

# **The deterrent effect of competition enforcement by the OFT**

Summary of comments to discussion document OFT 963

March 2008

OFT963a

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# 1 INTRODUCTION

- 1.1 In November 2007, the Office of Fair Trading (OFT) published a research report by Deloitte on the deterrent effect of competition enforcement.
- 1.2 The report assessed 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 of competition law. 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.
- 1.3 The report examined a number of 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. It also highlighted areas which, if addressed, could lead to an even larger positive deterrent effect.
- 1.4 At the same time as the Deloitte's report was published, the OFT decided to publish a discussion document to get a wider debate on the research's findings. The discussion document asked views on the methodology, suggestions for how we might improve and build upon the Deloitte's approach, and also for feedback on several issues raised by the research.
- 1.5 The OFT received six responses. This document summarises the responses to the questions we asked in the discussion document. The summary of responses does not reflect OFT views on the issues.

## **2 MAIN ISSUES AND COMMENTS**

2.1 Overall the research on deterrence undertaken by Deloitte and published by the OFT in 2007 received positive and constructive feedback from respondents. All respondents have welcomed the opportunity to comment. The OFT would like to thank all respondents for their considered and helpful responses.

### **General comments**

2.2 One respondent observed that the exercise of engaging businesses in a discussion about deterrence is a good thing in itself, and will serve to increase awareness of competition law within their respective industries and beyond.

2.3 Another respondent thought that the need for increased publicity and education identified in the survey is of particular interest. Results from a public survey carried out by the ESRC Centre for Competition Policy on attitudes to cartel enforcement in Britain confirm the need for better information dissemination as newspaper readership and education were found to have little effect. Increased publicity and education will create a greater stigma against cartels amongst members of the public and within industry.

2.4 Achieving this, however, was said to be very difficult because competition policy is itself in competition with other news stories. This challenge is often compounded by the fact the harm caused to individual consumers may be very small, or may be remote by virtue of the fact that upstream cartels can result in inflated prices being passed down the chain of production. The American Antitrust Institute has tried to enhance knowledge about competition issues by creating an educational film which it hopes will be shown in high schools to the consumers of tomorrow.

## **Key findings and confidence in the results**

*Question 1: Do you think there are any important factors that we have missed in interpreting these results that would affect the estimated size of deterrence effect?*

### Summary of responses

- 2.5 Respondents felt that the Deloitte's work is useful in estimating the deterrence effect. Notwithstanding the limitations, recognised by both the OFT and Deloitte, the approach of measuring the potential number of mergers / agreements / conduct abandoned, and using ratios to estimate the size of deterrence seems a practical and plausible way of measuring the deterrent effect.
- 2.6 One respondent highlights the limitations surrounding conclusions on cartels, arguing that the biases in the research do not necessarily indicate an under-reporting of undeterred infringements (as suggested by Deloitte) as 1) competition lawyers/compliance managers may have a tendency to exaggerate the number of infringements averted and 2) some of the agreements averted and modified may not have actually constituted an infringement, had they gone ahead. It also argues that the secretive nature of cartel agreements, and our very limited knowledge about them, makes it difficult to undertake meaningful measures of deterrence.

## **Relationship between enforcement and deterrence**

*Question 2: 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?*

### Summary of responses

- 2.7 One respondent supported the OFT attempting to gain a greater understanding of the marginal deterrent effect of its enforcement i.e. how deterrence changes with changes in OFT enforcement action. In this way, different types of enforcement actions and the extent to which they are used could be analysed in terms of their deterrent impact. This

would be a useful tool for reviewing and revising future enforcement policy. However, looking at the marginal deterrence effect would be more complex and data intensive than looking at the overall deterrence effect. The OFT would have to consider the cost-benefit of increasing resources for this purpose, before pursuing further studies in this area.

2.8 Most respondents considered that it is appropriate to repeat the study in about three years' time rather than sooner. It is unlikely that circumstances will have changed so significantly to warrant a repeat of the study within a year. A longer period would give the OFT greater clarity when assessing the specific deterrent effects of various types of competition enforcement.

2.9 In light of this study, respondents said, there are two significant challenges the OFT faces in enhancing deterrence: securing convictions under the criminal offence and improving publicity and education. Both are important drivers of deterrence in cartel enforcement. This suggests that a second study should be carried out once a number of convictions are secured under the cartel offence and improvements have occurred in publicity/education.

*Question 3: Do you have any other suggestions for how we might improve and build upon this first approach?*

Summary of responses

2.10 A few suggestions were made, including:

- analyse the deterrent effect of different types of cartels, by categorising infringements according to their nature (for example bid-rigging, price-fixing etc.) and the parties' motivations in entering into it (for example inadvertent? blatant? deliberate? crisis cartel? etc). The suggestion was made to distinguish cartels formed purely out of greed as opposed to crisis cartels; vertical restraints; and bid rigging, as the potential offenders face different sets of incentives
- separate abandoned agreements from modified ones: one view was that modified agreements may have been inadvertent and avoided

primarily as a result of internal compliance efforts, rather than as a result of OFT activity. By contrast, abandoned agreements might represent a more deliberate attempt at cartelising an industry that was forestalled because of the risk of enforcement action. In this case deterrence would more clearly depend on the risk of OFT enforcement

- expand the study to include larger samples of respondents and more industries (particularly upstream industries with high barriers to entry producing relatively homogenous goods) to provide a greater degree of confidence in the results
- include those individuals directly involved in a cartel in the survey, by expanding the study to include firms already found to have infringed competition law, in order to shed light on the impact of OFT enforcement
- continue to be concerned about business chilling particularly in the merger context. 76 per cent of lawyers said business chilling had never or rarely happened but this left 24 per cent lawyers and 11 per cent companies who said it has happened. This is not just due to the costs involved in a reference, but also to the weakening of the companies involved, and particularly of the target company, during the period required for the enquiry (such as lost managerial and financial control).

### **Under the radar mergers**

*Question 4: 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?*

Summary of responses:

- 2.11 Views of the respondents were mixed on this. One respondent considered that the most effective deterrent to under the radar mergers

is the power of the Competition Commission to order divestment in a merger that has proceeded without a prior clearance under the Enterprise Act. This power encourages a party to notify a merger that may give rise to competition concerns. There is, thus, no need for adopting a compulsory merger notification system instead of the current voluntary procedure. If introduced, compulsory notification of qualifying mergers might well result in notification of significantly more mergers out of over caution as happened with the EC system of notification of restrictive agreements. Such an over cautious approach would be likely to hamper and delay the present notification system without providing considerable additional benefits in terms of ensuring compliance. In any event, as below the radar mergers are generally those which fall at the smaller end of the scale, it is possible that the recently revised approach to markets of insufficient importance would apply to them.

- 2.12 Another respondent argued that setting up the duty to notify and the financial penalties to be paid in case of non - observance would be a good incentive for the firms to submit the merger to the competition authority's attention. They are of the view that the alleged effect of a mandatory system of notification (that of deterring mergers that would not harm competition) is less dangerous than the effect of a non-mandatory system (that of anti - competitive mergers of which the authorities do not become aware in time to take action). They also put forward a couple of suggestions for the system of voluntary notification: 1) an increase of time period in which OFT can take jurisdiction, from four months to at least one year, to enhance the competition authority's opportunities to find and to review the relevant mergers which may lessen competition; 2) the creation of a system of fines for the companies part to a finalized merger operation, subsequently found by the authorities to be anti - competitive, going up to maximum 10 per cent of their annual worldwide turnover for the preceding year.

### **Merger remedies**

*Question 5: Do you think we should modify our procedures in remedies negotiation for UIs? Please identify precisely how any changes you propose*

*would reduce the likelihood of false positives arising from changes to Phase 1 remedy procedures.*

Summary of responses

2.13 There were no responses on this.

### **Factors affecting deterrence**

*Question 6: Do you think the OFT needs to raise fines in order to ensure effective deterrence?*

Summary of responses

2.14 Deloitte's work finds that companies rank fines as less important than criminal sanctions, disqualification of directors and adverse publicity. A respondent argued that, however, companies still give fines a score of 3.13 on a scale from 1 (not at all important) to 4 (very important). This does not suggest that firms think fines are unimportant and that they are necessarily too low. The OFT already takes account of deterrence in its guidance on setting a penalty (OFT 423). In the future, it might also want to take account of Deloitte's findings when considering the adjustment to the fine required to deter other undertakings from engaging in anti-competitive behaviour. Penalties should reflect the circumstances of the particular case to ensure they are fair and proportionate, in order to give companies an incentive to comply with statutory and regulatory requirements now and in the future.

2.15 Another respondent argued that the maximum level of fines under the Competition Act 1998 (10 per cent of the undertakings group worldwide turnover) is set sufficiently high to ensure deterrence. The issue therefore is whether the OFT's approach to fining is sufficient to create a deterrent effect. While it would be very effective if fines were linked to the profitability of the cartel activity, it is acknowledged that the difficulties inherent in arriving at a profit figure may be too great and may result in time consuming disputes with the cartel participants. The

survey results of company representatives responsible for compliance demonstrate that director disqualification and criminal penalties are viewed very seriously within the relevant companies and are a potent consideration in the minds of individuals. At the time the interviews were conducted, there had been no publicity regarding director disqualifications. The respondent thought that the concern shown in the company survey about disqualification suggested there is scope for greater use by the OFT of publicity in respect of this sanction.

*Question 7: Do you think the OFT should make greater use of criminal penalties and director disqualifications?*

#### Summary of responses

- 2.16 One respondent thought that, given that the survey has revealed that sanctions such as criminal penalties and director disqualification may act as a greater deterrent, Deloitte's work gives the OFT further justification to exercise such powers in situations where individuals can be categorically linked to infringements, even though the exercise of such powers can be time-consuming and difficult.
- 2.17 Another respondent went further, by saying that, given that successful cartels can raise prices by between 15-60 per cent, it is reasonable to assume that fines well in excess of the current 10 per cent annual worldwide turnover cap will be necessary in at least some cases. However the problem is that fines of the magnitude necessary to ensure deterrence will increase the risk of infringing firms becoming insolvent. If corporate fines are not complemented with sanctions against individuals, there is a real danger that infringements are worthwhile despite enforcement.
- 2.18 Publicity surrounding the high profile applications for extradition to the US of alleged offenders is likely to have had the desired effect of promoting deterrence. Respondents thought that, now that the OFT has exercised its powers in respect of criminal prosecutions, it is likely that the deterrent effect of these sanctions will increase.

## Business chilling

*Question 8: 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 (for example policy document, type of case brought) would give clearer bright lines for business?*

### Summary of responses

- 2.19 A couple of respondents suggested it is often the case that the most harmful cartels are those that operate on a horizontal level. While resale price maintenance often operates to the detriment of the consumer, it is recognised that a vertical price restriction can in some circumstances be pro-competitive and enhance both total and consumer welfare. OFT should consider concentrating its enforcement activities on horizontal cartels, as the most severe damaging effects of anti - competitive behaviour (as far as the price restraints are concerned) are represented by horizontal agreements, rather than vertical price restraints.
- 2.20 Some respondents believe that clear guidelines, followed by practical examples, upon facts or operations qualified as forbidden agreements should be highly helpful for the companies in identifying the sort of illegal agreements not to be part in, and thus observe the competition rules.
- 2.21 Business chilling (i.e. businesses refraining from actions which, in fact, would not infringe the competition rules, for fear that they would) happens because there is no OFT guidance in some areas of competition law. In particular, there is little practical guidance on information exchange agreements between competitors (for example the exchange of information regarding safety issues), sufficient to assist companies who see a legitimate cause for information exchange that will not restrict competition.
- 2.22 If there is an area of concern or uncertainty, one of two things may happen. First, the business will decide not to seek advice, perhaps wanting to avoid incurring costs. Instead, they will not embark on the project concerned (even though, in fact, there is nothing wrong with

what they propose). Alternatively, they may seek legal advice. The lawyer consulted, in the absence of any precedent or guidance from OFT on the point, may advise 'conservatively', i.e. suggest that there may be a problem. The business will then not go ahead with the proposed course of action.

## **Abuse of dominance**

*Question 9: 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?*

### Summary of responses

2.23 One respondent observes that 'a dominant undertaking fights with one hand behind its back' is a not infrequently expressed complaint from undertakings with large market shares. This respondent would support the publication of detailed guidelines on issues arising in relation to dominance and abuse, as these would be undoubtedly helpful for dominant undertakings and their advisers, and concludes that there is no need for the OFT to take more abuse cases. Another respondent supported the OFT in pursuing some Chapter II cases within the OFT's overall strategic priorities and resource constraints.

*Question 10: Do you think there would be benefits to deterrence from the OFT or the European Commission publishing clear guidelines on Chapter II/Art 82?*

### Summary of responses

2.24 A respondent looked forward to the European Commission finalising its guidance on the application of Article 82. The current lack of guidance for Chapter II CA98 and Article 82 of the EC Treaty and the relatively few Chapter II infringement decisions might, as the OFT suggests, explain why the number of abuse of dominance cases deterred relative to those resulting in CA98 decisions is lower than for cartels or commercial agreements.

### **3 ACCESS TO RESPONSES**

- 3.1 The OFT was not asked to treat any responses to the consultation in confidence.

## **A FULL LIST OF RESPONDEES**

- A.1 Competition Council of Romania, [www.competition.ro](http://www.competition.ro)
- A.2 Andrea Stephan, ESRC Centre for Competition Policy & Norwich Law School, University of East Anglia,
- A.3 Competition Law Association (CLA),  
[www.competitionlawassociation.org.uk](http://www.competitionlawassociation.org.uk)
- A.4 OFWAT, Competition team
- A.5 Gilmour Stubbs, Knutsford, Cheshire
- A.6 David Whibley, Consultant in Competition Law, Morgan Cole, solicitors.