

CRA Competition Memo



Antitrust Enforcement and The Rule of Law

In August, the President of the Board of Trade, Mrs Margaret Beckett, published a draft Competition Bill. The key feature of the new bill is that it represents a significant move toward the system of competition law already in force in the European Union. Many commentators have welcomed this, saying that it will make life simpler to have one system and not two. We think that the welcome should be louder and for a more fundamental reason. The two features of competition law about which business most vigorously complains (and which, directly or indirectly, harm consumers) are inconsistency and lack of transparency. The real merit of moving towards the European Union's style of competition law is that there should be a reduction in inconsistency and an improvement in transparency in competition enforcement.

Costs of Regulation

The structure of competition law in the European Union (and in the United States) can be thought of as a series of economic hurdles. Each hurdle acts as a reminder to would-be regulators to ask themselves whether regulation is really warranted. Such hurdles are needed because it is very easy to come up with ideas that might in theory make markets work better, especially because markets in practice do not resemble the textbook model of 'perfect competition'. The real question the regulator must ask is not whether in theory the market can be improved but whether the defects found are sufficiently serious to outweigh the costs of intervention. It is possible that the option of doing nothing is the best one available.

The disadvantages of regulation are well understood by economists. For example, regulation adopted for one purpose often has perverse knock-on effects.¹ This is not to argue that regulatory intervention is never warranted. What it does mean, however, is that intervention should not be undertaken on the whim or hunch of the regulator. A series of systematic rules should be followed to gauge whether regulation is likely to improve matters.

¹ This is known as the 'law of unintended consequences'. For instance, rate of return regulation in utilities tends to result in over investment in capital.

EU Competition Law: Some Consistency

If we look at the way in which European competition law has been administered during its 40 year existence, we will find much to criticise. But one thing is clear: officials have felt the need to justify their actions, and particularly their interventions, by appeal to the criteria laid down in the Treaty of Rome as interpreted by the European Court of Justice.

The result has been that the Commission and the courts work with a consistent set of criteria which, in principle, require them to address the key economic question that we put above. All the criteria that are applied in competition law are directed towards answering this empirical economic question. If, for example, the relevant market is wide so that many firms compete, then one cannot coherently claim that a unilateral practice by one firm or an agreement between two of them will restrict, prevent or distort competition. If officials are required to define their markets carefully and to give justifications for their choice, then they are made to face that critical question: do we really need to intervene here?

In the same way, when the ECJ lays down that a court or the Commission must analyse the barriers to entry, then once again the critical question is being asked — do we really need to intervene here? For if the barriers to entry are low, then the market can be expected to become competitive within a reasonable time and there is no need to intervene. Furthermore, when officials are required to justify their conclusions on, say, market definition then a set of coherent economic criteria for market definition tend eventually to arise (see the Commission's Draft Notice on Market Definition). The UK Monopolies and Mergers Commission (MMC) does not currently face such disciplines.

The MMC and Consistency

The current UK system adopts a different approach to the law-based EU framework. It is characterised by a discretion-based system and there has been much less emphasis on ensuring consistency. This appears to be particularly apparent in the decisions made by the MMC. In part, this can be explained by

the structure of the body itself. The MMC is made up of a body of over 30 members with a shifting membership on each panel, drawn from very different backgrounds. In fairness, the MMC probably makes many more correct decisions than mistakes, but this is in spite of, rather than because of, the current UK approach to competition policy.

The absence of a rule-based economic framework has led to markedly different approaches to cases by the MMC. There are many examples both of a very free-market hands-off approach and a very interventionist stance. The high water mark of the non-interventionist approach was probably the MMC's 1986 *Tampons* report. In this case, the MMC decided against intervention in a market in which market power was being exercised on the basis that 'currently rewarding profit levels should act as a magnet to attract new suppliers'. Contrast this with the decision in the recently published *Domestic Electrical Goods* report. Here, there was evidence to suggest that manufacturers were making barely adequate returns, much less profits, in an environment in which prices were both highly visible and declining in real terms.² Yet the MMC recommended that legislation be adopted prohibiting a whole variety of practices, including the recommending of retail prices. It also recommended that manufacturers be compelled to supply to warehouse clubs.

One inefficient implication of MMC's inconsistency is that firms go out of their way to avoid an MMC inquiry even when they believe they have a good case.

Hope for the Future?

There are signs that the MMC may be taking steps to adopt a more systematic approach. A recent merger inquiry ('*London Casinos*') on which Lexecon advised was the first we have come across where the MMC approached market definition in a rigorous manner consistent with the methodology adopted in US and EU cases. Capital Corporation, owner of two high quality casinos located in Mayfair, was subject to a hostile takeover bid by its rival London Clubs, which owned seven casinos in London. The MMC adopted the clear economic criterion of the 5% (or SSNIP) test for market definition (the same approach proposed in the US Merger Guidelines

and the European Commission's Draft Notice on Market Definition). The MMC then analysed the relevant market in a systematic manner, taking into account the possibility of demand-side and supply-side substitutability. After a thorough analysis, the MMC concluded that the relevant market consisted of ten 'upper segment' casinos (eight of which were located in Mayfair). The post-merger market share would have been 79%. The MMC recommended that the merger be blocked and the Secretary of State concurred.

However, despite the rigour of the *London Casinos* report, the concern remains that under the current system, a similar merger might be assessed in an entirely different manner under a different panel. Past cases still give those parties subject to an MMC inquiry little guidance as to their own likely treatment. This adds to the cost and uncertainty of an MMC inquiry, which in turn gives the OFT more bargaining power at the pre-referral stage. Under the proposed new system, the power of the Director General of Fair Trading will be enhanced (with new investigatory powers and the authority to impose fines) and the MMC will be replaced by a new Competition Commission. The credibility of the new system will depend, in part, on the consistency, objectivity and rigour of the Competition Commission's approach to appeals against decisions of the DGFT, which suggests that a more systematic approach to decision-making will be crucial.

Conclusion

We do not believe that any competition law system anywhere in the world has succeeded in achieving clear beneficial results without adopting explicit economic criteria applied in a systematic fashion. Trying to do anything else eventually results either in decisions which have manifestly perverse economic effects (such as the 1936 US Robinson-Patman Act on price discrimination) or in the unpredictability that we get from the MMC. The most encouraging aspect of the proposed legislation is the importance placed on clear criteria.³ If the new system delivers what is promised, both business and consumers should benefit.

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² Of course, the combination of low profits and low prices is not a definitive test of competitiveness; certain practices, for example, might be sustaining an inefficient market structure. There was no suggestion, however, that this was the case in the *Domestic Electrical Goods* inquiry.

³ The suggestion that most vertical agreements should be exempted from the scope of the prohibition of anti-competitive agreements is particularly welcome.