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Agenda

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Market investigations: a commentary on the first five years

In place since 2003, the market investigations regime is a competition policy tool that is unique to the UK. It allows the Competition Commission to carry out two-year, in-depth inquiries into perceived competition concerns that cannot be dealt with under the standard competition rules on restrictive agreements and abuse of dominance. Five years on, what can be said of the merits and limitations of this policy tool?

The UK's market investigations regime has been in place since the Enterprise Act 2002 came into force in March 2003. In essence, market investigations involve the Competition Commission (CC) undertaking a detailed, two-year inquiry into a particular competition concern in a particular market that cannot be dealt with under the 'standard' competition rules—Articles 81 and 82 of the EC Treaty, covering restrictive agreements and abuse of dominance. If adverse effects on competition are found, the CC has far-reaching powers to impose remedies.

Five years and nine investigations later (see box below), it is worth taking some initial stock of the merits and limitations of this regime. The performance of the UK market investigation regime is also of interest to other jurisdictions that may be considering introducing similar competition policy tools.

There's nothing like it

An increasing number of countries have put competition rules in place—China being the most recent addition to this list.[1] In most instances the competition rules will consist of the three standard 'pillars' of competition policy—merger control, rules against anti-competitive agreements, and rules against abuse of dominance (or monopolisation). Several jurisdictions have also given their competition authorities certain powers to review or monitor particular industries or markets in order to identify competition concerns. Yet none of these powers is as far-reaching as the UK market investigations regime. For example, EU sector inquiries, a tool used extensively by the European Commission in the last five years in industries such as banking, energy and pharmaceuticals, are mainly 'information-gathering exercises' that can eventually lead to enforcement

Market investigations under the Enterprise Act 2003

Section 131(1). The UK Office of Fair Trading (OFT) and sector regulators with concurrent powers can make a market investigation reference to the CC if they have reasonable grounds for suspecting that any feature of a market prevents, restricts or distorts competition.

Section 134(1) and (2). The CC will decide whether any feature of a relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of goods or services. If so, there is an adverse effect on competition.

Section 138(2). In relation to each adverse effect on competition, the CC will take appropriate action that it considers reasonable and practicable to (i) remedy, mitigate or prevent the adverse effect on competition concerned; and (ii) remedy, mitigate or prevent any detrimental effects on customers that are the result of the adverse effect on competition.

Market investigations to date

	Start date	End date
Store cards	March 18th 2004	March 7th 2006
Domestic bulk LPG	July 5th 2004	June 29th 2006
Home credit	December 20th 2004	November 30th 2006
Classified directory advertising services	April 5th 2004	December 21st 2006
Personal current accounts in Northern Ireland	May 26th 2005	May 15th 2007
Groceries	May 9th 2006	April 30th 2008
Payment protection insurance	February 7th 2007	Ongoing (Provisional Findings published)
BAA airports	March 29th 2007	Ongoing (Provisional Findings published)
Rolling-stock leasing market	April 26th 2007	Ongoing (Provisional Findings published)

Source: OFT and CC websites. Oxera has advised on all nine investigations.

actions under Articles 81 and 82, but not to direct remedies as such.[2]

Therefore, one aspect to consider when assessing the merits and limitations of market investigations is whether there is in general a case for giving competition authorities wider powers beyond the 'standard' pillars.

One argument in favour of this is that Articles 81 and 82 cannot deal with all possible competition problems—for example, the situation of a concentrated market where there is a perceived lack of competition but where no supplier has market power individually and hence the standard rules are difficult to apply. Most jurisdictions have to rely on their merger control rules to try to prevent such situations from arising—an ex ante approach. In the UK, market investigations create the possibility of actually intervening in those situations ex post.

An argument against is that confining competition authorities' powers to the standard rules can be sound policy, and provide legal certainty to businesses. From a legal perspective, the market investigation regime under the Enterprise Act 2002 is rather different from Articles 81 and 82 in that there is not necessarily any wrongdoing involved (it is not a prohibition-based system)—the adverse effects on competition that the CC finds may not always arise from anti-competitive conduct by the firms in the market, but can also arise from government policy or from the inherent features of that market (see further below).

Seeing it in context

When making the policy evaluation, it is important to take into account the fact that market investigations by the CC are a form of 'phase 2' inquiry. The OFT and the sector regulators that have concurrent powers with the OFT to apply the competition rules are responsible for making market investigation references after their 'phase 1' inquiry. Usually phase 1 takes the form of a market study under Section 5 of the Enterprise Act 2002, which gives the OFT powers to gather and request information in relation to the exercise of its functions. A market investigation reference from the phase 1 authority may also come after a 'super-complaint' by a designated consumer body.

The OFT has completed 28 market studies to date, with an average duration of 12 months.[3] They were initiated for different reasons. In 15 cases, the origin was a competition concern identified by the OFT itself. Five market studies followed a specific government request; five resulted from a super-complaint; and three followed a review of a previous undertaking. The OFT does not have the same powers to impose remedies as the CC. Yet a frequent outcome of OFT market studies has been a recommendation to government to change legislation or policy (eg, some of the recommendations in the estate agents market study became part of the Consumer Estate Agents Redress Act 2007[4]). The Enterprise Act 2002 also allows the OFT and sector regulators to accept undertakings in lieu of a market investigation reference (that this can be a powerful tool is arguably shown by the acceptance by BT to functionally separate its network and other operations in lieu of a reference from Ofcom, the telecoms regulator, to the CC[5]).

In only five of its 28 concluded market studies has the OFT decided to refer the matter to the CC. The OFT has made three other references following preliminary inquiries after a super-complaint or other type of complaint, and the Office of Rail Regulation has made one reference—hence the total of nine market investigations to date.

This close link to market studies and other phase 1 inquiries is another important aspect to consider when assessing the merits and limitations of market investigations. The fact that the majority of market studies result in agreed undertakings, policy recommendations, or a clean bill of health, may imply that those cases that actually do result in a market investigation reference to the CC are those where the perceived competition problems are most significant, and hence where the benefits of an in-depth phase 2 inquiry may be greatest.

Furthermore, the design of the regime means that the CC has no discretion over what investigations it conducts. Rather, this depends on the areas of focus that are determined in market investigation references by the OFT and the other regulators. Thus, for the important policy question of whether market investigations target the right markets, one should not look only at the CC's market investigations. The policy choices made by the other authorities that carry out market studies should also be reviewed.

A final aspect to place market investigations in context is that it is not a completely new regime. The Enterprise Act 2002 builds on the previous regime of the so-called 'complex monopoly' and 'scale monopoly' inquiries carried out by the CC's predecessor, the Monopolies and Mergers Commission, under the Fair Trading Act 1973. Some of the main changes from the previous regime are the more specific powers of the OFT and sector regulators to make market investigation references, and of the CC to impose and enforce remedies; the possibility of 'super-complaints' by designated consumer bodies; and the 'adverse effect on competition' test instead of the broader public-interest test (see below).

How the 'adverse effect on competition' test has been applied

As shown in the box above, the formal test that the CC needs to apply is whether any feature, or combination of features, of a relevant market prevents, restricts or distorts competition. If so, there is an adverse effect on competition. The CC refers to this as the AEC test.[6]

How does the AEC test compare with the tests applied under the standard competition rules? As regards Article 82, it was noted above that market investigations are in part intended to address competition concerns in markets where no individual firm is dominant, so it is no surprise that the AEC test is broader than the dominance test. As regards Article 81, there is some commonality in the legal provisions themselves—Article 81 uses the terms 'prevention, restriction or distortion of competition' in relation to the object or effect of agreements, and European Commission guidance provides that there must be a likely 'appreciable adverse impact on the parameters of competition on the market, such as price, output, product quality, product variety and innovation'.[7]

In practice, many of the 'features' that the CC has identified under the AEC test are formulated in terms of the structure of the market, which is similar to standard competition tools (albeit that the thresholds for intervention are, by design, generally lower than under standard tools).

– **High concentration**—for example, classified directory advertising services (75% market share of Yell and stable concentration), groceries (high and persistent concentration) and BAA (common ownership of the main London airports and the main Scottish airports).

– **Entry barriers**—for example, Yell (network effects, brand), groceries (control of land), home credit (incumbency advantages) and rolling-stock leasing.

In some investigations the structural features identified were attributable to government policies. For example, the planning regime was considered an entry barrier in the groceries investigation, and the Department for Transport's rail franchise policy was found to reduce the potential for rivalry in the rolling-stock leasing investigation. The airport regulation system and planning restrictions were found to exacerbate competition concerns in the BAA airports investigation.

Other features have been defined more in terms of the conduct of suppliers in the market than in terms of structural features. Conduct leading to switching costs was identified as a feature in domestic bulk liquefied petroleum gas (LPG) (contractual restrictions, and the practice of replacing tanks each time a customer switches provider) and Northern Ireland banking (complex charging structures). In groceries, one feature was the exercise of buyer power by grocery retailers with respect to their suppliers.

Yet other features that the CC has identified have been formulated directly in terms of market outcomes (rather than, or in addition to, structure and conduct features that contribute to that outcome). For example, in store cards the feature giving rise to an AEC was that retailers did not exert competitive pressure on card providers, and that there was a lack of transparency on store card statements.

Finally—and this is where the AEC test arguably diverges most from the standard competition tools—in a number of cases the CC has formulated the features of the market in terms of customer behaviour rather than, as is more common, structural features or supplier behaviour.

– In store cards, features were that customers do not exert competitive pressure on interest rates and fees because of low sensitivity and a poor understanding of the product.

– In Northern Ireland banking, one of the features identified by the CC was that customers generally do not actively search for alternative personal current accounts.

This last feature, in the Northern Ireland banking investigation, has given rise to debate. Is it an adverse effect on competition that customers do not actively search for alternative providers? The CC itself noted in this inquiry that 'customers are generally not particularly interested in personal current accounts', and that 80% of those who had not switched bank gave as a reason the fact that they had been with their current provider for a long time.[8] If consumers do not care about a product, why should the competition authorities? Indeed, some commentators have accused the CC of 'paternalism'.[9]

One defence against this accusation is that, for competition to work, it is not only required that suppliers compete, but also that buyers exercise choice actively. Indeed, the large body of behavioural economics that has come to the fore in recent years—and that has attracted the interest of the OFT and other competition authorities around the world—confirms the argument that market outcomes can be sub-optimal when there is customer inertia or a lack of consumer information.[10]

Furthermore, while defining AEC features with reference to consumer behaviour will lead to a greater degree of

competition policy intervention than under the standard competition rules, concerns about 'over-intervention' may still be mitigated if the remedies ultimately imposed are proportionate to the concerns raised (see the next section).

Another aspect of the AEC test that is not too different from the approach under the standard competition rules is that the CC usually seeks to analyse whether suppliers in the market have a degree of market power individually or whether they act in a coordinated manner such that it can be said that they have joint market power. This resembles the standard approach in merger analysis, which also examines unilateral and coordinated effects.

The way the CC assessed coordinated market power in, for example, Northern Ireland banking and rolling-stock leasing, closely followed the criteria set out by the Court of First Instance in *Airtours* (2002)—ie, criteria related to transparency in the market, the ability of firms to retaliate against defectors, and the ability of outside competitors to undermine coordination.[11] In both of those cases the CC found that there was no coordination (indeed, one advantage of market investigations over merger analysis is that the former can assess coordination based on current evidence, while the latter will often involve a degree of speculation about future coordination after the merger has been completed).

As regards unilateral market power, the Yell inquiry was perhaps most similar to a standard dominance assessment. As noted above, Yell was found to have a 75% market share in the market for classified directory advertising, and entry barriers in the form of network and brand effects were deemed to be high. In contrast, in Northern Ireland banking, the CC concluded that all banks have unilateral market power, given that their customers switch infrequently.[12] This included the smaller banks, some of which had a market share of only 2–3%.[13] Finding competition concerns at such low levels of market share would be very unusual under the standard competition rules.

The nature of the remedies

The CC's guidelines on market investigation references highlight five factors determining its choice of remedies:[14]

- remedying the cause rather than the consequence of the problem is favoured;
- proportionality—an assessment of the costs and benefits of remedies;
- effectiveness—a preference for non-intrusive and easy-to-monitor remedies;
- timing—favouring remedies with benefits that arise in the short term;
- remedies should lead to benefits unattainable by other means.

There has been a broad range of remedies in the investigations thus far, to a large extent reflecting the broad range of AEC features found in the various investigations. At the more far-reaching end of the spectrum of intervention are the price control of Yell and the (proposed) divestiture of certain airports by BAA. In both investigations significant structural competition concerns were identified (see above). While far-reaching, these two remedies differ in that price control is a behavioural remedy and divestiture a structural remedy (ie, it seeks to change the underlying market structure).

At the other end of the spectrum of interventions, several investigations have resulted in relatively 'light-touch' remedies such as improving transparency and consumer information, and making consumer switching easier. The effectiveness of these remedies will depend to a large extent on how consumers respond to them.

In between these two categories are remedies aimed directly at making new entry easier (eg, a data-sharing requirement in the home credit market), and remedies prescribing product and contract features that should, or should not, be offered to consumers.

A separate category of remedies relates to the recommendations to change government policies or legislation—these were made in groceries, rolling-stock leasing (proposed), and BAA airports (proposed). The CC does not have powers to enforce those recommended changes itself.

Conclusion

In terms of assessing the effectiveness of this regime, it is inherently difficult, and perhaps too soon given its relatively short existence, to perform a full cost–benefit analysis (CBA)—although this may be somewhat more straightforward for individual investigations. CBAs of this nature require the assessment of direct costs to the CC and the parties, and direct and indirect benefits (and disbenefits) of intervention. This article has set out a number of further questions that ought to be addressed for such an assessment.

- The 'counterfactual' for the CBA would be a situation in which competition authorities could rely only on the 'standard' competition tools—ie, Articles 81 and 82 and merger control (although another, UK-specific, counterfactual could be the previous regime under the Fair Trading Act 1973).

- The legal and institutional framework means that market investigations cannot be assessed separately

from market studies—in particular as regards the policy choices made by the OFT and sector regulators (and not the CC) about which markets to refer for investigations.

It has also been discussed in this article how the substantive analysis applied during the two key stages of market investigations—the AEC test and the remedies—uses tools and concepts that are not very different from those employed under the 'standard' competition rules. Going forward, two issues with regard to the remedies still need to be addressed as part of the assessment of the merits and limitations of market investigations.

- Given that several market investigations have focused directly on consumer issues and resulted in remedies that rely on changes in consumer behaviour, there seems to be some potential for fruitful interaction between competition policy and the new literature on behavioural economics.

- Will government policies and legislation with adverse effects on competition change as a result of CC recommendations? As noted in this article, some of the market investigations have identified such policy concerns, but it is not yet clear to what extent those concerns will be addressed by the government, as that is beyond the scope of the CC's powers.

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[1] See Nicholson, K. (2008), 'From Brussels to Beijing: A Comparison of EC and Chinese Competition Law', *Agenda*, August. Available at www.oxera.com.
[2] The European Commission itself coined the phrase 'information-gathering exercise'. European Commission (2005), 'Financial Services Sector Competition Inquiry: Frequently Asked Questions', MEMO05/204, June 13th. See also Niels, G. and Pilsbury, S. (2007), 'Fishing Expeditions or Precision Strikes? An Economic Perspective on EU Sector Inquiries', *The 2007 Handbook of Competition Economics*, Global Competition Review, London, pp. 21–26.
[3] See 'OFT Market Studies: A Summary of Findings, Recommendations and Outcomes', available at http://www.oft.gov.uk/shared_oft/investigations/marketstudiessummary.pdf.
[4] Office of Fair Trading (2004), 'Estate Agency Market in England and Wales', OFT693, March
[5] Ofcom (2005), 'Final Statements on the Strategic Review of Telecommunications, and Undertakings in Lieu of a Reference Under the Enterprise Act 2002', Statement, Office of Communications, September 22nd.
[6] Competition Commission (2003), 'Market Investigation References: Competition Commission Guidelines', June, para 1.5.
[7] European Commission (2004), 'Guidelines on the Application of Article 81(3) of the Treaty', 2004/C 101/08, para 16.
[8] Competition Commission (2006), 'Market Investigation into Personal Current Account Banking Services in Northern Ireland—Provisional Findings', October, para 8 and Appendix 4.3.
[9] Ridyard, D. (2008), 'The Competition Commission's Northern Ireland Banking Market Investigation—Some Unanswered Questions on the Role of Market Investigations', *European Competition Law Review*, **29**:3, pp. 173–78.
[10] The OFT published two academic papers on the use of behavioural economics in competition and consumer policy: Armstrong, M. (2008), 'Interactions Between Competition and Consumer Policy', OFT Economic Discussion Paper, April; and OFT (2008), 'Assessing the Effectiveness of Potential Remedies in Consumer Markets', April.
[11] *Airtours plc v Commission of the European Communities*, Judgement of the Court of First Instance Case No. T-342/99.
[12] Competition Commission (2007), 'Personal Current Account Banking Services in Northern Ireland Market Investigation', May, para 4.623.
[13] Ibid., pp. 55–56.
[14] Competition Commission (2003), 'Market Investigation References: Competition Commission Guidelines', June.