

The deterrent effect of competition enforcement by the OFT

Discussion document

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Responding to this discussion document

Those responding to this discussion document are asked to supply a brief summary of the interests or organisations they represent, where appropriate. We ask that any comments be submitted in writing to:

Malgorzata.Filas@oft.gsi.gov.uk

Before **1st February 2008**.

Next steps

We will publish a summary of the comments in March 2008.

Data use statement for responses

Please note that we may choose to refer to comments received in response to this consultation in future publications. In deciding whether to do so, we will have regard to the need for excluding from publication, as far as that is practicable, any information relating to the private affairs of an individual or any commercial information relating to a business which, if published, would or might, in our opinion, significantly harm the individual's interests, or, as the case may be, the legitimate business interests of that business ('confidential information'). If you consider that your response contains such information, that information should be marked 'confidential information' and an explanation given as to why you consider it is confidential. All information received is subject to Part 9 of the Enterprise Act 2002.

If you are replying by email, these provisions override any standard confidentiality disclaimer that is generated by your organisation's IT system.

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INTRODUCTION

The OFT has published a research report by Deloitte on the deterrent effect of competition enforcement.

The report assesses the extent to which the OFT or Competition Commission's (CC) enforcement work in the areas of merger control (OFT and CC) and competition law (OFT only) deters other potential mergers and possible infringements. The report suggests that the deterrent effect is significantly greater than the direct effect of enforcement in all areas of merger control and enforcement of competition law against both anti-competitive agreements and conduct.

This is the first time the OFT has commissioned research into the wider benefits of competition enforcement. The research confirms that the OFT's merger control and competition law enforcement work plays an important role in preventing other anticompetitive behaviour from taking place and that the benefits of OFT work go well beyond the direct financial benefits in terms of lower prices that consumers get as a direct result of our merger and infringement decisions. Activity that deters cartels or abuse of dominance leads to major benefits: lower prices, wider choice, higher productivity and higher innovation. To put a price on all of this is difficult, but as the direct effect of competition enforcement in 2006/7 was £116m, OFT estimates that, given the scale of the deterrence effect, the benefits to consumers from OFT work may be at least a further £600m per year. This compares to an OFT total annual budget of about £70m.

The report examines a number of other questions, such as which sanctions are most important in deterring infringements of competition law, and which decisions have led to the greatest effect on companies' behaviour.

The report also highlights areas which, if addressed, could lead to an even larger positive deterrent effect. The findings of the research might therefore influence policy and prioritisation decisions by the OFT. Before we reach any firm conclusions based on this research, we would welcome a wider debate.

We would welcome views on the issues described in the research and, in particular, those highlighted in this discussion document.

Please send views in writing by **1 February 2008** to:

Malgorzata.Filas@oft.gsi.gov.uk

In March 2008 the OFT will publish a summary of comments received.

2 KEY FINDINGS

The report was based on a survey of senior competition lawyers, a survey of UK companies, and interviews with competition lawyers, economists and managers with responsibility for competition compliance.

The survey of lawyers suggests that over the period 2004-06, at least five proposed mergers were abandoned or modified on competition grounds before the OFT became aware of them for each one merger blocked or modified following intervention by the UK competition authorities.

The company survey suggested that a merger is more likely to be abandoned or modified if there has been a recent CC inquiry in the sector. While 12 per cent of all mergers considered by the companies surveyed in the period 2004-06 were abandoned or modified on competition grounds, this figure rose to 30 per cent for mergers in sectors in which there had been a CC inquiry since 2000.

The report also found that companies abandoned or significantly modified a large number of possible anti-competitive agreements and conduct because of the risk of OFT investigation. The legal survey suggests the following ratios of agreements and initiatives abandoned or significantly modified to those which resulted in a Competition Act 1998 (CA98) decision by the OFT over the period 2000-06:

Cartels	5 : 1
Commercial agreements	7 : 1
Abuses	4 : 1

These ratios should be interpreted as lower bounds for two reasons:

- The legal survey only captures mergers/agreements/conduct abandoned or significantly modified following external legal advice, but the decision to abandon or modify is often taken by companies without such advice.
- The ratio assumes that on average the same number of lawyers are consulted on proposed mergers which are abandoned or modified before the OFT became aware of them as on mergers blocked or modified following intervention by the UK competition authorities. If (as seems likely) the number of lawyers involved in cases which are blocked or modified following intervention is on average higher, then the ratio would be larger. The same applies to agreements and conduct.

Ratios were also calculated from the company survey. These are as follows:

Cartels	16 : 1
Commercial agreements	29 : 1
Abuses	10 : 1

The ranking is similar to the legal survey results (with most instances of commercial agreements deterred and least of abuses), but the company ratios are significantly larger. One explanation for the higher ratios is the existence of deterred activity on which external advice is not taken. These ratios are still conservative, because Deloitte assumed that any company reporting more than one instance of deterrence in a particular category (for example, a potential abuse) should be treated as having been deterred in only one instance in that category.

At the end of both legal and company surveys, the researchers asked whether respondents had any suggestions for what could be done to improve deterrence of competition law infringements in the UK. The most frequently made suggestions were: increased publicity and education, encouraging private damages actions, faster decision taking, more criminal prosecutions for cartels and more decisions/greater enforcement activity.

The research confirms that the OFT/CC's merger control and the OFT's competition law enforcement work are successful in preventing other anticompetitive behaviour from taking place and that the benefits of OFT work go well beyond the financial benefits in terms of lower prices that consumers get as a direct result of our merger and infringement decisions. Given that the direct effect of competition enforcement in 2006/7 was £116m, OFT estimates that, based on the scale of the deterrence effect, the benefits to consumers from OFT work may be at least a further £600m per year.

It is important to emphasize that these are OFT estimates. Deloitte did not provide monetary estimates but simply set out the size of the deterrent effects in terms of the numbers of proposed mergers abandoned or modified before the OFT becomes aware of them, relative to the number of mergers blocked or modified following intervention.

Question:

Do you think that there are any important factors that we have missed in interpreting these results that would affect the estimated size of deterrence effect?

Confidence in the results

Deloitte calculated 95 per cent confidence intervals for the deterrence ratios using a standard methodology. These show, with 95 per cent certainty, the limits within which the true lower bound ratios should lie. The narrowest interval is for cartels and the widest for commercial agreements.

For competition law enforcement another issue is that it may be difficult to separate the deterrent effect of different competition authorities (and also the deterrence arising from the risk of unenforceability). However Deloitte has mitigated this risk by asking respondents to identify behaviour which was abandoned/modified 'primarily because of the risk of OFT investigation', so Deloitte is confident that the ratios are lower bound.

Relationship between enforcement and deterrence

The research provides evidence that the deterrent effect is several times greater than the direct effect of enforcement. To improve our knowledge of the marginal impact of enforcement on deterrence, for example how deterrence changes with changes in our enforcement actions, we need to repeat the research in the future.

We had originally intended to re-run the study in 3 years time, but we would be interested in views on whether we should repeat it sooner, and, if so, whether 2008 would be too soon. OFT would be more likely to do this sooner if respondents believed such research would be beneficial.

Question:

Do you have views on the timing of the next study and also on the best way to pick up the marginal deterrent effect of enforcement?

Do you have any other suggestions for how we might improve and build upon this first approach?

3 POLICY ISSUES

There are also a number of policy issues arising from the findings of this report.

The report highlights areas which, if addressed, may lead to an even larger positive deterrent effect. These are:

Under the radar mergers

Some lawyers reported mergers completed in the last three years of which the OFT is unaware, which in their view the OFT would have been unlikely to give unconditional clearance. The number of 'under the radar' mergers was reported to be at least as high as the number which are blocked or modified following intervention by the UK competition authorities. The evidence suggests that these mergers are on average of a smaller scale than those for which the OFT requires a remedy or refers. Nevertheless, some considered this to be a lacuna in the UK merger regime. The most frequently suggested policy responses were: compulsory notification; increased monitoring by the OFT for qualifying mergers; a penalty system for completing mergers subsequently found to be anti-competitive.

Question:

OFT has recently undertaken to enhance its monitoring of under-the-radar mergers through the creation of a dedicated merger intelligence post. *What other policy responses do you think would have greatest beneficial impact? What other research, if any, do you think should be undertaken in order to support such policy responses?*

Merger remedies

Some legal advisers suggested that the OFT's procedures made negotiating remedies unnecessarily difficult. Specifically: 1) the OFT does not typically indicate what remedies would be sufficient to address their key competition concerns; 2) parties are not given the opportunity to enter into dialogue with the ultimate decision taker within the OFT (as opposed to the case team).

This was said sometimes to lead to mergers which were not anti-competitive being referred and then, given the parties' unwillingness to go through the CC process, abandoned, in other words, a false positive.

Against this, the parties are fully aware of what the OFT's concerns might be. In any case where there are serious issues the OFT provides an issues letter setting out possible concerns, and the parties' advisors are well placed to suggest remedies that address these concerns should they prove necessary.

Question:

Do you think we should modify our procedures in remedies negotiation for UILs? Please identify precisely how any changes you propose would reduce the likelihood of false positives arising from changes to phase I remedy procedures.

Factors affecting deterrence

The survey results show that sanctions which directly affect individuals (such as criminal penalties and director disqualification) are believed by companies to be more important in deterring infringements than sanctions which are imposed on businesses. Companies' ranking of fines amongst different kinds of sanctions, in particular, is comparatively low.

There might be two explanations for this: 1) fines are set too low so firms do not mind paying them, 2) the effect of fines on companies is not large compared to the effect that adverse publicity from an infringement decision can have on share prices.

Questions:

Do you think the OFT needs to raise fines in order to ensure effective deterrence?

Do you think the OFT should make greater use of criminal penalties and director disqualifications?

Business chilling

Decisions of competition authorities may, in addition to deterring anti-competitive behaviour, sometimes deter pro-competitive behaviour. This research suggests that this business chilling effect is present, but rare.

In relation to mergers, Deloitte asked respondents to indicate on a scale of 1 to 4 (where 1 is never and 4 is frequently) how often they thought that the UK regime deters mergers that would not be anti-competitive. 87 per cent of lawyers and 76 per cent of companies said that this had happened never or rarely.

In relation to competition law, Deloitte similarly asked respondents how often they thought that the UK competition regime deters agreements or conduct which would not be anti-competitive. 76 per cent of lawyers and 89 per cent of companies said that this had happened never or rarely. Both surveys found that the most frequent form of business chilling is where firms are concerned their behavior might be seen as a cartel (including resale price maintenance and information exchange). A common example given in the interviews was that of a

supplier who wishes to implement a promotion by requiring retailers to cut their retail prices. Companies are concerned that this may be seen as vertical price fixing and so refrain even though the effect would be to benefit consumers. This may be because some of the more prominent cases taken by the OFT under CA98 have related to vertical price restraints. A policy question is whether lower priority should be given to pursuing cases which involve vertical (intra-brand) price restraints. Cases such as Hasbro/Argos/Littlewoods and Replica Football Kits, however, have brought large benefits to consumers, and where firms can provide evidence that such behaviour is beneficial to consumers, the law allows for an exemption.

Question:

Do you think the OFT should give lower priority, in the cartel area, to pursuing cases which involve vertical (intra-brand) price restraints? What other actions by OFT (e.g. policy document, type of case brought) would give clearer bright lines for business?

Abuse of dominance

The legal survey reported a ratio of four initiatives avoided per OFT published decision in the abuse of dominance area. This is lower than in the cartels and commercial agreements areas.

All firms have the potential to merge or be in a cartel, but only a small minority would have the possibility to abuse a dominant position. There is no systematic bias, however, in Deloitte's results as the fact that only a small number of firms are able to abuse their dominant position is taken account of in both the numerator (instances in which a client abandoned or significantly modified a commercial initiative that may have been considered an abuse of dominance because of the risk of OFT investigation) and the denominator of the ratio (

number of cases in which the OFT published a decision under Chapter II where an allegedly dominant client was advised).

The lower ratio for abuse of dominance may be due to the current lack of guidelines for Chapter II of CA98 or Art 82 of the EC Treaty. It might also be due to the fact that the OFT has taken relatively few Chapter II infringement decisions. The report's findings may suggest that taking more Chapter II or Art 82 cases in the future would be a good step to ensure deterrence is maintained in the abuse of dominance area, and that providing guidelines would ensure businesses have guidance on which activities are lawful or unlawful.

Question:

Having regard to the UK economy and the system of concurrent regulation, do you think the OFT needs to take more Chapter II prohibitions or Art 82 infringement decisions in order to achieve effective deterrence?

Do you think there would be benefits to deterrence from the OFT or the European Commission publishing clear guidelines on Chapter II/Art 82?

NOTES

1. The research was commissioned by the OFT and carried out by business advisory firm Deloitte, supported by market research company, ORC International, who carried out the surveys. The OFT had no access to information that might be attributable by name or firm.

2. The study reports the results of three exercises:
 - 30 interviews with lawyers, economists and companies, undertaken between May and November 2006.
 - a telephone survey of 234 senior competition lawyers based in the UK and Brussels, undertaken between September and November 2006
 - a telephone survey of 202 UK companies, undertaken in February and March 2007.

3. On OFT estimates of financial benefits to consumers from OFT work in merger control, competition enforcement and scam busting for 2006/07, please download [Positive Impact 06/07](#) (pdf 325 kb).

4. Download ['Mergers: substantive assessment guidance'](#) (pdf 234 kb). This explains how the OFT approaches the substantive assessment of mergers under the Enterprise Act 2002 (in particular the substantial lessening of competition test) and the grounds on which the OFT refers mergers to the Competition Commission.

5. Download [Mergers - procedural guidance](#) (pdf 236 kb). This guidance provides general information and advice on the procedures used by the OFT in

operating the merger control regime set out in the Enterprise Act 2002. The guidance is due for review in the next 12 months.

6. Consequences of breaking the law: businesses that infringe competition law can be fined up to 10 per cent of their annual worldwide turnover. The OFT has published guidance explaining how we will set a financial penalty and will have regard to this when setting penalties. Other consequences are:

- Agreements that infringe Chapter I or Article 81 are void and cannot be enforced.
- Under the Enterprise Act 2002, it is a criminal offence for individuals to engage dishonestly in cartels. Individuals found guilty by a court can be imprisoned for up to five years and face an unlimited fine. See the OFT's Enterprise Act guidance: 'The cartel offence: guidance on the issue of no-action letters for individuals'.
- Company directors whose companies breach competition law may be subject to competition disqualification orders, which will prevent them from being involved in the management of a company for up to 15 years. See the OFT Enterprise Act guidance 'Competition disqualification orders'.
- Damages claims can be brought by third parties and by consumer groups on behalf of named consumers against businesses that breach competition law.

For further information and links to relevant guidance on this see

http://www.offt.gov.uk/advice_and_resources/resource_base/legal/competition-act-1998/consequences.