

“A Wise Man Proportions His Beliefs to the Evidence’: Scepticism and Competition Policy”

Peter Freeman, Chairman of the Competition Commission, spoke at a meeting of the David Hume Institute in the Royal Society of Edinburgh on 3 May 2007. The full text of his speech follows.

The title quotation (from Hume) – “a wise man proportions his beliefs to the evidence” – reflects the way in which the CC endeavours to conduct itself, whether in the context of its in-depth investigations into markets, mergers or in regulatory matters. The CC is unwilling to draw any conclusions beyond those that can be established from evidence and experience. In adopting an essentially sceptical approach, the CC acknowledges the primacy of its statutory responsibility to formulate reasoned decisions in its investigations based *solely* on that which can be established by means of sound, competition-related evidence. The Chairman outlined how the CC applies this sceptical approach to its merger and market investigation processes, with particular references to Scotland.

The speech also addresses the wider role of competition policy and the importance of keeping competition at the centre of economic policy throughout the United Kingdom overall. While the CC may be sceptical in the way it approaches the analysis of evidence in individual cases, it is highly optimistic about what competition policy can achieve on a UK-wide and international basis. Allowing markets to work effectively is the best system to deliver efficient businesses, innovation and benefits for consumers in terms of price, value for money and choice.

“A Wise Man Proportions His Beliefs to the Evidence’: Scepticism and Competition Policy”

**Lecture given by
Peter Freeman, Chairman of the UK Competition Commission¹
at a meeting of the David Hume Institute
in the Royal Society of Edinburgh
on 3 May 2007**

Ladies and Gentlemen, it is a pleasure to address you tonight on election night—probably a significant election night. I doubt what I have to say will influence your vote—there is still time to vote—and if it appears that it might, then one of us has clearly misunderstood the other!

The title of my talk is: “A Wise Man Proportions His Beliefs to the Evidence”: Scepticism and Competition Policy.’ The first part of this title—‘a wise man proportions his beliefs to the evidence’—is taken from the section ‘On Miracles’ in the *Enquiry Concerning Human Understanding* written by this Institute’s illustrious namesake. I was drawn to this quotation not because I would wish to suggest any correlation between the work of the Competition Commission (CC) and the performance of miracles. (In fact, the quotation is directed against the acceptance of miracles, which some might uncharitably say equates to some efficiency arguments put forward in merger cases.) Rather Hume’s words reflect the way in which the CC endeavours to conduct itself—whether in the context of its in-depth investigations into markets, mergers or in regulatory matters. The CC recognises that its ‘beliefs’, namely the views formed and decisions taken on competition-related matters during the course of an investigation and, if necessary, any ‘remedies’ subsequently imposed, must be based on clear and justifiable analysis undertaken using any and all of the evidence available to it.

This method of reasoning not only requires robust and transparent evidence-gathering processes, it also requires the CC to use its expertise to analyse that evidence and to consider the weight that should be given to each piece of evidence. In ‘proportioning’ our ‘beliefs’, we give serious weight to points where strong and convincing evidence exists, but will be sceptical about things for which there is no good evidence.

The second half of my title refers to ‘scepticism and competition policy’. ‘Scepticism’ can be construed in two distinct ways: (1) as a philosophical doctrine that casts doubts over the possibility of knowledge in itself; or (2) as a temperamental disposition which leads to an unwillingness to draw any conclusions beyond those that can be established from evidence and experience. Hume may have been a sceptic in both these senses, but it is this latter form of scepticism that, I suggest, guides the CC’s approach to competition policy. In adopting such a sceptical approach, the CC acknowledges the primacy of its statutory responsibility to formulate reasoned decisions in its investigations based *solely* on that which can be established by means of sound, competition-related evidence.

As to the ‘evidence’ that the CC will consider and the ‘beliefs’ that the CC will form, the CC’s statutory remit is to be an independent competition authority, free from political influence in any part of the United Kingdom, that focuses specifically on competition-related matters, rather than, say, one that oversees general industrial policies, such as employment, transport or environmental matters. The previous function of assessing ‘the public interest’ was deliberately discarded (save for certain very specific instances). This was a deliberate

¹All views are personal. The invaluable help of Elizabeth Harwick of the CC’s staff is gratefully acknowledged.

and explicit change brought about by the Enterprise Act 2002, with the intention of improving the quality and transparency of decision making in competition matters.

And competition policy is indeed UK wide. The CC, the Office of Fair Trading (OFT) and the Competition Appeal Tribunal (CAT) have a collective commitment to promoting competition and the interests of consumers and efficient businesses throughout the UK. Competition is a reserved, not a devolved, matter in the Scottish context. The recent establishment of the OFT's office in Scotland² reflects this commitment to Scotland as does the practice of the CAT to sit in the Court of Session in Edinburgh for Scottish cases.³ Tonight I will focus on the work of the CC and illustrate this with reference to Scottish influences.

I The Overall Context: 'Wise regulations in any commonwealth are the most valuable legacy'⁴

Hume observed that:

'wise regulations in any commonwealth are the most valuable legacy. ... Good laws may beget order and moderation in the government, where the manners and customs have instilled little humanity or justice into the tempers of men.'⁵

I do not wish to pass comment on 'the tempers of' any individuals in this—or any other—forum, but we should pay heed to Hume's reflections on the value of 'wise regulations' and 'good laws'. The CC has recently given evidence to the House of Lords Select Committee on Regulators,⁶ which is examining the role of the CC and other regulators and competition authorities. As we said in our evidence, the UK competition and regulatory institutional architecture can look rather complicated. It came into being over time for a variety of reasons, and I dare say, if you were starting again with a blank sheet of paper to plan the 'ideal' system, you would not produce what we have. Nevertheless, we are where we are, and we must do our utmost to ensure that the system works well in practice. As Professor William Kovacic, US Federal Trade Commissioner, observed in a speech at King's College, London recently in commenting on the 'optimal institutional design' of a competition (or consumer) authority, 'it is less important as to where you start from; what is more important is where you go.' A 'willingness to make refinements' is what makes a good competition authority.⁷ I will attempt to show the 'wisdom' of the still relatively new legislation which governs our competition work and the way in which we are willing to make refinements. But first let me briefly explain the CC's role.

The CC's role

The CC conducts in-depth inquiries into mergers, markets and the regulation of the major regulated industries. All cases are on reference from another body—the CC cannot instigate any investigation of its own initiative. On mergers, the OFT is the sole referring body on competition issues. (Ministers may make references on specific public interest issues such as national defence and security.) In relation to the market investigation régime, the power to refer also extends to the principal sectoral regulators. The CC also conducts 'second phase' regulatory reviews where we act, in effect, as an appeal body deciding price control and

²OFT press release, 16 March 2007.

³See, eg, *Aberdeen Journals v Office of Fair Trading* [2003] CAT 11, judgment of 23 June 2003.

⁴David Hume, 'That Politics May Be Reduced to a Science,' *Essays Moral, Political, and Literary*, Essay III, Part I, 1742.

⁵*Ibid.*

⁶See, for example, the oral testimony of the OFT and CC before the House of Lords Select Committee on Regulators of 27 February 2007. See www.parliament.uk/documents/upload/correctedEv520070227.pdf. See also the CC's written evidence to the Committee dated 9 February 2007: www.parliament.uk/documents/upload/Competition%20Commission.pdf.

⁷Professor William Kovacic, 'Using competition and consumer powers to make markets work well,' Centre of European Law lecture, King's College, London, 26 April 2007.

licence modification issues at the behest of the sectoral regulator or a regulated company. In addition, the CC acts as a fast-track appeal body for energy code modification appeals in the gas and electricity sectors. And we have a particular role in conjunction with the CAT in pricing appeals under the Communications Act 2003.

Last month, we received our first regulatory reference since 2002 (a mandatory quinquennial airports review).⁸ Two energy code modification appeals have been brought, one earlier this week and another that was abandoned at an early stage;⁹ no pricing appeals under the Communications Act have yet to be brought.¹⁰ This relative dearth of regulatory cases has caused us some concern (we query if the threat of a CC reference from a regulator can act as a 'credible threat' if that reference power is very rarely—if at all—used), and it also means that my comments here will focus primarily on our merger and market investigations and the CC's role as a competition authority.

Independent decision-making competition authorities: 'Preserving a proper impartiality in our judgments'

In his discussion of sceptical philosophy in *An Enquiry Concerning Human Understanding*, Hume stressed the importance of:

'preserving a proper impartiality in our judgments, and waning our mind from all those prejudices, which we may have imbibed from education or rash opinion. To begin with clear and self-evident principles, to advance by timorous and sure steps, to review frequently our conclusions, and examine accurately all their consequences; ... [these] are the only methods, by which we can ever hope to reach truth, and attain a proper stability and certainty in our determinations.'¹¹

I can't find better words than this to explain what it is we try to do. The impartiality of the UK competition régime flows from changes introduced by the Enterprise Act. Whilst the CC was established (as the successor body to the Monopolies and Mergers Commission (MMC)) by the Competition Act 1998, it was the Enterprise Act 2002 that brought about a fundamental change in our status and way of working. The 2002 reforms sought to take politics out of UK merger control and market inquiries. The objective was to produce powerful competition authorities, free from political interference, armed with a full range of powers. The Government aimed to achieve this by enhancing the independence and status of the competition authorities and by giving them decision-making powers subject to more specific judicial control. At the same time the broader 'public interest' tests formerly applied to merger control and to monopoly control were replaced by explicit competition-based tests, SLC in the case of mergers and AEC in the case of markets. I will explain these a little later.

⁸*Heathrow and Gatwick quinquennial review* referred to the CC on 30 March 2007. In 2002, the CC was asked to examine mobile phone termination charges and carried out the quinquennial reviews into the major London airports and Manchester airport.

⁹Appeal by E.ON dated 30 April 2007 on energy code modification UNC116; the *Utilita Electricity* appeal was abandoned soon after being made.

¹⁰One may be imminent.

¹¹David Hume, 'Of the Academical or Sceptical Philosophy', *An Enquiry Concerning Human Understanding*, Section XII, Part I, 1777 edition.

The importance of judicial control

Hume also said:

‘In all demonstrative sciences, the rules are certain and infallible; but when we apply them, our fallible and uncertain faculties are very apt to depart from them, and fall into error.’¹²

Our regulatory decisions are subject to normal judicial review by the High Court but under sections 120 and 179 of the Enterprise Act, our competition decisions are subject to a specific system of review before the CAT at the suit of ‘any person aggrieved’. In this role, the CAT is required to apply the same principles that would apply in judicial review (sections 120(4) and 179(4) Enterprise Act) rather than to hear an appeal on the merits of the case. To date, only the remedial action taken by the CC in two merger cases has been subject to review by the CAT: in *Somerfield*, the CC’s remedies’ methodology was found to be correct and appropriate, and in *Stericycle*, its approach to interim measures also was confirmed.¹³ No doubt, in time, the findings of one of our decisions itself will be subject to appeal and we may be found to have ‘fall[en] into error’, but we make great efforts to ensure the thoroughness of our review process and the robustness of our decisions.

Need for clear and justifiable analysis and robust and transparent processes

When asked whether he lived by his philosophy, Hume replied:

‘Be a philosopher; but, amidst all your philosophy be still a man.’¹⁴

This is sound advice. It is very important that we do not get too doctrinaire or theoretical in our approach to actual cases.

Hume’s advice is particularly relevant to our treatment of evidence, specifically of a technical nature, in arriving at our decisions. There is some tension between the need to look at competition effects on the basis of good economics, using proper data wherever possible, and articulating the results in language that non-specialist people can understand. A particular ‘philosophy’ or economic (or possibly accounting) theory alone, applied to complex facts in a way that is, on its face, comprehensible only to specialists, is not likely to be sufficient as an indication of whether harm to competition is probable or not. It is not a question of weighing incomprehensible technical economic evidence against obvious facts. It is much more a question of making the incomprehensible comprehensible and then to weigh or ‘proportion’ it against other comprehensible evidence.

II The Process of Investigation

In *A Treatise of Human Nature*, Hume advised that we should:

‘draw no conclusions but where [we are] authorised by experience.’¹⁵

The purpose of the CC’s process is to apply the lessons authorised by experience to the evidential material before it. The process is constantly being examined and improved, but

¹²David Hume, ‘Of scepticism with regard to reason’, *A Treatise of Human Nature*, Book I, Part IV, Section I, 1739.

¹³Respectively, *Somerfield PLC v Commission* [2006] CAT 4, decision of 13 February 2006; and *Stericycle International LLC, Stericycle International Limited, Sterile Technologies Group Limited v Commission* [2006] CAT 21, decision of 19 September 2006.

¹⁴David Hume, ‘Of the Different Species of Philosophy’, *An Enquiry Concerning Human Understanding*, Section I, 1777 edition.

¹⁵David Hume, *An Abstract of a Treatise of Human Nature*, 1740, paragraph 2.

there is no doubt that having more than half a century's experience as an authority breeds a degree of confidence.

The importance of process

In his essay 'Of Essay Writing', Hume referred to a process engaged in by the 'conversible' part of mankind:

'Where every one displays his thoughts and observations in the best manner he is able, and mutually gives and receives information, as well as pleasure.'¹⁶

I am not sure that our process ever gives pleasure. But bad process can generate a sense of grievance in parties out of all proportion to the business issues at stake, or even to the outcome of the investigation. Good process ought to leave parties feeling that, regardless of their views on the decision taken by an authority, at least they have been treated fairly. So it is in many ways just as important to conduct the investigation according to a fair process as it is to adopt a 'correct' decision.

The essential features of the CC's process are:

- involvement of CC members in the investigation;
- initial fact finding through questionnaires, meetings, 'site visits' and formal hearings;
- transparent administrative timetables and a large degree of publication of working papers and other materials;
- key signposts along the way—Issues Statement, Emerging Thinking (for markets); Provisional Findings; Notice of Remedies (if needed); and the Final Decision;
- formal hearings between the Commissioners and the parties on the substantive issues; and
- fixed overall maximum time limits for investigations.

I will now consider briefly the CC's work in mergers and market investigations, beginning with mergers.

III Mergers

The CC's function in relation to the UK merger control régime is to carry out a second-stage intensive investigation. The OFT carries out an initial investigation to assess whether the merger falls within the Enterprise Act jurisdiction.¹⁷ If the OFT considers the issues raised require further investigation then, unless the market concerned is very small or customer benefits outweigh the likely loss of competition,¹⁸ the OFT must refer the merger to the CC for investigation or accept undertakings in lieu of a reference.¹⁹ The régime is applied to both

¹⁶David Hume, 'Of Essay-Writing', *Essays, Moral and Political*, Vol 2, 1742. This essay was published in the 1742 edition and then was withdrawn from later editions.

¹⁷Section 33 (for proposed mergers) and section 22 (for completed mergers) Enterprise Act 2002 (EA 02). The jurisdictional test is whether the merger creates or enhances a 25 per cent or more share of supply or involves the takeover of an enterprise with annual turnover of £70 million or more.

¹⁸See OFT, *Mergers—Substantive Assessment Guidance*, May 2003, paragraphs 7.5 and 7.6 on markets of insufficient importance; and paragraphs 7.7 to 7.9 on customer benefits.

¹⁹On undertakings in lieu of a reference, see section 73 EA 02 as well as OFT, *Mergers—Substantive Assessment Guidance*, May 2003, Chapter 8, and OFT, *Mergers—Procedural Guidance*, May 2003, paragraphs 7.1 to 7.9.

proposed mergers and those completed (in some cases, a considerable time previously). There is no compulsory pre-notification of mergers but it is normal for parties to inform the OFT of what is going on, at least in major cases.

We are generally asked to look at around 15 or so mergers a year—a relatively small number given the extent of UK M&A activity. Of these, we typically allow around one-half to proceed without any restriction. A reference to the CC does not necessarily mean that a merger will be prohibited. But in a significant number of cases, we do prohibit. As Hume said:

‘Let us separate hearts which were not made to associate together. Each of them may, perhaps, find another for which it is better fitted.’²⁰

Substantial lessening of competition and merger specific effects

As I said earlier, we examine mergers to see if there is a substantial lessening of competition (SLC). The test of substantial lessening of competition is well-known and similar to that applied by many other merger control authorities. Two points in particular should be noted. First, SLC is a comparative test—it requires us to examine the effect of the merger compared to what would otherwise be. If the effect is significantly to lessen competition then we may have reason to intervene—we are not required to find any particular absolute level of competitive restriction. Second, we are looking at effects brought about by the merger itself. Other influences or changes in market conditions do not justify a prohibition of the merger itself.

Merger cases

Pre-Enterprise Act cases

What can we glean from our experience of merger cases? First of all it is worth noting how much merger control has changed in the last 25 years. In 1982 the MMC, our predecessor body, considered the proposed acquisitions of *Royal Bank of Scotland* (RBS) by *Standard Chartered* and *HSBC*.²¹ Neither of the bidders was engaged in retail banking in the UK, and there would be no significant reduction in competition in UK banking arising from either merger. It was also clear that, in the absence of the merger, there was little prospect that either bidder would be able to enter the UK retail banking market directly. In wholesale banking, there was ‘widespread and active competition among numerous banks, both British and foreign-owned,’²² so neither of the acquisitions would significantly restrict nor inhibit competition in that market either.

Despite this, by a majority of four to two, the MMC concluded that each of these mergers may be expected to operate against the public interest because they could be ‘seen as part of a process of economic centralisation’ that could be ‘seriously damaging to Scotland’. More specifically, the ‘removal of ultimate control from Edinburgh would lead to a deterioration in the quality and importance of decisions made in Scotland, and to loss of easy access to the most senior management of the RBS group for the rest of the Edinburgh financial community.’ This would ‘be a significant step in the long process of centralisation, reinforcing the impression of a ‘branch economy’, diminishing confidence and morale in Scottish business, and weakening public life and leadership in Edinburgh and Scotland’. The MMC

²⁰David Hume, ‘Of Polygamy and Divorce,’ *Essays Moral, Political, and Literary*, Essay XIX, Part I, 1742.

²¹MMC report, *The Hongkong and Shanghai Banking Corporation/Standard Chartered Bank Limited/The Royal Bank of Scotland Group Limited*, 22 December 1981.

²²*Ibid*, paragraph 12.6.

majority also did not think that a merger with Standard Chartered would transform RBS into a 'fifth force' that could match the 'big four', despite its predominance in Scotland.²³

This decision obviously has some resonance today²⁴ but the relevant point here is not its correctness or otherwise but to note that it was not a competition-based decision. As the MMC found, neither bid for RBS would lessen competition and, arguably, under the present law, both might have been cleared.

A slightly different contrast, showing that a competition-based merger control system can recognise changes in market conditions, comes from the two cases of *Bond Helicopters/British International Helicopters* (1992)²⁵ and *CHC Helicopter/Helicopter Services Group* (HSG) in 2000.²⁶ In the former decision, the MMC came to an adverse finding on the proposed merger affecting helicopter support services for the UK Continental Shelf oil and gas industry. By 2000, the CC (as it had become) considered that barriers to entry had reduced, and the buyer power of the energy companies increased, sufficiently to allow the merger of the Bristol and Bond businesses to proceed.

Post-Enterprise Act cases

Let me now turn to some more recent, post-Enterprise Act cases.

One case that aroused considerable interest here was the proposed merger between *Ottakar's* bookseller and Waterstones, owned by *HMV*.²⁷ This recent case received much media attention, as much because of the participants and third-party comments as for the intricacies of the competition issues. Indeed, several well-known authors provided evidence, as well as many other interested individuals and businesses.

The CC looked closely at competition at the local and regional level. In particular, we looked for any distinctive Scottish features, in light of third-party concerns about possible adverse effects of the merger on Scottish authors and publishers.²⁸ Our survey showed Borders as a significant constraint on Waterstone's and Ottakar's in the five locations in Scotland where their bookshops 'overlapped'. And generally we found that the effect of factors such as competition from Internet retailers and uniform national pricing were pretty much the same north and south of the border and we found no substantial lessening of competition.

A case with an even greater Scottish focus was in *Pan Fish/Marine Harvest*.²⁹ This was a merger of two Atlantic salmon farming companies with overlapping activities in Scotland and Norway. The inquiry team visited each of the parties' Scottish salmon fish farming operations and held hearings with several regulators, local councils and certain Scottish third parties in Edinburgh. Evidence was taken from all of the leading UK salmon retailers³⁰ and from many of the parties' customers and competitors, as well as from relevant regulators, local

²³Ibid, paragraphs 12.7 to 12.19; 12.38 to 12.40; and note of dissent by Mr R G Smethurst. More generally, see Chapter 10 of this MMC report on 'Evidence from Scotland'.

²⁴See, for example, John Kay, 'Head office must be in the best place for business,' *Financial Times*, 24 April 2007, which refers to the CC's 1982 RBS inquiry in light of RBS's current role as 'predator' rather than 'prey' in its ABN-Amro bid.

²⁵MMC report, *Bond Helicopters/British International Helicopters*, 16 September 1992.

²⁶CC report, *CHC Helicopter Corporation/Helicopter Services Group ASA*, 19 January 2000.

²⁷CC report, *HMV/Ottakar's*, 12 May 2006.

²⁸See, in particular, paragraphs 5.98 to 5.103 of the CC's final report, *HMV/Ottakar's*, 12 May 2006, on the assessment of regional competition.

²⁹CC report, 18 December 2006.

³⁰The UK salmon retailers consulted by the CC together accounted for about 75 per cent of all UK retail sales of salmon. See CC report at paragraph 5.20.

politicians and councils, and other interested parties through written and oral submissions, telephone conversations, and a customer survey.³¹

Although production was located in Scotland and in Norway, we found the relevant market for fresh, farmed Atlantic salmon was essentially the whole of Europe. In this context it was not thought likely that the merged group would try and raise prices by withholding production or that it would be able to raise prices to the relatively small number of UK customers who had a strong preference for Scottish salmon. On this basis the CC declined to intervene, although interestingly in France, where the merger also needed approval, this latter point clearly weighed more for French customers, and the authorities accepted an offer by Pan Fish to dispose of its Scottish business before allowing the merger to proceed.

I can't discuss merger control in Scotland without venturing into the field of transport. Again, two cases illustrate what we try to do.

In *First Group/Scottish Passenger Rail*,³² the CC had to consider the acquisition of the ScotRail franchise by FirstGroup, the leading UK bus travel provider. FirstGroup also operated five passenger train operating companies. During our inquiry, it was declared the preferred bidder for the new Scottish rail franchise.

Once again the CC took great pains to assess the likely effect of this on the ground—ie in those parts of Scotland likely to be affected. The CC found likely adverse effects not only on specific routes where bus and rail overlapped but also wider effects on public transport network markets within Scotland. The CC did not, however, go so far as to prohibit the acquisition of the franchise, partly because the routes affected were a relatively small part of the overall network, and instead accepted a package of behavioural undertakings from FirstGroup relating to fares, frequencies and other aspects of services on the affected routes.

In the current case of *Stagecoach/Scottish Citylink*,³³ the CC had to consider a completed joint venture covering certain important coach routes in Scotland, essentially Edinburgh–Glasgow and the so-called 'Saltire Cross' routes (Glasgow–Aberdeen and Edinburgh–Inverness).

This case is still continuing, so I cannot comment further on the substance of it, but I will just say the following. The CC's conclusion (adverse in respect of some routes) was only reached after a very thorough review and having taken extensive evidence from many interested parties in Scotland, including from a number of MSPs and MPs, local councils and governmental bodies.³⁴ Our published decision (which, incidentally, was not appealed to the CAT), sets out our reasons and our chosen remedies, which are perfectly consistent with our established methodology.

³¹See www.competition-commission.org.uk/inquiries/ref2006/panfish/third_party_summaries.htm for non-confidential summaries of third-party views on the merger from a number of salmon processors and retailers as well as the summary of the hearings with Scottish Sea Farms and the Scottish Executive and Fisheries Research Services. See also www.competition-commission.org.uk/inquiries/ref2006/panfish/third_party_submissions.htm for non-confidential versions of written submissions from: Ms Elspeth Atwooll, MEP for Scotland; the Argyll and Bute Council; Comhairle nan Eilean Siar (Western Isles Council); the Highland Council; the Highlands and Islands Enterprise, the Argyll District Salmon Fishery Board; the Association of Salmon Fishery Boards and Rivers & Fisheries Trusts of Scotland; the Marine Conservation Society; the Salmon Farm Protest Group; as well as from customers such as the salmon smokers Ritchies of Rothesay, located on the Isle of Bute.

³²CC report, 28 June 2004.

³³CC report, 23 October 2006.

³⁴See www.competition-commission.org.uk/inquiries/ref2006/citylink/third_party_summaries.htm for non-confidential summaries of third-party views on the merger and www.competition-commission.org.uk/inquiries/ref2006/citylink/third_party_submissions.htm for non-confidential versions of third-party submissions.

I can understand that some may find our decisions unpalatable, but we give all interested parties a fair opportunity to explain their case and they cannot say that they did not know who we are, what we do and how we operate.³⁵

Merger issues

I would not want to suggest, however, that all merger control is easy and straightforward. Indeed, there are several important points that we are addressing as the Enterprise Act regime ‘beds down’.

The counterfactual

One point I mentioned earlier is looking at what is the alternative to the merger. The ‘counterfactual’, as it is called, is an important part of the analysis. The starting point is the pre-merger situation. This will not always be the right alternative. In *Scottish Citylink*, the alternative to the merger on the Edinburgh–Glasgow route was withdrawal of one of the operators—so on that basis, the merger itself did not lessen competition on that route.

Completed mergers and interim measures

Another issue is how to handle mergers that have already been completed by the time the CC is asked to look at them as was the case, again, for *Scottish Citylink*. Recently we have seen a number of cases like this.

The UK operates a voluntary régime, so parties do not need to receive pre-merger approval from the authorities before closing a notifiable transaction. However, the CC has to be able to do its job and, in particular, to take necessary measures, if it finds there is an SLC. For that reason, the CC will normally insist on imposing ‘hold separate’ measures where appropriate, as the *Stericycle*³⁶ case (we subsequently did the same in *Stonegate Farmers/Deans Food*³⁷) shows. One way of avoiding this problem would be to move to a system of compulsory pre-notification of mergers—but I am not sure that business would welcome that at this stage, even though it is how almost every other country operates. But a consequence of having a voluntary system is that from time to time we have to unscramble completed mergers or joint ventures.

Size and significance of mergers

Then there is the question of proportion. The cases I have described were all significant cases, but from time to time we are asked to investigate quite small mergers which, although they may raise difficult competition issues, may not justify the full weight of our intervention. This is not a straightforward thing to deal with. The incidence and scale of merger activity is not predictable, so we must to a degree take the cases that come along. But, stepping back a little, it is clear that UK merger control will be best served if it focuses its resources on the cases that matter.

³⁵The CC and before it, the MMC, has considered numerous cases concerning transport in Scotland. Examples include: MMC report, *National Express Group (NEG)/ScotRail Railways Ltd*, 16 December 1997; MMC report, *FirstBus/SB Holdings*, 24 January 1997; MMC report, *SB Holdings/Kelvin Central Buses*, 27 April 1995; MMC report, *Stagecoach/SB Holdings*, 27 April 1995; MMC report, *NEG/Saltire Holdings*, 17 February 1994; and MMC report, *Highland Scottish Omnibuses Ltd*, 12 July 1990.

³⁶*Stericycle International LLC, Stericycle International Limited, Sterile Technologies Group Limited v Commission* [2006] CAT 21, decision of 19 September 2006.

³⁷CC report, 20 April 2007. See also the parties’ interim measures dated 20 November 2006 at: www.competition-commission.org.uk/inquiries/ref2006/stonegate/pdf/interim_undertakings.pdf.

Colleagues in the OFT are well aware of this issue. They have to apply a legal duty in relation to references under the watchful eye of the CAT and competitors. The OFT is actively considering some increase in the minimum size of the market that may be affected by a referred merger, assuming no special circumstances exist. This will contribute to reducing the burden on business and to reducing costs. Equally, we adapt our procedures to 'smaller' mergers, although there is always the problem that the complexity of the issues to be investigated does not necessarily correlate with the size of the merger or market affected.

Is UK merger control 'too heavy'?

That, in turn, raises the question of how thorough and intensive should our investigations be. Unfortunately, views on this tend to vary with the interest in the outcome. In a case like *HMV/Ottakar's*, the CC was encouraged to be very thorough but in cases where our decision is unfavourable to the parties we can be met with the objection that we have applied a disproportionately heavy process (*British Salt* is an example here, although the final result was a clearance).

The truth is there is no easy way to judge the appropriate weight of process, but I would just make four brief points:

- First, the proportion of relevant mergers actually referred to the CC remains small; by far the majority of cases are dealt with at the OFT stage.
- Second, the CC now applies 'lighter touch' methodology to cases where the issues involved are of limited scope.
- Third, the overall CC timetable, including the remedies stage, is not out of line with international practice.
- Finally, those who reproach us for the weight of process are sometimes the same people who ask for more opportunities to present arguments and evidence in the course of an inquiry.

Nevertheless, I don't dispute that between us and the OFT, the system needs to be made to work as speedily and as efficaciously as possible.

So that is all I want to say about mergers and I want now to talk briefly about the other main part of our work—the investigation of markets.

IV Market Investigations

Hume contended that:

'we have ... no choice left but betwixt a false reason and none at all'.³⁸

Well, in the UK competition régime we have a choice. The market investigation régime provides the UK authorities with an additional and parallel means of competition enforcement 'betwixt' and alongside the 'prohibition' systems of Articles 81/82 of the EC Treaty and their national counterparts (Chapters I and II of the Competition Act 1998). As far as I am aware, the CC is the only competition authority in the world not only with the power to investigate markets in detail, but also with the power to take decisions and to impose remedies. Being directed against whole markets, rather than the conduct of individual

³⁸David Hume, 'Conclusion of this book,' *A Treatise of Human Nature*, Book I, Section VII, 1739.

players, market investigations can concentrate on identifying and remedying market conditions without the need to ascribe fault or to impose penalties. This can help make cases less contentious for the parties and can lead to greater acceptance of necessary remedies. These factors, coupled with the statutory two year limit, mean that, although very thorough and detailed, CC market investigations can in some instances be preferable, for the taxpayer, the consumer and for business compared with proceedings under prohibition systems.

Reference to CC: discretion not duty

As with mergers, the CC cannot initiate a market investigation. The market in question must be referred by the OFT (or one of the major sectoral regulators).³⁹ The test for reference is whether the referring body has 'reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or part of the UK'.⁴⁰ If it has such grounds, it may refer the market to the CC for investigation. This is in contrast to the duty to refer in relation to mergers.⁴¹

Adverse effect on competition

As Hume said:

'all knowledge resolves itself into probability'.⁴²

Once a case has been referred to the CC, the CC must consider whether there are 'adverse effects on competition' (AEC) assessed by reference to 'features of the market' that 'prevent, restrict or distort competition'. In our AEC assessment, we consider any and all of the evidence or 'knowledge' available to us in determining the 'probability' that a feature does or is likely to prevent, distort or restrict competition. An AEC can derive from one or more of the following features:

- (1) The conduct of suppliers or acquirers of goods or services.
- (2) The conduct of customers.
- (3) The market structure.

Conduct includes any failure to act, whether intentional or not, and any other unintentional conduct. The legal framework requires the CC to identify an AEC from market features that restrict or distort competition. The categories of features, although broad, are not limitless, although it is open to the CC to decide that a feature may cover more than one category. Some things, such as excess or supranormal profits as an example, cannot in themselves be 'features' although they may suggest the existence of other features, such as high prices charged by suppliers.⁴³

³⁹The OFT's power to make a market investigation reference to the CC derives from Part 4, section 131, EA 02. In relation to the sectoral regulators, the ORR's reference power derives from section 67(2A) and (2B) of the Railways Act 1993; GEMA's in relation to gas derives from section 36A(2A) and (2B) of the Gas Act 1986 and, in relation to electricity, from the Electricity Act 1989, section 43(2A) and (2B); OFWAT's derives from section 31(2A) and (4) and section 36 of the Water Industry Act 1991; Ofcom's derives from section 370(1) to (3) of the Communications Act 2003; and the CAA's derive from section 86(2) and (4) of the Transport Act 2000.

⁴⁰Section 131, EA 02.

⁴¹*Association of Convenience Stores v OFT* [2005] CAT 36.

⁴²David Hume, *A Treatise of Human Nature*, Book I, Part IV, Section I, 1739.

⁴³See EA 02, section 131(2) and (3). Both the OFT and CC guidelines discuss in detail what is meant by market features. See, in particular, Part 3 of CC3, *Market Investigation References: Competition Commission Guidelines*, June 2003; and Part II of

What market investigations are for

In investigating markets we are trying to assess whether conditions in a given market are enabling some providers, or acquirers, of goods or services to get, hold and exercise a degree of market power to such an extent that competition is restricted, consumers are harmed and some intervention is justified.

People sometimes say—what is the point of this? Surely Articles 81 and 82 cover all the things that should be covered? Well, the kinds of situation that market investigations can cover, and which a prohibition system might miss, include:⁴⁴

1. *Unilateral effects*: The need to improve the operation of a market dominated by one or more players, who are not themselves ‘abusing’ that position (particularly where incumbents are protected by high natural or strategic entry barriers that impede self-correcting entry).
2. *Coordinated effects*: Non-collusive oligopoly behaviour falling short of illegal conspiracy, of the form economists would regard as tacit coordination leading to prices approaching the collusive (or monopoly) level.
3. *Vertical effects*: Issues of market structures in vertical cases with parties operating at different levels of the supply chain where some ‘unbundling’ is perhaps needed to correct distortions in competition or actual or perceived discrimination;
4. *Inefficient equilibria*: Where the market arrives at a ‘bad’ equilibrium from which no individual firm has an incentive unilaterally to deviate.
5. *Government barriers to entry*: Where government policy creates ‘artificial’ barriers to entry that may distort competition (often motivated by legitimate public policy considerations).
6. *Informational failure*: Where consumers lack the information to make informed choices or (perhaps more controversially) where they may not use that information to make good choices.

This is a substantial list of matters, which suggests that there is considerable utility in the market investigation régime, and indeed, the increasing volume of cases bears that out.

The market investigation régime has been in operation for nearly four years. In that time nine investigations have been started, four of which have been decided. Of the nine investigations, four are in the retail financial services sector—*Store Card Credit Services*, *Home Credit*, *Northern Ireland Personal Banking* and *Payment Protection Insurance* (all essentially financial services references with strong consumer protection elements); the others are *Domestic Bulk Liquefied Petroleum Gas (LPG)*, *Classified Directory Advertising Services (CDAS)*, *Groceries* and, most recently, *BAA Airports* (including its airports in Edinburgh, Glasgow and Aberdeen) and *Rolling Stock for Franchised Passenger Services (ROSCOs)*.⁴⁵ The régime appears to be operating at a level of about two to three references per year, giving a running case load of about three with an 18-month to two-year duration.

OFT, *Market investigation references: Guidance about the making of references under Part 4 of the Enterprise Act*, March 2003.

⁴⁴This formulation owes much to Dr Mark Williams of NERA.

⁴⁵CC report, *Store Card Credit Services*, 7 March 2006; CC report, *Home Credit*, 30 November 2006; CC report, *Northern Ireland Personal Banking*, 15 May 2007; *Payment Protection Insurance* was referred to the CC on 7 February 2007; CC report, *Domestic Bulk Liquefied Petroleum Gas*, 29 June 2006; CC report, *Classified Directory Advertising Services*, 21 December 2006; *Groceries* was referred to the CC on 9 May 2006; *BAA Airports* was referred to the CC on 29 March 2007; *Rolling Stock for Franchised Passenger Services* was referred to the CC on 26 April 2007.

The four cases (*Store Cards*, *Bulk Domestic LPG*, *Home Credit* and *CDAS*) that have been decided show a varied picture. In ***Store Cards*** (ie credit cards supplied by retailers), the CC found competition problems in the downstream market (ie between retailer and customer) and adopted essentially informational remedies—particularly a requirement to draw customers’ attention to APRs exceeding 25 per cent through a ‘wealth warning’ (which came into effect earlier this week)⁴⁶ as well as requiring certain insurance products to be un-bundled from the store card provision. In ***LPG*** (supply of bulk LPG as a domestic fuel in tanks), the CC found that customers could not easily switch suppliers and decided on measures to make the transfer of LPG tanks between suppliers much easier. In ***Home Credit*** (small sum credit given and collected on the doorstep), where the CC found very little competition but a rather fragile industry, it opted for market opening measures through improved data sharing; better information for borrowers on what obligations they are taking on; and an adjustment to the early settlement rebate régime to remove an existing inequity. And in ***CDAS*** (Yellow Pages and other classified directories), the CC required price controls on Yell to continue, although in a modified form. In relation to the five current cases, the CC has found, provisionally, absence of customer awareness and switching in *Northern Ireland Personal Banking*; and in *PPI*, *BAA Airports* and *ROSCOs*—it is too early to say. I will come back to the *Groceries* investigation.

Market investigation issues

So much for the description of where we are—but as with mergers there are several issues that need to be considered.

The competition test

First of all, there is no easy contrast to draw between current decisions based on competition grounds and old decisions applying the broader public interest test. The present régime followed nearly 50 years of monopoly control with the emphasis in the two decades up to 2003 on so-called complex monopoly situations, where a group of companies collectively exercised market power to the public detriment. But it is a long time since a monopoly was attacked other than on competition grounds. One has to go back to the 1980s and such cases as *Animal Waste*⁴⁷ and *White Salt*.⁴⁸ Even as controversial a case as the *Supply of Beer*,⁴⁹ which covered such matters as the terms for public house tenancy agreements, can be characterised essentially as a competition case. Other major pre-Enterprise Act monopoly investigations such as *New Cars*, *Fine Fragrances* and, more recently, *SME Banking* and *Extended Warranties*⁵⁰ came to essentially competition-based conclusions.⁵¹

Geographical scope

Secondly, and it is only fair to address this tonight, there is the question of geography. How well does the market investigation régime cope with issues in different parts of the UK? There are two different ways of looking at this: cases specifically directed to a particular part of the UK and cases that are UK-wide where it is important to cover all areas.

⁴⁶The CC’s remedies require that store card statements should have a ‘wealth warning’ statement on store cards with APRs exceeding 25 per cent. The minimum payment warning is the following wealth warning statement: ‘If you make only the minimum payment each month, it will take you longer and cost you more to clear your balance.’

⁴⁷MMC report, 3 April 1985.

⁴⁸MMC report, 25 June 1986.

⁴⁹MMC report, 21 March 1989.

⁵⁰CC report, *New Cars*, 10 April 2000; MMC report, *Fine Fragrances*, 11 November 1993; CC report, *SME Banking*, 14 March 2002; CC report, *Extended Warranties*, 30 September 2003.

⁵¹Sometimes we feel that people forget that our investigations are about competition. Some of the issues we are being asked to address in the *Groceries* investigation are much more appropriate to a public interest test.

On the first, cases such as *Scottish Milk*⁵² (pre-Enterprise Act) and *Northern Ireland Personal Banking*⁵³ (current) suggest that the CC appropriately engages with the relevant area. As with mergers, the CC goes to great lengths to visit, discuss with and listen to people in the relevant country or region.

A good example of this is the 1997 inquiry into *Solicitors' estate agency services in Scotland*.⁵⁴ Here the Commission concluded there was no harm to the public interest and that the supply of estate agency services by Scottish solicitors did not restrict competition from non-solicitor estate agents—on the basis of a great deal of evidence from Scottish consumers. This, it will be noted, is a case of a monopoly 'clearance'—something it is sometimes (wrongly) said we never do.

In relation to UK-wide cases, I believe that we do take care to explore all relevant parts of the country. In the current *Groceries* case, the CC has held formal hearings in Wales, Northern Ireland and, of course, Scotland as well as taking detailed, local, evidence. It is in regular contact with organisations, politicians, businesses and consumers in every part of the UK. It would be hard to justify the claim that any particular region or nation was not being fully considered.

But there are more general issues raised by our experience so far.

'Getting the right cases'

One is how to get the 'right' cases. The intensity of the process and the resources consumed by authorities and parties are such that market investigations must only be launched in appropriate cases. This places great importance on the OFT considering carefully, on the basis of all the information that comes available to it, which cases are appropriate for detailed investigation. This reflects the wider context in which OFT and CC operate and shows the different but complementary role each plays in the UK competition enforcement system. Whilst the CC acquires much knowledge of different areas of the economy in the course of its work, it does not replicate the OFT's systematic observation of how different market sectors are faring. And the role of sector regulators should be noted also. They too can make market references—for example, the recent reference by the ORR of Rolling Stock Leasing Companies. The sub-text here is that the market investigation régime is meant to make a difference to UK consumer interests, to the efficiency of UK business and, ultimately, to the productivity of the economy. These references are clearly significant enough potentially to have this effect and it is important that the régime continues to engage with markets of this kind.

Level of intervention

Another aspect of appropriateness is the CC's own sense of proportionality. Market investigations should be neither arbitrary nor disproportionate in their operation. Most markets could probably be said to be not 'working well' in some or other respect. And assessing what a competitive market would be, when confronted with a possibly uncompetitive one, is not a precise science. But here the CC's accumulated experience comes into play. An AEC is unlikely to be found on the basis of insignificant or transitory conditions—and likely adverse effects will be considered from the point of view of durability and sustainability. Interventions will be kept to an appropriate level. This was essentially why no formal test of 'appreciability' or *de minimis* was included in the legislation and I am sure Hume would have approved of this approach.

⁵²CC report, 22 December 2000.

⁵³Referred to the CC on 26 May 2005; CC final report, 15 May 2007.

⁵⁴MMC report, 29 August 1997.

Running a manageable process

Market investigations are genuinely difficult to do fully and fairly in a manageable time frame. The statutory maximum is two years and cannot be extended. The CC accordingly aims to conduct the substantive part of its investigations within about a year (this will not always be possible), leaving the remaining time to cover the all important aspects of remedy formulation should this be required (tasks which pre-Enterprise Act often took much longer than this). To achieve this, the CC has to keep control of its timetable and the principal parties must play their part in the process. In particular, whilst it will always give parties a proper opportunity to comment on the CC's evidence and likely reasoning, the line has to be drawn somewhere in this dialogue, as the CC comes to its decision. The CC is digesting the lessons of its experience so far, and is well aware that the incentives for delay can be quite powerful. But making these investigations work well and to time is a key CC objective.

Appropriate remedies

As I said, the CC is unique in combining a market investigation role with extensive remedial powers. If we find an AEC we have a duty to remedy it and any damage to customers as comprehensively as possible. We must, in considering what we do, take into account customer benefits that might be threatened. And our remedy powers are extensive, ranging from the making available of more information to consumers to changing the terms of agreements or the divestment of whole businesses.

We also have a deregulatory function. We cannot override contrary legislation but we can recommend that other parts of Government should change or repeal them. There is a commitment, as with the OFT, by Government to respond publicly to such a recommendation within 90 days. In the only, rather minor, instance of a recommendation so far (to the DTI to amend regulations for home credit), the Government accepted the CC's position in full.

Generally, in applying remedies so far we have proceeded cautiously. We take great care to act proportionately and to deliver an effective solution to the problem we have found. We have not so far ordered any divestment of assets or businesses, unless you regard the LPG 'tank transfer' remedy as a divestment. But in an appropriate case, we will not hesitate to do what is necessary, and I am confident that our processes are robust and fair enough for people affected to understand fully why a particular remedy is appropriate.

V Conclusion

In an autobiographical essay written shortly before his death, Hume commented that, on publication, his *Treatise of Human Nature*:

'fell *dead-born from the press*, without reaching such distinction, as even to excite a murmur among the zealots.'⁵⁵

Whilst we cannot aspire to the quality of Hume's prose or the remorseless rigour of his philosophy, we do aim to produce 'classics' in the sense of authoritative reports that provide useful and comprehensive conclusions that are widely respected and relied upon fairly soon after publication (instead of having to wait some time, as in the case of Hume's *Treatise*). But our reports are not aimed at, nor do they represent the views of, any particular group of 'zealots'. Whilst we listen to the views and evidence of all interested parties during the course of our investigations, the conclusions reached in our reports are cogently and

⁵⁵'My Own Life' in *The Life of David Hume, Esq. Written by Himself*, 1777.

robustly argued and based on competition grounds alone. By the end of our highly open and transparent review process, we would hope to have quelled most of the murmuring—even that of zealots—by having given all interested parties the opportunity to voice their views and by considering the merits of any views put forward.

I have covered a lot of ground tonight—probably more than is reasonable. There is much I have not said—I have not discussed our regulatory work or our residual public interest work at all, I have not gone into any detail on how market investigations fit into more general competition enforcement, our work with other competition bodies around the world and the constant efforts we make to improve our organisation and processes and to ensure that our analysis is best in class.

And you may well ask, what is it all for? What is the underlying objective we are trying to pursue as a competition authority? It is easy to lose sight of this under the pressure of events, but vital not to do so.

A French competition expert has observed that in France ‘competition’ means job losses and foreign takeovers. The brand recognition of competition policy in the UK is also quite low and is often seen either as something rather undesirable—‘cut-throat competition’ or ‘unfair competition’—and not appropriate for sectors of the economy like transport or energy.

In the USA, The Honourable Thomas Barnett, Assistant Attorney General and Chief of the Antitrust Division of the US Department of Justice, said recently:

‘The Supreme Court has called the antitrust laws the fundamental guiding principles for the organisation of our economy. We have found that encouraging competition is the best way to build up standards of living and prosperity within our economy. Effective and efficient enforcement of those laws is a pillar of our economic policy’.⁵⁶

That is a pretty good exposition of the importance of competition law, which resonates on this side of the Atlantic also. It is important for all of us, I would suggest, to keep competition at the centre of economic policy in the UK. The CC may be sceptical in the way it approaches the analysis of the evidence in individual cases, but it is highly optimistic about what competition policy can achieve. Allowing markets to work effectively is the best system yet devised to deliver efficient businesses, innovation and benefits for consumers in terms of price, value for money and choice. And in markets where there are no natural—or even unnatural—monopolies, regulation is normally a poor substitute for competition in this respect. The idea of an economy without a strong competition policy is very unattractive.

And here again Hume has some guidance for us. We are trying to protect and, if possible, promote competition. Whilst Hume did not actually write a treatise on competition (a concept more developed by his friend and legatee Adam Smith), he did write the following in his essay ‘Of the Jealousy of Trade’:

‘I will venture to assert, that the encrease [sic] of riches and commerce in any one nation, instead of hurting, commonly promotes the riches and commerce of all its neighbours; and that a state can scarcely carry its trade and industry very far, where all the surrounding states are buried in ignorance, sloth and barbarism.’⁵⁷

⁵⁶As quoted in *Concurrences*, No 3-2006, pp 6–9.

⁵⁷David Hume, ‘Of the Jealousy of Trade’, *Essays, Moral and Political*, Essay VI, Part II, 1752.

This points to the international benefits of competition. Whether here, tonight in Edinburgh, we are surrounded by states 'buried in ignorance, sloth and barbarism' is a matter I leave to the good sense of my audience.

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