulators.

On balance we believe that the most appropriate position is a move towards a Judicial Review approach, i.e. an appeal would need to challenge a specified error in the regulator's approach, procedure, analysis or reasoning.

GETTING THE INCENTIVES RIGHT FOR REGULATORS AND FIRMS (Consultation Questions 30-35)

The UK system is much closer to a model of inquisitorial agencies in search of the truth than it is to a prosecutorial system where the agency might focus on just one side of the evidence and present that to the court in the first instance, leaving the defence case to the regulated firms. Judicial Review is consistent with an inquisitorial approach to regulation, even if it restricts a firm's ability to challenge the regulator's decision. A Full Merits appeal forces the regulator to act in a less inquisitorial and a more prosecutorial manner before the appeal court or tribunal. This undermines the undoubted attractions of the inquisitorial system. Having weighed the evidence impartially in the first instance, the agency may have balanced extremes of evidence against each other, but during a Full Merits appeal, the agency may be required to emphasise one extreme because the firms will focus on the extremes of evidence in their favour. The shadow of a potential defence at a Full Merits appeal may exacerbate the difficulty for the agency to 'start in the middle' with a balanced view at its initial decision making.

The design of an appeals system also shapes the behaviour of the firms. It is important that firms have the incentive to be as open as possible with all relevant information and not to hold anything back. Although the government states there is no evidence that firms have done this in the past (para 3.23), there is a potential danger that regulators' decisions are viewed as a 'dress rehearsal' for the final determination at a Full Merits appeal. Where firms have held back information, they will hold a distinct advantage over the regulator, who will have given everything away at its initial decision. The firms in essence have two shots at getting their desired outcome.

For the same reasons, the government's proposals to allow only new evidence where there is good reason (Chapter 6) should be supported. In an area that hinges on complicated economic analysis that may be open to alternative interpretations, the ability to bring new evidence creates an incentive to hold back information or provide ever more expert opinions. This could amount to constantly moving the goal posts, thereby undermining the efficiency of the whole regulatory framework.

A move to Judicial Review makes it important that firms have adequate opportunities to present their arguments to the regulator, have access to all relevant information and can effectively challenge the regulator's data and/or

analysis. This, along with the danger already outlined of weakening quality in decision making practice, may necessitate additional internal safeguards.

Even under a pure Judicial Review system, the government should be mindful of firms using appeals strategically. In the context of merger control, market inquiries and regulation, a strong incentive to appeal may be created by a desire to delay the implementation of the regulator's decision (e.g. a divestiture) in the expectation of favourable changes to market conditions in the interim period, or the imposition of a more onerous regulatory constraint.

The concerns outlined above could be alleviated by strengthening the independence of the decision making process within the regulators. The Competition Commission provides a good model for this. Phase II mergers and market inquiries are undertaken by the CC's members. They are appointed by BIS and serve on a rotating basis. They are selected and appointed for their experience, ability and diversity of skills in competition economics, law, finance and industry. They include practitioners, academics and members of the business community. It is key that these individuals be independent of the regulator's management structure. An alternative option is to send the analysis to an external group of regulatory consultants (or possibly a single individual) for a second opinion. This would serve a similar role to the opinion of an Advocate General in the context of EU law.

WILL THE PROPOSED CHANGES REDUCE THE NUMBER OF APPEALS, THEIR COST AND LENGTH? (Consultation Question 3)

As we have reservations about the proposed reforms in relation to Competition Act 1998 cases, we focus on regulatory appeals for the purposes of this section.

The proposed changes are likely to reduce the number of appeals, their cost and length, but at the expense of eroding firms' ability to challenge regulators' decisions. Narrowing the grounds upon which appeals can take place should reduce their number. A form of 'flexible' Judicial Review, which includes appeals on specified grounds, could ease the abovementioned cost, but if these special grounds capture the areas where appeals tend to succeed, then the changes may fail to significantly reduce the number of cases. In terms of cost and length, the government's figures suggest that Judicial Review averages 4 months, while Full Merits appeals average 11 months (para 3.15). However, the former has hidden costs. In particular, quashed decisions will generally be remitted back to the regulator to remake the decision in the light of the court's or tribunal's findings, potentially leaving a period of limbo and requiring further effort to produce a new decision.

As has already been mentioned, it is right that restrictions be placed on the ability of parties to bring new evidence at appeal. Firms claim this is simply because there are pieces of information that only appear important after the regulator has

delivered its decision. However, this excuse seems weak so long as the firms were given adequate opportunity to engage with the regulator and challenge its data and analysis in the first instance. Sanction against a failure to follow this good procedure is the core of Judicial Review. Ex post analysis of a regulator's decision will always cause firms to re-evaluate how they formulated their case. As previously mentioned, allowing new evidence at appeal risks constantly moving the goal posts for regulation.

The proposed changes to costs should also be supported. It is right that regulators' exposure to costs be limited to where their conduct is characterised as having been unfair or unreasonable. A system in which the parties pay their own costs is more consistent with an inquisitorial model where the regulator is doing its best to make the right decisions. Regulators currently face huge cost exposure, especially in multi-party cases. This increases the scope for regulators to become overly risk averse and may make regulatory capture more likely. In appeals against economic regulatory decisions, where the regulator's costs are passed on to consumers through the license fees, there may be cases where it is appropriate for all consumers, not only those of the appealing company, to bear the costs. In this case the regulator may prefer to incur these expenses and pass them on to all license holders.

Minimising the length of cases is unlikely to have a significant impact on the quality or consistency of appeal outcomes.

CONCLUSIONS & RECOMMENDATIONS

1. Any discussion of streamlining regulatory and competition appeals needs to be considered alongside the question of certainty surrounding the law and regulatory practice. Greater certainty and consistency will always be the most effective way of reducing the volume and cost of appeals. This is true regardless of whether the system of appeal is Judicial Review or Full Merits.
2. A shift towards Judicial Review with a view to reducing the number of appeals will come at the cost of reducing firms' ability to challenge spurious decision making by regulators. While this cost is probably too high in the context of ex post infringement decisions, it is more acceptable in the context of ex ante regulatory decisions. The complexity inherent in these makes them less appropriate for Full Merits appeals. However, eliminating the right to appeal non-infringement decisions altogether (Question 39) would be a step too far.
3. Judicial Review of ex ante decisions is also consistent with the inquisitorial approach to regulation. It is important that all relevant information be addressed in the first instance and that the behaviour of the regulator or the firm is not shaped by the shadow of a possible Full Merits appeal. However, it is essential that firms have adequate opportunities to challenge

the regulator's data and analysis in the first instance. One possible way of meeting concerns about the quality of regulatory decisions, is to bolster the independence of decision makers, for example by employing independent experts similar to those convened by the Competition Commission. An alternative may be to get a second (published) opinion from an external expert or group of experts.

4. The proposed changes to the admittance of new evidence and to costs should be supported. These will encourage firms to engage fully with the regulator and not hold back evidence at initial decision. They will also encourage the regulator to be less risk averse.