

**WHAT IS A COMPETITIVE MARKET?
THE UNITED KINGDOM EXPERIENCE AND LESSONS FOR HONG KONG**

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Introduction

Theory and practice

Ladies and Gentlemen. It is a great honour and privilege to be invited to speak to you today about competition. I thank the University of Hong Kong and Norton Rose for this invitation.

Hong Kong has a new Competition Bill, due to take effect as an Ordinance in 2012. The United Kingdom has had a competition law for more than 60 years, the European Union for more than 50 and the United States for more than a century. Many new competition regimes have been established in recent years.² Of particular relevance to Hong Kong are China's Anti-Monopoly law, which took effect in 2008, the recent establishment of competition law in Singapore, Malaysia and Indonesia, and the increasing activity of the competition authorities in Japan and Korea, not to mention Australia and New Zealand.

There is perhaps a danger of being carried along by a wave of 'competition euphoria' and believing that the battle for competitive markets has already been won. I think this is a dangerous assumption and my purpose today is to try and bridge the divide between the policy and theoretical aspects of competition and their practical application.

It is easy enough to decide as a matter of policy that competition helps to promote economic efficiency and brings benefits for consumers, to pass a suitable law, and then to assume that these benefits can easily be realized in practice.

In fact, translating the theory into practice is very difficult. It requires strong institutions, a clear legal framework with judicial accountability, a system of evidence-based analysis using sound economics and a substantial measure of support from the business community and from consumers; above all, it requires cases. A competition regime that does not have a basic flow of well-conceived cases covering the main fields in which business is conducted will not be seen as effective, and the regime itself will be unlikely to produce the benefits that policy-makers expect.

So I will explain what I see as the key elements of a good regime relating these so far as possible to what we have in the UK and what is planned in Hong Kong; then I will examine what is the essential goal of competition policy—competitive markets—and how they are to be encouraged. I will illustrate these points from some of our recent case work, particularly our Investigation into *Grocery Retailing* conducted from 2006 to 2008.

¹Chairman, Competition Commission (CC). All views expressed are personal to the author and do not necessarily represent the views of the CC. The assistance of Trudy Feaster-Gee in the preparation of this paper is gratefully acknowledged.

²Fourteen jurisdictions and organizations supported the launch of the ICN in 2001. By August 2010, the ICN website lists nearer 150 organizations.

I shall also suggest to you that there is no unique way of using competition law to promote competitive markets—that the various instruments complement each other, and that other, overlapping policy imperatives have to be recognized and addressed. Only then can the theory be successfully translated into practice and something tangible be achieved.

The UK regime and Hong Kong's new law

Before examining what makes for an effective competition regime, let me refer briefly to the new law in Hong Kong and how it compares with the UK system.

The Competition Bill³ will prohibit anti-competitive agreements (the First Conduct Rule) and the abuse of substantial market power (the Second Conduct Rule). In this it broadly reflects international practice and the UK and EU certainly have equivalent provisions. The new Competition Commission will also have the power to conduct market studies into matters affecting competition in markets in Hong Kong.⁴ Such studies will be used as a way of identifying competition issues in a market, allowing the authority to bring cases, where applicable, to address these concerns. I will say more about this later.

On the control of mergers, there is a general framework in the Bill, but this applies only to mergers in the telecommunications sector.⁵ Of course some mergers may be subject to the Anti-Monopoly law in China, but no specific merger control is provided for Hong Kong, at least at the start. Again, I will come back to this, as I see merger control as a necessary and integral part of an effective competition regime. But I note that in India the introduction of merger control has caused controversy,⁶ that some countries, for example Malaysia, have not introduced merger control at all, and that even in the USA, EU and UK, merger control followed the introduction of general competition law only after a delay of several decades.⁷

As for institutions, Hong Kong will have a Competition Commission and a Competition Tribunal and two sector regulators with concurrent powers.⁸ In the UK we have an Office of Fair Trading (abbreviated to OFT), a Competition Commission (the CC) and a Competition Appeal Tribunal (known as the CAT) as well as five sector regulators with concurrent competition powers. Of course, what matters is not the name of the institution, although 'Competition Commission' sounds right to me, but what they comprise and what they do.

With those brief comparisons in mind, let us look at some more basic questions about what makes for an effective regime.

What makes an effective competition regime?

I am assuming that we all agree on the aims and objectives of a competition policy and that the contribution to economic efficiency and consumer welfare of markets being competitive and open is accepted and understood. I do not for one moment under-estimate the enormity of those assumptions, but I simply do not have time to debate them today. Instead I will

³C847-C1129, published 2 July 2010.

⁴Section 129(e) of the Competition Bill.

⁵Schedule 7, Part 2, paragraph 4 of the Bill.

⁶Prior to 1991, India operated a merger regime under the now repealed Monopolies and Restrictive Trade Practices Act 1969. When the Indian economy was liberalized in 1991, these merger provisions were abolished. For the past almost 20 years there has been no merger control in place in India. Merger controls were provided for in 2007 under amendments to the Competition Act 2002, though implementation was delayed by legal challenge before the Supreme Court and objections from industry and the merger provisions are not yet in force.

⁷The competition aspects of mergers have been regulated in the UK only since 1965 when the Monopolies and Mergers Act extended the jurisdiction of what was then the Monopolies Commission. The European Union's first Merger Regulation (Council Regulation EEC/4064/89) was not adopted until 1989. Whilst the Clayton Act 1914 remains the principal US statute regulating mergers, it was not until the Hart-Scott-Rodino Antitrust Improvements Act of 1976 that the US introduced pre-merger notification for certain mergers.

⁸The Telecommunications Authority and the Broadcasting Authority (sections 158 and 159 of the Competition Bill).

examine how these aims can be realized. Let me examine in turn the key elements listed above; this is in no particular order of importance.

Institutions

Competition enforcement by an arm of the executive generally has not worked very well. Politicians tend to be subject to competing, short-term pressures and the credibility of the system tends to be put in doubt. Instead there is a general international consensus that competition policy should be set by government but applied and enforced by independent authorities. Independence is relative, as authorities are necessarily organs of the state, but so far as possible they should have executive freedom within set policy limits and their decision-making should not be called into question by government. I see some recognition of this principle of operational independence in the new Bill.⁹

In the UK, a mixed system operated for many years with final decisions on mergers and markets taken by Ministers and decisions on restrictive agreements taken by a specialist court. Between 1998 and 2002 the system was changed to make all competition decisions a matter for independent authorities accountable to the courts through a specialist tribunal, with Ministerial override limited to a few clearly defined situations in mergers and markets.¹⁰

Of course there are many ways to structure independence and no single model dominates; it is the principle that matters. To be effective, these independent authorities also need structure, organization, resources, expertise and leadership. Again there is no unique model but all these elements are required.

Clear legal framework

Institutions will struggle to be effective unless there is a clear understanding of what principles they are to apply, and how they should apply them. The principles of competition law therefore need to be clearly stated and businesses, consumers and indeed government all need to be able to understand what these cover, how they will work, and what they are trying to achieve. The legal framework must address all of these matters and also provide the basis for the acceptance and enforcement of the law, sometimes against the wishes and perceived interests of those whom it touches. For example, a large fine or an order for divestiture can properly only be imposed after a fair legal process has been applied within a clear legal framework.

Judicial accountability

The corollary of giving the authorities independence from the executive arm of government is that they must be legally accountable to the judicial arm. Again, there is no fixed model for this. Accountability can either be to the general courts or, as in the UK and some other countries, to a specialist court dedicated to competition matters. In the USA and elsewhere, of course, the authorities' direct decision-making power is very limited and they must present their case to a court for decision. In Hong Kong, the Competition Commission will in

⁹Sections 11, 12, 26 and 27 of the Bill provide for decisions of the CC and the effect of those decisions. Part 5 of the Bill allows for review by the Tribunal. Section 31 provides for the Chief Executive in Council to exempt, by order published in the *Gazette*, specified agreements or conduct only if there are 'exceptional and compelling reasons of public policy for doing so'.

¹⁰See, regarding mergers, sections 42 and 59 Enterprise Act 2002 (EA) and in relation to market investigations, sections 132 and 139 EA describing the Minister's power to refer matters to the CC and to intervene on public interest grounds. The grounds for intervention (specified considerations) are set out in sections 58 and 153 EA.

particular have to apply to the Tribunal to impose fines and it is clear the Tribunal will play a major role in disputed decisions and enforcement generally.¹¹

However it is done, rights of defence and appeal to a judicial authority need to be provided so as to underpin the credibility and authority of the system as a whole. This is an aspect of the rule of law, and a competition policy without the rule of law would be a dangerous beast indeed.

Evidence-based analysis

Competition law has come a long way since its inception in US statutes at the end of the 19th century. Moreover, the science of competition economics (or should I perhaps say the art) now offers significant assistance in enabling authorities to decide whether a particular agreement or practice has good or bad effects and to enable predictions of likely effects to be less arbitrary than before. That is not to belittle the need to examine so called ‘real’ evidence, such as oral or written testimony, company documents, correspondence and plans. Nor should the use of competition economics mean that decisions are reached by inserting numbers into a black box and reading out the result. There is no substitute for gathering the most comprehensive evidence available of market structure, characteristics and behaviour and assessing it according to generally accepted economic principles—which of course themselves evolve with experience and better knowledge.

The need for consensus

Despite its sometimes draconian aspects, competition policy works by consensus, not diktat. The situations and cases covered by the authorities’ work are a small fraction of business activity. The authorities can decide cases and send strong signals—for example, on the undesirability of cartel activity. But for the law to be effective, business must understand and accept the purpose of competition law and consumers must be willing to complain and assert their interest in not being exploited. To achieve this requires patient, long-term explanation and reiteration. This is sometimes called ‘competition advocacy’. It applies equally importantly within government. It is particularly vital in the early years of a new regime, but it remains very necessary even in established systems like the UK.

For example, cartel activity by individuals was criminalized in the UK in 2002. Arguably, nearly a decade later, it is still not generally accepted by business and by the public that price fixing is a serious crime, as it does appear to be so accepted, for example, in the USA. These things take time.

Case work

A competition policy without cases is like a meal without the main course. Of course a lot can be achieved by policy statements, guidelines, informal settlements and speeches. But competition law can only be understood and can only progress and develop if it is applied to actual situations on the basis of actual evidence resulting in real decisions applied to real parties.

That is not to argue for a system of strict case precedent; far from it, every situation is different and the result in one case may not dictate the result in another. But the techniques and principles applied are best understood from reasoned decisions, where the conclusions have been tested by a process of discussion and argument, and if necessary by appeal to

¹¹Sections 90 and 91 of the Competition Bill.

the courts; and where the use of evidence to arrive at a conclusion and the significance of that conclusion for competition can be explained and understood.

For a new regime, the right balance of initial casework is all important. Over-ambitious activity that is not successfully fulfilled can severely damage credibility. Under-ambitious inactivity can have the same effect. A few well-conducted, clearly-reasoned cases are better than many superficial or poorly-reasoned decisions. And some hard-fought actions, even after perhaps initial setbacks, may help to establish a new authority as a force to be reckoned with. All this requires clarity of purpose, determination and stamina as the parties usually have more resources and plenty of outside help. But right will normally prevail provided it is pursued with determination.

For established regimes also this can be a problem. Again to take the example of the criminal cartel offence in the UK, it is possible that some of the difficulties in establishing its credibility are related to the dearth of readily understandable 'classic' cartel cases; and the CC is sometimes criticized (unfairly as we do not have the power to initiate cases) for not tackling issues in major economic sectors such as energy, banking and financial services, and concentrating on more peripheral issues.

But if it is an exaggeration to say that an authority is only as good as its last case, it is true that it is ultimately by the value and weight of its casework that an authority will be judged.

How to make a competitive market?

Having examined the constituents of an effective regime, we still have to consider how it is to achieve the aim of making markets competitive. If the regime is like a well-designed automobile sitting in its garage, how is it to be driven on the road?

The easy answer, of course, is by applying the law to actual situations to give results that affect the conduct of business in a way people can understand. But there are several ways of approaching this. At the risk of gross simplification let me summarize these as (1) prohibition of agreements and practices; (2) intervention to make markets work better; and (3) prevention of transactions that are likely to restrict competition. Let us examine each of these in turn.

(1) Prohibition

Prohibition is the generally accepted basis for most systems of competition law, derived from the original US antitrust statute of 1890 and applied worldwide. The law prohibits agreements that restrict competition and prohibits the abusive exploitation of market power—but not, significantly, the mere holding or gaining of market power. The prohibition is supported by sanctions, normally financial penalties but increasingly, for cartel infringements, by criminal sanctions including prison. The aim is to expose and forbid actual cartels and abuses and to deter others by the threat of prosecution and penalties. Anti-cartel law enforcement increasingly relies on so-called 'leniency' programmes under which those who confess and give evidence against other cartel members benefit from partial or total immunity from sanctions. Such programmes are not easily applicable to abuse of dominance cases.

Prohibition is the approach reflected in the new law in Hong Kong—stopping short of criminalization of cartel activity—but relying for its effectiveness on the identification and pursuit of offending companies and deterrence of others.

There is, of course, a huge body of jurisprudence and experience on these matters which I do not have time to consider here, all of which will be highly relevant to Hong Kong as the

new Competition Commission begins its work. But I would offer just a couple of cautionary words from the perspective of the UK Competition Commission.

First, deterrence is very important. But deterrence consists of several elements—the likelihood of detection, the chances of an adverse decision, and the severity of the punishment. In relation to this last point, the severity of punishment, there is some debate about how high monetary penalties need to be. For example, it is not clear whether current levels of fines imposed by the EU's DG Comp are 'too high' (because they seem unfair) or 'too low' (in the sense that they are not having sufficient deterrent effect). Concern about this question has contributed to the increased interest in the US model of criminalization and jail for cartel offenders, although that is not a route that is politically realistic at the EU level.

This in turn raises the question of whether anything should be done beyond prohibiting the practice in question and punishing the offenders. Or, put another way, once you have sent the offenders to jail, how do you make businesses compete? A prohibition system is by its nature negative; yet it is intended to achieve a positive result. Clear prohibitions are central to any effective system; but it is also important to ask how the absence or weakness of competition can be remedied, particularly if this arises from market conditions, structure or government regulation, rather than from the conduct of companies or consumers.

Finally, whilst the principles underlying the prohibition of cartels are fairly well established, those applying to the abuse of market power are much less so. Cartel cases usually require the careful assessment of evidence of cartel activity, a fair prosecutorial process and a proportionate penalty. Abuse of dominance cases are much more likely to turn on detailed assessment of the economic effects of the practice in question. Also, dominant companies tend to be large and well resourced. You only have to look at the long drawn out and complex actions against *Microsoft* in the USA and EU¹² to see that these cases are not easy to conduct and in particular are possibly not an obvious starting point for a newly-empowered authority. Paradoxically, in the UK, after the adoption of a prohibition system in 1998 there were several abuse of dominance cases in particular sectors (healthcare, local newspapers and alcoholic beverages).¹³ Whilst the OFT ultimately concluded these cases successfully, I am not sure that given a second chance they would follow that course.

(2) Market intervention

This leads to the question of whether, by intervention, markets can be made competitive, or more competitive. The UK has, in addition to the prohibition system, a market investigation regime (MIR) under which the authorities can investigate a given market to see if there are features that prevent, restrict or distort competition and which give rise to an adverse effect on competition (known as an AEC). If such be found, the authorities can intervene directly (subject to control by the courts) to change things, hopefully for the better. In an extreme case such intervention can lead to the compulsory divestiture of assets or businesses.¹⁴

Whilst the UK regime is unique in giving the authorities these direct powers to intervene,¹⁵ the concept of a sector or market inquiry is fairly widespread, and finds its place in Hong

¹²See, for example, *Case T-201/04 Judgment of the European Court of First Instance of 17 September 2007 [2007] ECR II-3601*; the settlement with Microsoft was agreed with the US Department of Justice on 2 November 2001 and was finalized on 6 November 2001: Civil Action No 98-1232 (CKK).

¹³The OFT made its first decision under Chapter II of the Competition Act 1998 in March 2001, when it imposed a penalty of £3.2 million on Napp Pharmaceuticals (*Case No. CA98/2D/2001*). On 15 January 2002 the CAT substantially upheld the OFT's decision on liability. In September 2002, the OFT ruled that Aberdeen Journals had engaged in predatory pricing (*CA98/5/2001*) and in June 2003 that ruling was upheld on appeal to the CAT. In January 2003, Bacardi-Martini gave assurances to the OFT that it would not maintain or enter into certain types of agreements with retailers which had the effect of excluding rival products. These assurances were slightly expanded voluntarily by Bacardi upon appeal by Pernod to the CAT. (See PN 10/03 and www.of.gov.uk/news-and-updates/press/2005/bacardi.)

¹⁴Schedule 8, paragraph 13, EA.

¹⁵There is a legislative proposal in Germany to bestow similar powers on the Bundeskartellamt.

Kong's Competition Bill, as we have seen. The EU in particular has made considerable use of these powers, most recently in relation to pharmaceuticals.¹⁶ Authorities generally find it useful to examine sectors or industries from time to time, often in response to complaints, to see if action is required.¹⁷ It is hard to imagine an effective competition policy that operates simply by a series of staccato and unrelated interventions without any underlying understanding of the markets in question.

But the UK market investigation regime provides more than a mere inquiry. The MIR is a self-standing legal framework, backed by many years of experience and by robust institutions, enabling whole markets to be examined and their operation improved, as a complement to and in support of the prohibition of anti-competitive agreements and practices. It is to one such investigation—*Grocery Retailing*—that I shall refer shortly.

(3) Preventing anti-competitive transactions

The third limb is one Hong Kong has put aside for now, namely merger control. My reasons for believing that every competition system ultimately has to include the control of anti-competitive mergers are simple. First, 'prevention is better than cure'. Dealing with the consequences of monopolization after the event is much more difficult than stopping it arising in the first place.

Second, without merger control, economic activity that is otherwise subject to competition law tends to become distorted in order to benefit from the merger exemption and other types of competition law tend to be distorted to try and catch mergers by other means. Attempts to catch mergers 'by other means' were a feature of EU enforcement prior to the enactment of merger control in 1989. For example, the *Continental Can* case,¹⁸ famously, in 1973 applied abuse of dominance law to the acquisition by a dominant firm of its last competitor; in *Philip Morris*¹⁹ the prohibition of restrictive agreements was applied to interlocking minority shareholdings between two competitors—a 'near merger'.

There are numerous arguments as to what the correct priorities and allocation of resources should be when starting up a new regime. Of course it is unwise to bog down a new authority in processing lots of unremarkable merger proposals. In the Indian context it has even been argued that merger control prevents the creation of national champions and is therefore undesirable. I do not agree with this argument, which seems to stand the justification for competition policy on its head. And I firmly believe that sooner or later, any competition system that operates effectively throughout an economy must embrace, in some form, the control of mergers, as it is integral to competition policy as a whole.

So much for the framework. Let me now try and illustrate how competition law can be used to promote competitive markets by examining the recent UK groceries investigation.

UK framework

Before doing so, I should emphasize that the market investigation regime in the UK is operated by the OFT and the CC together. The UK CC cannot itself initiate an investigation, but acts on a reference from, usually,²⁰ the OFT after it has conducted an initial study and

¹⁶On 8 July 2009 the European Commission adopted the Final Report on its competition inquiry into the pharmaceutical sector: see <http://ec.europa.eu/competition/sectors/pharmaceuticals/inquiry/index.html>.

¹⁷See, for example, the market study into the UK aggregates sector announced by the OFT on 7 September 2010, Press Release 93/10.

¹⁸*Case 6/72 Europemballage and Continental Can v. EC* [1973] ECR 215.

¹⁹*Cases 142 and 156/84 BAT and Reynolds v. EC* [1987] ECR 4487.

²⁰Sectoral regulators also have the power to refer markets to the UK CC for investigation.

decided there are issues to investigate further. The Groceries investigation followed from such a reference.²¹

The UK market investigation into grocery retailing

This was a two-year investigation into grocery retailing in the UK,²² which led to a report in April 2008, various remedial measures, some litigation and two major recommendations to government which are still in the process of implementation.

Why the investigation was launched

The reasons for starting the case were complex—reflecting the difficulty of agreeing on what is a competitive market. Grocery retailing in the UK was, and is, dominated by four large supermarket chains, accounting for about 70 per cent of sales. There were complaints of price parallelism if not outright collusion; of predatory pricing in particular localities; of an adverse effect on smaller retailers who were as a result suffering severely; of an ‘unfair’ purchasing advantage for large supermarkets in the supply chain with resulting detriment to smaller retailers and also to smaller suppliers and wholesalers; and of a subversion of planning/zoning law by major supermarkets to develop large stores, coupled with the strategic ‘banking’ of land to increase local and national dominance.

The market had been investigated several times, both in the context of mergers and in a previous market investigation in 2000.²³ The OFT was, perhaps understandably, a little reluctant to refer the market again to the CC, but bowed to pressure following a successful court case brought by various pressure groups in the CAT.²⁴ In addition, there was a heady brew of topical socio/political issues—were supermarkets ‘too big’? What sort of grocery market did consumers want? Was price all that mattered? Was collateral damage being caused to small shops and to the ‘high street’ from ‘too much’ competition? But underlying all these concerns was one essential question—was the grocery retailing market ‘competitive’.

Scale and logistics

The first point to note was the scale of the investigation. We reviewed commercial relationships throughout the whole UK grocery industry, from farmers and growers down the supply chain to the retailers. The CC received over 700 submissions, held nearly 100 hearings, held meetings and site visits throughout the UK, and obtained and collated a great deal of information. The investigation required significant resources. At the peak of the inquiry, 28 members of staff were actively engaged on the matter plus the six Commissioners (who were the decision makers).

Transparency

The CC conducted the investigation in a very transparent way. We posted most submissions and much evidence on our website. This was important but had to be done with care to

²¹Referred by the OFT to the CC on 9 May 2006.

²²See the homepage for the grocery inquiry at: www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm.

²³The OFT conducted an inquiry into the Major Supermarkets during September 1998–April 1999, the outcome of which was to refer the grocery retailing sector to the CC. The CC’s investigation lasted from April 1999 to October 2000 and found under then applicable competition rules that a complex monopoly operated with respect to pricing practices and supply chain practices but that the market was generally competitive. The report led to the major supermarkets agreeing to a Code of Conduct governing their dealings with the supply chain.

²⁴From February 2003 to August 2005 the OFT conducted a review of the operation of the Supermarkets Code of Conduct and concluded there were no grounds for a further reference to the CC. The Association of Convenience Stores challenged the OFT’s decision before the CAT during 2005. The OFT withdrew its decision and after further consideration, referred the market to the CC in May 2006. The ensuing investigation by the CC is the subject of today’s talk.

avoid breaching confidence and so discrediting our information gathering. This applied particularly to farmers, grocers and small suppliers who were afraid of retaliation by retailers if their identity became known.

We held formal hearings and many less formal exchanges with the principal parties and the many other interested parties—from the major supermarkets to individual retailers, suppliers, associations and pressure groups.

We also published large amounts of evidence in a series of formal statements—the Issues Statement, Emerging Thinking, Provisional Findings and Provisional Decision on Remedies. All in all, we went to great lengths to make sure our thinking and evidence were fully displayed and understood as we went along.

Use of powers to require the provision of evidence

Normally the CC works through cooperation, requesting and receiving voluntarily from companies the information we need. But we also used our powers to compel provision of information (section 109²⁵ powers) in several different situations.

For example, some trade bodies were willing to assist but had a policy of not supplying information on a voluntary basis, so a section 109 request enabled them to respond.

In other cases, certain organizations were less willing to supply additional information which they indicated was in their possession, and the section 109 powers were useful here also.

We also used these powers to examine the correspondence between two major supermarkets and their suppliers over a specific period of retail price reductions—an exercise which resulted in the provision of more than 100,000 emails for review.

The issues

Turning now to the substance of the investigation, we grouped the issues before us into three main categories—local competition and effect on small shops; the supply chain; and issues about land and planning. Apart from the issues we wanted to address, there were several other issues we felt obliged to address.

Non-competition issues

A range of issues which were clearly outside the competition arena was put to us during the investigation. These included the impact of grocery retailing on the nation's health, the social impact of low-priced alcohol sales, the importance of high streets and rural shops to social cohesion, the future of UK farming and self-sufficiency in food, working conditions at grocery suppliers in the developing world, and the environmental impact of grocery retailing.²⁶ These concerns provided important context and background to the investigation although they were not, in themselves, competition issues. Our investigation helped to give these points an airing, and many of the broader issues that were raised with us have subsequently also been looked at by the responsible government departments and agencies.²⁷

²⁵Section 109, EA.

²⁶Including concerns as to the transport of goods and excessive packaging and shopping bags.

²⁷For example, food labelling and minimum pricing for alcoholic drinks.

Misperceptions as to competition issues in the market

There were also some matters on which the general perception that there was a competition law problem was not borne out by the evidence.

For example, the competitive position of small (convenience) retailers relative to the large supermarkets was a key concern for many. We received much evidence from representative bodies and from others suggesting that the competitive pressure on convenience store operators was intense. This clearly was true but, on closer examination, we found the evidence of actual closures and openings of smaller stores was very mixed. And some of what was being objected to in terms of the greater attractiveness of supermarkets for some consumers appeared to be more about the effects of a competitive process than any lack of competition. UK shoppers, it appeared, claimed to want to protect smaller shops but preferred to do most of their actual shopping in larger stores.

Similarly, many parties raised the strong market position of the market leader, Tesco, as a matter of concern. We examined this issue very closely but in the end did not find there to be significant competition concerns that applied to Tesco over and above those that applied to other grocery retailers. Our assessment was that Tesco's market position was not unassailable; in other words, there was nothing that Tesco was doing that could not, over time, be challenged and equalled by competitors.

So what did we conclude?

Findings and remedies

We found that, in many important respects, competition in the UK groceries industry was effective and delivered good outcomes for consumers. Most of the specific allegations against the major supermarkets, as to strategic land banking, targeted predatory pricing or abuse of the planning process, we found to be unsubstantiated.

But we also found that not all was well. We had concerns in two principal areas. First, that several grocery retailers had strong positions in a number of local markets. Barriers to entry faced by competing grocery retailers meant that consumers got a poorer retail offer in terms of prices, quality and service than would otherwise be the case, while those grocery retailers with strong local market positions earned additional profits from weak competition in those markets.

Second, we found that the transfer of excessive risk and unexpected costs by grocery retailers to their suppliers through various supply chain practices, if left unchecked, would have an adverse effect on investment and innovation in the supply chain, and, ultimately, a bad effect on consumers.

As a result we applied remedies in these two areas. First, in relation to local markets that were 'highly concentrated', we introduced measures to outlaw the use of restrictive covenants to exclude competitors; and we made a formal recommendation to government to introduce a 'competition test' in the planning system to control new supermarket developments that would give any one large retailer more than 60 per cent of the grocery sales area in any concentrated local market. Tesco appealed this recommendation to the CAT on the grounds that we had not fully evaluated the effects of this measure. As a result we did further work to demonstrate that the benefits outweighed the costs. A slightly revised recommendation was duly made, was not further appealed, and is now being considered by government.

Second, to address our concerns about the supply chain we ordered the enactment of a new, strengthened obligatory Code of Practice,²⁸ covering all the major retailers. We also made a formal recommendation to government to set up an 'ombudsman' to oversee and enforce compliance with the new Code.

Regulating retailer/supplier relationships in this way is not without controversy. It can be argued that provided the downstream retail market is competitive, then suppliers large and small must look after themselves as pressure on them is in the consumer's interest. However, the evidence before us suggested this ideal model was not universally applicable in practice and that something needed to be done.

The new coalition government has accepted our recommendation to establish an enforcement mechanism for the enhanced Code.²⁹ The CC's measures to deal with grocery supply chain issues have attracted interest, and some imitation, in other countries including Ireland, Russia, Hungary, the Czech Republic and New Zealand.

Land issues

The CC's work on land issues in the grocery sector may also be of interest elsewhere. In the UK, many land agreements were excluded from the scope of the 1998 prohibition of restrictive agreements and ours was the first detailed review of the operation of the Land Agreements Exclusion Order. The CC recommended repeal of the Order in respect of the grocery sector. In the event, the Government decided to repeal the Order for all land agreements, not just those in the grocery sector.³⁰ As I indicated, the CC also prohibited the use of restrictive covenants to impede entry into highly-concentrated local markets for grocery retailing.

We looked closely at the impact of the planning regime on competition in the sector. The planning regime and its application by Local Planning Authorities, in accordance with its policy objectives (such as protecting town centres), necessarily act as a barrier to entry or expansion by retailers in a significant number of local markets. However, we were cautious about interfering too much with the planning regime, which clearly served an important social purpose. Also the planning regime was being extensively revised at the time of our investigation. In the result we decided to limit our specific measures to curtailing the use of retailer exclusivity deals in new developments.

Land and its use, in a crowded country like the UK—or indeed Hong Kong—raise competition issues of particular difficulty and complexity. These issues need to be considered carefully in the light of the circumstances and context. But in the light of our examination, I am not convinced that a general exclusion from competition law of agreements relating to the use of land is justified.

The competition paradox

The Groceries investigation is a good illustration of the paradox of competition. How were we to make sense of a market that was regularly described as 'fiercely competitive' (in the sense that there was little doubt that, taken overall, each major supermarket was trying to attract customers from its competitors) but where there were loud complaints of unfair

²⁸As described above, a Code of Conduct already existed following the CC's earlier market investigation in 2000, but it did not appear to work effectively and in particular lacked an enforcement mechanism.

²⁹In August 2010, the Government published its response to the consultation on taking forward the proposal to establish a body to monitor and enforce compliance with the groceries supply code of practice: www.bis.gov.uk/assets/biscore/business-law/docs/competition-matters/10-1011-groceries-supply-code-practice-government-response.

³⁰Repeal effective as of 6 April 2011. A copy of the statutory instrument repealing the Land Agreements Exclusion Order is available at: www.legislation.gov.uk/ukSI/2010/1709/pdfs/ukSI_20101709_en.pdf.

treatment of suppliers by major supermarkets, of collateral damage to the supply chain for smaller, independent retailers, of their consequential inability to compete with larger retailers and the resulting loss of outlet variety, choice and—yes—competition? In a nutshell, was too much competition harming competition?

We were certainly very aware of, and sensitive to, this phenomenon.

In the first place we looked hard at whether there really was ‘fierce’ competition between major retailers. Examination of possible coordination of prices showed that, despite the widespread pricing transparency, there were too many product lines and too much variation to make a pattern of consistent tacit price coordination feasible or likely. We noted the OFT’s investigations into alleged collusive conduct. We did, however, seek to prevent any one supermarket monopolizing any particular locality.

Second, the CC looked at the purchasing advantage of major retailers; again we found a mixed picture with some major retailers securing very large reductions, but other buying groups and wholesalers also able to secure sizeable discounts.

Third the CC looked at the positions of wholesalers to the independent trade, at the so-called ‘waterbed effect’ (suppliers trying to recoup from independents the discounts forced out of them by the majors) and at the actual position of small shops. In each case the CC found the evidence equivocal—certainly not enough on which to base an adverse finding.

What we would have done had we found the evidence much stronger, it is perhaps idle to speculate. Intervening to protect one group of competitors against another in the supposed interests of competition is not an easy task. There was much talk of ‘levelling the playing field’ but as with all metaphors, this attractive sounding phrase is hard to translate into anything practical.

We found it helpful to look to one of the basic objectives of competition enforcement: promoting the interests of consumers. The evidence that consumers valued what they got from major supermarkets was strong. As the recession bit in 2008/09, the importance of lower prices and value for money was accentuated. It might not have looked good to be seeking to raise prices charged by efficient retailers to protect what might be regarded as their less efficient competitors in an attempt to preserve a particular range of retail outlets.

So in this case, we found a competitive market was one where the consumer obtained good prices, quality, innovation and choice, rather than one where all competitors played on a ‘level playing field’. Competition is a rough and turbulent process in which individual competitors can get hurt whilst others do well. We looked at the need to ensure no one could acquire a position that could not be attained by their rivals. But there were many different views on where to strike the balance.

Interplay with other instruments

This was a market investigation. It may well be asked how this fits in with ‘normal’ competition law, ie the prohibition system that Hong Kong is about to implement.

The first point is that the CC’s investigation followed, and was accompanied by, several specific interventions by the OFT under the Competition Act 1998.

For example, the OFT had on several occasions examined local pricing practices by major supermarkets under our ‘Chapter II’ prohibition and found no breach of the law. In addition,

there were some pre-existing and ongoing cartel investigations on particular dairy and tobacco products and practices—in specific parts of the UK over specific periods.³¹

During the CC's inquiry, the OFT also began a further cartel investigation in respect of certain grocery practices. This investigation is continuing.³²

These are important matters, and the message they send is clear: illegal cartel activity will be pursued wherever it is suspected. But these individual cases are not the same as the comprehensive investigation that the CC carried out, which, whilst concluding that overall the consumer was getting a good deal from grocery retailers, nonetheless identified the need to intervene in two important respects, neither of which involved any finding of illegal conduct.

There had also been considerable merger control activity in the sector. Some 15 grocery retail mergers were considered by the OFT and the CC in the past two years alone,³³ and the current configuration of the top four retailers arose from the merger of Safeway and Morrisons in 2003, following a CC report which prohibited the other three major retailers from acquiring the failing Safeway business.³⁴ Important though it is, merger control cannot deal with organic growth, and is not a complete answer on its own.

So, all forms of competition law have played a role and they complement each other in a powerful manner. But market investigations allow for a detailed review of the market or specific parts of a market, and provide a comprehensive framework for any necessary measures.

Evaluation

It is important to consider the value of this investigative activity. The real rewards from competitive markets come from longer-term effects on welfare through gains in productivity, competitiveness and growth. But there are short-term direct benefits also. We calculated that our 'competition test' to improve competition in highly-concentrated local markets is likely to bring consumer benefits of £50–£125 million annually in terms of lower prices and better service.

Conclusion

What I have tried to do in this short account is to show how realizing the aims of competition policy is not a straightforward matter. The maintenance and encouragement of competitive markets is an important part of a successful economy, and competition law is an important contributor to that. But much careful planning, organizing and execution goes into achieving that contribution. Apart from that perhaps obvious point, there are some other more surprising conclusions to be drawn.

First, it is not always obvious what competition is, nor what a 'healthy level of competition' is. These difficulties are highlighted by the extensive submissions on non-competition matters which we sometimes receive during the course of inquiries. Some of these concerns seem to

³¹Dairy: OFT press release 170/07, OFT welcomes early resolution agreements and agrees over £116m penalties, 7 December 2007; OFT press release 175/07, OFT Statement of Objections against supermarkets and dairies—clarification, 13 December 2007; Tobacco: OFT press release 39/10, OFT imposes £225m fine against certain tobacco manufacturers and retailers over retail pricing practices, 16 April 2010. Appeals are currently before the CAT.

³²Investigation into certain retailers and suppliers, OFT case reference CE/8905-08, start date April 2008.

³³The OFT has regularly required divestiture of stores in order to secure merger clearance and referred certain transactions for Phase II review by the CC. See *A report on the acquisition by Somerfield of 115 stores from Wm Morrison Supermarkets*, CC report, 2 September 2005; *A report on the acquisition of the Co-operative Group's store at Uxbridge Road, Slough by Tesco*, CC report, 28 November 2007.

³⁴CC report, 18 August 2003

be that there is too much competition, not too little. This is an issue for any regime that includes effects-based analysis in its range of measures.

Second, ensuring that markets are competitive requires a rich set of policy instruments. I have tried to show how each part of the competition enforcement spectrum can play a role. The prohibition of restrictive agreements and abuse of market power is of course the starting point and much can be achieved through stopping and deterring unlawful practices. Merger control, as a preventive measure, is an essential complement to the rest of competition law. But there can remain competition problems that are unrelated to abusive conduct or anti-competitive agreements, and which cannot be forestalled by merger control. The ability to examine further and intervene to improve the operation of a market as a whole is an extremely valuable instrument for any competition authority.

Third, there is the need to assess competition issues in a wider context. There are likely to be many other, possibly conflicting, issues of public importance and concern, which need to be examined alongside the pure competition analysis. They may be highly relevant to that analysis and to some extent can be incorporated into it. Or it may simply be a question of trading off one set of policy imperatives against another. That, of course, is the task of government, but they need to have the issues clearly laid out.

Fourth, when intervention is needed, prohibition, punishment and deterrence may not achieve the desired objective on their own: more specific and tailor-made measures may be desirable and a process and institutional framework for clarifying such measures is very helpful.

Fifth, I have explained the ingredients of an effective enforcement system—strong institutions, a clear legal framework and a steady flow of decisions to provide clarity and assurance. But, even with all that in place, there are no grounds for complacency; ensuring that markets are competitive is hard work, in which the authorities have to rely on the support and involvement of the businesses which operate in markets and the consumers who benefit from them, not to mention the academic commentators who write about them and the advisers who advise.

Finally, we should not lose sight of the point of this whole exercise and of our original assumption that competition is beneficial. I have mentioned that the real rewards from competitive markets come from the longer-term effects on consumer welfare through gains in productivity, competitiveness and growth. But I also mentioned the short-term, direct, benefits. Even these, which are measurable, normally far outweigh the costs of obtaining them.³⁵

So, in conclusion, I would strongly suggest that, although the effort is considerable, the goal of making markets competitive is well worth it.

Thank you.

³⁵For example, we estimated that the benefits to consumers from the OFT and the CC prohibiting anti-competitive mergers in 2009/10 was £150 million a year in the form of lower prices in the short term. The OFT estimated the benefits deriving from the regime of prohibitions on anti-competitive conduct and agreements at £84 million annually (Annual average figure over 2007–2010: OFT Annual Report 2009/10, p41).