

**IBC Conference: UK Competition Law  
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**Peter Davis: New elements of merger policy**

**Introductory remarks**

US President Woodrow Wilson once said 'If you want to make enemies, try to change something.' Well, despite that warning, the Competition Commission is considering some incremental, but nonetheless potentially significant, changes to how it handles its merger and market inquiries. I should stress that, whilst these changes would be significant, they are not radical departures from the Commission processes that many in the audience today will know well. Rather, the proposals I'd like to describe for you today would represent another step in our process of incremental improvement, building on the existing strengths of the Commission.

My starting point will be a brief overview of the background to these proposals for change. One doesn't have to spend long at the Commission to see its distinctive strengths in action—not least its processes, members and staff working together to generate high quality analyses of sometimes very difficult questions. Among the Commission's strengths are an ability to undertake rigorous economic and legal analysis, a commitment to genuine transparency—vital in terms of both fairness and also in terms of quality assurance—and also direct access by parties to decision makers. None of those will be going away—when considering change, we certainly do not want to throw out the baby with the bathwater.

Nonetheless, after a thorough review of our people, our processes and our use of investigative and analytical techniques we have found some areas where we do consider there is scope for improvement. Most of what I want to say today relates to specific changes we are considering. I should emphasize that the final shape of some of these changes is still very much under discussion, but I trust that this early indication of the direction in which we are travelling will be both helpful and interesting.

**Background**

The Commission is rightly proud of its record as a world class competition agency. No organization can take 'rankings' too much to heart, but we've come at this review very much from the position that there was no sense in which the organization was 'broken.' Indeed, this year we were in the comfortable position of being one of only three competition authorities in the world ranked as 'five-star' by the Global Competition Review, the other two being DGComp and the FTC. Nonetheless, we are all very aware of the range of views both internally and externally on various aspects of the Commission's procedures and performance. And indeed, a great disadvantage of being at the top of such rankings is that there's only one direction to go—at least there's only one direction you will go if you don't focus fairly solidly on maintaining the process of continual improvement.

To make sure we are focussed on where we can improve, in late 2006 the Commission's Council, our strategic management board, set up three working groups to review our people, our processes and our investigative and analytical techniques. Both staff and Members were represented on each group. The objective was to identify those changes that would be required to deliver the Commission's strategic vision and enable us to successfully overcome any challenges we are likely to encounter in the next five years.

As part of the review, the Commission ran a series of face-to-face interviews with its Members. This survey led to a host of observations but I'd like to take you in particular

through a few—admittedly carefully chosen—quotes. They're carefully chosen to give you a sense of some of the views expressed internally and the challenges they raise.

First, a quote about the burden of our processes. One Member said:

*'If there was less time spent on the process, more time could be available for substantive discussion of the issues.'*

Second, a quote about timing and deadlines, about which a Member said:

*'I think we're far too British, too polite. It might be helpful sometimes to be a little bit American. There's 200 years in the slammer if you don't provide [the information] by 2 o'clock. If you look at this system it is soft, it's a system which allows you effectively to paint your own picture and to answer some questions but you don't actually have to answer the questions.'*

(For the record, I'm British—although after eight years in America in the 1990's I'm told I have a bit of a residual accent. Nonetheless, personally I think that 200 years in the slammer probably goes a tad far! That said, the quote raises a substantive issue—the extent to which parties view our deadlines as credible. I shall return to the issue later.)

In relation to the data we collect from the parties and analyze, yet another Member said:

*'I'd do lots more analysis of data. I'd have smaller questionnaires and much bigger data requests. So I would ask for less analysis to be done in the companies but I would ask for much more raw data and do much more analysis here. And then have lots more backing and forthing with the parties till we got the right numbers but make sure the evidence base was sound.'*

Now, these sorts of views really do give us serious pause for thought, as you would expect. However, the Council's Review was of course more than talking to the Commission Members. In fact a colossal amount of work was undertaken against the backdrop of a heavy inquiry workload throughout 2007.

Among other activities, we organized the formal survey of the Commission's members that I've already mentioned, we undertook some very helpful work comparing international structures and best practice, we conducted a series of staff focus groups and we held a number of round-table 'Chatham house rules' meetings on key issues with external experts. The Chatham house rules of course were designed to encourage attendees to speak freely.

All of this activity was squarely aimed at getting a clear view of where we suffer from weaknesses and how we might go about addressing and overcoming them. And indeed, from this review process, a number of key recommendations have emerged.

## **Outline of changes being considered**

I'd like to set out four different changes currently under discussion within the Commission. Of course, many more recommendations arose from our Council's Review. But the four elements I'd like to outline today will be, if fully implemented, potentially the most visible from the outside, and the most likely to have a direct impact on parties and their professional advisors.

Before I go into the details of these four changes, there is one over-arching point I would like to make. The first Member's quotation that I read out earlier draws attention to the perceived heaviness of the Commission's processes. This is a complex issue, going to the heart of our policies on transparency, on the use of hearings and on the application of so-called 'lean'

merger techniques. It is also related to the trend towards increased legal scrutiny of our decisions and the differing incentives on parties in merger and market inquiries. Whilst it is not possible to address such a complex issue in the context of my speech today, I would like to stress that we are acutely conscious of the demands our inquiries place on parties. We are committed both to streamlining our processes and making them proportionate. Among other things, the Commission will strive to ensure that the net effect of the changes I am about to describe is not to increase the regulatory burden.

### ***Enforcement of deadlines***

The first change we are contemplating is more rigorous enforcement of our deadlines for the submission of evidence during our inquiries.

Delays in the submission of evidence have held up progress on a significant number of Commission inquiries. When evidence is late, our timescales for the production of our working papers and our final report can become unacceptably compressed. This in turn places pressure on the parties and their advisors in terms of reviewing our working papers and alerting us to possible confidentiality issues. In short, these delays do no one any good.

Most of you will be familiar with the Commission's formal information gathering powers for merger investigations under section 109 of the Enterprise Act (which also apply to market investigations under section 176 of the Act). Section 109 gives the Commission power to issue a Notice requiring production of information or documents, or requiring specified individuals to give evidence to the Commission. Failure to comply with such a Notice within the time specified in the Notice can lead to penalties being imposed.

You will also know that the Commission only rarely uses these powers to ensure delivery of evidence and, to date, the Commission has never imposed a penalty under the Enterprise Act for a failure to comply with a section 109 Notice. Now it could be the case that all the parties we encounter consider that the Commission's threat to use its information gathering powers is so powerful that they do their utmost to submit evidence in accordance with our deadlines without the Commission actually needing to use its powers. In truth our deadlines are not always met—sometimes for quite understandable reasons, for example some parties realize they face greater difficulties in delivering the data we've requested than they initially anticipated. On the other hand, it is also a fact that parties sometimes have a clear incentive to delay progress in an investigation. The fact that we have never used our power to enforce compliance is not an indication that our deadlines are always respected although they generally are.

In the context of our current Payment Protection Insurance (PPI) market inquiry, we've been exploring a more extensive and flexible approach to issuing section 109 Notices. In the course of this inquiry, we've issued quite a large number of what I shall call 'comfort' section 109 Notices. First, we issued a number of Notices in order to provide companies, parties to the inquiry, with 'comfort' in relation to their compliance with data protection laws. I'm not a lawyer but I'm told that if we have required a company to give us data say about their customers for a customer survey, then this offers 'comfort' to the company that it is acting consistently with the data protection laws. There's nothing too controversial about this use of section 109 Notices. In fact, the Commission has issued section 109 Notices for this purpose in a number of other inquiries in the past.

As a side note (and particularly given recent events!) I should emphasize that, once we receive protected data, we are then of course subject to the full requirements of the data protection legislation in relation to our handling and use of that data. We take these responsibilities—and the need to safeguard all the confidential information we receive—very seriously indeed.

What was new in the PPI market inquiry was that we also issued section 109 Notices for our ‘comfort’ rather than the parties’. In the PPI inquiry we needed to obtain specific data from distributors and underwriters on prices and sales of PPI and also the underlying credit products. Many of the parties from whom we initially sought this data had difficulties retrieving the data, matching it across different databases and providing it in the format we requested. We therefore discussed with each party exactly what their capabilities were in terms of providing the necessary data, and how long this would take. As a result of these discussions, we issued more than five section 109 Notices specifying the data we required and the timeframe in which we required it, to both of which the party concerned had agreed in these instances. Thus we used the 109 Notices to provide us with ‘comfort’ that the data would actually show up in the timescale we agreed with the parties. Our experience of using section 109 Notices on the PPI inquiry has been positive so far, although some responses are still outstanding.

Broadly, we seem to have two options going forward. We could issue section 109 Notices as a matter of course on every inquiry, every time we request specific evidence from the parties. However, this would have implications in terms of our workload—and yours—as well as carrying the risk of engendering an atmosphere of confrontation. It also assumes that we are able to specify in advance precisely what evidence we require. An alternative approach might be to use section 109 Notices whenever we need to request evidence that is on the critical path in our inquiry process such that delay would immediately jeopardize our inquiry timetable, and where there has already been a dialogue with the party concerned as to what data and timeframes are realistic. In this scenario, section 109 Notices would, of course, also continue to have a role where parties refused or failed to provide information. Whichever approach we take, parties must be left in no doubt about the seriousness of our information requests.

If we use section 109 Notices more frequently following dialogue with the parties, the parties and you as their professional advisors may benefit from less onerous and wide-ranging requests—a point to which I want to return shortly. Parties may also find it easier to create the necessary internal business justification for deploying sufficient resources on dealing with the Commission’s inquiry—I leave it to you to judge whether parties will consider this a benefit or not!

Of course if we are to enforce deadlines for delivery of data on parties to a greater extent, it is incumbent on us to use our powers proportionately and only seek information we really need. We also need to make sure we are clear about the kind of evidence we are likely to request. To that end we are considering publishing guidance on our website for parties covering in general terms what evidence we are likely to request from them during an inquiry and why we will request it. The FTC has something similar on its website already: a brief paper entitled *Best Practices for Data, and Economics and Financial Analyses in Antitrust Investigations*.

### **Theories of harm**

The second significant change we are discussing involves the expansion of the ‘theories of harm’ concept to make sure that it becomes absolutely the central analytical framework for an inquiry. I want to talk particularly about theories of harm in merger inquiries today, and I will leave the topic of theories of harm in market investigations for another day.

Theories of harm are not new to the Commission. In fact, we first started considering them as a result of work undertaken for us by NERA, in which they reviewed the Commission’s activities during the first two weeks of its inquiries. Theories of harm are the hypotheses that the Commission wishes to test during an inquiry: in other words, the ways in which a merger could give rise to consumer detriment, whether by unilateral, coordinated and/or vertical effects, along with the necessary conditions for each. For clarity let me say—the use of the

term ‘theories of harm’ does not in any way mean that the Commission already believes that a merger **will** be harmful at the outset of an inquiry. It only means that we are clear as to the mechanisms by which a merger **could** be harmful, and testing these theories will be the basis of our analysis.

We already find theories of harm very helpful in our inquiry process. We currently aim to set them out at the beginning of an inquiry, building on, but not always limited to, the work of the OFT. The challenge we face is to make sure that the Theories of Harm are genuinely the central driving force of an inquiry. If we can do so we will be able to use the theories to target information requests at the evidence required to test each of the elements of a theory of harm. The ideal process might be to share the theories of harm with the parties at the outset of an inquiry, to log all significant evidence received against the theory or theories of harm to which it related, and to use the theories of harm, where appropriate and without unduly limiting ourselves, to drive subsequent information requests and guide our documentation reviews.

The benefit to us—and you—of the movement of the theories of harm framework to centre stage, where it should play a starring role throughout the life of the inquiry, is that it provides clarity as to our approach and the basis on which evidence will be assessed for all concerned. At its best, such a framework should help prevent anyone involved in the inquiry becoming side-tracked by issues which are interesting but perhaps in reality peripheral. For example, the technology underlying a party’s products can be important. Understanding the technology may, among other things, help us answer questions about supply-side substitution and market definition, and it may indicate what changes those markets may be facing in the period relevant to our inquiry. However, bottoming out all the technical details may not be necessary and may sometimes distract from the Commission’s need to perform a substantive analysis of the statutory questions. At the end of the day we must evaluate whether a merger will result in a Substantial Lessening of Competition (SLC).

### ***Increased use of primary evidence***

The third significant change involves the increased use of what I shall call ‘primary’ evidence. Not surprisingly submissions to merger inquiries from main parties and their advisors almost always run the argument that there is no competition problem. And markets are defined in such a way as to appear to prove their case. However, we do end up prohibiting roughly half of the deals that come to us for consideration. It is a fact of life for us that sometimes aspects of some parties’ submissions do not survive detailed scrutiny of the evidence base.

The Commission is therefore discussing using even more primary evidence; in other words documents and data generated in the normal course of a party’s business, outside the context of our—or any other competition regulator’s—inquiries. We do of course collect primary evidence already, but we often receive a greater volume of evidence from the parties that is deliberately prepared for the inquiry. From our point of view, such prepared evidence, whilst often extremely helpful, may not be as persuasive as primary evidence. As I’ve already mentioned, it is a rare submission from a party or its advisors which argues in favour of a market definition which is particularly unfavourable to the party. On the other hand, if a company has had to make the business case for a large investment, the market in which it operates is often scrutinized and evaluated carefully.

Primary evidence of course tells us about much more than just market definition. It gives us insight into how the parties manage their businesses, how they assess the state of competition outside the context of our inquiry and the nature of their corporate strategy. In addition, obtaining and analysing entire documents rather than carefully selected extracts is invaluable in giving us a full explanation of the parties’ statements and actions. As a general

rule of thumb, the weight that normally we find we can put on primary evidence is greater than the weight we can place on secondary evidence prepared directly for the inquiry.

The implication of such a change for us may well be that we will ask for an increased volume of both documentation and data at the outset of an inquiry. Handling those documents would be likely to require dedicated internal teams to systematically review it and fit it into our theories of harm framework. In the groceries inquiry, for example, the team recently went through tens of thousands of emails, so our experience in this area is increasing. You will be pleased to know, however, that we have no intention of going to US 'second request' volumes of documents. But we may need more documentation than we currently collect. For example, we've noted on some inquiries that extremely targeted document requests leave rather too much scope for documents to be omitted which sometimes show up later in an inquiry and appear to be 'smoking guns'.

On the data side, we may ask for sales, pricing and consumer-level data directly from customer databases. The Commission has sufficient expertise in appropriate software that it can merge company databases across different parties and in so doing obtain a view on the market which is not available to an individual party on its own. For example, in the recent Football Pools merger between Sportech and Vernons, we obtained and merged each company's customer lists so that we could determine which sets of customers the two companies had in common and whether marketing activity by one company induced switching to the other. In such cases and strictly where possible and appropriate, we will consider making arrangements to make as much of our analysis as possible transparent to the parties. We are unlikely to be able to provide access to such datasets to the parties themselves but in the Mid-Kent and South-East Water merger inquiry we experimented by setting up a dataroom to provide such transparency to parties' advisors. I note, however, that this was something of a special case, as the vast majority of the information concerned was in the public domain already. Doing so requires that we put in place sufficient safeguards to ensure that advisors do not convey more information than appropriate to main parties or their other clients. Obviously such access is a privilege, has resource implications and as a result the scope for, and feasibility of, access will be need to be judged on a case-by-case basis.

The broad strategy of using even more primary data should bring benefits to both the Commission and also to parties. For example, coming back to a point I raised earlier in relation to our information gathering powers, we envisage that it will reduce the initial size of market and financial questionnaires and also the amount of work required to be undertaken in-house by main parties. In merger inquiries involving a simple transaction, a company database will sometimes fit on a CD and requires little effort beyond saving the database to a disk—greatly reducing the burden on business. We can easily work with large databases. In the football pools merger, for example, we handled databases with just below a million customer records without stretching Commission resources. For the technocrats among you, we have recently set up a scalable distributed computing environment which currently allows 32 desktops to work in tandem on large computational and database problems. In addition, working directly with the primary data should reduce the extent of repeated reworking of our data or documentation requests. Since we will have the underlying data we will be able to cut it in any way we need to without going back to the parties time and time again. In such cases, we will, where appropriate, share our methodologies with the parties so that they are able to replicate our analysis should they wish to.

In addition to increased use of primary evidence, we have been thinking about ways in which we could improve our analysis of the data we obtain during our inquiries. It appears that some other competition authorities (for example, the FTC and DGComp) are more eager than we are to use third party data sets and, where appropriate, econometric analysis—although of course we have used both in the past. We are considering developing a more formal policy on the purchasing and use of third party data sets, such as those available

from Nielsen, CACI and TMS. We are also considering developing a list of criteria to help us identify suitable cases for the use of econometric analysis, and adopting best practice in how we undertake such analysis. Such techniques may, for example, be particularly helpful in inquiries related to branded consumer goods markets.

### ***Changes to reports***

The last initiative that I want to mention today is the possibility of changes to the Commission's reports. From a legal point of view, a Commission report has to contain the Commission's decisions on the statutory questions posed in the OFT reference, the reasons for them and such information as the Commission considers appropriate to enable an understanding of both. Yet there is no doubt that the Commission's reports have tended to become more complex and less accessible to a general audience as the analysis has become more sophisticated and detailed.

We are therefore considering ways in which we could change our reports to ease the burden of the inquiry process for both the Commission and the parties. We are actively debating report clarity, accessibility to a non-specialist audience and also the length of the reports. We certainly don't envisage that the analysis underpinning our reports would go away, but rather that there may be opportunities to clarify its presentation. However, whether we do actually make any changes depends greatly on our ongoing evaluation of any additional risks involved, particularly given that controlling some of these risks is not entirely in our hands.

### **Conclusion**

In summary I've outlined our proposals which envisage the Commission using its information gathering powers more in order to enforce deadlines more rigorously. I've also outlined what we see as the desirability of moving the 'Theories of Harm' to be absolutely front and centre stage in all aspects of our inquiries, so that our investigations are clearly focused on the questions and evidence that matter for evaluating an SLC. Third, I've described how we are exploring the greater use of primary data and existing documents. Finally, I noted that the Commission is considering the pros and cons of making various changes to its reports.

The Council's Review process has clearly delineated the direction of travel for the Commission. How far we go along each of these paths is, as I have said, open for discussion and no doubt will also be informed by our experience over the next few months. As always, we will continue to need the parties and their advisors to work with us to operate a manageable system. Such cooperation will help us retain those aspects of the current system that parties value, whilst making improvements to those aspects of the system that do not, at the moment, work as well as they could do for anybody.

I look forward to working with you all to make sure the Commission's processes are fair, transparent, efficient and thorough, so that we can make evidence-based judgements that get us to the right answers for UK consumers. Thank you.