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City of London Law Society Competition Law Committee DISCUSSION PAPER ON UK COMPETITION REFORMS

Introduction

The Competition Law Committee of the City of London Law Society submits this discussion paper by way of a contribution to the current debate on reforming UK competition law procedures and institutions, foreshadowed in the BIS draft Structural Reform Plan of July 2010 and in the BIS announcement of 14 October 2010.

The Committee is made up of solicitors specialising in UK and EU competition law in a number of law firms based in the City of London, who advise and act for UK and international businesses, financial institutions and regulatory and governmental bodies on competition law matters.

This discussion paper is presented in the spirit of highlighting legal and practical implications of possible reforms, drawing on our collective experience, to inform Ministers' deliberations and the wider debate. At this stage the Committee has consciously refrained from taking fixed positions on the various issues under consideration, but looks forward to contributing further to the debate both in the formal consultation and, to the extent that Ministers and officials might find it helpful, more informally.

In this paper we address the following possible areas of reform:

1 Amalgamating the OFT and the Competition Commission

2 Mandatory merger notification

3 "Public interest" test for merger assessment

4 Competition Act 1998 - OFT enforcement

5 Competition Act 1998 - sector regulators' powers

Summary

Amalgamating the OFT and the Competition Commission

- Amalgamation clearly brings efficiency benefits - avoiding duplication of effort both for the competition authorities and the parties making submissions to them.

- It would also be desirable to try to preserve some of the benefits of the current system, e.g.: (i) enabling a "fresh pair of eyes" to review a case, avoiding confirmation bias; and (ii) giving business people the opportunity to be heard directly by the senior decision-makers (as happens currently with hearings before Competition Commission "members").

- Possible solutions might involve:

  - Within the merged organisation, ultimate decision-making to rest with a small body of experienced, independent-minded individuals (an "Executive Panel") to whom businesses would have access. This would not replicate the old CC: the new Panel members would need to be continuously available for cases; they would be fewer in number (to build up a body of consistent decision-making); and crucially they would be supported by the staff of the single competition authority (avoiding duplication in administrative and premises costs).

  - In merger control: an enhanced right of appeal (on the merits, not just judicial review grounds) for the merger parties to challenge a prohibition decision before the CAT - this would be a powerful "check and balance", and discipline, for a single merged authority.

  - In market investigations: shorter timetables (for example, no more than six months for the initial "market study" phase) to be introduced following amalgamation and greater procedural fairness to be achieved either through the Executive Panel proposed above, or through enhancing appeal rights to the CAT.

  - In regulatory pricing determinations: Ofcom cases should be brought into line with the other regulatory regimes, removing the two-stage appeals process of going first to the CAT and then to the CC.

Mandatory merger notification

- There are advantages and disadvantages to moving to a system of mandatory merger notification.

  - Advantages of a mandatory system include: (i) greater transparency (less risk that potentially anti-competitive mergers would avoid scrutiny); and (ii) removing the difficulty of dealing with an already-completed merger which is then found to be anti-competitive.

  - Disadvantages of a mandatory system include that: (i) it creates unnecessary regulatory burdens, on business and on the regulators, of examining innocuous mergers; (ii) it is wholly contrary to the "self-assessment" approach applicable since 2004 for competition prohibition cases; and (iii) it adds unnecessary cost.

- The supposed problem of dealing with completed anti-competitive mergers seems to us exaggerated. The competition authorities have strong powers to prevent business integration that could prejudice the possibility of undoing completed anti-competitive mergers - through hold-separate measures. These seem to the Committee to work in general although the scope and terms of the undertakings requested could benefit from more focus and further refinement. Further this problem has to be balanced against the regulatory and private costs of a pre-clearance regime catching more benign mergers, but also with a narrower jurisdiction missing some mergers that should be looked at.

- If there were a move to a mandatory notification regime, it would make sense to review both the UK jurisdictional thresholds, and also whether the vague and broad concept of "material influence" would still be an appropriate test for scrutinising a transaction. We doubt that it would be practicable to have uncertain thresholds (share of supply) or concepts (material influence) in relation to a mandatory pre-clearance regime without there being a hugely unnecessary scrutiny of benign mergers at a huge cost to industry and business. While if there were only relatively brightline tests (turnover and decisive influence/de facto control as in the EU) a number of problematic mergers would fall outside of scope.

"Public interest" test for merger assessment

- If the merger control criterion in the UK were to be changed from "substantial lessening of competition" to a broader "public interest" test, various potential problems would need to be addressed:
  - A competition test offers greater predictability for business.
  - A broader test would be out of line with normal practice across the EU and globally - with the risk that Britain would be seen internationally as an unfavourable environment for business transactions.
  - There are real questions (highlighted by the *E.ON/Endesa* case (2006)), about whether a wider public interest test would be compliant with EU law.
- There needs to be some flexibility in the system to allow for exceptional circumstances. This already exists by virtue of the Enterprise Act 2002 s58.

Competition Act 1998 - OFT enforcement

- There are real concerns about the system for investigating infringements of the competition prohibitions (currently by the OFT under the Competition Act 1998) - including principally
  - There is no separation of powers, and limited procedural safeguards: a single body, with huge powers, including the power to impose quasi-criminal penalties, is simultaneously investigator, prosecutor and judge.
  - OFT procedures are extremely protracted in duration.
- A possible solution on procedural safeguards would be to have the Executive Panel, referred to above, within a single combined competition authority - with the OFT "prosecuting" a Statement of Objections before the Panel members.
- A possible way of dealing with the long duration would be to impose a two- or three- year time limit on the OFT's ability to issue a Statement of Objections, subject to the possibility of the CAT issuing an extension in exceptional circumstances.

Competition Act 1998 - sector regulators' powers

- There are signs that the system of concurrent Competition Act powers in the hands of sector regulators does not work well - their powers are used to only a limited extent, and there is scope for inconsistency in the way the Competition Act is applied.
- However, there are dangers in abolition of these powers - if sector regulators were deprived of Competition Act powers, they are likely to make greater use of *ex ante* regulatory powers.
- Possible solutions include
  - More transparent coordination between sector regulators and the OFT

2 Amalgamating the OFT and the Competition Commission

2.1 The Committee notes the Government's announcement of 14 October 2010 that it is minded to merge the Competition Commission and the competition and markets function of the OFT[1]. In this Section, we consider some of the implications and how such an amalgamation might benefit from the advantages of change without losing some of the valuable aspects of the old system.

Merger control

2.2 There are clearly advantages to be gained from moving to a new merged authority in terms of merger control procedure.

2.3 Most importantly, there are likely to be cost and efficiency savings for both the public and the private sector: A degree of duplication will be removed, as there will no longer be a need for a new case team at the Competition Commission to learn again what the OFT case team already knows about the merger. For their part, businesses will no longer bear the cost of having to provide the repeat submissions to the Competition Commission that they have already made to the OFT.

2.4 However, in designing the new combined competition authority, care should be taken that certain advantages in the current system are not lost.

2.5 First, the overall outcome of the process as it currently stands is widely viewed as sound. It is based on an important safeguard: the principle of a separation of powers (which some think sorely lacking in Competition Act enforcement - see Section 4 below), which entails in practice a new decision-maker looking at the merger after the initial first screen, removing the risk of "confirmation bias", i.e. the initial set of decision-makers having an interest (even if only psychological) in having their original concerns about the merger confirmed in the final decision. This separation of powers is not available in the EU Merger Regulation system where a single body, the European Commission, is responsible for decision-making throughout the process - and that fact has been a cause of concern about some European Commission decision-making in merger control. It will therefore be sensible, if there is to be a single merged competition authority, to ensure some separation of decision-making, so that the individual officials who form the initial view of a merger are not the same as those who take the final decision.

2.6 A second advantage of the current system, whose preservation would be widely welcomed, is that parties to Competition Commission proceedings appreciate the direct access to decision makers that it is part of the Competition Commission process - for example, through taking part in oral hearings before the Competition Commission Members who are the final decision-makers. This allows participants to feel confidence in the level of engagement of the responsible decision makers in the process, and particularly to know that they are making their submissions directly to those who will be taking the final decision in the case.

2.7 The Committee considers that it should be possible to safeguard these advantages while still achieving the efficiency benefits provided by a combined competition authority. One way to do this, although it is possible to envisage various structures to achieve the same aim, would be for the final decision on whether a merger is cleared (conditionally or unconditionally) or blocked to be taken by a small number of people - experienced and independent-minded - with executive

[1] Statement by Vince Cable, Secretary of State, Department for Business, Innovation and Skills, 14 October 2010.

decision-making powers who are separate from the initial decision maker(s). This could, for example, be an Executive Panel - although various governance models are conceivable - who can challenge the case team "prosecuting" the case. Panel members could also have the ability to set out dissenting opinions if required. Parties would have an opportunity to make submissions directly to the Panel in response to the case team's "prosecution" of the case.

2.8 The intention would not be to create a "son of Competition Commission", but rather to have a smaller group of individuals who would be continuously available for merger cases (although the role may not necessarily require a full-time five-days-a week commitment), in order to build up a body of consistent and predictable decision-making. Unlike the Competition Commission, the Executive Panel would be supported by the existing OFT staff, so that there would be savings both in terms of administrative and premises costs and also in avoiding the need for an entire team of officials to start reviewing the case afresh.

2.9 The removal of duplication should also allow for shorter time scales and more streamlined information gathering.

2.10 In addition, in order to build further procedural safeguards into a process handled by a single authority, a possibility would be to enhance the role of the Competition Appeal Tribunal (CAT) in merger control cases. A possibility would be to augment the current right of appeal in merger control cases by adding a new right for the merging parties only (and not third parties) to appeal against a decision blocking a merger on the merits of the case (and not only, as at present, on pure "judicial review" grounds such as lawfulness and procedural fairness). Pending mergers are time-sensitive and it is likely that such a right would not be frequently used in practice. However, even if not frequently pursued, the possibility of this asymmetric right of appeal would provide a powerful discipline for a new single authority.

Market investigations

2.11 The current UK system envisages a first look by the OFT (or a sector regulator such as Ofcom) which, based on wider competition and/or sector enforcement policy and expertise, would spot areas to be looked at and then refer such areas for a full investigation of up to two years by the Competition Commission. The Competition Commission findings are subject to appeal to the CAT on judicial review grounds only. The system is widely considered to be unnecessarily lengthy, creating uncertainties and waste of resources.

2.12 The length of the process could be curtailed if the OFT and Competition Commission stages were combined as a result of the proposed merger of the two authorities: for example, the initial "market study" stage could be completed within a firm deadline of six months (rather than the current system where the average duration of an OFT market study is around a year).

2.13 However, given the significant remedies that have been adopted in recent Competition Commission market investigations (such as, for example, the requirement that BAA divest a number of airports), there is a risk that an investigation by a single authority with no appeal mechanism (but only judicial review by the CAT) could raise a concern of lack of procedural safeguards, including that it is not fully compliant with the right to a fair trial in front of an independent and impartial tribunal enshrined in Article 6 of the ECHR. The right to appeal on a decision as momentous as the requirement for the UK's major airport operator, BAA, to sell off some of its biggest airports, should not have to depend purely on procedural matters such as whether or not the competition authority was biased.

2.14 The suggestion outlined above with regard to merger control - for the final decision of the new authority to be taken by an Executive Panel - could be adopted to alleviate any such concern in the case of market investigations. Again, the investigating case team would propose the results of their investigation and remedies to the Panel, who would challenge the findings in the light of submissions from the parties, thus providing an independent review and challenge within the market investigation process.

Regulatory pricing determinations

2.15 A similar theme applies to regulatory pricing determinations. These decisions involve a first-tier determination by the sector regulator, the possibility of "appeal" to the Competition Commission, and finally possible judicial review by the CAT.

2.16 In the case of telecoms pricing determinations, the process involves an additional stage: there is a first-tier determination by Ofcom, followed by an appeal to the CAT, which is obliged to refer price control issues to the Competition Commission, and then final judicial review by the CAT. There have been nearly 40 such cases since the adoption of the Communications Act 2003. They involve a large amount of public resources in both investigation and judicial defence. Ed Richards, Ofcom's chief executive, at a speech at the Jevons Institute this summer raised the question of

> "whether the regulatory system strikes the right balance between justice and efficiency in decision making. Or whether we have ambled somnolently into a world where regulators are expected to make timely decisions to promote competition, but find it ever increasingly difficult to do so."[2]

In some respects it is a fair question, but the answer is arguably not to lower the standards of judicial review which work perfectly well but rather to look at whether the number of degrees of appeal (and scrutiny on the merits) is disproportionate and inefficient. The process for telecoms price determinations could be simplified by eliminating the CAT appeal stage, so that there is simply a direct reference from the sector regulator to the Competition Commission for all matters, with the outcome of that second stage subject to judicial review before the CAT.

2.17 However, if the proposed merger of the Competition Commission and the OFT takes place as envisaged, the question will arise of who should conduct the second stage review. Referral straight to the CAT for a full reconsideration of the issue would seem less than ideal, given that the determinations involve policy questions as well as legal issues. Again, the suggestion mentioned above of the Executive Panel may provide a solution: the sector regulators could make their references to the Panel rather than to the Competition Commission, and the Panel would provide the independent, high level review required.

[2] Ed Richards, speech of 13 July 2010: "Competition law and the communications sector", available at the following link: http://media.ofcom.org.uk/2010/07/13/competition-law-and-the-communications-sector/.

3 Mandatory merger notification

3.1 A notable feature of the UK merger control regime is that there is no requirement for parties to a merger that satisfies the jurisdictional thresholds to notify the transaction to the OFT, and it is lawful to complete such a merger without prior approval by the UK competition authorities.

3.2 This contrasts with the position in relation to mergers subject to the EU Merger Regulation, where pre-notification and suspension of completion is mandatory. The same is true for mergers subject to the national merger control laws of every other EU Member State except Luxembourg (and Italy where there is no suspensory requirement). Outside Europe, most merger control regimes are also mandatory, including the USA, Japan, China and Canada, although Australia is voluntary for competition-based filings and mandatory only for certain foreign investments. The voluntary nature of the UK regime is therefore unusual in both EU and global terms.

3.3 **Voluntary or mandatory - *pros and cons:*** A move to a mandatory notification regime has a number of implications:

(i) **Additional burden for business and regulators:** A mandatory regime by its nature imposes potentially significant unnecessary regulatory burdens on businesses engaged in normal M&A transactions. Even parties to transactions that raise no material competition concerns are required to submit considerable information and argumentation by way of merger notification, and to delay implementation of the transaction pending the authorities' consideration. It then falls to the competition authority to consider and process these notifications - with pressure to do so within tight timescales in order to avoid unnecessary delay to completion of the transaction. The added burden is only borne by parties to innocuous mergers; parties to mergers that raise material issues would be likely in any case (in voluntary regimes) to notify, rather than take the risks of completing without clearance. The same point can be made about the use of regulatory resources: the additional work is likely to involve mainly administrative processing of straightforward notifications rather than substantive analysis of transactions that are likely to raise significant competition concerns. This does not appear to be the most efficient use of scarce regulatory resources.

(ii) **Efficient allocation of resources:** A voluntary regime is likely by its nature to result in parties notifying transactions only where there is some possibility of an adverse effect on competition (together with a small number of transactions where the buyer is particularly risk averse and/or has a policy of notifying all mergers irrespective of the degree of competition risk). Added to these proactive notifications will be those cases that the OFT chooses to investigate, either on its own initiative or as a result of a third party complaint, both categories of which will often (but not always) be transactions where there is potentially a substantive competition issue. The result is therefore that, for the most part, the OFT investigates mergers that may raise substantive issues, but does not (or at least need not) investigate mergers where the risk of a substantial lessening of competition is non-existent or minimal. This is likely to result in more efficient use of both the competition authorities' and the parties' resources, and costs are less likely to be incurred for deals that plainly do not warrant it.

(iii) **Self-assessment in competition cases:** It is perhaps worth noting that the approach in relation to the UK and EU prohibitions on anti-competitive agreements and abuse of dominance (the Competition Act Chapter I and Chapter II prohibitions, and Articles 101

and 102) is now "self-assessment" – the old notification regime for potentially anti-competitive agreements or abuse of dominance was abolished in 2004, so that businesses no longer notify such arrangements to a competition authority for formal clearance. The purpose of this "modernisation" measure for the prohibitions was to remove unnecessary regulatory burdens from businesses and allow them to take responsibility for legal liability and risk, while at the same time freeing up the competition authorities' resources to pursue cases with real anti-competitive implications rather than being wasted on innocuous cases. If that is a desirable objective for agreements and conduct, it is hard to see why it is not also desirable for mergers. To impose a mandatory notification requirement for mergers would run counter to this trend.

(iv) **Parties' negotiating position:** In a mandatory regime, the risk of entering into a transaction that is ultimately prohibited lies largely with the sellers – following an adverse finding, the buyer can simply walk away, while the sellers are left in the (potentially embarrassing) position of having acknowledged that sale of the business is an attractive strategic option, but having failed to achieve that sale. Under a voluntary regime, this position can be replicated if the buyer can negotiate with the sellers to make completion conditional on UK merger clearance, but the sellers will often seek to resist such conditionality unless the buyer's offer is so commercially attractive that its attractiveness outweighs the risk of future competition intervention. The voluntary regime therefore gives more flexibility to sellers, as conditionality can be a negotiating point in a transaction.

(v) **Speed of execution:** The voluntary regime may, however, operate to the advantage of certain purchasers if they are subject to UK merger control and are therefore able to complete immediately, while other purchasers require conditionality to comply with the EU Merger Regulation or another mandatory regime. This can be a factor affecting otherwise similar offers in a competitive bidding situation, although that can also be the case between offers from buyers who do not trigger any merger control filings and those who do.

(vi) **Transparency of merger activity:** An advantage from the competition authorities' perspective of a mandatory regime is that (subject to the jurisdictional thresholds) all mergers of significance are likely to be brought to the authorities' attention by pre-notification, so that there is limited risk that a potentially anti-competitive merger will avoid scrutiny simply because it does not come to the OFT's attention. Against this point is the relatively limited likelihood that a significant merger will be missed entirely by the OFT (given its monitoring activities and the vested interests of third parties in complaining), as well as the possibility of investigating a merger more than four months after completion if it has been given insufficient publicity. However, it may well be the case in the current voluntary regime that some transactions (the Committee believes only a very small number) that would warrant investigation are not reviewed by the OFT.

(vii) **No risk of invalidity:** A problem that may arise under a mandatory regime, but is not an issue in a voluntary regime, is that parties to a merger fail to appreciate that the transaction is notifiable. Generally, this will under a mandatory regime result in the transaction being legally invalid. Particularly if a transaction raises no substantive issues, what might be regarded as a technical error could have grave consequences for legal certainty and the efficient operation of the business.

(viii) **Issues over enforcement:** An issue that has from time to time concerned both the OFT and the Competition Commission is the potential difficulty, in a voluntary system, of dealing with a completed merger which is ultimately found to be likely to result in a substantial lessening of competition and meriting prohibition. The problem lies in re-establishing the acquired business as a separate business as it existed pre-merger - enabling it to be divested to a third party - in circumstances where staff may have been dismissed and the business integrated into the buyer's business. This is generally dealt with by "hold-separate" undertakings, discussed in more detail in paragraphs 2.6 to 2.13 below.

(ix) **OFT resources and fees:** A mandatory notification regime would result in significantly increased demand on the OFT, as they would be likely to face a significant increase in filings. (It is not so obvious that demand on the Competition Commission would increase significantly if we assume that most potentially anti-competitive mergers are already subject to scrutiny.)

3.4 **Practical implications for competition law advisers:** Both regimes have advantages and disadvantages for the competition law practitioner, but these are mainly to do with the practicalities of ensuring either that a merger caught by a mandatory filing requirement is identified in good time, or that a transaction under a voluntary regime is properly assessed for competition risk so that a client is fully informed. The two types of regime therefore make somewhat different demands on the practitioner, but the differences between them do not seem to the Committee material to the question of which would be better for business.

3.5 We therefore deal in the remainder of this section with two specific issues of relevance to this debate: first, the prevention of pre-emptive action (generally through "hold separate" undertakings to the OFT and Competition Commission); and, secondly, the nature of the jurisdictional thresholds should the UK move to a mandatory notification regime.

Avoiding pre-emptive action

3.6 In relation to pre-emptive action - that is, action (such as integration of businesses) that might prejudice a Competition Commission reference or any action ultimately required by the Competition Commission, such as divestment remedies:

- The OFT has powers[3] to accept from the merging parties (in practice, the buyer) such undertakings as it considers appropriate for the purpose of preventing pre-emptive action colloquially known as "hold-separate" undertakings. The OFT may, if necessary, make an order[4] if undertakings are not forthcoming, but in practice it does not usually need to exercise this power.

- Following a reference to the Competition Commission, there are automatic statutory restrictions[5] on the parties' ability without Competition Commission consent to continue with certain arrangements to integrate the merged businesses if completion has occurred, or to make certain share acquisitions if completion has not occurred. In practice, the Competition Commission will often supplement these statutory restrictions either by

[3] Enterprise Act 2002 section 71.

[4] Enterprise Act 2002 section 72.

[5] Enterprise Act 2002 sections 77 and 78.

adopting the OFT's initial undertakings (if any) or by seeking hold-separate undertakings or orders of its own[6].

3.7 In recent years it has become more common for the OFT to seek hold-separate undertakings in relation to any completed merger where there is a possibility, even if small, that a reference will be required. The OFT also tends to seek such undertakings earlier in its investigation than was previously the case.

3.8 In the period from the start of 2009 to the end of September 2010, the OFT accepted hold-separate undertakings in 18 cases (over 10 per cent of all cases). Of those 18 cases, none resulted in undertakings in lieu of a reference, but four were referred to the Competition Commission (one was still undecided at that date), with two of those four eventually cleared, one subject to a divestment undertaking, and one undecided. In addition, one completed merger (*Sports Direct/JJB Sports*) was subject to a hold-separate order by the Competition Commission and undertakings were given to the Competition Commission in relation to another merger completed following its clearance but then subject to a successful appeal (*Live Nation/Ticketmaster*) – both these transactions were ultimately cleared by the Competition Commission.

3.9 These figures do not seem to suggest that there are significant numbers of completed mergers that raise substantive competition concerns and therefore require hold-separate undertakings – in fact, most mergers where such action is taken are ultimately cleared. If we assume that the vast majority of transactions that may result in a substantial lessening of competition do come to the OFT's attention, then the current system for preventing pre-emption appears to be capable of dealing with this with relatively little effort.

3.10 Issues that arise for completed mergers under the current process are (i) the inconsistent application of the hold-separate undertakings process – only those completed mergers that come to the OFT's attention in good time are subject to effective undertakings, so other mergers that ultimately raise substantive issues may not be caught in time (though the figures above suggest that this is rare); and (ii) even where hold-separate undertakings are imposed relatively early, integration may already have progressed, for example through staff dismissals or branch closures, which reduces the efficacy of the undertakings.

3.11 However, in the Committee's experience these problems have not been significant in practice, so it appears that the current standstill arrangements are working in general although the scope and terms of the "hold separate" undertakings could benefit from more focus and further refinement. In fact, if anything, the OFT appears to be using standstill arrangements increasingly early and in a wide range of cases, including where there is little risk of potential harm arising from irreparable integration. That said, if it were to transpire that current practice was inadequate and significant anti-competitive mergers were getting through, the solution would lie in the hands of the OFT to make more extensive use of the powers it has. Moreover, where integration is advanced in relation to a transaction ultimately subject to prohibition or divestment undertakings, the burden of "re-creating" an effective competing separate business falls squarely on the buyer, so that it is at the buyer's own risk if it proceeds with integration prior to clearance.

[6] Enterprise Act 2002 sections 80 and 81.

3.12 In relation to anticipated mergers, the OFT currently has no powers to prevent pre-emption (although the Competition Commission has such powers). However, given that by definition the businesses have not yet merged, the Committee does not view this as a significant practical problem.

3.13 Accordingly, the Committee considers that if a voluntary notification system is retained, there is no need to reform any aspects of the current Enterprise Act provisions for preventing pre-emptive action by merging parties.

Jurisdictional thresholds

3.14 In terms of jurisdictional thresholds, the Committee's sense is that the alternative tests of UK turnover and share of supply operate satisfactorily for the current voluntary regime. However, if a mandatory regime were adopted, a number of issues would arise.

3.15 First, the turnover threshold is relatively easy to apply and suitable for a mandatory regime (the EU Merger Regulation and many EU national merger control regimes use turnover tests). An issue will be the level at which the threshold is set. If only a UK turnover test determined jurisdiction, then if the threshold remained at its current level of £70 million a number of mergers that raise substantive issues in small markets would fall outside the merger control regime. Avoiding this detriment needs to be balanced against the increased number of unproblematic transactions that would be subject to mandatory notification if the threshold was lowered.

3.16 By way of comparison, similar sized EU economies with national turnover thresholds as part of their mandatory regime are France (€50 million), Germany (€25 million) and Italy (€45 million). In common with other regimes, these also set a combined worldwide or national turnover threshold to be met by all parties. Germany is unusual in that only one party need meet the relevant national turnover threshold (with another party only required to have turnover in Germany in excess of a nominal €5 million). In most other countries, two or more parties must meet the threshold. In terms of the burden of compliance, inclusion of a combined worldwide turnover threshold makes little difference; a combined national turnover threshold will require more analysis unless either buyer or target satisfies the threshold on their own.

3.17 Secondly, the current share of supply test is extremely wide-ranging and gives the OFT significant flexibility to find that it has jurisdiction. Under the current voluntary regime, the wide scope for transactions to be caught is mitigated by the parties' ability to assess whether in fact a merger raises substantive competition issues. It is common for parties to conclude that, even if a merger is caught by the share of supply test, no notification is appropriate, often because a combined share of supply of 25 per cent does not equate to a share of a properly defined economic market of anywhere near the same level.

3.18 It is the Committee's experience that even where a jurisdictional threshold involves a market share test (for example, in Spain and Portugal), there can be considerable uncertainty as to whether the threshold is met, uncertainty which is often difficult to resolve during intense negotiations prior to signature of a transaction. Retention of share of supply as a jurisdictional basis for a mandatory UK regime would be likely to result in a high number of deals being made conditional on clearance on a precautionary basis, and to result in notifications of small transactions that in practice raise no substantive competition concerns.

Material influence

3.19 The jurisdiction of the OFT over transactions where "material influence" is acquired over a business would also need to be reviewed if the UK were to move to a mandatory notification system. The recent *BSkyB/ITV* case has demonstrated that it is possible to acquire material influence for the purposes of merger control jurisdiction with the acquisition of an extremely small shareholding.[7] In that case BSkyB was required to divest itself of enough shares to reduce its shareholding in ITV below 7.5 per cent, suggesting that there may be a risk of material influence arising from any shareholding of more than 7.5 per cent. Further, in the case of *Stora/Swedish Match/Gillette*, material influence was acquired without any shareholding being purchased at all, but from the existence of rights connected to non-voting convertible loan stock.8 In a mandatory system retaining the material influence test and the share of supply test, it would be difficult to be certain about the level of equity investment/control rights at which notification was required. Some secured lending or lending which contemplates equity conversion (e.g. some project finance and buy-out finance) could also be caught.

3.20 If such a wide range of transactions could be covered by the notification regime, it would be bound to lead to a significant increase in notifications - even if only precautionary ones. This would be a huge burden on business. It would create a large volume of extra work for the competition authority, potentially distracting scarce regulatory resources from considering transactions that raise more substantive issues.

[7] *BSkyB/ITV*, Competition Commission report of 20 December 2007, divestment remedy confirmed by the Court of Appeal in judgment of 21 January 2010, *BSkyB v Competition Commission* 2010 [EWCA] Civ 2.
[8] MMC report, *Stora/Swedish Match/Gillette*, March 1991.

4 "Public interest" test for merger assessment

4.1 It was widely suggested, in the light of public concerns about the *Kraft/Cadbury* takeover in early 2010, that such takeovers should face a higher hurdle, and that this could include changing the criterion for UK competition authorities to assess mergers from a competition-only test to a wider "public interest" test. The Committee notes that this suggestion now appears not to be a priority for the Government, and that the Takeover Panel has recently proposed amendments to the Takeover Code to address certain of the concerns raised by other means, in particular amending the Code to redress the balance in favour of the offeree company.[9] Nevertheless, for the completeness, the Committee thinks it helpful to put on record our thoughts on this.

4.2 The Committee considers that, if the main criterion for assessing mergers in the UK merger control regime - the test in the Enterprise Act 2002 s47(2) of whether the merger results in a "substantial lessening of competition" on a market in the UK - were to be replaced by a wider test of effects on the "public interest" such as existed under the Fair Trading Act 1973, a number of potential problems would need to be addressed:

(i) **Predictability for business:** A great advantage of the current "competition" test over a wider public interest test is that it allows for greater consistency in the framework for assessing mergers, and therefore greater predictability for businesses engaged in merger activity (or, indeed, under threat of takeover). Of course, it is in the nature of business, and of M&A activity in particular, that there cannot ever be complete predictability; but it is desirable that, so far as possible, regulatory uncertainty should be minimised. The danger of allowing a wide range of "public interest" factors to come into play, rather than a clear economic test of effects on competition, is that it maximises the scope for arbitrariness and uncertainty. Further, assessments of what matters for the public interest are, essentially, subjective *political* judgements, which it may not be appropriate for independent (and unelected) competition authorities to make. It is for these reasons that the last Labour Government introduced the "competition" test in the Enterprise Act, abolishing the old "public interest" test, and linked this with the depoliticisation of merger control through removing Ministerial interference from the merger control process (except in specific, exceptional cases, discussed in para 3.3 below). As the July 2001 White Paper issued by the (then) Department of Trade and Industry to pave the way for the Enterprise Act, put it:

> "Making competition the focus of the assessment will ensure that the underlying economic arguments can be brought to bear on the analysis of a merger in a clear and straightforward manner."[10]

The previous Government considered that the linked depoliticisation of merger control

> "will clarify arrangements and make decision-making more predictable. Business will no longer need to factor in the possibility that decisions will be influenced by political considerations."[11]

Those reasons seem to us as pertinent as when they were set out in 2001; arguably even

[9] Takeover Panel Code Committee, Review of Certain Aspects of the Regulation of Takeover Bids, 2010/22.

[10] *A World Class Competition Regime, Department of Trade and Industry*, July 2001, Cm 5233, para.5.8.

[11] *A World Class Competition Regime* (as above), para 5.4.

more so in the current uncertain economic climate faced by businesses.

(ii) **Consistency with international norms:** The practice of competition authorities assessing mergers solely according to whether they substantially lessen competition (rather than on wider public interest grounds) is now virtually universal, applying across the European Union, in the United States and Australia, and now also in, for example, India. If Britain were to move to a wider "public interest" test, we would be out on a limb internationally and entirely at odds with the practice across the whole of the EU. That matters in an increasingly globalised business world where transactions are increasingly multi-national and multi-jurisdictional. If Britain has a regime that is out of step with international norms, more complex and less predictable, Britain risks being widely seen as an unfavourable environment for business transactions and investment.

(iii) **Compliance with EU law:** In any event, there are good grounds to consider that a wider "public interest" test would be unlawful, putting the United Kingdom in breach of EU law. Specifically, the "Single Market" free movement rules enshrined in EU law from the outset - and in particular the provisions on freedom of establishment and free movement of capital now in, respectively, Articles 49 and 63 of the Treaty on the Functioning of the European Union - are now thought to preclude national authorities impeding cross-border mergers, except on very narrowly circumscribed grounds. In December 2006, when the Spanish energy regulator imposed certain conditions on the proposed *E.ON/Endesa* takeover (which had been cleared under the EU Merger Regulation), the European Commission made a legally-binding decision (subsequently upheld by the European Court of Justice) that the national regulator's conditions must not be imposed; the ground of the European Commission's decision was not merely the exclusive right of the European Commission to consider mergers within the jurisdiction of the EU Merger Regulation, but also the rules on freedom of establishment and free movement of capital[12].

4.3 **Flexibility:** We recognise that there may be exceptional circumstances where paramount policy considerations, and indeed Ministerial involvement, should be allowed to play a part. The existing legislation already allows for this in respect of national security and media plurality (Enterprise Act 2002 s58) and gives the Secretary of State the flexibility to legislate by order to add further grounds - a power which has been exercised once, in the special circumstances of the financial crisis of autumn 2008, when the Secretary of State added the public interest ground of "maintaining the stability of the UK financial system", enabling the *Lloyds/HBOS* merger to be cleared (when it would otherwise have been blocked on competition grounds). Indeed, even where mergers come under European Commission jurisdiction, there is flexibility for national authorities to intervene on grounds of national security, media plurality and the supervision of financial institutions.

4.4 **Cross-party consensus:** For all these reasons, there has been cross-party consensus that, save in specified and exceptional circumstances (such as national security or financial crisis), UK merger control should be based on an assessment of effects on competition, rather than wider public interest matters. This principle was adopted as a matter of policy from the mid-1980s onwards by the then Conservative Government, following a statement made by the then Secretary of State for Trade and Industry, Norman Tebbit, and was reinforced by the Labour

[12] European Commission press announcement, "Commission decides that Spanish measures in proposed E.ON/Endesa takeover violate EC law", IP/06/1853, Brussels, 20 December 2006.

Government by legislation in 2002. The Committee also notes the conclusion reached by the current Secretary of State in his July 2010 formal response to the Home of Commons BIS Select Committee report on the *Kraft/Cadbury* takeover that legitimate concern about unsuccessful takeovers

> "does not mean that we should return to the old-fashioned public interest test, which encouraged weak managements to lobby for protection".

5 Competition Act 1998 - OFT enforcement

5.1 In the light of the forthcoming consultation on the various potentially fundamental changes to the structure of UK competition law being considered in this paper, the question arises as to whether now is an appropriate time to review the administrative procedures provided for in the Competition Act 1998 in connection with the Chapter I and Chapter II prohibitions.

5.2 The efficiency of the OFT's decision making procedures has been considered in detail by the National Audit Office (NAO) in a number of reports. Most recently, in March 2010, the NAO observed that the sector regulators had so far made limited use of their enforcement powers, the case law that had arisen out of OFT and sector regulator investigations was not as rich as it needs to be, the decision-making process is unduly lengthy, most decisions are appealed to the CAT which may reduce the appetite for regulators to use their enforcement powers, and there appeared to be too much use of early resolution procedures.

5.3 The OFT is currently consulting on its investigation procedures under the Competition Act (the OFT issued its consultation paper in August 2010), and this may therefore be an appropriate time to consider engaging in a broader consultation relating to the structure of the OFT's (and sector regulators') investigatory and decision-making processes.[13]

5.4 The OFT's enforcement structure is based on the European Commission model and involves the OFT playing four roles: (i) it carries out investigations, having satisfied itself that it has reasonable suspicion of an infringement in order to exercise the stringent investigatory powers at its disposal, which include dawn raids and statutory demands for information, both of which are supported by the threat of criminal sanctions; (ii) it prosecutes alleged infringements by way of a Statement of Objections; (iii) it then adjudicates as to whether an infringement has in fact occurred by reviewing the parties' submissions in response to the Statement of Objections and conducting an oral hearing, and then taking a decision on whether there is an infringement; and (iv) finally it decides on the level of penalty, i.e. fines, that should be imposed if there is an infringement. Case law under the European Convention on Human Rights has confirmed that competition law penalties (which can be extremely high – the OFT has recently imposed a fine of £112 million on Imperial Tobacco) are criminal in nature.[14] A similar investigatory, prosecutorial and adjudicatory structure exists within each of the concurrent regulators.

5.5 **Separation of powers:** It seems clear, from both the perspective of political theory and the traditions of the common law, that the current OFT approach is exceptional given the risk of confirmation bias and the fact that the OFT is acting as a judge in its own cause. In this connection, most common law jurisdictions have adopted a clear separation between investigation and prosecution on the one hand and adjudication on the other; for example, in Australia, Canada, the Republic of Ireland, and the USA, prosecutions are brought by the competition authority (or relevant governmental department) before an independent judge who

[13] The Committee will also be submitting a response to the OFT consultation in due course.

[14] See, for example, *Société Stenuit v France* (1992) EHRR 509 where the Commission of Human Rights held that a decision to impose a fine under French competition law amounted to the determination of a criminal charge for the purposes of the Convention. The case was settled before the Court ruled. The leading textbook on EU competition law, Bellamy & Child (6th Edition), says in paragraph 13.030 that "It therefore appears that for the purposes of Article 6 of the Convention, proceedings by the Community for infringement of the competition rules should be regarded as the determination of a criminal charge...".
Note also that in the General Court of the European Union, Case T-1/89 *Rhône-Poulenc SA v Commission* [1991] ECR II-867, Advocate General Vesterdorf explicitly espoused the reasoning of the ECtHR in his opinion (p885) and noted that "in this connection considerable importance must be attached to the fact that competition cases of this kind are in reality of a penal nature".

decides whether an infringement has arisen and, if so, what penalty should be imposed. It is also relevant to note that the Competition Bill that is currently being considered in Hong Kong has adopted the judicial enforcement model, with enforcement actions being brought by the Hong Kong Competition Commission before the Competition Tribunal.

5.6 **Internal separation of powers:** The OFT's August 2010 consultation paper which explains and consults on the OFT's investigatory procedures demonstrates that, in seeking to overcome the inherent risks that an integrated structure entails, a range of individual decision-makers, committees and processes have been introduced into the internal decision-making structure. For example, a "Team Leader" is identified as running the case day-to-day; a "Project Director" directs the case and is accountable for delivery of high quality timely output; and a "Senior Responsible Officer" (SRO) is accountable for overall delivery of the case and "advises on the direction of the case". The SRO is typically responsible for deciding whether grounds for opening a formal investigation exist and whether the evidential requirements for issuing an SO have been met. The SRO can consult with other senior officers as he/she considers appropriate but does not necessarily review the evidence available on the case file, although the SRO can call for it if he/she thinks that it would be of assistance in exercising their functions. Coupled to this, the SRO is only described as being "typically" in attendance at oral hearings. It appears that the decision to issue a Statement of Objections is taken by the SRO, but it is not clear who takes the final infringement decision. Accordingly, at no time during the process can the parties under investigation be sure that they are submitting their views and evidence to the actual decision-makers. Moreover, there is no hearing officer; a hearing officer, although not a substitute for the existence of an impartial decision-maker, would assist in ensuring that the OFT's integrated procedures are seen and understood to be applied as fairly and transparently as possible.

5.7 **Duration of investigations:** As regards the length of investigations under the Act, a review of individual decisions shows that the OFT's and sector regulators' investigations under the Chapter I and Chapter II prohibitions can take many years. The chart attached shows the duration of each of the key stages of the OFT's and sector regulators' decisions since 2000 (excluding Mastercard which in many ways is exceptional). It is clear that there is often a protracted period from the date the Statement of Objections is issued until the date of the decision. For example, in the recent tobacco decision, a period of 24 months elapsed from the date on which a 418-page Statement of Objections was issued to the parties and the date on which the 583-page decision was finally adopted on 15 April 2010.

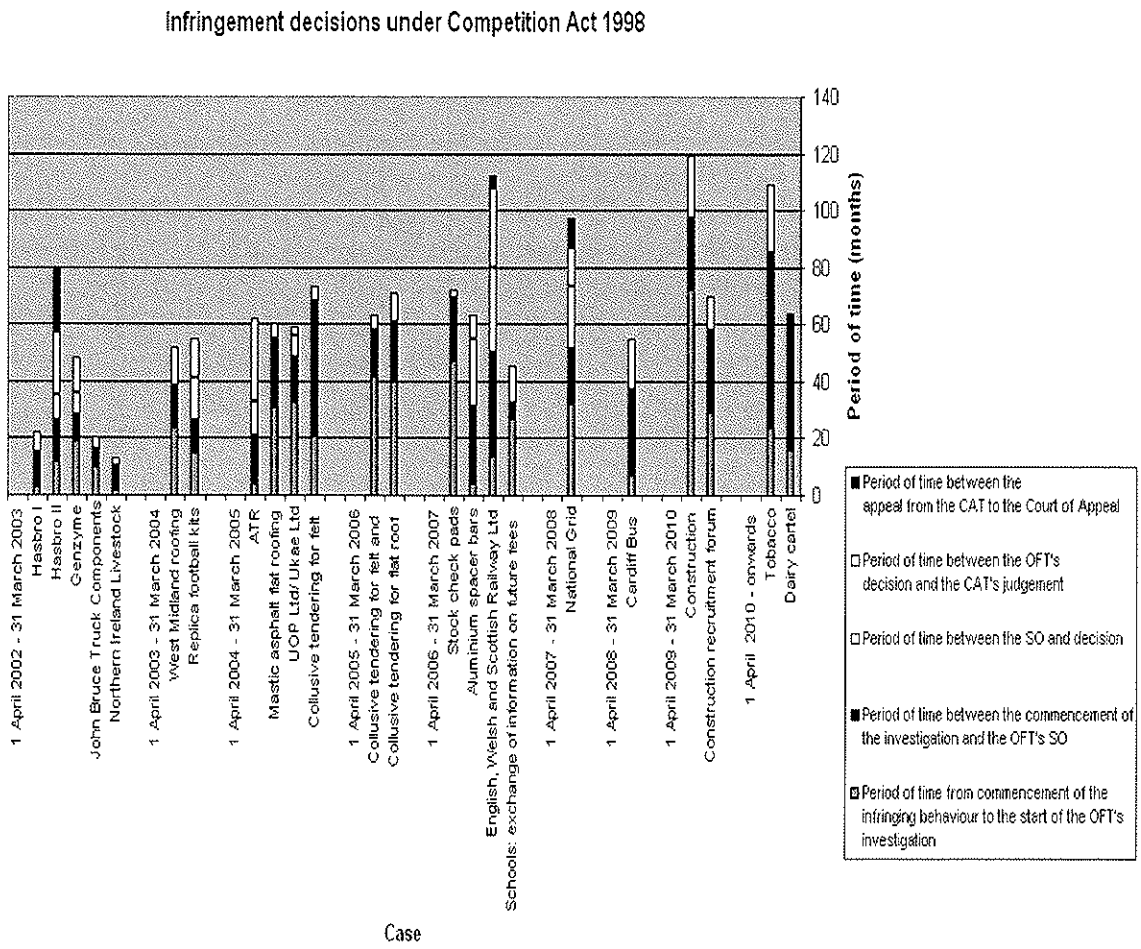
5.8 **Other possible reforms:** Other reforms which might be considered include:

- One possible approach which would seem to hold out the prospect of materially increasing procedural safeguards, and creating some form of separation of powers, would be to adopt for Competition Act cases the proposal set out in Section 1 above in relation to merger control and market investigations: that if the proposed amalgamation of the OFT and Competition Commission goes ahead, the new combined authority could have an Executive Panel with full decision-making power. In Competition Act cases, the case team (and the sector regulators) would "prosecute" a Statement of Objections before members of the Executive Panel, who would then be charged with reaching a final decision on the case. As explained previously, while the Panel would be within the OFT it is envisaged that its members would be independent decision-makers. Allowing parties to respond to a Statement of Objections before the Panel would ensure transparency and access for parties to the final decision-makers - avoiding the problem explained above of parties making submissions without knowing whether they are in fact addressing the final

decision-makers. The introduction of independent scrutiny at the Statement of Objections stage will provide a challenge to the case team's analysis, and should ensure rigour in OFT decision making. Such an approach is likely to avoid the issue of supplemental Statement of Objections. It may also encourage the sector regulators to use their enforcement powers and would certainly seem to hold out the prospect of consistency of outcomes as between the OFT and the sector regulators.

- A further reform that could be introduced would be to impose a two or three-year time limit on the OFT's ability to issue a Statement of Objections, subject to the possibility of an extension being granted by the CAT in light of particular circumstances. There would be an appeal to the Court of Appeal on a point of law and in relation to the magnitude of any penalty imposed by the CAT. The period for parties to appeal could be extended to 3-4 months, during which period settlement/early resolution negotiations could take place. As around 60 per cent of appeals to the CAT are determined within 12 months (according to the NAO's March 2010 report) the prospect for a more efficient and fairer process would appear to be significant.

- Further savings might be introduced if the OFT could avoid the need to engage in the redaction of documents on the case file, for example, by a confidentiality ring being instituted for the Appellants before the CAT.



6 Competition Act 1998 - sector regulators' powers

6.1 As part of its wide ranging review of the fitness for purpose of the UK competition law regime, The Committee believes that, in the context of this debate, careful consideration should be given to whether, and to what extent, the sector regulators - Ofgem, Ofcom, Ofwat, the ORR, the CAA and the NIAUR - should retain their role in investigating and enforcing Competition Act infringements.

6.2 In March 2010, the NAO observed in relation to the sector regulators that they had so far made limited use of their enforcement powers, that the case law that had arisen out of OFT and sector regulator investigations is not as rich as it needs to be, that the decision-making process is unduly lengthy and that most decisions are appealed to the CAT which may reduce the appetite for regulators to use their enforcement powers. In particular, the NAO recommended that

> "the Government should evaluate whether the incentives within the system for Regulators to use their competition powers are appropriate to establish the body of case law required for an effective competition system".[15]

6.3 The earlier DTI/Treasury report in 2006[16] recognised that the issue is not straightforward and considered that the limited number of infringement decisions emanating from the sector regulators did not necessarily demonstrate flaws in the regime, and that a number of factors may explain the lack of decisions, such as the structure of the markets, high levels of compliance within regulated markets and changes in behaviour in response to an investigation being instigated.

6.4 Leaving aside market investigation references which we deal within Section 1 above, and where only two references to date have been made to the Competition Commission by sector regulators (on rail rolling stock by the ORR, and on films for pay-TV by Ofcom), it seems to the Committee that the key question is:

- Do efficiency considerations and consistency in terms of enforcement outcomes point toward the current system being subsumed within either a single regulator or, as some have suggested, a "government service of competition experts"?[17]

6.5 **Key factors:** The tensions inherent in the question of where Competition Act investigation and enforcement should reside, in the Committee's view, include the following:

(i) Sector expertise and responsibility for optimising consumer welfare within a given sector reside with the sector regulators. There is a strong expertise based argument in favour of these powers continuing to reside with the sector regulators. This appears to be reflected in the Government's apparent approach toward more concurrency (in, for example post, airports, healthcare, and possibly banking).

(ii) Competition Act powers residing with both the sector regulators and the OFT should, in principle, lead to more Competition Act enforcement - given that the sector regulators are free from consideration of "high impact" prioritisation of Competition Act cases across all

[15] National Audit Office, Review of the UK's Competition Landscape, 22 March 2010, page 6.

[16] *Concurrent Competition Powers in Sector Regulation*, A report by the Department of Trade and Industry and HM Treasury, May 2006.

[17] National Audit Office, Review of the UK's Competition Landscape, 22 March 2010, page 7.

sectors in the way the OFT is, and that the OFT is in principle able to open a Competition Act case in a particular sector if it satisfies its prioritisation criteria and is best placed to do so (although it is not clear whether the OFT could do so over the objections of the relevant sector regulator)[18].

(iii) Arguably the sector regulator is best placed to decide which is the most appropriate tool in dealing with a particular issue (i.e. whether the best response is *ex ante* regulation via enforcement of licence conditions or the introduction of new conditions, or *ex post* enforcement via the Competition Act). As privatised markets move to more competitive structures, this should prompt a move toward more reliance on CA 98 enforcement and less reliance on regulatory interventions (and thought should be given to how the "right" regulatory incentives might be structured in this regard[19]).

(iv) In principle, however, enforcement skills favour economies of scale and learning effects from the investigation and prosecution of Competition Act cases more generally. The record of sector regulators enforcing competition law and the strength of competition law teams is variable across the regulators. Ofcom has the most extensive experience of prosecuting cases to infringement decisions and in the Committee's view the largest skilled pool of competition specialists.

6.6 **Consolidation of expertise:** The present system - involving as it does, at present, at least seven concurrent regulators in England and Wales, and little public evidence of the exchange of enforcement expertise and best practice[20] - appears to offer scope for some consolidation, either amongst sector regulators or at the least, between their competition teams.

6.7 **Danger of abolishing concurrent powers:** However the Committee sees dangers in the suggestion that the sector regulators' Competition Act powers be transferred to the OFT. A distinctive and valuable feature of the concurrency regime is that sector regulators may choose between sector specific regulatory powers and general competition powers to regulate markets (or indeed use both). The Committee considers that, if the sector regulators were deprived of that choice through the transfer of their Competition Act powers to the OFT, that would be likely to result in greater use of *ex ante* regulatory powers by sector regulators and the potential for even less Competition Act enforcement as a result of resourcing issues and prioritisation issues across markets rather than within them.

6.8 **Consistency:** A possible disadvantage of the current system is that competition law may be applied inconsistently between sectors, notwithstanding the concurrency working party, which is designed to share ideas between regulators. A solution to this difficulty might be provided if, as outlined in section 1 above regarding merger control, following the proposed merger of the OFT and the Competition Commission an Executive Panel is created within the new merged authority. As suggested in section 4.8 above, the Panel could be charged with the responsibility of hearing Statements of Objections in Competition Act cases - whether prosecuted by the OFT or the sector regulators - and reaching final decisions.

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[18] The Competition Act 1998 Concurrency Regulations 2004.

[19] One idea could be to prevent a regulator using "softer" regulatory powers with arguably lesser standards of proof in terms of evidence where CA 98 enforcement has been rejected by the OFT and/or the relevant sector regulator.

[20] The Committee acknowledges the establishment of the Concurrency Working Party (CWP), but the detail of the regularity and content of its meetings is not published.

6.9 **The way ahead:** In the Committee's view, therefore, consideration should be given to:

- means of ensuring better and more transparent co-ordination between sector regulators and the OFT are considered;
- the scope for the creation of a common resource of skilled competition specialists available to the sector regulators (either as a result of consolidation between the various sector regulators or sharing of resource between them);
- considering whether the structure of the merged OFT and Competition Commission offers any opportunities for increased consistency between regulators - for example by providing for Statements of Objections from all the sector regulators to be prosecuted before a new Executive Panel.

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