Restructuring Competition Policy

Response

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To speech by Peter Freeman, CBE, QC

On Restructuring competition Policy: What is the best institutional model?

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Thank you very much, Peter, for a very well presented and balanced consideration of the issues, both of competition policy and its objectives, and the detailed issues of the institutional model to deliver such outcomes. As a naval historian you have given us a fine overview of the Seven Seas of competition policy. The privilege of the respondent is to be selective about her areas, and I will select only three C's, in the alliterative sense – Compulsory notification (of mergers); Concurrency (of powers of competition authority(s) with sector regulators); and the role of Consumers.

First, Compulsory notification. Of the five mergers which I was involved in deciding (one with Peter as chair of the group), four had already been completed, and in one case the acquired company had virtually disappeared by the time we made our site visit early in the inquiry. Much information had been shared, and all but five employees out of thirty had left. It would have been extremely difficult to resurrect the remnants to become an active participant in the market. Luckily, the merger was cleared and so we didn't face that challenge. And my very first case only came to the Commission because the OFT didn't find out it had occurred until two months afterwards, and were not able to assure themselves that it was 'against the public interest' (this was before the Enterprise Act came into force). In their reference to the CC they said that "If more time had been available this merger [might] not be referred to the Competition Commission. However, the decision of the parties ***not to inform*** the OFT of completion of the transaction means that the … reference has had to be based on the evidence available." This turned out to be an extremely expensive omission for the company concerned and for the public purse.

Not only is the present system expensive, but mandatory notification may have benefits. My colleague, Bruce Lyons, has concluded from research across different régimes undertaken at Tilburg, that at the very least, there is no evidence that régimes with mandatory notification deter profitable mergers; indeed mandatory régimes may be associated with more successful acquisitions[1]. How could this be so? He argues convincingly that mandatory notification can encourage businesses to consider the reasons for their proposed merger and its likely consequences. If the

[1] See A Competition Régime for Growth: a consultation on options for reform, Response from CCP, by Bruce Lyons, Pinar Akman, Morten Hviid, Andreas Stephan and Catherine Waddams, 2011, http://competitionpolicy.ac.uk/c/document_library/get_file?uuid=b4aba809-b062-4a70-936c-8dfac7a0d0a4&groupId=36124

process can be made reasonably simple, mandatory notification may both yield benefits to business and save them and the authorities considerable expense in unnecessary inquiries and impossible reconstructions of acquired companies. Yes, as Peter says, it may sit uncomfortably with the present drive to eliminate red tape. But surely we want to retain (and indeed add) processes whose benefits exceed their costs, and dispose of the others. After all, the original red tape used to bind legal documents was introduced for the purpose of keeping relevant papers together. As long as the 'tape' is kept simple, it can perform an important positive function. Compulsory notification of mergers would offer benefits to all parties, and for the competition régime as a whole. It would ensure that mergers which might result in a substantial lessening of competition are considered by the authorities in a timely manner. I know it is not a popular call, but I urge its inclusion in the reforms.

So to my second C – Concurrency of powers with the sector regulators. In the third of these lecture series in 1993, Michael Beesley, himself a member of the Monopolies and Mergers Commission, spoke on Abuse of Monopoly Power and the relation between the competition authorities and the sector regulators. These regulators, he said, had three concerns: how to regulate natural monopoly; how to separate the natural monopoly elements from those open to competition; and how to enable competition to emerge against the interests of a usually dominant incumbent. It is the interaction between these three concerns which lies at the heart of the concurrency debate. The current régime was inspired by the political importance to the then newly elected Labour government of a competition régime that would suitably constrain any abuse of power by the recently privatised industries. But as Peter has reminded us in today's lecture, regulators have tended to use their powers themselves rather than refer matters to the more generalist competition authorities as originally intended (and as Michael Beesley recommended).

The other development since the current institutions were established, which has a direct bearing on this, is the accrual by sector regulators of a whole slew of non economic objectives, in particular environmental and social. Well designed taxes – sorry to use such a dirty word for an effective instrument too little used – can operate alongside well functioning markets. But it is very difficult to deliver social objectives through competitive markets – the competitive process does not target particular groups for whom the regulator has a statutory duty, for example. Ofgem expressed this clearly in introducing non discrimination clauses between regions. They "attached particular weight to …potential benefits for vulnerable consumers", given

their statutory duty "to have regard to the interests of"[2] such groups, even while they acknowledged concerns about the potentially detrimental effect of the clauses on competition[3]. Had the competition authorities been considering such a policy, they would have been concerned only with the competition effect. This was illustrated in the Rolling Stock Leasing market investigation (my last CC case – which incidentally ***removed*** non discrimination clauses from the ROSCOs' codes of practice). The Commission looked for a competitive rather than a regulatory solution, even though the Department for Transport had asked for a price cap to be imposed. The CC inquiry was focused, as statutorily required, on remedying, mitigating or preventing the Adverse Effect on Competition which had been identified. Similarly the CC report on the British Airports Authority noted: "Our concern therefore is solely with whether there are any features of the market that may adversely affect competition. It is not for us to form a view on other matters such as the significant environmental issues that arise from the operation and development of airports." (BAA final report p. 17)[4] In ROSCOs, since most of our suggestions were recommendations to the authorities, we could refer our findings back to them to consider in the wider context.

This highlights an inherent tension in the present system. If, for example, the energy market had been referred to the Competition Commission, as many, including the current Secretary of State have recommended, the CC would have focused on competition issues. But the regulator would have retained the 'non competition' duties in its regulatory tasks, so the monopoly part of the industry would remain an instrument for such non economic duties. Unlike the current situation, the competitive retail arm would not. In these circumstances, the question of who has primacy over the competition parts clearly depends on the Government's view of this issue – whether the whole industry should help to deliver such additional objectives, or only the monopoly parts. As we have observed, competitive markets are not generally good instruments for delivering social objectives, so an explicit removal of such obligations from these parts would seem sensible. As regulated sectors face increasing challenges, this question needs to be resolved in determining Concurrency and primacy of powers.

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[2] Addressing undue discrimination, Ofgem, 2009, p.2 http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Addressing%20Undue%20Discrimination.pdf

[3] See for example Non-discrimination clauses in the retail energy sector by Morten Hviid and Catherine Waddams Price, CCP working paper 10-18, http://www.uea.ac.uk/ccp/CCP_Working_Paper_10_18

[4] BAA Airports market investigation final report, 2009, Competition Commission.

And retail markets bring me on to my third C – Consumers, the end beneficiaries of these institutional questions. The OFT's strap line is 'making markets work well for consumers'; but there is increasing acceptance that we are not always unboundedly rational in our consumption decisions, and the active role of consumers is increasingly prominent under the influence of the government's Behavioral Insights team. In many of the CC's recent market investigations into final consumer markets, remedies are aimed at consumers' behaviour, even when the adverse effect on competition identified is on the supply rather than the demand side[5].

Another BIS consultation closed this week, on "empowering and protecting consumers", again with an institutional focus: "institutional changes for provision of consumer information, advice, education, advocacy and enforcement". This is largely concerned with the proposed transfer of OFT and Consumer Focus duties to voluntary organizations such as the Citizens Advice service. This seems to me a very dangerous move. We know that consumers make errors – our own research showed that a fifth of consumers switching energy provider to save money ended up on a more expensive tariff[6]. That might be one reason, Chris Huhne, why we are more reluctant to shop around for energy suppliers than for toasters. Of course as an academic, I would urge more research like ours at the Centre for Competition Policy, to understand better consumer activity (or more worryingly inactivity) and decision making. There is a real danger that empowering consumers becomes a byword for cutting support to protect them where necessary, and inform and support them where they can be active. Consumers are an essential part of the competitive process – if they are not active in seeking out good deals, then businesses will not bother to offer them, and incentives both for efficiency and rivalry are lost. So it is crucial that the competition authorities, whether one or two, retain a close watching brief on helping ***consumers*** to make markets work well and in examining the interaction with potential detriment arising from the supply side. Without this, markets won't work well, for consumers or for anyone else.

My 'C's have covered specific issues around Compulsory notification, Concurrency and Consumers, just three aspects from the excellent overview of the proposed

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[5] See Competition Remedies in Consumer Markets by Luke Garrod, Morten Hviid, Graham Loomes and Catherine Waddams Price, Loyola Consumer Law Review, 21, 4, 439-495, 2009

[6] Do Consumers Switch to the Best Supplier? by Chris M. Wilson and Catherine Waddams Price, Oxford Economic Papers, 62: 647-668, 2010

reforms which Peter provided. Overall I concur with him that while there are changes which would benefit what is already regarded as a world class system, institutional reform is neither necessary nor sufficient to achieve them.