

**LAW SOCIETY COMPETITION SECTION
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**Keynote address by
Peter Freeman¹**

'The world turn'd upside down'

Introduction

First of all thank you for giving me the opportunity to address you today. I am very honoured to speak at the first Annual Conference of the Law Society Competition Section (LSCS). I am sure the LSCS will be a worthy successor to the LSEG, as a forum to debate competition issues.

The line from which the title phrase is taken is from a ballad sung in protest against the abolition by Oliver Cromwell of Christmas festivities at the time of the English Civil War.² We are not facing civil strife today, but we are facing economic strife on a scale not seen since the 1930s. In that sense, our world has indeed turned upside down.

When I spoke at the LSEG, in July 2008, I asked the question 'Is competition everything?' With the benefit of hindsight, that looks to have been the right question to ask. I concluded that while competition remains the best way of delivering benefits to consumers, it will from time to time conflict with other policy objectives; and it is the essence of elected government to resolve these conflicts. That was nearly a year ago, and we have since had a severe financial crisis which has spread to the general economy; in other words we have had one or two 'natural experiments' since then. I will try today to revisit the events of the last year and relate them to the topics of today's conference.

You have a session later this morning on 'Competition and the wider world'. There is indeed a danger that we focus too much on local or regional aspects. The way that the events of the past year have played out has been genuinely international; issues that have arisen in relation to international relations, trade policy and coordination of economic measures are an essential backdrop to any discussion of 'domestic' competition. Put simply, a country with a strong domestic competition policy will tend not to adopt protectionist trade policies.

A critical time

This is a critical time for both competition policy and competition enforcement. These of course are different things, and we should be clear what we mean by them. Policy is the overall framework which provides the objectives and justification for what we do. Enforcement means the actions taken by authorities in pursuit of those objectives. I have always thought that the idea of 'enforcing' competition is rather heroic. Enforcing the law that prohibits infringements as in the case of Articles 81 and 82, yes; but in the CC's case, with our job of investigating mergers and markets, as well as our regulatory role, we are better described as acting to maintain, restore or promote competition, depending on the circumstances.

¹Chairman, Competition Commission (CC). The assistance of Dr Ingrid Nitsche of the CC's staff is gratefully acknowledged but all views expressed are personal to the speaker.

²'Yet let's be content, and the times lament, you see the world turn'd upside down.'

But it is undoubtedly a critical time. In terms of policy we have the impact of the financial and economic crisis, which I will discuss in a moment; but we also have important developments in the approach to market power and cartels.

In the USA, the new head of the DoJ's Antitrust division has withdrawn the statement of policy on single-firm conduct issued by her predecessor last September, essentially because it was too passive. Instead a more active stance is promised. The new Chairman of the Federal Trade Commission has adopted a similar position. In the EU, the European Commission last week condemned Intel for abusing its dominant position by exclusionary conduct, imposing the highest ever individual fine of over one billion euros. In the UK the CC has required BAA to sell three of its airports, an aspect of which is now being challenged by BAA; in the cartel field the Office of Fair Trading (OFT) has procured the first convictions under the criminal provisions of the Enterprise Act and there has been a significant, recent ruling on extradition to the USA. There is, in short, a fair amount of competition 'enforcement' either promised or in play, economic crisis notwithstanding.

Stepping back a little, we need to be clear what are the key issues underlying this activity and to keep them in mind as we go through the topics of this very interesting conference day.

First and foremost is the question of competition and the crisis in the financial sector. This has important lessons for us and requires careful consideration. Then there are the implications for competition policy and enforcement in the wider economy. Does recession mean any change in competition policy or enforcement? There is the broader question of how competition relates to other policies and how its enforcement should take account of them. This is particularly relevant in settling the right relationship between competition and regulation in the financial sector. Finally we have all the interesting doctrinal questions, such as the approach to monopolization; the approach to cartel enforcement and leniency; the need for deterrence and the appropriate level of penalties; the significance of private enforcement and the extent to which competition authorities should be able to control market structure by direct intervention.

I have to say that in my view these doctrinal questions are important, and interesting, particularly for those against whom the competition authorities act; but as we stand today they are second order questions. There is an even more important task than getting the doctrine right, for example, on monopolization or on structural remedies—and that is ensuring we get through the present economic difficulties without losing the commitment to competition itself.

The financial sector and competition

Let us start with the big one—what has happened in the financial sector and what this means for us. You have a whole session devoted to this so I will make only a few remarks.

This time last year the magnitude of the storm that was about to break was not generally understood. But we have to try and understand what happened if we are to learn the right lessons.

We now have a number of authoritative accounts documenting and explaining what occurred, not least the Financial Services Authority's (FSA) own review under the control of Lord Turner—the Turner Review³—which should be required reading for any would-be commentator. Another very clear account is in an article written by Sir John Vickers at the

³*The Turner Review: A regulatory response to the global banking crisis*, Financial Services Authority, March 2009.

end of 2008.⁴ These accounts describe the macroeconomic imbalances, the channelling of large, mainly Eastern, savings into Western assets accompanied by loose monetary policy and low interest rates. What is best described as regulatory failure, applied to exuberant financial practices and the development of ever more complex financial instruments, led to an enormous expansion of banks' leverage (ie the ratio of lending to asset values).

What was clearly not appreciated was that when asset markets went into reverse (which they did with a vengeance starting with the US housing market) the unravelling effect would be just as spectacular as the preceding era of exuberance.

The effect of this on confidence was felt first by banks themselves—with a drastic effect on inter-bank lending—and then by depositors—always the vulnerable area for banks. The run on Northern Rock was a vivid illustration of the devastating effect of a collapse of depositor confidence.

But this was only the start. The unravelling of asset values led straight into a crisis of under-capitalization as banks marked down the value of their assets at an ever-increasing rate. It is, I think, significant to the understanding of the *Lloyds/HBOS* merger⁵ that it was proposed at a time when the main issue was confidence, but concluded at a time when the issue was more one of capitalization.

Against this background we have had massive, and very necessary, government intervention, in the form of deposit guarantees and direct injections of capital, quantitative easing, a very large amount of international activity and much focus on reform of the regulation of financial services. And we are by no means out of the wood yet, with talk of the need for further bank and building society recapitalizations and a very mixed performance picture.

So what lessons can we draw so far in relation to competition? First of all, I believe that we have to accept that banks are to some degree 'special' and competition in banking has also to be regarded in some respects as 'special'; mainly because of the imbalance of product information between customer and supplier and the systemic effect of a major bank failure. But it would be a serious error to exempt the banking sector from the competition regime altogether or to ascribe these recent disastrous events to an excess, or even to a 'normal' amount, of competition. This has not yet been said explicitly on a wide scale—you will not find it in the Turner Review, for example—but it is a short step from calling these events a 'failure of the market' to blaming them on 'too much competition'.

There are two strands to this: whether competitive pressure led, for example, HBOS to overreach itself in domestic mortgages—lending far beyond the value of its security; or, whether competition enforcement—seeking to lower bank charges, encourage switching, etc—took attention off the needs of safety in the financial system—the danger of one bank failure triggering a general collapse. I suggest the answer in both cases is 'no'. The competitive instinct to expand and gain customers and market share is entirely sound; but the special features of banking—imbalance of information and systemic risk—put the focus on careful regulation. Similarly for competitive intervention; it seems odd that one cannot have both a proper customer offering (appropriately regulated) and also maintain proper respect for the dangers of systemic collapse. Indeed, in the recent *PPI* decision⁶ the CC took the view that in an economic downturn the case for intervention in the consumer's interest was if anything even more pressing.

The second lesson to draw is that it is necessary to improve regulation in financial services whilst at the same time preserving competition. Finding an acceptable regulatory settlement

⁴ *The Financial Crisis and Competition Policy: Some Economics*, GCP, December 2008.

⁵ Decision by Secretary of State under section 45, EA02, 31 October 2008.

⁶ [Market investigation into payment protection insurance, 29 January 2009.](#)

will not be easy, and it will take time. The focus should be on identifying genuine concerns about adverse effects of particular competitive activity, whilst still being aware that competition generally brings benefits. This exercise is difficult, and has some way to go.

Third, there must be an increased emphasis on safety and stability. The result of neglecting these has been only too clearly shown. But that should not mean the abandonment of competition. It is first of all important to preserve scope for competitive activity. But it is also important to maintain competitive market structures. The lessons from encouraging bank mergers, in the interests of stability, are at best ambiguous and a merged bank that is 'too big to be allowed to fail' creates its own set of problems, in addition to any adverse effect on competition. Whilst it will not be possible, or necessarily appropriate, simply to reverse mergers that have taken place, it would be preferable for the overall policy approach not to favour consolidation as an automatic solution and for competition enforcement (in this case merger control) to consider carefully on the evidence, in the normal way, whether allowing a particular merger to proceed is more or less competitive than letting the merging business fail.

Finally, there is the issue of so-called 'moral hazard' (that is the danger of insulating parties from the consequences of their actions). Joseph Schumpeter famously argued that the essence of capitalism was creative destruction. Two economists recently argued in the *Financial Times* that if things are to move forward, we should start restoring 'a little orderly creative destruction'.⁷ This would ensure that at least some of the risk associated with financial services is re-privatized and as a result creditors, not the public, bear the risk of non-systemic banks becoming insolvent. Otherwise, we leave banks with no incentives to behave more responsibly in the future. I am not advocating a policy of allowing banks to fail; I am simply saying that we have to move on from where we are at present.

The wider economy

Let us now turn to the rest of the economy, where it is very clear that the financial crisis is now having a serious impact. Does this mean that some change to the application of competition rules is appropriate?

Again, there are several important points.

First, most industries are typically not as 'special' as the financial sector; in other words, these industries will be much less prone to systemic risks. One can argue about the 'systematic' effect on component suppliers if a car manufacturer collapses, but it is on a different scale from the financial sector. It is necessary to face up to the harsh truths that economic activity is cyclical, that difficult conditions in periods of downturn sort out the efficient from the inefficient, and that the exit of inefficient firms is inevitably part of a properly functioning market economy.

Of course, the short term needs of preserving employment or security of supply or industrial capacity will weigh heavily with governments, and carefully targeted intervention to relieve the social or even the strategic effects of the downturn is entirely understandable and correct. What must be avoided is generalized support of industries in difficulty as this may harm economic prospects in the long run by keeping inefficient firms in business, and simply risks preserving present jobs at the expense of the creation of future jobs.

The market economy, underpinned by competition, has brought immense benefits to consumers and businesses which we should not lightly sacrifice. Intervention needs to be carefully targeted, limited in scope and duration and be subject to review, with an

⁷Matthew Richardson and Noriel Roubini, *Insolvent banks should feel market discipline*, *Financial Times*, 6 May 2009.

appropriate acknowledgement by those receiving assistance that they should take measures to adapt to the downturn.

Second, and consequently, there is no general issue over increased regulation, as in the financial services sector. The question is more one of how to apply competition policy, and whether there should be any less, or any more, vigour.

In terms of enforcement, I can only echo the OFT's Chairman Philip Collins, who said in a recent speech that the competition authorities should resist any calls for 'a more relaxed' view of competition enforcement and the adaptation of 'a more liberal interpretation' of the relevant exemption criteria.⁸ That is very much my view also.

But we have to recognize the current economic reality and context. In merger control, for example, these factors will inevitably affect what is the right thing to do in particular cases in terms of overall timing, in assessing what is the counterfactual situation (there will be more who seek to rely on some form of 'failing firm' argument) and in the process of implementation of remedies. Aspects of substantive analysis may change also, for example the analysis of new entry in relation to access to finance may be different and less favourable. All these things may be of considerable practical importance in individual cases, but they do not affect the basic tenets of competition policy and the need to apply them at the present time to whatever factual situation arises.

Is competition everything?

So in the light of this, how does the question we asked ten months ago look?

My basic proposition last year was that competition is not necessarily regarded by everyone as the solution to every problem. Competition policy is very important, but other policy objectives can be seen as of equal or greater importance and short-term imperatives may be seen as more significant. And I made the point that it is always open to governments to elevate other policies over competition.

Today, we are looking back on ten months during which one specific 'other policy objective', ie financial stability, has certainly risen to prominence. We have the new public interest ground introduced into the Enterprise Act prior to the *Lloyds/HBOS* decision, and the decision itself.

But I think the question remains the right one to be asking. In the light of recent events it is more important than ever to be aware first of the significance of competition in the market economy and why consumers benefit from it. The fact that competition produces benefits in terms of increased efficiency and productivity, innovation and more purchasing power for consumers through lower prices, is no less true in times of economic difficulty. Free markets underpinned by competition remain the preferred way to organize economic activity. But we do need to appreciate the wider policy context.

Competition clearly cannot on its own 'solve' the financial crisis—other imperatives such as financial stability have come to the fore in the short term. But in the longer term, the challenge is how to achieve the right degree of competition in the financial sector.

The issues I identified in other areas last year are as vivid as ever.

⁸*Preserving and Restoring Trust and Confidence in Markets. Keynote address to the British Institute of International and Comparative Law at the Ninth Annual Trans-Atlantic Antitrust Dialogue*, at p10, available on www.of.gov.uk.

The argument over ‘national champions’ runs through the debate in financial services, but is highly relevant to other sectors, such as defence, where the needs of international collaboration and the preservation of strategic industrial capability remain priorities for many countries (including our own). Examples of this include recent special intervention notice served by the Secretary of State in relation to underwater sonar, and the various exclusion orders in relation to aspects of the Defence Industrial Strategy.

In health, the reaction of the pharmaceutical industry to DG Comp’s preliminary report in its sector inquiry⁹ focused on the importance of intellectual property to encourage investment in R&D and how this might be threatened by the encouragement of generic competition. And the need to preserve strategic capabilities in pharmaceuticals is graphically illustrated by the current ‘swine flu’ outbreak and the public expectation that there will be adequate supplies of antiviral drugs and vaccines. More prosaically, but possibly of equal concern to some members of the public, the debate about whether alcoholic drinks that may be harmful to health are ‘too cheap’ continues.

In energy, particularly with reference to environmental policy, specific measures to promote certain forms of energy supply—wind, tidal or nuclear, provide a strong illustration that whilst some competition in the supply of these forms of energy is both feasible and desirable, competition in energy supply is not always seen to meet the government’s overall objectives, leading to the possible need for measures of more direct intervention. No doubt you will touch on these aspects in the session on sectoral regulation this afternoon.

In town and country planning, the discussion continues as to the appropriate part that competition should play. Here there is clearly some way to go and the idea that the planning system should recognize the benefits of competition offered by new retail entrants to existing incumbents, for example, has yet to bed down.

In transport, the CC’s report on Rolling Stock Leasing¹⁰ sets out in some detail the inter-relation between the architecture of the train operator franchising system and competition in the leasing of rolling stock; again an area where considerable disagreement as to the relative merits of each policy remains.

Striking the balance

So in some policy areas there is a balance to be struck between the important benefits that a well-applied competition policy will produce, and the occasionally different requirements of other policy objectives. There is little doubt that the events of the past year have made it even less likely (if it ever was) that competition will be seen to ‘trump’ everything else. The idea that financial markets will ‘self-correct’ has been discredited, and it is not a big leap to extend this view to markets generally.

In weighing up these factors, we need to bear in mind that the market economy we are talking about is not some neo-liberal paradise but an appropriate mix of public and private activity, with the state necessarily setting the overall framework for competitive, wealth creating, activity. As Samuel Brittan emphasized recently, even capitalism is not just about markets and prices, it needs much more in terms of a supporting framework including a significant element of state ownership and regulation,¹¹ as well as state financial support for individuals in need.

⁹ *Pharmaceutical sector inquiry preliminary report*, 28 November 2008.

¹⁰ *Rolling Stock Leasing market investigation*, 7 April 2009.

¹¹ *A catechism for a system that endures*, *Financial Times*, 1 May 2009.

So the point about mechanisms and process that I emphasized last year remains equally valid now. The UK has developed a system where the competition authorities are able to provide a clear analysis of competition issues, applying a transparent process; what then is important is that the requirements of other policy objectives, if these point in a different direction, should be equally clear and robustly reached, so that an effective balancing—clearly a task for government—can be carried out. This seems to have been effectively done in the *Lloyds/HBOS* decision, where the validity of the Secretary of State's decision and the process behind it were upheld by the CAT.

Conclusion

In conclusion, this is a very timely conference and the topics it covers are not only interesting and relevant in themselves but interesting because competition itself has come under scrutiny.

I have not discussed the issues of doctrine which are of great importance to competition specialists, and to those on whom their decisions impact, but have tried to place our work in a wider context. Businesses will only see cartel or monopolization enforcement activity as justified if the basic premise is accepted that competition is necessary and beneficial in bad times as well as in good.

It is necessary to study the implications of the financial crisis for competition and to consider how competition should operate in the economy generally when the economy is contracting. Competition is not a luxury policy relevant only to times of expansion and growth.

But this critical scrutiny of the relevance and effectiveness of competition and the appropriateness of enforcement is part of a wider picture. This wider picture involves giving competition policy its proper place in the wider policy spectrum and dealing with the overlaps and possible conflicts with other policies. It is not enough to say that competition should trump all other policies, as it clearly doesn't.

In some cases, competition is very important, but may not on its own be enough. So, if the state needs a particular defence facility in the interests of national security, a particular supply of vaccines to ward off a 'flu pandemic, or a nuclear power station to keep the lights on, it may not be enough to sit back and leave competition to provide the solution. Competitive markets may be necessary to deliver quality products and services at good prices, but they may not on their own be sufficient to meet all that is needed in the wider public interest.

In the converse case, where competition imperatives conflict with other policy requirements, then the focus is again on the state to provide the mechanism to weigh the issues in the balance. Such judgements are the essence of government. In the UK, the quality and transparency of competition assessments are generally high. What is then crucial is to ensure that the assessments under other policy heads are equally robust, and that the process for weighing up the conflicting issues is transparent and rational.

So I do not take the view that the need for a strong and effective competition policy has been swept aside by recent events and that it is no longer relevant to the current economic environment. Competition policy is very much alive and well and will, I believe, underpin economic activity in this country for the foreseeable future during this recession and in the recovery when the world turns the right way up again.

Thank you for your attention.