

## The Proper Limits of Competition Policy

***Economic Developments in European Competition Policy:  
Hot Topics in Antitrust Part II  
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### I. Introduction

In this session on *Hot Topics in Antitrust*, my choice of topic does not arise from the findings of a recent case or the current thinking on a particular economic concept. Rather, I would like to focus on a broader subject that has acquired a certain topicality in the UK—the proper limits to what competition policy, and for that matter competition authorities, can do.

Topicality arises from at least two current developments. First, the House of Lords Select Committee on Regulators<sup>1</sup> published a report recently on the role and activities of UK economic regulators. In this it considered the statutory remit of individual regulators and recommended that their duties should be clearly specified by Government, who should also indicate how they should be prioritized. This brought out clearly the fact that for sectoral regulators, at least, competition is just one policy and promotion of competition one objective amongst many. The Committee also stressed the importance of the promotion of competition by regulators. This in turn put into clear focus the competition remit of the two UK competition authorities, the Office of Fair Trading (OFT) and the Competition Commission (CC), which the Select Committee described as ‘functional regulators’.

Second, the current CC investigation into *Grocery Retailing*<sup>2</sup> has raised this issue. From the CC’s website,<sup>3</sup> it can be seen that the CC has received more than 550 submissions up to the recent release of Provisional Findings, including those from NGOs and charitable organizations; Members of Parliament and political parties; local government authorities, trade associations and unions; individual consumers; and even supermarket employees (not to mention several thousand postcards). Some of these submissions have urged the CC to broaden the focus of its investigation to include such matters as the extra value that small, independent local shops provide in terms of economic benefit, environmental distinctiveness and the social glue that holds communities together.

The social cohesiveness of local communities is not normally regarded as a matter for competition policy but on what basis is it to be excluded? I would like to attempt to disentangle what competition policy should aim to cover and what it should not, so as to see what are the ‘proper’ limits of competition policy. I will start by describing the remit of a competition authority such as the UK Competition Commission and consider what is possible within this remit. I will then consider whether there is scope for introducing wider issues within the competition analysis, and where this is not possible, how these issues may be addressed. I will conclude by emphasizing that competition authorities would be well advised to limit their interventions to issues of competition.

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<sup>1</sup>House of Lords Select Committee on Regulators, *UK Economic Regulators*, HL Paper 189-I and II, 13 November 2007.

<sup>2</sup>*Groceries* was referred by the OFT to the CC on 9 May 2006. Provisional Findings in that investigation were published on 31 October 2007.

<sup>3</sup><http://www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm>.

## **II. The remit of a competition authority**

### ***The Competition Commission***

I describe the CC partly because I know about it, but also because it is interesting as an authority that used to have a remit much wider than competition but no longer (at least for today's purposes) has this. The CC is one of two such independent specialist competition authorities in the UK, the other being the OFT. We conduct investigations, on reference from the OFT and other bodies, dealing with mergers, market investigations and a range of regulatory matters.

### ***Institutional independence of UK competition authorities***

The CC's role changed significantly with the implementation of the Enterprise Act 2002. Essentially the CC changed from being a body that provided detailed and comprehensive reports to Government, for Ministers to act on, into a body required to take decisions in its own right. This was pursuant to the policy of creating independent competition authorities subject to specialist judicial, rather than Ministerial, control.

### ***From public interest to competition***

The substantive test applied in the CC's assessments was also changed from a broad-based 'public interest' test<sup>4</sup> to a test based solely on competition. To a degree, this simply made explicit the practice of the previous decade. Within the broader public interest remit, cases had tended to focus on competition. But in 2002, the test for merger control was made 'SLC' (substantial lessening of competition) and in market investigations 'AEC' (adverse effect on competition) and the CC's methodology is now focused exclusively on competition. Some argued at the time for the continuing application of a broader public interest test particularly in relation to markets. However, it was decided that public interest considerations should be made more specific and should remain firmly within the control of Ministers.<sup>5</sup>

The main features of the new system were logically linked. Decision-making power was delegated to independent authorities. But, in consequence, the scope of their powers was limited to the field of their expertise. Giving a non-elected body decision-making powers over wider issues than competition was thought to be going too far.

### ***Retained public interest role of Ministers***

A mechanism was retained for dealing with these wider issues, and this mechanism involves a principal role for Ministers and an advisory role for the competition authorities. In each case the role is specific and closely delineated. For certain specified and limited areas of public interest, Ministers may intervene in mergers to require that investigations cover issues other than competition matters. In such cases, whilst the OFT and CC will investigate and report on those other matters, Ministers retain ultimate decision-making power with respect to any adverse effect on the public interest. This power to intervene is presently limited to cases concerning national security (which includes public security) and certain media

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<sup>4</sup>That is, a test that included competition amongst a number of other factors such as an effect on employment or on the balance of payments. The specific test was contained in section 84 of the Fair Trading Act 1973.

<sup>5</sup>Some have since argued that because consumers think market investigations can decide on general public interest issues there is disappointment and a 'democratic deficit' when they discover they cannot. It could equally well be argued, however, that reserving such matters to the elected Government removes any risk of a democratic deficit. See evidence of Freshfields Bruckhaus Deringer, 9 February 2007, paragraphs 4.1 and 4.2; and the evidence of the National Consumer Council, 29 January 2007. See House of Lords Select Committee on Regulators, *UK Economic Regulators*, HL Paper 189-11, 13 November 2007.

issues—freedom of speech, accuracy of presentation of news in newspapers, and media plurality.<sup>6</sup> Ministers may add further public interest criteria, but only by passing secondary legislation subject to approval by Parliament. These powers to intervene to protect the public interest have generally been used in mergers involving the defence industry and have been applied at the OFT stage only, although the CC has recently been considering issues of media plurality in the case of *BSkyB/ITV*.<sup>7</sup>

There is also a retained role for Ministers in market investigations which raise specified public interest issues—currently only national security—but in this case the role relates only to remedial action.

### ***The merger control remit***

So the CC's merger control powers are limited to assessing the effect on competition, specifically to decide whether a merger gives rise to an SLC. Where wider issues need to be considered, the system provides a specific mechanism, involving Ministers, to deal with those situations. We, the CC, are not expected or required to take decisions on non-competition issues or to balance competition policy outcomes against other policies.

A similar mechanism can be seen in the EC Merger Regulation. Article 21(4) of that Regulation recognizes the ability of member states to take measures to protect legitimate interests separately from the competition analysis carried out by the European Commission. The legitimate interests recognized include public security, plurality of the media and prudential rules. The scope of these provisions has caused controversy in some cases but their overall purpose is clear enough.<sup>8</sup>

### ***The market investigation remit***

The CC's market investigation powers are also limited to assessing the effect on competition. The UK market investigation regime is exceptional if not unique in giving the CC the power to take decisions and impose remedies, including structural remedies. The regime complements the prohibition system of Articles 81 and 82 EC and its UK counterparts.

We are required to investigate and to decide whether any adverse effect on competition derives from any features of the market that 'prevent, restrict or distort competition'.<sup>9</sup> 'Features' of the market may include its structure and the conduct (including failure to act) of suppliers or customers.<sup>10</sup> Where an AEC is identified our duties are similar to those that arise in merger cases. We must seek to remedy the AEC, and any detrimental effects on customers resulting from the AEC, as comprehensively as is reasonable and practicable, as I shall explain we have some discretion to protect specified consumer benefits.<sup>11</sup>

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<sup>6</sup>Section 58 Enterprise Act 2002 for mergers; Section 153 Enterprise Act 2002 for market investigations. Ministers may also refer markets (but not mergers) to the CC for investigation.

<sup>7</sup>*BSkyB/ITV* was referred by the OFT to the CC on 24 May 2007. The Provisional Findings in that investigation were published on 4 October 2007.

<sup>8</sup>See, eg Commission decisions of 26 September and 20 December 2006 finding that Spain has breached Article 21 of the EC Merger Regulation by virtue of the imposition of conditions on the proposed acquisition by E.ON of Endesa. On appeal to the ECJ—Case C-196/07, *Commission v Kingdom of Spain*. Note also that in cases where a merger has a Community dimension within the meaning of the EC Merger Regulation, sections 67 and 68 Enterprise Act 2002 make provision for the referral of the merger to the CC when the Secretary of State believes that one or more public interest considerations is concerned.

<sup>9</sup>Section 134 Enterprise Act 2002.

<sup>10</sup>Section 131 Enterprise Act 2002.

<sup>11</sup>See Section 134 Enterprise Act 2002 and, in particular, sub-section (6) and (8) and the discussion below.

## ***Acknowledgment of the wider context***

The market investigation regime expressly acknowledges the relevance of other rules and policies in two ways.

First, there is the CC's deregulatory function in relation to any restrictive effect of other legislation and regulation. The CC cannot override these but it can recommend that Government should change or repeal them. There is a commitment by Government to respond publicly to such a recommendation within 90 days.<sup>12</sup> This provides a means of highlighting any issues of broader public policy that affect competition or would be affected by measures the CC (or OFT) finds are necessary to maintain or promote competition. But it preserves the Government's freedom to act if, for reasons that it considers override the competition benefits, it chooses not to follow our recommendation.

The second way in which other policies are acknowledged is when the CC conducts a market investigation into a sector subject to specific economic regulation—for example energy, water or transport. Here in framing remedies the CC must take account of the specific objectives which the sectoral regulator has—for example, the water regulator's need to maintain water quality.<sup>13</sup>

So the regime does acknowledge the possible impact of other policies and provides specific mechanisms for addressing them. But some will argue that a market investigation should cover all aspects of the ways in which markets function, consider all consequences and provide a holistic solution based on a broad interpretation of competition and consideration of other policies. So let us now consider how an investigation regime that is expressly stated to be competition-based can address this point.

### **III. Competition, customers and consumers**

Let us first address one way that has been suggested, namely to take an expansive view of the interest of consumers, something which almost all competition regimes and authorities agree they are seeking to protect and enhance.

#### ***SLC/AEC and 'detrimental effect on customers'***

In the UK we have some help here from the legislation. In both our merger and market investigations, where we identify an SLC or AEC, we must seek to remedy that SLC or AEC and any 'detrimental effect on customers' as comprehensively as reasonable and practicable. Customers are not, of course, always the same thing as final consumers, particularly where the customer is a business intermediary. The statute defines a 'detrimental effect on customers' as 'higher prices, lower quality or less choice of goods or services in any market in the United Kingdom or less innovation in relation to such goods or services'.<sup>14</sup> The statute assumes that the detriments arise from the adverse effect on, or substantial lessening of, competition, which we are also required to remedy and allows considerable discretion as to how the CC's remedies are applied provided they cover the AEC/SLC and any resulting harm to customers.

It is at least clear from this that we are able to address aspects of detriment that fall within the four, admittedly broad, categories of effect on price, quality, choice and innovation. Our overriding approach will be to assume that an AEC or SLC will necessarily give rise to

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<sup>12</sup>In the only, rather minor, instance of a recommendation so far (to the then Department of Trade and Industry to amend regulations for home credit), the Government accepted the CC's position in full.

<sup>13</sup>Sections 68 of the Water Industry Act 1991 as amended by the Water Act 2003.

<sup>14</sup>Section 134(5) Enterprise Act 2002. The reference to customers includes future customers.

consumer harm falling within one or more of these categories even if that harm may be indirect and not readily identifiable. When the detriment strays outside that scope, for example if it is harm to the environment, or purely social detriment, then things start to get more difficult.

## **Efficiencies**

Of course these specific customer detriments are the flip side of what are often loosely referred to as 'efficiencies'. Another possible way of 'flexing' the strict competition analysis is by reference to efficiency benefits that may in some way mitigate competitive harm. In other words, the allegedly 'narrow' result of a pure competition analysis can be alleviated by considering countervailing benefits. In merger policy, in particular, it is often said that adverse effects on competition must be set against countervailing benefits that cannot be brought about without those adverse effects.

Efficiencies in this sense can either be considered as part of the competition assessment, or at the remedies stage or, arguably, both.<sup>15</sup>

The UK statute does not explicitly mention efficiencies in the context of the assessment of whether a merger gives rise to an SLC. However, it is implicit in the SLC test that if efficiencies that may increase rivalry between firms in the relevant market have arisen or will arise as a direct result of the merger, then this is a relevant factor in assessing the overall competitive impact of a merger. This is developed in the CC's (and OFT) guidelines,<sup>16</sup> although it is fair to say that in practice such arguments are rarely put forward.

In the context of market investigations, it is possible in principle for efficiencies to mitigate adverse effects on competition. For example, this could apply in a market characterized by significant vertical integration. Such a structure might lead to efficiency gains that could not be achieved without such integration.<sup>17</sup> However, the effects of vertical integration can be ambiguous.

## **'Relevant customer benefits'**

The second way in which efficiencies or other benefits can be set against harm to competition is at the remedies stage. In both the merger and the market investigation regimes, when considering the issue of remedies, the CC may take into account the impact that those proposed remedies would have on 'relevant customer benefits' arising from the merger or from the identified features of the market. Relevant customer benefits are the converse of the detriments, ie lower prices, higher quality or greater choice of goods or services in any market in the UK or greater innovation in relation to such goods or services.

In the context of a merger, the benefit must come as a result of the merger and must be unlikely to come without the merger. In a market investigation, the benefit must arise from the adverse features of the market and must be unlikely to arise without them.

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<sup>15</sup>In the case of agreements, this potential balancing of efficiencies with reduced/distorted competition is made explicit in Article 81(3) EC and, in the UK, its domestic equivalent, Part 9 of Chapter 1 of the Competition Act 1998.

<sup>16</sup>CC2 *Guidelines*, paragraphs 3.26 and 3.27. The CC's guidelines provide that if claimed efficiencies are to be taken into account, the CC will need to form an expectation that: (i) they can result within a short period of time; (ii) they will result as a direct consequence of the merger; and (iii) 'the efficiencies will increase rivalry among the remaining firms in the market.' See also OFT *Mergers: Substantive Assessment Guidance*, paragraphs 4.32 to 4.35 and, specifically, paragraph 4.34.

<sup>17</sup>Examples of efficiency improvements from vertical integration include improved organization between firms at different stages in the supply chain, resulting in, for instance, lower transaction costs, improved product design and removal of the 'double marginalization' that occurs when two non-integrated firms both have significant market power. A further potential benefit of vertical integration is that it can create greater confidence for specific investments when market contracts provide inadequate incentives and safeguards. See CC3, *Market Investigation References: Competition Commission*, June 2003, paragraphs 3.41 to 3.45.

## ***Stretching the competition analysis***

So there is some scope to apply a competition analysis flexibly at least in terms of taking account of benefits or efficiencies that to a greater or lesser extent counterbalance damage to competition. And equally, if the promotion of competition imperils customer benefits, the full force of pro-competition measures can be tempered. But beyond that, the effects of competition and competition policy on other policies is hard to accommodate within the competition analysis and some balancing or trade-off is needed.

## **IV. Competition policy and other policies**

In balancing competition policy against other policies it is necessary to consider both the policy framework and the institutional framework.

### ***Policy framework***

As to the policy framework I have no easy answer—indeed it is my theme that it is not the task of a competition authority to frame such a policy. It is worth noting some of the areas, however, where competition agencies do have to deal directly with possibly conflicting policy areas and have developed appropriate doctrines. I give three examples—national champions, intellectual property rights and state aids.

### ***‘National champions’***

It is sometimes suggested that the aim of creating so-called ‘national champions’ represents a conflict between industrial and competition policy. According to this idea, restrictions on competition must be permitted at the national or local level to produce undertakings of sufficient scale, particularly in strategic sectors, to operate successfully internationally. To deal with this issue, competition authorities have generally taken the view that the conflict is actually a false one because protecting an undertaking from local competition will tend to make it less fit to compete internationally. In other words, competition policy currently applied should deliver the environment for companies to become more efficient and globally more competitive and is in this sense the same as industrial policy.

### ***Intellectual property rights***

Here again it is suggested that competition policy—encouraging a competitive process to benefit consumers—must necessarily be at odds with the protection of intellectual property rights, which confer exclusivity on owners, authors and inventors in order to encourage innovation and creative effort. I do not have the time here to discuss what is in itself an enormous subject. My point is that over many years, and faced with a variety of different situations, competition authorities have applied competition policy in a way that recognizes the shared goal of encouraging innovation whilst putting limits on the exercise and in some cases the scope of the exclusivity involved. These cases can of course be massively controversial, *Microsoft* being an obvious example, but in essence they represent a striking of a balance between competition and intellectual policy rights policy.

### ***State aids***

Again, I have neither the time nor the expertise to discuss state aid rules in detail. But they are another example of a trade-off between the requirements of competition and what may loosely be called ‘public interest’.

The state aid rules recognize that there are circumstances in which government interventions are necessary for a well-functioning and equitable economy. Thus, aid to promote economic development in areas where the standard of living is abnormally low, or where there is serious unemployment, may be considered compatible, notwithstanding the potential for distortion of competition. In addition, certain types of aid are exempt from the application of the state aid rules. This includes cases where there are considered to be social policy reasons for favouring particular types of activity. So, certain categories of aid to SMEs will be exempt, as will training aid and employment aid for the creation of new jobs in assisted areas and for the recruitment of disadvantaged and disabled workers. R&D and environmental aid are also areas where social policy objectives may outweigh the strict application of competition rules. In each case, the aim must be to deliver the relevant social policy objectives whilst minimizing the impact on competition.

I have given three examples. There are many others—transport policy and so called network effects being one, and the many and varied aspects of environmental policies being another. One would even argue that in the past the purely competition policy objectives under EC law, particularly in relation to vertical territorial restrictions, had to be balanced against the market integration objective.

### ***Institutional framework***

As I said, there are often difficult judgements to make and it is my theme that it is far better if the task is reserved for Government rather than an independent competition agency. I appreciate that is a rather parochial position, more readily explicable within a national governmental structure, as in the UK, but I believe it may have more general application.

### ***The UK approach***

The UK approach, which I have described, is to allocate to the competition authorities responsibility for assessing and deciding on the enforcement of competition policy. The establishment and setting of that policy is clearly a matter for Government. And as I have described, the framework deals with the balancing of competition and other policy objectives in two ways. First, if such wider policy issues can be categorized as efficiencies or fall within the definition of relevant customer benefits they can be taken into account by the CC in its competition analysis or in setting remedies. In the context of merger control, to the extent that specific wider issues are identified by Government they can be added to the scope of the investigation itself, although the ultimate decision on them will be for Government. Second, the potential for policy conflict is recognized in the context of market investigations by the mechanism for deregulatory recommendations and response. Again, the ultimate decision is for Government.

If these mechanisms do not suffice, we have to recognize two types of possible conflict.

The first is where competition policy measures cannot be implemented without changes being made to other policies. A requirement that train companies should compete to operate trains over a single railway line would have obvious effects on transport policy, for example. The balancing here would be a task for Government.

The other case is when the competition measure can be implemented by independent competition authorities, but there is still a clear conflict with other policy objectives. Examples might include introducing more competition into professions which might affect standards of service, or reducing prices for drink or tobacco which might conflict with health policy. This is less straightforward.

The question arises whether the competition authority should apply a less competitive solution? I would say not. The authority's task is clearly to advocate and set out the solution that effective competition policy requires and certainly the CC would have a duty to implement that solution. Of course if there are relevant customer benefits that would be imperilled, then an element of pragmatism may enter in, albeit under a statutory discipline. Subject to that, predictability and certainty require a competition authority to put competition first. That is not to say that the authority—at least in our case—will not look quite hard to see if the conflict is real and the competition solution is realistic and practical.

It is also necessary to recognize that within its field of application, competition enforcement through independent agencies must not be interfered with. If the application of competition policy in this way is regarded as unacceptable then the proper recourse is for Government to change the system after appropriate debate at a political level. We live in a democracy, after all.

### ***General applicability***

Is this UK approach generally applicable? I suspect that whilst many countries delegate competition enforcement to independent competition authorities, the position on trade-offs with other policies is varied and will reflect the political structure of the country or, in the case of the EU, the supranational organization concerned.

The European Commission's position is interesting from this point of view. The Commission has competences across many policy areas and DG Competition's measures are decided ultimately by the Commission as a whole. So at first sight this seems to contradict what I am saying. On the other hand, it is hard to compare the EU, governed as it is by the Treaties, with the national model I have been considering. The particular status of the Commission—with powers delegated to it by the Council and with tasks under the Treaties—means that in the particular situation of the EU, exceptionally, the position of the competition authority as one limb of a body with wider responsibilities enables conflicting policy issues to be resolved better than if it were completely outside that framework. The necessary balancing is in this context more easily done within a body where different policies regularly have to be weighed up against each other all subject to the requirements of the Treaties and the law.

It is important to remember that the point here is not whether independent competition authorities can take competition decisions. That I hope is not controversial as a matter of principle. But instead we are talking about who decides whether competition or other policies should prevail. I am suggesting this is essentially a political question and pointing to the advantages of the UK model.

## **V. Conclusion**

So to draw this discussion together let me suggest the following:

1. An effective competition policy is a key contribution to a properly functioning market economy, contributing to other desirable features such as the standard of living, growth, innovation, and well served consumers. It should bring specific benefits in terms of price, quality, choice and innovation and offers mechanisms whereby these benefits, and the corresponding detriments, can be weighed up. I have probably been very niggardly as to the wider benefits of competition, in terms of economic democracy, and even political freedom. But I will stick to the limited list for now.
2. The institutional structure that exists in the UK and in many other countries is to give the task of enforcing competition policy to independent authorities with expertise in

competition and to empower them to decide individual cases. Setting policy remains the task of Government.

3. The UK structure also provides for mechanisms whereby the competition authorities can, if requested by Government, consider specific, wider issues with the ultimate decision reserved to Government.
4. Although competition analysis can consider many things, there are also things it cannot. Consequently measures designed to remove restrictions on competition or otherwise to promote competition may be impossible to implement without affecting the law or regulations giving effect to other policies. Competition authorities cannot easily resolve these situations within the scope of their powers.
5. In these cases of inconsistency or even conflict the exercise of balancing and trading off is political and is properly the task of Government. Not only is it Government that sets the limits of competition policy but it is Government that must also decide which solution is to be preferred or what is the appropriate mix of measures.
6. Lurking beneath this apparently benign and self-evident resolution however remains the other sort of potential conflict—ie when a competition policy solution can be implemented by the competition authority even though it conflicts with other policy measures. In these cases the question arises whether the authority should hold back, point out the problem and leave it for others to resolve? The answer is, in my view, not. It is the competition authority's job to set out and implement the competitive solution. That is what we are expected to do; certainty and predictability requires us to put competition first. Nevertheless, from time to time, it is necessary to act pragmatically. The UK provision for tempering competitive remedies if they put at risk relevant customer benefits is a useful framework. And it is not always sensible to press for solutions that obviously set competition against other policies without attempting to find a way round the potential conflict. Judging when that is appropriate is an art, not a science.