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Competition Law and Economics
A Partnership of Equals or a Struggle for Supremacy?

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Introduction

It is an old rhetorical trick to point up a supposed dichotomy, purport to analyse it critically, and conclude by stating that the dichotomy is after all false and reconciliation of the two opposites easy. I propose to use precisely this device in considering competition law and economics. It is fashionable (and sometimes amusing) to characterise competition policy or competition enforcement (as it is sometimes called) as an unhappy union of two fundamentally different disciplines, whose exponents themselves suffer from irreconcilable differences in attitude, methodology and objectives. We have all heard the jokes about lawyers who present alternative advice and leave you uncertain as to which course to take whilst charging you for both. And about the three economists with four opinions. The doyen of competition lawyers, Sir Jeremy Lever QC, tells the joke about the lawyer and economist without a tin-opener and unable to open a tin of baked beans. “But you agreed to bring a tin-opener” says the lawyer “I hold you accountable for this”. “Ah”, replies the economist, “It is easy – assume we have a tin-opener”.

As I said, pointing to differences is fun, but not very productive. Looking for areas of commonality is much better. Here we have only to look to a most distinguished exponent of competition law and economics, Professor Robert H Bork, for a telling phrase:

“Antitrust is necessarily a hybrid policy science, a cross between law and economics that produces a mode of reasoning somewhat different from that of either discipline alone”.[1]

Some years previously, Justice Brandeis, someone of whose opinions Professor Bork was not always enamoured, said:–

> “A lawyer who has not studied economics is very apt to become a public enemy”.[2]

And, in their long and detailed review of twentieth century antitrust, Law Professor (and now FTC Commissioner) William Kovacic and Economics Professor Carl Shapiro, concluded that:

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[1] *The Antitrust Paradox* (1978), page 8.
[2] Quoted in Cento Veljanovski *The Economics of Law* (1990), page 12.

> "The links between economics and law have been institutionalized with increasing presence of an economic perspective in law schools, extensive and explicit judicial reliance on economic theory, and with the substantial presence of economists in government antitrust agencies".[3]

But, before we dissolve into hopeless unity let us examine some principal reasons why the legal and economics based approaches to competition are sometimes thought to be less than wholly compatible. There are at least four propositions to consider:–

(1) law concentrates on the **form** of the supposed restriction of competition; economics considers the **effect**;
(2) law seeks to **prohibit**; economics seeks to **cure**;
(3) law proceeds on the basis of proper **evidence**; economics rests on **theory**;
(4) law looks for **certainty**; economics looks at each case afresh so creates **uncertainty**.

We will discuss the extent to which any of these propositions could be said to be true, and then consider some cases in which law and economics have been clearly and inextricably combined.

Proposition 1: form versus effects

It is said that competition law aims to prescribe rules by which behaviour can be assessed; or if rules are too inflexible, then presumptions. Economics concentrates on assessing the effects of behaviour in the light of economic theory, of appropriate assumptions and of the observed operation of the market. Put very crudely there is the "rules based" approach (bad) and the "effects based" approach (good). It may be instructive to see how this supposed difference in approach has shown itself in the development of competition policy in the US, the EU and the UK. Here we see signs of past struggles, and possibly lingering effects, even if passions have now abated somewhat.

The US experience

I do not pretend to be an expert in US antitrust law, and a little knowledge is always a dangerous thing, but no serious student of competition on this side of the Atlantic can fail to be conscious of the huge body of relevant practice and literature on the other.

The review article by Kovacic and Shapiro from which I quoted earlier documents the various ages of US antitrust law, all based on very modest (in length at least) statutory provisions. The authors give 1925 as the year of the first Supreme Court citation of an economist's work in an antitrust decision.[4] They describe vividly the

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[3]*Antitrust policy: a century of economic and legal thinking*", Competition Policy Center, University of California, Berkeley Working Paper No CPC99–09 (1999), page 19 (Kovacic and Shapiro).
[4]*Maple Flooring Manufacturers' Association v US*, 268 US 563 (1925). See Kovacic and Shapiro, page 6.

emergence, after 1945, of an active antitrust enforcement policy based on industrial organisation theories, with many form based aspects, leading to the revolt by the so-called Chicago School, led by Bork and Posner, developing the ideas of Aaron Director. By this school, antitrust interventions should be restricted to those instances (principally horizontal cartels and mergers) where consumer welfare was likely to be enhanced as a result. The idea that "competition" was not only not restricted but could actually be enhanced by arrangements (particularly "vertical" agreements) that contained overtly restrictive clauses such as exclusivity provisions was clearly a challenging one for many lawyers. So the Supreme Court ruling in *GTE Sylvania* (1978)[5], that vertical restraints were not automatically (per se) illegal but were subject instead to individual analysis (rule of reason), was a major milestone.

In the present "Post Chicago" age, where synthesis is all the rage, there is clear acknowledgement by judges, agencies, academics and practitioners that sound antitrust analysis should be economics based. As ex-FTC Chief Economist Luke Froeb said recently, in answer to the question whether economics was valuable in competition law:

> "We fought that battle in the 1980s and we won".[6]

The EU

The development of EC competition law also shows a genuine "struggle for supremacy" between law and economics, and the effects of this are with us today. The original Treaty provisions were relatively short and deliberately modelled on their US equivalents. But the early Treaty of Paris provisions relating to the coal and steel sectors were very much part of an economic system with predominantly corporatist and arguably protectionist objectives. Not until later was enhancing competition between steel or coal undertakings a major objective. And the Treaty of Rome competition apparatus had for many years a market integration focus so that for example "export bans" (a vertical restraint) on distributors and licensees were the cardinal sin, attracting large fines.[7] The scope of EC competition law was extended "horizontally" to cover joint ventures, and co-operation in research and development and "vertically" to cover licences of intellectual property and distribution agreements. Consideration of countervailing benefits was confined to the operation of paragraph 3 of Article 85 (later Article 81) administered exclusively by the Commission itself, pursuant to an elaborate system of individual notification combined with exemption by category. Abuse of dominant position (Article 86, later 82) also developed in an arguably formalistic fashion, with dominance often assessed by reference to market shares alone and abuses identified on a check list basis.

But, as with the US, EC law would undergo a revolution, although possibly a less radical one. Already in the 1960s the Court of Justice (whilst confirming the

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[5] *Continental Tyre Inc v GTE Sylvania*, 433 US 36 (1977).
[6] BIICL Litigation Conference, October 2004: Panel 6: *Use (and abuse?) of Economic Evidence* (2005).
[7] E.g. *Johnson & Johnson* (Commission Decision 80/1283) OJ [1980] L337/16 and *Volkswagen* (Commission Decision IV/35.733) OJ [1998] L124/60.

extension of Article 85(81) to cover vertical agreements and the overriding objective of market unity) had sown the seeds of an economics-based approach by emphasising that the anti-competitive nature of an agreement could only be assessed by reference to its legal and economic context.[8] To some extent the development of an "effects based" analysis of restrictive agreements was bedevilled by Article 81's reference to "*object or* effect" – ie if the parties intended to restrict competition, whether they succeeded was beside the point; but this did not greatly impede the moves towards reform of Article 81, first in relation to vertical agreements[9], then horizontals[10] and finally with the decentralising of Article 81(3)'s application to national authorities and courts with Modernisation.[11] Article 82 is presently undergoing a somewhat similar experience.[12]

So, again, we reach a stage of happy union where the most recent former Commissioner for Competition, Professor Mario Monti, on leaving office, could openly claim that "A major trend of this mandate has been to ensure that competition policy is fully compatible with economic learning".[13]

Nowhere has this been better illustrated than in merger control where what could almost be described as an excessive reliance on economics was subjected to a series of hard-hitting CFI judgments, the effect of which was to require the Commission to prohibit mergers only on the basis of sound theory, sufficient evidence (of whatever nature) and proper analysis.[14] At the same time the substantive test in EC merger control was aligned more on that applying in the so-called "Anglo-Saxon" countries, ie effect (or impact) on competition.[15]

The UK

The UK competition arena also offers a case study of form versus effects.

The old system for controlling restrictive agreements, the *Restrictive Trade Practices Act*, lasted some 44 years from 1956 to 2000. This was a system that moved between, and mixed up, form and effects based approaches with almost reckless abandon. Under this system, agreements were subject to registration on an extremely formalistic basis (if relevant restrictions were accepted by two or more persons relating to specified matters, with separate systems for goods and for

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[8]See particularly Case 56/65 *Société Technique Minière v Maschinenbau Ulm* (1966) ECR 235. For a later, strong example of this approach see Case C-234/89 *Delimitis v Henninger Bräu* (1991) ECR I-935.
[9]Regulation 2790/99 and Commission Guidelines (1999).
[10]Guidelines on Horizontal Co-operation Agreements (2000).
[11]Council Regulation 1/2003.
[12]See for example, DG Competition Discussion Paper on the application of Article 82 to exclusionary abuses (December 2005).
[13]Speech to Center for European Reform, 28 October 2004, quoted by DG Comp economist Benoit Durand at the BIICL Conference referred to in footnote 6 above.
[14]*Airtours plc v Commission*, Case T-243/99, [2002] ECR II-2585; *Schneider Electric SA v Commission*, Case T-310/01, [2002] ECR II-4071; *Tetra Laval v Commission,* Case T-80/02, [2002] ECR II-4519.
[15]See Council Regulation 139/2004/EC and Guidelines on the assessment of horizontal mergers (2004).

services agreements). They were then subject to an administrative exemption test of "economic insignificance" (clearly "effects"). If not so exempted, they were considered by a competition court applying a series of public interest tests ("Gateways"); altogether a glorious mixture. Enforcement was by proceedings for contempt of court to see if any later agreement was "to the like effect" as the prohibited one (an effects based approach applied formalistically). Resale price maintenance was, by contrast, prohibited from 1964, but applications to exempt certain sectors (medicines, books) produced much "economic" argument in court. All in all, this was a potent, if latterly somewhat discredited, mixture of law and economics, of form and effect.

Of course all that went with the *Competition Act 1998*, and UK law is now very much the blood relation of EC law, with a requirement to apply EC legal interpretations and a new, specialist tribunal that habitually relies on EC cases to interpret UK law.

More recently, and possibly paradoxically, the law prohibiting cartel behaviour by undertakings has been strengthened by the introduction of individual criminal liability with imprisonment as a sanction. In a conscious attempt to exclude any *effects* based defences, this offence is defined very much by reference to the *form* of the behaviour engaged in (coupled with a dishonest intent); no economics here at any rate.

But the UK's experience is instructive in other ways too. In parallel with (and pre-dating) the control of agreements, the UK has controlled misuse of market power and anti-competitive mergers by an administrative system built round the UK's own Commission – first "Monopolies", then "Monopolies and Mergers" and now "Competition". Here we are dealing not with prohibitions and penalties (the CC only became determinative in 2003) but with analysis and judgment; primarily for the future. Particularly under the pre-2003 law, there were formalistic aspects to this system (monopoly inquiries involved the formal identification of a 'monopoly situation' followed by a process of attributing public interest detriment to steps taken by the monopolists). And the influence of the law was strong, not least in fixing the relevant standard of proof and the definition of a "merger situation". But the essential work was in assessing evidence and coming to an individual judgment on each case. Precedent as such was eschewed, although consistency of approach was not actively discouraged.

Not that these judgments were necessarily based on economics. For many years the MC or MMC adjudged what was the damage to the public interest, looking, for example, at the fitness of an individual to acquire a business[16], the UK's strategic interests[17] and back-door nationalisation.[18] But assessment of competition was increasingly a key consideration and quite often economics played an important part in this. Any Commission of which, for example, Professor Basil Yamey was a member was going to acknowledge the importance of economics.

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[16] *Alan J Lewis/Illingworth, Morris Plc*, Cmnd 9012 (1983).
[17] *Government of Kuwait/British Petroleum Plc*, Cm 477 (1988).
[18] *Credit Lyonnais/Woodchester*, Cm 1404 (1991).

Now the *Enterprise Act* has made competition tests explicit for mergers and market investigations, and the CC's work involves coming to decisions applying these tests, on a similar economics based approach to its US and EU equivalents. So, a triumph for "effects" and law and economics operate harmoniously together (for the most part).

So I think in relation to Proposition 1 we can say that generally the tension between form based and effects based competition systems has been defused. That is not to deny the importance of legal forms. At a trite level, legal forms such as definitions of the persons or parties types of situations (such as mergers) to which competition should apply, and types of activity (eg hard core cartels) are essential elements of any competition system. But where an effects based approach is appropriate there seems little serious objection, at least intellectually, to its being applied. So let us examine the next proposition.

Proposition 2: prohibition versus cure

This proposition is that law seeks to identify infringing conduct and to prohibit it; whilst economics seeks to find out what is wrong with a given market situation and to cure it. Competition law typically judges behaviour against stated criteria. (Those criteria usually rely on a mixture of form and substantive definition, as we have already discussed.) Infringing behaviour is typically prohibited, and penalties imposed to punish the wrong doers and to deter others. (Criminalisation of behaviour, whether corporate or individual, adds a further layer of compulsion and punishment.) Economic analysis, by contrast, is not concerned with prohibition or punishment but in seeking to remove anti-competitive aspects to markets for the benefit of consumers and/or efficiency.

Again the UK experience of controlling market power is instructive in this context. The system of administrative control operated by the MMC up to 2003 was certainly not seen as ineffective by those to whom it was applied. But as it was not based on general prohibitions, it was thought to be not enough to deter the misuse of market power. This defect was addressed by adding to it in 1998 the Competition Act prohibition powers, albeit with an acknowledged potential overlap between the two systems. But it is misleading to see this as a case of substituting law for economics. Each part of the hybrid system needs to use economics correctly to characterise the market power and misuse. This is even more so under the *Enterprise Act* regime, where the CC investigates markets, decides on "market features" that adversely affect competition and determines "remedies", ie that things must change. The market investigation regime sits alongside, and occasionally overlaps with, the prohibitions in Article 81 and 82; but the task of assessing whether market power exits and the extent to which its use or abuse should be restrained is common to both.

So, to summarise, whether competition is best promoted by a system that identifies and punishes wrong doers, or by one that identifies and remedies situations where competition is seen as distorted, is a policy question. In each case, an appropriate use of competition economics is desirable.

Proposition 3: evidence versus theory

The proposition here is that law rests on proper evidence; economics on theory.

Legal analysis typically requires a number of pieces of evidence to be gathered, analysed and placed "end to end" in order to reach a legally robust conclusion. Lawyers consider this to be the right way to do things and the implication is that legal evidence adduced in this way is inherently reliable. By contrast it is said that economic analysis involves a more theoretical approach, based on models and assumptions to analyse market outcomes. The results may change fundamentally if the underlying assumptions are altered even slightly and the resulting evidence is therefore "unreliable".

Let us look at whether there is anything in this distinction.

In any particular case, legal decision makers assess various pieces of evidence, interpret the law, set out the appropriate legal conditions which need to be met and assess whether those conditions are met, on the basis of the evidence provided, to the appropriate legal standard. Such evidence might comprise statements by parties, in submissions or hearings, internal documents such as board papers, as well as customer surveys and market studies. Importantly, expert economic evidence is also very likely to be available. Such evidence will often seek to predict the likely outcome of a particular transaction or to analyse the effects of a course of behaviour on a market. Techniques used to do this include price elasticity analysis, critical loss analysis, switching analysis, merger simulation models, etc, etc.

It falls to the decision maker to test all the evidence provided and to seek clarification or further evidence where necessary, to weigh up the case for and against and decide which way the evidence points. The robustness of the conclusion is inextricably linked to the quality of the evidence provided and the quality of the analysis undertaken. The point is that so-called "economic" evidence is just as important in this process as any other type of evidence.[19]

Of course "economic" evidence is not absolute in character. The output depends on the inputs used. A robust economic analysis depends, as any other, on logical assumptions being used in conjunction with correct and relevant facts. Disagreement between economists as to the relevant facts and correct assumptions does not mean that the approach in itself is flawed. Judge Bo Vesterdorf (President of the Court of First Instance in Luxembourg) has referred to the need to make decisions on the basis of contradictory, inconsistent or inconclusive evidence:

> "This is the reality of everyday life and it is almost inconceivable that a case would yield such perfect economic data were there to be no

[19]Note that the "reliability" of economic evidence has to be judged not only by reference to other evidence (the "reality test") but also according to its own terms, e.g. as to sensitivity and significance of the results shown.

> disagreement between the two sides. If it did, the case would probably not reach the judiciary anyway".[20]

Economic evidence is no more and no less subject to uncertainty than any other. In this respect it is hard to see much useful distinction between "legal" and "economic" evidence. As the CC's Chief Economist, John Davies, said:

> "There is just evidence. Good and bad evidence is the same as good and bad economics. When something is bad economics and something is bad evidence, it is usually for the same reasons".[21]

Proposition 4: certainty versus uncertainty

In these caricatured descriptions of law and economics, a system of competition enforcement based on legal rules offers "certainty" whilst an effects based system relying on economic analysis offers "uncertainty", in the sense that *ipso facto* each case is different. However, as with all caricatures, reality may be less extreme.

Legal certainty is often cited as a desirable objective. There is certainly a case for laws being clear, easily understood and enabling the subject to know in advance what conduct is or is not legitimate. However, in the competition law context, both the possibility and the benefits of legal certainty may have been exaggerated.

Any rule based system raises immediate issues of inflexibility and narrowness of scope. In order to avoid allowing illegal conduct to escape control, any "net" must be drawn relatively widely, and any exemptions narrowly construed. The early history of Article 85(81) and the block exemption Regulation 67/67[22] is illustrative of this; only limited categories of exclusive distribution agreement qualified for exemption under this Regulation and, bizarrely, less restrictive agreements (eg semi exclusive) were found not to be within its terms.[23] Certainty was only obtained at a cost of inflexibility. As block exemption practice matured, later versions relied more on market share thresholds and mechanisms for withdrawal in individual cases.[24] But neither of these devices added much to "certainty". With the withdrawal of individual exemption and the notification systems following Modernisation,[25] it was even argued that notification had itself given legal certainty – a difficult argument to sustain given that no provisional validity existed. Moreover, as we saw in considering the UK RTPA experience, prohibitions based on legal definitions encourage formalism and enable avoidance.[26]

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[20] 5th Annual Trans-Atlantic Antitrust Dialogue on International and Comparative Competition Law. *Panel 4 – Economics in Court.*

[21] BIICL Conference referred to at footnote 6 above, *Panel 6 – Use (and abuse) of Economic Evidence.*

[22] The first Block Exemption for Exclusive Distribution Agreements enacted following confirmation by the ECJ that Article 85(81) applied to vertical agreements.

[23] See *Junghans GmbH* (Commission Decision 77/100) OJ L30, 2.2.77, p10

[24] See the current Block Exemption for vertical agreements, Regulation 2790/99.

[25] Council Regulation 1/2003.

[26] See above.

By contrast, there are few, if any, reliable rules of economics that enable undertakings to know in advance what conduct or situations will or will not be anti-competitive. In the search for effects on efficiency and consumer welfare economists can describe the *methods* they would employ and the *factors* they would examine, (eg entry barriers and sources of competitive advantage) but not the *result*. This will depend on the analysis. The most that economics will do is to identify correlations between efficiency and market situations or behaviour. An extreme example is "naked" price fixing cartels where an assumption can be (and usually is) made that this practice is detrimental to consumer welfare.

This may provide the clue to the resolution of this apparent dichotomy. Hard core cartels are prohibited under most rules based systems also, either as "per se" offences under US Antitrust law, or infringements of Article 81 requiring only proof of the fact of the infringement and an anti-competitive intention. There is also an economic presumption that cartels harm consumers.[27] So the two approaches overlap in the centre, at least.

But such clear cut situations may be relatively rare. It remains necessary to provide a degree of predictability in competition enforcement. Predictability from clear legal rules is not worth having if these do not reflect the underlying economics. The *per se* condemnation of vertical agreements in US antitrust prior to 1977 suffered from this problem. What is needed is predictability as to how the analysis will be undertaken, coupled wherever possible with working presumptions (such as vertical agreements in the absence of market power are benign). Guidance for firms and advisers needs to be relatively easy to understand – firms argue that it is too much to expect them to request the assistance of a phalanx of lawyers and economists each time they are considering whether to adopt a particular commercial strategy.

The current debate on Article 82 aptly illustrates this concern. A rules based approach appears no longer fit for purpose and the need to move to a more rational approach to identifying genuine (in the sense of economics based) abuses of market power more by reference to their effects seems desirable.[28]

You will notice that I have not mentioned "precedent". That is one aspect of legal certainty, found in common law systems, at least, that is of doubtful value in competition enforcement. Consistency of approach is valuable and useful but too slavish a repetition of doctrine (or dogma) is probably not useful in competition enforcement.

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[27]See, e.g. *Modern Industrial Organisation*, Carlton and Perloff (4th ed), Chapter 5. A successful cartel agreement shields firms from competitive forces and – in the worst case scenario – leads to monopoly outcomes: prices rise, output falls. Consumer harm arises when cartels succeed in raising prices because this leads to a loss of consumer surplus. Consumer surplus is a measure of consumer welfare and is defined as the excess of social valuation of product over the price actually paid. As prices increase, the difference between the perceived value of a product and the price paid decreases and thus consumer surplus is lost both for those consumers who continue to buy the product and those who do not buy at the new high prices.

[28]See the DG Competition Discussion Paper on the application of Article 82 to exclusionary abuses (December 2005) which sets out the Commission's proposed approach to a large number of exclusionary abuses.

The way forward

Having found none of these apparent dichotomies totally convincing, perhaps we can now assume that there is no insurmountable obstacle to combining the results of the application of law and economics to business situations, to produce Bork's "mode of reasoning somewhat different from that of either discipline alone".[29]

Let us first of all note that how this process works, depends to some extent on what forum it is applied in, ie before a competition authority or in a court. Let us look at the judicial forum first.

Economics in Court

We noted Judge Vesterdorf's comment about uncertainties. The task of articulating competition cases in a judicial environment, particularly where the system is adversarial, is not always straightforward.[30] In the USA, of course, and in many other countries, it is the norm. The competition agency must present its case before a judge and maybe also a jury, who must be convinced that the evidence justifies the conclusion. This system has much to commend it, but the question of how best to present economic analysis in these situations is not easily resolved. Judges (and juries) can find it difficult to decide between conflicting economic expert testimony. Not all judges can be expert economists, or specialist competition lawyers, and the legal/economics dichotomy can become more pronounced.[31] Of course, in systems where agencies have decision making powers similar issues arise, albeit more indirectly, when those decisions are subject to judicial review.[32] The CFI is one example of this situation arising; the CAT is another. Both these courts have shown they can operate on the Borkian model. But it may be easier to bring law and economics together in an administrative process within a competition authority.

Economics before the CC

I intend to be unashamedly parochial and look at the agency with which I am most familiar, the CC. Let us look at three examples of cases where economics played a crucial rôle, within a clear legal framework, in the relevant decision. All are mergers; and in two cases the final decision was favourable, although this was by no means a foregone conclusion; in the third case the decision was adverse.

The first is *DS Smith and Linpac*.[33] This involved a merger of two corrugated (cardboard) packaging companies. *Linpac*, the company being acquired, was the smaller of the two, with no "upstream" interests in raw materials. The principal

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[29]See footnote 1.
[30]For an interesting perspective on this system, see the discussion by Judge Diane Wood at the BIICL conference referred to at footnote 17 above (*Panel 4 – Economics in Court*).
[31]See e.g. *Courage v Crehan* in the UK High Court (*Crehan v Inntrepreneur Pub Co* (CPC) [2004] EWCA Civ 637).
[32]See the EC Commission's experience before the CFI and the OFT's before the CAT.
[33]*DS Smith Plc and Linpac Containers Ltd*, October 2004.

economic markets considered were “cases” (ie the finished product) and “sheet” (ie the intermediate product from which cases were made). The merger reduced the number of principal competitors in the sheet market from 6 to 5, and led to Smith being the largest UK supplier, although not by very much. There was a considerable “competitive fringe” accounting for about 25 per cent of supply.

The analysis centred on possible co-ordinated effects. The CC looked hard at the evidence for the existence of conditions favouring co-ordination prior to the merger and the effect of the merger on the likelihood of co-ordination occurring. This was an economic analysis, using criteria drawn from the CC’s own guidelines and from the CFI judgment in *Airtours*.[34] The analysis was complicated by the need to consider allegations of explicit (as opposed to tacit) co-ordination. Indeed it appeared that overt attempts to co-ordinate on headline price increases had been made, but that these were unsustainable because of the ability of the smaller suppliers to undercut. The CC tested this by analysing (i) the relationship between prices and costs (ii) the profitability of market participants and (iii) margin trends (to see if the headline price increases impacted on margins). The CC found a close correlation of prices to costs, no excessive rates of return and no significant impact on margins.

So the CC concluded that the merger did not make co-ordination more likely, but it was a reasonably close call.[35] The CC also thought that the allegations of explicit co-ordination required separate investigation by the OFT.

Without this degree of economic analysis, it is possible that the merger could either have been cleared at Phase I (as giving rise to no significant increase in concentration) or prohibited at Phase II (on account of the high degree of customer concern over attempted co-ordination on prices). Neither decision would have been sound and it is submitted that the application of economic analysis enabled a rational view to be reached on the effect of the merger on competition.

The second case was *Bucher/Johnson*,[36] involving powered road sweeping equipment. Here the merger involved the acquisition by Bucher, the leading EU supplier, based in Germany and Switzerland, of Johnston, the leading UK supplier. The main issues of substance were the definition of the geographic market (national or wider) and the potential for Bucher to supply machines to the UK in the absence of the merger. Both required considerable economic analysis. The conclusion that the UK was a separate market meant that there was little or no geographic overlap between the merging parties’ respective businesses. Under a rules-based approach, that would have disposed of the case, and indeed the parties’ submissions encouraged the CC to that view. But it was necessary to consider the elimination of *potential* competition, and here the argument was much more finely balanced. If competition was not presently affected (and encouraged) by actual or perceived threat of entry (or supply) to the UK by the Swiss company, then the merger amounted to little more than a change of control; if, however, it was, then that competitive effect was removed by the merger. The CC considered what was

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[34]Case T-342/99 *Airtours v Commission* [2002] ECR II-2585.
[35]The CC also considered, and rejected, the argument that Linpac was a “maverick” firm whose pricing behaviour pre-merger destabilised the market.
[36]*Bucher Industries AG and Johnston Sweepers Limited*, September 2005.

needed to comprise effective entry into the UK, partly by modelling and partly by reference to examples of successful, attempted or planned entry by others. It concluded that the threat of successful entry by Bucher was insufficient for its removal by the merger to have any significant effect. The analysis was complicated by conflicting evidence as to Bucher's actual plans, but in the final analysis these were irrelevant when set against the economic feasibility of those plans. The decision was not easy and the result could well have been different, had the assessment of the feasibility of entry been different.

These cases seem to represent the right combination of law and economics. The final decision is reached by analysis of the evidence within a sound theoretical framework of economics – in the first case co-ordinated effects, and in the second case potential competition. The legal framework operates to discipline the analysis – by compelling consideration of the effect of the merger on co-ordination possibilities in *Smith* and by concentrating on the *feasibility* of entry into the UK (as opposed to claims and plans) in *Bucher*.

And, crucially, the law imposes not only the burden of proof (on the CC to show SLC) but the requisite standard of proof – the CC has to form an **expectation** (ie more likely than not) that an SLC will result. This latter requirement operates as a powerful discipline on flights of economic fancy or excessive theorising.

The latest word on the Competition Commission's use of economic analysis comes from the Competition Appeal Tribunal (CAT) in the recent *Somerfield* case.[37] Unfortunately (or fortunately depending on your point of view) the CAT's ruling was, in the end, limited to the validity of the CC's approach to remedies. The application to review the substance of the CC's SLC finding in relation to 12 of the 115 acquired grocery stores was withdrawn mid-way through the case. So the CAT's decision describes the CC's findings and the reasoning behind them but expressly takes no position on them.[38] It is certainly not for me to speculate on what the CAT might have said, but it may be worth looking briefly at what the CC actually did.

The CC's "local competitive effects methodology" involved identifying a local market in which to apply a screening rule, and had a product dimension (competing fascias and sizes of stores) and a geographic dimension (how wide was the customer catchment area). This was a highly detailed exercise, which involved using survey results to work out diversion ratios, which, combined with evidence of high margins and illustrative price rises, led the Group to identify 12 defined areas, where it concluded that an SLC was likely. The geographic delineation was based on previously used methodology with some further adjustments. Suffice it to say that Somerfield criticised this methodology arguing in essence that it was too theoretical.

In a sense, the wheel has turned full circle with the parties subject to the process arguing for a "sanity test" or "reality check" on results produced by economic modelling. Let me say by way of reassurance, that this plea is unlikely to fall on deaf ears.

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[37]Ref [2006] CAT 4.
[38]See judgment, paragraph 49.

Conclusion

So let us try to sum up. Competition economics is now too well developed a subject to be relegated to the periphery of competition enforcement. It is incumbent on all those involved in the competition system to act in such a way as to enable the application of sound economics to produce fair and reasonable decisions. Recognition that this is the authorities' intention will hopefully increase acceptance and "buy in" by those upon whom the decisions bear. In this possibly naïve hope we are justified by the feeling that, on the whole, competition produces greater efficiency and better consumer welfare.[39] And that, of course, is a feeling that derives, like much else that we do, from economics.

P J Freeman
Chairman
March 2006

[39]Even those who argue that the effect of Government antitrust intervention is worse than non-intervention would presumably prefer interventions based on sound economics to random or rules-based interventions.