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New Developments in UK and EU Competition Policy

Edited by
Roger Clarke and Eleanor J. Morgan

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Preface

In the last decade, competition policy has become increasingly prominent and active. This book focuses on the substantial changes in competition policy that have taken place in recent years both in the UK and in the EU. These include new legislation as well as other developments which have had a significant effect on institutional structures, substantive assessment and procedures. There has also been an important change in the responsibilities for specific aspects of competition policy between the EU and Member States, including the UK.

In the UK, major changes have been introduced in the 1998 Competition Act and the 2002 Enterprise Act which have led to substantial reform of almost all aspects of competition policy, replacing earlier legislation in this area, namely the 1973 Fair Trading Act and the 1976 Restrictive Trade Practices Act. Amongst the changes, two new prohibitions have been introduced, one covering dominant firms and the other covering agreements between firms; there has been a new appraisal test in merger policy to focus explicitly on a 'substantial lessening of competition'; a leniency programme has been introduced in cartel cases, while criminal penalties have also been introduced in the case of hard core cartels. At the same time, there have also been significant changes in the powers of various competition authorities with the Secretary of State being removed from active participation in most competition cases and an increase in the responsibilities of the Office of Fair Trading and the Competition Commission. Parallel powers have been given to the sector regulators to investigate, in particular, dominant firms. In total, these changes have introduced a radically reformed competition policy in the UK which is the focus, in part, of this book.

At the same time, important changes have taken place in competition policy at EU level. Of these, perhaps the most important has been the introduction of the new 'Modernization Regulation' which provides the first major reform of procedures in EU antitrust policy since the provisions implementing the original EC Treaty. Amongst other things, this Regulation introduces a new 'legal exception' regime in dealing with Article 81(3); provides for a greater role for national competition authorities in Article 81 and 82 cases and for greater coordination of policy within the EU. In addition, a new merger regulation and horizontal merger guidelines were introduced in 2004 which seek to widen and clarify EU policy on mergers; a new block exemption regulation concerning vertical restraints was adopted in 1999, and active consideration is now being

given to reforming policy in the areas of dominant firms and State aids. These developments are in themselves wide-ranging and are also the focus of this book.

In producing this book, our main aim has been to provide an account and assessment of the new policies that have been introduced in many of the key areas discussed above. To this end, each of the contributing authors was asked to discuss the changes that have taken place in the area covered by their chapter and to assess economic and other issues surrounding these developments. It is, of course, true that many of these developments are quite new and so there is limited evidence of their effectiveness at the present time. Nevertheless, it is clearly important to identify the main issues that are likely to arise from the changes, and also to consider possible further developments in these fields. In this way, it is hoped that the examination of developments in competition policy in the UK and EU provided here will be of value to specialists in this area, as well as to non-specialists, including teachers and students of Industrial Economics and Law interested in the new developments that have taken place in this increasingly important area of policy.

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Roger Clarke
Eleanor J. Morgan

May 2006

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1. Introduction

Roger Clarke and Eleanor J. Morgan

There have been considerable changes in competition policy over the last few years in both the UK and EU. The aim of this book is to examine the recent developments in this important and lively policy area. In the UK, the 1998 Competition Act introduced major changes in legislation that moved it away from the long established framework (based on the 1973 Fair Trading Act and the 1976 Restrictive Trade Practices Act) towards a policy more closely in line with the EU's competition regime. Further significant changes were introduced in the 2002 Enterprise Act, dealing with merger policy, market investigation references and cartels. At the same time, additional legislation has been transforming the structure of regulation of the utility industries in the UK, moves which have also affected the work of the competition authorities. This book includes an account of these recent changes that, together, have substantially altered the UK competition policy regime and examines their implications.

Significant new developments in competition policy have also been occurring in the EU. Potentially, the most important of these at the procedural level has been the adoption of the new Modernization Regulation[1] which introduces substantial reform in the way policy towards monopolies and restrictive practices is dealt with compared with previous arrangements (based on the founding EC Treaty). This regulation amongst other things abolishes the notification system in relation to Article 81(3) of the Treaty, provides for more decentralized application of Articles 81 and 82 and for increased coordination of competition policy within the EU. In addition, the EU has adopted significant changes in other areas. In the case of merger policy, a new Merger Regulation[2] was introduced in 2004. This aims to ensure that the effects of mergers on competition, rather than their structural effects, are the focus of policy and to widen the scope of merger control. Policy on vertical restraints, one of the more difficult areas in competition policy, has also been changed with the adoption of a new Block Exemption Regulation[3] whilst important changes have also been made in policy on the most serious types of cartels, including a new leniency policy introduced in 2002. Together these and other legislative developments[4] have led to significant changes in the framework of EU competition policy and its operation that are an important focus of this study.

Competition policy is intertwined with other areas of policy and important new initiatives in industrial policy have affected policies to protect competition. In particular, there have been important steps at EU level towards liberalising the utility industries resulting in some convergence between competition policy and utility regulation that has affected the work of NCAs. The control of State aids is also a key component of EU competition policy and provision for centralised control was established under the founding EC Treaty. Recent changes have aimed to allow 'less and better targeted' aid and ensure competition is not unduly distorted in the attempt to achieve other policy objectives. Similarly, there are also potential tensions between the law regarding intellectual property rights (IPRs), which gives firms incentives to develop new products and new technologies, and the protection of competition in the market. Recent developments here include major Court judgements that clarify EU policy. Developments in these areas of competition policy are examined within the later chapters of the book.

One theme underlying recent changes in competition policy, particularly in the UK, has been the attempt to introduce greater harmonization of policy within the enlarging EU. In addition, there has also been an increased recognition that the degree of competition is a major determinant of the effectiveness of the market in bringing about economic efficiency and of its importance in providing benefits for consumers (for example, through lower prices, greater choice and better quality products). This belief has been reflected at the UK level in measures such as the substantial increase in powers given to the Office of Fair Trading (OFT) and the Competition Commission (CC) and also in policy underlying the progressive privatization of regulated industries where the aim has been to introduce competition into the market whenever possible, relying increasingly on market forces (overseen as part of competition policy) rather than sector specific regulation to ensure satisfactory performance. There have also been changes in procedures under the EU Modernization Regulation, as noted above, which envisage a larger role for NCAs in dealing with dominant firms and restrictive practices. These are expected also to give the Competition Directorate-General (DG Competition) more time to concentrate on the serious competition cases and to allow more effective policing of State aids as well as encouraging further progress with the liberalisation of the utilities.

The next two sections of this chapter provide a brief overview of the developments in the key elements of competition policy in the UK and EU in recent years. We begin with developments in the UK and, in particular, the two most recent major pieces of competition legislation– the 1998 Competition Act and the 2002 Enterprise Act. This is followed by a discussion of EU competition policy, including Articles 81 and 82 of the EC Treaty, as well as other areas of policy reform.[5] The final section of this chapter then provides an outline of the rest of the book.

DEVELOPMENTS IN UK POLICY: AN OVERVIEW

The developments in UK competition policy, as noted above, stem from the 1998 Competition Act and the 2002 Enterprise Act (see Figure 1.1). In the first of these, attention focused on horizontal and vertical agreements between firms and on dominant firms. In the second, a number of further important policy changes relating to cartels, market investigation references and mergers were introduced, accompanied by some significant procedural reforms. Together these changes have led to a substantial reform in UK policy in many of the key areas usually considered important in competition policy. This section reviews these developments.

Policy Reform: the Competition Act 1998

The primary aim of the 1998 Competition Act has been to bring UK competition policy more into line with policy in the EU (see Utton, 2000b).[6] As is well known, the Act introduced two important new prohibitions into UK law: the Chapter I prohibition which deals with cartels and restrictive practices, and is closely modelled on Article 81 of the EC Treaty, and the Chapter II prohibition which deals with monopoly problems in the form of dominant firms and is closely modelled on Article 82 of the Treaty.

In a little more detail, under Chapter I

> . . . agreements between undertakings, decisions by associations of undertakings or concerted practices which
>
> (a) may affect trade within the United Kingdom, and
>
> (b) have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom,
>
> are prohibited unless they are exempt in accordance with the provisions of this Part (Competition Act, 1998, Section 2(1)).

The wording of this test moved UK policy from an emphasis on the particular form of agreement to an 'effects based' policy that matches Article 81 of the EC Treaty (which applies to trade between Member States).

Similarly, in line with EU policy, the Act identifies a number of types of agreement that might infringe this effects based prohibition. Agreements may be prohibited if they:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
(b) limit or control production, markets, technical development or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts (Competition Act, Chapter I, section 2(2)).

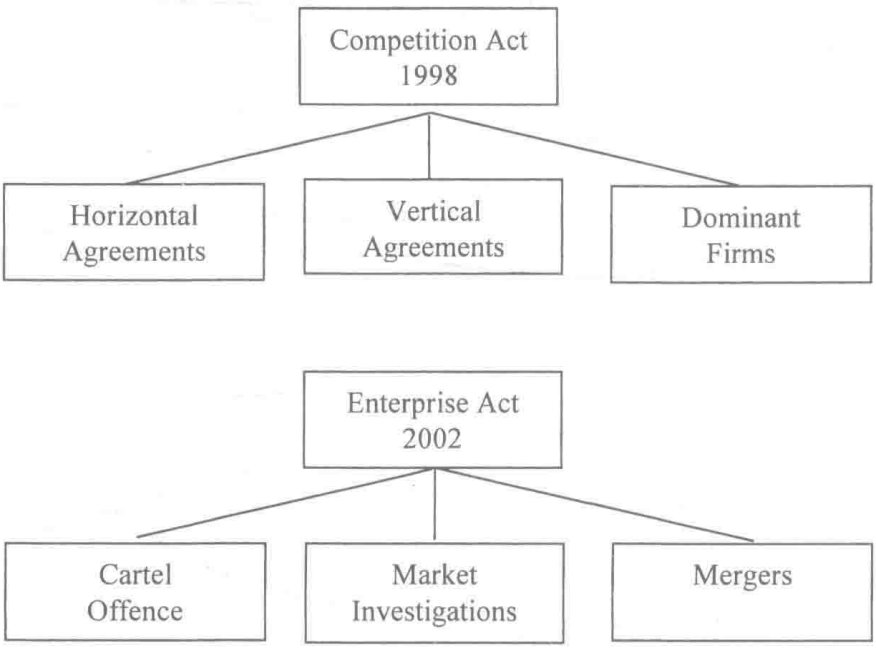

Figure 1.1 Recent UK competition policy

This list of types of agreement is not meant to be exhaustive, however, and other types of agreement may also be prohibited depending on their effects. The Act relates to both horizontal and vertical restraints. The strongest policy is toward horizontal agreements and, in particular, hard core cartels, such as agreements which fix prices, limit production, share markets or rig bids, which may act to prevent, restrict or distort competition and these are, typically, prohibited under the Act. In the case of vertical agreements, the view is generally held in the UK (as in the EU) that such agreements are unlikely to have undesirable effects if markets are competitive, although they may do where market shares are high.

The Act allows for several exemptions to the prohibition, again in line with EU policy. First, an agreement can be subject to an 'individual exemption' if the firms can show that the agreement contributes to improving production or distribution, or promoting technical or economic progress, and it also allows a fair share of the benefits to consumers. In this case, the agreement must be limited to only matters strictly necessary to achieve these benefit(s) and must not involve eliminating competition from a substantial part of the market.[7] Second, agreements may be subject to a 'block exemption', where a class of agreement is

exempted from the prohibition. This was applied, initially, to all non-price vertical agreements following the 1998 Act, although subsequently this block exemption has been removed in favour of the EU's effects based approach.[8] Third, an agreement can obtain a 'parallel exemption' in the UK if it already has an individual or block exemption at EU level and this provides for greater harmonization of UK policy with the EU.

There are two further exemptions to the prohibition on agreements which prevent, restrict or distort competition worth noting. First, under the Act, an 'appreciable effect test' is applied in line with EU policy whereby, in the case of a horizontal agreement, an agreement will not be found to have appreciable effect on competition if the combined market share of the firms involved is less than 10 per cent.[9] However, this does not apply to agreements between firms which fix prices or market shares, limit production or set resale prices (in hard core cartels) where no market share limit is set. The Act also gives immunity from financial penalties for 'small agreements' where the combined turnover of the firms is less than £20 million.[10] This is provided to protect small firms from possible bankruptcy (or, at least, financial difficulty) if a large fine were to be imposed. Again, the protection does not apply to agreements involving price-fixing or limiting supply or production, market sharing or bid-rigging.

The Competition Act also brought in significant changes in UK policy on monopolies/dominant firms. In this case, the Chapter II prohibition states that

> any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom (Competition Act, 1998, Section 18(1)).

As with the Chapter I prohibition, the Act gives examples of conduct that could constitute an abuse which are in line with EU policy. These include setting unfair prices and other trading conditions, limiting production, applying dissimilar conditions to equivalent transactions or using tie-in sales. Again, these are to be treated as examples and are not meant to be exhaustive.

The prohibition focuses on two issues: the idea of dominance and the abuse of a dominant position. As noted later in this chapter, EU policy as applied by the European Commission normally treats a market share above 50 per cent as evidence of dominance, although other factors, such as competition from other firms and new entrants, will also be taken into account. The OFT has indicated that evidence of dominance will not normally be found if a market share is below 40 per cent although again this can depend on other factors.[11] The Chapter II prohibition also applies to an *abuse* of a dominant position and hence does not apply to cases where a firm has a dominant position, but is not found to be abusing that position. This is in line with EU policy, and similarly with policy in the US.[12]

Procedures under the prohibitions are similar under Chapter I and Chapter II. The OFT[13] is required to keep markets under review and to undertake an investigation if an infringement of a prohibition is thought to exist. If the OFT finds evidence of an infringement, it will, initially, issue a 'provisional decision' following which firms affected are allowed to make a response. If it still believes an infringement exists, the OFT can then make an 'infringement decision' and also impose fines. Currently, the maximum fine for an infringement is 10 per cent of the worldwide turnover of the firms involved (usually calculated in the previous financial year), in line with EU policy. In contrast to earlier policy, however, firms can appeal the OFT's decision to the Competition Appeal Tribunal (CAT) (previously known as the Competition Commission Appeal Tribunal (CCAT))[14] which can refer the case back for review or vary the amount of a fine. The Act also allows for appeals to the Court of Appeal (or the Court of Session in Scotland) but only on points of law or the level of fines imposed.

The new policy strengthens earlier policies in a number of different ways. First, the Act gives wide powers to the OFT to investigate cases where an infringement of the prohibition is suspected and, if necessary, it can conduct 'dawn raids' on premises to collect information. This contrasts with the relatively weak powers it had to collect information under the earlier legislation. Second, the OFT has the power to reach decisions in restrictive practice and dominance cases and to impose fines. This compares with earlier policy on monopoly, in particular, where the Secretary of State had the power to make decisions and impose remedies. Decisions on restrictive practices were previously made separately by the Restrictive Practices Court. The provision for fines is also new. As well as strengthening the OFT's powers in these ways the Act gives a right of appeal to the OFT's decisions and this compares with very limited rights of appeal in earlier policy.

Following the introduction of the 1998 Act, the UK government, initially, chose to retain some parts of the 1973 Fair Trading Act (FTA), in addition to the Chapter II prohibition.[15] The main aim here was to ensure that there was no weakening of the law in this area. First, it took the view that while the new prohibition might be used against single dominant firms, experience at EU level suggested that it was less clear that it could be used to deal with collective dominance, where several firms might be involved. In light of this, it retained the 'complex monopoly' provisions of the FTA, which related to cases where several firms had a combined market share of 25 per cent or more. Second, it also decided that some positions of dominance might not be dealt with effectively with fines and, in particular, that structural remedies might be required. It, therefore, retained the 'scale monopoly' provisions of the FTA to deal with such cases.[16] These powers were, however, repealed and replaced under the provisions of the 2002 Enterprise Act.

Policy Reform: the Enterprise Act 2002

Further significant changes were introduced in the 2002 Enterprise Act. First, the Act tightened policy on restrictive agreements, in particular, to allow criminal penalties against individuals found to be involved in hard core cartels. Second, the Act introduced a revised policy on mergers updating the earlier policy under the FTA. Finally, the Act also introduced a new policy of 'market investigation references' which replaced the earlier monopoly provisions of the FTA.[17]

In the case of cartels, the Act strengthened policy in two areas. First, it provided for much wider powers of investigation in cases of hard core cartels. In addition to its powers to make 'dawn raids' under the 1998 Act, the OFT now has the power to engage in directed and covert surveillance, including the use of bugging devices, use of hidden cameras and so on. This reflects the stronger line being taken on hard core cartels in the UK (and, more generally, in the EU and US). Second, the Act created a new offence, 'the cartel offence', which introduces criminal penalties for individuals involved in hard core cartel cases. Under this provision[18] of the Act, which is similar to policy in the US, individuals (rather than firms) can be held liable for engaging in hard core cartels. The maximum penalty for this offence is an unlimited fine and/or imprisonment for five years. Cases will, typically, be dealt with by the Serious Fraud Office, although the OFT also has concurrent powers. This criminalisation of cartel activity, as noted above, is in line with US policy, but not with EU policy where no criminal penalties exist. This marks a significant difference between EU and UK policy.

The Act has also introduced a new merger policy replacing the earlier policy based on the 1973 FTA and resulting in several changes. First, responsibility for merger cases has been transferred to the OFT and the Competition Commission (CC), and the role of government ministers has been reduced in all but a very few cases.[19] Under the new policy, the OFT makes references to the CC as before but the CC now has the power to make decisions whether or not a merger is allowed to go ahead. This reflects a general move away from government intervention in competition policy in recent years. Second, the OFT and the CC are required to be more transparent in their decision-making, with the OFT, in particular, now being required to publish reasons for its decisions. Following this, both the OFT and the CC have published guidelines on how they will conduct merger investigations which are similar to the guidelines that have operated for a long period in the US. Third, there is a new right of appeal to the CAT which is able to review merger decisions and refer them back to the CC if necessary. Finally, the Act has also introduced a new competition test – the substantial lessening of competition (SLC) test – in merger cases. This test focuses directly on how the merger affects competition rather than on the broader 'public interest' test included in the earlier legislation. This is in line