



Volume 10 | Number 1 | Spring 2014

Competition Policy International

INSTITUTIONAL DESIGN FOR COMPETITION AUTHORITIES

David Currie, Alex Chishom, & Tim Jarvis, Andrea Coscelli & Antonia Horrocks, Robert O'Donoghue & Tim Johnston, Jackie Holland & Aurora Luoma, and Roderick Meiklejohn on Great Britain and Europe

Juan Delgado & Elisa Mariscal, Michael S. McFalls, Ana Paula Martinez & Mariana Tavares de Araujo, Cyril Shroff & Nisha Kaur Uberoi, Adrian Emch, and R. Ian McEwin on global jurisdictions

OF SPECIAL INTEREST

David S. Evans, Vanessa Yanhua Zhang, & Xinzhu Zhang on China's Anti-Monopoly Law

CURRENT CASES

Peter J. Levitas & Kelly Schoolmeester on *Bazaarvoice*

THE CLASSICS

Philip Lowe's *The Design of Competition Policy...* With an Introduction by **Lindsay McSweeney**



Edited by David S. Evans

**FOUNDER AND
PUBLISHER**

David S. Evans: *University of Chicago Law School, Chicago, IL, USA*

EDITOR-IN-CHIEF

David S. Evans: *University of Chicago Law School, Chicago, IL, USA*

CO-EDITORS

Elisa V. Mariscal: *Centro de Investigación y Docencia Económicas (CIDE), and Instituto Tecnológico Autónomo de México (ITAM) Mexico*

Mark Armstrong: *Oxford University, Oxford, UK*

Antonio Bavasso: *Allen & Overy, London, UK*

Keith N. Hylton: *Boston University School of Law, Boston, MA, USA*

R. Ian McEwin: *Chulalongkorn University, Bangkok, Thailand*

Susan Ning: *King & Wood, Beijing, China*

Michael A. Salinger: *Boston University, School of Management, Boston, MA, USA*

CHAIRMAN

Richard Schmalensee: *MIT Sloan School of Management, Cambridge, MA, USA*

EDITORIAL BOARD

Joseph England: *White & Case, New York, NY, USA*

Dennis W. Carlton: *University of Chicago, Chicago, IL, USA*

Einer R. Elhauge: *Harvard Law School, Cambridge, MA, USA*

Nicholas J. Forwood: *General Court of Appeals of the European Union, Luxembourg*

Herbert Hovenkamp: *University of Iowa College of Law Iowa City, IA, USA*

Valentine Korah: *University College London London, UK*

Mario Monti: *Bocconi University Milan, Italy*

Eduardo Pérez-Motta: *Federal Competition Commission and International Competition Network Mexico City, Mexico*

Patrick Rey: *IDEI and University of Toulouse, Toulouse, France*

Christopher Bellamy: *Linklaters London, UK*

Frank H. Easterbrook: *US Court of Appeals for the 7th Circuit, Chicago, IL, USA*

John Fingleton: *Fingleton Associates, London, UK*

Douglas H. Ginsburg: *US Court of Appeals for the DC Circuit, Washington D.C. USA*

William J. Kolasky: *Wilmerhale, Washington D.C. USA*

Bruno Lasserre: *Autorité de la Concurrence Paris, France*

Timothy J. Muris: *George Mason University, Fairfax, VA, USA*

Richard Posner: *US Court of Appeals for the 7th Circuit Chicago, IL, USA*

Vivien Rose: *Competition Appeal Tribunal, London, UK*

Bo Vesterdorf: *Plesner and Herbert Smith Freehills, Copenhagen, Denmark; Brussels, Belgium*

ON THE WEB

www.competitionpolicyinternational.com

Table of Contents

Letter from the Editor

David S. Evansix

Great Britain & Europe

Institutional Design and Decision-Making in the Competition and Markets Authority

David Currie, Alex Chisholm, & Tim Jarvis.....13

Making Markets Work Well: The U.K. Market Investigations Regime

Andrea Coscelli & Antonia Horrocks.....24

Notes From A Small Island: Natural Justice and the Institutional Design and Practice of Competition Authorities and Appellate Courts

Robert O'Donoghue & Tim Johnston57

Decision-Making Powers and Institutional Design in Competition Cases: The Application of Competition Rules by Sectoral Regulators in the United Kingdom

Jackie Holland & Aurora Luoma.....92

The Effectiveness of Competition Authorities: Four Questions

Roderick Meiklejohn110

Global Jurisdictions

Integrating Regulatory and Antitrust Powers: Does It Work? Case Studies from Spain and Mexico

Juan Delgado & Elisa Mariscal.....135

Institutional Design and Federal Antitrust Enforcement Agencies: Renovation or Revolution?

Michael S. McFalls.....160

Decision-making Powers and Institutional Design in Competition Cases:

The Brazilian Experience

Ana Paula Martinez & Mariana Tavares de Araujo.....179

Competition Commission of India: Institutional Design and Decision Making

Cyril Shroff & Nisha Kaur Uberoi.....197

Table of Contents *(continued)*

Chinese Antitrust Institutions—Many Cooks in the Kitchen <i>Adrian Emch</i>	217
Designing Competition Law Under Financial Crisis—Indonesia and Thailand Compared <i>R. Ian McEwin</i>	247
Of Special Interest	
Assessing Unfair Pricing under China’s Anti-Monopoly Law for Innovation-Intensive Industries <i>David S. Evans, Vanessa Yanhua Zhang, & Xinzhu Zhang</i>	282
Case Study	
What Can We Learn from <i>Bazaarvoice</i>? <i>Peter J. Levitas & Kelly Schoolmeester</i>	329
Classic	
The Design of Competition Policy Institutions for the 21st Century — The Experience of the European Commission and DG Competition <i>Philip Lowe</i>	15



*Letter from
the Editor*

The first competition law was passed in 1889 in Canada, followed shortly by the United States in 1890. Subsequent expansion of competition regimes was slow—it wasn't until 1957 that the European Union established an antitrust policy with the Treaty of Rome. There followed a steady growth—39 countries had established competition regimes as of 1989—but then antitrust exploded: By the end of 2004, 102 countries—over 85 percent of the world's population—had competition laws on their books, and about 120 do today.

But despite this proliferation, there's no consensus on the optimal structure for an authority. While most competition laws can trace their inspiration back to the United States (common law system) or the European Union (civil law system), laws still widely vary, as do the structure of the authorities created to enforce them, reflecting diverse cultural, legal, and political regimes. And while most authorities have an institutional interest in preserving and promoting competition, their ability and inclination to do so have also been challenged by political events—recently, in particular, the financial crisis that began in October 2008.

While differences across countries probably dictate that there is no one “best” design for a national competition authority, we can still hope for some general principles for those countries figuring out how to come up with the best design for their circumstances. And with more than 100 hundred countries, from undeveloped to highly developed, having competition laws there must be something every country can learn from others.

With this as background, this issue presents a lively discussion regarding effective institutional designs for competition regimes.

We're starting in Great Britain, which recently undertook a complete redesign of their competition structure, requiring substantial retrospection and analysis. David Currie, Alex Chisholm, & Tim Jarvis—the three senior executives of the new Competition and Markets Authority—lead off with a look at how the new agency's design and governance structures were created. Andrea Coscelli & Antonia Horrocks, who manage mergers and acquisitions for the CMA, describe specifically how the new markets investigations regime will be working.

Presenting an external viewpoint, Robert O'Donoghue & Tim Johnston highlight the importance of the rule of law in this process, explaining how the concepts of natural justice and fairness need to be reflected in an authority's design and operations. Jackie Holland & Aurora Luoma then focus on the topic of institutional design and decision-making within sectoral regulators in relation to competition cases.

Next, we look at a diverse range of specific institutional designs and dig deep to find out not only why they're designed the way they are, but whether they present an effective structure. Roderick Meiklejohn

presents an overview through a comprehensive comparison of competition authorities, with the goal of determining the factors that make them most effective.

Starting from west to east (as viewed on a Mercator map), we then look at specific countries. Juan Delgado & Elisa Mariscal analyze and compare the recent restructuring of the Mexican and Spanish authorities, focusing on the merits of a multi-purpose vs. single-purpose structure. Michael McFalls presents how political thought and expression in the United States have produced a complicated institutional design and asks if it needs to be simplified. Ana Paula Martinez & Mariana Tavares de Araujo consider lessons learned from Brazil's recent restructuring; in particular, Brazil's efforts to enhance its convergence to international best practices.

We move on to India, where Cyril Shroff & Nisha Kaur Uberoi investigate how, in the wake of the liberalization and privatization of India's market economy, it became increasingly important for India to shift its focus from curbing monopolies to developing a comprehensive competition policy, and report on India's progress in doing so. And, looking at another mega-economy, Adrian Emch analyzes the challenges presented by China's option for a three-headed structure in its competition regime.

To bring this section to a close, we look at two of the newest authorities. The 1997 Asian Financial Crisis was the impetus for the introduction of competition law in both Indonesia and Thailand, required by external agencies as a condition of financial aid. Further, Indonesian and Thai economies were shaped by numerous common and historical and political features. Yet, as Ian McEwin explains, Thailand has created an ineffectual regime, while Indonesia seems to be on the road to success. The reasons are eye opening.

We conclude our issue with three special features. David S. Evans, Vanessa Yanhua Zhang, & Xinzhu Zhang explore how to create an economic framework for applying an unfair pricing law in China. Consistent with the theme of this issue they examine how the experience of other jurisdictions, combined with the particularities of the Chinese Anti Monopoly Law and the history of market liberalization in China, can help guide the development of approaches to unfair pricing under the AML.

Our highlighted case this issue also concerns the question of innovation. Peter J. Levitas & Kelly Schoolmeester look at the recent *Bazaarvoice* case, where a triumphant U.S. Department of Justice effectively rebutted jurisprudential attacks regarding the enforcement of antitrust in a high-tech market and, further, overcame the lack of both demonstrable price effects and very few complaining customers to obtain a robust remedy for a consummated transaction.

And, finally, returning to our main theme our classic for this issue is Philip Lowe's 2008 article: *The Design of Competition Policy Institutions for the 21st Century—The Experience of the European Commission and DG Competition*. His message that competition authorities institutions must “constantly assess and re-assess their mission, objectives, structures, processes and performance” is as true today as it was then—and the driving force behind the changes we've highlighted in this issue.

David S. Evans (University of Chicago Law School)

August, 2014



*Great Britain &
Europe*

Institutional Design and Decision-Making in the Competition and Markets Authority

BY DAVID CURRIE, ALEX CHISHOLM, & TIM JARVIS¹

In this article, we set out how the reforms to the U.K. competition regime and the creation of the CMA will enable us to deliver “marked improvements” and meet the expectations on us to enhance the rigor of decision-making and to make more decisions, more quickly, with no attendant drop in quality. We look at institutional design and the governance structures within which decisions are made in the new agency. We describe how they build on what existed before and accommodate the pre-existing features of the U.K. system which have been carried forward into the new agency; and how we have taken the opportunity to enhance the rigor and transparency of decision-making, further developing reforms started under the previous regime. We examine the different types of decisions that will be made by the CMA and how the decision-making processes have been designed to ensure that robust, transparent, and timely decisions become synonymous with the new U.K. system. In doing so, we also touch on issues that, while not new, are nevertheless crystallized in the process of institutional reform: What is meant by independence of decision-making? How is the relationship between the agency and its government sponsors managed?

I. INTRODUCTION

The institutional design of competition authorities has attracted less academic interest than either the policy and practice of the authorities themselves or the analytical tools they adopt. However, the recent major reforms in, for example, Spain, Brazil, and the Netherlands have increased the attention being devoted to the impact of institutional reform on the outcomes and policy goals pursued.² What has been described as the “engineering” of agency design and implementation is seen as having a causal effect on the extent to which the theoretical benefits of competition policy may be realized. Put simply, “if theory is not grounded in the engineering of effective institutions, it will not work in practice.”³

The recent redesign of the competition institutions in the United Kingdom and the creation of a single agency, the Competition and Markets Authority (“CMA”), which began its work in April 2014, is likely to attract particular attention. The reforms were motivated not to address significant failings but instead to build on a system widely considered to be one of the world’s best. As has been noted: “to take the risks that come with such a drastic renovation makes sense only if the new regime promises marked improvements upon the performance of its already distinguished predecessor.”⁴

PUT SIMPLY, “IF THEORY IS NOT GROUNDED IN THE ENGINEERING OF EFFECTIVE INSTITUTIONS, IT WILL NOT WORK IN PRACTICE”

In this article, we set out how the reforms to the U.K. competition regime and the creation of the CMA will enable us to deliver “marked improvements” and meet the expectations on us to enhance the rigor of decision-making and to make more decisions, more quickly, with no attendant drop in quality. We look at institutional design and the governance structures within which decisions are made in the new agency. We describe how they build on what existed before and accommodate the pre-existing features of the U.K. system

which have been carried forward into the new agency; and how we have taken the opportunity to enhance the rigor and transparency of decision-making, further developing reforms started under the previous regime. We examine the different types of decisions that will be made by the CMA and how

THIS MEANS THAT THE KEY STRATEGIC DECISIONS OF THE CMA ARE MADE BY THOSE APPOINTED BY, BUT ACTING INDEPENDENTLY OF, THE GOVERNMENT

the decision-making processes have been designed to ensure that robust, transparent, and timely decisions become synonymous with the new U.K. system. In doing so, we also touch on issues that, while not new, are nevertheless crystallized in the process of institutional reform: What is meant by independence of decision-making? How is the relationship between the agency and its government sponsors managed?

II. INSTITUTIONAL DESIGN

The CMA has been established as a non-Ministerial Government Department led by a board. Importantly, this means that the key strategic decisions of the CMA are made by those appointed by, but acting independently of, the Government. This is not a unique structure in the United Kingdom and includes some well-developed safeguards against any perception of undue influence by the government of the day. For example, public appointments, such as those to the CMA board, are overseen by a Commissioner for Public Appointments who ensures that the best people get appointed to public bodies free of personal and political patronage. Needless to say, the relationship between the CMA and Government goes wider and is more nuanced than simply the appointment of the board. This is a theme to which we return in our concluding comments at the end of this article.

Non-executive board members are drawn from a range of backgrounds and are appointed for the skills and experience they bring rather than as representatives of particular interests. In line with its political traditions, the United Kingdom has not drawn on a model of interest group representation, more common in continental Europe, whereby different interests are specifically represented in decision-making bodies and

IN LINE WITH ITS POLITICAL TRADITIONS, THE UNITED KINGDOM HAS NOT DRAWN ON A MODEL OF INTEREST GROUP REPRESENTATION, MORE COMMON IN CONTINENTAL EUROPE, WHEREBY DIFFERENT INTERESTS ARE SPECIFICALLY REPRESENTED IN DECISION-MAKING BODIES AND DECISIONS RESULT FROM A NEGOTIATED SETTLEMENT OF THOSE INTERESTS

decisions result from a negotiated settlement of those interests. The CMA's mission is to bring benefits to business, consumers, and the economy: the board individually and collectively works to that mission and, where necessary, balances any competing demands. In doing so, it takes into account, is informed by, and is held to account by specific representative, interest groups as well as, of course, its Government sponsors and, ultimately, parliament. These interests are not, though, specifically represented on the board in what risks being a mechanistic and token way.

One advantage of the approach taken to the CMA board is to facilitate the appointment of the brightest and the best in the United Kingdom and internationally, from public service, business, and academia. This has been borne out in practice. Appointed following fair and open competition and an interview chaired by an independent Civil Service Commissioner,⁵ the non-executive members of the CMA

board are generally acknowledged to consist of an unparalleled group of individuals. Collectively, they have experience of promoting competition and protecting consumers through their leadership of highly regarded competition institutions and regulators in the United Kingdom and abroad (OFCOM, Competition Commission (“CC”), the European Commission’s Directorate-General for Competition (“DG Comp”), and the U.S. Federal Trade Commission (“FTC”)) as well as those with a history of contributing to economic growth through their experience in business.

The rest of the board is made up of the executive team which brings further experience from highly regarded regulators in the United Kingdom and abroad (Commission for Communications Regulation (“ComReg”), Ofcom, Office of Gas and Electricity Markets (“Ofgem”), and Office of Fair Trading (“OFT”)) and senior roles in the private sector with law firms and economic consultancies. In line with good models of corporate governance, the non-executive members of the board, including the chair, form the majority of the board; thus they are part of the leadership team but also have an important role in holding the executive to account.

The board is responsible for setting the strategic direction of the CMA. It is accountable for all decisions of the organization and directly responsible for some key operational decisions that are reserved to it. For example, an important feature of the U.K. regime is the power of the competition authority to commission a detailed investigation of a particular market where it is concerned competition may not be working effectively, even though there may not necessarily be any contraventions of competition law.⁶ Such an investigation may result in action being taken to promote competition with significant consequences for the businesses operating within that market. Given the significance of the CMA’s markets work, and the decisions on which areas to carry out an initial market study and whether to refer that market for a detailed investigation by a CMA group, it is important that these decisions are made by the board, based on consideration of the evidence.

THE TWO PHASES OF MERGERS AND MARKET’S WORK, PREVIOUSLY UNDERTAKEN BY SEPARATE ORGANIZATIONS, ARE NOW CARRIED OUT WITHIN ONE ORGANIZATION, THE CMA

Other decisions of the CMA are delegated by the board to the executive or are required by statute to be made by another part of the organization. For example, decisions on mergers and markets, once referred for a phase 2 investigation, are required to be made independently of the board by a group drawn from a separately appointed panel of experts who are not CMA staff. This mirrors the arrangements prior to the creation of the CMA under which decisions on mergers and markets referred by the OFT were made by groups of independent members acting on behalf of the CC.⁷ A key difference, discussed in more detail below, is that the two phases of mergers and markets work, previously undertaken by separate organizations, are now carried out within one organization, the CMA.⁸

It is neither practical nor desirable for the CMA board to make decisions on individual enforcement decisions that require a detailed analysis of the evidence in a case and the potential application of the relevant legislation. Similarly, although it adopts and publishes prioritization principles, which are important for transparency and demonstrating consistency, the board cannot practically make each decision about which

cases to pursue. Such decisions are therefore delegated by the board to the executive, the CMA staff, under the board's general power of delegation. The board does, though, determine and guide how these decisions are made, the processes involved, and the resources which are drawn on to analyze the evidence and inform the decisions.

Broadly, therefore, in addition to the board, there are two other sets of decision-makers within the CMA: the staff and the Panel. Before considering the decision-making processes in more detail, we briefly summarize below how the staff and Panel are accommodated within the new institutional design represented by the CMA.

III. CMA'S INSTITUTIONAL DESIGN

A. *The Staff Structure*

An early priority was to get in place an executive team that would lead the new CMA. As we note above, the OFT and CC were both highly respected agencies and the simplest and quickest option would have been to draw the new executive team from these organizations. However, we were keen that the new organization would be, and would be seen to be, strong relative not only to the OFT and CC but also to the wider competition community.

WE WERE KEEN THAT THE NEW ORGANIZATION WOULD BE, AND WOULD BE SEEN TO BE, STRONG RELATIVE NOT ONLY TO THE OFT AND CC BUT ALSO TO THE WIDER COMPETITION COMMUNITY

We therefore put all the top 30 senior positions out to public advertisement and a process of open competition regulated by the independent Civil Service Commission.

It was an endorsement of the quality of the leadership teams in the legacy organizations that around 80 percent of these posts were filled by former OFT and CC staff with some moving to new roles, ensuring the best fit of people to roles at the senior level within the new organization. Importantly, we were also able to attract talent from the private sector and those with senior level experience in other regulators. This has given us a very strong senior team to take the organization forward.

It was an endorsement of the quality of the leadership teams in the legacy organizations that around 80 percent of these posts

The CMA has been structured around two delivery directorates: an enforcement directorate, and a markets and mergers directorate. These are both headed by executive directors who sit on the board.⁹ The executive directors of markets and mergers and enforcement are responsible for the management and delivery of the cases and projects in their areas. However, most staff working on projects are not exclusively allocated to these directorates; they largely work flexibly across a number of areas of the CMA's responsibilities.

THUS PROJECTS AT THE CMA WILL BE DELIVERED BY MULTI-DISCIPLINARY TEAMS, WHICH SHARE EXPERIENCE AND SKILLS OF THE ENTIRE U.K. COMPETITION LEGISLATIVE FRAMEWORK

This is because, in considering how the new agency would work, a key driver was the need to deliver projects quickly and efficiently taking advantage of the synergies available from having a combined staff team drawn largely from the legacy organizations. We therefore established a new Project Management Office

(“PMO”) that would collect data on the CMA’s most valuable resource—its people—and use this to allocate staff to cases in the most efficient way.

In this way, we are able to exploit the synergies from co-locating staff working on different competition tools, such as enforcement under the Competition Act 1998 and merger control under the Enterprise Act 2000, and embed matrix working across all projects. Thus projects at the CMA will be delivered by multi-disciplinary teams, which share experience and skills of the entire U.K. competition legislative framework. It also enables us to manage more flexibly the inevitable ebbs and flows in case work and ensure that decisions about which cases to pursue are driven entirely by the evidence and according to our prioritization principles and strategic objects.

Similarly, we have established a new Research, Intelligence and Advocacy unit that has as one of its main objectives the identification of cases and projects for the CMA to pursue. Again, the unit itself is very lean but it draws on the expertise of staff from across the organization through the PMO to identify cases and carry out initial research. This makes the best use of staff experience and skills but also gives those staff different opportunities from the detailed case work that forms the majority of their work experience. Also, by concentrating intelligence in one place, the unit helps us to make the best choices when prioritizing cases to pursue, and enables us to be proactive as well as reactive when identifying potential cases.

INSTEAD IT DECIDED TO ENHANCE THE CONCURRENCY REGIME AND CLEARLY ESTABLISH THE CMA AS THE LEAD BODY IN A NEW U.K. COMPETITION NETWORK

There are exceptions to this generic model. For example, civil and criminal cartel work requires particular skills and experience that we did not want to spread too thinly throughout the organization. Similarly, the speed of throughput of phase 1 mergers work benefits from a dedicated team. However, even in these two examples we expect to see staff transfer between these and other areas of the CMA’s work especially where efficiencies might be obtained. For example, a strong cohort of staff with experience across both phases of a merger inquiry will ensure that consideration of a merger is seen as an end-to-end process. Synergies can be gained, such as in the way data and other evidence are collected, which should increase efficiencies and reduce the burden on the businesses involved. Thus we hope to address the feedback from businesses and their representatives some of them felt that, if their case was referred for a phase 2 inquiry, they were starting again and having to provide the same information more than once.

Finally, the CMA’s structure reflects reforms and enhancements to the regime under which sector regulators have concurrent competition powers in relation to the industries they regulate. In the policy debate that led to the recent reforms to the U.K. competition system and the creation of the CMA, there was much focus on the extent to which this aspect of the pre-existing regime had worked. Critics pointed to a lack of use of these powers by the regulators and what they perceived as regulators’ preference for regulation to seek to protect consumers. They argued that such regulation often had unintended consequences on competition and consequential detrimental effects on the very consumers who it was aimed to protect. One solution proposed was to scrap the concurrency regime and, in line with other regimes such as Spain and the Netherlands, transfer all competition powers away from the regulators to the national competition agency, the CMA.

The U.K. government rejected this solution, if not entirely the criticisms of the pre-existing concurrency regime. Instead it decided to enhance the concurrency regime and clearly establish the CMA as the lead body in a new U.K. Competition network. In doing so, it sought to retain the valuable complementarity of the sector knowledge of the regulators with the economy-wide perspective and body of competition knowledge embedded in the CMA.

This enhancement of the concurrency regime is manifest in the CMA structure in the form of a new Sector Regulation and Concurrency unit. This unit works closely with the sector regulators, sharing our specific competition expertise and, where needed, enhancing the operational capability of competition work across the regulated industries. The early focus of the CMA's work on two regulated sectors, banking and energy, shows how the complementarity the government sought to retain is being embedded in the new agency. For example, the CMA published a joint assessment of the state of the energy market with Ofgem and the OFT. This informed Ofgem's decision, in June 2014, to refer the energy market to the CMA for a phase 2 market investigation. Similarly, the CMA has also worked closely with the Financial Conduct Authority in its market study on competition in SME banking.

IN REFORMING THE U.K. COMPETITION REGIME, THE GOVERNMENT RECOGNIZED THE VALUE OF THE PANEL MODEL AND IT HAS BEEN INCORPORATED INTO THE NEW STRUCTURE

B. *The Panel*

One of the historic strengths of the U.K. regime has been the use in phase 2 merger and market decision-making, and regulatory appeals, of groups of independent specialists drawn from an appointed panel. All case decisions at the CC were made by groups of what were members of the Commission. Neither civil servants nor members of staff, their responsibilities were to direct an investigation, examine the evidence from it, and decide its outcome. They provided the much valued fresh pair of eyes to a case and importantly a level and breadth of expertise and experience which no public body could seek to attract on a salaried, permanent basis.

In reforming the U.K. competition regime, the government recognized the value of the Panel model and it has been incorporated into the new structure. The legislation establishing the CMA, the Enterprise and Regulatory Reform Act 2013, specifically provides for a panel of members to be appointed by the Government and required to make decisions on certain cases independently not only of the Government but also of the CMA board. Pre-existing CC members transferred to the new CMA panel and new appointments have been made. The Chair of the Panel, and another member of it, also sit on the CMA Board. As under the previous system, most panel members have wide outside interests and act as part of decision-making groups at the CMA on a call-down basis as required. We have, however, increased the cadre of Panel Deputy Chairs—who support the Panel Chair by chairing individual groups on mergers and market inquiries and investigations—and who adopt regular work patterns enabling them to act as a general source of expertise for the CMA as a whole.

Thus, in both our highly skilled workforce, which can work flexibly and efficiently, and our experienced CMA panel members, the CMA has an exceptional pool of talent to inform its decision-making. Designing the agency to accommodate and attract these people is only one part of the process; applying their skills to ensure robust and transparent decision-making on decisions delegated by the board, and protecting the decision-making process on decisions which are statutorily required to be taken independently of the board, has been an equally important task. In the following section, we review how decisions on particular cases and projects will be made at the CMA and how we believe we have built on what worked well before and facilitated the marked improvements we are seeking. Finally, we briefly consider what all this means for the perennial question of institutional independence and what we mean by independent decision-making.

IV. DECISION-MAKING AT THE CMA

The enforcement record of one of the CMA's legacy organizations, the OFT, had been subject to some scrutiny during the consultation on the institutional reforms which led to the creation of the CMA. Notable setbacks, such as the withdrawal of criminal cartel proceedings against British Airways executives and adverse findings in the Competition Appeal Tribunal on enforcement cases in the construction and tobacco sectors, had generated much external commentary and some criticism. The extent to which this criticism was or was not justified goes beyond the scope of this article but the OFT had already taken steps to learn lessons from these cases¹⁰ and the CMA has built on these steps.

ONE OUTCOME FROM THIS REVIEW WAS NEW GOVERNANCE ARRANGEMENTS FOR COMPETITION ENFORCEMENT DECISIONS INCLUDING USING DEDICATED GROUPS OF SENIOR STAFF, CASE DECISION GROUPS ("CDGS"), TO MAKE SPECIFIC DECISIONS IN COMPETITION ENFORCEMENT

The then Chief Executive of the OFT launched an organizational review of enforcement procedures in the wake of the adverse decisions on the tobacco and construction cases. One outcome from this review was new governance arrangements for competition enforcement decisions including using dedicated groups of senior staff, Case Decision Groups ("CDGs"), to make specific decisions in competition enforcement. The intention was to ensure that decision-making was made at the appropriate level of the organization with sufficient quality assurance of analysis and robust challenge to developing thinking.

We have developed these proposals further at the CMA taking advantage of the new institutional design features described above. We have been able to use the new resource offered by the CMA Panel and we are now using panel members on Case Decision Groups. Furthermore, at earlier stages of a case, before the Case Decision Group is appointed, senior decision-makers are supported and challenged at key decisions or milestones by others with appropriate skills and expertise. The same principles of support and challenge at decision points are also embedded in all our decisions. For example, decision meetings in phase 1 merger investigations are attended by three senior members of staff taking the roles of chair, decision-maker, and devil's advocate to ensure an appropriate level of support and challenge.¹¹ These processes are intended to enhance the level of challenge at key decision points, increasing the robustness of decisions, and ensuring that the risks are understood and accepted.

THERE ARE IMPORTANT PROTECTIONS AGAINST THESE RISKS IN THE LEGISLATION AND WE HAVE TAKEN STEPS TO PROTECT THE PROCESS AGAINST SUGGESTIONS OF CONFIRMATION BIAS

As noted above, Phase 2 decisions on mergers and markets will continue to be made by groups of independent panel members. However, the ERRA 2013 introduced shorter statutory timescales for phase 2 markets and, crucially, brought this phase of decision-making within the new unitary authority. In doing so, it set the CMA the challenge of taking advantage of the synergies offered by a unitary authority to facilitate faster decision-making while retaining the independence of decisions between the two phases.

To facilitate a more efficient end-to-end process, and take advantage of potential synergies between phases, the CMA would normally expect to have a degree of case team continuity between, for example, a market study (phase 1) and a market investigation (phase 2) case team. This should reduce the time taken for respective decision-makers at each phase to get up to speed on the issues and background. As noted above, it should help reduce the burdens on business and address concerns that parties are providing the same information twice during different phases of an investigation.

However, a theme of responses to the government consultation on changes to the competition regime was that, while there was a recognition that there was scope for reducing timescales and streamlining the regime in these ways, creating a two-phase process within a single organization raised two potential risks: an undermining of the independence of decision-making at phase 2, and confirmation bias.

There are important protections against these risks in the legislation and we have taken steps to protect the process against suggestions of confirmation bias. The independence of phase 2 decisions is enshrined in the legislation. When making decisions on phase 2 mergers and markets, CMA groups must act independently of the board.¹² In practice, this means ensuring a clear separation between the different decision-making parts of the CMA at phases 1 and 2. To take the example of markets work, if the CMA Board decides that a market investigation reference is to be made, it refers the matter to the Chair of the Board, who is responsible for constituting the market reference group that will undertake the market investigation. To distance further the board from the decision-making group, the Chair of the Board will delegate these responsibilities to the CMA Panel Chair (or one of the Deputy Panel Chairs). The CMA Panel Chair must ensure that any Board member who might reasonably be expected to be a member of the market reference group does not participate in the Board's consideration of whether to refer the matter.

THERE ARE OTHER AREAS OF OUR PROCESSES FOR DECISION-MAKING WHERE WE HAVE BEEN INFLUENCED BY PRACTICE OUTSIDE THE UNITED KINGDOM

Thus, the panel members are new decision-makers at the second phase, who will not have made the decision to initiate or refer the case. As such, the Phase 2 process remains a “fresh pair of eyes” review from independent decision-makers.

Our decisions not only need to be robust; they need to be fair and transparent and seen to be so. We have considered carefully how we can build on the experience of the legacy organizations and reflect feedback from our stakeholders. For example, parties now have access to the decision-makers during a phase 1 merger case addressing a key concern of respondents during the consultation about the reforms to the competition regime. Similarly, and in line with best practice in the United States, we are continuing the practice of offering parties “state of play” meetings during enforcement investigations. We offer each party under investigation separate opportunities to meet the case team including the decision maker. We will advise about likely timescales and generally share our provisional thinking on the case.

There are other areas of our processes for decision-making where we have been influenced by practice outside the United Kingdom. Drawing on the model of the Hearing Officer at DG-Comp, we have introduced a new role of Procedural Officer. Operating independently from case teams, the Procedural Officer adjudicates on disputes about CMA case-team decisions on certain significant procedural issues—such as deadlines for parties’ submission of information and the confidentiality of information that the CMA proposes to disclose or publish. The Procedural Officer also chairs oral hearings with parties in enforcement cases and reports on procedural issues to the relevant decision-maker following such hearings. We are confident that the Procedural Officer will play an important role in reviewing disputed internal procedural decisions, taking account as appropriate concerns expressed by parties, and in giving confidence to parties about the rigor and fairness of our decision-making processes.

INDIVIDUAL CASES MAY END UP BEFORE THE COURTS BUT THE COLLECTIVE IMPACT OF OUR DECISIONS WILL DETERMINE HOW EFFECTIVE WE ARE AS AN AGENCY

IN TERMS OF THE WIDER COMPETITION REGIME, IT IS WORTH NOTING THE INCREASING NUMBER OF PRIVATE DAMAGES ACTIONS FOR BREACHES OF COMPETITION LAW AND THE CURRENT U.K. AND EU INITIATIVES TO MAKE THIS PART OF THE REGIME MORE EFFECTIVE

Inevitably, of course, some of our decision-making processes and the decisions themselves will end up being challenged in the courts which will decide on disputes between the CMA and those affected by our decisions. A robust appeals system through the courts is important for reasons of natural justice. The possibility of appealing decisions is an integral and essential part of the competition regime, providing parties with a route to challenge decisions they perceive to be wrong. Decisions of the Competition Appeal Tribunal and the higher courts are also important for us in setting out what is expected of us; for example, in terms of process and the standard of evidence.

This important check on our decision-making is currently under review by the Government as part of its wider recent consultation on ways of streamlining regulatory and competition appeals. The CMA has not sought to influence the outcome of this review but we note the responses of our legacy bodies and very much support the aim of making appeals focused, faster, and more efficient while also allowing for robust decision-making and proportionate regulatory accountability.

Individual cases may end up before the courts but the collective impact of our decisions will determine

how effective we are as an agency. If we are to be effective, our decisions need to result in increased competition and act as a deterrence to anticompetitive behavior for the benefit of consumers, business, and the economy as a whole. To demonstrate our performance against this ambition we will publish annually an assessment of the impact of our work against a performance framework developed by our government sponsors. This includes a challenging requirement to demonstrate direct financial benefits to consumers of ten times our costs, which will help ensure our decisions are well targeted and have impact. We will also continue the practice of our predecessor organizations by undertaking regular surveys of external stakeholders and our own staff and responding appropriately to the assessment of our performance by others.

In terms of the wider competition regime, it is worth noting the increasing number of private damages actions for breaches of competition law and the current U.K. and EU initiatives to make this part of the regime more effective, including, in the United Kingdom, giving the CMA a limited role in facilitating redress where infringing businesses wish to offer redress voluntarily. We think that greater numbers of meritorious private actions are to be welcomed as they can

THE 2013 REFORMS HAVE ENHANCED THE REGIME BY, FOR EXAMPLE, REQUIRING US TO OPERATE TO SHORTER TIMESCALES AND GIVING US ADDITIONAL POWERS OF INVESTIGATION

complement strong public enforcement and because we consider it important that those who suffer harm from breaches of competition law obtain effective redress. It will be important, however, to ensure that the public and private aspects of the overall regime work well to reinforce rather than undermine each other. In that respect, we particularly welcome the proposals to preserve incentives to engage with the CMA's cartel leniency program.

V. AN INDEPENDENT AUTHORITY

When we consider the independence of the CMA's panel groups, and the independence of their decisions from the decisions of other parts of the organization at phase 1, issues can be managed internally taking into account the inevitable scrutiny our processes will rightly receive from those affected directly by our decisions. The process of institutional reform and the creation of the CMA highlighted, however, a broader question of independence, which is currently the subject of much discussion internationally: the independence of national competition agencies from government influence.

As we have noted elsewhere, the U.K. regime has evolved over the past few decades from one where governments could influence outcomes on the basis of poorly defined public interest considerations to one where the regime is independent and respected, with a considerable body of case law, and where public interest considerations apply only in clearly defined and limited areas.¹³ The 2013 reforms have enhanced the regime by, for example, requiring us to operate to shorter timescales and giving us additional powers of investigation.

A new feature of the regime in the legislation is a requirement that the Government give us a strategic steer. This has led some to argue that this risks weakening our independence.¹⁴ In our view, these arguments do not take sufficient account of the need for any regulator, including competition authorities, to be sensitive

to political and commercial realities. It is important that national competition authorities have an ongoing dialog with Government and other stakeholders such as consumer organizations and business. It is through such dialog that the authority can ensure that it is reflecting the views of these stakeholders and that it is not operating within an “ivory tower” informed only by a theoretical understanding of how markets, competition, and the economy work.

The specific risk arising from the essential dialog with government is that it is covert and therefore, how it influences the activities of the competition authority becomes the subject of speculation. The requirement for a public strategic steer makes the high level communication from Government open and transparent. The CMA board is not bound by the steer but, quite rightly, is required to have regard to it. We would argue, therefore, that rather than undermining our independence, the strategic steer enhances transparency and helpfully hones the framework of delegation to the CMA laid down in legislation.

VI. CONCLUSION

Ultimately, however, the CMA’s independence will be earned by its record. We will be judged by how we engage with the big competition issues and how we change the way they affect consumers, business, and the economy. Doing this successfully will require high quality, transparent decisions that stand up to detailed scrutiny from the courts and stakeholders. This involves bringing together the right people with the right skills in the right organizational structure and establishing decision-making processes that ensure decisions are robust and are the product of a fair and transparent process.

We have sought to summarize in this article how we have set up the new organization to fulfil these ambitions and to bring about the “marked improvements” that are expected of us. Institutional design is important. It defines who makes decisions and how they are made. Ultimately, it is on the quality of these decisions, and the impact they have, that the CMA and the 2013 reforms will be judged. ▲

¹ David Currie is Chairman of the CMA; Alex Chisholm is Chief Executive; and Tim Jarvis is Director of Executive Office, Governance and International.

² See, for example, William E. Kovacic & David A Hyman, *Competition agency design: what’s on the menu?*, GWU Legal Studies Research Paper No. 2012-135 (November 2012).

³ William E. Kovacic, *The Institutions of Antitrust Law: How Structure Shapes Substance*, 110(6) MICH. L. REV. 1019 (April 2012).

⁴ *Id.*

⁵ The Civil Service Commission regulates recruitment to the Civil Service, providing assurance that appointments are on merit after fair and open competition. The Commission is independent of Government and the Civil Service. Civil Service Commissioners chaired selection panels for all board appointments and the most senior tier of the CMA executive team.

⁶ See Andrea Coscelli & Antonia Horrocks, *Making Markets Work Well: The U.K. Market Investigations Regime*, 10(1) COMPETITION POL’Y INT’L (Spring/Summer 2014) for further details.

⁷ References for phase 2 market investigations could also be made by sectoral regulators. This remains

the case under the CMA.

⁸ Except where a market reference is made by a sectoral regulator.

⁹ Together with the Director of Corporate Services and the Chief Executive.

¹⁰ *Enforcement of consumer and competition law – lessons in best practice and cultural changes*, speech by Clive Maxwell, then Chief Executive of the OFT, January 2014

¹¹ Mergers: guidance on the CMA's jurisdiction and procedure, ¶7.45 (January 2014).

¹² Schedule 4 to the Enterprise and Regulatory Reform Act 2013, ¶49(1).

¹³ David Currie, *The Case for the British Model of Independent Regulation 30 years on*, The Currie Lecture (May 2014).

¹⁴ Response to consultation on statement of strategic priorities for the CMA, Department for Business Innovation and Skills, ¶15 (October 2013).

Making Markets Work Well: The U.K. Market Investigations Regime

BY ANDREA COSCELLI & ANTONIA HORROCKS¹

Competition policy is recognized by the U.K. government as a key driver of productivity and growth. The CMA's market investigations regime, which has had significant impact in the United Kingdom on a variety of key sectors such as groceries, airports, and banking, is a crucial tool in this regard. While the CMA's merger and behavioral enforcement work focuses on identifying and preventing anticompetitive arrangements between parties, abusive conduct by single firms, anticompetitive mergers, and promoting compliance with competition law, the CMA's markets work complements and supports the CMA's competition enforcement and advocacy activities, and also its consumer protection functions. It looks at markets to identify structural features or behavior preventing them from functioning well and causing consumer detriment, and has powers to impose wide-ranging remedies necessary to address any adverse effects found. This article explains the history of the U.K. market investigations regime; the legal framework for the regime; reflects on past investigations—both in terms of outcomes, procedures, and benefits to consumers; and looks forward to future CMA investigations.

I. INTRODUCTION

The Competition and Markets Authority (“CMA”) is the United Kingdom (U.K.)’s new competition and consumer authority, created by the Enterprise and Regulatory Reform Act 2013 (“ERRA 13”). The ERRA 13 brought together the U.K. Office of Fair Trading (“OFT”) and Competition Commission (“CC”) and the CMA acquired its powers on April 1, 2014.

The CMA's primary duty is to seek to promote competition, both within and outside the U.K., for the benefit of consumers² and its mission is to make markets work well in the interests of consumers, businesses, and the economy.³ It is an independent non-ministerial government department with responsibility for carrying out investigations into mergers and markets and enforcing competition and consumer law.

The CMA's market investigation powers allow it to investigate whether there are features of a market that restrict, distort, or prevent competition—an adverse effect on competition (“AEC”)—and, if so, what should be done about it. Features can include structural features (e.g. concentration, entry barriers, and regulation) and supplier or customer conduct.

Competition policy is recognized by the U.K. government as a key driver of productivity and growth. The markets regime, which has had significant impact in the United Kingdom on a variety of key sectors such as groceries, airports, and banking, is a crucial tool in this regard. The CMA's merger and behavioral enforcement work focuses on identifying and preventing anticompetitive arrangements between parties, abusive conduct by single firms, anticompetitive mergers, and promoting compliance with competition law.

The CMA's markets work complements and supports the CMA's competition enforcement and advocacy activities, and also its consumer protection functions, by looking at markets to identify structural features or behavior preventing them from functioning well and causing consumer detriment, even where there has been no breach of competition law.

The U.K. regime gives the CMA powers to impose remedies necessary to address the adverse effects on competition found following a thorough, transparent, and consultative two-phase process. Remedies need to be reasonable and proportionate.

The U.K. regime is relatively unusual globally, in providing the authority with the ability to implement structural change or legally binding behavioral remedies as a result of a market investigation. The market regime has a high reputation internationally for its quality of analysis, flexibility, and transparency. It was preserved by the latest reforms to U.K. competition law. In line with reforms made to other parts of the regime, there were changes made to strengthen the regime (extending the scope of the regime to cover cross-market issues and to enable public interest references, increasing information gathering powers) and changes to streamline the regime (tighter statutory timetables).

THE U.K. REGIME IS RELATIVELY UNUSUAL GLOBALLY, IN PROVIDING THE AUTHORITY WITH THE ABILITY TO IMPLEMENT STRUCTURAL CHANGE OR LEGALLY BINDING BEHAVIORAL REMEDIES AS A RESULT OF A MARKET INVESTIGATION

This article explains the history of the U.K. market investigations regime; the legal framework for the regime; reflects on past investigations—both in terms of outcomes, procedures, and benefits to consumers; and looks forward to future CMA investigations.⁴

II. HISTORY OF U.K. MARKET INVESTIGATIONS

Although the U.K. market investigations regime in its present form was created by the Enterprise Act 2002 (“EA02”), its origins can be traced to 1948 when the Monopolies and Restrictive Practices Commission was established to review monopolistic practices. This regime was substantially continued in the Fair Trading Act 1973. The Fair Trading Act required the Director General of Fair Trading to keep commercial activities under review in order to discover monopoly situations⁵ and gave the Director General the power to make monopoly references to the Monopolies and Mergers Commission (“MMC”).⁶ The MMC then had to apply a “public interest” test to what were known as “complex monopolies” before making recommendations to ministers. The Minister would take the final decision as to whether and how to remedy the complex monopoly situation.⁷

In 2001 the Department of Trade and Industry carried out a consultation on the U.K. competition regime (*2001 White Paper*).⁸ This followed the introduction of a new framework for investigating anticompetitive agreements and abuses of dominance in the Competition Act 1998. At that stage the U.K. antitrust regime was unusual compared to some of its more established global counterparts in having decision-making power in relation to mergers and market investigations vested with government ministers. The *2001 White Paper* set out a blueprint for a world-class independent competition regime for the United Kingdom,

noting the importance of competition to strong and effective markets, helping consumers get a good deal and driving innovation and productivity. This blueprint resulted in the creation, from the MMC, of the CC and wider powers for the OFT.

In recommending retaining the ability to investigate markets, the *2001 White Paper* noted that:

The ability to investigate markets as a whole is an important feature of our competition regime. Where a market is not working well, the complex monopoly provisions of the Fair Trading Act 1973 provide a very effective means of taking action, complementing powers under the Competition Act 1998 and EC law. Economic evidence shows that in markets where competitors engage in parallel behaviour, competition is often reduced to the cost of consumers.⁹

The U.K. market investigations framework was established by EA02. It gave the CC ultimate decision-making power in relation to both the assessment of harm and remedies. Ministerial power was retained in relation to a small, defined set of markets where public interest issues might arise (national security), with the addition of any other public interest markets requiring Parliamentary approval. The EA02 gave the CC the power to remedy any AECs it found, as well as implement structural changes or legally binding behavioral remedies to address market-wide issues.¹⁰

The regime set up a two-stage administrative review process, with the decision on substance at Phase 2 taken by an independent panel, rendering a full review on the merits unnecessary. This process has been replicated in the CMA.

MARKET INVESTIGATIONS ARE COMPLEX AND INTENSIVE—FOR BOTH THE PARTIES INVOLVED AND THE AUTHORITY

The 2001 changes also set up a specialist tribunal to hear appeals in competition matters—the Competition Appeals Tribunal (“CAT”).¹¹ Appeals in markets cases are on judicial review grounds.¹² The legal framework of the regime is described further below.

A market investigation (or “Phase 2” investigation) could be commenced as a result of a reference by either the OFT or a sector regulator, on the basis that there were features of a market that may have an adverse effect on competition.¹³ The OFT was under a duty to keep markets under review and refer those which it found were not working appropriately.¹⁴

Market investigations are complex and intensive—for both the parties involved and the authority. As such, prior to referring a market for investigation, the first-phase regulator would generally carry out a market study to examine the causes of why particular markets may not have been working well, taking an overview of regulatory and other economic drivers and patterns of consumer and business behavior.

These market studies (or “Phase 1”) examine the causes of why particular markets are not working well for consumers, leading to proposals as to how they might work better. Market studies can be used proactively to target areas where competition might not have been working very well for consumers, but for reasons that

might not be readily addressable using standard enforcement routes. The proactive nature of market studies was a key part of the underlying thinking of the government in introducing the regime, as competition policy had increasingly been seen as a key element of overall productivity policy, and it was consequently thought to be important to allow the competition authority discretion to target specific areas of the economy where competition problems might be particularly pronounced.

Market studies can look beyond individual abuses of dominance, agreements that reduce competition, or breaches of specific consumer protection legislation and consider all aspects of market structure and conduct. They were also the tool that best linked the consumer protection and competition responsibilities of the OFT (and now do so in the CMA), and which can respond to concerns where public restrictions may be distorting a market. As such, market studies can lead to a wide range of outcomes,¹⁵ including: (i) a clean bill of health, (ii) actions which improve the quality and accessibility of information to consumers, (iii) encouraging businesses in the market to self-regulate, (iv) making recommendations to the government to

THESE REFORMS LED TO THE
CREATION OF THE CMA, CREATING A
UNITARY AUTHORITY THAT WOULD
UNDERTAKE BOTH PHASE 1 AND PHASE 2
INVESTIGATIONS

change regulations or public policy, (v) taking competition or consumer enforcement action, or (vi) accepting undertakings in lieu of reference.^{16 17} The majority of market studies have led to outcomes other than a market investigation reference.

The OFT carried out more than 50 market studies and the CC 16 market investigations between 2004 and the end of March 2014, developing detailed guidance and processes to ensure expert analysis, flexibility, and transparency. A 2007 peer review noted that the regime was at the forefront of global best practice in these areas.¹⁸

In 2011, as part of the U.K. government's growth agenda, the Department for Business Innovation & Skills ("BIS") issued a consultation for further reform, having noted that despite its strengths there were aspects of the regime that it believed could work better.¹⁹

These reforms led to the creation of the CMA, creating a unitary authority that would undertake both Phase 1 and Phase 2 investigations. The market investigation framework was retained with some amendments, which included changes to the time frames for market investigations and remedies to reduce the time scales of these processes, as well as a decision to widen the scope for investigations to include cross-market practices.²⁰ A further change was to provide the CMA with powers to report on public interest issues in markets, when requested by the government. Despite the ERRA13 amendments, the substantial characteristics of market investigations remain the same, having been reviewed for the second time in a decade. Details of changes to the market investigations framework and process are further set out below.

III. THE LEGAL FRAMEWORK AND CHANGES UNDER THE ERRA13

A. *Enterprise Act 2002*

1. Market Studies

The first step towards a full market investigation has, to date, generally been a preliminary investigation into a market to determine whether there are characteristics of that market that deem it worthy of further study. The OFT was required under the Enterprise Act to keep U.K. markets under review.²¹ It would carry out preliminary work as to whether further investigation of a market was warranted (as part of its general prioritization of work)—this was the “pre-market study” stage. To do so, it used a tool called a “market study.” As noted above, these were informal investigations into certain areas of economic activity, and they were not specifically recognized in law until ERRRA 2013. There was no legal test for instigating a market study.

Some examples of the range of forms which market studies can take, and the range of outcomes which can result, are set out in Table 1 below.

Table 1: Market studies can take a range of forms and result in a range of outcomes²²

Strategic studies	Remote Communities – aimed to understand responsibility for frequent concerns raised by such communities	Advertising of Prices – research into advertising and pricing to determine which practices may mislead consumers and prioritise where to take action
Longer & larger studies	Personal Current Accounts – included analysis of bank data and customer surveys including psychological research. Significant recommendations and follow-up	Homebuilding – included surveys, analysis of land-banks, planning permissions and carried out case studies. Sector found to be broadly competitive
Shorter studies	Sale & Rent-back – a quick study of a growing sector which recommended statutory regulation	Medicines Distribution – examined changes to distributing medicines following significant volume of complaints. Recommended regulatory change
Led to enforcement	Quick House Sales – launched due to concerns about vulnerable consumers. Study led to consumer enforcement and undertakings being given by three firms	Outdoor Advertising – study prompted by concentration in the sector. Led to competition enforcement action on media owners’ contracts with local authorities
Led to MIR and significant reform	BAA Airports – A market study and investigation of BAA’s airports led to structural changes	Payment Protection Insurance - Super-complaint, market study led to market investigation and subsequent action
Recommendations for change to Government	Pharmaceutical Price Regulation Scheme – proposed a value-based pricing alternative to current scheme. Recommendations gradually taken forward over recent years	Defined Contribution Workplace Pensions - agreement secured from Pensions Regulator at the time of conclusion of the study for reforms to the sector

As shown in the above table, a market study can lead to a wide variety of further action (consumer information campaigns, recommendations to government, consumer or competition enforcement). However, some remedies could only be effected following a Phase 2 market investigation. When considering whether it was appropriate to make a reference, the OFT would consider whether it (or another regulatory or government) could remedy the issue.

The OFT had the power to refer a market to the CC for a statutory market investigation. The reference test was whether:

the OFT has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.²³

The market investigation reference was required to specify the goods and services to which the feature of the market related and could be framed to confine the CC's investigation to considering certain features of the relevant market.

The OFT exercised the power to make market investigation references concurrently with sector regulators and two references were made to the CC by sector regulators between 2004 and the end of March 2014 (Rolling Stock Leasing and Movies on Pay TV).²⁴ As at the date of publication the Office of Communications ("Ofcom"), the Gas and Electricity Markets Authority ("Ofgem"), the Water Services

THE SUPER-COMPLAINT PROCESS WAS INTENDED TO BE A FAST-TRACK SYSTEM FOR THESE BODIES TO BRING THESE MARKET FEATURES TO THE ATTENTION OF THE OFT OR ANOTHER REGULATOR IN ORDER TO OBTAIN A VIEW ON WHAT ACTION (IF ANY) IT WOULD TAKE

Regulation Authority ("Ofwat"), the Northern Ireland Authority for Utility Regulation ("URegNI"), the Office of Rail Regulation ("ORR"), the Civil Aviation Authority ("CAA"), and Monitor have concurrent competition powers and the ability to make market references. Under the Financial Services (Banking Reform) Act 2013 the Financial Conduct Authority ("FCA") will also have the concurrent power to apply Part 4 of the EA02. These powers will take effect on 1 April 2015.

Generally these regulators will also carry out a market study prior to making a reference (see, for example, the recent Ofgem/CMA market study into the energy market that led to a market investigation reference to the CMA in June 2014).

The OFT or the current regulator also had powers—when it considered that the test for a reference to the CC was met—to accept undertakings to remedy the AEC or detrimental effects on customers resulting from it, in lieu of such a reference.²⁵

In addition, section 11 EA02 provided designated consumer bodies the right to make a complaint about any feature or combination of features of a market in the United Kingdom for goods or services that

appeared to be significantly harming the interests of consumers (a “super-complaint”). The super-complaint process was intended to be a fast-track system for these bodies to bring these market features to the attention of the OFT or another regulator in order to obtain a view on what action (if any) it would take. Some of the early references were made following complaints by super-complainants (Home Credit, Northern Ireland Personal Current Account Banking and Payment Protection Insurance).

The Act also provided for ministerial power to make references, under certain conditions, if dissatisfied with a decision of the OFT not to make a reference, but none were made in the 2004-2014 period.²⁶

Given this structure for receiving references, the CC did not decide which cases it would receive and devote resources to, as references would be made by the OFT, a sector regulator, or Government.

2. Market Investigation References

The CC was required to decide whether any feature or combination of features of each relevant market prevents, restricts, or distorts competition in connection with the supply of any goods or services in the U.K.²⁷ The decision-makers were members of the CC, appointed to form an inquiry group for the purpose of making a decision on the market investigation reference. The members were independent decision-makers at the second phase who had no involvement with the decision to initiate or refer the case. They were drawn from a panel of experienced industry and competition experts, with a range of skills and backgrounds.²⁸

If an AEC was found, the CC was required to decide whether action should be taken to remedy, prevent, or mitigate that effect or any detrimental effect on customers that resulted from or might be expected to result from the AEC.²⁹ The CC was required to achieve as comprehensive a solution as was reasonable and practicable, having regard to the AEC. It could take into account any relevant customer benefits of the market concerned when determining the remedy. The CC had order-making powers to oblige firms to change behavior, but could also agree on behavioral and/ or structural changes with parties via the use of undertakings. Once final undertakings or orders were in place, the enforcement obligation shifted back to the OFT (or sectoral regulator, as relevant). The approach to remedies, an area of major innovation by the CC, and some of the remedies that have been applied in previous market investigations, are further explained below.

The EA02 placed timeliness and transparency requirements on the CC, requiring that the CC publish a report setting out its decisions, reasons for its decisions, and such information as it considered appropriate for facilitating a proper understanding of those questions and its reasons for its decisions, within two years of the reference.³⁰

B. Changes to the Regime—ERRA 13

Following the BIS Consultation of 2011 the market investigations regime was kept largely the same, with the framework outlined above little changed.

The ERRA13 makes provision for the governance and decision-making structure of the CMA reflective of the fact that the CMA is responsible for the conduct of both Phase 1 market studies and Phase 2 market investigations. The design of the new institution has kept the use of an independent panel of decision-makers at Phase 2.³¹

The CMA Board is responsible for key decisions relating to market studies and the making of market investigation references. If the CMA Board decides that a market investigation reference is to be made it refers the matter to the CMA Chair, who is responsible under the ERRA13 for constituting the market reference group that will undertake the market investigation. In practice, the CMA Chair will delegate these responsibilities to the CMA Panel Chair. As in the previous institutional structure, the decision-makers are groups of CMA members drawn from an independent panel (see above).

The CMA Board is required to make rules of procedure for market reference groups. Subject to these rules, groups can decide their own procedures. The CMA Board may also issue guidance on market investigation procedures, to which market reference groups must have all due regard when conducting market investigations.³³

The decision-making structure described above ensures that key decisions in market studies and subsequent market investigations are made by separate persons within the CMA. However, at the staff level, to avoid unnecessary duplication and to facilitate an efficient end-to-end markets process, the CMA would normally expect to have a degree of case team continuity between the market study and market investigation case teams.³²

THE DECISION-MAKING STRUCTURE DESCRIBED ABOVE ENSURES THAT KEY DECISIONS IN MARKET STUDIES AND SUBSEQUENT MARKET INVESTIGATIONS ARE MADE BY SEPARATE PERSONS WITHIN THE CMA

In addition to the changes in institutional structure affecting the market investigation regime, the ERRA 13 introduced some specific changes, which are summarized in Table 2 below.

Table 2: Key changes to the market investigation regime from ERRA13

Status of Market Studies	Not formally defined in law. Undertaken under OFT’s general powers. Have, however, always been approved by OFT Board.	Formally defined in law. To commence requires CMA Board approval to issue a market studies notice
Delivery timescales for market studies	Not specified – although OFT had set internal ambition to deliver references in 6 months and full studies in 12 months.	Reference required to be consulted on within 6 months of notice being issued - reference within 12 months. Full market studies within 12 months.
Information gathering powers at phase 1	None (aside from in period when a reference is being consulted upon)	CMA has information gathering powers once market studies notice has been issued
Types of reference	Standard market references – whether features of a market prevent restrict or distort competition.	In addition, introduced: cross-market references public interest references to look at competition issues alongside other pre-specified public policy objectives.
Delivery timescales for market investigations	Two years	18 months (plus 6 months for “special reasons”)
Delivery timescale for implementation of remedies following a market investigation	Unspecified	6 months (plus 4 months for “special reasons”)

Market studies are conducted under the CMA’s general review function in section 5 of the EA02. The ERRA13 introduced a formal requirement for a market study to be commenced by the issuing of a market study notice when the CMA exercises its function under section 5 for certain specified purposes.³⁵ Once such a notice has been issued, the statutory time limits and compulsory information gathering powers come into effect. These two changes were designed to work together—the assumption being that quicker studies could not be carried out unless information could be gathered more quickly. The OFT had previously gathered information on a voluntary basis.

The ERRA 13 also brought in statutory time limits for Phase 1 market studies (12 months), market investigations (18 months—extendable by six months for special reasons) and implementation of remedies

following a market investigation (six months—extendable by four months for special reasons). If the CMA wishes to make a market investigation reference, it must commence consultation within six months of initiating a market study.

A further change introduced by the ERA 13 is to enable the CMA to review conduct features that affected a number of markets (“cross-market references”), where it is expedient to do so. Such references are not expected to be numerous (as in many cases even a specific feature, e.g. barriers to switching, will differ significantly depending on the market) but this new ability will assist the CMA where features are identified which can be remedied in more than one market without requiring the significant resource of two separate inquiries.

THE CC HAS GENERALLY TAKEN A CONSERVATIVE VIEW IN DETERMINING LIKELY DETRIMENTS, MEANING THAT THE ACTUAL BENEFITS MAY BE GREATER THAN ESTIMATED ^a

Finally, the ERA 13 introduced an ability for the CMA to investigate public interest issues in market investigation references. The Secretary of State now has the power to make two different types of public interest references, only the latter of which is new: restricted public interest references (these are references that require the CMA to investigate competition issues, while the Secretary of State investigates defined public interest issues in relation to the matter referred); and full public interest references (this is a new type of reference requiring the CMA to investigate defined public interest issues alongside competition issues in relation to the matter referred). Part of the rationale for this wider scope was the view that the CMA may be well placed in future to carry out the sort of public interest-focused market reviews that had previously required the setting up of Independent Commissions (e.g. the Independent Commission on Banking).³⁷

IV. MARKET INVESTIGATIONS UNDER EA02

The first market investigation to occur under the EA02 was Store Cards,³⁸ which the CC received in 2004. Over the following decade, the OFT conducted over 50 market studies,³⁹ 11 of which resulted in a reference to the CC for a market investigation. The five other CC investigations resulted from regulator referrals and super-complaints.

It is estimated that over the period 2007-2010 consumers directly saved £345m per year⁴⁰ as a result of the OFT’s work on market studies, the CC’s work on market investigations, and reviews of orders and undertakings.⁴¹ However, measuring the avoided detriment is not straightforward and the CC has generally taken a conservative view in determining likely detriments, meaning that the actual benefits may be greater than estimated.

As noted above, the CC carried out 16 market investigations under the EA02, three of which (Private Motor Insurance, Payday Lending, and Private Healthcare) had not reached the stage of final report at the time of creation of the CMA. The work on these cases, along with cases which were already in the remedies implementation phase (such as Aggregates, Cement and Ready-Mix concrete) continues in the CMA.⁴²

Like market studies, market investigations can also vary widely in their scale, depending on the complexity of the market, the number and type of parties involved, and the data available to assess the market. Figure 1 below shows the size of some of the sectors investigated.

Figure 1: Size of sectors investigated

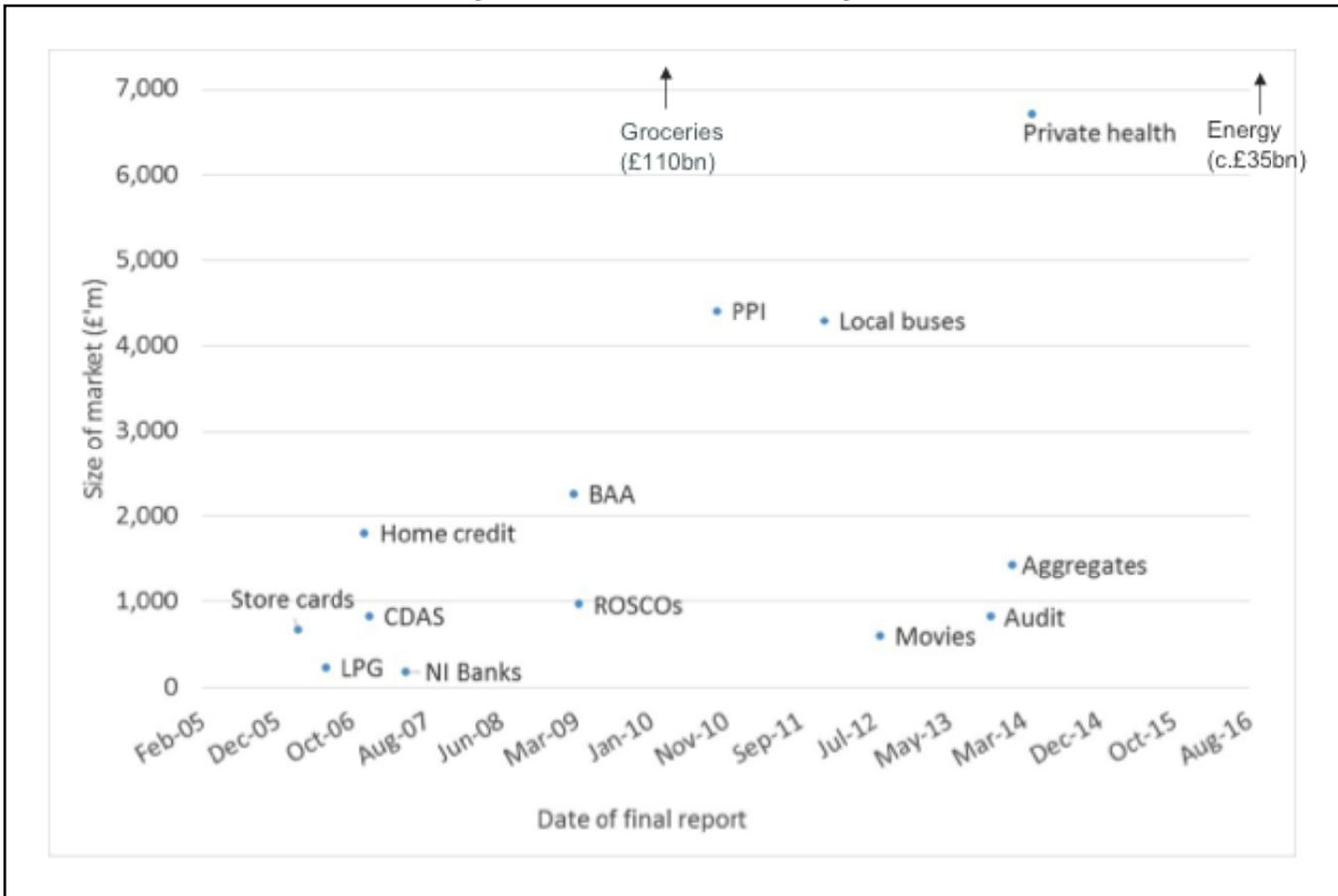


Table 3 sets out the market investigations carried out by the CC between 2004 and 2014.

Table 3: Competition Commission market investigations under EA2002

Name	Decision Date	Origin	AEC Finding	Appeal	Appealed / change in remedy	Remedies
Store Cards	2006	OFT	Yes	No	No	Credit providers required to provide more and better information on monthly statements (e.g. APR warning) PPI to be unbundled from other elements of store card insurance
Liquefied petroleum gas	2006	OFT	Yes	No	No	Measures to be introduced to enable tank transfer to make switching easier Changes to customer contracts required (including to notice and exclusivity periods) Information on the switching process to be standardised and improved
Home credit	2006	Super-complaint	Yes	No	Yes - order varied due to change of circumstances namely the coming into effect of the EU's Consumer Credit Directive (CCD)	Lenders obliged to share creditworthiness data with Credit Reference Bureaux Price comparison website established Early settlement rebate rules made fairer

Classified Directory Advertising Services	2006	OFT	Yes	No	No	Yell's Yellow Pages advertisements to remain subject to a price control Yell required to publish rate card and prepare accounts for the OFT of its UK printed regulated directory business. ⁶⁹
Northern Irish Banks – Personal Current Accounts	2007	Super-complaint	Yes	No	Yes - order varied due to change of circumstances namely the coming effect of CCD as transposed into UK law via a group of six Consumer Credit Act 1974 Regulations.	Banks required to provide better and clearer information on services, charges and interest rates Customers to be given at least 14 days' notice before charges and interest deducted from account Improvements to switching process introduced

Rolling Stock Leasing companies	2009	Office of Rail Regulation	Yes	No	No	Rolling Stock Leasing companies obliged to provide set of information to train operating companies in lease rental offer Non-discrimination requirements in Rolling Stock Leasing companies' Codes of Practice removed Recommendations made to DfT and Transport Scotland (including to introduce longer franchise terms) - not pursued by Government
---------------------------------	------	---------------------------	-----	----	----	---

Groceries	2010	OFT	Yes	Yes ⁷⁰	Partial - the remedy to introduce a competition test in planning decisions on larger grocery stores was amended to include a materiality threshold (less than 300 sq metres groceries sales area and the store has not in the immediately preceding five years been extended).	Recommended a 'competition test' be included in planning decisions on larger grocery stores – not pursued by Government Large grocery retailers prohibited from imposing new restrictive covenants Groceries Supply Code of Practice strengthened and extended and recommendations made about its enforcement; Government introduced legislation that created an Adjudicator
Payment Protection Insurance	2011	Super-complaint	Yes	Yes ⁷¹	Partial - the point-of-sale prohibition remedy would stop the completion of sales of PPI during the sale of the associated credit product, however retail PPI was exempted from this remedy	Ban on sale of PPI during sale of credit product and for 7 days afterwards Single-premium policies prohibited Measures to improve information available to make it easier to compare, search and switch

BAA Airports	2011	OFT	Yes	Yes ⁷²	No	BAA to sell three of its airports within two years (starting with Gatwick, then Stansted, followed by either Glasgow or Edinburgh) BAA required to improve consultation with airlines at Aberdeen airport and publish certain financial and other information Recommendations made to CAA (about Heathrow) and DfT (airport policy)
Local Buses	2011	OFT	Yes	No	No	Local bus operators that manage bus stations required to provide access to bus stations for rival operators on fair, reasonable and non-discriminatory terms. Number of recommendations made to DfT (eg on conduct and powers of local transport authorities)
Movies on Pay TV	2012	Ofcom	No	No	N/A	N/A

Audit	2013	OFT	Yes	No	No	FTSE 350 companies to tender for audit services at least every 10 years and their audit engagement to be reviewed on average every 5 years 'Big 4 only' clauses in loan agreements prohibited Accountability of external auditors strengthened
Aggregates, Cement & Ready-Mix concrete	2014	OFT	Yes (in cement ⁷³ only)	Yes ⁷⁴	Ongoing	Lafarge Tarmac to divest a cement plant (and some accompanying RMX plants if necessary) to facilitate entry of new cement producer Restrictions placed on timing of publication of GB cement market data and suppliers prohibited from generic price announcement letters to customers Measures to promote competition in GGBS supply chain

Private Healthcare ⁷⁵	2014	OFT	Yes	Yes	Ongoing	A restriction or ban on certain benefits and incentive schemes provided by private hospital operators to clinicians. A combination of measures to improve the public availability of information on consultant fees and of information on the performance of consultants and private hospitals The divestiture by HCA of either the London Bridge and the Princess Grace hospitals or the Wellington hospital including PMC Measures to ensure that arrangements between NHS trusts and private hospital operators to operate or manage a PPU will be capable of review by the CMA.
Private Motor Insurance	Ongoing	OFT	Ongoing	-		-
Payday Lending	Ongoing	OFT	Ongoing	-	-	-

In all but one case to date (Movies on Pay TV) an AEC was found in at least one market and remedies imposed.

Table 4: Competition Commission market investigations remedies under EA02⁴³

	Customer information	Switching Remedies	Lower entry barriers	Recommendations	Controlling outcomes	Structural remedies
Store Cards	X	(X)				
Domestic bulk liquefied petroleum gas	X	X				
Home credit	X	X	X	(X)	X	
Classified Directory Advertising Services					X	
Northern Ireland Personal Current Account Banking	X	X				
Groceries				X		X
Payment Protection Insurance	X	X		(X)		
BAA Airports			X	X		X
Rolling Stock Leasing	X	X	X	X		
Local Bus Services	(X)		X	X		
Statutory Audit Services	(X)	X	X			
Aggregates, Cement and Ready-mix Concrete	X					X
Private healthcare	X	(X)	X			X

Market investigation remedies typically focus on addressing the cause of the competition problem in order to make the market more competitive in future. They may be behavioral (e.g. information remedies or measures to reduce barriers to switching) or structural (e.g. divestment of business or assets). Remedies may also include recommendations to others—such as government, regulators and public authorities—in particular to change existing legislation. Successive governments have committed to respond within 90 days to any recommendation, indicating what action, if any, they propose to take.

Most remedies have been designed to open up markets, improve information to customers, or lower barriers to entry or switching. Out of all cases⁴⁴ to date, the CC decided that divestments were necessary in three cases—BAA-Airports; Aggregates, Cement and Ready-mix Concrete; and Private Healthcare—of which the latter two are currently under appeal. Remedies controlling outcomes (e.g. regulation of prices) have only been imposed twice.⁴⁵ Many of the CC's remedies have involved addressing consumer behavior rather than, or in addition to, the behavior of the supplier being investigated. For example, in Store Cards, Home Credit, and PPI a variety of information remedies were imposed to enable the customers to make better-informed choices, in order to improve competition.

REMEDIAL POWERS HAVE BEEN USED CAREFULLY, TO DESIGN PROPORTIONATE RESPONSES TO BEHAVIOR AND MARKET FEATURES THAT ARE ADVERSELY AFFECTING COMPETITION

The CC was able to utilize the wide powers available to it, which the CMA has retained, to design the most appropriate remedy to address the harm in a proportionate, consumer-focused manner.

While the OFT was responsible for monitoring market investigation remedies generally, in many cases the investigation involved regulated markets and, therefore, third-party regulators or government departments (e.g. in the case of Rolling Stock Leasing Companies) were also involved in designing and monitoring the remedy implementation. It is notable that a number of investigations involved elements of financial or insurance regulation (Store Cards, Home Credit, Northern Irish Banks—Personal Current Accounts, Payment Protection Insurance, Audit, Private Motor Insurance, Payday Lending) and another three investigations involved regulators with concurrent competition powers (Rolling stock leasing companies, BAA-Airports, Movies on Pay TV). One further investigation—Groceries—resulted in the creation of an additional regulatory scheme for the sector in the form of a strengthened Groceries Supply Code of Practice and a new Groceries Adjudicator.

A. Consumer Benefits of Market Investigation Remedies

Creation of market investigation remedies is by its nature a complex, information-intensive, and time-consuming process, with the need to not only consult with market participants but also with industry-specific regulators. The CC honed its ability to design complex remedies over the past decade, which will stand the CMA in good stead to continue this work.

There are several means by which market investigations can create benefits for customers: introducing measures that directly address or resolve the AEC and any customer detriments (i.e. remedies); affecting or influencing other regulators; creating an effect on parties' behavior via scrutiny of the sector;⁴⁶ and empowering customers to make better choices and address detriments. Remedial powers have been used carefully, to design proportionate responses to behavior and market features that are adversely affecting competition.

Evaluating Impact

Having determined that there are features of the market which may give rise to an AEC, the CMA then uses a benchmark of “a well-functioning market” to determine how the market may be judged to be performing. If it determines there are features in a market leading to an AEC, it moves to consider appropriate remedies.

Remedies seek to provide as comprehensive a solution as possible to the adverse effects on competition and any detrimental effects on customers, both price and non-price. That is, the remedy should address the detriment found but, as explained above, this is not something that can be quantified precisely. As such, the impact on competition needs to be assessed broadly.⁴⁷

Consideration of whether remedies are necessary and identification of the right remedy are highly dependent on the facts and context of the investigation. The clear preference is to deal comprehensively with the cause(s) of the AECs wherever possible, and by this means significantly increase competitive pressures in a market within a reasonable period of time. AECs are likely to result in costs to the U.K. economy and remedies can facilitate substantial benefits, facilitating economic growth and increasing choice for customers.

The CMA will assess the extent to which different remedy options are likely to deal comprehensively with the AECs. In evaluating the effectiveness of a particular remedy, the CMA will take account of: (i) the fact a remedy should be capable of effective implementation, monitoring, and enforcement; (ii) the timescale over which a remedy is likely to have an effect (with remedies showing results in a short time being favored, but packages of measures which show effects over a longer duration being considered in some cases); (iii) current law and regulation and legal/ regulatory changes which are expected to occur; and (iv) the manner in which the measures may interact with each other.

The CMA will also have regard to the proportionality of different remedy options, guided by the principle that a remedy should: (i) be effective in achieving its legitimate aim; (ii) be no more onerous than needed to achieve its aim; (iii) be the least onerous if there is a choice of measures; and (iv) not produce disadvantages disproportionate to the aim.

In reaching a judgment on a particular remedy, the CMA will consider its potential effects on those persons most likely to be affected by it, paying particular regard to customers but also paying regard to the impact on the businesses subjected to the remedies and other affected parties. In its assessment it will take into account a variety of evidence and use a variety of techniques (quantitative and qualitative) to analyze potential effects of remedy options.

The CMA will also assess *ex post* the potential beneficial effects of its interventions. Evaluating the effect of the remedial action is affected by:

- a. the difficulty of determining the extent to which change results from market investigation measures rather than other factors;
- b. the ability to gather relevant information—historically parties have been less forthcoming in market rather than merger evaluation and quality/ service effects are generally difficult to measure; and
- c. the need for a reasonable period to elapse, in many cases, before the impact of measures is apparent.⁴⁸

The more an AEC reflects longer-term and structural problems within a market, the greater significance the CMA will place on long-term development of competition, rather than quantifiable benefits. However, if the remedy aims to achieve relatively predictable short-term outcomes, the CMA may choose to quantify the changes as part of its evaluation of remedies. Similarly, the CMA will consider the potential negative effects of a remedy, including the costs to business.

THE IDENTIFICATION OF ANTICOMPETITIVE FEATURES OR IMPOSITION OF REMEDIES DO NOT MEAN THAT MARKET PARTICIPANTS HAVE INFRINGED THE LAW

THE MORE AN AEC REFLECTS LONGER-TERM AND STRUCTURAL PROBLEMS WITHIN A MARKET, THE GREATER SIGNIFICANCE THE CMA WILL PLACE ON LONG-TERM DEVELOPMENT OF COMPETITION, RATHER THAN QUANTIFIABLE BENEFITS

The CC evaluated the effectiveness of the remedies it imposed as a result of market investigations and the CMA intends to continue this program. Two such assessments have been published—in relation to the Store Cards and Home Credit market investigation remedies.⁴⁹ The Store Cards assessment found that many beneficial changes to the industry (lowering of APRs and lower outstanding credit balances on store cards) occurred. The assessment also found that these changes occurred *during* the market investigation, as retailers anticipated the changes likely to be required, rather than following remedies implementation. The Home Credit assessment found that a decline in bad debts had occurred—partially due to the remedy and partially due to more stringent lending criteria during the period analyzed.

From its internal assessments, the CC saw positive impacts as a result of market-opening remedy measures in relation to the Store Cards, Home Credit, Domestic Bulk Liquefied Petroleum Gas (where rates of switching increased from 0.5 percent to 4.0 percent between the period prior to the reference to 2013), and PPI markets (where as a result of the inquiry showing the extent of mis-selling in the industry the market reduced from £4.4 billion to c£1.2 billion in size and U.K. banks put aside c€27 billion for compensation to customers).

The CC also found positive impacts for consumers resulting from the divestiture measures imposed in BAA-Airports. Since the divestiture of Gatwick Airport by BAA, customer service has improved on a number of metrics (ratio of complaints, length of security queues, customer service); capital expenditure reports have shown foreseen efficiency savings from a different approach to capital expenditure (e.g. a proposal to improve

the baggage system costing £70 million rather than £120 million under BAA's proposal); and London airports are now competing for new capacity. Finally, in a number of cases the market investigation reports have had an impact with other regulators (e.g. PPI—for the FSA; Audit—for the European Union).

The remedies imposed by the CC have resulted in substantial positive impacts and the CMA foresees this trend continuing as measures from more recent and future market investigations are implemented.

B. The Market Investigation Process—Checks and Balances

Market investigations are a thorough examination of the market referred. The CMA seeks evidence from market participants, and has extensive powers to gather information. The process is investigative and the emphasis is on diagnosis and cure rather than prohibition, punishment, or deterrence. The identification of anticompetitive features or imposition of remedies do not mean that market participants have infringed the law. However, separate enforcement action can be taken by the CMA where there is a suspected breach of the law.

Given the potential costs to business of a market investigation, the case for referral, the case for information requests, the substantive case and any remedies must be explained to the parties. The CMA has detailed processes to allow for this, as set out in its guidance.⁵⁰

Table 5 below sets out the market process, from market study through to remedial action. This set of indicative timeframes does not take into account either extensions (on the basis of special reasons) or litigation which, as explained above, can significantly increase the overall timeframe of a market investigation reference, in particular the remedies implementation phase.

Table 5: CMA market study, market investigation and remedies timeframe

Stage of process	Timeframe
Market study notice published	Commencement of market study
Notice of proposed decision on possible market investigation reference published (if applicable) • consultation started (if applicable)	Within 6 months
Market study report published • reference made (if applicable)	Within 12 months
Reference	Pre-reference sharing of appropriate information with the CMA by the referring body
'First day letter'/initial information requests Publication of initial issues statement (setting out theories of harm) Initial submissions from main and third parties	Months 1=2
Site visits	Month 3
Publication of relevant working papers Publication of annotated issues statement Hearings with parties Final deadline for all parties' responses before provisional findings	Months 5-9
Publication of provisional findings Publication of remedies notice (if relevant)	Months 11-12
Consideration of responses to provisional findings and consultation on remedies (if needed). Response hearings with parties	Months 13-15
Publication of provisional decision on remedies (if needed) Final deadline for all parties' responses before final report	Month 16
Publication of final report Remedies implementation	Month 18
Accept final undertakings or make final order	6 months
Extension ability if special reasons why final undertakings cannot be accepted or a final order made within the statutory deadline	4 months

A market investigation will generally start with a first-day letter being issued to the key main parties and a period of detailed information gathering. An issues statement is released by the CMA at an early stage in the investigation, discussing theories of harm which frame the analysis the CMA intends to pursue. The CMA's analysis is developed during this phase and internal working papers are prepared. The approach will be

disclosed ahead of the main party hearings in an annotated issues statement and possibly also working papers. The CMA's provisional view as to whether there is an AEC will be published in its provisional findings. If there is a provisional AEC finding, the CMA will consult on this finding and seek views as to possible remedies and, at a later stage, publish its provisional decision on remedies for consultation.

The investigatory procedures are set out in the detailed guidance document CC3 (revised): *Guidelines for market investigations, their role, procedures, assessment and remedies*.⁵¹ Procedures have been developed to:

LITIGATION CAN ASSIST THE AUTHORITY TO CLARIFY AND CONFIRM THE SCOPE OF ITS POWERS AND MANY OF THESE CASES HAS DONE SO

(i) fulfill and balance different demands; (ii) meet statutory time limits; (iii) use CMA and parties' resources efficiently; and (iv) ensure a thorough, disciplined, and fair process.

The requirement for fairness includes giving the parties opportunities to understand the CMA's analysis affecting them; the CMA accordingly aims to be open and transparent in its work.⁵²

The statutory requirements to consult on provisional decisions which are likely to have an impact on the interests of any person (such as the finding of an AEC or a proposed remedy), together with the investigatory procedures developed by the CC and the information shared by the CMA on its website and with relevant parties as part of its commitment to transparency, provide the parties (including third parties) with an opportunity to understand and rebut, where necessary, provisional findings made by the CMA.

One way to consider how the regime has been working is the level of change in decisions between provisional findings and final report (which show an ability by the authority to adapt its decision to new information) and the level of, and success in, appeals.

In some cases the detailed consultation process that occurred during the inquiry resulted in significant changes in the decision between the provisional findings and final report, either regarding an AEC finding or remedies. For example, in *Movies on Pay TV*, the market changed significantly following publication of provisional findings and, as a result, the CC ultimately found there was no AEC in the relevant market(s). In the *Private Healthcare* inquiry, the CC changed its findings on some aspects of the case using information provided after provisional findings and in other cases the CC used information provided in response to its provisional decision on remedies to change or further tailor its proposed remedies.

ONE WAY TO CONSIDER HOW THE REGIME HAS BEEN WORKING IS THE LEVEL OF CHANGE IN DECISIONS BETWEEN PROVISIONAL FINDINGS AND FINAL REPORT AND THE LEVEL OF, AND SUCCESS IN, APPEALS

A further safeguard to the process is the ability to appeal a decision to make a market investigation reference; a decision regarding the AEC test; or a decision as to remedies, on judicial review grounds. Appeals can be made to the CAT with, following CAT's decision, further rights of appeal to higher courts: the Court

of Appeal, and then the Supreme Court. Decisions to impose remedies in five market investigations out of 13 decisions where remedies have been imposed (BAA-Airports, Groceries, PPI, Aggregates, Cement and Ready-Mix Concrete, and Private Healthcare) have been appealed.

Litigation can assist the authority to clarify and confirm the scope of its powers and many of these cases has done so. CAT judgments, and even some unsuccessful appeals, have resulted in internal reviews of the checks and balances in the processes, to ensure the best overall procedure possible. In particular, improvements have been made in relation to explaining the cost/benefit analysis in relation to particular remedies,⁵³ transparency,⁵⁴ evidence-based decision-making, and member and case team selection.⁵⁵ Details of some of these appeals are described further below.

In two market investigations, the CC amended its remedies as a result of these interventions (PPI, Groceries) and reassessed the manner in which it analyzed the effectiveness, timeliness, and proportionality of remedies.

In 2009 the Court of Appeal found that the CC had failed to take account of relevant considerations, including in the context of proportionality, when determining the remedy in the Groceries case.⁵⁶ The Court of Appeal stated, “Whilst the precise methodology adopted for assessing these matters, and the weight to be attributed to the results of such assessments are (subject to rationality or questions of law) likely to fall within the margin of appreciation of the CC, the assessments and the weighing must take place.” An appeal in PPI involved a similar finding and remittal to the CC to review the balancing of factors when considering a remedy.⁵⁷

The BAA market investigation resulted in two further appeals.⁵⁸ In relation to one of these, on further appeal from the CAT the Court of Appeal held that in assessing the proportionality of a remedy the assessment does not occur in a vacuum. The Court of Appeal upheld the CC’s decision to require the sale of Stansted Airport, finding that it was the only effective remedy.⁵⁹

The level of appeals to the CAT has increased in recent years. Two recent challenges have been on interim procedural decisions in market investigations and were made during the course of the investigation. These resulted in amendments to the CC’s process in one case. The second was stayed, with the CAT noting that the appeal would be better pursued after the CC’s final decision.⁶⁰

V. MARKET INVESTIGATIONS IN THE CMA—MAKING MARKETS AND MIR PROCESSES WORK WELL

During 2014-2015, the CMA aims to launch at least four new calls for information, market studies, or market investigations where it has the requisite evidence, and meet all statutory deadlines on new studies launched in 2014. The CMA will seek to use its tools across its portfolio to best deliver value and meet its aims and statutory objective.

The CMA's recent vision and values statement sets out the overall ambition of the CMA, and in particular to "Use the markets regime to improve the way competition works where evidence shows it can most benefit consumers."⁶¹ The focus is both on identifying and intervening in priority sectors where

WHEN CONSIDERING REGULATORY INTERVENTION, IT IS CRITICAL TO ACKNOWLEDGE THAT INTERVENTION IS NOT A COMPLETE PANACEA TO MARKET ISSUES AND THAT REGULATORY INTERVENTION CAN FAIL

market deficiencies are clearly harming consumers, including addressing competition in developing sectors such as online markets, where consumers are vulnerable to information asymmetries biases.

This strategic emphasis is complementary to the CMA's statutory functions to "conduct studies and investigations into particular markets where there are suspected competition and consumer problems, and to require market participants to take steps to address these problems."⁶²

When considering regulatory intervention, it is critical to acknowledge that intervention is not a complete panacea to market issues and that regulatory intervention can fail, either by not having the desired consequence or by having undesired consequences. The Chairman of the CMA David Currie recently acknowledged that because of the risk of government failure, government intervention needs to be carefully limited and focused on tackling the most egregious market failures. The intervention may not be simple—functional separation for BT in the telecoms sector was a technically complicated intervention—but it needs to be focused.⁶³

By having both phases of a market review in a single agency and having stronger relations with sectoral regulators, the CMA will be better placed than its predecessors to use the markets regime to improve the way competition works where it can most benefit consumers. A joined, end-to-end process will enable the CMA to use its resources efficiently across the spectrum of work undertaken in market cases (i.e. from initial scoping, to market study, to market investigation (where relevant)).

In addition to traditional sources of comment on the regime (from judgments, parties, and their advisers), the CMA has the benefit of a wide set of third-party views on the MIR regime—both from respondents to the 2011 BIS consultation and from respondents to its own more recent consultations on markets guidance. These comments shed light not only on what worked particularly well under the market investigations regime but also on what was perceived as not working well, or was subject to limitations. It has considered these views in relation to its guidance and its internal processes and has issued guidance reflecting the changes in the regime.⁶⁴ It has also adopted the OFT's guidance on Market Investigation References and the CC's guidance on Market Investigations.⁶⁵ It has expanded on how it aims to meet its ambition of delivering faster, better markets work in its Vision & Values Statement and its Annual Plan.

THE NEW SHORTER STATUTORY TIMETABLE WILL PLACE GREATER BURDENS ON BUSINESSES INVOLVED TO PROVIDE COMPLETE, ACCURATE INFORMATION AT THE RIGHT TIME

The market investigation process has been lauded for its transparency and for the in-depth nature of

its analysis. However, the new shorter statutory timetable will place greater burdens on businesses involved to provide complete, accurate information at the right time and on the CMA to ensure its processes are robust within this new timeframe.⁶⁶

The CMA is working hard to meet the challenge of ensuring this shorter timetable does not lead to either a move to gathering significant amounts of information (and therefore impose a burden on businesses) in an informal “pre-market study” phase and/or result in a truncated process whereby greater speed undermines the procedural safeguards required for a fair process.

In line with both the CMA’s Vision & Values framework and the Government’s strategic steer, the CMA is considering potential streamlining improvements, particularly around information gathering at Phase 1, handover between Phase 1 and Phase 2, and during Phase 2, in order to meet the new 18-month timetable for completing a market investigation.⁶⁷

VI. CONCLUSION

The U.K. markets regime has recently been endorsed through the BIS Consultation as a necessary and well-functioning tool for making markets work well in the U.K. and contributing to economic growth. The CMA has carefully considered comments about the regime in the process of designing the structure of the new authority, publishing guidance, and designing internal processes. The CMA is committed to better market intervention to ensure positive impacts for consumers and business in appropriate cases.

Alongside the markets investigation regime, the CMA also has a variety of tools to investigate and prevent anticompetitive mergers, halt and impose penalties on parties abusing a dominant position, entering into cartels or other anticompetitive arrangements or abuse, and remedy unfair consumer practices. However, for the reasons described above, and as shown by the outcome of previous market investigations, promoting competition and compliance with competition and consumer laws may not suffice to ensure all markets are working effectively in the best interests of consumers.

The CMA will continue to use the market investigation regime in an objective and proportionate manner to investigate key markets and implement effective and proportionate remedies where markets are found to be dysfunctional. As the Chairman of the CMA, David Currie, recently noted:⁶⁸

while markets represent the most effective way to organise complex and dispersed economic activity, markets do not always work well. This may be because there are impediments, such as entry barriers, to competition. It may also be because competition takes a malign form, with businesses competing to gouge, rather than serve, customers. [...] designing market interventions that enhance market performance is a complex, difficult and time-consuming task, and one that is best done calmly and out of the political spotlight. And that is particularly so because it requires a lot of careful analysis to avoid interventions that have unconsidered consequences.

Promoting effective competition on a fair basis is likely to be the best way to improve outcomes for consumers. But it may require more than that. In some cases, behavioural remedies may be the right way to go [...]. In others, structural remedies in the form of divestment may be appropriate [...]. And in some cases a package may be called for.

There is no science to the devising of remedies that improve failings in markets but which avoid adverse side effects. But there is no substitute for deep, considered analysis so that remedies are based on a sound understanding of how a market operates and focused on the features that need adjusting.

That takes time, diligence, objectivity and independence. That has underpinned the reputations of the OFT and Competition Commission, and is what the CMA is determined to uphold. ▲

¹ Andrea Coscelli is the CMA's Executive Director, Mergers and Markets, and Antonia Horrocks is a CMA Project Director. The authors would like to thank Dan Cliffe for his significant contribution to this article.

² ERA 13 s25(3).

³ The CMA's Vision and Values, Annual Plan 2014/15 and Prioritisation Principles.

⁴ For further information on the institutional structure and governance of the CMA see David Currie, Alex Chisholm, & Tim Jarvis, *Institutional Design and Decision-Making in the Competition and Markets Authority*, 10(1) COMPETITION POL'Y INT'L (Spring/Summer, 2014).

⁵ The definition of monopoly included not only monopoly and dominance situations but also conscious parallelism and agreements not caught by the Restrictive Trade Practices Act 1976.

⁶ Fair Trading Act 1973, section 78.

⁸ 'A World Class Competition Regime', Department of Trade and Industry, July 2001, Cm5233

⁹ 'A World Class Competition Regime', Department of Trade and Industry, July 2001, Cm5233, paragraphs 6.1 to 6.2.

¹⁰ EA02 S138.

¹¹ EA02 s12.

¹² The Court of Appeal has made it clear in various appeals (e.g. In *British Sky Broadcasting v Competition. Commission* [2010] EWCA Civ 2) that the standard for judicial review in the CAT is no different from that in non-specialist courts (such as the High Court or the Court of Appeal itself).

¹³ EA02 s131.

¹⁴ EA02 s5 & s131

¹⁵ See further *Market Studies: Guidance on the OFT approach* (OFT519), adopted by the CMA.

¹⁶ CMA3 – Market Studies and Market Investigations: Supplemental guidance on the CMA's approach.

¹⁷ An ICN report on market studies as carried out by regulators globally noted that "The most commonly acknowledged benefits of market studies were: to identify and address market failures; to build the authority's knowledge base; to address public restrictions on competition by means of advocacy; and to reach

better and more targeted enforcement decisions.” Market Studies Project Report, ICN Advocacy Working Group, 8th Annual Conference of the ICN. Zurich, June 2009.

¹⁸ P46, Peer Review of Competition Policy, by KPMG for Department for Business, Innovation and Skills, June 2007

¹⁹ *A Competition Regime for Growth: A Consultation on Options for Reform*. The Government considered that, while the U.K. competition regime was world-leading, there was scope for improvement, in particular to improve the robustness of decisions and strengthen the regime; to support the competition authorities in taking forward high impact cases; and to improve the speed and predictability for business. Many features of the consultation did not relate to the markets regime but rather factors such as strengthening the voluntary merger regime, the operation of concurrent competition powers with the sector regulators (an area where few cases had been brought since those powers were granted in 2004), and reforming the criminal cartel dishonesty office. The features of reform considered regarding the markets regime included:

- Enabling the CMA to carry out investigations into similar practices across different markets.
- Giving the CMA powers to report on public interest issues.
- Extending the super-complaint system to SME bodies.
- Streamlining the regime by reducing timescales and strengthening information gathering powers.
- Simplifying the remedies process and updating remedial powers.

Following the consultation (*see* Government Response to Consultation March 2012), the Government decided not to extend the super-complaint system to SME bodies. Most of the other features consulted on were amended to an extent—*see* Table 3.

²⁰ In some previous cases, there was a perception that the authorities had been hindered by the requirement to refer “a market” to the CC for review when, in fact, some practices affected multiple markets and could potentially have been remedied in a single investigation, and that this may have resulted either in narrower references than appropriate or in duplicative references.

²¹ EA02 s5.

²² Table sources: Remote Communities, Advertising of Prices, Personal Current Accounts (currently being updated), Homebuilding, Sale and Rent-back, Medicines Distribution, Quick House Sales, Outdoor Advertising, BAA Airports, Payment Protection Insurance, Pharmaceutical Price Regulation, Defined Contribution Workplace Pensions.

²³ EA02 s131. A “feature of a market” was to be construed as a reference to the structure of the market or any aspect of that structure; any conduct of one or more person who supplies or acquires goods or services in the market concerned; or any conduct relating to the market concerned of customers of any person who supplies or acquires any goods or services. EA02 131(2).

²⁴ EA02 Part 4.

²⁵ EA02 ss154 and 156. This occurred in relation to the creation of Openreach following Ofcom’s Strategic Review of Telecommunications, and following the OFT’s market study into Domestic Electrical Goods.

²⁶ EA02 s132.

²⁷ EA02 s134.

²⁸ The Act enabled the Secretary of State to make a public interest intervention if relevant, EA02 s139. In such cases the CC could, if it had found an AEC, make recommendations as to remedial action to be taken

by the Secretary of State. The Secretary of State had powers to decide whether any eligible public interest consideration was relevant to the report and, ultimately, whether any remedial undertaking should be vetoed as it may operate against the public interest. EA02 s150.

²⁹ EA02 explains that a detrimental effect would be higher prices, lower quality or less choice of goods or services for consumers or future consumers, or less innovation in relation to such goods or services.

³⁰ EA02 s136 -137.

³¹ *See, supra* note 4.

³² CMA 17

³³ CMA 3

³⁴ CMA 3

³⁵ For a more detailed explanation of the purpose of market studies, see chapter 2 of *Market Studies: Guidance on the OFT approach* (OFT519). Further information on the management of market studies is contained in chapter 4 of *Market Studies: Guidance on the OFT approach* (OFT519).

³⁶ During the 26 years in which the 1973 Fair Trading Act was in force there were three pan-market references: Collective Licensing 1988; Discounts to Retailers 1981; Full-line forcing and tie-in sales 1981.

³⁷ The Vickers Commission on Banking.

³⁸ Store cards.

³⁹ OFT Market Studies. This excludes Residential Property Management and SME Banking. PCA Banking is included in the original list, and is currently being updated.

⁴⁰ Positive Impact 09/10, OFT 2010.

⁴¹ BIS Consultation 2011, p20, and footnote 11: Note that this figure (£345m) for the direct financial benefits to consumers from market studies and reviews and MIRs is different from those presented as direct benefits for consumer from the market investigation regime (£317m) in the CC's Annual Report as: i) the former takes into account all OFT market studies, including those where referral to the CC is not considered a possible option, and ii) the latter includes referrals to the CC from other regulators and the OFT is not apportioned any benefits from these MIRs.

⁴² Payday Lending Provisional Findings and Private Motor Insurance Provisional Decision on Remedies.

⁴³ Remedies in Aggregates and Private healthcare are under appeal as at June 2014 and therefore shown in a different color in Table 1.

⁴⁴ Excluding Private Motor Insurance and Payday Lending, which are active cases.

⁴⁵ Classified Directory Advertising Services and Home Credit.

⁴⁶ *See* for example Store Cards, where APRs for store cards lowered during the course of the investigation.

⁴⁷ *See* further CC3 Revised, ¶¶ 322 onwards

⁴⁸ The time frame from decision to remedy implementation can be significant when the decision is appealed. For example, the CC issued a final report in BAA-Airports in 2009, which was appealed, reconsidered in part, and a supplementary report issued in 2011 with a timeframe of two years for BAA to sell the relevant airports. This decision was also appealed. As such, although the initial reference was in 2007, the full set of remedies have only been in place since 2013.

⁴⁹ Store Cards and Home Credit market investigation assessments.

⁵⁰ CC3 (Revised), CMA 17, CMA3, CC7 Revised.

⁵¹ CC3 (Revised).

⁵² The EA02 provides for the protection of confidential information relating to individuals and businesses. But the CMA may also disclose information under certain circumstances. The CMA has processes to protect confidential information and provide disclosure where necessary. For further details, see Chairman's Guidance on Disclosure of Information (CC7 Revised).

⁵³ Tesco, PPI, BAA.

⁵⁴ BMI Healthcare v CC [2013] CAT 24.

⁵⁵ CAT and CA Appeal on BAA – EWCA 2012 Civ 1077.

⁵⁶ Tesco v CC [2009] CAT 6.

⁵⁷ Barclays v CC [2009] CAT 27.

⁵⁸ BAA v CC (No 1) [2009] CAT 35; BAA v CC (No 2) [2012] CAT.

⁵⁹ “BAA's contention that the Tribunal erred in its approach to the assessment of proportionality ignores the fact that proportionality is not to be assessed in a vacuum. Whether a remedy under section 138 of the Act is proportionate must be considered in the context of the statutory scheme as a whole. In accordance with the statutory scheme in the Act, it has been decided that there is an AEC, that action should be taken to remedy it, and that the only effective remedy is a requirement that BAA sells Stansted. That requirement is in the public interest. It is inherent in such a statutory scheme that in order to secure the public interest, BAA will lose its freedom of choice as to whether and when to sell its asset.” BAA v Commission, Court of Appeal, [2012] EWCA Civ 1077.

⁶⁰ BMI Healthcare v CC[2013] CAT 24; Lafarge & Hanson v CC [2013] CAT 27.

⁶¹ Vision, values and strategy for the CMA, p.1.

⁶² Vision, values and strategy for the CMA, p.16

⁶³ *The case for the British model of independent regulation 30 years on*, The Currie Lecture, Cass Business School (21 May 2014).

⁶⁴ Market Studies and Market Investigations: Supplemental guidance on the CMA's approach (CMA3).

⁶⁵ There are three main existing guidance documents that relate to the markets regime: *Market studies: Market Studies: Guidance on the OFT approach* (OFT519), *Market investigation references* (OFT511), and *Guidelines for market investigations* (CC3 (revised)). Other guidance documents also contain information relevant to markets cases, including: *Super-complaints: guidance for designated consumer bodies* (OFT514) and *Chairman's Guidance on Disclosure of Information in Merger Inquiries, Market Investigations and Reviews of Undertakings and Orders accepted or made under the Enterprise Act 2002 and Fair Trading Act 1973* (CC7 (revised)).

⁶⁶ As noted by Laura Carstensen, a former Deputy Chair of the Competition Commission, “Can we go faster? Maybe—we are always looking for ways to do so consistent with fair procedure; ay, there's the rub. It is interesting that whilst business in general tends to demand greater speed, business in particular (ie when it is their case under consideration) tends to value a careful approach and adequate time allowance both for them to assemble their case and for us to consider it.” She goes on to note, “The levels of transparency currently adopted in the CC may arguably exceed those that are necessary for a legally fair process. But they are an important procedural safeguard and facilitate the taking of difficult decisions.” Speech by Laura Carstensen, Deputy Chairman, Competition Commission, ‘What is a good competition authority?’, Eversheds' General Counsels' Forum, 12 November 2010.

⁶⁷ CMA Vision & Values; BIS Strategic Steer, Annex 1. The CMA's Vision & Values statement notes

that the reforms are designed to: Improve the quality of decisions and strengthen the regime; Support the competition authorities in taking forward the right cases; and Improve speed and predictability for business.

⁶⁸ *Supra* note 63.

⁶⁹ Following a review of these remedies in 2012/13 the CC decided that, due to increased internet access, these remedies should be removed immediately.

⁷⁰ Tesco appeal to groceries market investigation.

⁷¹ Barclays appeal to payment protection insurance market investigation.

⁷² BAA airports appeal to BAA airports market investigation.

⁷³ And Ground Granulated Blast furnace Slag (GGBS) a substance with similar properties.

⁷⁴ Lafarge appeal to aggregates, cement and ready-mix concrete market investigation and Hope construction appeal.

⁷⁵ Subject to appeal.

⁷⁶ BMI appeal, and AXA appeal to private healthcare market investigation.

Notes From a Small Island: Natural Justice and the Institutional Design and Practice of Competition Authorities and Appellate Courts

BY ROBERT O'DONOGHUE & TIM JOHNSTON¹

The relationship between the institutional design, decision-making powers, and policy-making functions of competition authorities raises a diverse range of complex issues. These include how the authority's independence can be safeguarded, how it is funded, how to optimize resources, how to avoid confirmation bias, how to relate with non-competition authorities (e.g., sectoral regulators with concurrent powers or overlapping jurisdiction), and the relationship with the judiciary. This article starts from the optimistic—not to mention extremely presumptuous—position of trying to use the concepts of natural justice and procedural fairness as developed in the United Kingdom as something of a template for good practice and institutional design in competition law decision-making and appeals generally. Apart from familiarity (from the authors' perspective), there are some good reasons to do so. First, outside the realms of antiquity, the United Kingdom can lay a fair claim to popularizing the notion of a rule of law. Second, the United Kingdom is one of the oldest and most prominent adopters of a system of adversarial justice where the ability to challenge evidence remains paramount. Third, the common law is characterized as much by pragmatism as strict principle. The common law has developed an adaptable, rather than rules-based, approach to natural justice. As a result we consider that it is a useful resource when considering institutional design and operation of competition authorities. The law develops in real time, and not from the basis of an historic code. Fourth, in respect of competition law specifically, a fairly rich body of case law has developed in the United Kingdom around principles of natural justice, procedural fairness, and the use of evidence. That case law certainly appears richer than the corresponding case law of the EU Courts in Luxembourg. Finally, the United Kingdom has itself undergone major institutional reform of its various competition authorities, most notably by the creation of the Competition and Markets Authority, effective from April 1, 2014. This significant exercise prompted a period of introspection as to whether, for example, the practices applied by the competition authorities for the previous decades could be improved or adapted. The resulting guidance and related documents that emerged might therefore fairly be considered to be the state of the art in these matters.

I. INTRODUCTION

The relationship between the institutional design, decision-making powers, and policy-making functions of competition authorities raises a diverse range of complex issues. These include how the authority's independence can be safeguarded, how it is funded, how to optimize resources, how to avoid confirmation bias, how to relate with non-competition authorities (e.g., sectoral regulators with concurrent powers or overlapping jurisdiction), and the relationship with the judiciary.

The design and use of evidence by competition authorities within the European Union has attracted considerable attention in recent years. In the first instance there is of course a need to ensure that the authority has the requisite legal powers, resources, and trained personnel to secure the relevant evidence. A second

important facet is the desire to ensure that the rights of defendants or other affected parties are guaranteed, in both law and practice, by competition authorities and courts to whom an appeal against their decisions lie. This has led to a lively debate in the European Union as to whether the current practices of the Commission are fit for purpose and the supervisory role played by the EU Courts in this regard.²

The increasing emphasis on due process and the gathering and appreciation of evidence by competition authorities is unsurprising. First, the fines imposed by competition authorities have increased very significantly indeed, particularly at the EU level. Fines of *circa* EUR 1 billion have been imposed on Intel, Microsoft (cumulatively), and various cartelists (cumulatively).

WHAT WAS CONSIDERED FAIR AT THE TIME OF THE EU'S INCEPTION, WITH VERY LIMITED ENFORCEMENT AND NOMINAL FINES, MAY NOT BE ACCEPTABLE TODAY

As the stakes increase, so too will concern as to process and institutional design on critical matters such as evidence. The concepts of natural justice and procedural fairness can and do adapt with the times. What was considered fair at the time of the EU's inception, with very limited enforcement and nominal fines, may not be acceptable today.

Second, the EU model of competition law has been exported with considerable success to a very large number of other jurisdictions—the International Competition Network has well over 120 members, many of whom have modeled their laws and institutions on the EU model. The export of substantive law almost inevitably leads to interest in the procedural and due process safeguards that underpin the application of that substantive law. Or perhaps more accurately, the significant fragmentation in enforcement has triggered a desire to identify the underlying common principles in relation to due process and evidence.³

Third, at least in the European Union, there has been a very significant trend towards the settlement of cases via (ostensibly) voluntary commitments, early resolution agreements, leniency, and other forms of resolution. These facilities have been applied in major global cartel cases as well as leading unilateral conduct cases. The rise and rise of these arrangements has raised twin connected concerns: whether a lack of fairness in the process leading to a prohibition decision practically compels defendants to settle cases, and whether the relative lack of formality within these settlement procedures can itself lead to procedural and evidential unfairness.

THE PROPER DEVELOPMENT OF SUBSTANTIVE COMPETITION LAW MAY BE MATERIALLY AFFECTED BY MATTERS OF PROCEDURE AND EVIDENCE AND INSTITUTIONAL DESIGN IN WAYS THAT ARE NOT ALWAYS FULLY APPRECIATED

Fourth, the issues of institutional design and procedural fairness in the European Union have taken on particular prominence in the light of the ongoing debate concerning whether the appellate role of the EU Courts complies with the requirements of Article 6(1) of the European Convention of Human Rights (“ECHR”) and the equivalent provision in Article 47 of the EU’s Charter on Fundamental Rights. If concerns arise as to the effectiveness of judicial review, this will also inevitably lead to increased focus on whether the procedure for decision-making by the Commission is deficient in material respects. Or put differently, if there

is less confidence in the administrative decision-making process, more will be demanded of the appeal courts.

Fifth, the proper development of substantive competition law may be materially affected by matters of procedure and evidence and institutional design in ways that are not always fully appreciated. If the undoubted discretion vested in a competition authority is not subject to effective procedural safeguards, the likely result will be an expansion of the jurisdiction and impact of competition law: a “mission creep.” This in turn is likely to result in an over-inclusive, or at least more haphazard, application of competition law since there may be insufficient internal checks and balances on the end-product: a competition authority’s decisions. In short, procedural deficiencies may have at least an indirect impact on the substantive application of competition law. Better and fairer procedures are likely to restrain any unwarranted ‘mission creep’.

THE COMMON LAW HAS DEVELOPED AN ADAPTABLE, RATHER THAN RULES-BASED, APPROACH TO NATURAL JUSTICE

Finally, matters of evidence and procedural fairness are not simply a one-way street intended to confer ever-increasing rights on defendants or other affected parties. Competition authorities will be better able to defend their own decision-making if appellate courts have greater confidence that the

best evidence has been gathered and in a way that is fair to those affected. If the appellate courts have a high level of confidence in the robustness of the competition authority’s institutional structure and procedures and practices in relation to evidence, they are not only much less likely to overturn decisions on matters of procedure, but are also likely have greater confidence in the decision-making as a whole.

This article starts from the optimistic—not to mention extremely presumptuous—position of trying to use the concepts of natural justice and procedural fairness as developed in the United Kingdom as something of a template for good practice and institutional design in competition law decision-making and appeals generally. Apart from familiarity, from the perspective of the authors, there are some good reasons to do so. First, outside the realms of antiquity, the United

THERE IS NOTHING LIKE UNIVERSAL AGREEMENT ON WHAT, PRECISELY, NATURAL JUSTICE AND PROCEDURAL FAIRNESS DEMAND IN THE CONTEXT OF COMPETITION LAW PROCEEDINGS (OR, INDEED, MORE GENERALLY)

Kingdom can lay a fair claim to popularizing the notion of a rule of law. Second, the United Kingdom is one of the oldest and most prominent adopters of a system of adversarial justice where the ability to challenge evidence remains paramount. Third, the common law is characterized as much by pragmatism as strict application of principle. The common law has developed an adaptable, rather than rules-based, approach to natural justice. As a result we consider that it is a useful resource when considering institutional design and operation of competition authorities. The law develops in real time, and not from the basis of an historic code. Fourth, in respect of competition law specifically, a fairly rich body of case law has developed in the United Kingdom around principles of natural justice, procedural fairness, and the use of evidence. That case law certainly appears richer than the corresponding case law of the EU Courts in Luxembourg. Finally, the United Kingdom has itself undergone major institutional reform of its various competition authorities, most notably by the creation of the Competition and Markets Authority (“CMA”), effective from April 1, 2014. This

significant exercise prompted a period of introspection as to whether, for example, the practices applied by the competition authorities for the previous decades could be improved or adapted. The resulting guidance and related documents that emerged might therefore fairly be considered to be the state of the art in these matters.

The above rather highfalutin claims should not of course be overstated. In reality competition law is a small component of national legal systems and the approach to it will be conditioned heavily by the general approach to administrative and constitutional law and the legal system in individual jurisdictions. The United Kingdom system of enforcement and appeals in competition law cases is also by no means the predominant model even within the European Union. More fundamentally, there is nothing like universal agreement on what, precisely, natural justice and procedural fairness demand in the context of competition law proceedings (or, indeed, more generally). But the pragmatism at the heart of the common law means that much of what is contained in the case law and guidance in the United Kingdom is often a useful starting point when considering what is common sense or basic good practice. In this reductionist sense it may therefore have something to commend it more generally.

What follows divides broadly into four parts:

- Part II provides an overview of how the concepts natural justice and fairness have evolved under the general common law.
- Part III deals with two separate but related aspects of the European dimension to the debate, namely (1) the standards developed under the Article 6 case law of the European Court of Human Rights (“ECtHR”) and (2) the position under EU law in respect of competition law proceedings and appeals to the EU Courts.
- Part IV sets out how the concepts of fairness and natural justice have been employed in U.K. competition law proceedings by reference to the guidance of the CMA and case law.
- Part V condenses our views into a series of core principles, set out as bullet points in the conclusion.

II. EVOLUTION OF NATURAL JUSTICE AND FAIRNESS UNDER ENGLISH LAW GENERALLY

The English common law has long antecedents in dealing with the scope and nature of the right to a fair trial and procedural fairness.⁴ The leading case concerning what English judges have traditionally called natural justice is *R v Secretary of State for the Home Department ex parte Doody*.⁵ The case concerned the setting of life sentences for serious criminals. The Secretary of State was entitled to set a minimum tariff to be served, having taken into account the view of the judge who sat at trial. The House of Lords held that the Secretary of State could not make that determination without first informing the prisoner what the sitting judge had recommended. He also had to allow the prisoner to make written submissions as to the proper punishment.

Lord Mustill's leading judgment summarized the principles of fairness from the authorities as follows (p. 560 at D-G):

What does fairness require in the present case?...1. Where an Act of Parliament confers an administrative power there is a presumption that it will be exercised in a manner which is fair in all the circumstances. 2. The standards of fairness are not immutable. They may change with the passage of time, both in the general and in their application to decisions of a particular type. 3. The principles of fairness are not to be applied by rote identically in every situation. What fairness demands is dependent on the context of the decision, and this is to be taken into account in all its aspects. 4. An essential feature of the context is the statute which creates the discretion, as regards both its language and the shape of the legal and administrative system within which the decision is taken. 5. Fairness will very often require that a person who may be adversely affected by the decision will have an opportunity to make representations on his own behalf either before the decision is taken with a view to producing a favorable result; or after it is taken, with a view to procuring its modification; or both. 6. Since the person affected usually cannot make worthwhile representations without knowing what factors may weigh against his interests fairness will very often require that he is informed of the gist of the case which he has to answer.

Thus, the judgment established two key overriding principles. First, that fairness has certain hallmarks that are likely to apply in most cases: a person who may be adversely affected will very often need to be given an opportunity to make representations and they must ordinarily be made aware (at the very least) of the “gist of the case he has to answer.” Second, that the standards that should be applied are not always the same, and will depend on the context.

Building on the principle of fairness identified in the common law, the cases may broadly be broken down into four headings:

A. *The Right of Access to the Court*

Parties to litigation must be allowed access to the court; that right has frequently been dubbed a “constitutional right” notwithstanding the lack of any written constitution in the United Kingdom. That constitutional right may be subject to qualification, for example on procedural grounds: a plaintiff may lose its claim as a result of excessive delay. However, as Scrutton J held in *R v Boaler*,⁷ the right of access to the court is “one of the valuable rights of every subject to the King... I should be slow to give effect to [any ouster of that right which] is a most

PARTIES TO LITIGATION MUST BE ALLOWED ACCESS TO THE COURT; THAT RIGHT HAS FREQUENTLY BEEN DUBBED A “CONSTITUTIONAL RIGHT” NOTWITHSTANDING THE LACK OF ANY WRITTEN CONSTITUTION IN THE UNITED KINGDOM

serious interference with the liberties of the subject.”

B. *The Right to be Heard*

The right to make submissions, on your own behalf, is an historic feature of English civil and criminal law. One of the

best known statements on this issue was set out in a case concerning the right of a local authority to demolish buildings. The plaintiff's house had been destroyed because of his failure to give proper notice of his intention to build it. Willes J held that the property should not have been destroyed without first giving the owner the right to put his objections first:⁸

a tribunal which is by law invested with power to affect the property of one Her Majesty's subjects, is bound to give such subject an opportunity of being heard before it proceeds: and that the rule is of universal application and founded on the plainest principles of justice.

C. *The Right to Know the Case Against You*

The right to be heard is closely connected to the further right to know the case against you. In *Ridge v Baldwin*, the Chief Constable of Brighton had been dismissed, after criminal proceedings were initiated against him.⁹ He was not given the right to appear before the Watch Committee (which terminated his employment) or to make submissions in his defense. The House of Lords held that the Watch Committee had acted unlawfully. As Lord Morris explained (at 114):

EQUALITY OF ARMS EXTENDS BOTH TO THE RIGHT TO PRIOR NOTICE OF THE CASE AGAINST YOU AND ALSO TO KNOW THE EVIDENCE THAT IS RELIED UPON AGAINST YOU

It is well established that the essential requirements of natural justice at least include that before someone is condemned he is to have an opportunity of defending himself, and in order that he may do so that he is to be made aware of the charges or allegations or suggestions which he has to meet: see *Kanda v Government of Malaya*. My Lords, here is something which is basic to our system: the importance of upholding it far transcends the significance of any particular case.

The common law courts have frequently described this principle as the requirement that there be "equality of arms." Equality of arms extends both to the right to prior notice of the case against you and also to know the evidence that is relied upon against you.

There has also been a substantial new body of case law, arising out of the new Closed Material Procedures (where defendants are not made aware of all of the evidence against them) in terrorism cases. The Courts have held, following *Doody*, that fairness must be determined by reference to the circumstances of the case as a whole.¹⁰

D. *The Right to Test Evidence Brought Against You*

The common law authorities establish that the right to an oral hearing is not absolute; the Court must ask whether the parties should be given an oral hearing in order to properly put their case. Where an oral hearing has been ordered, the normal position is that a party should be entitled to cross examine witnesses

who have given evidence against them.¹¹ In a criminal case, the House of Lords has held that a defendant must know the identity of the party making allegations and accusations against them.¹² Witness anonymity is only allowed in cases where Parliament has expressly provided for it.

III. THE EUROPEAN DIMENSION

A. *The ECHR Dimension*

Article 6 (1) provides that:

In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law...

The precise scope of procedural protection provided by Article 6 in competition cases has been the subject of extensive judicial and extra-judicial comment in recent years. The Article 6 case law imposes a higher standard of protection in the context of criminal, as opposed to civil, cases. At first glance, the position in respect of competition matters appears clear. Regulation 1/2003 provides that any fine imposed by the Commission, in respect of infringements of competition law “shall not be of a criminal law nature.” However, legislation cannot oust the application of Article 6(1) protections if, on a proper analysis, the matters at issue

THE DISPUTE HAS TURNED, AT LEAST IN THE COMPETITION LAW SECTOR, ON WHETHER OR NOT COMPETITION LAW PROCEEDINGS SHOULD STILL BE TREATED AS “NON-TRADITIONAL” CASES THAT ATTRACT A LOWER LEVEL OF JUDICIAL SUPERVISION

fall within the scope of Article 6(1). Indeed, it had long been accepted by the EU Courts prior to Regulation 1/2003 that at least some of the Article 6(1) protections are engaged in competition law cases.¹³ That was also the unanimous view of the ECtHR in *Menarini Diagnostics v Italy*.¹⁴

The legal and procedural complexity arises out of the fact that not all criminal cases need to be treated in the same fashion. There is a longstanding historic distinction within the case law of the ECtHR between the procedural protections afforded in “hardcore” criminal cases and in less substantial matters.

The leading case (at least until recently) which elaborated on that distinction was *Jussila v Finland* (Application no 75053/01). The Applicant had had his tax returns examined by the Finnish authorities, who had imposed a EUR 308 surcharge, following reassessment.¹⁵ The Applicant challenged that determination but was not offered an oral hearing in order to contest the tax authorities’ decision. Under Finnish law, the imposition of the surcharge was an administrative punishment. Nonetheless, the Grand Chamber held that the imposition of a tax surcharge was a matter that attracted the protection of the criminal case law under Article 6.¹⁶

THE LEGAL AND PROCEDURAL COMPLEXITY ARISES OUT OF THE FACT THAT NOT ALL CRIMINAL CASES NEED TO BE TREATED IN THE SAME FASHION

However, the Grand Chamber went on to find that no oral hearing was necessary in such a case:

There are clearly ‘criminal charges’ of differing weight. What is more the autonomous interpretation adopted by the Convention institutions of the notion of a ‘criminal charge’ by applying the Engel criteria have underpinned a gradual broadening of the criminal head to cases not strictly belonging to the traditional categories of the criminal law, for example administrative penalties (Ozturk, cited above), prison disciplinary proceedings... customs law... competition law... Tax surcharges differ from the hardcore of criminal law; consequently the criminal-head guarantees will not necessarily apply with their full stringency.¹⁷

The different protections afforded in “hardcore” criminal cases, as opposed to “non-traditional” cases has become the object of intense focus in recent years. The dispute has turned, at least in the competition law sector, on whether or not competition law proceedings should still be treated as “non-traditional” cases that attract a lower level of judicial supervision.

In *Menarini v Italy* (Application no. 43509/08), Menarini had been fined EUR 6 million for participating in a price-fixing cartel in the diabetes diagnostics sector. It complained that the standard of review applied by the domestic courts was only a review of legality, implying that its Article 6 (1) rights had been breached because the Italian courts had not conducted a full merits review by a court of full jurisdiction.

The Second Section of the Strasbourg Court affirmed, once again, that the imposition of a fine in a competition law context is a criminal sanction, for the purposes of Article 6. Where such a sanction is imposed in a non-judicial context (for example by an administrative authority), Article 6 requires that it be subject to review by a court of unlimited jurisdiction.¹⁹

The features characterizing a judicial body with unlimited jurisdiction include the power to quash all aspects of fact and law of a contested decision issued by the lower body. It must in particular have competence to examine all questions of fact and law relevant to the dispute brought before it.

The Court went on to hold that, in this case at least, the review had been a review of full jurisdiction. The various appellate courts, and the Conseil d'état in particular, had examined the facts in detail and had reviewed the sanction imposed. Therefore, there had been no violation of Article 6(1).²⁰

THE DEBATE OVER ISSUES OF NATURAL JUSTICE AND THE RIGHT TO A FAIR TRIAL (AND THE IMPLICATIONS THAT THESE HAVE FOR COMPETITION LAW PROCEEDINGS) HAS IF ANYTHING, LONGER ANTECEDENTS—AND RAISES GREATER CONCERNS—AT AN EU LEVEL

However, the Court was not unanimous on this question. In a powerful dissenting opinion, Judge Pinto de Albuquerque determined that: “control by the administrative courts was simply formal since it did not touch upon the hardcore of the reasoning underlying the administrative decision to impose a fine... The applicant was deprived of an independent analysis of the grounds for its appeal.”²¹ In his

view, Menarini had not been entitled to properly challenge the findings of fact that had already been made against it.

B. *Evaluating EU Competition Law Procedure*

The debate over issues of natural justice and the right to a fair trial (and the implications that these have for competition law proceedings) has if anything, longer antecedents—and raises greater concerns—at an EU level. Two separate but related criticisms have been ventilated. The first is that the Commission’s procedures for the adoption of competition law decisions are no longer fit for purpose.²² The second is that the level of judicial scrutiny of Commission decisions in competition law appeals to the EU Courts is insufficient and, in particular, that there is a light touch review of matters said to involve complex economic assessments by the Commission.

1. Criticisms of Commission Procedure

The essential elements of the Commission’s procedures have remained in similar form since Regulation 17/62 in 1962.²³ The changes effected by Regulation 1/2003 were relatively minor in this regard.²⁴ In an attempt to address the concerns expressed, the Commission has made a number of changes to its procedures, such as having internal “peer review” teams in more difficult cases,²⁵ adding oversight from the Chief Economist Unit,²⁶ publishing Best Practices guidance on procedure for Article 101 and 102 TFEU cases,²⁷ some tinkering with the role of the Hearing Officer,²⁸ and the creation of the post of European Ombudsman.²⁹ But these changes are relatively minor overlays on a procedure that has remained largely unchanged for decades. They do not address the following fundamental criticisms:³⁰

THE MOST FUNDAMENTAL CRITICISM OF THE COMMISSION’S PROCEDURE IS THAT IT ACTS AS “JUDGE AND JURY,” WITH THE SAME OFFICIALS DRAFTING BOTH THE STATEMENT OF OBJECTIONS AND THE ULTIMATE DECISION

a. The Commission as Judge and Jury

The most fundamental criticism of the Commission’s procedure is that it acts as “judge and jury,” with the same officials drafting both the Statement of Objections and the ultimate Decision. Most of the officials are lawyers or economists and few—if any—will have had any training on making judicial-type assessments, including the skills and techniques of objective, forensic decision-making. The oral hearing before the Commission tends to be window-dressing because the same people presenting the Commission’s case are also the decision-makers. The hearing is not public and involves no cross-examination of witnesses or any other real testing of evidence.

The Commission’s recent changes to its procedures, while commendable, do not address this fundamental issue. The “peer review panel” process is private and, while reputedly probing, does not require the panel to read and review all the evidence and arguments. Their report is not made available to the defendant. The same applies to the Chief Economist’s opinion. The Hearing Officer deals only with procedural issues, and does not really deal with substantive legal or factual issues. The Ombudsman too is mainly limited to procedural issues and competition law is a very small part of the office’s overall work.³¹

BUT LOBBYING TENDS TO BE EXTENSIVE IN MAJOR COMPETITION LAW CASES, AND IN A MANNER THAT LACKS TRANSPARENCY

b. The Decision-making Process is Arcane

The actual decision in a competition law case is taken by the College of 28 EU Commissioners. These are political appointees who will not have seen any of the evidence in the case and will typically have little or no detailed awareness of the issues that arise for their decision. Lobbying of Commissioners is rare nowadays but it does occur—usually in the cases that matter most. When lobbying does occur, the submissions made are not part of the Commission’s case file and it is entirely unclear what influence they may have had on the outcome.

c. The Actual Decision-making Process Has Become Diffuse and Lacks Transparency

It is of course a democratic right of undertakings and individuals to lobby public institutions and, in particular, legislative bodies. But lobbying tends to be extensive in major competition law cases, and in a manner that lacks transparency. Commissioners, Commission officials, the Legal Service, and other Directorates-General may be lobbied but it is typically unclear who has been contacted and whether they have been influential. The chain of command may be ignored so those with formal responsibility for decision-making may not be the ones who are most influential in the actual decision-making. Again, notes of meetings will not usually appear on the Commission’s case file. As one commentator notes “the procedure in practice has become less structured, less formal, and more diffuse.”³⁴

IT HAS BEEN SUGGESTED ANECDOTALLY THAT THE COMPETITION COMMISSIONER OFTEN DECIDES THE HEADLINE FIGURE, HIMSELF/HERSELF, WITH OFFICIALS THEN TASKED WITH WORKING BACK TO THAT FIGURE USING THE FINING GUIDELINES

d. Record Fines and Significant Discretion

The levels of fines in many recent competition law cases have been staggering, with Intel fined EUR 1.06 billion in 2009 and Microsoft paying a similar cumulative amount for its various transgressions in respect of tying and interoperability abuses. This has led one commentator to say, probably correctly, that “the amount of the fines imposed by the Commission ... exceed fines imposed by the public authority in any democracy of which I am aware for any offence.”²⁵ While the Commission has published Fining Guidelines,²⁶ it has been suggested anecdotally that the Competition Commissioner often decides the headline figure, himself/herself, with officials then tasked with working back to that figure using the Fining Guidelines.

e. Commission Procedures Not Compliant With the ECHR

It is frequently argued that the Commission’s procedures do not correspond with the standards laid down in Article 6.²⁷ As a leading commentator notes:³⁸

the procedures of the European Commission in determining guilt or innocence under the competition rules, and in imposing sanctions, manifestly do not correspond to the standards established by the ECHR. Condemned parties have often invoked these arguments before the Community courts, so far with little success. The number of cases has grown and the concerns become more strident as the penalties have become fiercer.

This view is shared by others.³⁹ Concerns in this regard have become more pressing given greatly increased fines in recent years and the increasing role of the Commission as a lead enforcement agency in major cases such as *Microsoft*, *Intel*, and *Google*. Moreover, the Charter of Fundamental Rights is now fully part of EU law,⁴⁰ and guarantees as a minimum the ECHR rights. It is also envisaged that the European Union will soon become a party to the ECHR.⁴¹

2. Criticisms of “Light Touch” Judicial Review by the EU Courts

Criticism has also been voiced about the robustness of judicial review of Commission decisions in competition law appeals.⁴² The EU Courts have developed a self-imposed restraint based on limited oversight of “complex economic assessments.”⁴³ This is not objectionable in itself—on matters of economic policy or judgment there may not be a single “right” answer—but it has been suggested that the notion of limited deference has been distorted. The initial notion of deference to Commission assessments had a decidedly narrow context.⁴⁴ However, its scope has expanded to comprise all manner of assessments by the Commission, including technical assessments where the Commission does not obviously possess any expertise or superior ability.⁴⁵

It has also been suggested that the EU Courts have been too unwilling in recent years to make use of their own rules of procedure on matters such as oral testimony, expert evidence (they can appoint their own expert(s)), and a willingness to inspect places and things that may be of relevance to the issues on appeal.⁴⁶

CRITICISMS OF JUDICIAL REVIEW BY THE EU COURTS HAVE PERHAPS BEEN MOST ACUTE IN RELATION TO ARTICLE 102 TFEU APPEALS

The issue of oral testimony is particularly important. Experience in adversarial litigation shows that documents read in context, with the benefit of oral explanation and testing from different parties, often have a quite different meaning to what one might suppose by merely reading the document “cold.” In legal cases, context is everything. It is also suggested that the EU Courts have not been rigorous enough in establishing a clear forensic hierarchy that distinguishes evidence according to its inherent value.⁴⁷ The best evidence in any case is clearly contemporaneous evidence. *Ex post* statements, particularly those made by rivals or customers with a vested interest in the outcome of a decision/appeal, and which have not been tested in evidence, are of much less value. The position is *a fortiori* in relation to anonymous evidence.

ON THE OTHER HAND, THE EU COURTS PLAINLY HAVE ENGAGED IN VERY DETAILED AND SOPHISTICATED REVIEW OF COMMISSION DECISIONS ON OCCASION

Criticisms of judicial review by the EU Courts have perhaps been most acute in relation to Article 102 TFEU appeals.⁴⁸ In many cases, the EU Courts have engaged in extremely cursory analysis of anticompetitive effects, based largely on assumed, or inferential, effects. For example, in *BA/Virgin*, the Court of Justice concluded that the Commission had satisfactorily demonstrated the concrete anticompetitive effect of the rebates in question.⁴⁹ But there is no reference to what this “concrete” evidence was, and it is difficult to see what it could have been given that the Commission itself did not base its decision on such concrete effects. Similarly, in *Tomra*, the Commission set out a series

of diagrams in its decision that were said to illustrate the anticompetitive “suction” effect of the Tomra rebates—based on negative prices at the margin. It was clear that those diagrams contained multiple admitted errors. However, that was considered to be irrelevant by the EU Courts on appeal.⁵⁰ The logical conclusion of those errors was that Tomra’s prices at the margin were not negative, and would therefore allow an equally efficient rival to survive. For the Commission to posit anticompetitive effects based on rivals’ difficulties to match the prices seems hollow in such circumstances. Even if this did not vitiate all of the Commission’s analysis, it clearly affected, and undermined, some of it.⁵¹

ONE SOMETIMES HAS THE IMPRESSION THAT MUCH DEPENDS ON THE COMPOSITION OF THE INDIVIDUAL CHAMBER OF THE EU COURTS THAT HAPPENS TO DEAL WITH THE PARTICULAR CASE

On the other hand, the EU Courts plainly have engaged in very detailed and sophisticated review of Commission decisions on occasion. The best recent example is *AstraZeneca*.⁵² The General Court devoted over 260 paragraphs of its judgment dealing with the issues of market definition and dominance, and engaged in a degree of review that was extremely detailed, irrespective of whether one agrees with the outcome. Ordinarily one would think that such assessments were complex economic assessments *par excellence*. As impressive, the General Court engaged in a rigorous review on the issue of causation in respect of the second abuse of deregistration. While it accepted that AstraZeneca’s deregistration tactics were capable of restricting competition insofar as it related to delaying generic entry, it held that the Commission’s case insofar as it was alleged that deregistration prevented parallel trade had not been made out. The Court held that the Commission had to demonstrate that the public authorities in question were liable to withdraw, or did usually withdraw, parallel import licenses following deregistration.⁵³ In the case at hand, the Commission had established a causal link between deregistration and the revocation of parallel import licenses in Sweden, but not in Denmark or Norway.⁵⁴ Thus, the Court annulled the decision insofar as it was alleged that AstraZeneca’s deregistration had prevented parallel trade to occur in Denmark and Norway.⁵⁵

Overall, however, there is a lack of consistency in approach from the EU Courts under Article 102 TFEU. It is, for example, extremely difficult to reconcile the Court of Justice’s apparent endorsement of the principles underpinning the Guidance Paper in *Post Danmark*⁵⁶ with its judgment, only two weeks later, in *Tomra*.⁵⁷ Another striking feature of the case law is inconsistency between Court of Justice judgments in Article 267 TFEU preliminary references and appeals in direct actions. Most of the Article 102 TFEU cases that are generally regarded as progressive arise in the context of Article 267 TFEU preliminary references, and not direct actions.⁵⁸ It is equally difficult to reconcile the low intensity of the General Court’s review in cases such as *BA/Virgin* with its robust approach in *AstraZeneca*. One sometimes has the impression that much depends on the

THE EU COURTS’ (SELF-REFERENTIAL) VIEW IS NOT WITHOUT CONTROVERSY

composition of the individual chamber of the EU Courts that happens to deal with the particular case. There does not appear to be a single overall coherent direction or approach.

C. *The EU Courts and Article 6 ECHR*

The division within the ECtHR in *Menarini* has been reflected in the commentary that has followed it. Much of the debate has focused on the standard of review applied by the EU Courts in competition law cases. Some commentators regard *Menarini* as an endorsement of the procedure and practices of the General Court.⁵⁹ Others have criticized the judgment as contradicting the ECtHR's own pre-existing case law and, in any case, regard the EU Courts practices and procedures deficient in material respects under Article 6(1).⁶⁰

NONETHELESS, WHERE AN APPELLATE COURT RARELY IF EVER ACTUALLY HEARS LIVE WITNESS EVIDENCE, THAT IS LIKELY TO BE AN INDICATION THAT THE COURT'S GENERAL APPROACH AND METHODOLOGY INVOLVES SOMETHING RATHER LESS THAN A REVIEW OF FULL JURISDICTION

The EU Courts have, perhaps not surprisingly, rejected these criticisms of their judicial review functions.⁶¹ They consider that the review of legality provided for under Article 263 TFEU—supplemented by the unlimited jurisdiction in respect of the amount of the fine, provided for under Article 31 of Regulation No 1/2003 in accordance with Article 261 TFEU—meets the requirements of the principle of effective judicial protection in Article 47 of the Charter of Fundamental

Rights and, therefore, Article 6(1). In particular, they have held that the EU Courts' review of the law and the facts means that they have the power to assess the evidence, to annul the contested decision, and to alter the amount of a fine.⁶² Accordingly, they have concluded that Article 6(1) does not preclude a "penalty" from being imposed by an administrative body such as the Commission which does not itself satisfy the requirements laid down in Article 6(1) since there is subsequent review by a judicial body that has full jurisdiction.

The EU Courts' (self-referential) view is not without controversy. Article 263 TFEU limits the EU Courts' review to Commission decisions to one of control of "legality" and this can only logically be understood as being a lesser form of review than the "unlimited jurisdiction" conferred on the EU Courts in respect of fines. Therefore, what the EU Courts' judgments on this issue appear to be saying is that, despite Article 263 TFEU only providing for a review of legality, the EU Courts **in practice** engage in a deeper review that includes review of findings of fact and—to a certain extent—more complex (non-factual) assessments made by the Commission. But this position is open to the forceful criticism that the protections of Article 6 /Article 47 are not therefore actually enshrined in the TFEU but depend on the willingness of the particular Chamber of the EU Courts to engage in a review compliant with these provisions in practice.⁶³ In short, it is argued, judicial protections ensured in this precarious way are simply not compatible with the obligations under Article 6/Article 47.

THE COURTS SHOULD NOT RELY ON ANY MARGIN OF APPRECIATION TO BE GRANTED TO THE COMMISSION AS A BASIS FOR FAILING TO CONDUCT "AN IN-DEPTH REVIEW OF THE LAW AND THE FACTS"

The critical question has now become whether the combination of a "limited" review of the decision itself, combined with the full review of the sanction by the EU Courts, is sufficient to satisfy the requirements

of Article 6(1). In *Schindler*,⁶⁴ Schindler had been fined over EUR 100 million for participating in a cartel in the elevator installation market. The Court of Justice affirmed that the combination of the roles of investigator, jury, and judge within the Commission was not, of itself, a breach of the company's Article 6 rights.⁶⁵ The crucial question is whether the decision is subject to review by a court of unlimited jurisdiction and whether or not, in practice, that court did conduct a full review. The courts should not rely on any margin of appreciation to be granted to the Commission as a basis for failing to conduct "an in depth review of the law and the facts."⁶⁶ The Court concluded that the General Court had conducted a proper and sufficient appeal on the basis of its unlimited jurisdiction.

The second plea raised in *Schindler* concerned the failure of the General Court to hear evidence from live witnesses. The Court's answer to that question was less than satisfactory. It pointed out that the burden lies on the appellant to put in evidence of the facts that it relies upon.⁶⁷ While that is true, as far as it goes, the Court failed to address the substantive issue underlying the complaint: whether the justice of the case made it useful to call witness evidence that might have a material bearing on key issues in the grounds of appeal.

IF THE DISTINCTION BETWEEN
HARDCORE CASES AND THOSE WHICH
ARE NOT HARDCORE LIES IN THE SCALE
OF THE SANCTION, THEN IT HAS CLEARLY
BROKEN DOWN IN THE COMPETITION
CONTEXT IN THE EUROPEAN UNION

The decision in *Schindler* demonstrates some of the less-than-satisfactory consequences of the *Menarini* decision. In the first place, the Court in *Menarini* answered the question by reference to the particular investigation and appeal process in the case itself. As a result, it failed to answer the critical question: whether or not control of legality review is sufficient **in principle** to satisfy the requirements of Article 6(1)? The Court made findings of fact as to what happened in that case, and avoided making findings of law that would have been of general application. Whether or not that approach was correct in this individual case, it failed to comprehensively clarify the issue. In order to determine whether or not a review of full jurisdiction has taken place, future courts will need to inquire into the precise nature of the review carried out in each particular case.

Furthermore in *Menarini* itself, the Strasbourg court did not provide much assistance as to the kinds of factors, or hallmarks, that would characterize a substantive merits review. For example, it can be argued with some force that the hearing (or otherwise) of evidence functions, in at least some cases, as an indicator of the kind of review that is being conducted. At a hearing where the appellate court calls witnesses (whether of its own motion or in response to a request by one or more parties), forms its own impressions of the evidence, and makes its own determinations as to reliability, it is highly likely that the court is conducting a substantive review on the merits. Of course a court will not always need to hear live evidence in order to conduct a full review: in the circumstances of a particular case it might well be possible to conduct a merits review without witnesses appearing in court. Nonetheless, where an appellate court rarely if ever actually hears live witness evidence, that is likely to be an indication that the court's general approach and methodology involves something rather less than a review of full jurisdiction. At the very least, in our view, an appellate court should ask itself, in all cases,

whether witnesses should be called in order to assist it in formulating its decision.

The second reason why the *Menarini* decision is unsatisfactory is that it failed to address the central underlying issue within the Article 6 case law: the distinction between “hardcore” and “non-traditional” criminal matters. The ECtHR relied on *Jussila* as its authority for the proposition that there are different types of criminal case. In principle that reasoning is sound. The procedural protection that is afforded where a small tax surcharge has been imposed need not be the same as the level of protection required in, say, a murder trial. Nonetheless, it is by no means clear that competition law now falls into the “non-hardcore” camp. *Jussila* itself was concerned with tax surcharges on a comparatively minor scale. The case relied upon in *Jussila* for the proposition that competition law cases were not “hardcore” (*Société Stenuit*) itself concerned with a fine of 100,000 French francs applied during the 1970s. By contrast, the fines imposed by the Commission on individual companies in recent years have on occasion exceeded EUR 1 billion. If the distinction between hardcore cases and those which are not hardcore lies in the scale of the sanction, then it has clearly broken down in the competition context in the European Union.

It might be argued that competition cases are not hardcore on the grounds that competition law infringements are found against legal persons, not private individuals. Therefore, they are not criminal cases in the ordinary sense; they do not attract the full protection of Article 6(1). In the U.K. context, at least, that is no longer the case. The Enterprise Act 2002 has introduced individual criminal liability for certain types of cartel-based activity. However, even in jurisdictions where that is not the case, the severe sanctions imposed and the social stigma attached to an adverse finding may well affect private, as well as legal, persons.

In summary, *Menarini* was, at best, a missed opportunity. At worst, it affirmed an outdated and unwarranted distinction. It upheld the boundary between hardcore and non-hardcore cases and determined that competition cases do not attract the full criminal protections of Article 6(1). We consider that that distinction has lost its usefulness. The scale of sanction and the social stigma that arise in connection with competition law infringements make them more akin to hardcore criminality and less akin to taxation surcharges or small administrative fines.⁶⁸ It may well be that competition law was not hardcore at some point in the past but it is becoming impossible to credibly argue that that is the position now. Furthermore, *Menarini* failed to provide what would have been useful guidance concerning the standard of review that should be applied to non-hardcore cases. In short, the standard of review must be assessed against only a somewhat opaque set of criteria, on a case-by-case basis. As a result, we consider that *Menarini* is unlikely to be the final word on this question.

A TREATY AMENDMENT COULD DO THE SAME THING OR GO EVEN FURTHER IN TERMS OF INSTITUTIONAL REDESIGN

D. The Options for Reform

If compliance with Article 6 /Article 47 is not ensured by the practical availability of effective judicial review, there are two basic alternatives. The first is that the TFEU is amended to make expressly clear that the review

is not limited to a control of legality but involves a full appeal on the merits or unlimited jurisdiction.⁶⁹ The second alternative is that the prosecutorial and decision-making elements of the Commission's process should be split, thus making the EU Courts an adversarial forum in which the Commission and the defendant(s) would put forward evidence and submissions. One commentator suggests that "the only way in which these criticisms could be satisfied without an amendment of the EU Treaties would be to give the General Court (formerly the Court of First Instance), instead of the Commission, the power to adopt prohibition decisions and to impose fines in competition cases."⁷⁰ This solution is not as radical as it seems: it was proposed by the European Parliament as early as 1981.⁷¹ A Treaty amendment could do the same thing or go even further in terms of institutional redesign.

IV. PROCEDURAL FAIRNESS IN U.K. COMPETITION PROCEEDINGS

A. *The CMA's Guidance*

IN BASIC TERMS, THE CMA SEEMS TO HAVE ESTABLISHED A HIERARCHY OF CONFIDENTIALITY TREATMENT, WHERE INFORMATION HAS BEEN RELIED UPON AGAINST A PARTY

In recent years, the topic of procedural fairness in the context of competition proceedings has largely been articulated as a debate concerning the rights of parties to access information and the use of that evidence by the various U.K. regulators.

The UK's new consolidated regulator, the CMA, came into being on April 1, 2014. The CMA has published both general guidance and specific guidance for the competition context: *Transparency and disclosure: Statement of the CMA's policy and approach and Guidance on the CMA's investigation procedures in Competition Act 1998 cases*. This guidance builds on the considerable experience of its two predecessor competition authorities, the OFT and Competition Commission, in such matters.

The General Guidance stresses the CMA's commitment to openness and transparency. It grants the Authority a wide discretion to determine whether or not information that has been passed to it should be treated as confidential (§§4.12-4.24).

The CMA has a general power to redact confidential information and also to use confidentiality rooms and data rooms in order to enable disclosure, while also protecting the confidentiality of the data itself (§4-29):

Sometimes the CMA may use confidentiality rings or data rooms as a means of making disclosure of confidential information while recognizing the restrictive nature of the disclosure. Their use will be restricted to when it is necessary to make the disclosure for the purpose of facilitating the CMA's functions by ensuring due process...

Data rooms and confidentiality rings are described as a mechanism to enable the legal representatives of the parties to test the evidence that has been relied upon against them. The CMA reserves to itself the right

to impose restrictions on the bringing into and taking out of the data room of “such items as materials, notes and equipment.” (§4.31-32)

In basic terms, the CMA seems to have established a hierarchy of confidentiality treatment, where information has been relied upon against a party. Material that is particularly confidential will be disclosed only through a data room, and possibly subject to restrictions concerning what notes are taken from that material. Less confidential material will be disclosed into a confidentiality ring.

THIS BEGUILINGLY SIMPLE PRINCIPLE GIVES RISE TO SIGNIFICANT COMPLEXITIES IN COMPETITION LAW CASES

The specific guidance relating to Competition Act 1998 investigations notes that the CMA will act in line with its confidentiality obligations (as set out in Part 9 of the Equality Act). It does not go much further than the general guidance. The CMA exercises its discretion to determine whether or not to use data rooms and confidentiality rings;

THE ADVERSARIAL PROCEDURE FOLLOWED IN A COURT OF LAW IS NOT APPROPRIATE FOR INVESTIGATIONS BY A COMPETITION AUTHORITY THAT ACTS AS AN ADMINISTRATIVE DECISION-MAKING BODY

they are used where it is proportionate to do so and where there are “clearly identifiable benefits” from doing so. The CMA’s guidance also makes clear that they will only be used where “any potential legal and practical difficulties can be resolved swiftly in agreement with the parties involved.” (§11-24) What is not clear, in this context, is what the CMA will do with information that it does not consider should be placed into a confidentiality ring and/or data room. The CMA does not state explicitly that such information will be discounted from its analysis of any potential infringement. Nonetheless, the clear implication must be that information that cannot be shown in any form to the parties cannot be relied upon in order to find against them. This seems axiomatic under principles of natural justice in English law.

The mechanisms set out in the new CMA Guidance do not differ materially from those that were employed by the CMA’s predecessors (the OFT and the Competition Commission). The Competition Commission’s *Guidance on Disclosure of Information in Merger Enquiries, Market Investigations and Reviews of Undertakings and Orders Accepted under the Enterprise Act 2002 and the Fair Trading Act 1973* provides, in similar but different form, that “fairness” should be considered when deciding how to handle the dual imperatives of confidential information and the need to disclose. It also considers the possibility of using data rooms and confidentiality rings. But it is fair to say that the new CMA Guidance on this topic is more comprehensive and more detailed.

B. The Case Law

In the 1990s U.K. competition law received a significant overhaul, bringing its essential features more closely in line with EU competition law. But even under the older legislation such as the Fair Trading Act 1973 the English courts had identified a duty of fairness on competition authorities when conducting investigations and

found breaches of that duty in appropriate cases.⁷³

In *Interbrew S.A. and Interbrew UK Holdings Ltd v. Competition Commission and others* [2001] EWHC Admin 367, the High Court summarized the principles in relation to fairness in competition law proceedings as follows:

1. A competition authority owes a duty of fairness in conducting its investigation (in *casu* merger control).

THE CAT FOUND THE DATA ROOM REGIME
FUNDAMENTALLY DEFICIENT IN THREE
RESPECTS

2. The standard of review on appeal in relation to procedural fairness is not based on principles of judicial review, namely whether the procedure adopted was one that no reasonable decision-maker could have adopted. Thus, the standard of review in respect of procedural unfairness does not require the degree of unreasonableness needed to overturn a decision on normal judicial review grounds under administrative law.

3. The content of the duty will vary from case to case but generally it will require the decision maker to identify in advance areas which are causing him concern in reaching the decision and to act fairly by giving to the person whose activities are being investigated reasonable opportunity to put forward facts and arguments in justification of his conduct before a conclusion is reached that may affect him/her adversely.

4. Where ECHR rights are at stake those adversely affected should be involved in the decision making progress to a degree sufficient to provide them with the “requisite protection of their interests.”

5. The adversarial procedure followed in a court of law is not appropriate for investigations by a competition authority that acts as an administrative decision-making body. As a result, the authority has a wide discretion as to how its proceedings should be conducted.

6. Fairness is a flexible concept that is fact-and context-dependent. However, the Court will be slow to intervene in procedural matters (on the basis that, if the authority has directed itself properly on the requirements of fairness it will be unlikely that its choice of procedure will nonetheless be unfair).

THE EVER-INCREASING USE OF
QUANTITATIVE AND OTHER EVIDENCE
OF CONSIDERABLE GRANULARITY AND
DATA INTENSITY IN COMPETITION LAW
PROCEEDINGS MEANS THAT THERE
MAY BE REAL PRACTICAL DIFFICULTIES
IN DISCLOSING ALL AVAILABLE
INFORMATION TO THE AFFECTED
PARTIES

On the facts, the High Court upheld Interbrew’s complaint that it was given no opportunity to deal with the crucial ground upon which the Competition Commission recommended a divestment of Bass Brewers during its merger assessment. In particular, it was given no fair opportunity to deal with the reason why the Competition Commission took the view that Whitbread, with Stella Artois, would not be a viable and independent competitor that would remedy the

consequences of the duopoly.

Following the entry into force of the Competition Act 1998, the U.K. Courts have had multiple occasions to contend with the application of the concept of procedural fairness in the context of competition law proceedings. This body of case law has considerably developed the basic concepts of natural justice and procedural fairness as articulated in the earlier (non-competition) cases and adapted them to a competition law setting.

C. The Right to be Informed of the Case Against You

One of the basic tenets of administrative law decision-making is that the objections formulated by a public body must be made known to the defendant so that it has a proper opportunity to respond to, challenge, or correct objections made against it. This beguilingly simple principle gives rise to significant complexities in competition law cases.

THE DUTY TO COMMUNICATE THE GIST OF THE CASE DID NOT IMPLY THAT DISCLOSURE WAS ALWAYS TO BE EITHER DETAILED OR LIMITED

First, the need to make the affected party aware of the case against it will often run up against the need to ensure the confidentiality of sensitive information provided by third parties. Indeed, in many cases, the third parties concerned will be direct rivals of the affected party and disclosure of the third-party information would in normal circumstances be likely to amount to a serious violation of competition law in other contexts.

A second related point is that the competition authorities will in many cases have a legal duty to protect third-party confidential information that is co-extensive with any duty they owe at common law or otherwise to comply with principles of natural justice.⁷⁴ At the very least, trade-offs may be required between the two sets of obligations.

Third, in certain cases, disclosure even of the identity of the third party providing the information may create issues regarding retaliation or other commercial consequences. This applies in particular for smaller rivals or downstream purchasers or customers.

Finally, the ever-increasing use of quantitative and other evidence of considerable granularity and data intensity in competition law proceedings means that there may be real practical difficulties in disclosing all available information to the affected parties, at least in a time frame that makes meaningful consideration of it possible. More importantly, one can query the need to disclose all such information to allow the affected party to meet the objection(s) against it. Typically, the communication of the gist of the information or point will suffice.

The English courts have grappled with these competing considerations in various competition law cases. In *BMI Healthcare Limited & others v Competition Commission* [2013] CAT 24 the Competition Appeal Tribunal (CAT) concluded that the measures put in place by the Competition Commission allowing the

affected parties and their access to a specially-created on-site “data room” for confidential information were fundamentally deficient and unfair. The case concerned the market investigation regime operated by the Competition Commission under the Enterprise Act 2002 whereby it can investigate whether the features of

IN PARTICULAR, THE CAT HELD THAT, PROVIDED THAT THE GIST IS PROPERLY DISCLOSED, REDACTIONS OR OTHER FORMS OF WITHHOLDING OF MATERIAL CAN BE PERFECTLY PROPER

a particular market have an adverse effect on competition and, if so, then impose wide-ranging remedies. The Competition Commission sought to protect confidentiality by establishing an on-site data room, which its own guidance envisaged. Confidential information was made available in the data room and was accessible during working hours on two consecutive days.

The CAT found the data room regime fundamentally deficient in three respects.⁷⁵ First, the regime limiting the affected parties’ advisers (e.g., economists) to recording in their notes only own client data or information derived solely from own client data and/or from data in the public domain was wrong in principle. This was because that information was already available to the advisers outside the data room from their own client(s). Moreover, the real information of interest was not confidential information that was own client data or in public domain, the parties’ crucial concern was to see how the Competition Commission relied upon that data.

Second, while it may have been justified on confidentiality grounds to prevent the removal of items from the data room—in contrast to a confidentiality ring where the information is provided to a circumscribed list of individuals—the Competition Commission failed to put in place measures to ensure that this obstacle did not undermine the drafting of a proper and considered response by those affected by the market investigation. In particular, the advisers: (1) had no access to other material that they might need to look at, (2) had no opportunity to discuss matters with persons outside the data room, and (3) had no opportunity to test the robustness of the confidential information (for example, by analyzing and cross-checking data contained in tables of information and data redacted by the Competition Commission in its decision setting out its provisional findings).

Finally, the period of time in which the advisers were allowed access to the data room was unreasonably short. As a general rule of thumb, the CAT considered that a data room ought to be open at reasonable business hours up until the end of the consultation period, and ought to provide for multiple visits due to the iterative process of responding to the Competition Commission’s provisional findings.

In two more recent cases—*Ryanair Holdings plc v Competition Commission* [2014] CAT 3 and *Group Eurotunnel SA v Competition Commission* [2013] CAT 30—the CAT grappled with situations in which confidential information had not been entirely withheld but the affected parties were only informed of the gist of the information or the point against them.

In *Ryanair*, the Competition Commission’s final report concluded that Ryanair’s minority stake in Aer

Lingus granted it material influence over Aer Lingus and resulted in a substantial lessening of competition. The final report referred to the views expressed and evidence given to it by a number of airlines that had been specifically identified. However, certain passages referring to discussions that had taken place between Aer Lingus and other airlines were redacted to protect the identity of the airlines concerned and the confidentiality of those discussions.

Ryanair contended that disclosure of the identity of the various airlines referred to in redacted passages was important so that it could test the credibility of the evidence in question. The CAT disagreed, concluding that the Competition Commission did in fact disclose in broad terms the gist of the information which was redacted and that disclosure of the identity of the individual airlines was unnecessary. The redactions went no further than was necessary to protect the confidentiality of very sensitive commercial matters between airlines who were competitors or potential competitors of Ryanair. The duty to communicate the gist of the case did not imply that disclosure was always to be either detailed or limited. The CAT emphasized that the duty to disclose the gist of the information or objection varies from case to case depending on the context (at [8]):

We agree that you do have to look at the facts of each case. At one end of the spectrum there may be a case where numbers are involved and you need to see the relevant numbers or data in order to understand the gist of what is being put. In other cases, more like the present, you need to know what the general position is.

A similar conclusion was reached in *Eurotunnel*. Eurotunnel, the operator of the Channel tunnel passenger and freight services, was one of several bidders for the assets of Sea France, a ferry operator between Dover and Calais. A competing bid was put in by DFDS, another ferry operator. The Competition Commission concluded that the Eurotunnel/Sea France merger might be expected to result in a substantial lessening of competition (i) in the market for the supply of transport services to passengers on the short sea and (ii) in the market for the supply of transport services to freight customers on the short sea.

In reaching the conclusions it did in its final report, the Competition Commission had to balance Eurotunnel's right to know the case against it with the need to protect third-party confidential information. The Competition Commission sent summaries or descriptions of specified information to (typically) the party who had provided it, in order to verify the factual correctness of the content and to identify any confidential material, prior to publication. The party was then asked to provide reasons for any requests of excisions of the material from published documents. Where the Commission considered appropriate, the names of parties were anonymized and ranges of figures substituted for actual figures. Eurotunnel complained about the redactions and requested that the unredacted materials be disclosed into a confidentiality ring. The Competition Commission refused this request.

The CAT concluded that there was nothing in the Competition Commission's general approach to criticize. It sought to balance the interests of confidentiality and the interests of disclosure. Eurotunnel's argument that—in withholding information in the manner that it did (i.e., by using summaries of information provided, redacting, anonymizing, and using ranges)—the Commission acted unfairly could only

succeed if the Competition Commission was obliged to disclose to Eurotunnel all inculpatory and exculpatory material including transcripts or summaries of evidence provided to it by third parties. The CAT rejected this argument, essentially because the gist of the points made had been communicated to Eurotunnel, in some detail, and it was in a position to make responsive submissions. In particular, the CAT held that, provided that the gist is properly disclosed, redactions or other forms of withholding of material can be perfectly proper. The situation would only be different if the defendant could show that this withholding meant that it was unable to understand the gist of the case being made against it. Thus, for example, the Competition Commission was justified in making omissions and redactions from the summaries of evidence from DFDS and customers and the transcripts of their oral evidence and of other persons who attended for interview because the gist of the points made by them was disclosed to Eurotunnel.

ORAL EVIDENCE HAS ALSO BEEN USED TO GREAT EFFECT IN COMPETITION LAW APPEALS IN THE UNITED KINGDOM

D. Third Parties and the Right to be Heard

As noted above, it is trite that objections formulated by a competition authority must be made known to the party/parties affected by them. This typically applies to defendants in competition law proceedings and the need to inform them of the objections made against the conduct or agreement(s) under scrutiny. But in *Unichem Limited v Office of Fair Trading* [2005] CAT 8 the CAT applied a more granular version of this general principle and further extended it to cover the situation of third parties.

UniChem complained about the OFT's decision not to refer the proposed acquisition by Phoenix Healthcare Distribution Limited of East Anglian Pharmaceuticals Limited to the Competition Commission. One of the grounds of appeal was that the OFT purported to make findings of primary fact about the logistics and economics of UniChem's distribution system, UniChem's past pattern of success in certain regions, and UniChem's service levels on the basis of information supplied largely by the merging parties, without checking certain facts with UniChem itself or discussing with UniChem the inferences about UniChem which the OFT was minded to draw from the material supplied by the merging parties.

Even though the CAT considered it “strongly arguable” that the OFT's decision not to refer the

TOBACCO IS A STRIKING CASE WHERE ORAL EVIDENCE AND CROSS-EXAMINATION HAD A MATERIAL—IF NOT DECISIVE—BEARING ON THE QUASHING OF THE COMPETITION AUTHORITY'S DECISION

merger remained within the bounds of reasonableness,⁷⁶ it nonetheless quashed the decision on the basis that the OFT did not know enough about the reach and logistics of UniChem's network and the economics of delivery routing to have an adequate factual basis for its decision. In particular, the OFT's omission to seek comments from UniChem on those matters was considered to be of “decisive importance.”⁷⁷

Similar issues were raised in *CTS Eventim v Competition Commission* [2010] CAT 7.⁷⁸ Eventim, a provider of ticketing services and a ticket agent and a promoter of live music events, challenged the

Competition Commission's decision to approve the merger between Live Nation and Ticketmaster. One of the grounds of appeal was that the Competition Commission had deprived Eventim of a reasonable opportunity to respond to the main reasons for the Competition Commission's reversal of its provisional view that the merger would result in a substantial lessening of competition, as well as the Competition Commission's analysis of (i) Eventim's own German language board documents and/or (ii) Eventim's own forecasts for its proposed U.K. activities before adopting its final decision.⁷⁹ The Competition Commission evidently considered that there was considerable force in these procedural arguments since it agreed to retake the decision before the appeal was even concluded before the CAT.

E. The Ability to Call and Challenge Witnesses

One of the most striking manifestations of natural justice in appeals in competition law cases in the United Kingdom is the fact that witnesses are often called by one or more parties to give evidence on matters of fact or expert opinion. This includes the competition authorities themselves tendering witnesses to support key factual or contextual aspects of the relevant theory of harm. Once a witness is tendered in this way, he/she can then be cross-examined by one or more adverse parties.

This oral tradition in English law reflects of course the adversarial nature of proceedings in common law jurisdictions. This tradition contrasts with the more judge-led inquisitorial model applied in many civil law jurisdictions (although some civil law jurisdictions do allow for questioning of witnesses upon application or for a party to submit questions for the judge to put to a witness). Oral evidence certainly plays a very important role in civil (and criminal) proceedings in the United Kingdom.

FIRST, THE BEST EVIDENCE WILL GENERALLY BE RELEVANT CONTEMPORANEOUS DOCUMENTS, SUBJECT OF COURSE TO THEIR MEANING BEING AT LEAST TOLERABLY CLEAR

Oral evidence has also been used to great effect in competition law appeals in the United Kingdom. Perhaps the most notable example is a series of appeals in relation to decisions rendered by the OFT regarding price parity clauses in the tobacco sector, for which various manufacturers and retailers were fined a cumulative total of almost £200 million. The clauses concerned multiple different brands of the two main tobacco manufacturers, Imperial and Gallaher. The parity clauses were expressed in different ways, such as requirements that a particular Imperial brand be sold at a price "not more expensive than," "at least 5 pence less than" or "not more than 3 pence more expensive than" the competing linked Gallaher brand. In elaborating the theory of harm the OFT posited four key effects of the price parity clauses:⁸⁰

- a. If the retail price of Gallaher's brand increases, then the retail price of [Imperial]'s rival brand must also increase.
- b. If the retail price of [Imperial]'s brand increases, then the retail price of Gallaher's rival brand must also increase.

c. If the retail price of [Imperial]’s brand decreases, then the retail price of Gallaher’s rival [brand] must also decrease.

d. If the retail price of Gallaher’s brand decreases, then the retail price of [Imperial]’s [rival] brand must also decrease.

The only witness tendered by the OFT was a former tobacco buyer for one of the major retailers. She had given a signed witness statement to the OFT in 2005. In that statement she stated that if the price of Imperial’s brands went up because of a wholesale price increase, she would not put up the price of the Gallaher brand if Gallaher had not announced a price increase. She also said that the Imperial account manager would ask her to move the prices up and down on his own brands but her recollection was that “he never told me to do anything with a competitor brand.” Moreover, when asked in cross-examination whether she had regarded herself as bound by the four constraints identified above by the OFT she said firmly that she had not. Thus, there was nothing in her oral evidence that was inconsistent with what she had said in her witness statement. The fact that the OFT’s own principal witness did not support the OFT’s theory of harm led to the decision being quashed by the CAT. Critically, this lack of support was in part elicited in cross-examination, albeit the CAT did suggest that had OFT tested the evidence more stringently, the implications of that evidence for the OFT’s theory of harm would have become clearer, and sooner.

Tobacco is a striking case where oral evidence and cross-examination had a material—if not decisive—bearing on the quashing of the competition authority’s decision.⁸¹ But it is not atypical.⁸² Indeed, in multiple appeals before the CAT, both appellants and competition authorities have sought to tender witnesses on key factual issues in the appeal. For example, in *Tesco v OFT* [2012] CAT 31, Tesco relied on witness evidence, among other things in the context of a so-called ABC information exchange, to determine circumstances where A may be taken to intend that B will make use of that information to influence market conditions by passing that information to other retailers.

ORAL EVIDENCE MAY ALSO HAVE SOMEWHAT LESSER VALUE IN COMPETITION LAW CASES WHERE THE CREDIBILITY OF THE WITNESSES IS NOT CENTRAL TO THE ISSUES IN THE CASE, E.G., AS IN A FRAUD CASE

Tesco also laid considerable emphasis on the OFT’s failure to interview witnesses during its investigation or indeed to call witnesses for the appeal. The CAT did not consider that this circumstance was dispositive, since there was a credible explanation for the witnesses’ absence—namely the OFT’s position that its case stood or fell on the contemporaneous documents. But the CAT did not consider this explanation wholly satisfactory and it noted, for example, that (1) a number of the documents relied upon by the OFT were far from clear and explanations had not been available because of the OFT’s decision not to gather evidence from the authors and/or recipients of the documents, (2) in light of the OFT’s decision not to seek witness evidence, any doubt in the mind of the CAT as to the content or meaning of documents relied on by the OFT must operate to the advantage of Tesco, and (3) the lack of a formal power of witness compulsion should not be thought to either preclude or discourage the OFT from even attempting to contact witnesses who might be able to provide details or evidence of material facts, and the failure to do so may lead the court

to conclude that the evidence of the infringement was not sufficiently strong.

F. Evidence and Corroboration

Because of the strong oral and adversarial tradition in English law, the English courts have also developed an acute—and nuanced—appreciation of the hierarchy of evidence that often appears lacking in analogous cases at an EU level. Several points bear emphasis. First, the best evidence will generally be relevant contemporaneous documents, subject of course to their meaning being at least tolerably clear. The position was well-summarized by Leggatt J in *Yam Seng Pte Limited v International Trade Corporation Limited* [2013] EWHC 111 (QB) (para. 8):

I approach the evidence on the basis that, as in almost every case where there is a contemporaneous documentary record, the documents provide the best evidence of what happened.

Second, not all written evidence is equal. A contemporaneous document is clearly primary evidence whereas, say, a written response to a request for information by a competition authority is *ex post* (and often self-serving) evidence, usually made on behalf of a body corporate or undertaking.⁸³ The same may be true of leniency statements or settlement agreements,⁸⁴ particularly in systems where subsequent applicants to obtain any reduction must bring to light matters not already known to the competition authority.⁸⁵ The temptation to gild the lily in such circumstances may be significant.⁸⁶ There is also a good, if rather old-fashioned, case for preferring written evidence accompanied by a statement of truth from the individual concerned.⁸⁷

THE PROCESSES THAT COMPETITION AUTHORITIES ACTING AS INVESTIGATOR, JUDGE, AND JURY FOLLOW ARE NOT ORDINARILY, ON THEIR OWN, ENOUGH TO SATISFY THE BASIC STANDARDS OF PROCEDURAL FAIRNESS

Third, care may need to be taken with oral evidence given some time after the facts in the context of a trial. Leggatt J, again, in *Yam Seng Pte Limited v International Trade Corporation Limited* [2013] EWHC 111 (QB), put it well (para. 8):

Human memory is notoriously unreliable, and the strong interests and emotions to which disputes resolved through litigation give rise are powerful distorting factors, however honest and well-intentioned the witness. Indeed, the more patently honest and convincing the witness, the greater can often be the risk of placing reliance on their testimony.

Oral evidence may also have somewhat lesser value in competition law cases where the credibility of the witnesses is not central to the issues in the case, e.g., as in a fraud case. In competition law cases one is also not always dealing with a primary fact but with matters of appreciation that do not have a single “right” answer. And one has to control for the fact that (i) evidence in chief will often be prepared with considerable assistance from lawyers and (ii) oral evidence given a long time after the fact may have the gilt edge of hindsight.

The context in which the oral evidence is given may also matter. There may, for example, be a significant

difference between witness statements tendered by business executives in the context of agreements which the parties operate in a clandestine fashion because they know they are acting illegally (and evidential difficulties

THE PRECISE MEANING OF
“FULL JURISDICTION” IS STILL,
DISAPPOINTINGLY, UNCLEAR

arise because the participants deliberately failed to record or retain information about what they were doing) and situations in which agreements are entered into openly for legitimate purposes, albeit they may also have some anticompetitive effect.⁸⁸

The executives’ evidence may, for example, shed important light on the purpose of particular agreements or practices or their effects. To state the obvious, those who conceived of and implemented an agreement or business practice, with novel- or difficult-to-discern effects, may be able to shed some useful light on its purpose(s) and effect(s).

Finally, while there may in appropriate cases be caveats as to the value of oral testimony, it can be an important source of evidence where the written evidence is fragmentary or expressed in a telegraphic manner. In particular, oral evidence may have considerable value in resolving a conflict between documents, which is a frequent occurrence. In *Armagas Ltd v Mundogas SA (The Ocean Frost)* [1985] 1 Lloyd’s Rep 1 at 57, Goff LJ stated as follows:

Speaking from my own experience, I have found it essential in cases of fraud, when considering the credibility of witnesses, always to test their veracity by reference to the objective facts proved independently of their testimony, in particular by reference to the documents in the case, and also to pay particular regard to their motives and to the overall probabilities. It is frequently very difficult to tell whether a witness is telling the truth or not; and where there is a conflict of evidence such as there was in the present case, reference to the objective facts and documents, to the witnesses’ motives, and to the overall probabilities, can be of very great assistance to a Judge in ascertaining the truth.

V. CONCLUSION—THE PRINCIPLES

In democratic countries, certain principles of institutional design and decision-making ought in our view to be regarded as immutable in competition law cases. They are:

1. The guaranteed independence of the decision-maker, which not only includes freedom from outside interference but also the resources and personnel to take effective decisions;
2. The right to know the case against you;
3. The right to see the evidence, both inculpatory and exculpatory, and to challenge it;
4. The right to be heard by the actual decision-maker;
5. The right to a reasoned decision within a reasonable period; and

6. The right to an appeal of the decision before an independent, competent court.

The above principles are in our view a non-negotiable minimum. But progressive jurisdictions interested in the quality of decision-making and fairness should in our view endeavor to go beyond this. Issues to bear in mind in this regard include:

1. Competition authorities need to develop a proper understanding of, and training in, the gathering and assessment of evidence. These are skills entirely separate from technical competence in substantive matters. The best evidence will usually be contemporaneous documents, assuming that their meaning is at least tolerably clear. But competition authorities should also make more use of oral evidence in appropriate cases, both to corroborate or explain documents and to understand the purpose and likely effects of particular agreements or conduct. This will entail the need for formal powers to take statements.

2. Competition authorities frequently act as investigator, judge, and jury. While obviously far from ideal, it may not be *per se* objectionable if there is a proper right of appeal (see (4) below). In any event, the processes that competition authorities acting as investigator, judge, and jury follow are not ordinarily, on their own, enough to satisfy the basic standards of procedural fairness (whether established under the common law or Article 6 EHCR). So, at the very least they should aim to ensure:

- a. Genuine separation between the investigative teams and decision-makers.
- b. A transparent decision-making process. For example, records should be kept of meetings and transmitted to the defendants or affected parties as a matter of course.
- c. A proper, adversarial hearing before the actual decision-maker.
- d. Parties should know the case against them in full and should be able to test the evidence against them properly. There is no reason why decision makers should not hear live evidence, where necessary and useful.
- e. Informality and lobbying should be deprecated.

3. Competition authorities will often have to balance the need for disclosure against the obligation to protect confidential information emanating from third parties. In general, the competition authorities should be given some leeway in doing so since the interests at stake require trade-offs to be made. The competing interests can normally be accommodated by the following sliding scale: (i) making the defendant or affected party aware of the gist of the information or point—the extent of which will depend on the context, including the importance of the issue and the level of confidentiality concerns; or (ii) putting it into a confidentiality ring accessible to circumscribed persons; or (iii) operating a data

room at which the information may be meaningfully accessed by a party's advisers but not physically removed.

4. A competition authority's decision should be subject to oversight by a court with full jurisdiction. The precise meaning of "full jurisdiction" is still, disappointingly, unclear. Nonetheless, it is clear that a review by a court of "full jurisdiction" must include:

- a. A review on the merits extending to the review of evidence, findings of fact, findings of law, and the penalty imposed.
- b. The capacity to substitute the findings of the competition authority with its own determinations. This may not imply a full rehearing on all issues, but nor should the appeal proceed on the basis of a premise that just because a competition authority has made a decision in respect of a matter that requires some appreciation of complex matters, the competition authority must be presumed to have got it right. It should also be appreciated that competition authorities have no particular expertise in making technical assessments unrelated to their core expertise (e.g., patent quality), and should be afforded no deference in such matters.
- c. Parties should be given an opportunity to make full and detailed submissions in their defense.
- d. While it is not necessary in every case, the court should be able and willing (on occasion) to call for live evidence and to make its own determinations on the facts. Documentary evidence is often expressed in telegraphic terms, or lacks context, or is fragmentary in nature. Novel agreements or practices may also benefit from explanation by those most familiar with them. ▲

¹ Robert O'Donoghue & Tim Johnston, Barristers, Brick Court Chambers.

² For an overview see International Chamber of Commerce, *Due Process in EU Antitrust Proceedings, Discussion Paper*, 15 April 2014. This is a draft document that has recently become unavailable. The *CPI Antitrust Chronicle* also recently ran a full series of articles on due process and competition law enforcement. See 6(1) CPI ANTITRUST CHRON. (June 2014).

³ For an overview of these issues see P. Lugard, *Procedural Fairness and Transparency in Antitrust Cases: Work in Progress*, 6(1) CPI ANTITRUST CHRON. (June 2014). See also S. Wong, *Thinking About Procedural Fairness of Competition Law Enforcement Across Jurisdictions: A Suggested Principled Approach*, ICN Column in *Competition Pol'y Int'l*, (April 23, 2014), available at <https://www.competitionpolicyinternational.com/thinking-about-procedural-fairness-of-competition-law-enforcement-across-jurisdictions-a-suggested-principled-approach>.

⁴ When describing the common law, it is normal to talk of "English law" (more properly the law of England and Wales). That common law differs from Scottish law. However, where we refer to competition law it is as U.K. law: the substantive and procedural law of competition in the United Kingdom is broadly

consistent.

⁵ [2004] 1 AC 531.

⁶ R. CLAYTON & H. TOMLINSON, *THE LAW OF HUMAN RIGHTS*, ¶11.44 (2009). See the judgment of Lord Diplock in *Bremer Vujlkan Schiffbau and Maschinenfabrik v South India Shipping Corporation Ltd* [1981] AC 909, at 977.

⁷ [1915] 1 KB 21.

⁸ *Cooper v Wandsworth Board of Works* (1863) 14 CB (NS) 180.

⁹ [1964] AC 40.

¹⁰ *Secretary of State for the Home Department v MB* [2008] 1 AC 440.

¹¹ *R v Newmarket Assessment Committee, ex p Allen Newport* [1945] 2 All ER 371.

¹² *R v Davis* [2008] AC 1128.

¹³ Cases C-204/00P C-205/00P, C-211/00P, C213/00P, C-217/00P, and C-219/00P *Aalborg Portland and Others v Commission* [2004] ECR I-123.

¹⁴ Application no. 43509/08 & 44.

¹⁵ *Jussila v Finland* (Application no 75053/01) ¶ 10.

¹⁶ *Id.* ¶¶38-39.

¹⁷ *Id.* ¶43.

¹⁸ *Id.* ¶¶41-45.

¹⁹ *Id.* ¶59.

²⁰ *Id.* ¶¶64-67.

²¹ Dissenting judgment, ¶7.

²² See, e.g., J. Temple Lang, *Three Possibilities For Reform Of The Procedure Of The European Commission In Competition Cases Under Regulation 1/2003*, CEPS Special Report (November 2011), available at [http://aei.pitt.edu/32989/1/Reform_of_Commission_Procedure_in_Competition_Cases_with cover.pdf](http://aei.pitt.edu/32989/1/Reform_of_Commission_Procedure_in_Competition_Cases_with_cover.pdf); I. Forrester QC, *Due Process In EC Competition Cases: A Distinguished Institution With Flawed Procedures*, 34 EUR. L. REV. 817 (2009). This debate is not new: see, e.g., F. Montag, *The Case For A Radical Reform Of The Infringement Procedure Under Regulation 17*, 8 EUR. COMPETITION L. REV. 428 (1996).

²³ EEC Council Regulation No 17: First Regulation implementing Articles 85 and 86 of the Treaty, OJ 1962 L 13/204.

²⁴ Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ 2003 L1/1.

²⁵ This involves selecting an internal “shadow” team to play devil’s advocate on the core aspects of the case, leading to an internal debate. It is sometimes said to be influential, although it is impossible to verify such claims. For a discussion see P. Marsden, *Checks And Balances: EU Competition Law And The Rule Of Law*, COMPETITION L. INT’L (February 2009).

²⁶ See L.H. Röller, *Using Economic Analysis To Strengthen Competition Policy Enforcement*, MODELLING EUROPEAN MERGERS: THEORY, COMPETITION POLICY AND CASE STUDIES (P. Bergeijk & E. van Kloosterhuis, eds. 2005).

²⁷ See DG Competition, Best Practices on the Conduct Of Proceedings Concerning Articles 101 and 102 TFEU, OJ 2011 C 308/6. The most significant changes were the introduction of (voluntary) state of play meetings between the Commission and defendant(s) to give greater transparency on the stage of the

Commission's proceedings. Three-way meetings between the complainant, Commission, and defendant were also proposed. For an overview see M. Glader, *Best Practices In Article 101 And 102 Proceedings: Some Suggestions For Improved Transparency*, 1 COMPETITION POLY INT'L (April 2010). On due process and EU competition law generally, see I. VAN BAEL, *DUE PROCESS IN EUROPEAN UNION COMPETITION PROCEEDINGS* (2011).

²⁸ See Decision of the President of the European Commission on the function and terms of reference of the hearing officer in certain competition proceedings, OJ 2011 L 275/29.

²⁹ See <http://www.ombudsman.europa.eu/en>.

³⁰ It bears emphasis that these criticisms are institutional or organizational, and are in no way reflective of DG Competition's (or the EU Commission's) officials, who are high caliber, extremely diligent, and of high integrity.

³¹ A notable intervention by the Ombudsman was his decision in *Intel*. It concerned the Commission's failure to keep a note of a five-hour meeting with a senior Dell executive. Dell was the most important customer in the case and the Commission's decision relied extensively on evidence from Dell (including the individual concerned) to inculcate Intel. The Ombudsman found that this event should have been classed as a meeting for the purposes of Article 19 of Regulation No 1/2003, that it could not be excluded as it concerned potentially exculpatory evidence, and that the failure adequately to record it constituted maladministration on the part of the Commission. He did not, however, make any finding as to whether the Commission had infringed Intel's rights of defense. See Decision of the European Ombudsman Closing His Inquiry Into Complaint 1935/2008/FOR Against the European Commission of July 14, 2009. On appeal, the General Court held that (1) the meeting was not a formal meeting for purposes of Article 19 of Regulation No 1/2003 and (2) by making available to the applicant, during the administrative procedure, the non-confidential version of the note to the file and by offering it the possibility to submit its observations on that document, the Commission remedied the initial omission in the administrative procedure, with the result that that procedure was not vitiated by an irregularity. See Case T-286/09 *Intel Corporation Inc. v Commission* [2014] ECR II-nyr.

³² In Case T-286/09 *Intel Corporation Inc. v Commission* [2014] ECR II-nyr, Intel argued that the Commissioner for Competition, Neelie Kroes, had stated publicly that the Commission had applied a certain price/cost test in its decision in that case, which the Commission then sought to disavow on appeal. The General Court dismissed this argument on the basis that the decision was made by the College of Commissioners, not the Commissioner for Competition (¶159).

³³ This echoes a comment often attributed to Henry Kissinger: "Who do I call if I want to call Europe?"

³⁴ See J. Temple Lang, *Three Possibilities For Reform Of The Procedure Of The European Commission In Competition Cases Under Regulation 1/2003*, CEPS Special Report (November 2011), available at http://aei.pitt.edu/32989/1/Reform_of_Commission_Procedure_in_Competition_Cases_with_cover.pdf. The same author, using Regulation (EC) No 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents, forced the Commission to publish its internal Manual of Procedure, which can now be found at http://ec.europa.eu/competition/antitrust/antitrust_manproc_3_2012_en.pdf. Following publication, he criticized the Manual of Procedure in certain respects, including: (1) it does not deal with submissions to other parts of the Commission in competition cases, which has been a feature of some recent (and controversial) decisions; (2) it

does not deal with the legal principle of good administration, including in particular the need to take notes of meetings; (3) it does not refer to the Charter on Fundamental Rights, which is now part of EU law; and (4) it does not deal with due process and impartiality. See J. Temple Lang, *The Strengths And Weaknesses Of The DG Competition Manual Of Procedure*, 1(1) J. ANTITRUST ENFORCEMENT 104-131 (2013).

³⁵ I. Forrester QC, *Due Process In EC Competition Cases: A Distinguished Institution With Flawed Procedures*, 34 EUR. L. REV. 817 (2009).

³⁶ Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003, OJ 2006 C 210/2.

³⁷ This also assumes that the Commission's procedures are not purely administrative in nature but have sufficient quasi-criminal character to fall within Article 6 ECHR. As discussed earlier in this article, by far the better view is that Article 6 ECHR is engaged.

³⁸ Forrester, *supra*.

³⁹ Temple Lang, *supra*.

⁴¹ See Article 6 TEU. The Charter has the same legal value as the EU treaties.

⁴¹ Accession became a legal obligation under Article 6(2) TEU. The Court of Justice will, however, need to render an opinion on the compatibility of the accession with EU law. But the EU Courts, the EFTA Court, and the ECtHR have taken a series of steps even before accession to subject Commission proceedings and judicial review of competition decisions to many of the obligations reflected in Article 6 ECHR. See Case C-389/10 P, *KME Germany AG, KME France SAS and KME Italy SpA v Commission* [2011] ECR I-13125; Case C-407/08 P, *Knauf Gips KG v Commission* [2010] ECR I-6375; Case E-15/10, *Posten Norge AS v EFTA Surveillance Authority*, judgment of 12 April 2012, not yet reported (EFTA Court); and Case 43509/08, *A. Menarini Diagnostics SRL v Italy*, judgment of the European Court of Human Rights of September 27, 2011.

⁴² See I. Forrester QC, *A Bush In Need Of Pruning: The Luxuriant Growth Of Light Judicial Review*, EUROPEAN COMPETITION LAW ANNUAL 2009: EVALUATION OF EVIDENCE AND ITS JUDICIAL REVIEW IN COMPETITION CASES, pp. 407-452 (C.D. Ehlermann & M. Marquis, eds. 2010).

⁴³ See, e.g., Case 42/84, *Remia and others v Commission* [1985] 2425, ¶34. For a detailed discussion see the contributions from Panel II in EUROPEAN COMPETITION LAW ANNUAL 2009: EVALUATION OF EVIDENCE AND ITS JUDICIAL REVIEW IN COMPETITION CASES, pp. 9-473 (C.D. Ehlermann & M. Marquis, eds. 2010), and in particular those by Judge Forwood, Judge (and now Advocate General) Wahl, and Judge Ó Caoimh from the EU Courts.

⁴⁴ *Remia, ibid* (in *casu* duration of a non-compete clause and the doctrine of ancillary restraints).

⁴⁵ Forrester, *supra* note 42 at 407-452.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ The Commission has enjoyed a staggering success rate in Article 102 TFEU appeals, and one that is asymmetrically better than other areas of competition law appeals. Data gathered in 2006 by the former Chief Economist, Damien Neven, record that the Commission's success rate in Article 102 TFEU cases was 98 percent, compared to only 58 percent under the EU Merger Regulation and 75 percent in Article 101 TFEU cases. See D. Neven, *Competition economics and antitrust in Europe* at 17, available at http://ec.europa.eu/dgs/competition/economist/economic_policy.pdf. While Neven attributes this disparity in success rates to the fact that appeals outside the Article 102 TFEU context typically look at the effects of practices and not their form,

this is not a fully satisfactory response. The disparity between Article 101 and 102 TFEU appeals is striking, since most Article 101 TFEU cases concern admitted cartel infringements. More to the point, in Article 102 TFEU cases the EU Courts are clearly looking at issues of anticompetitive effects in more detail than before: the concern is that it appears to be making no difference to the outcome in those cases whereas it has in the areas of merger control and Article 101 TFEU. Equally, the Commission's success rate in cases in the appeal courts in Luxembourg is not matched by the success rates of private litigants in national courts involving Article 102 TFEU or the success rates of NCAs applying Article 102 TFEU or its national law equivalent. This cannot be explained solely by the discretion the Commission enjoys over which cases to pursue. If anything, the incentives of private litigants should be at least as good in this regard, and probably more so in those national legal systems where the loser pays the winning side's costs.

⁴⁹ Case C-95/04 P, *British Airways plc v Commission* [2006] ECR I-2331, ¶31. (“the Court further held not only that the bonus schemes at issue were likely to have a restrictive effect on the United Kingdom markets for air travel agency services and air transport, but also that such an effect on those markets had been *demonstrated in a concrete way by the Commission.*”) (emphasis added). Given that the Commission and EU Courts eschewed any need to demonstrate actual or likely anticompetitive effects with concrete evidence, it is difficult to see how this conclusion was justified.

⁵⁰ Case T-155/06, *Tomra Systems ASA and others v Commission* [2011] ECR II-4361, ¶258 *et seq.*

⁵¹ The EU Courts' approach in appeals against Commission decisions under Article 102 TFEU contrasts with their robust approach in reviewing Commission merger control decisions. The best examples are Case T-342/99, *Airtours plc v Commission* [2002] ECR II-2585 and Case T-5/02, *Tetra Laval BV v Commission* [2002] ECR II-4381, and Case T-80/02, *Tetra Laval BV v Commission* [2002] ECR II-4519, on further appeal in Case C-12/03, *Commission v Tetra Laval BV* [2005] ECR I-987.

⁵² *AstraZeneca*, OJ 2006 L 332/24, on appeal Case T-321/05, *AstraZeneca v Commission* [2010] ECR II-2805 and Case C-457/10 P, *AstraZeneca v Commission* [2012] ECR I-nyr.

⁵³ *Id.*, ¶¶806-808.

⁵⁴ *Id.*, ¶845.

⁵⁵ The General Court's findings in this regard were upheld on appeal in Case C-457/10 P, *AstraZeneca v Commission* [2012] ECR I-nyr.

⁵⁶ Case C-209/10, *Post Danmark A/S v Konkurrencerådet*, [2012] ECR I-nyr.

⁵⁷ Case C-549/10 P, *Tomra Systems ASA and others v Commission* [2012] ECR I-nyr.

⁵⁸ See, e.g., Case C-7/97, *Oscar Bronner GmbH & Co KG v Mediaprint Zeitungs und Zeitschriftenverlag GmbH & Co KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co KG and Mediaprint Anzeigengesellschaft mbH & Co KG* [1998] ECR I-7791; Case C-418/01, *IMS Health GmbH & Co OHG v NDC Health GmbH & Co KG* [2004] ECR I-5039; Case C-52/09, *Konkurrensverket v TeliaSonera Sverige AB* [2011] ECR I-527; and Case C-209/10, *Post Danmark A/S v Konkurrencerådet* [2012] ECR I-nyr.

⁵⁹ K. Lenaerts, *Due Process In Competition Cases*, 1(5) NEUE ZEITSCHRIFT FÜR KARTELLRECHT – NZKART, 5 (May 2013): “the system of judicial review of Commission decisions relating to proceedings under Articles 101 TFEU and 102 TFEU affords all the safeguards required by Article 47 of the Charter [and by implication Article 6 of the European Convention on Human Rights].”

⁶⁰ International Chamber of Commerce, *Due Process in EU Antitrust Proceedings. Comments on and analysis of the European Commission's and EU Courts' Antitrust Proceedings* 225/717 (April 15, 2011): “Current

EU Antitrust Proceedings Are Not in Line with the European Convention on Human Rights (ECHR).”

⁶¹ See most recently Case T-286/09 *Intel Corporation Inc. v Commission* [2014] ECR II-nyr, paragraphs 1609ff, citing Case C-386/10 P *Chalkor v Commission* [2011] ECR I-13085 and Opinion of Advocate General Mengozzi in Case C-521/09 P *Elf Aquitaine v Commission* [2011] ECR I-8947, paragraph 31.

⁶² See Case C-386/10 P *Chalkor v Commission* [2011] ECR I-13085, ¶67. See also Case C-389/10 P, *KME Germany AG, KME France SAS and KME Italy SpA v Commission* [2011] ECR I-nyr ; Case C-407/08 P, *Knauf Gips KG v Commission* [2010] ECR I-6375; Case E-15/10, *Posten Norge AS v EFTA Surveillance Authority*, judgment of 12 April 2012, not yet reported (EFTA Court)

⁶³ See Sir C. Bellamy, *ECHR and Competition Law Post-Menarini: An Overview Of EU And National Case Law*, 47946 E-COMPETITIONS (July 5, 2012). In *MasterCard*, AG Mengozzi accepted that Article 6(1) ECHR compliance by the EU Courts depended on “the way in which that review is actually exercised.” See Case C-382/12 P *MasterCard and others v Commission* [2014] ECR I-nyr, ¶122.

⁶⁴ Case C -501/11 P *Schindler Holding and others v Commission* [2013] ECR II-nyr.

⁶⁵ *Id.* ¶¶33-35.

⁶⁶ *Id.* ¶37.

⁶⁷ *Id.* ¶46.

⁶⁸ This appeared to be the position of Advocate General Eleanor Sharpston in *KME*. While she had “little difficulty in concluding that the procedure whereby a fine is imposed for breach of the prohibition on price-fixing and market-sharing agreements in Article [101(1) TFEU] falls under the ‘criminal head’ of Article 6 ECHR,” she added that the fining procedure in EU competition law cases “differ[s] from the hardcore of criminal law; consequently, the criminal-head guarantees will not necessarily apply with their full stringency.” See Opinion in Case C-272/09 P *KME and others v Commission* [2011] ECR I-nyr, ¶¶64, 67. The Court of Justice did not explicitly address this distinction.

⁶⁹ Bellamy (*supra*) has proposed some suggested amendments in this regard.

⁷⁰ See J. Temple Lang, *Three Possibilities For Reform Of The Procedure Of The European Commission In Competition Cases Under Regulation 1/2003*, CEPS Special Report 194 (November 2011).

⁷¹ See Resolution on the Tenth Report of the Commission of the European Communities on Competition Policy, OJ 1982 C 11/78.

⁷² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284387/cc7_revised_.pdf.

⁷³ See, e.g., *R -v- Take-over Panel ex parte Guinness PLC* [1991] QB 146.

⁷⁴ See, e.g., Sections 169(1)-(3) (duty to consult) and Section 169(4) (protection of confidentiality) of the Enterprise Act 2002 in the context of market investigations by the Competition Commission.

⁷⁵ See ¶¶70ff.

⁷⁶ See ¶278.

⁷⁷ *Id.*

⁷⁸ In *Stagecoach v Competition Commission* [2010] CAT 14, Stagecoach’s ground of review that the Competition Commission acted unfairly in preferring evidence of Preston Bus Limited’s witnesses over that of Stagecoach’s witnesses (Preston Bus Limited being the (hostile) takeover target) was not ruled upon by the CAT since other grounds disposed of the appeal.

⁷⁹ *CTS Eventim AG v Competition Commission* [2010] CAT 7 (ground 1).

⁸⁰ See, *Imperial Tobacco Limited and others v OFT* [2011] CAT 41, ¶28.

⁸¹ By way of counter-example, in the recent General Court judgment in Case T-540/08, *Esso v Commission* [2014] ECR II nyr, there was a clear conflict between the witness statement relied upon by one of the parties and certain documents on the Commission file. The General Court did not call the witness and cross-examine him, in order to resolve that conflict ¶ 67ff.

⁸² The approach of the English courts to the hearing of evidence in competition law cases stands in marked contrast to the recent practice of the General Court in similar appeals. In *Duravit*, the General Court refused a request under Article 68 of its Rules of Procedure to hear witnesses in a cartel case. See Case T-364/10, *Duravit AG and others v Commission*, [2012] ECR II-nyr, ¶¶135, 147, 196, 200.

⁸³ Several commentators at a recent conference on the *Intel* judgment of the General Court questioned the Court's treatment of the evidence. Criticisms included: (1) the Court's preferring various "nuances" derived from Dell's response to a Commission Request for Information over a clear statement that the agreement on rebates was not "explicitly conditioned on exclusivity or minimum volume commitments" (see ¶468); (2) the Court considering a Lenovo response to a Request for Information as "not credible" (¶¶1070, 1078), despite its relying heavily on other responses in other contexts being sufficient evidence by themselves or, at most, as evidence requiring only weak additional corroboration; (3) the Court preferring the unsworn evidence of a single, apparently lower level Dell employee over sworn testimony given by Dell's CEO in U.S. proceedings (¶¶495, 502, 558, 566); (4) reliance on customer "expectations" and/or "impressions" to show *de facto* exclusive dealing, without evidence that Intel itself was aware of those expectations/impressions (or could avoid them being created or formed) (¶¶525, 527); and (5) ignoring evidence of individuals directly involved in negotiations with Intel in favor of evidence from individuals who were not. See "*Intel v Commission: More Eco- Or More Ordo-Friendly?*," Liège Competition and Innovation Institute (LCII), Brussels (June 16, 2014).

⁸⁴ See, *Tesco v OFT* [2012] CAT 31, ¶110(a) ("The [Early Resolution Agreements] are unsworn documents, containing admissions which Tesco has not had the opportunity to test by cross-examining the individuals who it is alleged engaged in the conduct or had the relevant state of mind.")

⁸⁵ Indeed, in U.K. case law, the leniency regime if anything has resulted in more adverse inferences being drawn **against** competition authorities in relation to evidential gaps. The reason is that a condition of leniency is that the applicant has an ongoing duty to assist the competition authority (including in appeals) and that the failure of a competition authority to secure support for its theory of harm or core factual evidence from a cooperating leniency applicant may be an eloquent silence justifying some adverse inference against the competition authority. See, e.g., See *Tesco v OFT* [2012] CAT 31, ¶110(a) ("This, it seems to us, is a particularly important factor given the obligation contained in each [Early Resolution Agreement] requiring the relevant admitting party to use its reasonable endeavors to secure the co-operation and attendance of witnesses—an undoubtedly powerful tool in the hands of the OFT but one of which it has not availed itself.")

⁸⁶ See, *Tesco v OFT* [2012] CAT 31, ¶110(d) ("Although entering into an [Early Resolution Agreement] with the OFT is, in one sense, contrary to the interests of an admitting party, which might be thought to make it more likely than not that the admission is true, there are a number of other factors that might lead an undertaking to take a 'commercial' decision to admit liability for an infringement, which might be, at least in part, untrue or which the undertaking simply has not investigated. These factors include the prospect of a substantial penalty reduction and the avoidance of potentially protracted proceedings both before the OFT and, possibly, before this Tribunal."). This comment was made in the context of early resolution agreements,

which are not the same as leniency statements. But the general point remains good.

⁸⁷ See, *Imperial Tobacco Limited and others v OFT* [2011] CAT 41, ¶86.

⁸⁸ *Id.* ¶88.

Decision-Making Powers and Institutional Design in Competition Cases: The Application of Competition Rules by Sectoral Regulators in the United Kingdom

BY JACKIE HOLLAND & AURORA LUOMA¹

In the United Kingdom various sectoral regulators have concurrent power to apply EU and U.K. competition law alongside the national competition agency, the Competition and Markets Authority (“CMA”). It is a somewhat unusual system and there has been much debate over past years about whether this system works effectively or whether it results in the underuse of competition law powers in regulated sectors. Recent reforms in the United Kingdom have sought to reinforce competition law enforcement by sectoral regulators. Moreover, concurrency is on the increase with additional regulators having been given concurrent powers over recent years and the CMA indicating that it will also focus its attention on competition in regulated sectors.

It remains to be seen what these developments mean in practice for the regulated sectors, but we can expect increased efforts to apply competition law in these sectors, both by the CMA and the regulators themselves. The success of these efforts will depend on the institutional design and decision-making structures within sectoral regulators and how well these promote the use of competition law powers, where appropriate, in a consistent and effective manner—something which will need to be worked out by the regulators and CMA on the ground.

In this paper, we focus on the topics of institutional design and decision-making within sectoral regulators in relation to competition cases. We start by considering why there has been so much focus on ensuring that the competition rules are applied in the regulated sectors in the United Kingdom. We then review alternative models for applying competition rules in regulated sectors used in different jurisdictions and consider the internal institutional design factors that might influence the sectoral regulators’ focus on competition cases in the U.K. context.

I. INTRODUCTION

In the United Kingdom various sectoral regulators² have concurrent power to apply EU and U.K. competition law alongside the national competition agency, the Competition and Markets Authority (“CMA”).³ It is a somewhat unusual system and there has been much debate over past years about whether this system works effectively or whether it results in the underuse of competition law powers in regulated sectors.

For the time being at least, the concurrency regime is here to stay with the Department for Business Innovation and Skills (“BIS”) choosing to maintain the concurrency regime during the recent reform of U.K. competition law, while providing a power to remove concurrent powers from a regulator in certain circumstances. With the aim of incentivizing sectoral regulators to use their competition powers instead of their regulatory powers, a primacy duty was placed on the concurrent regulators, obliging them to consider the use of their competition powers first before taking action under their regulatory powers.⁴

IN FACT, CONCURRENCY IS ON THE INCREASE WITH ADDITIONAL REGULATORS HAVING BEEN GIVEN CONCURRENT POWERS OVER RECENT YEARS

In fact, concurrency is on the increase with additional regulators having been given concurrent powers over recent years, including Monitor (the U.K. healthcare regulator), whose powers came into effect on April 1, 2013, and the Financial Conduct Authority (“FCA”), whose powers vest on April 1, 2015. In the meantime, the Strategic Steer for the CMA issued

by BIS in October 2013,⁵ and the CMA’s Annual Plan published in April 2014,⁶ also indicate an intention for the CMA itself to focus its attention on competition in regulated sectors.

It remains to be seen what this means in practice for the regulated sectors, but we can expect increased efforts to apply competition law in these sectors both by the CMA and the regulators themselves. The success of these efforts will depend on the institutional design and decision-making structures within sectoral regulators and how well these promote the use of competition law powers, where appropriate, in a consistent and effective manner—something which will need to be worked out by the regulators and CMA on the ground.

In this paper, we therefore focus on the topics of institutional design and decision-making within sectoral regulators in relation to competition cases. We start by considering why there has been so much focus on ensuring that the competition rules are applied in the regulated sectors in the United Kingdom. We then review alternative models for applying competition rules in regulated sectors used in different jurisdictions and consider the internal institutional design factors that might influence the sectoral regulators’ focus on competition cases in the U.K. context.

II. BACKGROUND—WHY IS THE APPLICATION OF COMPETITION RULES IN THE REGULATED SECTORS IMPORTANT?

A. *Competition Enforcement in Regulated Sectors in the United Kingdom*

As is common in many countries, widespread sectoral regulation came into being with the privatization of state monopolies in areas such as utilities and telecoms in the 1980s and 1990s. The conventional philosophy has been that sectoral regulation is a necessary step to protect consumers in previously monopolistic markets, with the idea that regulation would eventually “wither away” in favor of open competition supported by competition law enforcement:

The original principle at the time of privatisation of many of the utilities was that sectoral regulation would be withdrawn over time as effective competition was introduced into the market. [...] Competition would replace the role of price control regulation [...].⁷

The United Kingdom is relatively unusual within Europe in having a concurrency regime whereby both the competition authorities and sectoral regulators have competition enforcement powers. This means

that the sectoral regulators have the power to apply competition law in order to deal with anticompetitive agreements or abuses of a dominant position that relate to activities in their respective sectors, concurrently with the CMA.⁸ The concurrent regulators also have the power to initiate market investigations in sectors where competition is considered not to be working effectively under the UK Enterprise Act 2002.

The perceived benefits of a concurrency system are that it: (a) leverages the regulators' industry expertise, enabling them to use their sector-specific knowledge when bringing cases in their sectors; (b) maximizes the enforcement of competition law through working in partnership, enabling more cases to be brought in aggregate; and (c) encourages regulators to rely on their general competition law powers instead of sector-specific regulatory powers where appropriate (absent concurrent competition powers, regulators may be reluctant to pass an issue on to be dealt with by the national competition agency and so may use their sectoral regulation powers instead). There may also be a further potential advantage in terms of stimulating competition among the various regulators, leading to enhanced performance.⁹

The potential disadvantages include: (a) the complexity of the system; (b) the scope for conflict and inconsistency in application of competition rules by a number of independent bodies; and (c) the inefficiencies caused by the duplication of effort and resources; for example, through each regulator needing to recruit and train specialized staff.

However, rather than issues arising from a proliferation of conflicting decisions from different sectoral regulators, there has been little enforcement of competition law in the regulated sectors in the United Kingdom.¹⁰ Since 2000, when the majority of the sectoral regulators were given concurrent powers, there have been only two competition law infringement decisions by regulators in the United Kingdom and three phase

HOWEVER, RATHER THAN ISSUES ARISING FROM A PROLIFERATION OF CONFLICTING DECISIONS FROM DIFFERENT SECTORAL REGULATORS, THERE HAS BEEN LITTLE ENFORCEMENT OF COMPETITION LAW IN THE REGULATED SECTORS IN THE UNITED KINGDOM

II market investigation references (and one other case, where undertakings were accepted in lieu of a market investigation reference).¹¹ The concurrency arrangements in the United Kingdom have been reviewed several times by different institutions and, in each case, the lack of competition enforcement by sectoral regulators was noted and questioned.¹² Most recently in the consultation document paving the way for the current reforms it was noted by BIS that:

Given that regulated sectors contain many of the most dominant companies and uncompetitive market structures and cover services of considerable consumer interest, this comparative lack of activity in the regulated sectors seems surprising.¹³

Part of the reason for the concern may well have been a comparison with the portfolio of work undertaken by the European Commission, where high profile precedent cases in various regulated sectors have been relatively commonplace.¹⁴

The reasons put forward for the paucity of competition enforcement in the regulated sectors in the United Kingdom have been varied, including: (a) the difficulty of bringing lengthy competition law cases,

particularly in complex areas such as abuse of dominance; (b) the overly close relationship with the relevant sector, perhaps resulting in regulatory capture; and/or (c) that regulation may be the more effective and immediate tool in some regulated markets.¹⁵

There was also a perceived reluctance by the Office of Fair Trading (“OFT”), the predecessor to the CMA, to engage actively in regulated markets. It has been observed that in part this may have been a result of the resources available to the OFT (which had a much smaller budget than the budgets available to sectoral regulators). This may have led the OFT to focus on investigating concerns in relation to non-regulated industries, leaving the sectoral regulators to lead on issues in their own sectors.¹⁶ This would not be surprising given the presence of regulators dedicated to covering these markets with the ability to bring competition cases where appropriate.

For these reasons, there has been substantial focus on the enforcement of competition rules in regulated sectors in the United Kingdom and the concurrency model itself. Regulated markets account for a reported 25 percent of the U.K. Gross Domestic Product, covering key areas such as utilities, telecoms, transport, and financial services.¹⁷ Their proper functioning is therefore critical to the U.K. economy as a whole.

INDEED, THE CONTINUATION OF THE CONCURRENCY MODEL WAS QUESTIONED DURING THE RECENT REFORMS IN THE UNITED KINGDOM

B. What are the Alternatives?

It is a valid question whether, despite the good intentions in implementing the concurrency regime in the United Kingdom initially, and the recent reforms to strengthen the system, such a regime would be contemplated if a system of competition law enforcement in regulated sectors were being put into place *ab initio* in today’s world. Indeed, the continuation of the concurrency model was questioned during the recent reforms in the United Kingdom.

There are other models that offer some of the benefits of concurrency but also avoid some of the pitfalls (such as inconsistency, duplication, and the inefficient allocation of cases). Two of the most prevalent are:

- *Separation of Powers*: A clear division between competition authorities (with exclusive competition law enforcement powers) and sectoral regulators (with only regulatory powers); and
- *Combination of Powers*: The combination of competition and regulatory authorities (or some regulators or regulatory powers) into a single regulatory body.

The first is the more common system in the rest of Europe. This system has the benefits of: (a) consistency of outcome, with one body exercising competition powers across the entire economy and possibly spotting cross-industry trends more easily; (b) a clear focus and remit for the different bodies; and (c) avoiding

regulatory capture. However, absent robust mechanisms to share industry expertise with the competition agency, this system may fail to capitalize upon the industry expertise of sectoral regulators. It also places a high burden on the national competition authority (with often limited resources) to manage competition law compliance across all sectors, which could result in under- or no enforcement in certain regulated sectors if the issues arising in those sectors were not prioritized for investigation.

The second model has been recently adopted, for example, in Spain and the Netherlands. In 2013 the Spanish national competition authority was combined with the regulators for railways, energy, telecoms, airports, postal services, and broadcast media as a single “super-regulator” that both enforces competition rules and directly regulates economic sectors.¹⁸ The rationale was reportedly to gain efficiencies from integrating several institutions with common objectives and complementary activities.¹⁹

IT IS ALSO OPEN TO QUESTION WHETHER A SINGLE BODY CAN MAINTAIN AND DEVELOP THE INDUSTRY-SPECIFIC EXPERTISE OF DEDICATED SECTORAL REGULATORS

While this model offers potential benefits in terms of consistency and efficiency, since competition and regulatory enforcement are in the hands of a single body, questions arise as to whether competition law enforcement in specific regulated sectors could be undermined by being subsumed within the wider priorities of a single super-regulator (compared to having a dedicated competition agency focusing on the use of competition powers).²⁰ It is also open to question whether a single body can maintain and develop the industry-specific expertise of dedicated sectoral regulators.

In the Spanish system, this appears to have been addressed through internal structures by maintaining distinct investigative directorates for each regulated sector (energy, communications, transport) as well as a directorate for the promotion of competition, all of which are under the supervision of, and report to, a council which will form the decision-making body. The council will have separate competition and regulatory chambers, each of which can opine on cases of the other chamber.

C. The Recent Reforms in the United Kingdom

Ultimately, the recent U.K. reforms sought to reinforce the concurrency regime, develop further the relationship between the CMA and the sectoral regulators, and enhance the “emphasis on early and proper consideration of the use of anti-trust powers (under Part 1 of the Competition Act 1998 (“CA98”) by the sector regulators.” The Chairman of the CMA has recently noted:

Co-operation between the competition authority and the regulator is, we believe, the best way forward. In collaboration, the regulators bring their deep knowledge of the sector; while the CMA brings the competition expertise that the regulators, particularly the smaller ones, may lack, as well the consistency of approach across sectors, both regulated and unregulated. And given the resourcing disparity noted above, collaboration is the only realistic way forward if we are to have good portfolio of competition cases in the regulated sectors.²²

The reforms sought to address some of the perceived weaknesses in the system by increasing the incentives for sectoral regulators to use their competition powers. These include both positive and negative incentives. Positive incentives (carrots) include: (a) the primacy duty for the regulators to consider using their competition law powers before using their regulatory powers²³; (b) enhanced support in the form of sharing expertise, knowledge, and resources between the CMA and the regulators to assist regulators in bringing competition cases; and (c) the requirement for the CMA to produce an annual report on the effectiveness of the concurrency regime and the application of competition powers in the regulated sectors, which may encourage regulators to consider what action under their competition powers they will be able to report at the end of the year and hence incentivize action.

Negative incentives (sticks) include the threats that the CMA can in certain circumstances, up to the point when the Statement of Objections (“SO”) has been issued, take over a case being brought by a regulator, and that the Secretary of State can make an order to remove the concurrent powers from the regulator altogether in certain circumstances.

There have also been wider questions around the appropriate balance between competition law enforcement and regulation in these sectors—the detail of which is beyond the scope of this article. Recent thinking has recognized increasingly the likely on-going role of regulation in these sectors (there is less focus on the idea that sectoral regulation would “wither away” and competition would take over). It has been

IT HAS BEEN RECOGNIZED THAT COMPETITION LAW ENFORCEMENT IS NOT ALWAYS SUFFICIENT TO ENSURE WELL-FUNCTIONING MARKETS WHERE MARKET FORCES ALONE ARE INADEQUATE TO ENSURE COMPETITIVE OUTCOMES

recognized that competition law enforcement is not always sufficient to ensure well-functioning markets where market forces alone are inadequate to ensure competitive outcomes.²⁴ The current reforms do not address this issue in detail but note that “regulators should have the freedom to choose the best tools to achieve their desired outcomes.”²⁵ This is a relevant factor for designing effective decision-making processes, as

discussed further below.

Against this background, we consider below how the concurrency system is organized in the United Kingdom, and give consideration to how regulators may organize themselves to meet their obligations most effectively under the revised concurrency regime.

III. CONCURRENCY IN PRACTICE

A. *The Relationship Between Different Regulatory Bodies*

The Enterprise and Regulatory Reform Act 2013 (“ERRA”) sought to reinvigorate many of the systems that were put in place to support the concurrency model. In particular, the ERRA looked to promote efficient allocation of competition cases and consistency in decision-making between the regulatory bodies, two factors which are critical to the success of a concurrency model. Specifically:

- The CMA’s Concurrency Guidance²⁶ sets out principles according to which the CMA and regulators must inform each other when they propose to exercise competition functions and believe there may be concurrent jurisdiction.
- There are a number of general principles to determine who will be responsible for a case, including: (a) whether the CMA or regulator has experience with dealing with the undertakings/complainants involved, similar issues, or the relevant sector; (b) whether the case affects more than one sector; and (c) whether the CMA considers it necessary to take jurisdiction for policy reasons. These principles are not new, but place greater emphasis on the role of the CMA. Where previously it was the norm that the regulator whose sector was concerned by the case would lead the investigation, under the new guidelines the norm is that either the regulator or the CMA will lead the case, “depending on which of them is better or best placed to do so.”²⁷
- There is an obligation—based on similar provisions in the EU Regulation on the implementation of rules laid down in Articles 101 and 102 TFEU²⁸—to share a Statement of Objections (“SO”) with the CMA (or the regulator if the CMA wants to issue a SO) no later than 15 days before issuing the SO. The same obligation applies to any provisional or final findings, decisions, or notices. This is designed to provide an opportunity for the CMA or regulator to comment on the approach being taken and to raise any concerns in advance of the formal document being issued to the parties, and it therefore can play a role in achieving a consistency of approach.
- A coordinating body—the UK Competition Network (“UKCN”)—operates as a forum for developing practical working arrangements, discussing matters of common interest, and coordinating the provision of advice and information on the application of the law to the public. The UKCN will share information on strategic options to use competition or regulatory powers to promote market mechanisms and competition law developments, as well as cooperating on enforcement work including sharing know-how and resources.
- There are provisions for sharing expertise between bodies—for example secondments of staff, regular meetings at all levels, providing training and answering specific queries from time to time, and providing information or advice on a specific sector or market or an area of competition law policy.
- Some consistency of procedures is achieved since the CMA Rules that set out procedures for competition cases²⁹ also apply to the sectoral regulators (albeit these are relatively high level).
- Consistency of substantive outcome is supported through section 60 CA98³⁰ and by the role of the Competition Appeals Tribunal, which hears appeals of competition law decisions made by the CMA and all the sectoral regulators.

OF PARTICULAR NOTE IN OUR VIEW IS WHETHER THE UKCN WILL ACHIEVE THE DESIRED AIM OF RE-INVIGORATING WORKING PARTNERSHIPS BETWEEN THE REGULATORY BODIES

These basic mechanisms are not new, but it will be interesting to see whether in their revised form they will serve to shore up competition enforcement in regulated sectors when combined with the new primacy duty, the power for the CMA to take over cases, and the threat of the removal of concurrent powers, as referred to above.

Of particular note in our view is whether the UKCN—essentially building on the work of the previous Concurrency Working Party³¹—will achieve the desired aim of re-invigorating working partnerships between the regulatory bodies. The UKCN’s Statement of Intent makes it clear that regulatory heads should involve themselves personally in the establishment and supervision of an appropriate program of work and to manage the delivery of agreed actions.³² The requirement for senior level staff to be involved in the UKCN suggests a desire to ensure that suitable focus is given to this initiative.

Another key element is the opportunity to share expertise between bodies. Staffing and resources are likely to remain practical obstacles for the running of CA98 cases at the CMA and within the sectoral regulators. While secondments have been in place between regulators for some time, the proposal to increase secondments could be particularly useful to share expertise on particular aspects of competition law enforcement procedures, such as the conduct of dawn raids and oral hearings, and, where the CMA is carrying out an investigation in a regulated sector, by providing staff with specialized industry knowledge. Short-term secondments may play a significant role in minimizing disruption for the seconding body, while lending key expertise to the sectoral regulator or CMA in areas of competition law investigations that are critical to the enforcement process.

One of the disadvantages of the concurrency regime is that the CMA and sectoral regulators may end up fighting to secure the services of the relatively limited pool of experienced competition lawyers and economists who are willing to work on the agency side of the house. In the past year, the CMA and the FCA in particular have carried out large-scale recruitment exercises. While some new talent has been attracted into the agencies, many posts are filled from recruits from one of the other U.K. competition agencies. This can be

THERE ARE A NUMBER OF DIFFERENT
WAYS IN WHICH REGULATORS CAN
ACCOMMODATE THEIR COMPETITION
LAW ENFORCEMENT OBLIGATIONS
WITHIN THEIR INSTITUTIONAL
STRUCTURE

very valuable in terms of sharing and building on know-how of how cases are run in other agencies, but it can also be disruptive to the agency that has lost staff. A radical alternative would involve having a central pool of resources capable of running CA98 cases in any sector, perhaps based at the CMA but seconded out to work on specific cases at the regulators.

In practice, it will be interesting to see whether the CMA seeks to take on CA98 cases in regulated sectors itself or whether instead it operates an enhanced partnership working model, supporting and encouraging the regulators to take CA98 cases.

B. The Conflict of Powers Within Regulatory Bodies—Decision-Making Processes

In addition to establishing systems that ensure smooth operation of concurrent powers between regulators, a concurrency model must support effective decision-making processes *within* regulatory bodies, to promote appropriate competition law enforcement.

There are a number of different ways in which regulators can accommodate their competition law enforcement obligations within their institutional structure. They may choose to have a specific competition division separate from their regulatory enforcement work or they may choose to have an enforcement division covering both competition and regulatory enforcement work.

The FCA provides one example. It was established on April 1, 2013 and set up a specialist Competition Department, headed by former senior OFT personnel, with a view to ensuring the implementation of the FCA's objectives to promote competition.³³ This is housed within the Policy, Risk and Research Division separate from its Enforcement and Financial Crime Division, which is responsible for regulatory enforcement. Having announced in 2013 that it would employ market studies as its preferred tool to examine competition issues,³⁴ the FCA has since launched four such studies,³⁵ with plans to launch at least one further investigation in 2014.³⁶ No guidance on its approach to concurrency has yet been published, but this should be expected when its concurrent powers come into force in 2015. It is therefore not yet clear whether competition investigations will be run by the Competition Department or, together with regulatory enforcement, by the Enforcement and Financial Crime Division.

THE ORGANIZATIONAL CULTURE, BUDGET ALLOCATION, AND DECISION-MAKING PROCESSES WITHIN THE REGULATOR MAY WELL HAVE A SIGNIFICANT IMPACT ON THE TYPE OF CA98 CASES THAT ARE PURSUED, AND POTENTIALLY ON THEIR OUTCOME

This model can be contrasted with Ofgem, which operates through four different sub-groups: (i) Smarter Grids and Governance: Transmission—regulating gas and electricity transmission networks, (ii) Smarter Grids and Governance: Distribution—regulating gas and electricity distribution, (iii) Sustainable Development, and (iv) Markets—regulating wholesale and retail gas and electricity markets. Ofgem operates under a published enforcement vision “to achieve a culture where businesses put energy consumers first and act in line with their obligations” and seeks to achieve its objectives by using “a range of enforcement tools.”³⁷ Ofgem's draft guidance notes that it will consider “at an early stage in the process” whether it is more appropriate to use competition law or regulatory powers.³⁸ Under its new system, the Enforcement Oversight Body (“EOB”) reviews strategic priorities and may also make decisions on opening cases and whether to use competition law powers. The members of the EOB are usually senior civil servants from across Ofgem. It is chaired by the senior partner with responsibility for enforcement, who is a member of the sustainable development sub-group.

It will be interesting to evaluate in the future whether the choice of internal structure has an impact on

the level of competition law enforcement undertaken.

The institutional arrangements provide the setting for the implementation of competition enforcement, but the organizational culture, budget allocation, and decision-making processes within the regulator may well have a significant impact on the type of CA98 cases that are pursued, and potentially on their outcome. The questions that may be relevant include:

- What are the organization's core objectives for CA98 enforcement; for example, is the organization focused on the speed of delivery, the number of cases completed, or the robustness of the final decision if the case is appealed?
- Does the organization have a preference for (i) "quick interventions" designed to resolve issues as quickly as possible (e.g. through informal commitments from the parties), (ii) robust final decisions having precedent value and providing a strong deterrent effect, or (iii) a mix of both?
- Has a budget been specifically allocated to a team dedicated to CA98 enforcement, who will then be actively seeking CA98 investigations to pursue? Or does no such specific budget exist, with the effect that pipeline CA98 cases will have to "fight" with other types of potential pipeline cases for staffing and resources?
- Is the organization culturally content with pipeline cases being opened at an early stage and then closed if the original concerns turn out to be unfounded or is the organization reluctant to be perceived to be making a U-turn in such circumstances?

These are all questions, which it is suggested, that regulatory bodies will need to consider in establishing an internal structure that can effectively implement competition law powers.

IV. DESIGN OF DECISION-MAKING PROCESSES FOR REGULATORY BODIES

IN PRACTICE, THIS MEANS THAT THE REGULATORS MAY CHOOSE TO INTERPRET THE CMA RULES DIFFERENTLY AND SO THEIR PROCEDURES MAY VARY FROM THE CMA'S IN SOME RESPECTS

For CA98 cases, there are several key stages at which decisions need to be made, each of which could have an impact on the success of the concurrency regime: (i) the Pipeline/Case Opening Stage—deciding which cases to investigate, which tool(s) to use, and which body (European Commission, CMA, or regulator) is best placed to investigate the case; (ii) the Investigation Stage—investigating the issues, ultimately resulting in a decision on whether or not to issue a SO; and (iii) the Final Decision Stage—making the final decision on whether or not there has been an infringement or not and, if so, on the imposition of financial penalties and/or directions.³⁹ We consider below some of the key considerations that may be relevant in constructing an effective decision-making process for concurrent competition law enforcement.

While the CMA Rules apply to sectoral regulators, they are relatively high level, with much detail being included in the CMA's Procedural Guidance for CA98 Cases.⁴⁰ In practice, this means that the regulators may choose to interpret the CMA Rules differently and so their procedures may vary from the CMA's in some respects.

A. *Pipeline / Case Opening Stage*

At the Pipeline/Case Opening Stage, the regulator or the CMA may have received a complaint or leniency application about an alleged anticompetitive practice, or they may have identified the potential issue themselves from horizon scanning. In any agency there are likely to be a number of competing pipeline cases and it is unlikely that the agency will have resources to investigate them all. In the United Kingdom, the competition agencies do not have a duty to investigate all CA98 complaints or allegations and are free to close investigations on administrative priority grounds. For a sectoral regulator, the pipeline cases may include alleged breaches of license conditions as well as CA98 issues and, given the new primacy duty on regulators to consider the use of CA98 powers first, tool selection may become a particularly challenging issue.

HUMAN NATURE WOULD SUGGEST THAT SOME WOULD CHOOSE THE EASIER REGULATORY OPTION ON RATIONAL VALUE FOR MONEY GROUNDS ALONE, AND IS THIS SUCH A BAD OUTCOME?

For the concurrency regime to be successful, the following questions should be considered:

- What are the prioritization principles used to decide whether to investigate a case? For example, would a sectoral regulator take into account the fact that the practice in question was prevalent in a number of regulated industries and so the decision could provide an important precedent?
- What factors will the regulator take into account when deciding whether to use its CA98 or regulatory powers? In many cases the quickest and easiest enforcement route may be to use their sectoral regulation powers, resolving consumer detriment more quickly and efficiently. In what circumstances should the regulator choose, nevertheless, to use its CA98 powers, which may involve greater costs of investigation and an uncertain outcome?

There are no easy answers to these questions. Ultimately the answer will depend on the desired outcome for the regime—is the key driver to solve issues in the most efficient way possible or to ensure that CA98 cases are brought in the regulated sectors? The new primacy duty and annual reporting on activity in the regulated sectors suggests a clear desire that the CA98 tool be used to address issues in regulated sectors, partly due to the deterrent impact that such decisions may have for businesses in the sector in question but also more

AN INTERESTING QUESTION IS WHETHER WE WILL SEE AN EVEN GREATER CONVERGENCE OF INVESTIGATION PROCEDURES BETWEEN THE CMA AND REGULATORS

widely across the economy. But how will this work in practice if the relevant decision-maker in a regulator is presented with two alternatives—a relatively more certain regulatory route which will be quicker and easier to follow or a more complex, risky,

and costly CA98 route? Human nature would suggest that some would choose the easier regulatory option on rational value for money grounds alone, and is this such a bad outcome?

B. Investigation Stage

Once the case has been opened and allocated to a regulator, the new “claw back provision” comes into play—allowing the CMA to take the case back at any point until the SO has been issued. Will this have an impact on the way the regulators run the case? Will they be incentivized to liaise more closely with the CMA to ensure that they are content with the progress of the investigation? Will CMA representatives sit on the steering committees of regulator cases as has sometimes happened in the past? If so, this must be welcome news. Some of the regulators, especially the smaller ones, may not have much experience of running competition cases. History has shown that there can be considerable challenges in running such cases and the sharing of expertise and know-how between the CMA and sectoral regulators (in both directions) should be routine.

An interesting question is whether we will see an even greater convergence of investigation procedures between the CMA and regulators. For example, for parties to investigations and their lawyers, there is

ONE PARTICULAR CONCERN IS THE
NEED TO ENSURE CONSISTENCY
BETWEEN CA98 DECISIONS, WHETHER
TAKEN BY THE CMA OR A REGULATOR

limited value to the regulators pursuing different investigation procedures. We would hope that the renewed efforts of the UKCN to develop common know-how, share best practice, and enhance process handling should aim to ensure that minimum standards and common procedures are followed where possible;

for example, rolling out the CMA’s commitment to hold a state-of-play meeting with the parties to the investigation before the decision is taken to issue an SO, in order to provide access to the relevant decision-maker and/or the Procedural Officer role.

C. The Decision Stage

The CMA Rules provide that the person who makes the final decision in a case must be different from the person who conducted the investigation and issued the SO.⁴¹ This provision was included to address a perceived confirmation bias in that the decision-maker(s) who previously decided to issue a SO could then also decide, following the parties’ written and oral representations, whether an infringement had taken place.

Once an SO has been issued, building on the procedural reforms made by the OFT, the CMA appoints a Case Decision Group whose members have not been involved with the case previously to review the parties’ written representations, attend the oral hearings with the parties, and then reach a decision on whether or not there is an infringement decision. This is an important way of providing access for the parties to the decision-makers on the case.

Some of the regulators may consider that their existing procedures for CA98 cases already meet this requirement. Others have taken the opportunity to change them. For example, Ofgem has set up an

Enforcement Decision Panel that will take important decisions in contested enforcement cases and is staffed by external specialists (including competition lawyers and economists). For regulatory decisions, the FCA has a distinct decision-making panel (the Regulatory Decisions Committee) that makes final decisions on contested cases (after a decision is taken as to which powers to use in the investigation). It will be interesting to see whether the FCA adopts a similar or different model for its CA98 cases when it receives its concurrent powers in 2015.

A PARTICULARLY KEY DECISION TO BE MADE UNDER THE NEW REGIME WILL BE THE “PRIMACY DUTY DECISION” ON WHETHER OR NOT TO USE THE CA98 POWERS FOR A SPECIFIC ISSUE

One particular concern is the need to ensure consistency between CA98 decisions, whether taken by the CMA or a regulator. It is critical, in order to assist businesses seeking to comply with the law, that CA98 decisions demonstrate a consistent and clear approach to defining what types of behavior breach the law, which will also provide an important deterrent effect. As mentioned above, the new concurrency arrangements provide for the regulators to send the CMA a copy of their draft decision 15 days before it is adopted.

But does this really provide a suitable mechanism for achieving consistency of approach? Certainly by this stage it would be difficult and cause significant time delays if the CMA were to require fundamental changes in the way the case was being argued and these may even require the issuing of a Supplementary SO to the parties. This seems like a mechanism of last resort, with the CMA and regulators more wisely spending time discussing the case at earlier stages of the case. But what if they cannot agree on the way the case should be argued? How will such disputes be resolved? It would seem an unsatisfactory outcome if cases end up being closed on administrative priority grounds along the way due to a lack of agreement on the handling of the case. The UKCN should seek to guard against such outcomes.

D. How To Evaluate Decision-Making Options

The choice of decision-making model will depend on the regulator’s objectives. The regulator is likely to have a number of objectives, some of which may naturally conflict with one another, such as:

- Speed/Efficiency—ensuring that cases are completed as quickly and efficiently as possible, including capitalizing on know-how rather than reinventing the wheel each time;
- Robustness/Quality—ensuring that the final decision is robust, so that it can be defended successfully on appeal;
- Procedural Fairness—ensuring that parties under investigation are treated fairly and given the opportunity to exercise their rights of defense fully;
- Consumer outcome—ensuring that any consumer detriment is addressed;

- Transparency—ensuring that the decision is made public to deter other businesses from engaging in the practice in question and also to help businesses seeking to comply;
- Consistency—ensuring that the decision is consistent with other decisions of the regulator and other regulators/the CMA so as to provide clear guidance to business as to what is and is not acceptable under competition law; and
- Policy/precedent—taking a decision that will act as a precedent for the industry or the wider U.K. economy on an important issue.

The relative importance of some of these objectives varies according to the stage the case is at. For example, robustness may become increasingly important as the case progresses, whereas speed and efficiency may be equally important throughout the case. Transparency is important at specific stages—primarily at the complaint stage (so that others with relevant information are aware that an investigation is underway so that they can come forward) and the final decision stage (to provide a deterrent and also guidance for businesses seeking to comply). Procedural rights are of course important at all stages. It is particularly important to ensure that the parties know the identity of the relevant decision-maker at each stage of proceedings and have access to that decision-maker before key decisions are taken.

Any final decision-making model is likely to be a compromise between some of the objectives; for example, there may be trade-offs between achieving both speed and robustness of decision-making. A particularly key decision to be made under the new regime will be the “primacy duty decision” on whether or not to use the CA98 powers for a specific issue, and this will be one area where the regulator will need to put an appropriate system in place to weigh the conflicting objectives. In some cases this may involve a complex consideration of the best way to address the potential consumer detriment in terms of speed/efficiency as against the opportunity to create a precedent competition law decision to the benefit of the wider economy. These are not easy decisions to take.

V. CONCLUSIONS

WE WILL NOT NEED TO WAIT LONG FOR A FURTHER REVIEW OF THE CONCURRENCY REGIME

The changes to the U.K. competition landscape have been designed to beef up the use of competition law enforcement powers in the regulated sectors by the sectoral regulators and/or the CMA. In the past, regulators had the ability to use competition law enforcement, but there was a perception that there was under-enforcement in these sectors, with greater reliance being placed on sector-specific regulatory powers to fix issues arising. The changes have been principally designed to increase the regulators’ incentives to use competition law tools in preference to their regulatory powers.

But will this have any effect in practice? Much will depend on how the regulators organize themselves

internally—the focus and importance they give to competition law enforcement compared to regulatory enforcement and their internal decision-making processes. It remains to be seen whether there are a raft of cases waiting to be tackled under competition law by the CMA or the regulators, or whether it will turn out that regulatory enforcement may be an efficient way to tackle such issues. Whatever the outcome, the enhanced co-operation between the CMA and the regulators must be a positive move. Ensuring that expertise is shared across organizations enforcing the same law will ensure that efficiencies are gained cross-organization in all directions. There is plenty of scope for the CMA to learn from the practice of the sectoral regulators, as well as the other way round.

We will not need to wait long for a further review of the concurrency regime. The ERRA 2013 requires BIS to review the operation of the antitrust provisions of CA98 and produce a report on the outcome of the review by April 1, 2019. No doubt the success, or otherwise, of the enhanced concurrency arrangements will feature heavily in this review.

By then there should be a richer evidence base available in the form of the CMA's annual reports on concurrency, which may prove to be livelier reading than one might have expected, with the regulators and the CMA keen to show that they are using their powers effectively. We hope, however, that BIS will not be overly focused on the number and speed of cases, but will instead look at the outcomes for consumers and whether these were best achieved through the use of competition or regulatory powers. It may also be wise for BIS to consider the different internal structures and decision-making processes followed to see whether any lessons can be learned as to which models operate most effectively to encourage the use of competition law powers where appropriate. ▲

¹ Jackie Holland is a Special Adviser and Aurora Luoma a Senior Associate in the Competition Group of Slaughter and May. Until October 2013, Jackie was a Senior Director of the Office of Fair Trading and its Procedural Adjudicator for Competition Act 1998 (“CA98”) cases. This article reflects solely the views of the authors, and does not reflect the views of Slaughter and May, its partners, or its clients. It reflects developments up to July 9, 2014.

² As at June 30, 2014 these were the Office of Communications (“Ofcom”), the Office of the Gas and Electricity Markets (“Ofgem”), the Water Services Regulation Authority (“Ofwat”), the Office of Rail Regulation (“ORR”), the Civil Aviation Authority (“CAA”), the Northern Ireland Authority for Utility Regulation (“NIAUR”), and Monitor (the UK health regulator). From April 1, 2015, the Financial Conduct Authority (“FCA”) will also have concurrent powers.

³ The Enterprise and Regulatory Reform Act 2013 (“ERRA 2013”) abolished the Office of Fair Trading (“OFT”) and Competition Commission (“CC”), the previous national competition authorities in the U.K., and established the CMA. The CMA has taken over the competition (and some consumer) functions of the OFT and all the functions of the CC. The CMA began its role as the new U.K. national competition agency on April 1, 2014.

⁴ The primacy duty for Monitor will not be commenced until a later date.

⁵ BIS, *Response to Consultation on Statement of Strategic Priorities for the CMA*, (1 October 2014).

⁶ CMA, *Competition and Markets Authority Annual Plan 2014/15* (CMA 15), (1 April 2014).

HM Treasury and Department of Trade and Industry, *Concurrent Competition Powers in Sectoral Regulation*, May 2006 (the “HMT/DTI Report”), ¶1.4.

⁸ Both Articles 101 and 102 of the Treaty on the Functioning of the European Union (“TFEU”) and the Chapter I and Chapter II prohibitions of CA98.

⁹ See William E Kovacic and David A Hyman *Competition Agency Design: What’s on the Menu?* 8(3) EURO CJ 527-538 (2012).

¹⁰ It should be noted, however, that the evidence points only to a small number of infringement decisions. It does not confirm whether or not there has been under-enforcement of competition law; that is whether there have been cases which should have resulted in an infringement decision but which have not been pursued by a regulator or the OFT/CMA.

¹¹ The infringement decisions were: ORR decision of 17 November 2006 *English, Welsh and Scottish Railway Limited*, [2007] UKCLR 937; and Ofgem decision of 21 February 2008 *Investigation into National Grid* [2008] UKCLR 171. The market investigation references were: ORR decision of 26 April 2007 *Leasing of rolling stock for franchised passenger services*; Ofcom decision of 4 August 2010 *Premium pay TV movies* and, more recently under the new regime which came into force on April 1, 2014, Ofgem decision of 26 June 2014 *Supply and acquisition of energy in Great Britain*. The undertakings in lieu of a market investigation reference were accepted by Ofcom in its decision of 22 September 2005 *Strategic Review of Telecommunications*. These numbers do not include a larger number of no grounds for action or case closure decisions. For the full figures, please refer to the CMA, “*Baseline*” *annual report on concurrency—2014* (1 April 2014).

¹² See the HMT/DTI Report, ¶11; House of Lords Select Committee on Regulators, UK Economic Regulators ¶6.24 (November 2007); National Audit Office (“NAO”), *Review of the UK’s Competition Landscape*, (the “NAO Report 2010”), ¶4.11 (March 2010).

¹³ BIS, *A competition Regime for growth: a consultation on options for reform* (the “BIS Consultation”), ¶7.7 (March 2011).

¹⁴ See, for example, the following decisions in the period from 2010: Commission decision of 18 December 2013 *Deutsche Bahn I/III*, Case AT.39678/AT.39731, OJ 2014 C86; Commission decision of 10 April 2013 *CEZ*, Case AT.39727, OJ 2013 C251; Commission decision of 22 June 2011 *Telekomunikacja Polska*, Case AT.39525, OJ 2011 C324; Commission decision of 4 May 2010 *E.On gas foreclosure*, Case AT.39317, OJ 2010 C278; Commission decision of 14 April 2010 *Svenska Kraftnat*, Case AT.39351, OJ 2010 C142; and Commission decision of 17 March 2010 *EDF: Long Term Electricity Contracts in France*, Case AT.39386, OJ 2010 C133.

¹⁵ See for example the NAO Report, ¶3.8; and the BIS Consultation, ¶¶5.10-5.12 and footnote 4.

¹⁶ See for example the speech by Lord Currie, Chairman of the CMA, *The new Competition and Markets Authority: how will it promote competition?*, Beesley Lectures, (7 November 2013).

¹⁸ Speech by Lord Currie, Chairman of the CMA, *Preventing and reducing anti-competitive activities—a UK perspective*, Chatham House conference, (24 July 2013).

¹⁸ The Comisión Nacional de los Mercados y la Competencia (“CNMC”) was established in October 2013 and involved a merger of the National Energy Commission, the Telecommunications Market

Commission, the Railway Regulatory Committee, the National Commission for the Postal Sector, the Commission for Economic Regulation of Airports, the National Gaming Commission, and the State Council for Audiovisual Media with the Competition authority. The newly formed CNMC absorbed all the powers of the other regulators, while some powers transferred to the Ministers for Industry. A similar approach has been taken in the Netherlands, where the Consumer and Markets Authority was created in April 2013 through the merger of the Consumer Authority, the Competition Authority, and the Post and Telecommunications Authority.

¹⁹ CNMC, *Strategic plan of Spain's national authority for markets and competition: Competition, market supervision and efficient economic regulation* (13 May 2014).

¹⁰ Criticism has been leveled, including by Neelie Kroes (European Commission Vice-President), at the new system due to a perceived lack of independence of the CNMC, concern that the combination of roles will undermine competition law enforcement, and the ability of just ten council members to cope with all the cases coming from one competition authority and seven regulatory agencies (*see* Edurne Navarro Varona & Luis Moscoso, *Merger of competition authority and regulators in Spain: creation of the National Markets and Competition Commission*, 34(1) ECLR 518-522 (2013)).

²¹ ERRA 2013, Explanatory Notes, ¶370.

²³ Speech by Lord Currie, Chairman of the CMA, *The new Competition and Markets Authority: how will it promote competition?*, the Beesley Lectures (7 November 2013).

²³ Prior to these reforms certain regulators, such as Ofcom, ORR, and Ofgem, already held obligations to consider the use of their competition law powers before exercising some of their regulatory powers, see for example, section 317(2) Communications Act 2003, section 55(5A) Railways Act 1993, section 28(5) Gas Act 1986 and section 25(5) Electricity Act 1989.

²⁴ See for example: the speech by Richard Price, Chairman of ORR, *Experience across the regulators: The use of regulatory and competition powers for promoting consumer welfare*, UK Regulators' Network, (31 March 2014); and the speech by Amelia Fletcher, *Privatisation, economic regulation and competition in the utilities: Have we got the balance right?*, Beesley Lectures, (14 November 2013).

²⁵ BIS, *Growth, Competition and the Competition Regime: Government Response to Consultation* ¶8.5 (15 March 2012).

²⁶ CMA, *Regulated Industries: Guidance on concurrent application of competition law to regulated industries* (12 March 2014) (the "CMA's Concurrency Guidance"). This replaces previous guidance from the OFT and sets out information about which regulated sectors are affected by the concurrency provisions and the scope of the concurrent powers. It also explains the way in which the concurrent application and enforcement of competition law works in practice.

²⁷ *Id.* ¶3.22.

²⁸ Council Regulation (EC) No 1/2003 of 16 December 2002; Article 11(4) states that a Member State's competition authority shall provide its envisaged decision to the EU Commission 30 days before the decision is to be adopted.

²⁹ Competition Act 1998 (Competition and Markets Authority's Rules) Order 2014, SI 2014/458.

³⁰ Section 60 CA98 requires that competition matters in the United Kingdom should be dealt with in a manner that is consistent with EU competition law.

³¹ The UKCN replaced the Concurrency Working Party (“CWP”) which was a forum for regulators and the OFT to co-ordinate on the application of concurrent competition law powers. The CWP was formed in 1997 to, among other things, facilitate a consistent approach by the sectoral regulators and the OFT in the exercise of their functions and powers under the CA98. The UKCN brings together the CMA with the CAA, the FCA, Ofcom, Ofgem, Ofwat, the ORR, and the NIAUR (Monitor attends with observer status).

³² UKCN, *Statement of Intent*, §A.6 (December 2013).

³³ Once the FCA has full concurrent powers, its remit will become more aligned with the other sector regulators. However, it is already conducting competition work under its existing mandate (it has a statutory objective to promote competition in the interest of consumers and a duty to promote competition when discharging general functions), in particular via the use of market studies.

³⁴ FCA, *The FCA’s approach to advancing its objectives*, 37 (July 2013).

³⁵ The markets under investigation are the cash savings market, the retirement income market, the SME banking market, and the market for general insurance add-ons.

³⁶ After taking over responsibility for Consumer Credit from the OFT in April 2014, the FCA announced that it was planning to conduct a market study into the credit card market (FCA press release, *FCA announces competition review into credit cards—particular focus on how industry works with those in difficult financial circumstances*, (3 April 2014)). In addition, on July 9, 2014 the FCA launched a Call for Inputs to inform its review of competition in the wholesale banking sector to identify any areas that might merit investigation through a market study.

³⁷ Ofgem, *Draft Enforcement Guidelines*, ¶¶1.10 and 1.12 (28 March 2014).

³⁸ *Id.* ¶2.26.

³⁹ There are of course many other potential outcomes in a CA98 case, e.g. informal assurances, commitments, no grounds for action, or administrative priority closure decisions. Only the process to infringement decision is illustrated for simplicity purposes.

⁴⁰ *CMA Competition Act 1998: Guidance on the CMA’s investigation procedures in Competition Act 1998 cases*, 12 March 2014.

⁴¹ CMA Rules, Rule 3. Note that Rule 3(3) of the CMA Rules provides that the final decision must be a collective decision taken by at least two persons.

The Effectiveness of Competition Authorities: Four Questions

BY RODERICK MEIKLEJOHN¹

When comparing national competition authorities, four questions arise: How great is the risk that the government's powers of appointment could be used to "capture" the competition agency? What are the minimum resources needed to enable a competition authority to function effectively in a developed country? Does the ability to impose sanctions on individuals, as well as companies, significantly enhance the effectiveness of national competition authorities? What are the advantages and disadvantages of charging competition authorities with responsibilities in other, related policy areas as in Germany and the United Kingdom—Are there significant synergies—Is there a danger that priorities will be unclear? The aim of the present article is to discuss, with reference to a wide range of countries, considerations that are relevant to answering these questions.

I. INTRODUCTION

In a previous article for the *CPI Antitrust Chronicle*,² Pierre Buigues and I compared the national competition authorities in three EU countries and suggested four questions that are worthy of further study. These questions are:

- How great is the risk that the government's powers of appointment could be used to "capture" the competition agency?
- What are the minimum resources needed to enable a competition authority to function effectively in a developed country?
- Does the ability to impose sanctions on individuals, as well as companies, significantly enhance the effectiveness of national competition authorities?
- What are the advantages and disadvantages of charging competition authorities with responsibilities in other, related policy areas as in Germany and the United Kingdom? Are there significant synergies? Is there a danger that priorities will be unclear?

The previous article surveyed competition authorities in France, Germany, and the United Kingdom to identify similarities and differences in their institutional characteristics and approaches. It found that, in spite of a large degree of convergence, substantial differences still remained. The four questions posed in the conclusion were intended to illustrate the extent of these differences.

The aim of the present article is to discuss, with reference to a wider range of countries, considerations that are relevant to answering these questions. In so doing, I do not suggest that the factors considered here, however important, are the only ones that may have a significant influence on a competition authority's effectiveness.

One major problem in comparing individual features of national competition régimes is that many of these features are highly correlated. For example, well-resourced competition authorities are more likely to be found in countries where competition policy is relatively strict, with strong investigative powers granted to autonomous authorities and high penalties for violations. Such correlations make it difficult to evaluate empirically the relative importance of any one feature of the régime.

There is a body of empirical evidence, as well as theoretical argument, to support the conviction that competition policy can have a positive impact on perceived intensity of competition³ and on economic growth,⁴ at least in developed countries. However, the empirical work so far undertaken does not permit firm conclusions to be drawn about particular characteristics of that policy or the agencies that implement

ONE MAJOR PROBLEM IN COMPARING INDIVIDUAL FEATURES OF NATIONAL COMPETITION RÉGIMES IS THAT MANY OF THESE FEATURES ARE HIGHLY CORRELATED

it. Indeed, there are a number of ways in which a competition policy could have detrimental effects on economic efficiency; for example, by imposing excessive compliance costs on enterprises, by the over-use of *per se* prohibitions, or by creating a climate of uncertainty through inconsistent implementation.

Two econometric studies look at the effects of specific features of competition regimes. Voigt⁵ examines four indicators of the quality of a competition regime: the legal basis, the application of the “economic approach,” the *de jure* independence of the competition authority, and its *de facto* independence. His results suggest that these factors, in particular *de facto* independence, may have a positive influence on total factor productivity (“TFP”). However, this effect is no longer apparent when broad indicators of the quality of state institutions are included in the regressions. A possible reason for this is that Voigt’s study covers a wide range of countries including poor, less-developed countries. Tay-Cheng (2011)⁶ suggests that a minimum level of economic development may be a precondition for the successful implementation of competition policy.

IT FINDS A STATISTICALLY SIGNIFICANT LINK BETWEEN “BETTER” COMPETITION RÉGIMES AND TFP GROWTH AND, IN A LESS ROBUST WAY, LOWER PRICE-COST MARGINS

Another study, carried out by Lear⁷ for the European Commission, looks at the impact of competition policy on TFP and price-cost margins over twelve developed countries. It finds a statistically significant link between “better” competition régimes and TFP growth and, in a less robust way, lower price-cost margins. The measures of the quality of a competition régime (competition policy indexes) are based on detailed features of both the competition law and the competition authority. The authors find that the problem of multicollinearity does not allow robust conclusions to be drawn about the individual impact of each feature. However, the study finds some indications that three factors may play important roles: (i) the formal independence of a competition authority, (ii) the level of sanctions and, especially, (iii) the strength of the authority’s investigative powers. The present article touches upon two of these three features, examining one way in which the real independence of a competition authority may differ from its formal status and one way in which penalties for violations of competition law may be strengthened.

As far as the resources of competition authorities are concerned, the Lear study finds a non-significant

effect, although this is probably due to a high correlation with other features.⁸ The fourth question, the enforcement of competition policy through multi-purpose authorities, is not addressed by any of the empirical studies.

II. GOVERNMENT CAPTURE

The Introduction cites two studies, Voigt (2006) and Buccirossi et al. (2012), which suggest that the independence of competition authorities may play a significant role in determining their economic impact. Furthermore, a survey carried out by KPMG in 2007 for the U.K. Department of Trade and Industry⁹

LESS THEORETICAL ATTENTION HAS BEEN PAID TO THE QUESTION OF GOVERNMENT CAPTURE OF SUPPOSEDLY INDEPENDENT REGULATORS

indicated that respondents ranked political independence third in importance out of 13 factors that influence the effectiveness of a competition regime. The main reason why political independence should be so important is that it is a way of ensuring consistency and predictability in decision-making,

provided that the underlying law clearly defines the principles to be applied by the agencies.

Industry capture of government and regulatory bodies has been much studied following Stigler's seminal paper of 1971.¹⁰ Less theoretical attention has been paid to the question of government capture of supposedly independent regulators. Nevertheless, the problem is not entirely ignored in practice, since in most jurisdictions there are some limits to the government's freedom to select heads of competition authorities. In some countries, such as the United States and Japan, the approval of the legislature is required. In others, such as Austria, Belgium, and Canada, appointments are made by a non-executive Head of State,¹¹ albeit acting on a proposal from the government. In Australia, the national government must consult the governments of the states and territories. Italy is exceptional in that the government plays no formal role in appointments of the members of the board of the AGCM,¹² who are chosen by the two presidents of the chambers of parliament for fixed seven-year terms—a procedure which seems to be designed to minimize government influence, although it does not eliminate the possibility of party-political influence¹³.

There are several reasons why government capture should be of interest. Before discussing these, it may be useful to outline the advantages of independence.

Voigt¹⁴ & Salzberger list eleven reasons why politicians may choose to delegate powers. Of these, possibly the most important in the context of delegation to independent agencies are:

- to shift responsibility, when the blame attached to taking unpopular decisions outweighs the benefit from popular decisions;
- to resolve problems of uncertainty as to the desirable policy or the outcome of regulation (in terms of either the politician's value-system or his/her popularity);
- to establish bodies that enjoy public confidence when the government fears losing its legitimacy;

- to protect policies against reversal after a change of government by raising the “cost” of change;
- to enhance credible commitment; and
- to reduce politicians’ workloads.

The aim of reducing a politician’s workload may seem one of the more trivial of these motives but is probably one of the most important, when taken in combination with responsibility shifting. A large proportion of antitrust decisions are of a technical nature and the press, legislators, and the public usually show little interest in them. A politician has little to gain from personal involvement in such decisions, so they would normally be delegated to civil servants. If they are delegated within a government department, the minister runs the risk of incurring the wrath of some significant interest group, the press, or a party donor as the unexpected result of an apparently technical decision taken by those under his authority. The minister can avoid this risk if the decision-making power is delegated to an independent agency. An incidental benefit of this could be that politicians can thereby save time that would otherwise have to be devoted to lobbyists.

FROM THE POINT OF VIEW OF SOCIETY AS A WHOLE, PROBABLY THE MOST IMPORTANT ADVANTAGE OF THE INDEPENDENT AGENCY LIES IN ITS FUNCTION AS A COMMITMENT MECHANISM

From the point of view of society as a whole, probably the most important advantage of the independent agency lies in its function as a commitment mechanism. Society has an obvious interest in having laws that delineate the boundaries between licit and illicit behavior as clearly as possible, and which are consistently applied. The greater the degree of uncertainty, the greater the risk that initiative will be stifled. Where, as in competition policy, it is nevertheless necessary to allow a wide margin of appreciation to a public authority or the courts, the appropriate criteria of judgment need to be specified in order to provide a minimum degree of legal certainty. Charging an independent agency with the enforcement of the policy, subject to control by the courts, provides some assurance that powers will be exercised in a consistent way according to the statutorily defined criteria. A policy shift or an *ad hoc* deviation from the policy, motivated by political expediency, cannot be achieved simply and quietly by an internal ministerial instruction.

The foregoing paragraph touches on another important aspect of independent agencies: their value as a mechanism for ensuring transparency. In their areas of responsibility, their existence makes it difficult for the government to change the direction of policy without public announcement and debate. But they are also entrusted in most countries with an advocacy role in other policy areas. For example, the Bundeskartellamt has published opinions on the competition impact of German government proposals in the fields of energy policy, health insurance, and waste management. These opinions, unlike responses to interdepartmental consultations, are readily available to legislators and the public.

In spite of these advantages of independent agencies, there are circumstances in which governments can be tempted to try to exert an influence on them. Perhaps the most obvious possible motive for government

interference is political expediency. For example, if a foreign takeover of a large firm is politically so unpopular that the ruling party risks losing a significant number of votes, the government may try to influence the outcome of the merger control process. In other cases, the government may itself be captured by an interest group, either through corruption or as a result of asymmetric information, and seek to exercise its influence on behalf of that special interest.

These motives may lead to *ad hoc* government attempts to influence competition authorities in particular cases. If such attempts are successful, they introduce an element of inconsistency that undermines the credibility of competition enforcement and adds to the uncertainty of economic decision-making. However, it seems unlikely that such cases occur frequently enough, or are sufficiently foreseeable, to induce a government to select candidates for competition authority posts solely or mainly on the basis of their willingness to follow instructions.

The general ideological stance of the government may play a more important role in determining the choice of senior competition officials. Political parties may be hostile or lukewarm towards competition policy either because of *dirigiste* tendencies or because they adopt a *laissez-faire* attitude to the economy. The difficulty of changing the underlying legislation and institutional structure may lead such governments to prefer a more indirect and less transparent approach. A *dirigiste* government may, for example, try to enlarge the scope of the competition authority's interventions in order to conform to an ill-defined notion of public interest. In other cases, it may seek special treatment of a publicly owned corporation or a "national champion." A *laissez-faire* government, on the other hand, will favor a general reduction in the scope of intervention.

Today, all governments in developed countries lie in an ideological area between the most extreme forms of *dirigisme* and *laissez-faire*, where there is both general agreement about the market mechanism as the best means of achieving economic efficiency and a recognition that some form of competition policy is needed to safeguard this mechanism. Within this area there still remains considerable scope for differences of approach.

In the implementation of competition policy, the differences are revealed notably by the standard of proof required to justify a prosecution or a merger challenge and the degree of skepticism exhibited towards defense arguments, particularly arguments purporting to show the contestability of markets or efficiency gains.

It is probably unavoidable that governments will use their power over appointments to competition authorities to select candidates who are close to their own ideological position. Thus, Republican presidents in the United States and conservative ministers in Europe may prefer a candidate who takes a restrictive view of the need for enforcement action while U.S. Democrats and European social democrats may favor a more interventionist candidate. When personnel changes at the top of the competition authority reflect the ideological preferences of the government they can lead to changes in enforcement practice,

THE GENERAL IDEOLOGICAL STANCE OF
THE GOVERNMENT MAY PLAY A MORE
IMPORTANT ROLE IN DETERMINING
THE CHOICE OF SENIOR COMPETITION
OFFICIALS

creating a climate of uncertainty, even if the changes are to some extent predictable.

On the basis of a survey of antitrust lawyers and merger enforcement data for the period 1982-2007, Baker & Shapiro¹⁵ conclude that significant fluctuations of this kind have occurred in merger control in the United States as a consequence of ideological shifts in the Antitrust Division of the US Department of Justice (“DOJ”). They argue that merger enforcement at the DOJ was significantly laxer during the second term of

IT ALSO SEEMS LIKELY THAT THE RISK OF EXCESSIVE LAXITY IS GREATER THAN THAT OF OVER-REGULATION

the Reagan administration and both terms of the George W. Bush administration than at any other time during the period covered. They find that these shifts in enforcement practice were much more pronounced at the DOJ than at the Federal

Trade Commission (“FTC”), which also has merger control powers. However, unlike the DOJ, where the senior officials all change when there is a change of administration, the FTC has a bipartisan composition and each of the five commissioners is appointed for a fixed term not coterminous with a presidential term. Baker & Shapiro therefore argue that the observed variations in the practice of the DOJ are mainly attributable to political changes.

The courts can impose some limits on such fluctuations and, indeed, on more direct government interference. However, the effect of judicial review is asymmetric. When a competition authority challenges a merger or takes action against anticompetitive behavior, it is required to publish detailed findings and may, in many cases, need a court order to give effect to its decisions. The defendant firm has a strong incentive to contest a competition authority’s finding. By contrast, when the authority decides to take no action or to accept weak commitments, customers—particularly if they are private consumers—have a much weaker incentive to challenge the decision because their interests are often too diffuse to justify risking significant sums on litigation concerning a single item of expenditure. Furthermore, any such challenge will be handicapped by an extreme asymmetry of information between the customers on one side and the defendant and the competition authority on the other.

THE COURTS CAN IMPOSE SOME LIMITS ON SUCH FLUCTUATIONS AND, INDEED, ON MORE DIRECT GOVERNMENT INTERFERENCE. HOWEVER, THE EFFECT OF JUDICIAL REVIEW IS ASYMMETRIC

The considerations outlined above suggest that capture by government can undermine the credibility of a competition authority and the consistency of its enforcement practice. One means by which such capture can be achieved is through the government’s power to appoint, or influence the choice of, senior officials. However, it seems probable that the effect makes itself felt more strongly through shifts in the general ideological stance than through direct interference in specific cases. It also seems likely that the risk of excessive laxity is greater than that of over-regulation.

III. RESOURCES

It is intuitively obvious that the effectiveness of competition policy must be related to the resources available for its enforcement, even if the empirical evidence is sketchy. As Tay-Cheng Ma¹⁶ observes, “the competence

and credibility of the enforcing agency are highly dependent on the existence of adequate human and financial resources for monitoring, detecting, and proving violations so as to apply the law effectively.”

It also seems reasonable to assume that the resources required by a competition authority are a function of the size of the country. However, it is unlikely that there is a simple linear relationship between the optimal resources of an authority and the country’s size. An obvious reason for non-linearity is economies of scale. In addition there may be many country-specific factors that influence an authority’s need for resources. These may include:

- The openness of the economy, which limits market power by making markets more contestable.
- The quality of the justice system: an overloaded or inefficient system will tie up more of the competition authority’s resources.
- The existence of a firmly rooted “competition culture” and widespread respect for the law. Although these two qualities do not necessarily go together, both can ease the competition authority’s load by reducing the prevalence of violations and by making them easier to detect and rectify.
- Membership of the EU or EFTA: interventions made by the European Commission or the EFTA Surveillance Authority may reduce the need for action at the national level.
- The relative pay of qualified economists, lawyers, and other skilled staff needed by competition authorities.

Table 1 (see Appendix) shows data on the budgetary and staff resources of a selection of competition authorities in developed countries throughout the world. Comparisons are rendered difficult by the fact that many of these authorities have tasks outside the antitrust field and only a few of them provide estimates of the

IT SEEMS THEREFORE THAT
COMPETITION AUTHORITIES IN
MANY COUNTRIES WERE NOT ONLY
SHELTERED FROM THE WORLDWIDE
TIGHTENING OF BUDGETARY
DISCIPLINE DURING THIS PERIOD, BUT
WERE EVEN ABLE TO EXPAND

share of their resources devoted to the latter. Furthermore, some authorities express their staffing data in full-time equivalents (“FTE”) while others only provide the numbers of employees. In order to scale the data, three ratios are included in the table: agency budget/GDP, agency budget/population, and staff/population.

The table suggests that economies of scale are very important: there is an obvious contrast between the large countries and most of the smaller ones. Nevertheless, the variation between countries is surprisingly wide. For example, if we compare only single-purpose agencies and those multipurpose authorities that provide estimates of the share of antitrust in their resource use, we find that—relative to the size of the country—Norway has more than twice as many staff as the Netherlands or Switzerland and seven times as many as Austria. Given

that these are all relatively small countries, and even allowing for the fact that the Norwegian authority, unlike most of the others, provides only total staff numbers rather than full-time equivalents, these differences seem difficult to explain solely on the basis of economies of scale. Curiously, however, the Netherlands is the outlier in this group in terms of budgets. The mismatch between budgets and staff numbers is also evident in the case of Italy, where the budget is generous compared with other large countries but the staffing level is remarkably low.

In terms of staffing, the smaller countries mostly cluster around 10-15 per million population, with the exceptionally high level already noted in Norway and exceptionally low levels in Austria¹⁷ and the Czech Republic. Authorities in the larger countries mostly have between three and six employees per million, those of France and Italy being comparatively understaffed.

Looking at the evolution of competition agency budgets between 2009 and 2012, we find quite significant reductions in the Netherlands, Slovenia, Spain, and the United Kingdom. In the Netherlands and Spain, staff numbers also fell, although there was a 13 percent increase in the combined staff of the U.K. authorities. Budgets increased more than 10 percent in the Czech Republic, Denmark, Germany, Japan, Norway, and Sweden. Staffing levels also rose significantly in Germany, Norway, and Sweden, as well as Finland, France, Switzerland, and the United States. It seems therefore that competition authorities in many countries were not only sheltered from the worldwide tightening of budgetary discipline during this period, but were even able to expand. This suggests a widespread belief in these countries that competition agencies had not yet reached their optimum size. It is also noteworthy that the new Competition and Markets Authority in the United Kingdom has a budget of £66 million for its first year of operation, an increase of about 100 percent in nominal terms compared with the combined budgets of the former Office of Fair Trading and Competition Commission in the financial year 2012-2013.

Table 2 (see Appendix) juxtaposes indicators of resources and an indicator of the perceived effectiveness of competition authorities (*Global Competition Review's* star ratings). It reveals no clear relationship between the two and it is noteworthy that the higher ratings are all awarded to large countries, suggesting the possibility of some bias in the GCR approach. However, among the large countries, Italy stands out in having both a much low staffing level and a lower rating. Comparing the smaller countries, the Netherlands has the highest rating although five other countries have significantly higher staffing levels.

IT HAS BEEN SUGGESTED THAT THE MOST IMPORTANT INDICATOR OF STAFFING ADEQUACY IS NOT THE TOTAL EMPLOYMENT IN THE AGENCY BUT THE NUMBER OF LAWYERS AND ECONOMISTS

On the other hand, as noted above, the Dutch competition authority has a remarkably generous budget. The Danish competition authority has the lowest rating in this list in spite of being relatively well resourced.

It has been suggested¹⁹ that the most important indicator of staffing adequacy is not the total employment in the agency but the number of lawyers and economists. Where data are provided by the national reports to the OECD Competition Committee, they show that in most authorities lawyers and economists account for about 70-80 percent of the total staff. However, the proportion seems to be lower in larger authorities (about 44 percent in the Bundeskartellamt and about 50 percent in the two former U.K.

authorities). Unfortunately, France and the United States do not provide any information on this point. On the basis of the information available, the conclusions drawn from this table would not be altered by taking into account the number of economists and lawyers employed.

Given the wide disparities between the resources of national competition authorities and the interest of this question not only to the authorities themselves but also to the national finance ministries, more research on this subject would clearly be of immediate practical value.

IV. INDIVIDUAL SANCTIONS

Many observers²⁰ consider that the fines hitherto imposed on undertakings, although they show an upward trend, have not generally been high enough to have a strong deterrent effect. Connor & Helmers²¹ note that fines on companies participating in international cartels usually represent a small percentage of the value of affected sales and that recidivism is widespread, suggesting that cartel sanctions have been an inadequate deterrent.

If the above conclusion is correct, there are three main ways in which sanctions can be strengthened:

- higher fines;
- easier private litigation; and
- sanctions against individuals as well as companies.

The strongest argument in favor of individual sanctions rests on the hypothesis that firms are unable to exercise effective control over the behavior of their agents, even if they have strong incentives to do so, such as high corporate fines. This may be particularly true in companies with dispersed shareholdings. Furthermore, the monitoring and incentives required to guarantee compliance by managers may be such as to discourage the legitimate exercise of managerial initiative. Recent revelations about the banking sector (the LIBOR scandal and allegations of exchange rate manipulation) tend to reinforce skepticism about the ability of firms to control their employees' behavior. It follows from this skepticism that an effective system of cartel deterrence requires that individual company executives be held legally responsible.

IT FOLLOWS FROM THIS SKEPTICISM THAT AN EFFECTIVE SYSTEM OF CARTEL DETERRENCE REQUIRES THAT INDIVIDUAL COMPANY EXECUTIVES BE HELD LEGALLY RESPONSIBLE

The second argument in support of individual sanctions rests on the claim that, in order to act as an effective deterrent against anticompetitive conduct, fines levied on companies would have to be “impossibly high.” Although the argument has been couched in terms of fines, the possibility of private litigation should also be taken into account.

According to the standard economic theory of deterrence,²² the optimal level of the financial sanction (S) for an antitrust violation should be $S = H/\alpha$, where H is the harm to consumers and α is the probability of detection and conviction. The deterrent level of fine is therefore inversely proportional to α , which is generally assumed to be quite low (not above 0.2).²³ H is a function *inter alia* of the overcharge and the length of time over which the cartel operates. According to Connor & Helmers,²⁴ the median overcharge of international cartels is 25 percent and the mean may be as high as 30 percent, while they are thought to have a typical life of five to six years. Averaging scholarly studies of cartels operating during the period 2000-2009, Connor & Lande²⁵ calculate a median of 20 percent for national cartels and 25.8 percent for international cartels. The harm to consumers can therefore be very high relative to total sales in the affected market. The combination of a high level of harm with a low probability of punishment leads to the conclusion that fines must be very high in order to have a deterrent effect.

The claim that deterrent fines are “impossibly high” is based on the following arguments:

1. Such fines could exceed the existing statutory limits.
2. The fines (or fines plus private damages) would often exceed the companies’ ability to pay, with resulting bankruptcies and reduction in competition due to the exit of firms.
3. The fear of very high financial penalties might induce firms to adopt inefficient financing structures with increased distribution of profits and a heavy reliance on debt in order to make themselves “judgment proof.”
4. High financial penalties could harm the interests of “innocent” stakeholders, such as creditors and employees.
5. Financial penalties might be passed on to consumers in higher prices.²⁶

The first problem is the least important, since the law can be amended to allow for higher fines. As far as the second argument is concerned, Buccirosi & Spagnolo²⁷ suggest that, if bankruptcy procedures are efficient, bankruptcy need not entail exit from the market. Even if exit does occur, they argue that the reduction of competition in one market could be a price worth paying for an economy-wide deterrent effect. The force of the other three arguments seems to be stronger, although it should be noted that “judgment proofing” entails costs that would enter into the firm’s calculations of the net gain from participation in a cartel.

Furthermore, it should be borne in mind that many of the participants in cartels are multi-product firms selling in many countries, while the scope of the cartels is usually limited to specific products and geographic markets. The turnover in the affected market may therefore be considerably less than the firms’ total turnover and the risk that

THE CONCLUSION FROM THE ABOVE DISCUSSION IS THAT THE CASE AGAINST RELYING ON CORPORATE FINANCIAL PENALTIES TO ACHIEVE DETERRENCE IS STRONG BUT NOT OVERWHELMING

a deterrent fine would exceed the ability to pay is consequently perhaps not as great as commentators such as Wils have suggested.

Buccirossi & Spagnolo²⁸ suggest that the size of the minimum deterrent fine can be greatly reduced if the probability of detection and punishment is increased by improving the design of leniency schemes as well

IT APPEARS, THEREFORE, THAT CRIMINAL SANCTIONS AGAINST INDIVIDUALS MAY BE A SIGNIFICANT DETERRENT BUT THAT THEIR EFFECTIVE IMPLEMENTATION REQUIRES THE FULFILLMENT OF A NUMBER OF PRECONDITIONS

as by introducing a system of rewards to encourage more firms and individuals to report offenses. Furthermore, by granting reductions of fines to firms that have “cheated” on a cartel, the authorities could increase the incentive to cheat, thereby reducing the harm to consumers and undermining the stability of the cartel.

The conclusion from the above discussion is that the case against relying on corporate financial penalties to achieve deterrence is strong but not overwhelming. We now turn to the arguments in favor of imposing sanctions on individuals.

These sanctions may be administrative (fines or disqualification from exercising management functions) or criminal (fines imposed by criminal courts, imprisonment, community service orders). Table 3 (see Appendix) shows that national competition law makes provision for individual sanctions in a wide range of developed countries, although in some countries these provisions are not applied in practice.

IN VIEW OF THE WEAKNESSES OF THE OTHER TYPES OF INDIVIDUAL SANCTION THERE IS A GENERAL CONSENSUS THAT IMPRISONMENT IS MOST LIKELY TO BE AN EFFECTIVE DETERRENT

The risk of being personally penalized not only makes managers more reluctant to engage in illegal activity but also creates an incentive for them to report offenses to the authorities, if coupled with a leniency scheme. The increased risk of whistle-blowing by employees also adds to the incentives for companies themselves to report cartels.

The impact of sanctions against individuals depends on the type and severity of the penalty. Individual fines are probably the least effective since companies can find ways of compensating employees, even in countries where the law expressly forbids such indemnification. Fines imposed by criminal courts may be marginally more effective than administrative fines because of the stigma attached to a criminal conviction. Disqualification from directorships or other management functions may act as a deterrent because of its effect on career prospects. However, companies may find ways of compensating employees and even retaining them in influential positions, e.g. by giving them new job titles or engaging them as consultants,

In view of the weaknesses of the other types of individual sanction there is a general consensus that imprisonment is most likely to be an effective deterrent. The prospect of being incarcerated with “common” criminals is particularly daunting for those who have hitherto enjoyed a high social status while it is difficult for

companies to find adequate ways of compensating them for such an experience and for the stigma attached to a prison sentence.

However, there are disadvantages associated with criminal sanctions. Perhaps the most important is that the standard of proof is higher in criminal trials than in administrative or civil law. In English law this is expressed in the contrast between “beyond reasonable doubt” and “the balance of probabilities.” In addition, the defendant enjoys enhanced rights, in particular protection against self-incrimination. A third problem is that prosecution in criminal cases often requires the approval of the public prosecutor’s office and even the transfer of the case from the competition authority to the public prosecutor. As Wils²⁹ points out, prosecutors may lack expertise in competition law and be reluctant to accord priority to such cases when their case load also includes child abuse and manslaughter. When the case comes to court, the prosecutor may then face a non-specialist judge and a jury for whom the notion of an antitrust crime is a novel concept. Although these problems are not insurmountable, they lengthen the investigation and prosecution processes and make it necessary to decide at an early stage whether an investigation is to be carried out under criminal law or administrative law. Perhaps because of these difficulties, there has so far been only one criminal prosecution of individuals involved in a cartel in the United Kingdom although the possibility has existed since 2002.

IN ONLY TWO RECENT CASES HAVE GOVERNMENTS OPTED TO REDUCE THE SCOPE OF THEIR NATIONAL COMPETITION AUTHORITIES TO FOCUS MORE NARROWLY ON ANTITRUST ENFORCEMENT

Most of the problems outlined above do not apply to the United States, where the DOJ is both a competition authority and a public prosecutor and, where there is a long tradition of criminal prosecution of antitrust offenses. Perhaps because of this, the prosecution of cartel offences is widely regarded as more effective in the United States than in other countries. Wils quotes a staff member of the DOJ who asserts, “the threat of criminal prosecution in the United States has deterred a significant number of global cartels from extending their conspiracy into the United States.” It is also noteworthy that the United Kingdom’s only criminal cartel prosecution to date relied on a plea bargain struck between the defendants and the U.S. authorities.³⁰

It appears, therefore, that criminal sanctions against individuals may be a significant deterrent but that their effective implementation requires the fulfillment of a number of preconditions, such as public acceptance of the notion that hardcore cartels are criminal conspiracies, a well-resourced prosecutor’s office, prosecutors and judges with expertise in competition law, and close liaison between the competition authority and the prosecutor.

Fulfilling these conditions comes at a cost. The investigation procedure is also more costly than an administrative procedure, while the risk of a failure to achieve a conviction is greater. Further costs to be taken into account are the public expenditure on imprisonment and the loss resulting from withdrawing the offender from economic activity during the period of his/her sentence.

The above discussion shows that though the imposition of sanctions on individuals—imprisonment in particular—may strengthen deterrence it is not an easy option. Those countries that have not already embarked on this route may be well advised to consider first the possibilities for exploiting the potential of corporate liability more fully, as suggested by Buccirosi & Spagnolo.

V. MULTI-PURPOSE AUTHORITIES

Table 4 in the Appendix lists a sample of 26 national competition authorities throughout the world and shows their responsibilities outside the traditional field of competition policy. Only seven of these can be classed as single-purpose antitrust agencies (eight if we include the Antitrust Division of the U.S. Department of Justice). The most common additional functions of competition authorities lie in the fields of consumer protection, oversight of public procurement procedures, and regulation of network industries (public utilities). As the table shows, new competences were added quite recently in some countries (Italy in 2007; Finland, Netherlands, and Spain in 2013).

In only two recent cases have governments opted to reduce the scope of their national competition authorities to focus more narrowly on antitrust enforcement. In France, the *Autorité de la Concurrence*, which began work in 2009, combined the main competition enforcement responsibilities of the Ministry of Economy, Industry and Employment with those of the former Conseil de la Concurrence, leaving consumer protection with the Ministry. In the United Kingdom, a new Competition and Markets Authority (“CMA”) came into

EVEN THOUGH COMPETITION POLICY
MAY HAVE THE SAME ULTIMATE GOALS
AS CONSUMER PROTECTION AND
NETWORK INDUSTRY REGULATION,
THERE ARE IMPORTANT DIFFERENCES
BETWEEN THESE POLICIES IN
THE CRITERIA USED TO JUSTIFY
INTERVENTION AND IN THE METHODS
AND TIMING OF SUCH INTERVENTION

being in April 2014. This authority combines the competition policy functions of the former Office of Fair Trading (“OFT”) and Competition Commission (“CC”). Most of the consumer protection duties of the OFT were dispersed between several other bodies. However, the CMA retains some functions in this field as well as the appeal functions of the CC in matters concerning the regulation of network industries.

In terms of their ultimate objectives, there are significant overlaps between competition policy, network industry regulation, consumer protection and, public procurement oversight. All of these policies are to a large extent concerned with consumer welfare. In relation to competition policy, there is a lively debate, mainly in the context of merger control, about whether total, rather than consumer, surplus is the appropriate objective.³¹ Nevertheless, maximizing consumer welfare is more or less explicitly deemed to be the main concern of competition policy in almost all jurisdictions. The same is true, in principle, of consumer protection legislation and also of measures to ensure that public procurement is open and fair, if we consider the consumer as a taxpayer and take into account the potential spillover effects on consumer markets that can arise from distortions in public procurement markets. The regulation of network industries, with its focus on opening up markets and protecting consumers from the abuse of dominant positions, also places a strong emphasis on consumer welfare.

The following discussion concentrates on consumer protection policy and network industry regulation. The other functions performed by multi-purpose agencies, such as public procurement and state aid control, are much less resource-intensive and probably much less likely to give rise to conflicting priorities within a competition authority.

INDUSTRY CAPTURE MAY THEREFORE BE ONE CAUSE OF CONFLICT BETWEEN CONSUMER PROTECTION AND COMPETITION POLICY

Even though competition policy may have the same ultimate goals as consumer protection and network industry regulation, there are important differences between these policies in the criteria used to justify intervention and in the methods and timing of such intervention.

The following general features of competition policy enforcement contrast with the approaches of both consumer protection and network industry regulation:

1. Competition law lays down general principles, rather than detailed prescriptions, and the “rule of reason” approach is preferred to per se prohibitions.
2. Competition law is enforced on a case-by-case basis.
3. Except in merger control cases, competition authorities intervene only if there is evidence of an infringement of the law.
4. Competition authorities are responsible for policing the whole economy. They therefore lack specialized knowledge of particular sectors and tend to prefer structural to behavioral remedies.
5. As they have no continuous relationship with any particular sector, they are less prone to industry capture than sectoral regulators.
6. Competition policy aims to protect or enhance the welfare of consumers in general, rather than particular groups of consumers.

Consumer protection policy is concerned especially with preventing sellers from making fraudulent,

AS A RESULT, REGULATORS HAVE RESPONSIBILITIES THAT COULD COME INTO CONFLICT WITH THE OBJECTIVE OF OPENING MARKETS TO COMPETITION, MOST NOTABLY BY BURDENING OPERATORS WITH OBLIGATIONS THAT COULD CONSTITUTE BARRIERS TO ENTRY

unjustified, or misleading claims about their products and services; improving consumer information; and prohibiting the sale of dangerous products. The definition of minimum standards of information—in terms of honesty, the way products are described, and the amount of information provided—is often considered to be too complex to be decided on a case-by-case basis and may therefore be subject to detailed legislation or codes of conduct agreed between the consumer

protection bodies and the suppliers. This may entail close ongoing interactions between the agency and the industries concerned, leading to a risk of capture. Indeed, Armstrong³² notes, “in the 1950s and 1960s, the FTC often took a very expansive view of which adverts were misleading, and this was used to protect incumbent firms from new entrants.”

Industry capture may therefore be one cause of conflict between consumer protection and competition policy. Even in the absence of capture, consumer protection measures may unintentionally increase barriers to entry to the detriment of competition in the market. Another cause of conflict may be, as Armstrong points out, that measures to protect the interests of vulnerable (e.g. less well-informed) consumers may have detrimental effects on other consumers, so that there may be no overall net benefit to consumers.

As far as network industry regulation³³ is concerned, the first priority is usually to open up previously monopolized markets to competition. In this respect, the objectives agree with those of competition policy. However, differences of approach arise from the special problems encountered in markets where there is a long history of monopoly control and government intervention, together with high sunk costs of entry and a natural monopoly element in part of the network. For example, regulators have to pay continuous, close attention to the conditions of access to the infrastructure and to consumers (i.e. to make it easy for customers to switch suppliers). They therefore need to have substantial sector-specific expertise and to maintain intense and continuous oversight over the regulated sectors. They may intervene directly in the price-setting process by imposing a cap on access charges or even, in some cases, on the prices paid by final consumers.

In addition to their market-opening tasks, network industry regulators are also expected to pursue social and environmental goals and to ensure security of supply. The social goals may include protecting vulnerable customers from denial of service in the event of unpaid bills or even cross-subsidizing low-income consumers and consumers in peripheral areas. The environmental goals include in particular the promotion of renewable energy sources. Although it could be argued that these objectives might be more efficiently achieved by direct government action through taxation, the social security system, and subsidies, the reality is that most countries have chosen a regulatory approach. As a result, regulators have responsibilities that could come into conflict with the objective of opening markets to competition, most notably by burdening operators with obligations that could constitute barriers to entry.

THE TRADE-OFF BETWEEN THE POLICY OBJECTIVES IS NOT NECESSARILY TRANSPARENT IN A MULTI-PURPOSE AUTHORITY

It could be argued that multi-purpose authorities are an efficient means of resolving the possible conflicts discussed above since they bring together all the interested regulators in one organization, which is then obliged to decide on the appropriate trade-off. As suggested by the preamble of the Spanish law creating a new National Markets and Competition Commission (“CNMC”),³⁴ they also make it easier for officials in different policy areas to exchange ideas and information and pool their expertise, for example by seconding network regulators to a merger case team.

Sector inquiries, where the reasons for the malfunctioning of markets—and hence the nature of the potential remedies—are unknown at the outset might perhaps yield more fruitful results if conducted jointly by consumer and competition policy specialists. The Spanish law also points out that, compared with single-sector regulatory agencies, a body with economy-wide responsibilities is less prone to industry capture. Furthermore, multipurpose authorities may reduce costs to business by creating a “one-stop shop,” while some savings in administrative overheads and other support costs are an additional benefit.

However, there are risks associated with such arrangements. First, the trade-off between the policy objectives is not necessarily transparent in a multi-purpose authority. This may be particularly important for the authority’s advocacy role, i.e. when it is making policy recommendations or replying to a government consultation. When two agencies are involved, although the procedures are more cumbersome, they do allow the issues to be openly discussed. Second, decisions in cases where objectives or methods conflict may be influenced by the balance of power in the institutional structure. Since consumer protection and network regulation tend to be more resource-intensive and have a higher public profile they may come to dominate over competition policy. Third, this intra-institutional balance of power may unduly influence priority-setting and the allocation of resources.

In conclusion, if one believes that transparency of decision-making is an important determinant of the quality of decisions, and if one is concerned to maintain the integrity of competition policy enforcement, the safest option seems to be a single-purpose competition authority with freedom to comment on the policies of other agencies. However, a multi-agency system can work efficiently if the following conditions are in place:

1. The underlying legislation should make it possible to determine unambiguously in specific cases where the ultimate decision-making power lies.
2. There should be efficient inter-agency consultation procedures.
3. Information and know-how should be freely exchanged between the agencies, supported where necessary by arrangements for the secondment of staff.

VI. CONCLUSIONS

This article discusses four rather disparate questions, which were selected to illustrate the wide range of variation that still exists between national competition regimes in spite of a strong trend towards convergence.

2. THE QUESTION OF THE OPTIMAL RESOURCES NEEDED BY A COMPETITION AUTHORITY UNDER DIFFERENT NATIONAL CONDITIONS IS ONE THAT WOULD REWARD FURTHER RESEARCH

From the point of view of national policy-making, this diversity excludes the easy option of following an international consensus but offers the prospect, albeit with much more research, of gaining a clearer view of the major determinants of effectiveness.

The tentative conclusions arising from the discussion of each of these questions can be summarized as follows:

1. Government power over the appointment of senior officials probably does not lead to a high risk of interference in specific cases. However, it could give rise to significant fluctuations in the general approach of the competition authority. One way of dampening these fluctuations might be to adopt the collegiate structure of the FTC in the United States, where members are appointed at different times as vacancies arise and there is a requirement for a political balance in the composition of the Commission. However, the latter condition would be difficult to achieve in countries with multi-party systems. Another possible solution is exemplified by Germany, where the president of the BKA is nominated by the government but has no decision-making power in individual cases.
 2. As far as the resources of competition authorities are concerned, we observe very wide disparities, both in terms of finance and in terms of personnel. Beyond some indications that economies of scale may be very large there is no obvious explanation for these disparities, which may primarily reflect the relative political importance attached to competition policy in different countries. The question of the optimal resources needed by a competition authority under different national conditions is one that would reward further research.
 3. Our third question asks whether the ability to impose sanctions on individuals, as well as companies, significantly enhances the effectiveness of competition policy enforcement. While the argument in favor of sanctioning individuals seems to be strong, there is a general consensus that the threat of imprisonment is the only individual sanction that is likely to be an effective deterrent. However, there are many obstacles to the effective criminalization of cartel offenses and the costs of imprisonment itself should not be disregarded. Before embarking on this route, countries should perhaps first consider whether the potential of corporate liability has been fully exploited.
 4. Finally, we find that most countries have opted for multi-purpose rather than single-purpose authorities. Multi-purpose authorities offer some advantages in terms of the exchange of ideas and expertise, flexible use of resources, reduced administrative overheads, and “joined-up” decision-making. On the other hand, they present the risk that one policy area may come to dominate over the others in the allocation of resources, the definition of priorities, and the decision-making process. Where there are differences of approach or outright conflicts between policies, these differences should ideally be debated in an open and transparent manner, something that is less easy to achieve within a single agency than when responsibilities are separated. ▲
-

APPENDIX

Table 1: Budgets and staff of competition authorities, 2009 and 2012

Country	Budget Mio US\$ at current prices and PPP	Budget/GDP millionths	Budget per head of pop. US\$	Staff (italics denote FTE)	Staff/population millionths
Austria¹					
2012	3.26	9	0.39	28	3.3
2009	2.85	9	0.34	32	3.8
Canada					
2012	41.49	28	1.19	<i>428.5</i>	<i>12.3</i>
2009	42.07	32	1.25	<i>420</i>	<i>12.5</i>
Czech Rep.³					
2012	11.02	38	1.05	<i>46</i>	<i>4.4</i>
2009	9.81	36	0.94	<i>44</i>	<i>4.2</i>
Denmark³					
2012	10.32	43	1.85	69	12.4
2009	7.74	36	1.40	68	12.3
Finland¹					
2012	6.79	32	1.26	79	14.6
2009	6.41	33	1.20	67	12.6
France¹					
2012	24.26	10	0.37	188	2.9
2009	22.50	10	0.35	175	2.7
Germany					
2012	34.39	10	0.42	<i>296</i>	<i>3.6</i>
2009	26.92	9	0.33	<i>277</i>	<i>3.4</i>
Italy²					
2012	78.03	38	1.31	106	1.8
2009	n.a.	n.a.	n.a.	n.a.	n.a.
Japan²					
2012	83.49	18	0.65	519	4.1
2009	73.20	18	0.57	513	4.0
Netherlands³					
2012	53.79	74	3.22	<i>132</i>	<i>7.9</i>
2009	59.54	87	3.61	<i>142</i>	<i>8.6</i>
Norway¹					
2012	10.33	31	2.07	113	22.7
2009	9.38	35	1.95	104	21.7
Slovenia¹					
2012	1.13	19	0.55	<i>18</i>	<i>8.8</i>
2009	1.46	27	0.72	<i>17</i>	<i>8.4</i>
Spain					
2012	18.64	12	0.40	187	4.0
2009	18.90	13	0.41	203	4.4
Sweden²					

2012	15.63	38	1.65	115	11.7
2009	14.07	48	1.52	109	11.8
Switzerland¹					
2012	n.a.	n.a.	n.a.	72.6	9.1
2009	n.a.	n.a.	n.a.	58.2	7.6
UK^{3,4}					
2012	47.27	21	0.74	356	5.6
2009	53.87	25	0.87	315	5.1
USA^{3,4}					
2012	279.83	17	0.89	1211	3.9
2009	265.96	18	0.87	1271	4.1

Notes:

FTE = full-time equivalents

¹ Single-purpose competition authority.

² Multi-purpose authority, staff data are estimates of the part devoted to antitrust.

³ Multi-purpose authority, both budget and staff data are estimates of the antitrust share.

⁴ Combined data for two agencies with antitrust responsibilities.

Sources: Annual reports of competition authorities to OECD Competition Committee. PPP exchange rates from OECD StatExtracts, *Purchasing Power Parities for GDP*. Population data from Eurostat.

Table 2: Staffing levels and perceived effectiveness

	GCR stars 2013	Staff/pop 2012	Antitrust budget/ GDP Millionths, 2012
Large countries (>40 million pop)			
USA	5	3.9	17
Germany*	5	3.6	10
France	5	2.9	10
UK**	4.5	5.6	21
Japan	4.5	4.1	n.a.
Italy	3.5	1.8	n.a.
Smaller countries			
Netherlands	4	7.9	74
Norway	3	22.7	31
Finland	3	14.6	32
Sweden	3	11.7	n.a.
Switzerland	3	9.1	n.a.
Czech Rep.	3	4.4	38
Austria	3	3.3	9
Denmark	2.5	12.4	43

*Staff includes those employed in public procurement control.

** Average of OFT (4 stars) and Competition Commission (5 stars).

Sources: Global Competition Review, Rating Enforcement 2013. Other sources as Table 1.

Table 3: Sanctions against individuals in national competition law

Type of sanction	Countries
None	Luxembourg, Netherlands
Administrative fines	Germany
Criminal fines	Australia, Canada, Estonia, Greece, Ireland, Israel, Japan, Norway, U.K., U.S.
Imprisonment	Australia, Canada, Estonia, Ireland, Israel, Japan, Norway, U.K., U.S.
Criminal sanctions for bid-rigging only	Austria, Germany
Criminal sanctions provided for but not applied	Cyprus, France, Slovakia
Disqualification of directors	Australia, U.K.

Table 4: Responsibilities of national competition authorities

Country	Competition authority	Responsibilities outside core competition policy (Antitrust)
Australia	ACCC	Consumer protection, regulation of network industries
Austria	BWB	None
Belgium	ABC/BMa	None
Canada	Competition Bureau	Consumer protection
Czech R.	UOHS	Public procurement procedures, state aid
Denmark	KFST	Consumer protection, public procurement, regulation of water sector
Finland	KKV	Consumer protection (since 2013)
France	Autorité de la Concurrence	None
Germany	BKA	Public procurement procedures
Hungary	GVH	Consumer protection
Ireland	Competition Authority	None
Italy	AGCM	Consumer protection (from 2007), conflict of interests (from 2004)

Japan	JFTC	Consumer protection, protection of SMEs (subcontracting)
Korea	KFTC	Consumer protection, protection of SMEs (subcontracting)
Netherlands	ACM	Consumer protection (from 2013), regulation of network industries
Norway	KT	None
Poland	UOKiK	Consumer protection, state aid
Slovenia	Competition Protection Agency	None
S. Africa	Competition Commission	None
Spain	CNMC	Regulation of network industries (from 2013)
Sweden	KKV	Public procurement procedures
Switzerland	COMCO	Public procurement procedures
Taipei	FTC	Subcontracting
UK	CMA	Consumer protection, appeals on network industry regulation
USA	FTC	Consumer protection
	DoJ	Antitrust division has no other functions

¹ Formerly Head of Section (Competition Policy), Directorate of Economic and Financial Affairs, European Commission. Thanks are due to Pierre-André Buigues for very helpful comments.

² P-A Buigues & R. Meiklejohn, *National Competition Authorities in France, Germany, and the United Kingdom: Resources, Independence, and Enforcement*, 8(1) CPI ANTITRUST CHRON. (August 2013).

³ M. Krakowski, *Competition Policy Works: The Effect of Competition Policy on the Intensity of Competition – An International Comparison*, Hwwa Discussion Paper 332, Hamburg Institute of International Economics (2005).

⁴ For example, M.A. Dutz & A. Hayri, *Does more intense competition lead to higher growth?*, World Bank, Development Research Group, Research Working Paper No. 2320 (APRIL 2000). Much more nuanced results are obtained by Tay-Cheng Ma, *The effect of competition law enforcement on economic growth*, 7(2) COMPETITION L. & ECON. 7(2), 301-334 (2011).

⁵ S. Voigt, *The Economic Effects of Competition Policy – Cross-Country Evidence Using Four New Indicators*, Icer Working Paper No. 20/2006, International Centre for Economic Research, Torino, 2006.

⁶ *Supra* note 4.

⁷ P. Buccirossi et al, *Competition Policy and Productivity Growth: An Empirical Assessment*, Lear Research Paper (May 2012); Laboratorio di economia, antitrust, regolamentazione, Rome, (May 2012), and *Measuring the deterrence properties of competition policy: the competition policy indexes*, 7(1) J. COMPETITION L. & ECON. 165-204 (2011).

⁸ The study does not consider the separate effect of resources but uses an indicator whose value is largely determined by them.

⁹ KPMG, *Department of Trade and Industry, Peer Review of Competition Policy* (06 June 2007), available at <http://webarchive.nationalarchives.gov.uk/20121126080325/http://www.berr.gov.uk/files/file39863.pdf>. The respondents were officials of competition authorities, businesses, competition lawyers, and economists. The two most important factors were considered to be technical competence in terms of legal and economic analysis.

¹⁰ G. Stigler, *The Economic Theory of Regulation*, 2(1) BELL J. ECON. 3-21 (1971).

¹¹ In Canada, the Governor-General.

¹² Autorità Garante della Concorrenza e del Mercato.

¹³ Indeed, some observers consider that “there is a high level of political interference in the Italian regime”: KPMG (2007), *supra* note 9.

¹⁴ S. Voigt & E. Salzberger, *Choosing Not to Choose: When Politicians Choose to Delegate Powers*, 55(2) KYKLOS, 289-310 (2002).

¹⁵ J.B. Baker & C. Shapiro, *Detecting and Reversing the Decline in Horizontal Merger Enforcement*, 22 (3) ANTITRUST (Summer 2008).

¹⁶ *Supra* note 4.

¹⁷ The European Commission notes in its recommendation on Austria’s 2014 national reform program that “Despite increases in the budget of the Austrian Federal Competition Authority, it remains significantly understaffed in comparison to the authorities of other Member States of a similar or smaller size.” COM (2014), Brussels, 2 June 2014.

¹⁸ Estimated share of competition enforcement.

¹⁹ See Buccirossi et al., *supra* note 7. This is also implicit in the OECD Competition Committee’s standard format for national annual reports and in the GCR rating procedure.

²⁰ See W.P.J. Wils, *Is Criminalization of EU Competition Law the Answer?* 28(2) WORLD COMPETITION 117-159 (June 2005). Much of the discussion in this section is based on Wils.

²¹ J.M. Connor & C.G. Helmers, *Statistics on Modern Private International Cartels*, Aai Working Paper, No.07-01, American Antitrust Institute (10 January 2007). See also J.M. Connors & R.H. Lande, *Cartels as Rational Business Strategy: Crime Pays*, 34(2) CARDOZO L. REV. (December 2012).

²² G. Becker, *Crime and Punishment: An Economic Approach*, 76(2) J. POL. ECON. 169-217 (1968).

²³ See Wils, *supra* note 20. The perceived probability of punishment may be even lower than the real probability if managers over-estimate their ability to evade detection.

²⁴ See Connor & Helmers, *supra* note 21.

²⁵ *Supra* note 21.

²⁶ There is some evidence of a “sunk cost bias” amongst firms that leads them to price according to average rather than marginal cost. The finding that cartel participants do not usually lower their prices after

being fined is consistent with this. See P. Buccirosi & G. Spagnolo, *Optimal Fines in the Era of Whistleblowers. Should Price Fixers still Go to Prison?* Lear Research Paper 05-01, Laboratorio di economia, antitrust, regolamentazione, Rome (12 December 2005).

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Supra* note 20.

³⁰ Office of Fair Trading, *Three imprisoned in first OFT criminal prosecution for bid-rigging*, Oft Press Releases, 72/08, (11 June 2008).

³¹ For an overview of the arguments with references to the literature, see EUROPEAN MERGER CONTROL: DO WE NEED AN EFFICIENCY DEFENCE?, Ch. 2 (F. Ilzkovitz & R. Meiklejohn, eds. 2006).

³² M. Armstrong, *Interactions between Competition and Consumer Policy*, 4(1) COMPETITION POL'Y INT'L (Spring 2008).

³³ For a discussion of differences between antitrust and network industry regulation, see P.-A. Buigues & R. Meiklejohn, *European Integration and Network Industries*, INTERNATIONAL HANDBOOK ON THE ECONOMICS OF INTEGRATION, VOL. II (M.N. Jovanović, ed. 2011).

³⁴ Ley 3-2013 of 4 June 2013, Boletín Oficial del Estado Núm 134, 5/6/2013. English translation available at <http://www.cncompetencia.es/Inicio/Legislacion/NormativaEstatal/tabid/81/Default.aspx> (consulted 15/5/2014).

³⁵ For example, the Competition Commission expressed the opinion that the practice of giving sectoral regulators concurrent powers to enforce competition law has not worked well in the United Kingdom. See Department for Business, Innovation and Skills (UK), *Responses to BIS Consultation: A Competition Regime for Growth* (15 March 2012).



Global Jurisdictions

Integrating Regulatory and Antitrust Powers: Does It Work? Case Studies from Spain and Mexico

BY JUAN DELGADO & ELISA MARISCAL¹

There are a wide variety of possible structures for regulatory regimes in countries. This article focuses on the analysis of multi-purpose regulators that combine regulatory and antitrust powers, such as the Mexican IFT and Cofece, as well as the Spanish CNMC. We focus on institutional design, review the existing literature on the pros and cons of single-purpose vs. multi-purpose regulators, and use the new Spanish and the Mexican institutional settings to contrast how such pros and cons are designed to operate on paper and how they do so in real life. Our goal is to look for evidence, at the very initial stage of the reforms in both these countries, of whether these countries are moving closer to a rule of law equilibrium.

I. INTRODUCTION

As evidenced by the recent wave of regulated agencies' restructuring across the world, both developed and developing countries have key concerns regarding establishing agencies that will credibly regulate sectors plagued by market failures and/or that will arbitrate competition in markets that ought to function freely. The goal of these reforms reflects a growing concern with building a legal order that is effective, as well as laying the groundwork to provide incentives for citizenry to behave in a lawful manner. In other words, establishing an effective "rule of law."

HOWEVER, IN OTHER NATIONS, THERE EXIST MULTI-PURPOSE INSTITUTIONS COVERING ALL IMAGINABLE COMBINATIONS

With this objective in mind, some nations have created both single-purpose regulators and separate antitrust authorities, whose sole responsibilities, respectively, are to regulate specific sectors and to enforce antitrust rules. However, in other nations, there exist multi-purpose institutions covering all imaginable combinations. As pointed out by Kovacic & Hyman,² the most common arrangement is to combine antitrust with consumer protection statutes and/or public procurement laws, but other combinations exist. These include institutions regulating various industries, such as the German Bundesnetzagentur (which regulates energy, telecommunications, post, and railways); institutions applying both antitrust law and industry regulation as is the case of the Mexican Instituto Federal de Telecomunicaciones (Federal Telecommunications Institute ("IFT")), which has regulated and enforced antitrust law in the telecoms sector industry since September 2013); the recently created Spanish Comisión Nacional de los Mercados y la Competencia (Markets and Competition Commission ("CNMC")) which merged six industry regulators plus the antitrust agency); and the Dutch Authority for Consumers and Markets ("ACM") (which merged the Competition Authority, NMa, the Consumer Protection Authority, and the Post and Telecommunications Authority ("OPTA")).

This article focuses on the analysis of multi-purpose regulators that combine regulatory and antitrust powers, such as the Mexican IFT, the Spanish CNMC, and the Dutch ACM. We will further argue that

WE WILL FURTHER ARGUE THAT THE MEXICAN FEDERAL ECONOMIC COMPETITION COMMISSION HAS ALSO BECOME A MULTI-PURPOSE REGULATOR AS IT NOW INCLUDES BOTH EX POST AND EX ANTE REGULATORY POWERS

the Mexican Federal Economic Competition Commission (Comisión Federal de Competencia Económica (“Cofece”)) has also become a multi-purpose regulator as it now includes both ex post and ex ante regulatory powers—the latter in the form of identification of barriers to competition and compelling access to essential inputs, both of which can result in divestiture.

The article focuses on institutional design and does not analyze other factors affecting regulatory outcomes such as framework and enforcement.³ It reviews the existing literature on the pros and cons of single-purpose vs. multi-purpose regulators and uses the new Spanish and the Mexican institutional settings to illustrate how such pros and cons are designed to operate in paper and how they do so in real life. In other words, we look for evidence, at the very initial stage of the reforms in both these countries, whether these countries are moving closer to a rule of law equilibrium.⁴

A. *The Spanish Reform*

In Spain, the government proposed in 2012 the merger of six sector-specific regulators (energy, telecoms, media, postal, air transport, and railways) and the antitrust enforcer into a single regulator, the CNMC. The proposal was officially motivated by recent episodes of conflict between regulatory and antitrust interventions in the telecoms sector as well as the need to reduce the size and cost of the public administration under current strict government budget constraints.

The decision, however, was heavily criticized for not being the result of rigorous analysis on the needs and failures of the existing scheme, putting at risk the experience and achievements of regulatory and antitrust policies realized during more than a decade.⁵ There were questions on whether the structure of the new macro-regulator guaranteed a materialization of the potential benefits of the merger.⁶

The CNMC, now responsible for the regulation of the different industries and for horizontal enforcement of antitrust law in all industries, started operations in the last quarter of 2013. CNMC is structured around three sector-specific investigation directorates (energy; telecoms, audiovisual and broadcasting; and transport and postal) and an antitrust directorate. There are two resolution chambers: the regulatory chamber, which deals with sector-specific regulation; and the antitrust chamber, which enforces antitrust law. Both chambers meet at plenary sessions to resolve potential conflicts and to deal with general topics. The investigation and resolution phases are formally separated.

The institutional reform did not, however, entail major legal changes regarding substantive issues—both antitrust law and sector-specific legislation remain basically unchanged.

THERE WERE QUESTIONS ON WHETHER THE STRUCTURE OF THE NEW MACRO-REGULATOR GUARANTEED A MATERIALIZATION OF THE POTENTIAL BENEFITS OF THE MERGER

B. *The Mexican Reform*

In Mexico, after more than a decade of trying and failing to enact asymmetric regulation in the telecoms industry, the new government of President Peña Nieto set out in its “Pacto por México,” a new route to effectively implement telecommunications reform. The reform included changes to the competition agency, which had been deeply involved in telecommunications litigation over the last decade. This pact led to a Constitutional reform (June 2013), which granted new powers to a re-founded autonomous antitrust agency and created a new telecoms and broadcasting regulator with powers to enforce competition rules in both the telecommunications and broadcasting sectors, thus becoming a multi-purpose regulator. While a similar proposition has been discussed for other regulated sectors (most notably energy), so far those changes have not been enacted.

In essence, this reform implied an important divestiture of the existing antitrust regulator’s powers, which had been notably focused on telecommunications and were absent in other important regulated and non-regulated sectors⁷. While it sought to streamline judicial processes in telecommunications, it may have opened the door for a more complicated interaction among regulators; not just in the telecommunications sector over the near future, but also with other sector-specific regulators, as antitrust and regulatory enforcement powers come into question with new changes to various laws.

For example, a new development in the completely re-written secondary laws dealing with competition policy—which come into effect on July 7, 2014—entrust Cofece, the new agency, with *ex post* and *ex ante* powers. While the law maintains Cofece’s powers to enforce remedies for anticompetitive

IN ESSENCE, THIS REFORM IMPLIED AN IMPORTANT DIVESTITURE OF THE EXISTING ANTITRUST REGULATOR’S POWERS, WHICH HAD BEEN NOTABLY FOCUSED ON TELECOMMUNICATIONS AND WERE ABSENT IN OTHER IMPORTANT REGULATED AND NON-REGULATED SECTORS

conduct and perform merger reviews, it curtails its ability to do so in telecommunications and broadcasting. Cofece still has the ability to undertake studies into competition conditions in other regulated sectors that may trigger price controls and asymmetric regulation, but it adds the possibility for Cofece to sanction directly—without requiring coordination with other sector regulators and in some cases even requiring divestiture—those markets where it considers that there are high “barriers to competition” and where economic agents or undertakings have control of “essential inputs”.

The constitutional reforms of 2013 changed the management of both agencies, establishing a complicated system to name the now 7-person board (vs. 5 previous commissioners) through a merit-based process. The process, however, is unnecessarily rigid, effectively barring more experienced private-sector candidates from ever participating in the plenum of either agency and eliminating the possibility of any kind of revolving door policy between government and private sector. We discuss this and some of the other challenges that lie ahead for both regulators in the next section.

II. INTEGRATING ANTITRUST AND REGULATORY POWERS: A NORMATIVE ANALYSIS

A. Synergies vs. Conflict

Following Kovacic & Hyman,⁸ multi-purpose agencies can realize policy synergies (in addition to other administrative synergies) and lower costs associated with coordinating policy between separate institutions

A JOINT MANDATE TO REGULATE AND COMPETE MAY ALSO AFFECT THE FORCE WITH WHICH THESE TWO OBJECTIVES ARE PURSUED AND IMPLEMENTED IN PRACTICE

with related functions. They emphasize that such synergies will only arise if the functions to be combined are true policy complements. Under this view, it might make sense to merge institutions that look at similar issues (such as network industry regulators) or at the same issue from different angles (such as antitrust and regulation in a specific sector). If policies are not

complementary, synergies will not develop. Also, the integration of several functions under one roof might contribute to policy coherence by turning a conflict between institutions into an internal conflict, but still not necessarily provide any synergy.

Excessive diversity among policy objectives or sectors might lead to lack of specialization, especially when the resolution body within the institution is unique, as is the case for the Spanish regulatory chamber (all sectors) or for the Mexican IFT board (*ex ante* and *ex post* regulation). For example, even if the economic principles of network industries regulation are similar, and there might be synergies in coordinating their application, there are also sector specificities that require sector expertise. A multi-purpose regulator might be able to exploit potential synergies but still lack the expertise to address sector specific issues.

Realizing synergies requires an appropriate internal organization that guarantees a coherent outcome. The sum of different operating units dealing with different topics under the same roof does not necessarily guarantee the realization of potential synergies. As reported by Hyman & Kovacic,⁹ rivalry between operating units can be beneficial “if it results in synergies that serve the larger aims of the agency” but can also be destructive “if it manifests itself in credit-claiming or other measures designed to enhance the visibility of the operating unit as an end in itself.” The internal organization and the institutional culture are crucial in determining the outcome.

THE INTEGRATION OF SEVERAL FUNCTIONS UNDER ONE ROOF MIGHT CONTRIBUTE TO POLICY COHERENCE BY TURNING A CONFLICT BETWEEN INSTITUTIONS INTO AN INTERNAL CONFLICT, BUT STILL NOT NECESSARILY PROVIDE ANY SYNERGY

The creation of multi-purpose regulators dealing with both sector regulation and antitrust enforcement can also generate conflicts.¹⁰ The mandate of sector-specific regulators is generally broader and includes additional objectives other than the promotion of competition. For example, the telecoms regulator might encourage infrastructure sharing for environmental or public health reasons, and this might turn into a conflict with competition policy. Therefore, the assessment and the outcome of specific cases might differ substantially.

A joint mandate to regulate and compete may also affect the force with which these two objectives are pursued and implemented in practice. For example, one important task of any antitrust authority is competition advocacy—it may be the case that advocacy plays a secondary role (or no role at all) compared to regulatory objectives in a given sector. Who then advocates competition when the two mandates of a multi-purpose regulator conflict?

A STRONG MULTI-PURPOSE REGULATOR WILL BE ABLE TO BETTER INFLUENCE DECISION-MAKERS AND GET ITS PROPOSALS THROUGH THE POLITICAL PROCESS

The integration of institutions can also increase administrative efficiency.¹¹ Administrative procedures can be simplified and duplication of administrative departments (accounting, human resources, IT) can be avoided. This is generally a second-order benefit and should by no means be a driver for integration. Integration should not be motivated by the possibility of reducing fixed administrative costs (a one-time cost benefit), but should rather be motivated by a policy efficiency and an increased effectiveness that can be passed on to the constituency the institution serves (similar to the analysis of efficiencies under merger review).

B. Advocacy

WITH SINGLE-PURPOSE REGULATORS, POLICY-MAKERS WILL GET “PURE” COMPETITION AND REGULATORY RECOMMENDATIONS AND ANY CONFLICT WILL HAVE TO BE RESOLVED OPENLY

The advocacy functions of regulatory and competition authorities refer to those activities beyond law-enforcement such as industry studies and reports, comments and recommendations on new laws and regulations, and public awareness activities that aim to contribute to the authorities’ goals. Most antitrust and regulatory agencies have powers to take advocacy initiatives in the form of recommendations or

guidance that are not necessarily binding for the regulated entities, the government, or other agents.

The creation of multi-purpose regulators has two potential effects on advocacy activities: On the one hand, an integrated institution might be more powerful and influential but, on the other, the diversity of the agenda of a multi-purpose regulator might dilute and weaken its positions.

A strong multi-purpose regulator will be able to better influence decision-makers and get its proposals through the political process. Also, being able to use a multi-perspective approach could allow regulators to elaborate a more comprehensive and effective strategy on sector-specific issues.

A multi-purpose regulator should have access to deeper expertise in regulated sectors, which often possess complex and unique competition problems. When specific-sector regulators and competition authorities are separated, “(c)ompetition authorities often lack the sector-specific expertise the regulators do have” and “(a)s a consequence, they may easily get caught in a scrimmage of technical arguments with great risk to lose the fight.”¹² Therefore, sector-specific expertise could help to strengthen competition analysis in regulated sectors.

Being multi-purpose might, however, affect negatively the attainment of some specific objectives. Advocacy activities within multi-purpose, sector-specific regulators combine competition objectives with other objectives in their agenda, which could conflict with competition such as investment promotion, technological development, or rapid network deployment. This will require multi-purpose regulators to make trade-offs and choices, therefore reducing the strength of stand-alone arguments.

Regulation and competition advocacy require different priorities and objectives and therefore their recommendations will have different natures implying different approaches.¹³ With single-purpose regulators, policy-makers will get “pure” competition and regulatory recommendations and any conflict will have to be resolved openly. However, in a multi-purpose regulator, the differences in approaches will be resolved internally, reducing the transparency of the discussion and hiding possible discrepancies between the competition and the regulatory approaches. This will imply, for example, that “pure” competition and “pure” regulation-specific advocacy arguments will be weakened vs. the case of a single-purpose regulator.¹⁴

IF THE INDEPENDENCE OF REGULATORS IS NOT FULLY GUARANTEED BY THE LEGAL FRAMEWORK, THE EXISTENCE OF FEWER MULTI-PURPOSE REGULATORS MIGHT FACILITATE GOVERNMENT CONTROL AND INFLUENCE ON REGULATORY DECISIONS

Any bias towards a more regulatory approach or a more competition-oriented approach will depend on the internal structure of advocacy units: If sector-specific units take the lead in sector-specific advocacy initiatives, competition arguments can be undermined. The balance of the final outcome will depend to a large extent on the internal allocation of responsibilities, and especially on whether the relationships between the competition and the regulation staff are cooperative or competitive.

Finally, these implications for the advocacy functions will just be present in regulated sectors. Advocacy in non-regulated industries will mostly focus on competition aspects, which can result in an unbalanced advocacy approach to regulated vs. non-regulated industries.

C. Independence vs. Accountability

Agency independence is essential for efficient application of competition law and regulation. An independent institution will avoid political interference that can affect the agencies’ objectives and effectiveness. An independent agency will solve commitment problems that can exist when it has strong ties to the government.¹⁵ Also, independence of competition authorities is linked to effective antitrust enforcement.¹⁶

Governments can try to influence regulatory and antitrust policy enforcement in order to benefit their own political agenda. If the independence of regulators is not fully guaranteed by the legal framework, the existence of fewer multi-purpose regulators might facilitate government control and influence on regulatory decisions. On the contrary, the existence of several regulators overlooking a specific issue—say a merger in the communications industry, which is analyzed by both the antitrust authority and the sector-specific regulator—might make the

implementation of the government agenda more difficult.

NEVERTHELESS, COHERENCE
CONSIDERATIONS RARELY MAKE IT INTO
THE LEGISLATIVE DISCUSSION

Responsibilities for a specific sector might be diluted if the sector is supervised by several regulators. Thus, the integration of competition and regulatory powers can solve the problem of assigning responsibilities and thus improve accountability.¹⁷ Sector-specific regulators can always blame the competition authority for the deficient functioning of a market (and vice versa). On the other hand, a too broad agenda can make the assumption of responsibilities by top managers more difficult since they might not be able to get a deep knowledge in all subjects.

An independent agency contributes towards building a country's "rule of law" through its ability to enforce laws that are known and relatively settled, and which undergo revisions by a judiciary that is schooled in legal reasoning and is independent of political manipulation. In addition, an independent agency will more likely use its powers to enforce technical decisions and rules vs. short-term political goals or agendas. This contributes towards compliance with these laws, as people are more likely to comply with rules that are viewed as treating them "fairly".¹⁸

COHERENCE AND COORDINATION
ISSUES AMONG REGULATORS ARE
SOMETIMES RESOLVED THROUGH
MERGERS OR SEPARATION OF POWERS

On the other hand, critics note that autonomous institutions tend to represent an autonomous bureaucracy and hence are beyond the reach of the general citizenry, as they are not beholden to the voting public. A solution to this valid critique is ensuring that these agencies function in a transparent manner and that they are accountable, making the risk of capture less serious. Increasing independence makes an institution's accountability more difficult. Independence from the political process is important, but independent regulators must have some form of mechanism in which they are accountable via, for example, the control of their budgets or through the disclosure and transparency of their activities.¹⁹

D. Coherence and Coordination: The Value of Primacy and Deference

When an agency is reformed to incorporate a combination of duties, one of the first questions that arises is whether its policy remains coherent or not. In other words, the considerations of complementarity in its new functions, which we discussed above, are crucial to its efficient functioning. Nevertheless, coherence

A SOLUTION TO THIS VALID
CRITIQUE IS ENSURING THAT
THESE AGENCIES FUNCTION IN
A TRANSPARENT MANNER AND
THAT THEY ARE ACCOUNTABLE,
MAKING THE RISK OF CAPTURE
LESS SERIOUS

considerations rarely make it into the legislative discussion. A consequence is that the consistency of new mandates within an agency will have to be resolved within the organization—not in an open and transparent manner, but as decisions are enacted. It is usually the outcome of an agency's decisions, and not its legal mandate, that will determine the final effects of the reorganization brought about by a legal change in regulators.²⁰

The issue of coherence in an agency facing a multiplicity of objectives or, if concurrence exists, when

an agency is required to coordinate with another will affect an agency's credibility with the parties it regulates. Taking the first issue into account, an organization with varied and conflicting mandates will lack credibility when it enacts certain policy objectives since other purposes written into laws and regulations can eventually become a priority and may or may not conflict with the agency's current actions. This problem exists whether the agency is multi-membered or managed by a single person.

A PROLIFERATION OF REGULATORY AGENCIES INCREASES THE RISK OF JURISDICTIONAL OVERLAPS AND THEREFORE OF CONFLICTS, PARTICULARLY WHEN PRIMACY OR DEFERENCE HAS NOT BEEN AGREED UPON OR ESTABLISHED

If we consider the second issue, the lack of coherence in the face of concurrency, agencies with concurrent mandates but differing objectives will have to solve the problem of coordination to ensure that their decisions lend certainty to the undertakings they regulate. Coordination will very likely result in a slower decision process as collaboration takes place. Coordination problems are sometimes solved internally, but they may play out in public or over long periods of time, leading to a lack of predictability in enforcement and policy application.

THUS AN AGENCY'S CREDIBILITY AND BRANDING IN TERMS OF THE WORK IT IS CAPABLE OF DOING ARE CRUCIAL TO SET EXPECTATIONS IN LINE WITH ITS PRIORITIES

Coherence and coordination issues among regulators are sometimes resolved through mergers or separation of powers. This affects the institutional design of regulatory bodies and their setup as single (specialized) or multiple enforcers of competition policy. A single antitrust enforcer has exclusive enforcement in these matters and so coherence problems are eliminated—but not necessarily coordination problems, as the enforcer's actions may hinge upon sectors regulated by a different agency.

In the case of multiple enforcers Kovacic & Hyman²¹ note a plurality of models, going from the concurrence of agencies with similar mandates (the DOJ Antitrust Division and the FTC), different levels of government (federal and state), shared or concurrent responsibilities among regulators (FCC and DOJ), to the models we are addressing here: a multi-purpose, multi-sectorial agency with antitrust and regulatory powers over various regulated sectors (the case of Spain), or a specialized antitrust agency across all sectors but one where a sector regulator has multi-purpose objectives as it can regulate and apply antitrust law exclusively (the case of Mexico's Cofece and IFT).

In seeking to solve coherence and coordination problems through new institutional design, potential new problems need to be considered—such as cost (where will the money come from?), capture (is it easier or harder to capture a single purpose regulator that oversees multiple sectors but needs to coordinate in order to enforce the law or a multi-purpose regulator who may have conflicting objectives?), and political influence (who is benefitting from the new design and is this an equilibrium that truly improves the social outcome vis-à-vis the previous setup?).

For the problems laid out above, it should become clearer that intervening at the level of institutional design by creating or merging agencies is not necessarily a simple solution. A proliferation of regulatory agencies increases the risk of jurisdictional overlaps and therefore of conflicts, particularly when primacy or deference has not been agreed upon or established.

For example, Petit argues that the traditional distinction between *ex ante* enforcement (regulators) and *ex post* sanctions (competition agencies) is overly simplistic.²² Sector regulation has incorporated the opening of markets and elimination of bottlenecks in its mandate, bringing it closer to competition law standards, while competition agencies, particularly in Europe, have increasingly taken on “quasi-regulatory enforcement policies.” In contrast, merging all objectives into an “all powerful” agency may simply internalize a problem that was publicly evident before. The problems then change, giving rise to a lack of transparency in priority setting and resolution, a need for accountability as all power becomes concentrated into fewer actors, and a greater coherence problem as multiple mandates and priorities need to be reconciled.

THE RISK OF REGULATORY CAPTURE SEEMS THEREFORE TO BE REDUCED WHEN COMPETITION AND REGULATION ARE INTEGRATED UNDER A MULTI-PURPOSE INSTITUTION

E. Priority Setting

Priority setting might be diluted under a multi-purpose regulator. A too broad mandate can be translated into confusion about both objectives and the criteria needed to make a preliminary assessment of the seriousness and importance of some matters.²³ In addition, a broad mandate risks leaving a discussion of policy priorities in the hands of an agency based on its own set of internal restrictions, which may or may not coincide with the expectations set out by the legislative branch or the public in general. To put it bluntly, a broad mandate

THE INTEGRATION OF COMPETITION AND REGULATORY POWERS MIGHT REDUCE FORUM-SHOPPING OPPORTUNITIES, IMPROVING AGENCIES' USE OF RESOURCES AND POLICY INSTRUMENTS

with no transparency requirements about the allotment of funds, setting of goals, etc. may lead to an agency working hard but underperforming relative to a performance bar expected by society. Thus an agency's credibility and branding in terms of the work it is capable of doing are crucial to set expectations in line with its priorities.

This is especially relevant when the objectives of different divisions of a multi-purpose regulator conflict. For example, in a regulator with joint powers for regulation and competition in the telecoms sector, the regulation division may give priority to rapid infrastructure deployment over the existence of competitive markets. In such a case, a multi-purpose agency would have to balance which combination of policy objectives better serves society. If the mechanism for setting priorities is not well defined and sufficiently transparent, the quality of the regulatory process might be affected and the outcome might not necessarily enhance social welfare.

The integration of different powers and responsibilities under one roof will require, at least initially, a lot of effort to integrate, coordinate, and maintain the overall internal coherence. There are risks that

an agency's priorities will be biased towards internal procedures rather than focused on policy objectives. Although such a risk is in principle temporary, it might become permanent if not properly addressed.

F. Regulatory Capture and Regulatory Arbitrage

According to Cseres, “concerns about agency capture may dictate to have agencies with broad jurisdictions to make them more likely to resist pressure from any one interest group.”²⁴ Similarly, Kovacic & Hyman state that “[a] multiplicity of functions does provide a safeguard against capture. Owing to the breadth and diversity of its duties, a multi-purpose agency provides a more elusive target for any single industry group.”²⁵ The risk of regulatory capture seems therefore to be reduced when competition and regulation are integrated under a multi-purpose institution. Also, a multi-purpose, multi-sector regulator will be exposed to a larger number of industries and therefore be able to use experience across sectors to adopt more informed and unbiased decisions in specific sectors, reducing not only conscious but also unconscious potential capture.

THE SPANISH GOVERNMENT PUT FORWARD SEVERAL REASONS FOR THIS INSTITUTIONAL REFORM

However, there are also views arguing that the integration of regulatory and competition powers could actually increase the influence of the industry on the regulator because “[s]plitting regulatory tasks and monitoring technologies among several non-benevolent regulators may reduce their discretion in engaging in socially wasteful activities.”²⁶ This is the case when different institutions have shared powers over a specific sector; for example, in the case that the competition authority can review decisions by regulators.

Therefore, the overall effect of the integration of functions in one single regulator can reduce the risk of capture when regulators prior to the integrations were too small and there was not an effective control of decisions between agencies; but it could be negative when regulators were already large enough but competition authorities could review regulators' decisions.

Finally, the existence of discrepancies between regulators that have concurrent (vs. complementary) powers over one sector can result in regulatory arbitrage. Companies can look for those agencies whose decisions are more favorable to them through “forum shopping.” The integration of competition and regulatory powers might reduce forum-shopping opportunities, improving agencies' use of resources and policy instruments.

III. THE CASES OF SPAIN AND MEXICO

A. Institutional Reform in Spain

1. Background

The new multi-purpose regulatory authority in Spain, the Comisión Nacional de los Mercados y la

THE STRUCTURE DOES NOT ALLOW
ELUCIDATING HOW POTENTIAL
SYNERGIES ACROSS DEPARTMENTS
CAN ARISE, SO CREATING
SYNERGIES WILL DEPEND ON HOW
THE INSTITUTIONAL CULTURE
DEVELOPS

Competencia (“CNMC”) (in English, the Markets and Competition National Commission) started operations in October 2013.²⁷ The new CNMC integrated the former antitrust authority, Comisión Nacional de la Competencia (“CNC”) and six sector-specific regulators responsible for telecommunications, audiovisual media, energy, railways, airports, and postal services²⁸ (of which two were projected but not yet created).²⁹

The Spanish government put forward several reasons for this institutional reform. Chief among them were increasing the coherence between regulatory and antitrust decisions through better integration of *ex-ante* regulation and *ex-post* antitrust enforcement, reducing costs by increasing administrative efficiency, reducing the risk of regulatory capture, and integrating *ex-ante* and *ex-post* approaches. Other political motivations for the merger were widely discussed in the press at the time since one of the consequences of the integration was the dismissal of the previous members of the different boards and the appointment of new members by the new parliamentary majority.³⁰

The creation of the macro-regulator involved a re-assignment of responsibilities, and some minor previous regulators’ functions were assigned to the respective ministries.³¹

The new CNMC consists of a decision board, composed of ten members, and four Directorates (antitrust, energy, telecommunications and audiovisual, and transport and postal services). There are other horizontal units such as a legal service that reports to the board and a competition advocacy department that reports directly to the Chairman.

The board is divided in two chambers: the antitrust chamber, chaired by the Chairman, and the regulatory chamber, chaired by the Deputy Chairman. The antitrust chamber deals with antitrust infringements and mergers, and the regulatory chamber deals with *ex-ante* sector-specific regulation in all industries covered by the sector Directorates. There is a mechanism for exchanging opinions between chambers and discrepancies between chambers are resolved at plenary sessions of the two chambers.

The members of the board are proposed by the government for a six-year non-renewable term, and approved by the Parliament. The appointment criteria are completely opaque. The actual board members proposed by the government did not face any opposition in Parliament where the party supporting the government had an absolute majority.

For infringement proceedings, there is a functional separation between the board and the four directorates.³² Directorates conduct investigations in infringement cases. Once the investigation phase is finalized, the Directorate makes a proposal to the Board, which analyzes it and adopts a decision (which does not necessarily follow the line of the proposal).

2. Assessment

- **Synergies vs. Conflict**

The new CNMC is organized into four Directorates that replicate the structure of the former independent regulators (antitrust, energy, telecoms plus the new audiovisual powers, and transport which includes the former railways and postal regulators plus the new airports regulator). The structure does not allow elucidating how potential synergies across departments can arise, so creating synergies will depend on how the institutional culture develops (i.e. whether there is collaboration or rivalry between departments).

IN EITHER CASE, “PURE” COMPETITION ARGUMENTS WILL BE UNDERMINED SINCE THE PROMOTION OF COMPETITION WILL NO LONGER BE THE SOLE GOAL OF THE INSTITUTION

Synergies might potentially arise at the Board level both within the regulatory chamber that will deal with the several industries and therefore can apply consistent regulatory principles, and across chambers since the consultation mechanism between chambers can realize synergies between regulation and antitrust enforcement.

However, there are obstacles to the realization of synergies:

- if there is no collaboration across departments, synergies at the board level might come too late in the procedure;
- the diverse agenda of the regulatory chamber can lead to a lack of specialization of board members and inability to exploit potential synergies; and
- the functioning of the cross-chambers consultation mechanism will depend on the rules established and on whether Board members adopt a conflict or a collaborative attitude. Games of power between chambers might make synergies more difficult to arise.

Finally, the Spanish government argued that the increased administrative efficiency derived from the removal of duplicated costs and the simplification of the structure of the regulator would produce important cost savings, an argument that is especially relevant under the current public budget constraint. The government predicted cost savings of EUR 28 million.³³ However, this is a side argument that does not justify per se the creation of a multi-purpose regulator, unless there are also important policy synergies.³⁴

ACCOUNTABILITY IS, IN PRINCIPLE, EXPECTED TO IMPROVE, SINCE IN REGULATED SECTORS A SOLE INSTITUTION WILL BE RESPONSIBLE FOR THE SUPERVISION OF THE MARKETS AND THE ENFORCEMENT OF ANTITRUST LAW

- **Advocacy**

The fact that the CNMC is a bigger institution with broader responsibilities makes it potentially more influential over the legislative process. Also, combining sector-specific and competition expertise puts the institution in a better position to submit more informed opinions on sector-specific regulatory initiatives or to create more comprehensive market studies.

However, depending on how responsibilities are assigned internally, this combination could also introduce some bias. The new CNMC maintains a separate competition advocacy department, which already existed in the preceding antitrust agency. This department is in charge of elaborating market studies as well as participating in the legislative process through non-binding reports and recommendations. However, it is not clear from the CNMC structure and functions how advocacy responsibilities are assigned within the regulator, and whether advocacy initiatives in the regulated sectors will be led by sector-specific units or coordinated by the competition advocacy unit. In the former case, competition arguments might become of secondary importance in favor of other regulatory goals. In either case, “pure” competition arguments will be undermined since the promotion of competition will no longer be the sole goal of the institution. Also, if the advocacy reports in regulated sectors are approved by the regulatory chamber, the regulatory bias might be reinforced.³⁵

BOTH TIMING AND POWERS DIFFER
IN ANTITRUST AND REGULATORY
INTERVENTIONS

The integration of regulatory and competition powers under the CNMC does not necessarily mean that discrepancies will disappear, but rather that they will be resolved internally. Possible internal conflicts might not be visible to policymakers and legislators who will receive a sole report. To avoid this, the advocacy reports should reflect any potential conflicts between regulation and competition advocacy and should not attempt to reconcile them.

Again, the outcome will very much depend on whether the directorates and chambers adopt a cooperative or a rivalry approach. A rivalry approach is not necessarily negative if it enriches the discussion and such discussion is reflected in a transparent manner in the final report. Under the current setting, it is difficult to anticipate which model will prevail.

- **Independence vs. Accountability**

The creation of the CNMC did not entail major changes in the system of appointment of board members, which are proposed by the government and heard by the Parliament. The current appointment system lacks transparency and is not necessarily based on the merits of the candidates. Under this setting, the smaller number of board members and the fact that they are politically appointed make the risk of government influence more likely.³⁶ Also, the excessively broad agenda of the regulatory chamber and the lack of expertise of some board members in both chambers make board members more exposed to government influence.

Accountability is, in principle, expected to improve, since in regulated sectors a sole institution will be responsible for the supervision of the markets and the enforcement of antitrust law.³⁷

The new institution budget is set by the government, which reduces the independence of the agency but makes it more accountable.^{38 39} However, the large number of industries covered by the new agency and the small size of the chambers (five members each) make it difficult for board members to know the details

SUCH A BROAD STRATEGIC PLAN DOES NOT PROVIDE INDICATIONS OF HOW PRIORITIES WILL BE SET AND INTERNAL CONFLICTS WILL BE SOLVED

of all the adopted decisions. For example, according to the Chairman of the CNMC, the board has adopted nearly 1,000 decisions during its first eight months of operation,⁴⁰ of which almost three-quarters corresponded to the regulatory chamber.

This implies that the five members of the regulatory chamber have adopted an average of 20 decisions per week in six industries.

The number of decisions is likely to increase in sectors such as railways and airports, which are at early stages of liberalization. The topics range from technical network issues to audiovisual contents and advertising regulation. It is therefore not credible that the members of the regulatory chamber will be able to take proper responsibility for such a volume of decisions covering such a broad set of issues.

- **Coherence and Coordination**

One of the reasons put forward by the Spanish government to justify the merger was to address some concerns regarding conflicting decisions of industry regulators and the antitrust agency.⁴¹ Companies claimed that this led to high regulatory uncertainty. The CNMC can promote a more coherent application of competition principles in regulated sectors.

However, there are factors that could limit coordination:

1. Coordination depends not only on the institutional arrangements but also on the institutional culture. If the sector-specific divisions and the competition division do not develop a culture of cooperation, coherence will not be guaranteed.

2. The different natures of regulatory and competition administrative procedures make a formal coordination difficult. Both timing and powers differ in antitrust and regulatory interventions. While regulatory intervention is normally *ex ante* and does not aim to sanction, antitrust investigations are *ex post* and aim to sanction specific conducts. This difference is blurred but not totally eliminated under the current convergence of regulatory and antitrust principles.

DEPENDING ON THE LEVEL OF COORDINATION AND CONTROL ACROSS DIVISIONS AND ACROSS CHAMBERS, FORUM SHOPPING MIGHT OR MIGHT NOT BE REDUCED

3. It is also not clear how such coordination will be articulated at directorate and board levels. If coordination does not occur explicitly at directorate and at board levels, the integration might result in an internalization of potential conflicts leading to a lack of transparency in resolution. This problem might be aggravated by the multiple mandates of the regulator and the difficulty in reconciling priorities and objectives.

- **Priority Setting**

THE NEWLY FORMED AUTHORITIES
WERE GRANTED AUTONOMY—A
COMPLETELY NOVEL FORM OF
INSTITUTIONAL MAKEUP IN MEXICO
UNTIL NOW

The CNMC has integrated supervisory powers over a large number of sectors, which could lead to a dilution of priority setting. In its first strategic plan⁴² presented in May 2014, the CNMC set three broad goals that are not specific to a multi-purpose regulator: rigorous interventions, transparency and independence, and the realization of synergies. It then developed a list of actions, which are mostly related to the process (e.g. an integrated approach to problems, internal communication, efficient use of resources). Just a few actions refer to vague policy objectives such as the active prosecution of cartels.

Such a broad strategic plan does not provide indications of how priorities will be set and internal conflicts will be solved but, on the contrary, it keeps a large degree of uncertainty regarding policy objectives, decision mechanisms, and internal allocation of human and financial resources of the new regulator.

Also, the fact that there is no organic integration of the antitrust and the regulatory departments means the setting of priorities at directorate level will not truly benefit from an integrated institutional setting. Only the Plenary of the Board is in a position to set comprehensive priorities covering regulation and antitrust but the separation of the investigation and the decision phases and the broad range of issues covered by the Board make the process of setting priorities a complex task.

- **Regulatory Capture and Regulatory Arbitrage**

To prevent regulatory capture was one of the drivers of the reform. This is certainly an issue for the smaller regulators (railway, postal, and the yet to be created, airports regulator), since they may lack enough resources to face monopolies or quasi-monopolies in their respective markets.⁴³ A large multi-sector regulator reduces in principle the risk of being captured.

There are two aspects that may contribute to maintain or increase the risk of regulatory capture: First, the structure of the new regulator keeps industry responsibilities under different directorates which are still subject to capture by big industry players. Second, the broad agenda of the regulatory chamber means that members of the chamber cannot be experts on all supervised sectors and therefore might be more receptive to arguments by large industry players. The risk of capture will therefore depend on the degree to which the

competition division can be heard, and the extent to which the interplay between chambers can limit the risk of capture of sector-specific divisions and of the regulatory chamber.⁴⁴

Finally, it is not clear that “forum shopping” will be attenuated under the new structure since complaints will still follow different routes depending on whether they are submitted on the basis of sector regulation or competition law. Regulatory complaints will be dealt with by sector-specific units and decided by the regulatory chamber. Competition complaints will be investigated by the competition division and decided by the competition chamber. Depending on the level of coordination and control across divisions and across chambers, forum shopping might or might not be reduced.

ONE OF THE STATED OBJECTIVES WITH THE REFORM WAS TO ALLOW BETTER COOPERATION AND INFORMATION SHARING BETWEEN THE SECTOR REGULATORS AND THE AREA CHARGED WITH OVERSEEING ANTITRUST

B. Institutional Reform in Mexico

1. Background

In its “exposition of motives” to the 2013 constitutional amendment, the Mexican government noted two key objectives that had a direct incidence on telecommunications and antitrust under the “Pact for Mexico,” which all three major political parties signed at the beginning of President Peña Nieto’s presidency in 2012:

1. “Extend the benefits of an economy formed through competitive markets.” Within this agreement the government agreed to strengthen the Federal Competition Commission (CFC at the time, now “Cofece”) and create specialized tribunals in competition and telecommunications.
2. “Guarantee equitable access to world-class telecommunication services.” Meaning that a right of access to broadband would be recognized, and the sector regulator Comisión Federal de Telecomunicaciones (COFETEL at the time, now “IFT”) would be granted autonomy. In addition, a telecommunications backbone would be developed and competition would be instilled in broadcasting, telephony, and data services.

After a very short discussion period from late February to early April of 2013, Congress voted to pass changes to various articles in the Constitution. These Constitutional reforms triggered the formation of new telecommunications and competition authorities in Mexico and came into effect on June 11, 2013.

THE NEW REGULATOR WILL HAVE TO “WALL OFF” THE INVESTIGATION AND MERGER REVIEW CASE TEAMS TO AVOID BEING ACCUSED OF ACTING AS A JUDGE, JURY, AND EXECUTIONER

A rare characteristic of the constitutional reforms was the length and detail of the amendments. Constitutions are usually meant to be coordinating devices among heterogeneous actors that aid in the enforcement of the law, but are not meant to dictate behaviors or transform culture.⁴⁵ They provide a

framework with which to evaluate both transgressions to rules and the effectiveness of enforcement. In the case of the Mexican reforms, the stated aim of the legislators in drafting lengthy permanent and transitory articles was to avoid special interests from subsequently “watering down” any significant changes during the process of drafting the secondary legislation. Given how long the drafting of secondary legislation has taken, these concerns may not have been completely without grounds.⁴⁶

The newly formed authorities were granted autonomy—a completely novel form of institutional makeup in Mexico until now, with the exception of the Central Bank, the Statistics Office, and the Electoral Commission. Autonomy does strengthen the mandate of these institutions but generates a number of practical difficulties and uncertainties, from the very basic: Who issues their codes of rulings? How are funds to be disbursed to them? Should legal adjustments be made to ensure they comply with the transparency and civil service responsibilities that the remaining federal public administration entities follow? To the more complex: How do two autonomous regulators interact with regulators that, while being technically autonomous, belong to the executive and may have a different standing with the judiciary? If they are completely autonomous, are they a fourth branch of government and, if so, are they even constitutional?

THE INCORPORATION OF EXPERIENCED
COMPETITION ECONOMISTS AND
LAWYERS IS AN IMPORTANT BOOST TO
IFT, BUT IT HAS COME AT A COST TO
COFECE

difficulties and uncertainties, from the very basic: Who issues their codes of rulings? How are funds to be disbursed to them? Should legal adjustments be made to ensure they comply with the transparency and civil service responsibilities that the remaining federal public administration entities follow? To

New commissioners were selected through an open, merit-based process and began their responsibilities in September 2013, basing their power on two old laws, Federal Telecommunications Act 1996 (“LFT”) and Federal Economic Competition Law of 1993 (“LFCE”)—both of these having been amended partially over time. Meanwhile as secondary legislation has not yet been passed, the two new institutions have not yet formally announced their internal restructure, as it is dependent on bylaws to secondary legislations that have not come into force. We will, nevertheless, describe in general terms the current institutional make up with the caveat that it is still undergoing changes as we draft this article.

IFT will likely have to face a difference in the interaction that exists between the substantive or technical areas and its plenum in a regulation vs. a competition context. While technical areas work with and report to the plenum on a regular basis while performing their various duties aimed at designing, supervising, and enforcing regulation, the nature of the interaction in an adversarial context, as is the case with antitrust, is completely different. The new regulator will have to “wall off” the investigation and merger review case teams to avoid being accused of acting as a judge, jury, and executioner.

This, of course, is not a problem in Cofece where technical areas have been accustomed to working at arms length with its plenum. In fact, reforms which very strictly separate the investigative from the trial phases of the case were aimed at increasing procedural fairness and further legitimizing Cofece’s decisions. The Investigative Unit Head (Autoridad Investigadora (“AI”)) has been raised to the level of the commissioners. The Plenum no longer relies on the AI to oversee the trial portion of a case, and a new Instruction Secretary position has been created to give continuity and report to Plenum. New powers on reviewing “barriers to competition”—currently being interpreted as the possibility of undertaking market studies—and determining

“essential inputs” will likely lead to a restructuring of competencies between various directorates: regulated markets, economic studies, and perhaps even unilateral conduct investigations, since “essential inputs” are also regarded as an abuse of dominance conduct.

2. Assessment

- **Synergies vs. Conflict**

The most significant change comes in IFT with a completely new unit (Unidad de Competencia Económica (“UCE”)) charged with overseeing antitrust investigations and modeled after Cofece’s previous model. One of the stated objectives with the reform was to allow better cooperation and information sharing between the sector regulators and the area charged with overseeing antitrust. The reasoning for the merger was precisely to exploit these synergies.

The UCE is broken into three directorates: a merger review, an investigation and an adjudication area meant to keep separate the inquiry of anticompetitive allegations, and merger review during the trial portion of the legal procedure. Competition advocacy remains with the office of the head of the UCE who collaborates with the other units within IFT but at the same time functions as an independent division within IFT since it has to respect one of the key reforms introduced in the Constitution, which is the separation of investigative work from the decision-making process. Although this can be seen as applying to the plenum in deciding competition cases, it remains to be seen how regulatory analyses and decisions, which are *ex ante*, will not be “contaminated” with *ex post* resolutions applying on a case-by-case basis to individual economic agents—an issue of coherence which we take up later.

In the case of Cofece, a similar problem does not arise since its directorates of investigation have traditionally been separated from its market and economic studies directorates. The latter two will likely no longer report to the Investigation Area Head (the Executive Secretary) but to a new Instruction Secretary or similar office charged with following the trial phase of the cases and perhaps the advocacy obligations of Cofece.

In terms of Cofece, no synergies are gained from the new makeup imposed by the Constitution, but a larger bureaucracy—with an incommensurate budget—will have to be created.

ANOTHER POINT OF CONCERN ARE THE STRICT GUIDELINES THAT CONGRESS HAS IMPOSED ON FUTURE AND MERITORIOUS CANDIDATES WHICH WILL LIKELY RESULT IN GOOD PUBLIC SERVANTS—BUT ONLY PUBLIC SERVANTS—HAVING THE POSSIBILITY TO BE APPOINTED AS COMMISSIONERS

As Hyman & Kovacic mention,⁴⁷ it is a common complaint among regulated entities that additional powers are rarely assigned new budgets that allow them to face these new responsibilities. In this case, Congress did increase budgets for both: IFT’s threefold (350 percent increased from approximately U.S. \$50 million to U.S. \$230 million) and Cofece’s 33 percent. Cofece’s budget increase will hardly cover the fees for the new administration responsibilities and two additional commissioners’ posts with their respective staffs.

In addition, Cofece was not allowed to introduce changes to the law that would enable it to obtain monies from late fees or from merger notifications. One immediately visible effect has been its inability to retain a large portion of its qualified staff as an important number of competition experts have left the old antitrust regulator for better salaries and positions with the new telecommunications regulator. The incorporation of experienced competition economists and lawyers is an important boost to IFT, but it has come at a cost to Cofece, which even before the reforms often suffered from a shortage of qualified economists and lawyers.

- **Advocacy**

Having joint regulatory and competition knowledge may better position IFT to lobby Congress for important regulatory changes. With both regulatory and competition knowledge it will be able to make more informed opinions but, as is the case of Spain, additional responsibilities while sometimes complementary

IT WILL BE A CHALLENGE FOR IFT TO
MANAGE AND PRIORITIZE ITS DIVERSE
MANDATE

may also be conflicting and lead to bias in decision-making. In contrast to the CNMC, the same plenum decides regulatory and competition cases so that two conflicting positions will very

likely be resolved inside the organization and not be subject to external scrutiny and discussion. That is, unless the new regulator adheres to transparency criteria that present competition and regulatory arguments side by side.

Given the size of the Competition Unit vis-à-vis the other units at IFT, there is a very real risk that regulatory-based considerations will trump competition ones and that advocacy will be weakened within the IFT. A concurrency of faculties in advocacy opinions in telecom with Cofece would be a welcome reform in the future.

- **Independence vs. Accountability**

The possibility for reelection as president of each agency after an initial four-year term, subject to Congressional decision, puts in jeopardy the independence with which the presidents of IFT and Cofece will act over his or her initial four-year terms.

Another point of concern are the strict guidelines that Congress has imposed on future and meritorious candidates which will likely result in good public servants—but only public servants—having the possibility to be appointed as commissioners. To avoid regulatory capture the law forbids any person who has worked or represented an economic agent subject to regulation or investigation during the three prior years to their appointment to become an eligible candidate for Commissioner. In addition, there is a bar against candidates serving in companies that were subject to regulation or investigation during the three subsequent years after

AVOIDING REGULATORY CAPTURE
SHOULD NOT IMPOSE UNNECESSARY
BURDENS ON THE AUTHORITY, BUT THE
RIGIDITY WITH WHICH INVESTIGATIVE
AND RESOLUTION PHASES HAVE BEEN
SEPARATED RESULTS IN AN IMPORTANT
AND LIKELY UNNECESSARY BURDEN ON
THE AUTHORITIES

they served as commissioners. The likelihood that anyone but political appointees and civil servants will fulfill or agree to these conditions is low making independence suspect over time.

With the degree of scrutiny they are facing as completely new autonomous institutions—one that

THE SUCCESS OF THE NEW INSTITUTIONAL SETTINGS BOTH IN SPAIN AND MEXICO IS YET TO BE PROVED

will likely continue—both regulators have so far been cautious and responsible about publishing their annual work plans and quarterly reports. The production of guidelines, foreseen in the secondary legislation, that will make transparent and provide certainty in their enforcement actions will be a crucial metric for how accountable they are in the future.

- **Coherence, Coordination, and Priority Setting**

A key driver for the constitutional amendment that granted competition powers to the telecommunications regulator was to improve the coordination that had been lacking even if improving between CFC and COFETEL. Nevertheless, there was no clear analysis of the reasons that had led to this poor coordination, created mostly by the CFC's determinations of a lack of effective competition conditions that were the trigger to impose asymmetric regulation. Consequently all competition powers were granted to IFT (mergers, investigations, advocacy), not just those relating to the imposition of regulation. As a result, the new telecommunications entity has a large and not necessarily complementary mandate reflected in its annual work plan for 2014, which includes: freedom of speech and universal access; competition, free market access, and eliminating restrictions to competition and innovation; ensuring quality, competitive prices, and security; regulating and supervising the use of spectrum, networks, and telecommunications and broadcasting services; and protecting rights of users and audiences.⁴⁸

It will be a challenge for IFT to manage and prioritize its diverse mandate. This may be reflected in the judiciary, where economic agents have traditionally turned when defending conflicting rules or their enforcement. The newly minted specialized tribunals will have an important workload in ensuring that the new reforms do not deteriorate into excessive and unnecessary litigation, as was the case before.

Another important aspect to note is that although the merging of competition authority into the telecommunications regulator was seen as a “clean” way of resolving coordination problems, coordination will still be key between IFT and Cofece. Both have to enforce the same law in competition matters, and any similarities or discrepancies with which they do so may result in excessive litigation brought before the tribunals or the possibility of regulatory arbitrage, which we take up next.

- **Regulatory Capture and Regulatory Arbitrage**

Although there are certain undertakings that very clearly fall into the purview of the telecommunications regulator, there are others such as value-added services operators, which lie in a grey area. Much has been written about the behind the scenes disputes between U.S. regulators regarding their own

purviews,⁴⁹ but this is new to Mexico and will present not just an interesting coordination challenge between IFT and Cofece, but could open up a new avenue of litigation among economic agents falling into this grey area and seeking to arbitrage between them.

Avoiding regulatory capture should not impose unnecessary burdens on the authority, but the rigidity with which investigative and resolution phases have been separated results in an important and likely unnecessary burden on the authorities. In the case of competition, historically there were internal complaints of having very little interaction between the technical areas and plenum to the point where commissioners only heard one side of the argument (the external parties) and not the other (the directorates). We hope to take up this point in future research.

IV. CONCLUSIONS AND FUTURE RESEARCH

There are synergies and benefits to gathering regulatory and competition powers under one roof, but in order for these elements to be exploited special attention should be put on institutional and organizational design. Just merging several institutions into one larger one does not guarantee the realization of promised synergies and benefits.

The building of an institutional culture is also important. Like in any merger, there are aspects of institutional culture that are valuable in the separate entities and thus need to be preserved, while others have to be modified either for the joint entity or for individual departments or subsidiaries. In essence, the creation of a new culture is needed to change the way of working. There needs to be a clear strategy driven by top management and absorbed by the staff. As pointed by Lyons⁵⁰ for the U.K.'s CMA, the first thing the chairman and the board members of the new institutions will have to get right is a “common culture of genuinely independent collective decision making.”

Within this process clear risks need to be recognized, such as the risk of running independent divisions with no clear unifying mandate (it need not be single, but it must be cohesive and priorities need to be clear). Externally, the government has to believe in the concept of an independent institution. As pointed out by Hadfield & Weingast, “this is not just a matter of building institutions; it requires the achievement of a shift in common knowledge systems of beliefs.”⁵¹

A transitional period is essential to ensure that there is enough flexibility to adjust to change and ensure a smooth transfer of the strengths, knowledge, and experience from previous institutions into the new organization. When a transitional period is clearly announced it also signals to all parties—internal and external to the new agency—that the period of uncertainty is finite and reduces posturing and opportunistic behavior by economic agents as change is enacted and implemented.

The configuration of a small board with enormous responsibilities over a broad number of sectors and a complex system of interactions between chambers can act as a bottleneck to the functioning of the

institution. A more sensible option seems to opt either for the German model (with nine specialized ruling chambers) or for the Dutch model (with a minimalistic board with limited managerial responsibilities).

Increased responsibilities require even better appointment mechanisms that select the best candidates to occupy the decision posts. In both cases described here, the current mechanism does not guarantee a transparent selection of the best candidates going forward, and in some cases not necessarily based on their merits. If the quality of the board is important in a single-purpose regulator, it becomes crucial in a multi-purpose regulator where not only highly technical expertise is required, but also capacity to know and relate sectors, and to have a broader overview over the issues at stake is essential.

The ultimate aim of institutional design is to ensure an effective enforcement of the law. The success of the new institutional settings both in Spain and Mexico is yet to be proved. Some features of the new institutions were not fully motivated by the aim of improving regulation enforcement. This can lead to a non-materialization of the potential benefits. The fine-tuning of the institutional design, the details of the implementation, the internal procedural design, and the new culture of the institutions and governments will be crucial to exploit the complementarities of regulatory and antitrust policies. ▲

¹ Juan Delgado is Director at Global Economics Group. He thanks Héctor Otero for his comments and suggestions and Jaime Pingarrón for his excellent research assistance. Elisa Mariscal is an adjunct professor of Economics & Law at CIDE and Director at Global Economics Group. She thanks Alexis Pirchio for his excellent research assistance.

² W.E. Kovacic & D. A. Hyman, *Competition Agency Design: What's on the Menu?*, Public Law and Legal Theory Paper no. 2012-135 and Legal Studies Research Paper No. 2012-135 (2012), hereafter “Kovacic & Hyman.”

³ See Coglianese for a review of the determinants of regulatory outcome, C. Coglianese, *Measuring Regulatory Performance: Evaluating the impact of Regulation and Regulatory Policy*, OECD. Expert Paper No. 1 (2012).

⁴ G.K. Hadfield & B. R. Weingast, *Microfoundations of the Rule of Law*, Center for Law and Social Science Research Paper Series No. CLASS13-5, (November 7, 2013), hereafter “Hadfield & Weingast.”

⁵ Allendesalazar comments on the concerns related to the creation of the new regulator, R. Allendesalazar, *Una reforma arriesgada*, Gaceta jurídica de la Unión Europea y de la competencia, ISSN 1575-2054, N° 31, págs. 5-10 (2013).

⁶ In addition, the decision was accused of being politically motivated with the aim of replacing the regulators' boards appointed by the previous government. See F. Trillas, F. *The Institutional Architecture of Regulation and Competition: Spain's 2012 Reform*, IESE Working Paper WP-1067-E. April (2013), hereinafter “Trillas.”

⁷ At some point during 2008-12, for example, the CFC's general directorate of regulated sectors was almost fully devoted to analyzing dominance issues in telecommunications markets, while the unilateral conduct general directorate's portfolio was split 50 percent in telecommunications and broadcasting with the remaining portion assigned to all other sectors of the economy. This represents a highly skewed distribution of

human and financial resources considering that telecommunications made up only 2.73 percent of Mexico's GDP in 2008 (Source: World Bank).

⁸ Kovacic & Hyman, *supra* note 2.

⁹ D.A. Hyman & W. E. Kovacic, *Competition Agencies with Complex Policy Portfolios: Divide or Conquer?*, Illinois Program in Law, Behavior and Social Science Paper No. LE12-14 pp. 2012-70 (2013) hereafter "Hyman & Kovacic."

¹⁰ Petit reports potential conflicts between antitrust and regulatory policies in the telecoms sector in Europe and the increasing overlap between competition agencies and NRAs at the European level. Competition and regulation interact in the regulatory framework on electronic communications adopted by the EC in 2002, which introduces competition law concepts and principles at the core of it. N. Petit, *The Proliferation of National Regulatory Authorities alongside Competition Authorities: A Source of Jurisdictional Confusion?*, in *REGULATION THROUGH AGENCIES IN THE EU* (Damien Geradin, Rodolphe Muñoz, & Nicholas Petit, eds. 2005) hereafter "Petit."

¹¹ M.J. Trevilcock & E. M. Iacobucci, *Designing Competition Law Institutions: Values, Structure and Mandate*, 41(3) *LOYOLA UNIV. CHICAGO L.J.* 455 (Spring, 2010).

¹² International Competition Network, *Advocacy and Competition Policy Report*, ICN Conference, Italy (2012).

¹³ See, for instance, K.W. VISCUSI, J. E. HARRINGTON, & J. M. VERNON, *ECONOMICS OF REGULATION AND ANTITRUST*, 3rd Ed. (2000); D.W. Carlton & R. C. Picker, *Antitrust and Regulation*, NBER working paper series. Working Paper 12902 (2007); S.L. Dogan & M.A. Lemley, *Antitrust Law and Regulatory Gaming*, 87 *TEXAS L. REV.* 685 (2009); and M. Hellwig, *Competition Policy and Sector-Specific Regulation for Network Industries*, Max Planck Institute for Research on Collective Goods (2008) for discussions on the different roles and objectives of regulatory and antitrust policies.

¹⁴ Multi-purpose regulators might have to balance between conflicting regulatory and competition goals limiting the role of policymakers and politicians. The fact that regulators and neither policy-makers nor politicians decide on the combination of policies might reduce, in principle, political interference. Acemoglu & Robinson conclude that this does not necessarily have to be welfare enhancing since pure technical advice might ignore political considerations that might also enhance welfare. They determine that welfare maximizing policy makers should not just work to solve market failures, but should take into account the later political ramifications of their decisions. Economic reforms implemented without an understanding of their political consequences rather than solely promoting economic efficiency can significantly reduce it. D. Acemoglu & J. A. Robinson, *Economics versus Politics: Pitfalls of Policy Advice*, NBER Working Paper Series. Working Paper No. 18921 (2013)

¹⁵ B. LEVY & P. SPILLER, *REGULATIONS, INSTITUTIONS AND COMMITMENT: COMPARATIVE STUDIES IN TELECOMMUNICATIONS*, (1996).

¹⁶ Dutz & Vagliasindi and Borrell & Jimenez find that independence has a statistically significant positive effect on antitrust effectiveness—M. Dutz & M. Vagliasindi, *Competition Policy Implementation in Transition Economies: An Empirical Assessment*, 44(4-6) *EUR. ECON REV.*, 762-772 (May, 2000) and Jimenez Borrell & J. Jimenez, *The drivers of effectiveness in competition policy*, Documento de trabajo de FUNCAS, 2007/363. (2007).

¹⁷ J. Black, *Calling Regulators to Account: Challenges, Capacities and Prospects*, LSE Legal Studies Working

Paper No. 15/2012 (2012).

¹⁸ Hadfield & Weingast, *supra* note 4.

¹⁹ Kovacic & Hyman, *supra* note 2.

²⁰ Hadfield & Weingast, *supra* note 4.

²¹ Kovacic & Hyman, *supra* note 2.

²² Petit, *supra* note 10.

²³ Hadfield & Weingast, *supra* note 4.

²⁴ K.J. Cseres, *Integrate or Separate. Institutional Design for the Enforcement of Competition Law and Consumer Law*, Amsterdam Law School Legal Studies Research Paper No. 2013-03 (2013).

²⁵ Kovacic & Hyman, *supra* note 2.

²⁶ T. E. Olsen & G. Torsvik, *The Ratchet Effect in Common Agency: Implications for Regulation and Privatization*, 9(1) J. L. ECON. & ORG.136-58, (April 1993).

²⁷ Ley 3/2013, of June 4th that creates the *Comisión Nacional de los Mercados y la Competencia*. Available at <http://www.boe.es/boe/dias/2013/06/05/pdfs/BOE-A-2013-5940.pdf>

²⁸ Energy (CNE, Comisión Nacional de la Energía), Telecomunicaciones (CMT, Comisión Nacional del Mercado de Telecomunicaciones), Railways (CRE, Comité de Regulación Ferroviaria), Postal (CNSP, Comisión Nacional del Sector Postal), Airports (CREA, Comisión de Regulación Económica Aeroportuaria) and Audiovisual (CEMA, Consejo Estatal de Medios Audiovisuales).

²⁹ CEMA and CREA.

³⁰ See Trillas, *supra* note 6.

³¹ Those for which the law understood that the functional separation from government was not necessary (e.g. handling consumer claims.)

³² The procedure is not that clear in the case of non-infringement procedures such as reports, studies, and opinions.

³³ From that amount, 3.6 million corresponded to the lower number of board members, 18.7 million to the non-creation of the two pending regulators, and 5.8 million to administrative efficiencies. See *Proyecto de Ley de Creación de la Comisión Nacional de los Mercados y la Competencia. Memoria del análisis de impacto normative*, (27 de septiembre de 2012).

³⁴ Important administrative synergies can arise, for example, from merging the Ministry of Environment and the Ministry of Defense. However, the lack of policy synergies makes irrelevant any potential administrative synergies.

³⁵ This might also lead to some asymmetry between advocacy initiatives in regulated and non-regulated industries, as advocacy activities in non-regulated sectors will be addressed by the competition advocacy unit from a competition perspective.

³⁶ The appointment of the new board has been preceded by the dismissal of the board members of the existing regulators before the end of their mandate, which has raised some concerns on the independence requirements set by European legislation. See Trillas, *supra* note 6.

³⁷ Leaving aside the shared responsibilities that some regions have on competition matters and also the EU competition and regulation competences.

³⁸ Under the previous model, some regulators such as the energy and the telecoms regulators were funded via industry levies. Such levies still exist but are now collected and distributed by the government.

³⁹ Autonomy has to be more than just financial. A. Estaché & David M. Mortimert, *Politics, Transaction Costs, and the Design of Regulatory Institutions*, Policy Research Working Papers (1999). It should also mean that the regulator should be able to recruit its own staff. The new regulator favors the recruitment of civil servants for top positions, which limits the recruitment autonomy and the expertise of the regulator. The autonomy of the regulator and the quality of the regulatory outcome are reinforced by allowing the incorporation of experienced economists, lawyers, and engineers from both the private and the public sectors.

⁴⁰ Hearing of the CNMC President on the Parliament. See, *Comparecencia del presidente de la CNMC en el Congreso de los Diputados.*” (May 13, 2014).

⁴¹ Perhaps the most remarkable example was the EC antitrust decision against Telefónica for the anticompetitive nature of broadband prices that had been previously approved by the national regulator. See COMP/38.784—Wanadoo España v Telefónica.

⁴² *Plan Estratégico de la Comisión Nacional de los Mercados y la Competencia: Competencia, Supervisión de Mercados y Regulación Económica Eficiente* CNMC (7 de mayo de 2014).

⁴³ In Spain there is just one airport public operator (AENA), while there are large public dominant ex-monopolies in the railway industry (RENFE’s market share is close to 85 percent on the freight market, while it is the only operator in the railway passenger transport market) and postal sectors (CORREOS’ market share is around 90 percent on the traditional postal sector).

⁴⁴ There is a rotational system between chambers by which after a certain period of time board members switch chambers to reduce the possibility of capture. However, this will affect negatively board members specialization.

⁴⁵ Hadfield & Weingast, *supra* note 4.

⁴⁶ The Federal Law of Economic Competition was published May 23 in the Federal Daily Gazette and will be enacted 45 days after its publication (July 7, 2014). The Federal Telecommunications Law—a far more contentious piece of legislation—was discussed in the Senate first, where it was decided to postpone voting until an extraordinary period is called in June or July. It will then have to pass to the Chamber of Deputies and, if any changes are made, returned to the Senate for final confirmation. This situation obviously puts the new telecom regulator on shaky ground in its current decisions.

⁴⁷ Hyman & Kovacic, *supra* note 9.

⁴⁸ *Programa Annual de Trabajo 2014*, Instituto Federal de Telecomunicaciones.

⁴⁹ Hyman & Kovacic, *supra* note 9.

⁵⁰ B. Lyons, *Will the New U.K. Competition and Markets Authority Make Better Antitrust Decisions?*, 5(1) CPI ANTITRUST CHRON. (May, 2012).

⁵¹ Hadfield & Weingast, *supra* note 4.

Institutional Design and Federal Antitrust Enforcement Agencies: Renovation or Revolution?

BY MICHAEL S. MCFALLS¹

Institutional design, properly defined, both circumscribes and defines the practice of antitrust law in the United States. The structure of antitrust law and enforcement in the United States reflects so many disparate strands of political thought and expression that it seems almost impossible that it could function, much less cohere. But that very mixture of currents and cross-currents is quintessentially American—and keeps the importance of institutional design very much alive and significant in U.S. antitrust law. And although fundamental reinvention is unlikely, incremental changes are both possible and desirable, particularly those within the discretion of the enforcement agencies themselves. Below, we discuss what kinds of changes may be useful for the enforcement agencies to consider.

I. INTRODUCTION

Institutional design is a term that would seem completely irrelevant to most practitioners who make their living in antitrust law in the United States. For many, it is a topic confined to academic circles (at least in the United States), a craft applied to many countries whose borders or governmental structure did not exist when the Sherman Act (and, in many cases, the Clayton Act) emerged, and a possibility whose moment has passed in a country with a dysfunctional legislative branch and a conservative judiciary.²

But institutional design, properly defined, both circumscribes and defines the practice of antitrust law in the United States. The structure of antitrust law and enforcement in the United States reflects so many disparate strands of political thought and expression that it seems almost impossible that it could function, much less cohere. But that very mixture of currents and cross-currents is quintessentially American.

At the center of the antitrust enterprise in the United States are the Sherman Act and Clayton Act, which are wonderfully broad, terse statutes that confer substantial enforcement discretion on the executive branch. The existence of two federal enforcement agencies (the Antitrust Division of the Department of Justice (“DOJ”) and the Federal Trade Commission (“FTC”)) reflects the modern progressive belief in expert agencies (hence the existence of the FTC) and the desire to avoid making enforcement of the antitrust laws at the DOJ captive to the political party resident in the White House (which oversees the Department of Justice) or to the current bent of the federal judiciary.

Private attorneys general, as well as state attorneys general, (“AGs”) also provide an additional safeguard against a lack of aggressive enforcement or scarce enforcement resources. The legislature cannot force executive branches or independent agencies to enforce their antitrust laws, but it can and does allow private parties and state AGs to pick up any slack during

THE STRUCTURE OF ANTITRUST LAW AND ENFORCEMENT IN THE UNITED STATES REFLECTS SO MANY DISPARATE STRANDS OF POLITICAL THOUGHT AND EXPRESSION THAT IT SEEMS ALMOST IMPOSSIBLE THAT IT COULD FUNCTION, MUCH LESS COHERE

eras where the executive agencies may opt to be less active. And at the very top of the antitrust pyramid is the federal judiciary, which provides the same constraint on overreach—whether by private or governmental plaintiffs—that it is supposed to provide in other aspects of our daily lives.

More importantly, institutional design, appropriately imagined, is a continuing organic process that encompasses not only the structural parameters of U.S. antitrust law but also the internal machinery of U.S. enforcement agencies. Here, we depart from fundamental aspects of design, defined by Congress and bounded by the judiciary, to decisions within the discretion of the enforcement agencies. In some respects, and in some eras, the agencies have dramatically expanded their authority beyond what many believed were appropriate boundaries. In other instances, the agencies have acted to protect the integrity of their investigational and enforcement processes by reducing unnecessary burdens, refining and publicizing evolving standards for

MORE IMPORTANTLY, INSTITUTIONAL DESIGN, APPROPRIATELY IMAGINED, IS A CONTINUING ORGANIC PROCESS THAT ENCOMPASSES NOT ONLY THE STRUCTURAL PARAMETERS OF U.S. ANTITRUST LAW BUT ALSO THE INTERNAL MACHINERY OF U.S. ENFORCEMENT AGENCIES

enforcement, and otherwise refusing to exercise the maximum extent of their substantive or procedural authority even when convenient to do otherwise. The staffs of the agencies exercise this sort of discretion every single day, applying far more sophisticated standards to their investigations and reducing unnecessary procedural burdens on parties even when a matter becomes adversarial.

In this light, institutional design is very much alive and important in U.S. antitrust law. And although fundamental reinvention is unlikely, incremental changes are both possible and desirable, particularly those within the discretion of the enforcement agencies themselves. Further progress can and should be made.

Below, I discuss what kinds of changes may be useful for the enforcement agencies to consider. First, I identify central objectives for antitrust enforcement agencies. Second, I examine whether and how the agencies have achieved these objectives in the merger review process, and what changes may allow them to enhance their performance in meeting the central objectives that we identify. Third, I compare agency performance in the civil non-merger context, and explain how the FTC could enhance its speed and impact by doing less and trusting the federal judiciary to do more. I also address why these changes would not render either of the agencies irrelevant, and why they do not require or justify fundamental reallocations of authority between the DOJ and FTC.

A final section discusses how and why the federal antitrust enforcement agencies should enjoy at least equal footing with sister federal agencies with respect to competition issues. Unfortunately, the Supreme Court has gone in precisely the opposite direction without any justification. Perhaps more frequent self-restraint at the antitrust agencies would lead the Supreme Court to restore balance between the antitrust agencies and other authorities with respect to authority over competition issues. In the interim, the

AND ALTHOUGH FUNDAMENTAL REINVENTION IS UNLIKELY, INCREMENTAL CHANGES ARE BOTH POSSIBLE AND DESIRABLE, PARTICULARLY THOSE WITHIN THE DISCRETION OF THE ENFORCEMENT AGENCIES THEMSELVES

enforcement agencies can and will continue to develop relationships which will protect and advance the values of competition in other parts of the federal government.

II. IMPORTANT OBJECTIVES FOR ANTITRUST ENFORCEMENT AGENCIES

A full discussion of the objectives of antitrust enforcement agencies (and antitrust law itself) is obviously beyond the scope of this article. But a quick discussion of important enforcement agency objectives is essential before evaluating agency performance, analyzing the impact of structure on performance, and recommending revisions in design.

The most important aspect of agency performance is accuracy. The agencies have a substantial independent incentive to select cases appropriately, particularly when resources are scarce. But the full array of non-pecuniary incentives for agencies and staffers can produce results that are just as biased as decision-making based solely on economic self-interest.

Judicial review (based on a balanced, adversarial process) is ultimately the most important guarantor that agencies will select their cases appropriately. All are aware that courts occasionally produce opinions that fall well short of the mark. But more often than not, this is the result of poor advocacy, not poor judgment. The question is not whether the agencies have more expertise than judges, or fewer economic incentives than

THE MOST IMPORTANT ASPECT OF AGENCY PERFORMANCE IS ACCURACY

their private adversaries. One could say the same with respect to multiple aspects of law enforcement and regulation. The question is whether the agencies can show that the outcome they seek—whether criminal, civil, or equitable—is supported by evidence reviewed by an independent federal judge with life tenure. Limitations on judicial review and authority marginally increase the likelihood of agency overreach.

Another important dimension of agency performance is doctrinal flexibility. This not only enables agencies to limit their own case selection appropriately, but also to expand the range of tools to use in investigations and enforcement. There is very little in the way of institutional design that can directly enhance the ability of the agencies to encourage and use novel legal and economic thinking in their activities. But the adversarial nature of the litigation process, coupled with judicial review and supremacy, creates an important incentive for the agencies to find appropriate vehicles for challenging the doctrinal status quo. Again, more judicial review, not less judicial review, is likely to enhance the ability of the agencies to respond to new issues and thinking.

A third important dimension of agency performance is legitimacy, which also includes factors like transparency, consistency, and self-restraint. Even when agencies are arriving at more accurate or innovative outcomes, their decisions may lack appropriate legitimacy or impact if they are unclear, misunderstood, easily distinguishable, inapplicable to other

AGAIN, MORE JUDICIAL REVIEW, NOT LESS JUDICIAL REVIEW, IS LIKELY TO ENHANCE THE ABILITY OF THE AGENCIES TO RESPOND TO NEW ISSUES AND THINKING

THE U.S. MERGER REVIEW PROCESS
IS A PRODUCT OF A FLAWED
STRUCTURAL DESIGN AND REMARKABLE
INSTITUTIONAL ADAPTATION

cases, or the result of coercive tactics or circumstances. The enforcement agencies have understood for years that their ability to have an impact on the business community can depend significantly on the perceived legitimacy of their decision-making. Unfortunately, traditional institutional design can have very little impact on legitimacy without subjecting multiple staff decisions to judicial review (even though many today are not even subject to review by agency management). The ability of the agencies to achieve these objectives depends largely on their willingness to implement controls that may serve their longer-term interests while compromising shorter-term objectives.

A fourth important dimension is efficiency—arriving at good decisions in a manner that avoids unnecessary delay and cost. Up to a point, efficiency and accuracy can coexist as objectives. But those who would complain about the cost of investigations and litigation should consider the alternative—*per se* rules against potentially ambiguous conduct, presumptions against mergers that may be benign, and a considerably slower growth in our understanding of how competition truly works. The real problems in the U.S. system arise when the agencies impose significant costs and delays without producing good or accurate results, or when they obtain results by imposing greater costs in an effort that avoids judicial review.

III. FEDERAL ANTITRUST ENFORCEMENT: MERGER REVIEW

The U.S. merger review process is a product of a flawed structural design and remarkable institutional adaptation. Merger review rests on four fundamental pillars:

1. Section 7 of the Clayton Act, passed in 1950, sets the substantive standard by permitting challenges to mergers and acquisitions that may substantially reduce competition. This facilitates challenges to deals even before they have actually resulted in anticompetitive effects.³
2. The Supreme Court decision in *United States vs. General Dynamics*⁴ underscored the importance of analyzing the importance not only of evaluating what would be likely to happen in the future as a result of the deal, but also of comparing the deal's potential impact with what would have happened absent the acquisition. This focus on the but-for world substantially increases the complexity and richness of merger review.
3. The Hart-Scott-Rodino Act, which requires companies involved in deals that meet certain thresholds to obtain agency review and approval before closing. The agencies have substantial discretion to issue requests for additional information before letting certain potentially problematic deals close, which gives them extraordinary leverage in public-company deals.
4. Judicial review, as the agencies must pursue preliminary injunctive relief from an independent federal court if they have chosen to challenge mergers after a request for additional information.

The flaws in the design are obvious: (1) the existence of two enforcement agencies compel the agencies to allocate matters, industries, and/or enforcement responsibilities; (2) the ability to issue Second Requests without any meaningful judicial constraint confers extraordinary leverage on the enforcement agencies to delay or kill deals; and (3) preliminary injunction trials after a Second Request do not make sense if confined to market definition and market shares.

THE INCREASING SUBSTANTIVE SOPHISTICATION OF THE ENFORCEMENT AGENCIES IS ATTRIBUTABLE LARGELY TO THE LEGAL REQUIREMENT OF OBTAINING INJUNCTIVE RELIEF FROM INDEPENDENT FEDERAL COURTS

Fortunately, the enforcement agencies have, for the most part, adapted extraordinarily well to the pre-merger system. They have allocated industries in a manner that makes sense. They have devised a system for clearing transactions that cross categories over which each has principal enforcement responsibility. Their staffs have accumulated expertise in particular industries, demonstrated flexibility in negotiating Second Requests, and structured remedies that resolve competitive problems short of litigation or full-stop injunctions. Most significantly, the agencies have formulated and revised guidelines for horizontal mergers that reflect increasing sophistication well beyond what traditional antitrust law has required.⁵

The increasing substantive sophistication of the enforcement agencies is attributable largely to the legal requirement of obtaining injunctive relief from independent federal courts. While sometimes criticized for implausible market definitions,⁶ the agencies have also offered greater quantitative sophistication (in the form of economic data and analysis) and more qualitative richness (with better and deeper interpretation of ordinary-course documents).⁷ When chided for facile presumptions based on share and concentration, the agencies responded with richer variations of competitive effects analysis, based on unilateral theories of harm and more sophisticated models of coordinated interaction.⁸ When rejected for burden-shifting on issues like entry and efficiencies,⁹ the agencies responded with their own evidence on why entry or efficiencies would not be sufficient to deter or reverse anticompetitive effects.¹⁰

The best example of how judicial review has dramatically improved agency performance is in the hospital merger context. Only after the agencies lost seven consecutive hospital mergers in federal court did the FTC reconsider its approach to litigating them. Using important doctrinal innovations from leading health care and antitrust economists, agency staff retooled and began challenging transactions with a different

WITH GREATER SOPHISTICATION HAS COME IMPRESSIVE EXERCISES OF PROSECUTORIAL DISCRETION, WITH THE AGENCIES CLOSING INVESTIGATIONS IN A NUMBER OF RELATIVELY HIGH-PROFILE TRANSACTIONS AT THE SAME TIME THAT THEY WERE EXPANDING THEIR CREDIBILITY WITH VICTORIES ACROSS THE FULL SPECTRUM OF ENFORCEMENT THEORIES

approach to geographic market definition and competitive effects analysis. The most recent litigated hospital merger challenges against *Promedica*,¹¹ *OSF*,¹² *Phoebe Putney*,¹³ and *St. Luke's*¹⁴ reflect a substantially more modern and persuasive approach to challenging hospital mergers, each with a different flavor of enforcement. Not surprisingly, the agencies have prevailed in every one of these challenges. With greater sophistication has come impressive exercises of prosecutorial discretion, with the agencies closing investigations in a number

of relatively high-profile transactions at the same time that they were expanding their credibility with victories across the full spectrum of enforcement theories.¹⁵ Thus, although there remain a number of open, legitimate questions about specific aspects of the Commission’s hospital merger enforcement program.

Other areas of merger enforcement could benefit from comparable litigation efforts. In the pharmaceutical, biotechnology, and life sciences space, the FTC staff has done an extraordinarily good job of articulating and applying evolving theories of potential anticompetitive effects. But there is no doubt that the crucible of litigation would provide additional public benefits in this context, either legitimizing or circumscribing some of the agency’s more aggressive enforcement efforts. The FTC has not retreated or ducked these challenges, going to court in cases like *Thoratec/Heartware*¹⁶ and *Lundbeck*.¹⁷ But in *Thoratec*, the parties abandoned a transaction that would almost certainly be enjoined, and in *Lundbeck*, the district court and appellate court did not deal with antitrust issues with a steady or credible hand. The answer to poor or disappointing judicial decisions is to litigate more, not less, at least in appropriate cases. Unfortunately, the vast majority of pharmaceutical and medical device transactions raising any significant antitrust issues are resolved with surgical divestitures with little or no impact on the underlying transaction.

This phenomenon is not unique to life sciences deals—many transactions raise issues relating to only a small portion of the deal, imposing delay on parties, and uncertainty for all affected parties, including employees, suppliers, and customers. At the end of this protracted period of review, the parties often settle to avoid still further delay, regardless of the underlying merits.

The increasing frequency of quick consents in arguably marginal circumstances has led to much grouching in the private bar about the increasingly regulatory nature of federal antitrust enforcement (in contrast to a law enforcement model).¹⁸ Although the agencies are making better and more informed decisions based on the documents, data, and information obtained from Second Requests, they can use their leverage to force consents and remedies without effective judicial review. Transparency of merger best efforts provisions, the amount of time required to get through the Second Request and litigation processes, and the insignificant portion of overlap in multiple public company deals confer so much leverage to the enforcement agencies that judicial review is sometimes not a meaningful alternative. When judicial review is no longer a meaningful alternative, the agency—particularly staff—acts without fear of constraint.

THE INCREASING FREQUENCY OF QUICK CONSENTS IN ARGUABLY MARGINAL CIRCUMSTANCES HAS LED TO MUCH GROUCHING IN THE PRIVATE BAR ABOUT THE INCREASINGLY REGULATORY NATURE OF FEDERAL ANTITRUST ENFORCEMENT (IN CONTRAST TO A LAW ENFORCEMENT MODEL)

Thus, although courts have a positive impact as a constraint on agency overreach, the HSR process itself may confer too much leverage to ensure that judicial review and constraint is as meaningful as it could be. What could be done to make review more meaningful while retaining the benefits of broader discovery and more sophisticated analysis?

First, the agencies themselves could impose more limits on their initial investigations, requiring their

staffs to request documents from fewer custodians and less data. Although they have done this before,¹⁹ they could agree to go still further. For example, in exchange for more limited production obligations, parties could agree not to use other information, data, and documents that are not provided to staff. After one month of HSR review parties could pull and refile, and could spend the second month collecting and producing documents and data for a quick look Second Request. The staff would take an additional four to six weeks to review the material, then give the Commission and DOJ two weeks to decide whether to pursue injunctive relief. Parties agreeing to a track like this would proceed directly to district court, litigating preliminary relief on a very basic record with limited testimony. Both district and appellate court review of agency action would be more likely to occur in multiple cases.

Second, agencies and the courts could accelerate the timetable for merger litigation. During the initial investigation, and after their recommendations to pursue preliminary injunctive relief, the agencies could and should share their discovery with private parties. This would not only reduce the amount of time that parties must spend in discovery during preliminary injunction litigation, but would also increase the accuracy and legitimacy of agency decision-making. Unilateral, asymmetric discovery may have justifications during the bulk of an investigation, but once the agency staff have indicated a desire to pursue injunctive relief, they should be obliged to share discovery to the same extent they would be required to disclose their evidence in federal litigation. This avoids one of two extremes—that staff exaggerates the power of their evidence in engaging with the parties, or that parties systematically underestimate the weight and force of staff's evidence.

THIS WOULD NOT ONLY REDUCE THE AMOUNT OF TIME THAT PARTIES MUST SPEND IN DISCOVERY DURING PRELIMINARY INJUNCTION LITIGATION, BUT WOULD ALSO INCREASE THE ACCURACY AND LEGITIMACY OF AGENCY DECISION-MAKING

Third, the federal courts should be the final word on these issues, regardless of whether the DOJ or the FTC brings the case. The FTC should return to its traditional position that it does not have a lower standard for obtaining preliminary injunctive relief than the DOJ, even if it is correct that it may be entitled to receive injunctive relief under a lower standard. Here's why:

1. The Commission's aggressive pursuit of a lower standard creates a preposterous divergence in the treatment of mergers depending on whether parties, industries, or matters belong to the DOJ or FTC under their clearance agreement.²⁰ This undermines the legitimacy of FTC actions, particularly consent decrees obtained through inappropriate leverage gained from the unabashed exercise of maximum prosecutorial power.²¹
2. This lower standard is based on a fundamentally flawed premise that the FTC's expertise is greater or necessary for adjudicating merger cases. Many would argue that there is plenty of evidence to the contrary. Moreover, if the Commission's expertise cannot be duplicated by DOJ, why is DOJ reviewing any mergers?
3. The related positions that the FTC has begun to take in these cases—that it need not settle on

relevant market definitions, and that it need not offer substantial evidence of anticompetitive effect—are impossible to reconcile with either the extraordinary amount of discovery that the agency has already enjoyed in its investigation and the alleged expertise that would justify judicial deference to its allegedly superior adjudicative capabilities. Notably, this injunctive authority under 13(b) arose before the Hart-Scott-Rodino Act, which already essentially confers almost unlimited power on the agencies to enjoin a transaction while they investigate it.

SIMILARLY, THE CONTINUING USE OF MARKET SHARES AND RELATED PRESUMPTIONS IS NOT ONLY INCONSISTENT WITH HOW THE AGENCIES INTERNALLY EVALUATE MOST TRANSACTIONS, BUT ALSO GROSSLY INAPPROPRIATE IN LIGHT OF THE DISCOVERY THE AGENCY OBTAINS IN SECOND REQUESTS

Other actions and statements from the FTC are also flatly inconsistent with the broad and lengthy discovery that the agencies undertake during Second Request review. For example, some at the Commission continue to use a threshold for authorizing complaints that is far too low given the information at its disposal—whether there is “reason to believe” that the transaction or behavior may violate antitrust law. In the merger context, this is a proper standard for determining whether a Second Request is appropriate, not whether the pursuit of an

injunction is appropriate. Similarly, the continuing use of market shares and related presumptions is not only inconsistent with how the agencies internally evaluate most transactions, but also grossly inappropriate in light of the discovery the agency obtains in Second Requests.

The desire to win is understandable for all of us. So too is the impulse for an agency to assert the full extent of powers when so many assert so confidently that their legal powers fall well short of their exercise. But even if we agree that an exercise of power is permitted, we need not agree that it is appropriate or prudent.

REFERENCES TO INCIPIENCY ARE IRRELEVANT IN THE HSR ERA: ALL HSR-RELATED MERGER REVIEW OCCURS BEFORE TRANSACTIONS RESULT IN ANTICOMPETITIVE EFFECTS

Bypassing federal judicial review, or limiting it to issues decided by the Supreme Court over 50 years ago,²² does nothing more than validate the most extreme criticisms of the merger review process and the enforcement agencies. Further these actions cast a long, unfortunate shadow over an extraordinary effort by hundreds of people at both agencies to make a horribly

designed structure relatively efficient, sophisticated, and even dynamic.²³

Thus, the FTC should join the DOJ in seeking injunctive relief in federal court on an aggressive timetable consistent with the extraordinary amount of discovery that staffs obtain through the HSR process. Moreover, they should not try to circumvent judicial review any further or differently by suggesting they bear anything less than a burden of showing that the merger is more likely than not to reduce competition in a relevant market.

References to incipency are irrelevant in the HSR era: all HSR-related merger review occurs before transactions result in anticompetitive effects. And the fact that the courts do not require the agencies to prove potential anticompetitive effects with certainty does not mean that mere possibilities should suffice.

The agencies should prove that anticompetitive effects are at least reasonably probable, which, under any reasonable interpretation of the Clayton Act in the HSR era, must mean more likely than not.

IV. CIVIL NONMERGER ENFORCEMENT

The structure of civil non-merger enforcement in the United States bears some superficial similarities to the merger enforcement structure. Two federal antitrust agencies share enforcement responsibilities and generally allocate oversight of particular industries (and in some cases, companies) to either agency depending on their traditional focus and staff expertise (which now parallels the division to which the agencies agreed for merger enforcement). Each enforces Section 1 and 2 of the Sherman Act, and theoretically is able to enforce the Robinson-Patman Act and Section 3 of the Clayton Act.

THIS HAS LED FEDERAL COURTS TO BE SKEPTICAL NOT ONLY OF PRIVATE ANTITRUST CHALLENGES, BUT OF ANTITRUST LAW ITSELF, WITH DRAMATIC ADVERSE CONSEQUENCES FOR THE DEVELOPMENT OF SOUND ANTITRUST LAW

There are, however, significant differences between the merger and civil non-merger enforcement regimes.

THIRD, THE STATUTORY STRUCTURE FOR FEDERAL AGENCY ENFORCEMENT PROVIDES A POTENTIALLY MORE EXPANSIVE ROLE FOR THE FTC TO DEVELOP CIVIL NON-MERGER ANTITRUST LAW

First, private plaintiffs assume a far more important role in the number, nature, and importance of challenges under Section 1 of the Sherman Act. Absent leadership from the agencies, the development of Sherman Act jurisprudence can arise in contexts that may have little to do with preserving consumer welfare, and can be brought by private parties and attorneys whose expertise is often inferior to agency lawyers and whose incentives may lead to challenges in cases with no merit. This has led federal courts to be skeptical not only of private antitrust challenges, but of antitrust law itself, with dramatic adverse consequences for the development of sound antitrust law and the ability of the agencies to conduct their core mission vis-à-vis other federal and state governmental entities.

Second, in non-merger areas, the agencies often lack the leverage provided by the waiting period requirements of the HSR regime. Private parties are better positioned to resist overbroad information requests, and delay compliance with agency requests. This can significantly delay agency non-merger investigations and challenges, perhaps even rendering agency action moot. This also increases the importance of private plaintiffs in the solution of distinct antitrust issues, as they are often more willing than agencies to commence legal proceedings without full or even marginal visibility into the facts underlying their case.

Third, the statutory structure for federal agency enforcement provides a potentially more expansive role for the FTC to develop civil non-merger antitrust law. Historically, increasing congressional frustration with DOJ's incentive and ability to prosecute antitrust challenges under the Sherman Act, coupled with extraordinary optimism about the ability of an independent agency to become an effective prosecutor and adjudicator of antitrust issues, led to the creation of the FTC itself.²⁵ Armed with a variety of investigative powers and adjudicative responsibilities, the FTC can seek to go beyond the Sherman Act in challenging

particular species of business practices, notably under Section 5 of the FTC Act. It also enjoys substantial home court advantages in making sure that its view of the law becomes the law of the land.

Finally, judicial review is a far more meaningful option in the non-merger context, substantially increasing the legitimacy of federal enforcement actions in two important respects. First, when parties settle despite the ability to obtain judicial review of their behavior, the consent in non-merger contexts is more likely to reflect a realistic appraisal of underlying merits. That is especially true when the agencies do not seek monetary relief. Second, when the agencies prevail, they often obtain opinions that vindicate their views of the law, and are far less distinguishable than opinions in the merger context, which are generally more driven by facts and often *sui generis*.

MORE EFFECTIVE NON-MERGER ENFORCEMENT WOULD ENHANCE THE LEADERSHIP OF THE AGENCIES IN DEVELOPING ANTITRUST LAW

As with the federal merger review system, no legislation is required to improve federal antitrust enforcement in the civil non-merger context. The agencies have all the tools required to perform effectively, and private parties have sufficient access to judicial review to ensure adequate protection against any potential overreach by the agencies. The primary question that the agencies face is how to improve their selection of investigations, as well as their pace, which would conserve resources, enhance their ability to litigate a broader array of non-merger issues, and make relief more timely and meaningful in those cases where enforcement is appropriate.

More effective non-merger enforcement would enhance the leadership of the agencies in developing antitrust law. It could also limit the substantial collateral damage that private antitrust litigation causes to the agencies in their efforts not only to enforce the Sherman Act in courts, but also to advance the competition mission with other federal authorities and state governments.

AT THE END, THE CASE PRODUCED ONE OF THE GREAT MODERN OPINIONS IN ANTITRUST LAW

V. THE RECENT DOJ CIVIL NON-MERGER ENFORCEMENT RECORD

Below, we evaluate the performance of both the DOJ and the FTC over the past 15 years. The demonstrable success of DOJ in bringing a variety of enforcement actions under both Section 1 and 2 of the Sherman Act raises substantial questions about whether the FTC requires greater authority to achieve effective enforcement outcomes. Indeed, the FTC's record in several crucial areas of competition law and policy suggests, ironically, that exercising greater authority has substantially undermined the effectiveness of its efforts. Contrary to the view of some commentators, the FTC has acted consistently with its statutory mandate, and its failure to achieve timely, meaningful, or pervasive impact in cases involving standard-setting deception and Hatch-Waxman settlements should lead the agency to consider whether it should make its enforcement process leaner and more agile.

The DOJ has had a remarkable level of success across industries and issues over the past 15 years.

THE ABILITY OF THE DOJ TO PROSECUTE THESE INVESTIGATIONS AND CHALLENGES UNDER THE SHERMAN ACT SUGGEST THAT THERE ARE NO SUBSTANTIAL LEGAL IMPEDIMENTS TO BRINGING CHALLENGES BASED ON NOVEL LEGAL THEORIES OR NOVEL BUSINESS PRACTICES

No discussion of contemporary antitrust enforcement is complete without an examination of the DOJ's case against Microsoft. What began as an attempt to enforce a consent decree blossomed into a full-blown Section 2 case that involved almost every conceivable issue that can arise in a Sherman Act proceeding. At the end, the case produced one of the great modern opinions in antitrust law,²⁶ involving one of the most important companies in the world, in a case that any business

would ignore only at their own peril. The commercial impact of the case and remedy was immense;²⁷ the legal impact of effective enforcement went well beyond the defendant itself. Arguably, the most extraordinary aspect of the case was its rapidity through every aspect of the antitrust enforcement system. The DOJ was able to achieve an important public benefit, principally in the form of validation from an en banc panel of the D.C. Circuit.

Microsoft is important. And the application of traditional antitrust principles to a relatively novel technological context made the case complicated. Nevertheless, the DOJ's achievement in *Microsoft* is one of many in the past 15 years. Other crucial enforcement efforts include the following:

- The DOJ's successful challenge to VISA and MasterCard rules prohibiting members from issuing cards with other credit card networks.²⁸
- The DOJ's traditional challenge to Dentsply's exclusive agreements, vindicated in the Third Circuit.²⁹
- The DOJ's innovative (although unsuccessful) efforts to challenge above-cost pricing by American Airlines that allegedly impaired the efforts of new entrants to compete.³⁰
- The DOJ's challenge to swap agreements involving the Village Voice and independent weeklies, a traditional horizontal restraints case in the context of acquisitions.³¹
- The DOJ's successful, widespread investigation into no-poach agreements among Silicon Valley employers.³²
- The DOJ's rapid, (thus far) successful, and politically unpopular challenge to Apple's agreements with book publishers.³³
- The DOJ's innovative, swift, and effective challenges to agreements between Verizon and cable companies, which would have reduced the incentive of Verizon and cable companies to compete more vigorously against each other.³⁴
- The DOJ's ongoing challenges to vertical agreements between merchants and payment systems allegedly reducing horizontal interbrand competition.³⁵

Very few of these challenges involve conventional antitrust theories—arguably only the *Dentsply*, *Village Voice*, and *Apple* cases fit traditional antitrust molds. And in those cases, the DOJ moved rapidly and effectively to obtain timely relief. In *Apple*, the DOJ confronted and overcome substantial cross-currents. Other cases involved novel enforcement theories or the application of more traditional antitrust standards to very complicated facts. The ability of the DOJ to prosecute these investigations and challenges under the Sherman Act suggest that there are no substantial legal impediments to bringing challenges based on novel legal theories or novel business practices.

VI. THE FTC RECORD

Despite considerably more tools at its disposal, the FTC's civil non-merger enforcement record over the past 15 years is comparatively lackluster. To be sure, there have been important, successful enforcement efforts in a number of areas—real estate, state action immunity, and petitioning immunity. But despite the efforts of many dedicated employees, the FTC has faced substantial difficulty in shaking its historical reputation as a disappointment in its non-merger enforcement efforts.

First, the FTC still sometimes pursues marginal cases involving small or low-profile defendants or matters where enforcement will have little or no impact on courts or the business community.³⁶ Even when the defendants are higher-profile, the commercial impact and legal significance of the action can be painfully small. In the *Three Tenors*,³⁷ the FTC successfully applied the Quick Look to a restriction on competitive sales of an older recording in connection with the joint production and sale of a new recording. The D.C. Circuit usefully affirmed, and added yet another decision scaling back the free-rider defense in horizontal restraint cases.³⁸ But how much did the Commission spend in time and resources reminding the antitrust bar and business community that this sort of restriction was not permissible, and what else might the Commission have done with the resources?

Second, even the victories in *North Texas Physicians*,³⁹ *RealComp*,⁴⁰ and *North Carolina Dental*⁴¹ took so long, and involved facts so convoluted, that they have had limited impact on areas of law or the economy in which they could and should have had greater impact. (Because the Supreme Court will review the *North Carolina Dental* decision, its impact could become more significant.) Moreover, it is very difficult to see how Part III adjudication is necessary in these cases. District and federal appellate courts can easily apply the Quick Look—indeed, federal courts did so in the release estate sector in 1980—in a case brought by the DOJ.⁴² If

THIRD, EVEN WHEN THE STAKES HAVE BEEN MORE SIGNIFICANT, AND THE CONTEXT MORE APPROPRIATE FOR PART III AND SECTION 5, THE FTC'S ENFORCEMENT EFFORTS WERE NOT SUFFICIENTLY QUICK OR WELL-DEVELOPED TO BE EFFECTIVE

anything, the Quick Look should be easier for district courts to apply than the rule of reason. The substantial expenditure of limited resources on Part III matters does not make much sense to outsiders in these contexts. And when one contrasts these cases with the DOJ challenges in the payment system cases, or the Verizon-cable-company agreements, the small legal and commercial impact of these expensive FTC enforcement actions becomes even more evident.

UNFORTUNATELY, THE QUALITY OF THE DECISION DID NOT JUSTIFY THE TIME AND RESOURCES REQUIRED TO PRODUCE IT

Third, even when the stakes have been more significant, and the context more appropriate for Part III and Section 5, the FTC's enforcement efforts were not sufficiently quick or well-developed to be effective. In *Rambus*,⁴³ the FTC took nine years to investigate and challenge standard-setting practices of a single defendant before a single standard-setting body from 1991 to 1996. Multiple parties were already challenging the validity and enforceability of Rambus patents. Nevertheless, the FTC continued to press the enforcement action through protracted administrative litigation, which predictably ended in long opinions resulting in the Commission's finding of liability after significant periods of time. The D.C. Circuit understandably rejected the Commission's findings, holding that the Commission, like any other plaintiff, should demonstrate that the allegedly illegal conduct actually resulted in anticompetitive effects, a position all the more legitimate in light of the years of investigation and litigation that had preceded appellate argument.⁴⁴

Fourth, even when the FTC has obtained favorable settlements, it has lost substantial public benefits resulting from litigation. In two challenges involving Intel,⁴⁵ the FTC took aggressive positions on bundled pricing, unilateral refusals to deal, and allegedly unlawful product design. Although the defendants was obviously a high-profile target, the inability or willingness of the FTC to achieve its objectives through the judicial process undermined the impact and perceived legitimacy of these enforcement actions. Few antitrust lawyers are parsing the consent decrees in these cases for meaningful guideposts when advising leading companies. DOJ, by contrast, used enforcement actions against Microsoft and Apple to reaffirm important principles of antitrust law in novel factual contexts, articulating legal principles clearly, concisely, rapidly, and, in the view of the courts thus far, correctly.

Fifth, in an area where the FTC has invested the greatest amount of resources, it has won a battle but ultimately lost a war. In 1998, the FTC began investigating Hatch-Waxman settlement agreements. For a variety of reasons, the FTC moved slowly, eventually entering consent decrees in both cases.⁴⁶

After settling the first two sets of agreements that it investigated, the FTC subsequently challenged a set of agreements between Schering-Plough and generic companies involving K-Dur.⁴⁷ Though the FTC did not apply the label of *per se* illegality to the arrangement, the opinion appeared to outsiders to take precisely that position. Taking advantage of their ability to choose their appellate court, the defendants selected the Eleventh Circuit, which had already ruled in an earlier appeal in private litigation that settlements within the scope of the patents at issue were presumptively lawful. Not surprisingly, the Eleventh Circuit showed no deference to the FTC's view of facts or law, and reversed.⁴⁸ The FTC watched as the Second and Federal Circuits reached similar results.⁴⁹

In 2008, the FTC renewed its enforcement efforts in a challenge to Cephalon's settlements with four generic companies involving Provigil, going directly to district court.⁵⁰ Separately, the FTC challenged agreements between Solvay with generic companies involving Andro-Gel in district court. These were

transparent attempts to create circuit splits to expedite Supreme Court review of the issue.

Eventually, the strategy bore fruit. The Supreme Court took the *Andro-Gel* case and reversed.⁵¹ Unfortunately, the quality of the decision did not justify the time and resources required to produce it. The Supreme Court rejected the extreme position that any patent settlement within the nominal exclusionary scope of the patents-in-suit would be lawful. But it did not articulate any meaningful guidance on how lower courts should evaluate the impact of a settlement.⁵² Thus, 16 years after the FTC began its enforcement efforts, we finally have a Supreme Court decision, but it is not useful for other cases, resulted from FTC action in district court (not Part III), and is not based on Section 5. It is hard to imagine that the DOJ could have

THE FTC SHOULD ALSO CONTINUE ITS EFFORTS TO GUIDE THE DEVELOPMENT OF NON-MERGER LAW IN ITS AMICUS EFFORTS

done less simply using Sherman Act authority in district court. Indeed, more than a year after the Supreme Court decision, the FTC continues to litigate *Cephalon* in district court, now pressing for restitution while private plaintiffs press for treble damages.

Although the FTC felt vindicated by the *Actavis* decision, it should step back and seriously consider whether its textbook approach to investigation and prosecution served the public interest. This is not to second-guess the actual decisions the FTC actually made. Each step—settling the initial cases, collecting information and issuing reports, litigating in Part III, and pursuing challenges in federal court to avoid appellate forum-shopping and create circuit splits—made perfect legal sense and was a sound public policy decision. Cumulatively, however, the amount of time and resources required to obtain such a largely ambiguous opinion with little guidance for future cases seriously raises questions about whether the FTC should continue to press ahead with the protracted Part III litigation process.

Speculation about the feasibility or speed of an alternative course is unnecessary. Right when the FTC began its investigations, it was commencing a challenge in federal court to exclusive agreements that Mylan reached with active pharmaceutical ingredient suppliers, which enabled Mylan to corner three separate generic pharmaceutical markets and raise the prices of all three substantially. The FTC investigated the case rapidly, and went straight to district court to obtain rapid injunctive and other equitable relief.

PERHAPS THE MOST SUBSTANTIAL BASIS FOR CRITICIZING FEDERAL ANTITRUST AGENCY PERFORMANCE OUTSIDE THE MERGER CONTEXT IS THE RELATIVELY MODEST IMPACT THAT THE FTC AND DOJ HAVE HAD ON SISTER AGENCIES THROUGHOUT THE FEDERAL GOVERNMENT

There is no reason that the FTC could not pursue precisely the same kind of challenges in other cases going forward. Moreover, given the flexibility that courts have shown in DOJ's challenges under the Sherman Act, there is no obvious reason why the FTC must or should use authority under Section 5 as an independent source of doctrinal authority.

The FTC should also continue its efforts to guide the development of non-merger law in its amicus

efforts. In fact, one of the most effective enforcement victories over the past 15 years resulted from amicus efforts in private litigation,⁵⁴ followed by advocacy before the Federal Drug Administration (“FDA”)⁵⁵ and in favor of legislative reform. In the Orange Book listing cases, the FTC identified potential weaknesses in the FDA patent notification system, which undermined the integrity of that process in several notable instances while also permitting branded firms to exclude competition that might otherwise have occurred. Broader amicus efforts, along with more effective collaboration with sister agencies, may enable the Commission to cover more substantive ground more credibly across the industries for which it bears primary enforcement responsibility.

VII. THE RELATIONSHIP OF THE AGENCIES TO OTHER FEDERAL AUTHORITIES

Perhaps the most substantial basis for criticizing federal antitrust agency performance outside the merger context is the relatively modest impact that the FTC and DOJ have had on sister agencies throughout the federal government. The role of other federal government entities as regulators and even as market participants can have a significant impact on the competitive structure and performance of industries and participants. Although the federal agencies have traditionally attempted to assert the importance, even hegemony, of competition as a public policy value, the recent role of the agencies has been low-profile at best.

This does not reflect the absence of opportunities from a competition policy perspective. In its capacity as the most important domestic customer of pharmaceuticals, health care services, rare earth minerals, and numerous high-technology defense industry products, the federal government would benefit from continuing counsel from antitrust enforcers on how to ensure that their upstream suppliers continue to be cost-competitive, innovative, and prevent bid-rigging among other ills.

And in their capacity as industry regulators, numerous federal agencies would benefit from continuing

THUS, IMMUNITY COULD APPLY EVEN WHEN THERE IS NO ACTUAL OR DIRECT CONFLICT BETWEEN ANTITRUST AND OTHER REGULATORY LAW

collaboration with federal antitrust regulators to ensure that their regulatory activities do not unnecessarily reduce competition. That is especially true for agencies like the FDA and Department of Defense (“DOD”). But it is also true for governmental actors like the Federal Reserve, Securities and

Exchange Commission (“SEC”), Federal Deposit Insurance Corp. (“FDIC”), and Treasury. The return of the DOJ to greater activism in the financial sector is welcome but long overdue.

One reason for the reticence of federal antitrust agencies in acting more directly in regulated sectors may be the Supreme Court’s decision in *Credit Suisse Sec. (USA) L.L.C. v. Billing*.⁵⁷ There, the Supreme Court arguably articulated a more expansive doctrine of implied antitrust immunity at the intersection of securities law and antitrust law. Justice Breyer identified four factors that were crucial in determining whether implied antitrust immunity would apply to conduct:

1. the existence of regulatory authority to supervise the conduct at issue;

2. “evidence that the regulatory entities exercise that authority . . .”;
3. “a resulting risk” that if antitrust and other laws, “if both applicable, would produce conflicting guidance, requirements, duties, privileges, or standards of conduct . . .;” and
4. whether the conflict affects “practices that lie squarely within an area” of activity that the other body of law seeks to regulate.

Thus, immunity could apply even when there is no actual or direct conflict between antitrust and other regulatory law. Indeed, in *Billings* itself, the challenged behavior also seemed to violate the securities laws.

This displacement of antitrust law and principles in circumstances where compliance with antitrust law would not undermine the spirit or letter of other federal regulation or law may have consequences that regulators at other agencies themselves may not welcome. Perhaps it is attributable to the skepticism that the Supreme Court has about private antitrust enforcement.⁵⁸

Even in the shadow of *Billings*, the federal agencies may nevertheless continue to play an important role in preserving and expanding principles of competition in sectors regulated or dominated by the federal government as regulator or commercial actor. Outside of the intellectual property context, where the Supreme Court shares the knee-jerk hostility of antitrust agencies to the U.S. Patent and Trademark Office (“PTO”) and even Federal Circuit, the DOJ and FTC will have to continue an approach based on deep knowledge, mutual respect, and more frequent, material collaboration with sister agencies in activities within and outside the enforcement agencies.

AND ALTHOUGH THE RELATIVE SPECIALIZATION OF EACH AGENCY’S STAFFS IS ARGUABLY THE RESULT OF HISTORICAL ACCIDENT, NOT INSTITUTIONAL DESIGN, IT IS PRECISELY THE KIND OF INCREMENTAL ADAPTATION THAT HAS MADE THE U.S. ANTITRUST AGENCIES SO EFFECTIVE

Fortunately, each of the agencies has experienced staff familiar with the regulatory and commercial terrain of the industries also regulated by sister agencies. In fact, it is this experience and familiarity that are the strongest guarantee that each of the agencies would continue to enjoy and merit an independent existence as a federal antitrust enforcement agency. And although the relative specialization of each agency’s staffs is arguably the result of historical accident, not institutional design, it is precisely the kind of incremental adaptation that has made the U.S. antitrust agencies so effective. ▲

¹ Partner, Ropes & Gray LLP, Washington, D.C. The author was also Attorney-Advisor to FTC Chairman Robert Pitofsky from 1998 to 2000. This article reflects solely the views of the author, and does not reflect the views of Ropes & Gray, its partners, or its clients.

² For others, institutional design has been a hot topic for some time, and certainly not confined to academic circles. For leading discussions of institutional design in the U.S. context, see DANIEL A. CRANE, *THE INSTITUTIONAL STRUCTURE OF ANTITRUST ENFORCEMENT* (2011); William E. Kovacic & David A.

Hyman, *Competition Agency Design: What's on the Menu?*, GW Faculty Publications & Other Works (Paper 628) (2012); William E. Kovacic, *The Institutions of Antitrust Law: How Structure Shapes Substance*, 110 MICH. L. REV. 1019 (2012); D. Daniel Sokol, *Antitrust, Institutions, and Merger Control*, 17 GEO. MASON L. REV. 1055 (2010); Harry First, Eleanor M. Fox, & Daniel Hemli, *Procedural and Institutional Norms in Antitrust Enforcement: the U.S. System* in THE DESIGN OF COMPETITION LAW INSTITUTIONS: GLOBAL NORMS, LOCAL CHOICES (Eleanor M. Fox & Michael J. Trebilcock, eds., 2012). And though not discussed in terms of “institutional design,” the ongoing debate over the relative expertise and roles of agencies and federal courts is an essential part of the dialog over agency structure and performance. See Douglas H. Ginsburg & Joshua D. Wright, *Antitrust Courts: Specialists Versus Generalists*, 36 FORDHAM INTL. L.J. 788 (2013); Joshua D. Wright & Angela M. Diveley, *Do Expert Agencies Outperform Generalist Judges? Some Preliminary Evidence from the Federal Trade Commission*, J. ANTITRUST ENFORCEMENT 1-22 (2012).

³ See Deborah L. Feinstein, Director of FTC Bureau of Competition, *The Forward-Looking Nature of Merger Analysis*, pp. 2-3, available at http://www.ftc.gov/system/files/documents/public_statements/forward-looking-nature-merger-analysis/140206mergeranalysis-dlf.pdf (2014).

⁴ 415 U.S. 486 (1974).

⁵ See Horizontal Merger Guidelines, Department of Justice and Federal Trade Commission, available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.html> (Aug. 19, 2010); Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, available at <http://www.justice.gov/atr/public/articles/263528.htm>.

⁶ United States v. Sungard Data Sys., 172 F. Supp. 2d 172 (D.D.C. 2001); United States v. Oracle Corp., 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

⁷ FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997); FTC v. Swedish Match, 131 F. Supp. 2d 151 (D.D.C. 2000); United States v. H&R Block, 833 F. Supp. 2d 36 (D.D.C. 2011).

⁸ FTC v. CCC Holdings, 605 F. Supp. 2d 26 (D.D.C. 2009); FTC v. Whole Foods Mkt., Inc., 548 F.3d 1028 (D.C. Cir. 2008); United States v. Bazaarvoice, Inc., Case No. 13-cv-00133-WHO (N.D. Cal. Jan. 8, 2014), memo. op. at <http://www.justice.gov/atr/cases/f302900/302948.pdf>.

⁹ United States v. Baker Hughes, Inc., 908 F. 2d 981 (D.C. Cir. 1990).

¹⁰ FTC v. H.J. Heinz Co., 246 F.3d 708 (D.C. Cir. 2001); FTC v. Cardinal Health, 12 F. Supp. 2d 34 (D.D.C. 1998).

¹¹ Promedica Health System, Inc. v. FTC, Appeal No. 12-3583 (6th Cir. Apr. 22, 2014), available at <http://www.ca6.uscourts.gov/opinions.pdf/14a0083p-06.pdf> (affirming Commission on unilateral effects theory).

¹² FTC v. OSF Healthcare Sys., Inc., 852 F. Supp. 2d 1069 (N.D. Ill. 2012) (granting preliminary injunction based on coordinated effects theory).

¹³ FTC v. Phoebe Putney Health Sys., Inc., 133 S. Ct. 1003 (2013) (holding that state action doctrine did not immunize hospital merger-to-monopoly from FTC challenge).

¹⁴ Findings of Fact and Conclusions of Law, FTC v. St. Luke's Health System, Ltd., No. 13-cv-00116 (D. Idaho, Jan. 24, 2014), consolidated with lead case St. Alphonsus Medical Center-Nampa et al. v. St. Luke's Health System Ltd., No. 1:12-cv-00560 (D. Idaho, Jan. 24, 2014) available at <http://www.ftc.gov/system/files/documents/cases/140124stlukesfindings.pdf>

¹⁵ Deborah L. Feinstein, FTC Bureau of Competition Director, *Antitrust Enforcement in Health Care:*

Proscription, Not Prescription, 14 (June 19, 2014), available at http://www.ftc.gov/system/files/documents/public_statements/409481/140619_aco_speech.pdf.

¹⁶ See Administrative Complaint, In the Matter of Thoratec Corp., FTC Dkt. 9399 (2009) <http://www.ftc.gov/sites/default/files/documents/cases/2009/07/090730thorateadminccmpt.pdf>.

¹⁷ *FTC v. Lundbeck, Inc.*, 650 F.3d 1236 (8th Cir. 2011) (affirming rejection of FTC and State of Minnesota challenge to acquisition of two drugs allegedly permitting owner to raise prices substantially).

¹⁸ Joe Sims & Deborah P. Herman, *The Effect of Twenty Years of Hart-Scott-Rodino on Merger Practice: A Case Study in the Law of Unintended Consequences Applied to Legislation*, 65 ANTITRUST L.J. 865 (1997); A. Douglas Melamed, *Antitrust: The New Regulation*, 10 ANTITRUST 13 (1995); E. Thomas Sullivan, *The Antitrust Division as a Regulatory Agency: An Enforcement Policy in Transition*, 64 WASHINGTON U. L.Q. 997 (1986).

¹⁹ See, e.g., DOJ's Merger Review Process Initiative, available at <http://www.justice.gov/atr/public/9300.htm>; see also a similar initiative from the FTC, available at <http://www.ftc.gov/sites/default/files/attachments/merger-review/mergerreviewprocess.pdf>.

²⁰ See Nathan Chubb, *Agency Draw: How Serious Questions in Merger Review Could Lead to Enhanced Merger Enforcement*, 18 GEORGE MASON L. REV. 533 (2011).

²¹ See Joe Sims & Michael McFalls, *Negotiated Merger Remedies: How Well Do They Solve Competition Problems?*, 69 GEO. WASH. L. REV. 932 (2001). But see also Lawrence M. Frankel, *Rethinking the Tunney Act: A Model for Judicial Review of Consent Decrees*, 75 ANTITRUST L.J. 549 (2008); Steven C. Salop, *Merger Settlement and Enforcement Policy for Optimal Deterrence and Maximum Welfare*, 81 FORDHAM L. REV. 2647 (2013).

²² *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963).

²³ There are legitimate questions that others have asked from the opposite end of the spectrum, including fundamentally, whether there is structural bias towards under-enforcement. See Lawrence M. Frankel, *The Flawed Institutional Design of U.S. Merger Review: Stacking the Deck against Enforcement*, UTAH L. REV. 1 (2008). One solution is to defer substantially more to agency judgments about the appropriateness of injunctive relief in merger cases, akin to the deference allegedly shown to regulators in administrative rulemakings. But the structure of merger enforcement and civil non-merger enforcement itself demonstrates a congressional interest in compelling the agency to carry its burden of proving that criminal, injunctive, or other civil relief is appropriate. Moreover, one of the underlying assumptions of the argument—that the agencies have superior access to information—actually weights heavily in favor of allocating the burdens of proof and production on the agencies, not on private parties with limited discovery power. The argument for deference to the agencies is far stronger with respect to merger remedies, where the agencies have substantially more expertise and liability has either been proven or conceded.

²⁴ *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962).

²⁵ See generally Marc Winerman, *The Origins of the FTC: Concentration, Cooperation, Control, and Competition*, 71 ANTITRUST L.J. 1 (2003).

²⁶ *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001).

²⁷ Others have disagreed about the impact of the case, particularly the remedy. See especially Carl Shapiro, *Microsoft: A Remedial Failure*, 75 ANTITRUST L.J. 739 (2009). I am confident that the remedy was incomplete and imperfect, but even more confident that the public interest in the enforcement effort itself was immense.

²⁸ *United States v. Visa U.S.A., Inc.*, 344 F.3d 229 (2d. Cir. 2003).

²⁹ *United States v. Dentsply Int'l*, 399 F.3d 181 (3d Cir. 2005).

³⁰ United States v. AMR Corp., 335 F.3d 1009 (10th Cir. 2003).

³¹ See <http://www.justice.gov/atr/cases/f200600/200673.htm>.

³² See, e.g., Complaint in United States v. eBay, Inc., CV12 58690 (N.D. Cal. November 16, 2012), available at <http://www.justice.gov/atr/cases/f288900/288918.pdf>.

³³ United States v. Apple Inc., 952 F. Supp. 2d 638 (S.D.N.Y. 2013), available at <http://www.justice.gov/atr/cases/f299200/299275.pdf>.

³⁴ Final Judgment, United States and State of New York v. Verizon Communications, Inc. et al, Case 1:12-cv-01354 (RMC) (D.D.C. Aug. 13, 2013), available at <http://www.justice.gov/atr/cases/f300000/300002.pdf>.

³⁵ Complaint, United States v. American Express Co. at al (E.D.N.Y. Oct. 4, 2010), available at <http://www.justice.gov/atr/cases/f262800/262864.htm>.

³⁶ Fortunately, there are fewer examples today than 15 years ago, but there also continue to be matters that predictably lead to widespread puzzlement and scorn. See, e.g., Kimberly Strassel, *Piano Sonata in FTC Minor*, available at <http://online.wsj.com/news/articles/SB10001424052702303562904579224251626379422> (Nov. 28, 2013).

³⁷ PolyGram Holding, Inc. v. FTC, 416 F.3d 29 (D.C. Cir. 2005).

³⁸ See also Toys ‘R’ Us v. FTC, 221 F.3d 928 (7th Cir. 2000); Chicago Professional Sports Ltd Partnership v. NBA, 961 F.2d 667 (7th Cir. 1991).

³⁹ North Texas Specialty Physicians v. FTC, 528 F.3d 346 (5th Cir. 2008).

⁴⁰ RealComp II Ltd. V. FTC, 635 F.3d 815 (6th Cir. 2011).

⁴¹ North Carolina State Board of Dental Examiners v. FTC, 717 F.3d 359 (4th Cir. 2013), cert. granted, No. 13-534 (U.S. March 3, 2014).

⁴² United States v. Realty Multi-List, 629 F. 2d 1351 (11th Cir. 1980).

⁴³ Rambus, Inc. v. FTC, 522 F.3d 456 (D.C. Cir. 2008).

⁴⁴ *Id.* at 467. Indeed, the D.C. Circuit noted that the FTC had not shown that the adoption of the same standard was not the likelier of two potential outcomes, *i.e.*, that the deception had more likely than not reduced competition. *Id.*

⁴⁵ In the Matter of Intel Corp., FTC Dkt. No. 9288, available at <http://www.ftc.gov/enforcement/cases-proceedings/intel-corporation-matter>; In the Matter of Intel Corp., FTC Dkt. No. 9341 (2010), available at <http://www.ftc.gov/enforcement/cases-proceedings/061-0247/intel-corporation-matter>.

⁴⁶ In the Matter of Hoechst Marion Roussel, Inc., et al, FTC Dkt. 9293 (2001), available at <http://www.ftc.gov/enforcement/cases-proceedings/9810368/hoechst-marion-roussel-inc-carderm-capital-lp-andrx>; In the Matter of Abbott Labs., et al, FTC Dkt. C-3945 (2000), available at <http://www.ftc.gov/enforcement/cases-proceedings/9810395/abbott-laboratories-matter>.

⁴⁷ In the Matter of Schering-Plough Corp., et al, FTC Dkt. 9297 (2003), available at <http://www.ftc.gov/sites/default/files/documents/cases/2003/12/031218commissionopinion.pdf>.

⁴⁸ Schering-Plough Corp. v. FTC, 402 F.3d 1056 (11th Cir. 2005).

⁴⁹ In re Tamoxifen Citrate Antitrust Litig., 466 F.3d 187 (2d Cir. 2006); In re Ciprofloxacin Hydrochloride Antitrust Litig., 544 F.3d 1323 (Fed. Cir. 2008); see also In re: Ciprofloxacin Hydrochloride Antitrust Litig., 604 F.3d 98 (2d Cir. 2010). Judge Posner, sitting as a district judge, went still further in *Asahi Glass Co. v. Pentech Pharmaceuticals Inc.*, 289 F. Supp. 986 (N.D. Ill. 2003), essentially requiring plaintiffs to

show that the settlement (and underlying litigation) was essentially a sham.

⁵⁰ See Complaint in *FTC v. Cephalon, Inc.*, initially filed in D.D.C. on February 13, 2008, *available at* <http://www.ftc.gov/sites/default/files/documents/cases/2008/02/080213complaint.pdf>. Eventually, the case was consolidated with private litigation involving essentially the same facts.

⁵¹ *FTC v. Actavis Inc.*, 570 U.S. ____ (June 17, 2013).

⁵² Indeed, the antitrust bar read in *Actavis* that settlements could sometimes harm competition, that large payments from branded pharmaceutical companies to generic companies could skew incentives based solely on merits in the underlying patent litigation, that patent holders can have the ability to reach anticompetitive agreements, and that efficiencies may sometimes justify litigation settlement. All of these were pretty self-evident propositions to many in the patent and antitrust bar when these settlements first emerged. What the antitrust bar needed (or at least desired) was a clearer standard for counseling, or at least a workable standard for litigating. Unfortunately, the Court's opinion provides neither.

⁵³ See Amended Complaint, *FTC v. Mylan Labs. Inc., et al.*, 1:98CV03114 (D.D.C. Feb. 8, 1999), *available at* <http://www.ftc.gov/sites/default/files/documents/cases/1999/02/mylanamencmp.htm>.

⁵⁴ See Memorandum of Law of Federal Trade Commission as Amicus Curiae in *SmithKline Beecham v. Apotex Corporation*, Case No. 99-CV-4304, 00-CV-4888; 01-CV-159; 01-CV-2169 (E.D. Pa. 2003), *available at* http://www.ftc.gov/sites/default/files/documents/amicus_briefs/smithkline-beecham-corp.v.apotex-corp./smithklineamicus.pdf; Memorandum of Law of Amicus Curiae The Federal Trade Commission in *Opposition to Defendant's Motion to Dismiss In re Busiprone Patent Litigation/In re Busiprone Antitrust Litigation* (S.D.N.Y. 2002), *available at* http://www.ftc.gov/sites/default/files/documents/amicus_briefs/re-busiprone-antitrust-litigation/busiprone.pdf.

⁵⁵ See Statement of FTC Chairman Timothy Muris on FDA Proposals, *available at* <http://www.ftc.gov/news-events/press-releases/2002/10/statement-federal-trade-commission-chairman-timothy-muris-fdas> (Oct. 21, 2002).

⁵⁶ Prepared Testimony of Federal Trade Commission on Greater Access to Affordable Pharmaceuticals Act (Aug. 1, 2003), *available at* <http://www.ftc.gov/public-statements/2003/08/prepared-statement-federal-trade-commission-greater-access-affordable>.

⁵⁷ 551 U.S. 264 (2007).

⁵⁸ For an extremely persuasive critique of *Billing*, see Howard A. Shelanski, *The Case for Rebalancing Antitrust and Regulation*, 109 MICH. L. REV. 683 (2011).

Decision-Making Powers and Institutional Design in Competition Cases: The Brazilian Experience

BY ANA PAULA MARTINEZ & MARIANA TAVARES DE ARAUJO¹

This article discusses the experience of Brazil regarding institutional design and decision-making powers and Brazil's efforts to enhance its convergence to international best practices, thereby improving Brazil's competition law enforcement. We describe the history of Brazil's competition law and policy system, and go on to discuss the benefits, as well as the efficiency and productivity costs, that result from the bifurcation of prosecutorial and adjudicative roles within the administrative system; warn that independency for a competition agency can be a two-edged sword; and emphasize the need to consider resources when designing and implementing merger and control systems.

I. INTRODUCTION

In the last several years, procedure and process rules that apply to competition law have been at the forefront in the agenda of international fora and of several jurisdictions. The International Competition Network ("ICN") and the Organization for Economic Co-Operation and Development ("OECD")² have promoted discussions among its members on procedural fairness and transparency, which can be achieved within different institutional designs. Likewise, many scholars have devoted substantial attention to institutional

"INDEPENDENCY" GRANTED TO A
COMPETITION AGENCY CAN BE A
DOUBLE-EDGED SWORD

design and decision-making powers' issues and have assessed the performance of competition agencies around the world based on individual frameworks.³

The present article discusses the experience of Brazil regarding institutional design and decision-making powers and its efforts to enhance convergence to international best practices and, with that, to improve competition law enforcement in the country. While describing Brazil's competition law and policy system since the 30's to today, we plan to demonstrate:

1. The bifurcation of prosecutorial and adjudicative roles within the administrative system, although helpful from a due process and procedural fairness point of view, can come associated with a heavy toll on efficiency and productivity.
2. "Independency" granted to a competition agency can be a double-edged sword: It protects the agency against "regulatory capture" but it can also limit the ability of the agency to foster competition advocacy within the government. Early-stage adopters of a competition framework should be concerned with the "perils of insulation."
3. Merger control systems cannot be designed and implemented without regard for actual resources at the disposal of the antitrust agency. For agencies with scarce resources at hand, an "imperfect" *ex-post* merger system might be more indicated than a pre-merger system. The incremental experience in

Brazil of transitioning to a full-blown *ex-ante* merger control only after the ecosystem was mature and properly resourced probably makes sense for other developing economies.

II. THE EARLY DAYS: FROM THE '30S TO THE MID-'90S

Brazil's Constitution of 1934 explicitly provided that "crimes against the economy" would be treated as crimes against the Brazilian State, where severe penalties would apply. At that time, Brazil relied on extensive government intervention, with broad-ranging price controls and a great number of state-owned companies operating in different segments of the economy. Law No. 431 of May 18, 1938⁴ was passed in this context. It established that it was a crime to attempt to manipulate markets for essential goods for the purpose of maximizing profits or gains (the law referred to artificially increasing or decreasing prices); sanctions included from six months to two years of jail time.

Likewise, Law No. 869 of November 18, 1938,⁵ which was inspired by the *U.S. Sherman Act*, was specifically targeted to promote competition—prohibiting practices such as cartels and anticompetitive mergers, predatory pricing, and interlocking directorates involving competitors, among other actions. Such conducts were treated as a crime, punishable with jail sentences from 2-10 years. For other anticompetitive conducts, such as resale price maintenance, the law established less severe sanctions—jail times from six months to two years and the payment of a criminal fine. The law also provided for sanctions against legal entities, to be applied by the Ministry of Justice. The statute had limited application and there is no record of enforcement actions taken based on these laws.

Following the end of the Second World War, Brazil's Congress passed Law No. 7.666, of June 22, 1945,⁶ known as the "Malaia Law," which provided that anticompetitive acts against the "national economic interest" were to be considered an administrative infringement, in addition to being a crime. The draft law was submitted by the then Minister of Justice Agamemnon Magalhães. A federal government agency was created to enforce such law, named "Comissão Administrativa de Defesa Econômica—"("CADE"). At its early stages, CADE was a branch within Brazil's Presidential Office and presided over by the Minister of Justice himself.

Among the reasons for the adoption of Law No. 7.666/1945, Agamemnon Magalhães listed the need to battle against trusts and other form of economic concentrations that could harm Brazil's working class and its small industries. The wording of the provisions clearly indicates that Congress' least worry was to maximize economic efficiency; conversely, protectionism and the need for greater State-intervention were the main goals of the law. Due to the political context that followed its enactment—Brazil's President Getúlio Vargas left government a few months later in October that same year⁷—the law produced no enforcement record and ended up being revoked in early November 1945.

In 1946, the Brazilian Congress passed a new Constitution that explicitly promoted competition. Its Article 148 provided that any form of abuse of dominance targeted to dominate national markets, eliminate competition, or arbitrarily increase profits would be punishable. It was the first time that legislation made use

of the expression “abuse of economic power” in Brazil—this approach was then followed by the 1967, the 1969, and the 1988 Constitutions as well.

Despite the 1946 constitutional provision, it was only in 1962 that Brazil adopted, after extensive legislative discussions, a competition law that once again set forth an administrative system to enforce competition rules.⁸ Law No. 4,137, of September 10, 1962,⁹ created the Administrative Council for Economic Defense (Conselho Administrativo de Defesa Econômica (a new “CADE”)), empowered to fight against the abuse of

THE 1962 LAW WAS NOT EFFECTIVE PRIMARILY BECAUSE OF PROTECTIONIST MEASURES IN PLACE AGAINST IMPORTS, AND PRICE CONTROLS

economic power. In his introductory statement, Agamemnon Magalhães referred to the abuse of economic power as a “power of economic and political corruption” and to one of the “four powers of the Republic,”¹⁰ which therefore needed to be harshly punished by the State. This legislation reflected Congress’ shift from a standpoint where its concern was focused on protecting the working class, included in Law No. 869 of 1938, to another where the main purpose was to protect consumers.

Under the 1962 law, CADE was based in Brasília,¹¹ with jurisdiction to investigate and sanction anticompetitive conduct affecting the Brazilian territory. It was subject to the Council of Ministers, a body under the President of the Republic. CADE was then composed of one chairman and four commissioners, appointed by Brazil’s president following a recommendation of the Council of Ministers, for a term of four years,¹² except for the chairman, who could be removed by Brazil’s president at any time. Commissioners could be exceptionally removed due to malfeasance as specified by law. Decisions were taken by a majority, formed by at least three commissioners out of four voting members. CADE had limited investigative powers, basically the ability to review financial statements and annual reports of companies and inquiry witnesses on alleged anticompetitive practices.

DESPITE THE 1946 CONSTITUTIONAL PROVISION, IT WAS ONLY IN 1962 THAT BRAZIL ADOPTED, AFTER EXTENSIVE LEGISLATIVE DISCUSSIONS, A COMPETITION LAW THAT ONCE AGAIN SET FORTH AN ADMINISTRATIVE SYSTEM TO ENFORCE COMPETITION RULES

However, regardless of the stated goals to promote competition and preserve markets, the 1962 law was not effective primarily because of protectionist measures in place against imports,¹³ and price controls.¹⁴ Moreover, at that time, most of Brazil’s largest industrial, transportation, and financial enterprises were State-owned or private monopolies, and the country was from 1964 until 1985 subject to a military regime with direct influence over CADE’s nominations and law enforcement. Against this backdrop, the existence of CADE had a marginal impact in promoting competition in the marketplace and/or protecting consumers.

There is limited data on enforcement during that period, but the available record indicates that in 21 years—from 1963 to 1984—CADE reviewed 152 cases and imposed only 16 sanctions against anticompetitive practices in Brazil, most of them reverted by judicial courts. This is substantially less than CADE’s performance in just seven months after the regime became market-based; for example, from May to

December 1996 the agency reviewed 162 cases and imposed 20 sanctions for illegal behavior.¹⁵ According to CADE:

The promotion of competition was not a priority in Brazil under the old framework. During the “CIP era,” bodies like CADE existed from a formal perspective but they were not envisioned to work (...). Authorities used and abused their powers to intervene in the economy, while at the same time the bureaucratic system for competition cases turned the competition system ineffective.¹⁶

The transition into a market-based economy began in 1988, when again a new constitution was passed in Brazil. From that moment on several substantial macro- and micro-economic reforms were implemented. So, differently from what had happened before, the constitutional provision that established that competition was a crucial feature of the “economic order” now carried considerable meaning. This led the way for the country to adopt privatization programs, for the reduction of trade barriers, and for the vast majority of price controls to be eliminated. Moreover, inflation was controlled with the introduction of a new currency (Real (“BRL”)) in 1994.

As part of the 1990s reforms, a new competition law was introduced in 1994, jump-starting the modern era of competition law in Brazil, as discussed below. A few years before, Congress had enacted Brazil’s Economic Crimes Law (Law No. 8,137/90), which established that some types of anticompetitive conduct may be considered a crime, subject to penalties of 2-5 years of imprisonment or to the payment of a criminal fine. The dual nature (administrative and criminal) of Brazil’s competition system was, therefore, preserved in the 1990s reforms. Furthermore, in 1991 Congress passed Law No. 8.158, which created the then “National Secretariat of Economic Law” (Secretaria Nacional de Direito Econômico (“SNDE”)), within the Ministry of Justice, which was responsible for reviewing merger cases.

DIFFERENTLY FROM WHAT HAD HAPPENED BEFORE, THE CONSTITUTIONAL PROVISION THAT ESTABLISHED THAT COMPETITION WAS A CRUCIAL FEATURE OF THE “ECONOMIC ORDER” NOW CARRIED CONSIDERABLE MEANING

III. A LANDMARK: LAW NO. 8,884, OF JUNE 11, 1994

The introductory statement to the 1994¹⁷ law pointed out the reasons that justified the adoption of a new competition law in Brazil: (i) lack of specialized staff, (ii) the need to create a more effective legal services office within CADE, (iii) the need for a more rational merger control system, and (iv) the need for an institutional reform.

The 1994 law introduced relevant institutional changes, reconfiguring CADE as an independent agency¹⁸ responsible for adjudicating all types of competition cases, including merger reviews and prosecution of anticompetitive conducts. The agency was comprised of six commissioners and a chairman, and all of its decisions were subject to judicial review. CADE’s commissioners and chairman were appointed by the President of the Republic and confirmed by Congress, for a term of two years, with the possibility of being reappointed for one additional term. Decisions were taken by majority, formed by at least three commissioners

out of five voting members.

In this regard, there were two main changes introduced by the 1994 law when compared to the 1962 law: (i) the Executive Power could no longer appoint members to CADE without getting Congress' confirmation, aligned with the constitutional principle of checks and balances; and (ii) terms were reduced from four years to two years, which later proved to be a wrong decision.¹⁹

TERMS WERE REDUCED FROM FOUR YEARS TO TWO YEARS, WHICH LATER PROVED TO BE A WRONG DECISION

Two other agencies outside CADE were responsible for investigating anticompetitive practices and issuing non-binding reports in connection with merger reviews, namely the Secretariat of Economic Law of the Ministry of Justice (Secretaria de Direito Econômico (“SDE”)) and the Secretariat of Economic Monitoring of the Ministry of Finance (Secretaria de Acompanhamento Econômico (“Seae”))—the agencies were jointly referred as the “Brazilian Competition Policy System” (Sistema Brasileiro de Defesa da Concorrência). The SDE was headed by a secretary of state appointed by the president of the Republic and was divided into two divisions, one with responsibility for enforcing the competition law (Departamento de Proteção e Defesa Econômica (“DPDE”)), and the other responsible for the consumer protection law (Departamento de Proteção e Defesa do Consumidor (“DPDC”)). The SEAE was also headed by a secretary of state appointed by the president of the Republic and was originally composed of public officials that had previously served in price-controlling commissions. The system was, therefore, based on ensuring full independence to the decision-making agency (CADE) while leaving the agencies with investigative powers under the umbrella of the Federal government.

FROM 1994 TO 2003, THE BRAZILIAN COMPETITION AUTHORITIES FOCUSED PRIMARILY ON MERGER REVIEWS, AND SUBSTANTIAL RESOURCES WERE DEVOTED TO REVIEWING COMPETITIVELY INNOCUOUS MERGERS

To address concerns regarding procedural fairness, two independent legal officers were established within CADE: (i) CADE's attorney general, who represented CADE in court and could render opinions in all cases pending before the agency; and (ii) the federal public prosecutor, who could also render opinions in connection with any case pending before CADE.

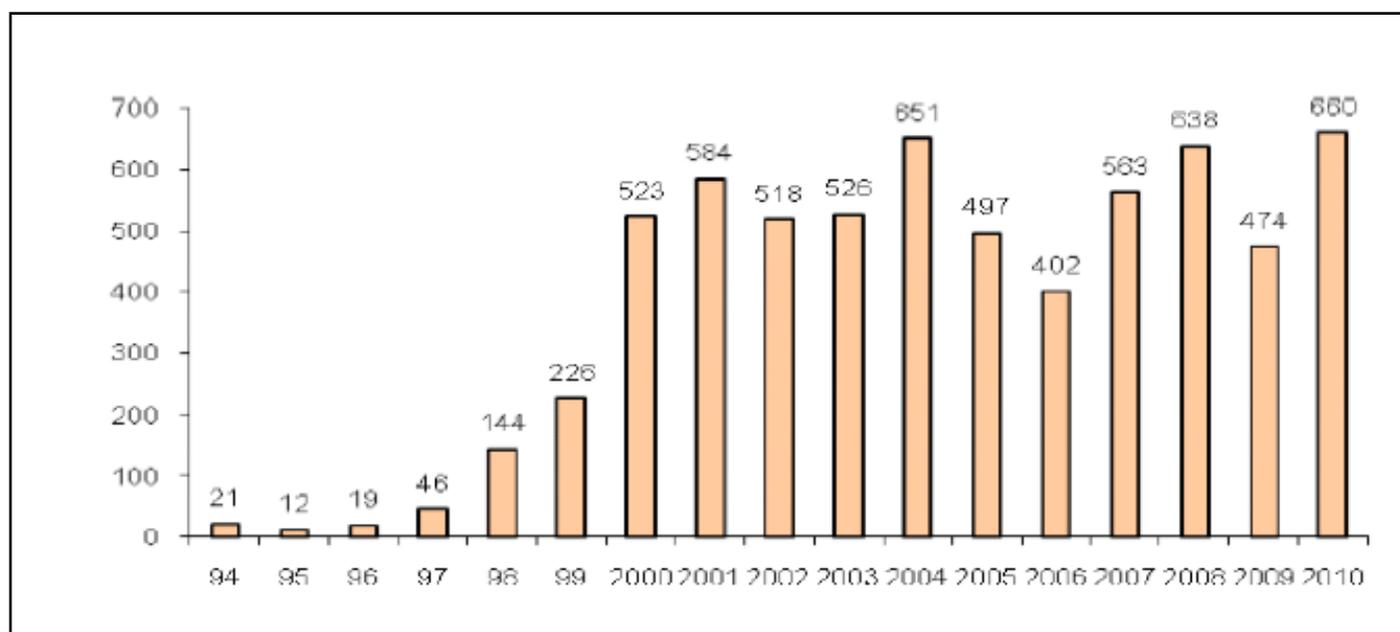
The 1994 Law introduced a more coherent structure to the post-merger control system established in 1991. Article 54 of the law provided that any act that could limit or otherwise restrain competition must be submitted to CADE for review. Under §3 of Article 54, the acts for which this submission was required included transactions aimed at any form of economic concentration which caused any participating company or group of companies to achieve 20 percent of market share of a relevant market, or in which any of the participants has posted annual gross revenues equivalent to at least BRL \$400,000,000.00.

The 1994 law was amended three times: in 1999, to create a merger filing fee; in 2000 to empower the SDE with dawn raid powers and the ability to execute leniency agreements with wrongdoers in exchange of

confession and cooperation; and in 2007 to allow settlement of cartel investigations.

From 1994 to 2003, the Brazilian competition authorities focused primarily on merger reviews, and substantial resources were devoted to reviewing competitively innocuous mergers. The post-merger review system proved to be very inefficient: CADE reviewed around 8,000 transactions, and in only a few instances decided to block them—there were a small handful of other cases in which remedies were imposed in order for the transaction to be approved.²⁰

Mergers reviewed by CADE (1994-2010)²¹



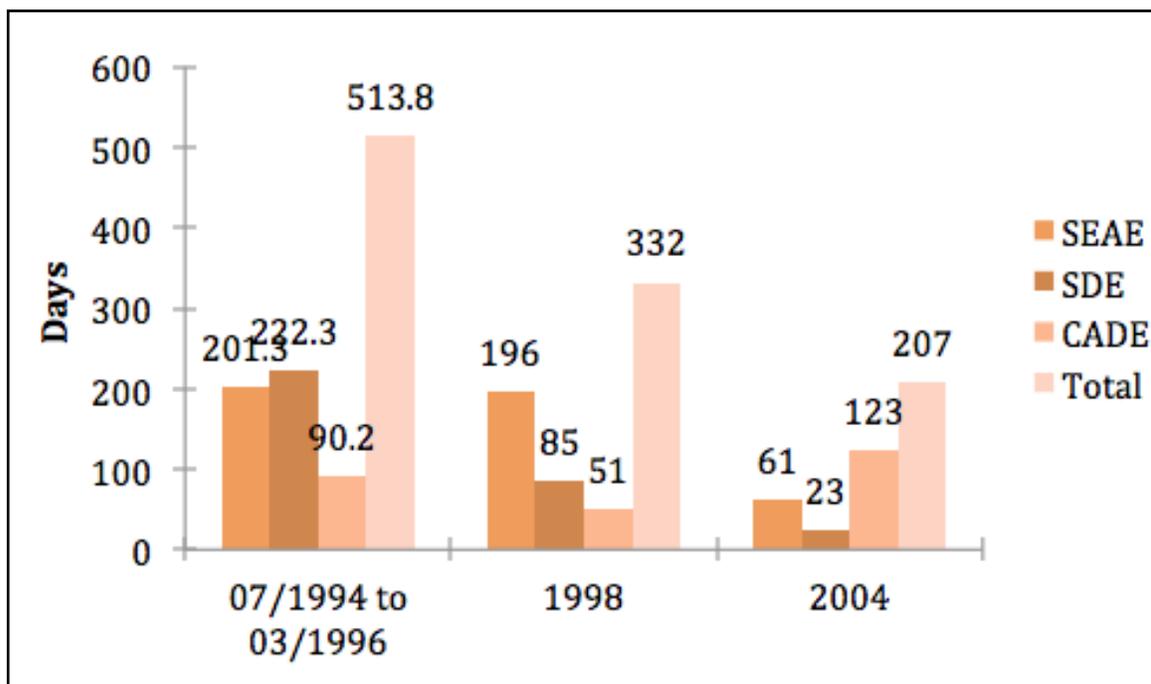
Remedies and Transactions blocked by CADE (1994-2010)²²

	94	95	96	97	98	99	00	01	02	03	04	05	06	07	08	09	10
Remedies	2	4	8	8	4	7	17	12	9	8	43	37	16	37	58	19	27
Transactions blocked	2	0	0	0	0	0	2	0	0	0	1	0	0	0	1	1	1

Regarding the timeframe for the review of filed transactions, under Law No. 8,884/94, SEAE had 30 days in which to issue an opinion about the transaction, which was then forwarded to SDE. Upon receipt of SEAE's opinion, SDE also had 30 days to issue its own opinion. Both opinions were then forwarded to CADE, which in turn had to issue its decision in 60 days. The law also required that CADE's attorney general issue an opinion within 20 days, which the reporting commissioner could or could not take into account in preparing his/her own opinion.

Notwithstanding the 120-day review period established by the law, the Brazilian merger review system was, on average, not completed within 120 days.²³ From July 1994 to March 1996, the average review period for a transaction was 514 days. This number was reduced to 332 days in 1998 and to 207 days in 2004 as a consequence of a number of measures adopted by the agencies to deal with the institutional challenges of the system.

Average period of time for merger reviews (1994 – 2004)



Source: From July 1994 to March 1996, CADE’s 1996 annual report; 1998, CADE’s 1998 annual report, and 2004, CADE, SDE, and SEAE’s 2004 annual report.

In the absence of a more rational legal framework, merger review had to be improved through infra-legal measures such as the: (i) adoption of a simplified filing form in 1996 and in 1998;²⁴ (ii) introduction of a “fast track” procedure for simple cases²⁵ and cooperation agreements among SDE, SEAE, and CADE’s legal services, reducing overlapping functions;²⁶ (iii) provision of consent decrees (Medida Cautelar) or agreements with the parties (Acordo para Presevar a Reversibilidade da Operação or APRO) that prevented complex transactions from being closed prior to CADE adjudicating the case;²⁷ and (iv) ability of CADE to issue binding interpretations of law with the purpose of ensuring legal certainty regarding the notification thresholds (Súmulas).²⁸

Starting from 2003, as a result of reducing overlapping functions between SDE and SEAE, SDE started to dedicate its resources to the fight against cartels and to use the enhanced investigative tools granted by the Brazilian Congress in 2000 (mainly dawn raids and leniency). With direct evidence being available in the cases to be adjudicated, CADE began imposing record fines (up to 25 percent of the company’s gross turnover in the year preceding the initiation of the investigation, doubled for recidivism) on companies and executives were found liable for anticompetitive conduct.

Brazil's competition authorities' strategy of focusing available resources on cracking cartels proved successful and there was an increasing number of investigations of anticompetitive practices, as well as dawn raids. There were also a growing number of applicants to the leniency program. More than 30 leniency agreements have been signed since 2003, and more than 300 search-and-seizure warrants have been served since then to obtain evidence of illegal conduct. Well-known international cases, such as air cargo, marine hose, compressors, and CRT, were initiated in Brazil through leniency applications filed before the SDE. As a result of such prioritization, Brazil's anti-cartel program became widely respected both in Brazil and abroad.²⁹

Brazil's settlement program, later introduced in 2007, represented a remarkable improvement as early cooperation on the part of the defendants saved public resources, cut down litigation, enabled early payment of a significant sum of money, and provided expedited treatment and more certainty and transparency to the business community. Settling also proved beneficial for the defendant, as it often meant a more efficient use of resources on the part of the company. Over 30 settlements have been executed by CADE since 2007, approximately 15 of which were in connection with cartel investigations.

Fines imposed by CADE for anticompetitive conduct /Investigations settled with CADE (1994-2011)

Case	Initiation of the Investigation –Adjudication	Fines (U.S.\$)	% of the Total Turnover
Beer (abuse of power)	2003-2010	170 million	2%
Industrial Gases	2003-2010	1.3 billion	25% (50%)
Steel Bars	1996-2005	210 million	7%
Crushed Rock	2002-2005	45 million	15-20%
Flat Steel	1996-1999	38 million	1%
Security Services	2003-2007	25 million	15-20%
Vitamins	1999-2007	10 million	20%
Sand Extractors	2006-2008	1.35 million	10-22.5%

Case	Initiation of the Investigation –Settlement	Settlement (U.S.\$)
IT Services	2005-2011	20 million
Compressors	2009-2009	60 million
Plastics Bags	2006-2008	15 million
Cement	2006-2007	19 million
Compressors	2009-2009	50 million
Marine Hose	2007-2008, 2009 and 2011	10 million

Enforcement records under the 1994 law showed that, as a policy matter, enforcers were determined to impose stiffer sentences against anticompetitive conduct that targeted Brazilian businesses and consumers. Further progress, however, depended on broad legislative reform.

In order to change the institutional framework in a way that was consistent with the ever-increasing challenges in enforcement, antitrust authorities proposed a fairly bold overhaul of the 1994 regime. The reform aimed to increase efficiency and bring greater rationality to competition enforcement in Brazil. In essence, the proposed changes consisted of:

1. restructuring the system by creating a single competition agency to enable the government to eliminate existing overlaps among agencies;
2. adopting a pre-merger review system and incorporating appropriate standards of materiality as to the level of the “local nexus” required for merger filing;
3. introducing sanctions and other specific provisions addressing anticompetitive conduct investigations, including amendments to the leniency program and criminal sanctions; and
4. enhancing human resources for the new agency.

The bill, which was aligned with the recommendations issued by the OECD in its 2005 and 2010 Peer Reviews of Brazil’s competition law and policy, went through intense legislative discussions after 2000 and was finally approved by Congress in November 2011.

IV. THE WAY FORWARD: BRAZIL’S NEW COMPETITION LAW

A. Creation of a Single Competition Agency

The new law, which entered into force in May 2012, consolidated the investigative, prosecutorial, and adjudicative functions of the Brazilian competition authorities into one autonomous agency. CADE was restructured to include: (i) an administrative Tribunal composed of six commissioners and a chairman, responsible for adjudicating merger and antitrust cases; (ii) a Directorate General for Competition (“DG”—*Superintendência-Geral*), responsible for conducting antitrust investigations and reviewing merger cases; and (iii) an Economics Department, responsible for providing economic support both for the Tribunal and the DG. All CADE’s decisions are subject to review by non-specialized judicial courts—either *de novo* review or deferential to fact-finding.

BRAZIL’S SETTLEMENT PROGRAM, LATER INTRODUCED IN 2007, REPRESENTED A REMARKABLE IMPROVEMENT AS EARLY COOPERATION ON THE PART OF THE DEFENDANTS SAVED PUBLIC RESOURCES, CUT DOWN LITIGATION, ENABLED EARLY PAYMENT OF A SIGNIFICANT SUM OF MONEY, AND PROVIDED EXPEDITED TREATMENT AND MORE CERTAINTY AND TRANSPARENCY TO THE BUSINESS COMMUNITY

The DG, appointed by the President of the Republic and confirmed by Congress for a two-year term, performs the former functions of SDE's Antitrust Division and SEAE, combining the roles of an investigator and a prosecutor. The main goal creating the bifurcated agency structure was to preserve independence of the decision-making body, although some argue that this did not eliminate a certain "confirmation bias" due to the close relationship existing between the DG and CADE's Tribunal officials.

The bifurcation of prosecutorial and adjudicative roles within the administrative system, although helpful from a due process and procedural fairness point of view, is still associated with a heavy toll on efficiency and productivity, with the average length of antitrust investigations being much more significant when compared to systems like the United States or the European Union.

SEAE continues to exist but deals exclusively with "competition advocacy" before the Brazilian regulatory agencies and other governmental bodies. It is particularly relevant that this function continues to be performed by SEAE, since its position as part of the powerful Ministry of Finance affords it access to many other government bodies. Now divested of its other responsibilities, it may be in a better stance to promote competition standards within government.

THE NEW LAW, WHICH ENTERED INTO FORCE IN MAY 2012, CONSOLIDATED THE INVESTIGATIVE, PROSECUTORIAL, AND ADJUDICATIVE FUNCTIONS OF THE BRAZILIAN COMPETITION AUTHORITIES INTO ONE AUTONOMOUS AGENCY

The fact that the antitrust investigative agencies were within the Ministry of Justice and Finance in the early days of competition enforcement in Brazil played a very important role in disseminating the concept of competition within the government and strengthening the role of CADE, the then competition tribunal. An important lesson can be learned from the Brazilian experience: Policy makers should be careful when creating independent competition agencies at the beginning of establishing a competition regime—if the country has no competition culture, it is likely that the agency will lack power and resources to enforce the competition law and will be left excluded (what we refer to as being the "perils of insulation").

Also, the fact that the primary investigative agency for anticompetitive behavior was within the Ministry of Justice allowed for a more comprehensive platform for cooperation with the criminal authorities, as the Federal Police was also within the structure of the Ministry of Justice. This is not to say that cooperation cannot take place under the new framework, but it certainly requires an added effort on the part of the DG.

As for CADE, under the 1994 law, as previously discussed, its chairman and commissioners were appointed by the President of the Republic and approved by Congress for terms of two years, which could be renewed once. Under the new law, this was changed to a single term of four years, with staggered terms to avoid simultaneous vacancies and the possibility that a quorum could not be convened. The reasoning behind the change was to avoid pressures on commissioners who would still be eligible for reappointment—which could affect their ability to vote on cases—and also to reduce the relatively high turnover rate.

Finally, the use of economic analysis in Brazil has grown dramatically in competition matters over

recent years and is expected to play a major part in every important abuse of dominance and merger case under the new regime. The creation by the 2011 law of an Economics Department within CADE is certainly a watershed event in that respect.

B. Merger Control

After almost 25 years of a post-merger review system being in place in Brazil, the new law introduced a mandatory pre-merger notification system.³¹

The maximum period to conduct the merger review is 330 calendar days from the day of filing or from the date CADE considers the filing to be complete. Simple cases can be cleared solely by the DG without the need for being reviewed by the Tribunal. The few complex cases that require the adoption of remedies to address antitrust concerns, or transactions that have to be blocked, necessarily need to be reviewed by CADE's Tribunal.³² This rearrangement of roles between the prosecutorial and adjudicative agency has brought more efficiency to Brazil's competition system and freed-up resources of the Tribunal to focus on the review of complex cases.

THIS ARGUES THAT THE BRAZILIAN EXPERIENCE OF TRANSITIONING TO A FULL-BLOWN EX-ANTE MERGER CONTROL ONLY AFTER THE ECOSYSTEM WAS MATURE AND PROPERLY RESOURCED MAY SERVE AS AN INSPIRATION TO OTHER DEVELOPING ECONOMIES

In 2013, the average review period for simple case was 25 calendar days,³³ aligned with international best practices. This argues that the Brazilian experience of transitioning to a full-blown *ex-ante* merger control only after the ecosystem was mature and properly resourced may serve as an inspiration to other developing economies.

Regarding the criteria for the substantive merger review, the new law follows the same lines of Law No. 8.884/94, and the 1994-2012 CADE case law generally governs CADE's decisions under the new system.

C. Prosecution of Anticompetitive Behavior

Article 36 of Brazil's new competition law deals with all types of anticompetitive conduct other than mergers.

POLICY MAKERS SHOULD BE CAREFUL WHEN CREATING INDEPENDENT COMPETITION AGENCIES AT THE BEGINNING OF ESTABLISHING A COMPETITION REGIME—IF THE COUNTRY HAS NO COMPETITION CULTURE, IT IS LIKELY THAT THE AGENCY WILL LACK POWER AND RESOURCES TO ENFORCE THE COMPETITION LAW AND WILL BE LEFT EXCLUDED

The statute did not change the definition or the types of anticompetitive conducts that could be prosecuted in Brazil under the previous law. The law prohibits acts "that have as object or effect" to (i) limit, restrain, or in any way cause injury to open competition or free enterprise; (ii) control a relevant market of a certain good or service; (iii) increase profits on a discretionary basis; or (iv) engage in market abuse. Article 36, §30 contains a lengthy but not exclusive list of acts that may be considered antitrust violations provided they have as an object, or produce, the above-mentioned effects. The listed practices

include various types of horizontal and vertical agreements and unilateral abuses of market power.

The table below provides a summary of the main changes introduced by the new competition law regarding sanctions:

Main changes introduced by the new competition law regarding sanctions

Law No. 12,529/11	Law No. 8,884/94
Corporate fines	
Fines range between 0.1 and 20 percent of the company's or group of companies' pre-tax turnover in the sector of activity affected by the conduct in the year prior to the beginning of the investigation, but should be no less than the amount of the unlawful gain from the conduct. CADE may resort to the total turnover whenever information on revenue derived from the relevant "sector of activity" is unavailable or not reliable.	Fines range between 1 and 30 percent of the company's pre-tax total turnover in the year prior to the beginning of the investigation, but should be no less than the amount of the unlawful gain from the conduct (i.e., the fine is to be calculated as a percentage of the defendant's total revenues, not just those that derives from the affected or relevant market).
Directors and Officers Fines	
Directors and Executives of companies in violation may be fined between 1 and 20 percent of their company's fine.	Directors and Executives of companies in violation may be fined between 10 and 50 percent of their company's fine.
CADE needs to establish fault or negligence on the part of the directors and executives.	No need to prove fault or negligence.
Other Individuals and Non-profit Entities	
Other individuals; public or private legal entities; as well as any association of persons or <i>de facto</i> or <i>de jure</i> legal entities, legally incorporated or not, which do not perform business activities, may be fined between BRL 50,000.00 (fifty thousand reais) to BRL 2,000,000,000.00 (two billion reais) .	Other individuals; public or private legal entities; as well as any association of persons or <i>de facto</i> or <i>de jure</i> legal entities, legally incorporated or not, which do not perform business activities, may be fined between BRL 6,000.00 (six thousand reais) to BRL 6,000,000.00 (six million reais) .
Other sanctions that may be imposed to Companies (the previous and the current competition laws contain similar provisions)	
Corporate spin-off, transfer of control, sale of assets, or any measure deemed necessary to cease the detrimental effects associated with the wrongful conduct.	
Publication of the decision in a major newspaper at the wrongdoer's expense.	
Prohibition of the wrongdoer from participating in public procurement procedures and obtaining funds from public financial institutions for up to five years.	
Inclusion of the wrongdoer's name in the Brazilian Consumer Protection List.	
Recommendation to the tax authorities to block the wrongdoer from obtaining tax benefits.	
Recommendation to IP authorities to grant compulsory licenses of patents held by the wrongdoer.	

The new law also modified Brazil's Leniency Program.³⁴ The 2000 rule that leniency was not available to a "leader" of the cartel was eliminated. The elimination of the disqualification of the "leader" as an applicant in the law does not necessarily mean that the authority will disregard the role played by a cartel participant in determining whether to grant leniency or not—Article 86 of Law No. 12,529/2011 provides that the authority *may* grant leniency if the program requirements are fulfilled. Therefore, the authority is no longer required to address arguments that a leniency applicant must be disqualified for having been a leader in a conspiracy, but this will most likely not be followed by policy changes resulting in immunity from sanctions independent of the role played by each party. Further, a grant of leniency currently extends to criminal liability under the Federal Economic Crimes Law but not to other possible crimes under other criminal statutes, such as fraud in public procurement. The new law broadens the leniency grant to extend to those crimes as well.

Law No. 12,529/2011 also introduced changes to the criminal sanctions applicable to anticompetitive conduct. The previous provision of the Federal Economic Crimes Law set forth jail terms of 2-5 years *or* the payment of a criminal fine. The new law amended that provision and established that anticompetitive behavior may be punished with a jail term of 2-5 years *plus* the payment of a criminal fine. Criminal prosecution continues to be solely against individuals, and State and Federal-level prosecutors are the ones in charge of prosecuting the conduct.

Finally, as for procedure, both the previous law and the current law grant court-like due process protections. In the balance between agency effectiveness and rights of defense, the law opted for the latter, aligned with provisions of Brazil's constitution.

D. Increased Agency Staffing

An important element in the new law is the provision for 200 permanent positions in CADE. These positions would not require candidates to be specialists in antitrust regulation but, rather, the new staff would be drawn from other specialties in the federal civil service. Until 2012, the most serious problem confronting Brazil's competition authorities has been its lack of resources, compounded by a high rate of employee turnover which adversely affects its institutional memory. The agencies have been chronically understaffed, leading to a large backlog of investigations. To date, CADE has hired around 50 officials out of the 200 that have been provided for under the new law.

V. CONCLUSION

Although institutional design is more of an art than a science, a healthy predisposal to constantly learn, measure, and evaluate data and outputs is paramount to assure institutional dynamism. "Reforming" needs to be a constant exercise, and, indeed, striving after an effective institutional design has been a constant challenge for Brazil's competition system during the past 25 years.

IN THE BALANCE BETWEEN AGENCY EFFECTIVENESS AND RIGHTS OF DEFENSE, THE LAW OPTED FOR THE LATTER, ALIGNED WITH PROVISIONS OF BRAZIL'S CONSTITUTION

THE MAIN CHALLENGE NOW IS TO ENSURE THAT THE JUDICIAL REVIEW OF ITS DECISIONS WILL NOT UNDERMINE WHAT HAS BEEN ACCOMPLISHED AT THE AGENCY LEVEL.

The regime in place today was built upon the experience accumulated during this time, and resulted in the implementation of a bifurcated agency/tribunal model: The DG is appointed for a two-year term, which can be renewed once and, at the tribunal level, commissioners serve a single term of four years, with staggered terms to avoid simultaneous vacancies and the possibility that a quorum can not be convened. This system, although helpful from a due process and procedural fairness point of view, can come associated with a heavy toll on efficiency and productivity. The legislators' decision that an independent agency would be in charge of enforcement, while SEAE's role would be limited to competition advocacy, had, as its purpose, reducing the risk of political intervention.

That is not to say that the previous system did not prove to be beneficial to promoting competition enforcement in Brazil. Quite to the contrary—the fact that the antitrust investigative agencies were within the Ministry of Justice and Finance in Brazil's early days of competition enforcement played a very important role in disseminating the concept of competition within the government and strengthening CADE's role.

An important lesson can be learned from the Brazilian experience: Policy makers should be careful when initially creating independent competition agencies—if the country has no competition culture, it is likely that the agency will lack power and resources to enforce the competition law and will be left excluded; what we have referred to throughout the text as being the “perils of insulation.” In other words, independency might well be a double-edged sword.

CADE now seems to have all it needs to have an effective competition system: a mature system with broad investigative powers; a sufficient budget; and increased staffing, as provided for under the new law. The main challenge now is to ensure that the judicial review of its decisions will not undermine what has been accomplished at the agency level. ▲

¹ Ana Paula Martinez is a partner in Levy & Salomão Advogados. She was the Head of the Antitrust Division of the Secretariat of Economic Law from 2007 to 2010, and co-headed the cartel sub-group of the ICN with the U.S. Department of Justice. Before entering the government, Ms. Martinez was an associate with Cleary Gottlieb Steen and Hamilton LLP. She is licensed to practice law in Brazil and New York and served as an antitrust advisor to UNCTAD, the World Bank, and to the Government of Colombia. Ms. Martinez holds a Master of Laws from both the University of São Paulo and Harvard University and is a Ph.D. in Criminal Law. She is also a Law Professor at the Graduate Program of Fundação Getúlio Vargas—RJ. Mariana Tavares de Araujo is a partner with Levy & Salomão Advogados. Prior to joining the firm, Ms. Araujo worked with the Brazilian government for nine years, four of which she served as head of the government agency in charge of antitrust enforcement and consumer protection policy. Before joining government, she was the General Counsel of a biotech firm in Brazil. Besides advising private parties, Ms. Araujo provides counseling in competition-related matters for the World Bank and is currently a non-governmental advisor to the ICN. She is also a Law Professor at the Graduate Program of Fundação Getúlio

² See OECD, *Procedural Fairness and Transparency* (2012), http://www.oecd.org/document/20/0,3746,en_2649_37463_50235668_1_1_1_37463,00.html, for a summary of OECD's three roundtable discussions on transparency and procedural fairness held during 2010 and 2011. See also Christine A. Varney, former Assistant Attorney General, U.S. Dep't of Justice, *Coordinated Remedies: Convergence, Cooperation, and the Role of Transparency* (February 15, 2010), <http://www.justice.gov/atr/public/speeches/255189.htm>. See also Rachel Brandenburger, Special Advisor, International Antitrust Division, US Dep't of Justice, *International Competition Policy and Practice: New Perspectives?*, King's College, London (October 29, 2010), <http://www.justice.gov/atr/public/speeches/70980.htm>.

³ See, e.g., William E. Kovacic, *Rating the Competition Agencies: What Constitutes Good Performance?*, 16 GEO.MASON L. REV. 903 (2009); William E. Kovacic, *Getting Started: Creating New Competition Policy Institutions in Transition Economies*, 23 BROOK J. INT'L L. 403 (1997). Also see Eleanor M. Fox & Michael J. Trebilcock, *The Design of Competition Law Institutions and the Global Convergence of Process Norms: The GAL Competition Project*, New York University Law and Economics Working Papers. Paper 304 (2012), available at http://lsr.nellco.org/nyu_lewp/304.

⁴ A copy of the law is available at http://www.planalto.gov.br/ccivil_03/decreto-lei/1937-1946/Del0431.htm.

⁵ A copy of the law is available at <http://legislacao.planalto.gov.br/legisla/legislacao.nsf/vivTodos/64751179347B52E3032569FA005E374F?Opendocument>.

⁶ A copy of the law is available at http://www.planalto.gov.br/ccivil_03/decreto-lei/Del7666.htm.

⁷ There was also alleged political pressure from the United States to revoke Brazil's Law No. 766/1945, as the law was perceived as being based on nationalism protectionism. See Letter No. 26, dated June 27, 1945, from Brazilian Ambassador based in Washington to the Brazilian President. See Luiz Carlos Delorme Prado, *Infrações da Ordem Econômica e legislação de defesa da concorrência no Brasil: uma perspectiva histórica*, Farina: Laércio (org.) A NOVA LEI DO CADE. Ribeirão Preto: Migalhas 96-122, p. 102 (2012). See also DARCY RIBEIRO, AOS TRANCOS E BARRANCOS: COMO O BRASIL DEU NO QUE DEU, RIO DE JANEIRO: GUANABARA DOIS (1986): "Getúlio issued the antitrust law, which prompted a major reaction from the representatives of foreign companies. Otávio Mangabeira has even requested the Army's intervention against the enforcement of the Malaia Law, named after the Minister of Justice Agamenon Magalhães, due to its physical characteristics. The Malaia Law was envisioned to fight the acts against the economic and moral order. The morality aspect has not moved anyone, but the protection of the economy—inspired by the US legislation—has prompted a negative reaction especially on the part of the foreign companies, which were not willing to accept a government control as the one which existed abroad."

Agamenon Magalhães presented draft law No. 122/48 to the House in March 1948 stating that "so that the Brazilian State could be empowered, it has to be above any economic power." Agamenon's son later resubmitted the draft under No.3 in 1955. In 1961, the then President of the Republic, Jânio Quadros, defended the existence of a criminal system, where decision-making powers were restricted to the criminal courts. Under his proposal, individuals were subject to jail time from 1-5 years and convicted foreigners could be expelled from Brazil. Congress rejected President Quadros' proposal and passed the draft law that provided for the existence of an administrative system.

⁹ A copy of the law is available at http://www.planalto.gov.br/ccivil_03/leis/1950-1969/L4137impressao.htm.

¹⁰ See Congress' Official Journal, 2.444 (Abril 16, 1948).

¹¹ The agency started its activities in Rio de Janeiro as Brasília was still under reforms to become the capital of Brazil.

¹² They could be reappointed for one additional term, under CADE's Internal Rules, issued on March 9, 1964. See http://www.planalto.gov.br/ccivil_03/decreto/Antigos/D53670.htm.

¹³ Brazil is well-known for having adopted, since the 30's, an import substitution industrialization ("ISI") policy, which is a trade and economic policy that advocates replacing foreign imports with domestic production.

¹⁴ On August 29, 1938, Brazil created the so-called "Comissão Interministerial de Preços" (Interministerial Pricing Commission), a body composed of representatives of different Ministries to regulate prices. Price regulation was abolished in Brazil in the mid-90's.

¹⁵ See CADE's 1996 Annual Report. Brasília: Official Press (1997).

¹⁶ *Id.*

¹⁷ A copy of the law is *available at* http://www.planalto.gov.br/ccivil_03/leis/l8884.htm.

¹⁸ The agency was associated with the Ministry of Justice solely for budgetary purposes.

¹⁹ The OECD, in its 2000 review of Brazil's Competition Law and Policy, concluded that the term was too short, resulting in rapid turnover in the agency. See OECD, *Competition policy and regulatory reform in Brazil* (2000), Paris: OECD press, *available at* http://www.cade.gov.br/internacional/OECD_2000_Report.pdf.

²⁰ The blocked transactions were: the proposed joint venture between asbestos producers Brasilit/Eternit (Case No. 06/94, adjudicated in 1996); the proposed joint venture Brasil-Álcool/Bolsa Brasileira do Álcool among alcohol producers with the goal of serving as a joint selling agency for all output of the members (Case No. 08012.002315/99-50, and Case No. 08012.004117/99-67, adjudicated in 2000); and the merger between chocolate makers Nestlé/Garoto (Case No. 08012.001697/2002-89, adjudicated in 2004, in which CADE ruled that the transaction had to be unwound, notwithstanding the fact that the transaction had closed two years earlier. The decision is now being challenged in Brazil's judicial courts). Only in cases involving high concentrations in the Brazilian market and a lack of efficiencies resulting from the transaction has CADE imposed restrictions in order to approve the transaction (e.g., Case No. 12/94, Rhodia/Sinasa; Case No. 27/94, Kolynos/Colgate-Palmolive; Case No. 16/94, Siderúrgica Laisa/Grupo Korf GmbH, "Gerda Case"; Case No. 58/95, Brahma/Miller; Case No. 83/96, Antartica/Anheuser Bush). According to the OECD & Inter-American Development Bank, *Competition Law and Policy in Brazil: A Peer Review*, at 31 (2005), although CADE has imposed conditions on approximately 3.4 percent of transactions for the period 2000/2005, structural requirements directing the sale or utilization of assets were imposed only in four cases.

²¹ Table extracted from Ana Paula Martinez, *An Overview of Merger Review in Brazil and Upcoming Challenges*, TEMAS ATUAIS DE DIREITO DA CONCORRÊNCIA, Singular: São Paulo (2012). 2011 data not available in 2011 CADE's Annual Report.

²² *Id.*

²³ All deadlines provided for in the Law were interrupted whenever any of the agencies requested additional information, either from the companies involved in the transaction or from third parties.

²⁴ On August 28, 1996, CADE issued Resolution No. 5, which reduced the number of items on the filing form. Such resolution was primarily responsible for the 66 percent decrease in the time consumed by

merger reviews after the issuance of Resolution No. 5 (the average review period in CADE was reduced from an average of 604 days pre-Resolution No. 5 to 204 days in December 1997 (source: 1998 CADE's annual report). Shortly thereafter, on August 19, 1998, CADE issued Resolution No. 15 (this resolution revoked Resolution No. 5/96 and was then known as "Super 5"), which reduced the number of the items on the filing form from eighty-five to fifty. Although the aim of reducing the merger review process from 7 months to 2.4 months in one year was not achieved, it is undeniable that Resolution No. 15/98 contributed to a decrease in the time consumed by the merger review process.

²⁵ The first measure was the issuance by CADE of Resolution No. 8 of April 27, 1997, pursuant to which CADE's Commissioners could prepare simplified reports in cases in which the SEAE, SDE, and CADE attorney-general opinions were all favorable, permitting summary judgment of a case. Another important step toward expediting merger reviews in Brazil occurred in February 2002 when the SEAE and SDE issued a joint note, providing that simple cases incapable of causing changes to the existing competition environment could be reviewed by means of a simplified procedure, subject to the sole discretion of the Secretariats. This procedure was memorialized by SEAE and SDE Joint Resolution No. 01/2003, as amended by Joint Resolution No. 8/2004, which reduced to fifteen days the time within which SDE and SEAE had to issue their respective opinions.

²⁶ The first one was executed in 2006 and a more comprehensive version was later adopted in 2009.

²⁷ This proved to be insufficient to deal with the scrambled-eggs dilemma of a non-suspensory system. In this regard, CADE's final decision in the Nestlé-Garoto transaction (Merger Case No. 08012.001697/2002-89) in 2004 requires mention. CADE ruled that the transaction had to be unwound within 150 days, notwithstanding the fact that the transaction had closed two years earlier. The decision is now under the analysis of the Judiciary.

²⁸ The Anglo-American concept of binding judicial precedent (i.e., *stare decisis*) is virtually non-existent in Brazil, which means that CADE's commissioners are under no obligation to follow past decisions in future cases. CADE's internal rules were amended to allow CADE to codify a given statement via the issuance of a binding statement (legal certainty is only achieved if CADE rules in the same way at least 10 times).

²⁹ According to the OECD 2010 *Competition Law and Policy in Brazil – A Peer Review*, "Brazil's anti-cartel programme is now widely respected in Brazil and abroad" and "[i]n a few short years Brazil has developed a programme for criminally prosecuting cartels that places it as one of the most active of all countries in this area." Similarly, the 2008 and 2009 "Rating Enforcement" published by the *Global Competition Review* states, respectively, that "Brazil has the fastest-growing cartel enforcers in the world" and that "[t]here were some notable achievements in the SDE's cartel busting programme in 2009, in terms of both results and procedure." Along the same lines, Thomas O. Barnett, while Assistant Attorney General of the U.S. Department of Justice Antitrust Division, acknowledged "the great progress achieved on this front in Brazil." (See Thomas O Barnett, *Perspectives on Cartel Enforcement in the United States and Brazil*, BRASILIA (April 2008)). As a result of such improvements, Brazil has shifted from exclusively being a recipient of technical assistance—and in this respect, it is worth noting the assistance received from the U.S. authorities during the late 1990s and early 2000s—to being a provider of technical assistance to countries interested in improving their anti-cartel programs, such as Chile and Argentina.

³⁰ One of the defendants had its fine doubled for recidivism.

³¹ Law No. 12,529/2011 provides for minimum-size thresholds, expressed in total revenues derived in

Brazil, for two merging parties. The 20 percent market share test in the 1994 law was eliminated in the new law, following international best practices which recommend that notification thresholds should be clear and understandable, based on objectively quantifiable criteria. The law also introduced a claw back provision that allows CADE to review transactions that fall outside the merger thresholds within one year of their closing. Fines for “gun jumping” range from BRL 60,000 to BRL 60 million. Violations can occur even if the parties to the transaction do not compete in the same markets. In cases involving competitors, coordination of competitive activities or detailed information exchanges can also lead to a cartel violation, subjecting the parties to fines from 0.1 percent to 20 percent of a company’s (group of companies’ or conglomerate’s) gross revenues generated in the “sector of activity” affected by the infringement in the year prior to the initiation of the investigation.

³² For complex cases, the law allows the Reporting Commissioner to authorize the parties to close the transaction before receiving CADE’s clearance, subject to conditions such as the limitations on the freedom of the acquirer to liquidate assets, integrate activities, dismiss workers, close stores or plants, terminate brands or product lines, and alter marketing plans.

³³ See CADE’s website, www.cade.gov.br.

³⁴ Brazil has a Leniency Program that follows the general lines of the U.S. Program and adopts a winner-takes-all approach. It has the following general features: (i) full or partial immunity from administrative sanctions for the first company and/or individual to apply for a leniency agreement; (ii) immunity from criminal sanctions, provided that the individual(s) sign the agreement along with the company; (iii) full confidentiality of the application; (iv) requirement for immediate cessation of the applicant’s involvement in the alleged or investigated violation; and (v) the applicant must effectively and permanently cooperate with the investigation. Full or partial administrative immunity for companies and individuals depends on whether the DG was previously aware of the illegal conduct at issue. If the DG was unaware, the party may be entitled to a waiver from any penalties. If the DG was previously aware, the applicable penalty can be reduced by one- to two-thirds, depending on the effectiveness of the cooperation and the “good faith” of the party in complying with the leniency agreement. In the leniency agreement, the DG states whether it was previously aware of the conduct and makes a recommendation to CADE, which will recognize the benefits while adjudicating the case.

Competition Commission of India: Institutional Design and Decision Making

BY CYRIL SHROFF & NISHA KAUR UBEROI¹

Over the last few decades, an increasing number of countries have taken legislative measures coupled with effective enforcement initiatives to foster competition. In India, the enactment of *The Competition Act, 2002*, the principal legislation governing competition law in India, along with the establishment of the Competition Commission of India as its chief enforcement authority was one of the biggest transformations witnessed by the Indian regulatory space in the recent times. In this article we note how competition law and enforcement has evolved and brought India a step closer to unification with mature antitrust jurisdictions. We also argue that it is imperative that India continue to take lessons from global experiences in competition law enforcement to improve its effectiveness.

I. HISTORY AND BACKGROUND: COMPETITION LAW IN INDIA

Over the last few decades, an increasing number of countries, including India, have taken legislative measures coupled with effective enforcement initiatives to foster competition. The benefits of introducing competition into a market include significant price reductions, better product development, and innovation. The (Indian) Competition Act, 2002 (as amended) (“Act”), replaced the (Indian) Monopolies and Restrictive Trade Practices Act (“MRTP Act”), 1969, which contained provisions dealing with cartelization and unfair trade practices, but not merger control.

The enactment of the Act, the principal legislation governing competition law in India, along with the establishment of the Competition Commission of India (“CCI”) as its chief enforcement authority, was one of the biggest transformations witnessed by the Indian regulatory space in the recent times. The Act seeks to promote and sustain competition in markets, protect consumer interests, and ensure freedom of trade. The substantive test and benchmark for analysis under the Act is to prohibit practices that have an appreciable adverse effect on competition (“AAEC”) in India. While competition law and enforcement is an evolving field in India, the introduction of the Act was desirable since it brought India a step closer to unification with mature antitrust jurisdictions. However, it is imperative that India continue to take lessons from global experiences in competition law enforcement to improve its effectiveness.

IN THE WAKE OF LIBERALIZATION AND PRIVATIZATION, IN ORDER SUSTAIN AND PROMOTE COMPETITION IT HAD BECOME INCREASINGLY IMPORTANT FOR INDIA TO SHIFT ITS FOCUS FROM CURBING MONOPOLIES TO DEVELOPING A COMPREHENSIVE AND ROBUST COMPETITION POLICY

The Act was brought into force nearly a decade after its inception. In 1999,² the Government of India appointed a High Level Committee on Competition Policy and Competition Law (“Raghavan Committee”) to conceptualize a modern competition law for India, drawing from international trends and developments. In addition, the Committee was to recommend a legislative framework entailing a new law or appropriate

amendments to the then existing MRTP Act, given that the provisions of the MRTP Act had become obsolete in light of initiatives taken by the Government of India in 1991.³

In the wake of liberalization and privatization, in order sustain and promote competition it had become increasingly important for India to shift its focus from curbing monopolies to developing a comprehensive and robust competition policy. Further, the enactment of the Act was not only considered necessary, but also desirable, to better realize economic reforms, curb high levels of concentration (since wealth and assets were controlled by a small number of businesses), and promote good governance.

II. COMPETITION LAW FRAMEWORK

After undergoing several rounds of consultations with the relevant stakeholders, the Indian Parliament ultimately enacted the Act in December 2002. However, on account of legal impediments as well as skepticism and opposition among the business fraternity, the effective provisions of the Act only came into force in a phased manner, with provisions relation to anticompetitive agreements (Section 3) and abuse of dominance (Section 4) coming into effect on May 20, 2009 and merger control provisions (Sections 5 and 6) coming into effect on June 1, 2011.

Akin to other jurisdictions, competition law enforcement under the Act adopted a three-pronged approach:

(a) *Anticompetitive agreements*:⁴ The Act prohibits agreements which are anticompetitive in nature, i.e. agreements which cause or are likely to cause an AAEC in India. For instance, price-fixing, market sharing, output restriction, and cartels;

(b) *Abuse of Dominance*:⁵ The Act prohibits a dominant enterprise from abusing its dominant position in the market. For instance, predatory pricing, excessive pricing, unfair conditions in sale, tying, leveraging, denial of market access, and limiting production; and

(c) *Regulation of Combinations*:⁶ The Act regulates all acquisitions of an enterprise and mergers or amalgamations of two or more enterprises, where the asset or turnover thresholds prescribed under the Act are met (“Combinations”), to ensure that such Combinations do not cause an AAEC in the relevant market in India.

III. INSTITUTIONAL FRAMEWORK UNDER THE ACT

The Act provides for the establishment of the following enforcement agencies:

(a) the Office of the Director General (“DG”) is the investigative arm of the CCI and is authorized to investigate contraventions of the Act;

(b) the CCI is the nodal authority established under the Act; and

(c) the Competition Appellate Tribunal (“COMPAT”) is the appellate authority under the Act.

Appeals from decisions made by the CCI can be filed with the COMPAT within a period of 60 days from the date on which a copy of the order made by the CCI is received by the parties.⁷ Further appeals from the COMPAT lie with the Supreme Court of India, the apex court of the country, and such appeals need to be filed within 60 days from the date of communication of the COMPAT’s order.⁸

A. CCI and COMPAT

For the purposes of the Act, the Central Government established the CCI with effect from October 14, 2003. Under the scheme of the enactment, the CCI was established as a quasi-judicial body and has been conferred with all the powers of a corporate personality. The CCI comprises a Chairperson and six other members, who have specialist knowledge and professional experience in areas such as international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs, and competition matters and are appointed by the government on the recommendations of a selection committee.⁹ Further, each of the members supervises specialist cells such as the Investigation, Economic, Combination, Anti-trust, and Legal Divisions.

The merger notifications filed with the CCI are first scrutinized by case officers allotted to specific cases. Although the members of the CCI are approachable, and the CCI positions itself as a progressive regulator willing to engage with industry, as the competition regime has steadily gained ground the regulator has started taking strong views and positions and is pro-actively conducting market research, tracking M&A deals through deal announcements, and undertaking several *suo motu* investigations for cartelization.

UNDER THE ACT, THE CCI IS VESTED WITH “INQUISITORIAL, INVESTIGATIVE, REGULATORY, ADJUDICATORY AND TO A LIMITED EXTENT EVEN ADVISORY JURISDICTION.”

The CCI undertakes a quasi-judicial adjudicatory function in deciding whether or not any particular agreement, practice, or conduct is in violation of the substantive provisions of the Act, or whether a Combination notified to it under the merger control provisions is likely to cause an AAEC or not. Under the Act, the CCI is vested with “inquisitorial, investigative, regulatory, adjudicatory and to a limited extent even advisory jurisdiction.”¹⁰ The CCI is vested with powers of wide magnitude and can pass orders having serious outcomes, including modification of agreements, division of dominant enterprises, modification of Combinations, disapproving a particular Combination, and dealing with complaints or information filed. Moreover, the CCI can evolve its own procedure and is vested with powers akin to those of a civil court.¹¹

It is well-established that principles of natural justice must apply to quasi-judicial proceedings as well. However, in *SAIL*,¹² while deciding upon the question of whether the opposite party has a right to notice and

hearing when the CCI forms a *prima facie* opinion, the Supreme Court observed that based on larger public interest and compelling reasons, it can be stated there is no absolute proposition of law that the right to notice and hearing is a mandatory requirement under principles of natural justice. The Supreme Court further held that even though the CCI is required to conform to the principles of natural justice which have been enunciated by the courts, the scope of the duty of the CCI should not be rendered nugatory by imposition of “unnecessary directions or impediments which are not postulated in the plain language of the section itself.”

While examining the effect of the provisions with respect to the establishment and composition of the CCI, the Supreme Court in *Brahm Dutt*¹³ observed that the CCI is an expert body which has been created in consonance with international practice. The Supreme Court further stated that it might be appropriate “to consider the creation of two separate bodies, one with expertise that is advisory and regulatory and the other adjudicatory.” Accordingly, the COMPAT (i.e., the appellate body) was created by the Competition (Amendment) Act 2007 with a judge of the Supreme Court/ Chief Justice of a High Court as its Chairperson, and was established by the Central Government by notification dated May 15, 2009. It comprises a three-

IT IS PERTINENT TO NOTE THAT THE CCI, FOR ALL PRACTICAL PURPOSES, CONTINUES TO PERFORM BOTH FUNCTIONS, I.E. ADVISORY/ REGULATORY AND ADJUDICATORY

member panel headed by a retired representative of the judiciary.¹⁴ The functions of the COMPAT as envisaged under the Act are to hear and dispose of appeals against the directions of the CCI and to adjudicate on claims for compensation.¹⁵

The COMPAT embodied the concept of separation of power as envisaged by the Supreme Court in *Brahm Dutt*. However, it is pertinent to note that the CCI, for all practical purposes, continues to perform both functions, i.e. advisory/ regulatory and adjudicatory.

B. Office of the DG

The Act, for the purposes of investigation, provides for the establishment of a specialized wing of the CCI known as the DG; comprising the DG and Additional DGs. Under the scheme of the Act, the DG is required to assist the CCI in investigating any contravention of the provisions of the Act or its regulations.¹⁶ Based on the holding of the Supreme Court in *SAIL*,¹⁷ the purpose of the DG’s investigation is two-fold: (a) to collect material and verify information and thereafter submit a report based on its findings; and (b) to enable the CCI to examine the DG report and pass an order subsequent to hearing from the concerned parties.

IT IS PERTINENT TO NOTE THAT THE DG DOES NOT HAVE *SUO MOTO* POWERS FOR INITIATING INVESTIGATIONS UNDER THE ACT

The DG undertakes detailed time-bound investigations and provides a scheme of reference for such investigations after the CCI has taken cognizance of a matter and decided, without entering upon any adjudicatory or determinative process, that there is sufficient preliminary evidence to show a *prima facie* violation. Typically, the DG’s investigation includes written submissions, depositions, interviews, meetings with the party(s) who filed the information with the CCI, the opposite parties, and third-party stakeholders (such as competitors, suppliers, customers, etc). Pursuant to the investigation, the DG is required to submit a

report, containing its findings on each of the issues raised in the information, supported by all the evidence, analysis, documents, and statements collected during the course of the investigation.¹⁸

In contrast to the powers conferred to a police officer for conducting an investigation under the Code of Criminal Procedure, 1973 (“CrPC”), it is pertinent to note that the DG does not have *suo moto* powers for initiating investigations under the Act. In this regard, the Delhi High Court observed that:

an investigation by the DG, pursuant to the CCI forming an opinion that prima facie there exists a contravention of the provisions of the Act and directing investigation by the DG, cannot be treated at par with the investigation by a police officer into a cognizable offence... the Act gives no power, to carry out suo motu investigation to the DG, but as opposed to the CrPC, the Act envisages the application of the rule of audi alteram partem during the course of investigation by the DG.¹⁹

The Competition Amendment Bill, 2012 (“Amendment Bill”)²⁰ proposed providing the DG with search and seizure powers, similar to those provided under the CrPC. However, the Amendment Bill has now lapsed and it remains to be seen whether it will be re-tabled before the Indian Parliament. In the event that the changes proposed by the Amendment Bill are given effect, subsequent to obtaining proper authorization from the Chairperson of the CCI, the DG would be able to conduct dawn raids and investigations with ease. Although there have been no dawn raids thus far, the new powers of the DG, if conferred, will be actively used in conducting dawn raids for cartel investigations, creating a fear of quicker detection among cartel members.

It is useful to note that the Supreme Court²¹ has distinguished between the concepts of “inquiry” and “investigation” provided under the Act. “Inquiry” commences when the CCI, in exercise of its powers, issues a direction to the DG. The DG is thereafter expected to conduct an “investigation” in accordance with the directives of the CCI. “Inquiry” continues with the submission of the report by the DG until the time the CCI passes its final order in accordance with the law. Thus, while the term “inquiry” encompasses the overall inquisitorial and adjudicatory function undertaken by the CCI, the “investigative” functions of the CCI are specifically undertaken by the DG.

IT IS USEFUL TO NOTE THAT THE SUPREME COURT HAS DISTINGUISHED BETWEEN THE CONCEPTS OF “INQUIRY” AND “INVESTIGATION” PROVIDED UNDER THE ACT

C. Powers of the CCI and the DG

The scope of the DG’s investigation is limited to the information considered by the CCI. The Delhi High Court in *Grasim Industries*²² noted, “the formation of an opinion that prima facie there is a contravention of the provisions of the Act, is a sine qua non, for investigation by the DG.” In contrast, the powers of the CCI are much wider in their ambit and, therefore, the CCI can treat evidence collected by the DG as information and subsequently direct the DG to conduct investigation. This is also in line with the observations of the Bombay High Court in *Kingfisher Airlines Limited v. Competition Commission of India*,²³ where the Court

directed the CCI to enquire and investigate into every complaint received under the Act and not to stifle investigation, except in account of compelling reasons.

Further, under the scheme of the Act, the recommendations made by the DG do not bind the CCI, which is entitled to take a contrary view and proceed accordingly. Thus, if the DG reports that there is no contravention of the provisions of the Act, the CCI has the following three options: (i) to close the matter forthwith; (ii) to direct further investigation by the DG or to conduct further quasi-judicial inquiry on its own; or (iii) in case it does not agree with the DG and does not feel the necessity of any further investigation or inquiry, to pass an appropriate order, as provided in Section 27 of the Act.

On the other hand, if the DG reports contravention of the provisions of the Act, the CCI can: (i) close the proceedings forthwith if, in its opinion, no contravention of the provisions of the Act is made out and no further inquiry was called; (ii) undertake quasi-judicial inquiry into the contravention reported by the DG; or (iii) accept the report without directing any further inquiry and proceed to pass orders in accordance with the provisions of the Act. As stated above, the CCI's final decision may be appealed before the COMPAT within a period of 60 days

IV. INSTITUTIONAL ARRANGEMENTS: SECTORAL REGULATORS AND THE CCI

In the policy changes introduced in 1991, several specialized sector-specific regulators were also established to deal with, among other matters, market failures, the existence of natural monopolies,²⁴ the need for the creation of a level playing field, and the promotion of competition in the given sectors. Although it might appear that sector-specific regulators and competition authorities share a similar set of objectives, they, however, have different functions, perspectives, and areas of oversight, which make their relationship unique and their interface critical. While sector-specific regulators focus on specific sectors of the economy and identify behavioral issues *ex ante*, a competition authority takes a holistic view of the economy and addresses behavioral issues *ex post*,²⁵ presumably on account of failures by the sector-specific regulator or by virtue of limitations on the power of a particular sector-specific regulator.

A holistic reading of the provisions of the Act confers the CCI with the crucial responsibility of managing economy-wide competition issues on a sector-agnostic basis. However, a number of independent regulators such as the Telecom Regulatory Authority of India, the Central Electricity Regulatory Commission, the Insurance Regulatory Development Authority (“IRDA”) and the Petroleum and Natural Gas Regulatory Board established under specific legislations also appear to be bestowed with the power to oversee and regulate competition in their respective sectors. Accordingly, the interface between competition policy and sector-

A HOLISTIC READING OF THE PROVISIONS OF THE ACT CONFERS THE CCI WITH THE CRUCIAL RESPONSIBILITY OF MANAGING ECONOMY-WIDE COMPETITION ISSUES ON A SECTOR-AGNOSTIC BASIS

specific regulation poses complex questions, particularly concerning the underlying relationship between the two sets of regulators. The reasons for this apparent conflict in jurisdiction between competition authorities and sector-specific regulators have been attributed to the lack of legislative clarity in relation

to the powers vested in such authorities and the fact that sector-specific regulation was introduced a long time before competition law.

A. *Legislative Ambiguity*

The edifice of the relationship between sector-specific regulators and the CCI lies in the interplay among Sections 18, 21, 21A, 60 and 62 of the Act, which are unfortunately shrouded in uncertainty.

Section 18 of the Act makes it obligatory for the CCI to regulate activities that raise competition concerns by: (i) eliminating practices having an adverse effect on competition, (ii) promoting and sustaining competition in the market to protect the interests of consumers, and (iii) ensuring freedom of trade carried on by other participants in the market.²⁶ Further, while Section 60²⁷ of the Act is sector agnostic and provides for a typical non-obstante clause emphasizing the supremacy of the Act over all competition related matters, Section 62²⁸ of the Act, in essence, provides that the Act ought to work in consonance with other enactments.

IRONICALLY, IT IS NOT NECESSARY FOR THE STATUTORY AUTHORITY TO ABIDE BY SUCH OPINION

Interestingly, both these provisions are mandatory in nature. The inherent inconsistency between the two ought to be resolved by way of a harmonious construction to the effect that all other laws for the time being in force continue to have effect in so far as the provisions of such laws do not directly contradict the provisions of the Act. To the extent that the intent and purpose of the Act and similar existing laws can be reconciled, both shall co-exist and continue to complement each other.

This ambiguity is further illustrated by the interaction between Section 21²⁹ of the Act, which states that a statutory authority may refer an issue to the CCI, in any proceeding before it, if the need arises. Thereafter, the CCI is bound to deliver its opinion within a stipulated period of 60 days. Ironically, it is not necessary for the statutory authority to abide by such opinion. On the other hand, in relation to any conflict between the provisions of the Act and a particular statute, Section 21A³⁰ of the Act provides for non-binding reference by the CCI to the statutory authority entrusted with the implementation of such statute. Further, Section 54 of the Act adds to the ambiguity and leads to a conflict by providing that the ambit of the CCI's powers extends to all sectors and it is only the Central Government which can exempt any enterprise or class of enterprises or particular conduct from the application of the Act. It must be noted that this power of the Central Government has been used very sparingly so far.³¹

The Central Government, in an attempt to reconcile the interests of the two sets of regulators and address the jurisdictional overlap, has proposed to introduce an amendment by way of the Amendment Bill to Section 21 and 21A of the Act, requiring statutory authorities to *mandatorily refer* matters relating to “competition” to the CCI and vice-versa. While the banking sector and insurance sector are not wholly exempt from the purview of the Act, ailing banks or insurers shall continue to be dealt with under the Banking Regulation Act, 1949 and the Insurance Act, 1938, respectively.

B. Competition Law Overlap Example 1: The Insurance Sector

An instance of the overlap between sector-specific regulators and the CCI is illustrated by the interface between the Act and the IRDA (Scheme of Amalgamation and Transfer of Life Insurance Business) Regulations, 2013 (“IRDA Regulations”), which vests the IRDA with the power to regulate Combinations³² in the insurance sector. The insurance sector in India is regulated under the Insurance Act, 1938 read with the Insurance Regulation and Development Authority Act, 1999 (“IRDA Act”) under which the sector-specific regulator IRDA was established to regulate, promote, and develop the insurance and re-insurance sector.

The IRDA Regulations provide for a mandatory “in principle” approval of the IRDA prior to implementation of a Combination. Further, the parties intending to enter into a scheme (i.e. a Combination) are required to provide a “notice of intention” to the IRDA describing the nature of transfer or amalgamation at least a month before the date of application. Moreover, Regulation 8(3)(d) of the IRDA Regulations require the transacting parties to seek any other regulatory approvals, including that of the CCI, only after receipt of the “in-principle” approval from the IRDA.

As such, based on the IRDA Regulations, the 30-day trigger for filing the merger notification with the CCI would begin *on the day the ‘in-principle’ approval is received from the IRDA*. This is in stark contrast with the position adopted by the CCI in *Exide Industries Limited/ING Life*³³ (which related to the acquisition of the remaining 50 per cent. equity stake of ING Life by Exide from the existing shareholders of ING Life), wherein the CCI held that the 30-day trigger for filing a merger notification to the CCI, under Section 6(2) of the Act, would begin *on the day the transacting parties submit the “notice of intention” to the IRDA*. Thus, it appears that compliance with one set of regulations could lead to a breach of another set of regulations,

THUS, IT APPEARS THAT COMPLIANCE WITH ONE SET OF REGULATIONS COULD LEAD TO A BREACH OF ANOTHER SET OF REGULATIONS, THEREBY LEADING TO CONFUSION AND RISK OF PENALTIES FOR NON-COMPLIANCE

thereby leading to confusion and risk of penalties for non-compliance. Given that the Act prescribes the highest economic penalties in India, it is important to resolve such apparent conflicts between the CCI and sectoral regulators.

It has been argued that while sectoral regulators wield their sphere of influence in relation to their specific sectors, the CCI possesses the necessary expertise and understanding to evaluate anticompetitive practices and apply competition law principles in relation to the economy as a whole. Therefore, competition law enforcement is the exclusive domain of the CCI and the same cannot be usurped by regulatory authorities. In order to strike a balance, it is crucial for sectoral regulators and the CCI to establish a proactive interface without impinging upon their respective jurisdictions.

C. Competition Law Overlap Example 2: Mismatch in Timelines Between CCI and Securities Exchange Board of India

The Securities & Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations,

2011 (“Takeover Regulations”) mandate that a public announcement for: (i) exercising 25 per cent. or more of the voting rights in a target company; (ii) acquiring within any financial year additional shares or voting rights in a target company entitling the acquirer to exercise more than 5 per cent. of the voting rights; or (iii) acquiring, directly or indirectly, control over the target company shall be *made on the date of agreeing to acquire shares or voting rights in, or control over the target company*. Thereafter, an acquirer must make payment to public shareholders who have tendered their shares in the open offer within 15 days from the date of closure of an open offer, a stage which is likely to be reached within 70 days to 90 days from the date of the public announcement. If such a payment is not made, an obligation is imposed on the acquirer to pay interest on the amount due to the public shareholders.

HOWEVER, THUS FAR, THE CCI HAS DISPLAYED A LACK OF UNIFORMITY IN ITS DECISION-MAKING PROCESS

Therefore, the CCI has a period of 210 days under the Act (excluding clock stops) to clear a transaction and, pending such clearance, no implementation activities (including payment to public shareholders) can be undertaken. Accordingly, the mismatch of timelines between the date on which payment obligation under the Takeover Regulations arises and the date of CCI’s approval can result in a mismatch between the Act and Takeover Regulations timelines in instances of a merger notification being filed by a listed company which has undergone an extensive Phase I review. And, thus, it can result in the imposition of a large amount of interest on the acquirer.

V. DECISION MAKING UNDER THE COMPETITION LAW FRAMEWORK

The CCI, being a quasi-judicial body is not necessarily bound by its own precedent; however, certainty is a pre-requisite for any good regulatory regime and industry generally has a legitimate expectation that regulators such as the CCI will abide by their own past decisional practice. Accordingly, a fair, consistent, and transparent decision-making process is essential in order to uphold the authenticity of a competition authority’s actions.

However, thus far, the CCI has displayed a lack of uniformity in its decision-making process, because of the following reasons:

- (a) there are no guidelines on important aspects of decision making such as definition of relevant market, calculation of assets and turnover to determine notifiability, treatment of horizontal agreements, safe harbors while assessing competition law concerns emanating from an agreement, and, most importantly, determination of penalties; and
- (b) most of the CCI orders (especially Combination approval orders) are not speaking orders.

A. *Lack of Guidelines*

Since 2011, the CCI has already amended the Combination Regulations multiple times, and while the CCI has used these opportunities to close the loop on several structuring innovations employed by industry to avoid merger control, certain technical and practical issues continue to baffle industry and require to be addressed.

1. **Determination of Relevant Market:**

Under the Act, the relevant market is defined as the market determined by the CCI to be the relevant product market, the relevant geographic market, or both the product and geographic markets.³⁴ Further, the relevant product market is defined as the market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices, and intended use.³⁵ The relevant geographic market is the market comprising the area in which the conditions of competition for the supply of goods or services or the demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighboring areas.³⁶

Owing to the absence of any guidelines on the determination of relevant market, the CCI has, in its past decisional practices, been extremely inconsistent with the manner in which relevant market is defined. It is well accepted that determination of relevant market is the most important tool in a competition inquiry, especially in abuse of dominance and merger control cases. A narrow definition of relevant market will inflate the market share figures of the concerned entity and vice versa.

The “Small but Significant Non-transitory Increase in Price” (“SSNIP”) test is the most accepted and common tool used by competition law regulators for defining the relevant market, both on the product side as well as the geographic side. However, its application has often been questioned on account of an inherent price distortion in markets dominated by a single or a handful of enterprises, referred to in the antitrust literature as the “cellophane fallacy.” Therefore, antitrust scholars have warned against the use of SSNIP test in an abuse of dominance case because the definition of relevant market in a dominance case is for analyzing the conduct of a dominant enterprise which has happened in the past (*ex ante* analysis) and a SSNIP test will not reveal correct results for defining the market where the market has been distorted because of the pricing behavior of

THE INDIAN MARKET, IN PARTICULAR,
POSES INTRINSIC ISSUES WHICH MAKE
THE APPLICATION OF THE SSNIP TEST
DIFFICULT

the dominant undertaking. As such, a SSNIP test is a preferable test to be used in a merger analysis because merger analysis is a future-looking exercise (*ex post* analysis) and the market is not distorted prior to the merger.

In India, the SSNIP test has been used by the CCI on multiple occasions but its approach has not been uniform. The Indian market, in particular, poses intrinsic issues which make the application of the SSNIP test difficult; for instance, lack of market data, difficulties in conducting consumer surveys and determining an appropriately representative sample group, extreme price sensitivity of consumers, etc. Furthermore, the

characteristics of certain sectors do not permit the application of the SSNIP test, particularly in those sectors where quality of service, and not price, exerts a greater influence on customer choice.

In the absence of economic tests capable of application in the Indian market, determinations of “relevant market” are often guided by pure public perception and the wisdom of CCI members, without adequate statistical data to support the same. For example, while in *Belaire Owner’s Association v. DLF Ltd*³⁷ the CCI restricted the relevant market to a mere suburb of the National Capital Region, in *Consumers Guidance Society v. Hindustan Coca Cola Beverages Pvt Ltd*³⁸ the CCI held that the relevant geographical market cannot be confined to the closed market inside the premises of multiplexes and considered the relevant market to be the market for all multiplex theatres across India.

HOWEVER, AS WITH THE CASES CITED ABOVE, CCI’S APPROACH WITH RESPECT TO DEFINING RELEVANT MARKET IN MERGER CONTROL CASES HAS NOT BEEN CONSISTENT.

In *Surinder Singh Barmi v. Board of Control of Cricket in India*, (“BCCI case”)³⁹ the Board of Control of Cricket in India (“BCCI”) was alleged to be abusing its dominant position in relation to the grant of franchise rights, media rights, sponsorship rights, and commercial contracts related to the organization of the Indian Premier League. However, the CCI arrived at a simplistic definition of the relevant market as the “market for the organization of private professional cricket leagues/events in India.”

By contrast, in the case of *Dhanraj Pillay v. M/s Hockey India*,⁴⁰ the CCI undertook a far more detailed analysis and considered it appropriate to define the relevant market on the basis of each specific allegation against the association. Moreover, the CCI adopted an application of the “effects” based test in this case in order to determine the actual effect of the conduct of Hockey India. It is notable that in the *BCCI* case,⁴¹

HOWEVER, IN INDIA, CONTRARY TO INTERNATIONAL NORMS, THE PENALTIES IMPOSED BY THE CCI ARE SOLELY AT ITS OWN DISCRETION

although the CCI’s order states that it employed the SSNIP test for determination of the relevant market, the decision did not present any empirical analysis to indicate how the SSNIP test was applied and what the conclusions of such analysis were.

Finally, in the case of *Ajay Devgn Films v. Yash Raj Films Private Limited*,⁴² while the informant alleged that the relevant market should be considered to be the “film industry in India,” the CCI did not completely accept the same in its order and, as such, left open the definition of what the relevant market ought to be.

The relevant product market may be defined by conducting an economic analysis of demand-side substitutability (i.e. substitutability from a consumer perspective) and supply-side substitutability (i.e. ability of potential suppliers or producers to switch to the production of the relevant product) as well. In the European Union and the United States, demand-side substitutability is considered to be the more important of the two and also finds specific reference in the Act. However, as with the cases cited above, CCI’s approach with respect to defining relevant market in merger control cases has not been consistent. In *NHK Automotives/ BBTCL*,⁴³ the CCI considered demand-side substitutability and end-use of various types of springs in order to delineate the relevant product market. In *Diageo Plc./ United Spirits Limited*,⁴⁴ the CCI, with regards to the highly

differentiated alcoholic beverages market, considered not only price-point differentiation but also the effect of supply-side substitutability.

2. Lack of penalty guidelines

Competition jurisprudence in India suffers from the absence of penalty guidelines which are intended to elucidate and provide guidance as to how the CCI ought to calculate penalties for violations of competition law. Given that CCI has become very aggressive in its enforcement activity, levying fines to the tune of INR 120 billion to date, it is essential that CCI announce detailed penalty guidelines. The trend so far has been that the CCI has applied differential standards for imposing penalties, without providing any coherent reasons and justifications in relation to the process or formulae adopted to calculate the penalties imposed.

For instance, the CCI imposed a penalty of 7 per cent. in the *DLF* case⁴⁵ while it imposed a penalty of only 3 per cent. in *Coal India*.⁴⁶ With respect to merger filings, an interesting development—reflecting the keenness of CCI in enforcing the mandatory, suspensory merger control regime—is the imposition of penalties for gun-jumping, despite the Act does not contain any charging provision. In *Etihad Airways/ Jet*

THE COMPAT ALSO OBSERVED THAT THE ADJUDICATORY ROLE OF THE CCI NECESSITATES THAT IT CONSIDERS RELEVANT FACTORS BEFORE DETERMINING A PARTICULAR PENALTY AMOUNT LINKED TO THE ENTERPRISE'S TURNOVER

Airways,⁴⁷ the CCI imposed a penalty of INR 10 million on the acquirer, Etihad, for allegedly implementing certain aspects of the Commercial Co-operation Agreement entered into with Jet Airways early, as well as not notifying the sale and lease back of Jet Airways' prime landing slots in London's Heathrow airport. Therefore, for companies in India, the calculation of penalties remains a highly contentious issue.

It is pertinent to note that antitrust jurisdictions such as Pakistan and Singapore have guidelines on the imposition of financial penalties. Most recently, Malaysia has also issued draft penalty guidelines which are presently undergoing a public review process. However, in India, contrary to international norms, the penalties imposed by the CCI are solely at its own discretion. Earlier, the Competition Commission of India (General) Regulations, 2009 ("*General Regulations*") had a regulation which allowed for a show cause hearing with the concerned parties before the CCI levied any penalty. However, even that regulation has been deleted, which makes the whole issue of penalty even more murky.

Notably, the COMPAT has attempted to provide guidance on the manner in which penalties ought to be calculated, but its guidance does not find a basis in any legal provision. Pertinently, in several instances, such as *Gulf Oil Corporation Ltd*⁴⁸ and *MDD Medical Systems*,⁴⁹ while upholding the decisions of the CCI, the COMPAT has significantly reduced the penalty imposed on the parties and also cited reasons for such reductions in penalties. This reiterates the grave necessity for the CCI to, first, extend the benefit of a lucid and standard methodology guiding the imposition of penalties and, second, give detailed reasoning in its orders for arriving at a particular penalty amount.

3. Concept of turnover

In addition to the above, a related topic of contention has been the “turnover” which ought to be taken into account while levying financial penalties under the Act. Companies in India that are active across multiple product lines are often housed under a single entity and, as such, companies lack clarity as to how CCI calculates penalties for infringing conduct. This has become a matter of grave concern and uncertainty.

The Act provides that a maximum penalty of 10 per cent. of the average turnover for the preceding three years can be levied for abuse of dominance/vertical agreements. For cartels, the maximum penalty is up to three times the profit or 10 per cent. of turnover for each year of existence for cartels (whichever is higher). But the Act fails to clarify whether “turnover” for calculating such penalties is only the relevant turnover, i.e. the turnover that can be attributed to the business in which the violation of competition law took place, or the general overall turnover of the contravening enterprise.

The concept of relevant turnover was introduced in India for the first time by the COMPAT in *Aluminium Phosphide Tablets*.⁵⁰ This opportunity came before the COMPAT in an appeal against the decision of the CCI penalizing three aluminium phosphide tablet manufacturers for bid-rigging under Section 3(3) of the Act. The CCI had levied a total penalty of INR 3170 million, but this penalty was significantly reduced by the COMPAT. In its analysis, the CCI had not given any basis for the amount of the penalty, and had calculated the penalty based on the total turnover of the enterprise.

The COMPAT held that the CCI should have only considered the “relevant turnover” while calculating the penalty, since the infringing enterprises in this case were multi-product companies. Further, in its formal orders, the COMPAT reprimanded the CCI for the lack of reasoning and elucidated that the CCI must consider the doctrine of proportionality while imposing penalties. The COMPAT also observed that the adjudicatory role of the CCI necessitates that it considers relevant factors—such as the financial health of the company, its reputation, and the likelihood of the company being closed down due to the harsh penalty—before determining a particular penalty amount linked to the enterprise’s turnover. The COMPAT’s order is currently on appeal before the Supreme Court of India where it waits to be seen whether the COMPAT’s guidance will be upheld.

HOWEVER, THE CCI ORDERS CONTINUE TO BE DEVOID OF ANY COGENT THEORIES OF HARM OR ECONOMIC ANALYSIS WHICH CAN SET PRECEDENT VALUE FOR FUTURE MERGER NOTIFICATIONS

Given that Indian competition law is largely patterned on EU law, the CCI should take a leaf out of the EU’s practice and publish detailed guidelines on important aspects to give appropriate guidance and also to ensure that there is consistency in stances adopted by the CCI. One of the primary reasons for the European Union becoming a mature antitrust jurisdiction is that enterprises have, at their disposal, important guidelines on all important facets of competition law. Further, the EU Commission undertakes a periodical assessment of each of its guidelines and makes modifications to the same from time to time, keeping it up to date.

B. Lack of Reasoned Orders

The Supreme Court, through a plethora of its decisions, has interpreted the doctrine of natural justice to include issuance of reasoned and speaking orders by any authority exercising judicial function.⁵¹ The Supreme Court, in *SAIL*,⁵² directed the CCI:

In consonance with the settled principles of administrative jurisprudence, the Commission is expected to record at least some reason even while forming a prima facie view. However, while passing directions and orders dealing with the rights of the parties in its adjudicatory and determinative capacity, it is required of the Commission to pass speaking orders, upon due application of mind, responding to all the contentions raised before it by the rival parties.

Further, emphasizing the importance of the quasi-judicial functions exercised by the CCI and the COMPAT, which can have far reaching consequences, the Supreme Court reiterated the necessity of supporting orders with reasons in *Rangi International Ltd v. Nova Scotia Bank and Ors.*⁵³

Despite this well-settled proposition of law, and the Supreme Court's explicit directives, the CCI's orders continue to be criticized due to lack of reasoning. As discussed above, the COMPAT has tried to fill the gaps in the CCI's orders by listing mitigating/ aggravating factors taken into account to reach conclusions regarding contravention of the provisions of the Act and imposition of penalties.⁵⁴

Further, the CCI's orders under Section 27 of the Act not only lack a comprehensive economic analysis of relevant market, but also display ambiguities and inconsistencies. Even in merger control cases, though the CCI issues several information requests, the definition of the relevant market and the competition impact assessment they give in the orders are minimal and do not contain either specific delineations of the relevant market or an overview of all the information considered by the CCI in its merger evaluation process.

As a general practice, the parties, while filing merger notifications, undertake self-assessments of the relevant market and, typically, in its order, the CCI tends to accept the market definition put forth by the parties or leaves the same open for interpretation. There have been very few known instances where the CCI has asked parties to further drill down into the relevant market to analyze the impact on the market on account of a proposed transaction. However, the CCI orders continue to be devoid of any cogent theories of harm or economic analysis which can set precedent value for future merger notifications.

Given that the CCI is at an extremely nascent stage and is in the process of developing the competition law jurisprudence, which will go a long way in determining how businesses are carried out in India, it is imperative that the CCI issues speaking orders. This will not only lead to the CCI establishing a regime of certainty and predictability, as a result of which stakeholders, i.e. enterprises and practitioners, can arrive at accurate conclusions, but will also be of utmost importance in the event its orders are challenged before higher authorities.

VI. POLICY MAKING FUNCTION UNDER THE COMPETITION LAW FRAMEWORK

A. *Draft National Competition Policy*

In 2011, the (Indian) Ministry of Corporate Affairs constituted a Committee for framing a National Competition Policy (“Committee”). This Committee took feedback from various stakeholders, including chambers of industries, corporations, law firms, and members of civil society and subsequently issued a draft National Competition Policy Statement (“Draft Policy”), which aimed at integrating principles of competition in various economic policies of the government and, thereby, promoting a competitive market structure in the economy.

THE CCI IS ENCOURAGING CORPORATE INDIA TO INITIATE COMPETITION COMPLIANCE PROGRAMS

Competition Policy (“Committee”). This Committee took feedback from various stakeholders, including chambers of industries, corporations, law firms, and members of civil society and subsequently issued a draft National Competition Policy

Statement (“Draft Policy”), which aimed at integrating principles of competition in various economic policies of the government and, thereby, promoting a competitive market structure in the economy.

The Draft Policy also aimed at promoting good governance by bringing in greater transparency and accountability. It contemplated that where a separate regulatory arrangement is set up in different sectors, the functioning of the concerned sectoral regulator should be consistent with the principles of competition as far as possible and there should be an appropriate coordination mechanism between the CCI and sectoral regulators to avoid overlap in interpretation of competition related concerns. Further, any deviation from the principles of competition should be made only to meet desirable social or other national objectives, which should be clearly spelled out. The following initiatives were proposed as part of the Draft Policy:

ANY ANALYSIS/OPERATION OF THE REGULATORY FRAMEWORK GOVERNING A PARTICULAR SECTOR WILL IMPLICITLY INVOLVE A COMPETITION LAW ANALYSIS OF THE SECTOR WITH THE END GOAL BEING A PRO-COMPETITIVE STRUCTURE LEADING TO CONSUMER WELFARE

- institutional separation between policy making, operations, and regulation;
- a review of existing policies, statutes, and regulations of the Government (which may restrict or undermine competition) from a competition perspective with a view to removing or minimizing their competition-restricting effects;
- a procedure for making a competition impact assessment of proposed policy, law, and regulations before they are finalized;
- “competitive neutrality,” such as adoption of policies which establish a “level playing field” where government businesses compete with private sector;
- national, regional, and international cooperation in the field of competition policy enforcement and advocacy; and
- in order to ensure effective competition, third party access to essential facilities in the infrastructure

sector, owned by a dominant enterprise, to be provided on reasonable and fair terms.

While the Draft Policy has not yet been put into effect, its mandate and intent rings loud and clear and any analysis/operation of the regulatory framework governing a particular sector will implicitly involve a competition law analysis of the sector with the end goal being a pro-competitive structure leading to consumer welfare.

B. Leniency Program

In the context of the difficulty in securing evidence to prove the existence of cartels, a leniency program has been introduced, whereby leniency may be granted by the CCI under the Competition Commission of India (Lesser Penalty) Regulations, 2009 (“Leniency Regulations”) to the first three cartel participants who apply to the CCI and provide such information as may constitute “vital disclosures” as defined under the Leniency Regulations.

Thus far, market sources indicate that the leniency program has been utilized in three instances but an order on the basis of such an application is still awaited. It is, however, unfortunate that the identity of a leniency applicant in the conveyor belt sector was made public during the CCI’s investigation into this sector.⁵⁵ Going forward, the CCI will have to ensure that the identity of applicants is not compromised in order for people to have faith in this process. Nonetheless, the CCI is aggressively promoting its leniency program in order to better investigate cartelization and it is likely, given the high penalties being imposed under the Act, that cartel participants will come forward under the leniency program and assist the CCI in its investigations.

THIS GREATER COORDINATION BETWEEN THE CCI AND GLOBAL COMPETITION REGULATORS WILL SIGNIFICANTLY IMPACT GLOBAL CARTEL INVESTIGATIONS AND CROSS-BORDER M&A MERGER CONTROL NOTIFICATIONS

C. Competition Advocacy and Compliance Programs

While the CCI has indicated that it intends to continue to monitor markets and investigate either *suo motu* or on the basis of complaints/information received, as a part of its responsibility to undertake competition

THE CCI HAS NOT BEEN SHY IN INVOKING ITS EXTRATERRITORIAL JURISDICTION

advocacy, the CCI is encouraging corporate India to initiate competition compliance programs. On account of the CCI’s investigative zeal and the headline penalties being imposed, Indian companies are gradually coming to realize the importance of ensuring that their business practices are in compliance with competition law and that strong and comprehensive competition compliance programs could serve as mitigating factors in the event of a CCI investigation.

In early 2013, the CCI Chairperson, Mr. Ashok Chawla, met with the heads of 100 of the largest

listed companies in India in a move to improve awareness of the competition law regime in India and, also, to impress upon them the importance of competition compliance and emphasize how the existence of a competition compliance program could possibly act as a mitigant for contravening companies. Mr. Chawla, as well as the members of the COMPAT, regularly speak at various industry events to increase awareness about the CCI's enforcement priorities and the benefits of a strong competition culture in the market.

Further, the CCI, consistent with international best practices, has been offering informal consultations on procedural aspects relating to the Act. The CCI recently announced that they will expand the scope of this facility to provide consultations on substantive issues, including pre-filing consultation.⁵⁶ This will undoubtedly help create greater awareness among market participants and allow them the facility to set their house in order on the basis of guidance received from the CCI.

D. Coordination With Other Competition Regulators

The CCI is also looking to increase interaction and cooperation with global competition law regulators. The CCI signed an antitrust memorandum of understanding ("MOU") with the Federal Antimonopoly Service (Russia) on December 16, 2011. The U.S. Federal Trade Commission and the Department of Justice also signed a MOU with the Government of India, Ministry of Corporate Affairs, and the CCI to promote increased cooperation and communication among competition agencies in both countries. On June 3, 2013, the CCI signed a similar MOU with the Australian Consumer and Competition Commission. The CCI also signed an MOU with the Directorate General for Competition of the European Commission (DG, Competition) on Cooperation in the field of competition laws.

In addition to these MOUs, the CCI is actively engaging with several competition law authorities from the United Kingdom, Japan, Korea, and others to enter into arrangements for cooperation in the field of competition law. This greater coordination between the CCI and global competition regulators will significantly impact global cartel investigations and cross-border M&A merger control notifications.

VII. CONCLUSION

The success of Indian competition law and its effectiveness depend on a variety of factors including initial architecture of law, institutional design (including independence of the CCI), resources, manpower, economic training, and governmental support in promoting competition, as well as the balance of power between proponents and opponents of the Act. Given that the Act and its enforcement is still at a very nascent phase, it is very critical that the CCI adopts international best practices, in order to provide more clarity to the industry and practitioners.

The CCI has made substantial headway in rolling out the competition regime in India. The CCI, in spite of being hamstrung by certain shortcomings such as shortage of manpower, has been very aggressive in its enforcement outlook which has made the industry sit up and take notice of the CCI. The CCI has shrugged

off the image of the previous antitrust regulator, MRTP Commission, which was dubbed by scholars as a “toothless tiger” because of its weak enforcement structure and legislative intent. The CCI has gone a long way in ensuring that practices by enterprises which distort the competitive effect of the market are curbed. However, there are still areas of antitrust jurisprudence, like compensation to claimants and their interplay with the scope of compensation under the Consumer Protection Act, 1986, which are yet to be tested.

Given India’s place as one of the world’s fast growing economies, the world is closely watching the evolution of the Indian competition regime. The CCI has not been shy in invoking its extraterritorial jurisdiction, including penalizing foreign acquirers such as Titan International and Temasek, for belated merger notifications and Google Inc. for non-cooperation with the DG during the process of investigation. This again emphasizes the need for the CCI to adopt international best practices and provide clarity while establishing a regime of certainty and predictability. ▲

¹ Cyril Shroff (cyril.shroff@amarchand.com) is a Managing Partner of Amarchand & Mangaldas & Suresh A. Shroff & Co. (“AMSS”) and Nisha Kaur Uberoi (nishakaur.uberui@amarchand.com) is a Partner and Head of the competition law practice of AMSS (Mumbai Region). The authors would like to acknowledge the contribution of Soumya Hariharan, Senior Associate and Shweta Vasani, Aishwarya Gopalakrishnan and Swati Baghel, Associates in the Mumbai competition law practice at AMSS.

² S.V.S. Raghavan Committee.

³ Moreover, the MRTP Act did not allow for the imposition of penalties or grant sufficient powers of regulation, thereby rendering the MRTP Commission ineffective.

⁴ Section 3 of the Act.

⁵ Section 4 of the Act.

⁶ Sections 5 and 6 of the Act.

⁷ Section 53B of the Act.

⁸ Section 53T of the Act.

⁹ Sections 8 and 9 of the Act. Prior to the Competition (Amendment) Act, 2007, the language of the provision read as follows: “The Chairperson and every other member shall be a person of ability, integrity and standing and who has been, or is qualifies to be a judge of a High Court, or, has special knowledge of, and profession experience of not less than 15 years in international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs, administration or any other matter, which, in the opinion of the Central Government may be useful to the Commission.”

¹⁰ *Competition Commission of India v. Steel Authority of India Ltd. and Anr.* (2010) 4 CompLJ1 (SC).

¹¹ Section 36 of the Act.

¹² *Supra* note 10.

¹³ AIR 2005 SC 730.

¹⁴ Section 53C and 53D of the Act.

¹⁵ Section 53A of the Act.

¹⁶ Section 41 of the Act.

¹⁷ *Supra* note 8.

¹⁸ Regulation 20(4) of the Competition Commission of India (General) Regulations, 2009.

19 *Grasim Industries v. Competition Commission of India, High Court of Delhi*, WP(C) 4159 of 2013.
20 The Competition Amendment Bill is currently tabled before the Parliament of India.

21 *Supra* note 10.

22 *Supra* note 18.

23 (2010) 4 CompLJ 557 (Bom).

24 A natural monopoly is one that arises from the nature of the industry, where the presence of one effective player in a particular market proves most cost-efficient.

25 It should be noted that the merger control review process under the Act is *ex-ante*.

26 Preamble to the Act.

27 Section 60 of the Act.

28 Section 62 of the Act.

29 Section 21 of the Act.

30 Section 21A of the Act.

31 On December 11, 2013, the Central Government exempted Vessel Sharing Agreements (“VSAs”) in the liner shipping industry from the purview of Section 3 of the Act for a period of one year. However, VSAs continue to be subject to the supervision of the Director General, Shipping, Ministry of Shipping and all existing and new VSAs that are claiming this exemption are required to be registered with the Director General, Shipping.

32 An acquisition of shares, assets, voting rights, or control of one or more enterprises or merger or amalgamation of enterprises.

33 Combination Registration No. C-2013/01/08.

34 Section 2(r) of the Act.

35 Section 2(t) of the Act.

36 Section 2(s) of the Act.

37 Case no. 19 of 2010.

38 Case no. UTPE 99 of 2009.

39 Case no. 61 of 2010. By way of disclosure, the authors are representing BCCI in the appeal filed against CCI’s order.

40 Case no. 73 of 2011.

41 *Supra* note 41.

42 Case no. 66 of 2012.

43 Combination Registration No. C-2011/10/05. By way of disclosure, the authors represented NHK Automotives in this filing.

44 Combination Registration No. C-2012/12/97. By way of disclosure, the authors represented USL in this filing.

45 *Supra* note 39.

46 *Coal India Ltd v. Gulf Oil Corporation Ltd and Ors*, Case no. 6 of 2011.

47 Combination Registration No. C-2013/04/122. By way of disclosure, the authors represented Etihad and Jet before the CCI and COMPAT in relation to the merger notification.

48 Appeal nos. 82 to 90 of 2012. The COMPAT agreed with the CCI’s conclusion that the collective boycott of auction conducted by Coal India Limited for the tender of explosive supplies amounted to

bid-rigging. However, taking into consideration mitigating factors, such as first breach by the appellants, intention of the parties, etc, the penalty was reduced to 10 per cent. of the penalty imposed by the CCI.

⁴⁹ Appeal nos. 93 to 95 of 2012. The COMPAT upheld the conclusion of CCI with respect to bid-rigging in the matter of supply and installation of the modular operation theatre and medical gases manifold system at Sports Injury Centre, Safdarjung Hospital, New Delhi. However, based on mitigating factors, the COMPAT decided to reduce the penalty from 5 per cent. to 3 per cent. of the turnover of the parties (i.e. from INR 30 million to INR 18 million).

⁵⁰ *M/s United Phosphorus Limited & Ors v Competition Commission of India & Ors*, Appeal no. 79, 80 and 81 of 2012.

⁵¹ See, *Siemens Engineering & Manufacturing Co. of India Ltd. v. Union of India*, (1976) 2 SCC 981; *Babubhai & Co. v. State of Gujarat*, (1985) 2 SCC 732; *Assistant Commissioner, Commercial Tax Department, Works Contract and Leasing, Kota v. Shukla and Brothers*, (2010) 4 SCC 785.

⁵² *Supra* note 10.

⁵³ 2013 (7) SCALE 228.

⁵⁴ See, *Gulf Oil Corporation Ltd v. Competition Commission of India & Ors*, *supra* note 49; *MDD Medical Systems India Private Limited & Ors. v. Competition Commission of India & Ors*, *supra* note 50; *M/s United Phosphorus Limited & Ors v Competition Commission of India & Ors*, *supra* note 51.

⁵⁵ http://articles.economictimes.indiatimes.com/2014-02-27/news/47739680_1_alleged-cartel-competition-commission-regulator

⁵⁶ Press Release, Amendment to Combination Regulations - 28 March 2014, *available at* <http://www.cci.gov.in/images/media/Regulations/Press%20Release.pdf>.

Chinese Antitrust Institutions—Many Cooks in the Kitchen

BY ADRIAN EMCH¹

The Anti-Monopoly Law has been in force for over six years. When the AML was enacted in August 2007, the question of which authority would be in charge of AML enforcement was still undecided. There were three strong contenders for the job—the Ministry of Commerce, the National Development and Reform Commission, and the State Administration for Industry and Commerce. The three authorities played active roles during the normative process, probably with a view to showcasing their credentials for the enforcement authority job. MOFCOM took the lead in the drafting of the 2004 version of the draft AML and, not surprisingly, the 2004 draft explicitly mentioned MOFCOM as the sole enforcement authority. Yet, as it turned out, China would have three authorities after all. During July and August 2008—just about when the AML started to take effect—the State Council issued so-called “*san ding*” notices through which it gave central government ministries and equivalent organizations instructions on their jurisdiction, staff, and internal organization. Through their *san ding* notices, MOFCOM, NDRC, and SAIC all obtained powers to enforce the AML in a limited way. An antitrust regime with three authorities is complicated, as is the particular jurisdictional carve-up. This paper examines what issues arise with this three-headed authority structure, and how they can be addressed.

I. INTRODUCTION

The Anti-Monopoly Law (“AML”) has been in force for over six years.² This is not much, compared to the 13 years or so it took to enact the law. Reportedly, one of the main reasons why the legislative process took so long was the struggle about which authority would have jurisdiction to enforce the law.

There were three strong contenders for the job—the Ministry of Commerce (“MOFCOM”), the National Development and Reform Commission (“NDRC”), and the State Administration for Industry and Commerce (“SAIC”). The three authorities played active roles during the normative process, probably with a view to showcasing their credentials for the enforcement authority job. For example, MOFCOM took the lead in the drafting of the 2004 version of the draft AML.³ Not surprisingly, the 2004 draft explicitly mentioned MOFCOM as the sole enforcement authority.⁴

All three authorities had some credible claims for being the AML enforcement body, based on the pre-existing antitrust-related work they had done: MOFCOM had been in charge of merger control since 2003; NDRC had been enforcing the Price Law,⁵ including its antitrust-related provisions, since 1998; and SAIC had been the authority to enforce the Anti-Unfair Competition Law (“AUCL”),⁶ with some antitrust-related rules, since 1993.

In 2007, it seems, the decision on who would enforce the AML had still not been made. But legislators thought the AML needed to be adopted. The way out was to draft the AML in a generic manner, by referring only to the “anti-monopoly enforcement authority,” or authorities, in the law. This had the advantage of

allowing the enactment of the AML without waiting for the institutional question to be resolved. At the same time, this type of generic manner approach has been used not infrequently in Chinese legislative processes.⁸

In short, when the AML was enacted in August 2007, the question of which authority would be in charge of AML enforcement was still undecided. In my first paper about Chinese antitrust, a few months after the AML was passed, my co-author and I expressed hope that there would be a new and, in any case, a single, antitrust authority.⁹ Three authorities, we found, was not a good idea.

Yet, as it turned out, China would have three authorities after all. During July and August 2008—just about when the AML started to take effect—the State Council issued so-called “*san ding*” notices through which it gave central government ministries and equivalent organizations instructions on their jurisdiction, staff, and internal organization.¹⁰

AN ANTITRUST REGIME WITH THREE AUTHORITIES IS COMPLICATED, AS IS THE PARTICULAR JURISDICTIONAL CARVE-UP

Through their *san ding* notices, MOFCOM, NDRC, and SAIC all obtained powers to enforce the AML in a limited way. MOFCOM is in charge of merger control. NDRC’s responsibility is to take on monopoly agreements, abuses of dominance, and anticompetitive abuses of administrative powers (dubbed “administrative monopoly”) as long as the underlying anticompetitive conduct is related to pricing. If the conduct is not related to pricing, it falls under SAIC’s jurisdiction.

An antitrust regime with three authorities is complicated, as is the particular jurisdictional carve-up. This paper examines what issues arise with this three-headed authority structure, and how they can be addressed. First, section II will provide some background, and describe the scope of jurisdiction of the three authorities. Section III will look at the potential overlaps in jurisdiction of the authorities and the resulting problems, while section IV will put forward a few ideas on how to diffuse the potential for jurisdictional conflict. Section V will conclude.

II. BACKGROUND AND SCOPE OF JURISDICTION

A complete description of governmental stakeholders in the Chinese antitrust space would require a discussion of bodies other than MOFCOM, NDRC, and SAIC, such as the Ministry of Industry and Information Technology or the Ministry of Transportation, which have some limited sectoral antitrust powers.¹¹ However, this discussion is beyond the scope of this paper.¹²

This section will only focus on the three official antitrust authorities. For ease of presentation, given the relatively clear delimitation of its powers, I will start with MOFCOM, followed by NDRC and SAIC.

A. *Ministry of Commerce*

MOFCOM is the ministry in charge of foreign and domestic trade and commerce. It was established in 2003 as a result of the merger between the previously separate authorities in charge of domestic trade and foreign

REPORTEDLY, MOFCOM HAD THE
AMBITION OF BECOMING THE SOLE AML
ENFORCEMENT AUTHORITY

trade. MOFCOM currently has over 30 departments that perform different functions, including (i) foreign investment, foreign cooperation, and aid; (ii) WTO matters; (iii) domestic commerce; (iv) services; and (v) industry safety.

1. **Before the AML**

Since 2003, MOFCOM has been the authority approving foreign M&A deals under the Regulation on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors.¹³ MOFCOM and SAIC were the two authorities in charge of the “antitrust review” under that regulation. However, for some reason, in practice only MOFCOM was seen to actively take on cases.¹⁴ In 2006, the Regulation on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors was amended, and in 2007 MOFCOM published guidelines on the notification requirements and process.¹⁵

In addition, MOFCOM had played an active role in the legislative process of the AML. In 1994, the State Economic and Trade Commission, one of MOFCOM’s predecessors, was requested by the State Council to prepare the legislative work for the AML. After its establishment in 2003, MOFCOM assumed, and continued to perform, this responsibility. In 2004, it established an antimonopoly investigation office, whose main function was the drafting of antitrust legislation and international communications.¹⁶ Reportedly, MOFCOM had the ambition of becoming the sole AML enforcement authority, as it proposed in a draft version of the AML submitted to the State Council in 2004.¹⁷

2. **After the AML**

According to its *san ding* notice of July 2008, MOFCOM has the power to (1) conduct antitrust review in merger cases, (2) provide guidance to domestic enterprises facing antitrust litigation overseas, and (3) organize international exchanges and cooperation on multilateral and bilateral competition policies.¹⁸

After receiving the *san ding* authorization, MOFCOM established the Anti-Monopoly Bureau in September 2008. The Anti-Monopoly Bureau currently has seven divisions, and about 30 or so staff.

To implement its mandate under the *san ding* notice, the Anti-Monopoly Bureau lists an antitrust-related range of powers on its own webpage, going into more detail and, at times, expanding the scope of the mandate somewhat—for example, claiming jurisdiction over investigations into anticompetitive conduct in foreign trade.¹⁹

B. National Development and Reform Commission

NDRC is the governmental authority leading the formulation of economic and social development policy, macroeconomic management, and economic reform. It was formed on the basis of the previous State Planning Commission, which used to be the most powerful governmental agency in the planned economy phase. Today, NDRC still retains a great range of powers to review and approve various important matters, including domestic investment, economic development, key resources, etc. Price regulation is one of NDRC's economic management responsibilities.

IN ANTITRUST TERMS, THE MOST IMPORTANT MANDATE FOR NDRC WAS ITS RESPONSIBILITY FOR “INVESTIGATING AND HANDLING PRICE LAW VIOLATIONS AND PRICE MONOPOLY CONDUCT IN ACCORDANCE WITH THE LAW”

1. Before the AML

Since before the AML NDRC had been enforcing the Price Law, including its antitrust-related provisions. Under that law, NDRC and its local counterparts have jurisdiction over various types of pricing conduct, including cartels, predatory pricing, and price discrimination.²⁰

In 2003, NDRC issued an implementing regulation of the Price Law, to provide more details on the antitrust provisions in that law.²¹ Subsequently, the regulation was abrogated after NDRC published implementing rules of the AML.²²

2. After the AML

The *san ding* notice for NDRC in July 2008 conferred upon it responsibility for: (1) drafting rules on price supervision and inspection, (2) guiding and organizing price supervision and inspection, (3) handling cases related to product and service prices and fee collection involving violations of price-related laws by central government agencies, and (4) handling price monopoly conduct and reconsideration cases and appeals concerning the sanctions imposed for price violations.²³

In antitrust terms, the most important mandate for NDRC was its responsibility for “investigating and handling price law violations and price monopoly conduct in accordance with the law.”

Internally, NDRC drafted more detailed rules on the extent of jurisdiction of its antitrust unit, the Price Supervision and Anti-Monopoly Bureau.²⁴ The Bureau is the department in charge of antitrust enforcement within NDRC. By 2013, it had around 40 staff, although only some of them work on AML cases.²⁵

C. *State Administration for Industry and Commerce*

SAIC is the authority in charge of market supervision and management. Its role includes a wide variety of tasks such as consumer protection, product quality and food safety, company registration, trademark registration, etc.

1. **Before the AML**

Already, before the enactment of the AML, SAIC had been tackling some types of anticompetitive conduct under the AUCL. The AUCL contains a number of antitrust-related prohibitions, including those against tying and exclusive dealing by public service enterprises and statutory monopolists, predatory pricing, tying, and bid-rigging.²⁶

Apart from its work enforcing the AUCL, as noted above, SAIC also shared jurisdiction with MOFCOM over the merger control process under the Regulation on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors. In practice, however, SAIC did not play an active role in this process.²⁷

Beyond the case work, SAIC was also seen to participate in the legislative process of the AML. It was appointed by the State Council to prepare the AML draft along with MOFCOM.²⁸

2. **After the AML**

The *san ding* notice for SAIC in July 2008 stated that SAIC is responsible for: (1) formulating specific antimonopoly and anti-unfair competition measures; (2) carrying out antitrust enforcement; (3) investigating unfair competition practices, commercial bribery, smuggling, and other cases violating economic laws; and (4) supervising the handling of large, significant, or typical cases.²⁹

THE *SAN DING* GAVE SAIC RESPONSIBILITY FOR “ANTI-MONOPOLY ENFORCEMENT IN SUCH ASPECTS AS MONOPOLY AGREEMENTS, ABUSES OF A DOMINANT MARKET POSITION AND ABUSES OF ADMINISTRATIVE POWERS TO ELIMINATE OR RESTRICT COMPETITION (NOT INCLUDING PRICE MONOPOLY CONDUCT).”

In the antitrust area, the *san ding* gave SAIC responsibility for “anti-monopoly enforcement in such aspects as monopoly agreements, abuses of a dominant market position and abuses of administrative powers to eliminate or restrict competition (not including price monopoly conduct).”

SAIC’s own view of its jurisdiction is the same as the description in *san ding* notice.³⁰

The department responsible for antitrust enforcement within SAIC is the Anti-Monopoly and Anti-Unfair Competition Enforcement Bureau. The Bureau was established in 2009, and currently has five divisions, although only some of its staff deal with antitrust work in the strict sense.

III. POTENTIAL FOR JURISDICTIONAL CONFLICT

This section will focus on the three official authorities, and will look at two potential areas of jurisdictional conflict: first, between NDRC and SAIC and, second, between MOFCOM and NDRC/SAIC.

The section will also highlight the problems brought about by this potential for conflict.

A. NDRC/SAIC Division of Jurisdiction

In my view, there two broad areas where the potential for conflict could arise: first, there could be a conflict in cases where the allegedly anticompetitive conduct—as a single action—could fall under the jurisdiction of both NDRC and SAIC.

AT THE MARGINS, BOTH NDRC AND SAIC INCLUDED PROVISIONS GIVING THEM JURISDICTION OVER CONDUCT THAT COULD BE VIEWED AS AN EXPANSION OF THEIR JURISDICTION

In other words, the jurisdictions of the authorities directly overlap to an extent. Second, conflicts could arise in cases that have several different elements (not a single action) which each fall under the jurisdiction of a different authority.³¹ I call these two scenarios “concurrent” jurisdiction and “parallel” jurisdiction, respectively.³²

These two scenarios will be examined below, followed by a description of the problems.

1. Concurrent Jurisdiction

In certain instances, the potential for concurrent jurisdiction is enshrined in the law itself. In other instances, the potential arises through the expansive case practice of the authorities.

a. Legal Provisions

As noted above, the AML did not allocate jurisdiction for enforcement to specific, named authorities. This means we must look at the AML implementing rules adopted by NDRC and SAIC.

An analysis of these rules shows that, at the margins, both NDRC and SAIC included provisions giving them jurisdiction over conduct that could be viewed as an expansion of their jurisdiction relative to the *san ding* notices (i.e., price-related conduct v. non-price related conduct).

(i) NDRC Expansion

NDRC’s key regulation implementing the substantive provisions of the AML—the Anti-Price Monopoly Regulation—contains two provisions that seem to expand NDRC’s field of action.³³

First, Article 13 contains a prohibition against dominant companies refusing to deal with trading partners “through the setting of excessively high sales prices or excessively low purchase prices,” unless valid

reasons justify the conduct. In other words, Article 13 regulates a particular type of “constructive” refusal to deal: instead of refusing outright to deal with the business partner, the dominant company makes an offer on terms so unfavorable that the partner cannot but decline. In the case of Article 13, the constructive refusal to deal is operated through pricing means—in the case of a dominant supplier, a price so high that the buyer cannot accept it.

The jurisdictional overlap is created by the circumstance that, as a general rule, a refusal to deal is not directly price-related: the dominant company simply says no, without any discussion or setting of prices. Not surprisingly, therefore, Article 4 of the Regulation on the Prohibition of Conduct Abusing a Dominant Market Position³⁴ (“SAIC Abuse of Dominance Regulation”) implements the refusal to deal prohibition of the AML, implicitly claiming enforcement jurisdiction for SAIC.

In contrast, the constructive refusal to deal in Article 13 of the Anti-Price Monopoly Regulation is directly price-related, as it is operated through excessive price demands.

The potential scope of jurisdictional clash between NDRC and SAIC can actually be very real, just on the face of the text of the rules. Indeed, Article 4 of the SAIC Abuse of Dominance Regulation lists a few examples of how refusals to deal can be implemented. Paragraph (4) includes the example of “setting restrictive conditions to make it difficult for the trading partner to continue conducting transactions with it.”

THE POTENTIAL CLASH OF JURISDICTION
IN THE DISCOUNTS AREA IS PARTICULARLY
STRONG

Now, Article 13 of the Anti-Price Monopoly Regulation precisely contemplates the scenario of a specific “restrictive condition” (*i.e.*, excessive prices) making it difficult for the buyer to accept the offer from the dominant supplier. Of course, a consistent interpretation of Article 13 of the Anti-Price Monopoly Regulation and Article 4(4) of the SAIC Abuse of Dominance Regulation could be that SAIC has jurisdiction over non-price related constructive refusals to deal, and NDRC over price-related constructive refusals to deal. However, so far, the soundness of this interpretation has not been confirmed in actual cases.

Second, Article 14 of the Anti-Price Monopoly Regulation states that exclusive dealing “through methods such as price discounts” is prohibited, absent valid justifications. The idea is similar to that of the constructive refusal to deal discussed above: a type of anticompetitive conduct (here, exclusive dealing) is implemented through pricing means (here, discounts). The idea that certain types of discounts can have the same or similar effects as exclusive dealing (through contractual obligations) is not new. In the famous *Hoffman-La Roche* case in the European Union, the European Court of Justice basically put contractual exclusive dealing and loyalty discounts on equal footing.³⁵

Again, as with the potential jurisdictional conflict in the refusal to deal area, the potential for conflict here is that a type of conduct that is perhaps most often of non-price nature (*e.g.*, contractual stipulations)—over which SAIC has jurisdiction—is implemented through pricing means—where NDRC’s jurisdiction starts

to kick in.

The potential clash of jurisdiction in the discounts area is particularly strong, as SAIC and its local offices investigated loyalty discounts under the AUCL before the AML was enacted. In the China Southern case, the dominant airline in Hunan, *China Southern*, had classified its distributors into five categories depending on their degree of loyalty (as measured by the percentage of the dominant airline's tickets among all the plane tickets sold by the distributors). For those distributors who were more loyal (e.g., who sold all or most tickets from the dominant airline), the airline offered higher discounts on its tickets on 30 routes and the possibility to obtain tickets on the most popular routes on a preferential basis. The local Administration for Industry and Commerce ("AIC") in Hunan held such behavior to be anticompetitive. As the case was investigated in 2005, before the AML came into effect, the AIC sanctioned the airline under the AUCL.³⁶

IN SHORT, IN THE AREAS OF REFUSAL TO DEAL, EXCLUSIVE DEALING, AND DISCRIMINATORY TREATMENT, THERE IS CONSIDERABLE SCOPE FOR JURISDICTIONAL OVERLAP

Hence, in the discounts area, both NDRC and SAIC have a claim for jurisdiction that cannot be easily rebutted. On the one hand, NDRC can refer to Article 14 of the Anti-Price Monopoly Regulation. On the other hand, SAIC can claim jurisdiction over exclusive dealing in general, under Article 5 of the SAIC Abuse of Dominance Regulation, and on the basis of the understanding that—in most cases—exclusive dealing cases are not directly related to pricing. SAIC might also be tempted to use the *China Southern* case as reference of actual case work in the area.

(ii) SAIC Expansion

Article 17(6) of the AML prohibits discriminatory treatment “concerning trading conditions, *such as transaction prices*” to trading partners in equivalent conditions.³⁷ Logically, the discriminatory treatment prohibition is also implemented in the Anti-Price Monopoly Regulation. Its Article 16 repeats the AML prohibition, just deleting the words “trading conditions, such as,” and hence does not attempt to expand NDRC's jurisdiction.

In turn, Article 7 of the SAIC Abuse of Dominance Regulation, which implements the AML prohibition of discriminatory treatment, also copies the text of the AML prohibition but drops the words “such as transaction prices.” Interestingly, the SAIC regulation does not add wording such as “non-pricing related” trading conditions. In a way, this open formulation could be interpreted as an attempt by SAIC to expand jurisdiction. Yet, after stating the general rule, Article 7 lists a few examples of factors where discriminatory treatment can occur, mainly referring to non-pricing elements: (i) product quantity, variety, or quality; and (ii) after-sale services, such as warranty, maintenance, components, and spare parts, etc.

However, Article 7 of the SAIC regulation also includes two elements that seem to relate to pricing. On the one hand, the provision prohibits unjustified discrimination through differences in terms “such as

volume discounts” or payment conditions and delivery.³⁸

Here, again, there seems to be a high potential for jurisdictional clash between NDRC and SAIC. Again, one way of using a consistent interpretation to harmonize the different rules would be that—on the face of the text of its implementing regulation—NDRC would only be interested in pursuing jurisdiction over discrimination of the *transaction price* as such (that is, the *price level*), while SAIC would have jurisdiction over other conditions related to pricing including *discounts*.

However, this type of interpretation seems awkward, as a discount seems to be part of the price. Furthermore, given its claim of jurisdiction over exclusive dealing operated through discounts, it would seem strange if NDRC were to renounce jurisdiction over discriminatory treatment implemented through differentiated discounts.

In short, in the areas of refusal to deal, exclusive dealing, and discriminatory treatment, there is considerable scope for jurisdictional overlap. The underlying reason for the potential overlap is that, in many (if not most) instances, the same type of anticompetitive conduct (*e.g.*, exclusive dealing) can be implemented in various forms and methods, including through methods that directly relate to pricing and those that do not.

THERE ARE A NUMBER OF CASES WHERE NDRC AND SAIC HAVE VENTURED OUT OF THEIR PRICE-RELATED V. NON-PRICE RELATED JURISDICTION STRAIGHT-JACKETS

Yet an entirely different animal is the draft Regulation on the Prohibition of Conduct Eliminating or Restricting Competition by Abusing Intellectual Property Rights (“draft SAIC IPR Regulation”), circulated on June 11, 2014 for public comment.³⁹ As its title indicates, the draft SAIC IPR Regulation was prepared by SAIC, and the idea is that SAIC will enforce it.⁴⁰ To an extent, the draft regulation follows the categories of anticompetitive conduct it claimed in its non-IPR related implementing rules; in the abuse of dominance area, for example, the draft SAIC IPR Regulation covers refusal to deal, exclusive dealing, tying, unreasonable restrictions, and discriminatory treatment. In addition, the draft regulation rarely refers directly to pricing conduct.

However, the SAIC draft also attempts to regulate IPR-specific figures, such as patent pools, standard essential patents, collective copyright management, and abuses through warning letters.⁴² Obviously, these figures are broad in scope, and seem to go beyond the non-pricing domain. For example, Article 13 deals with the implementation of patents in standards; in many standard essential patent cases, the level of the royalty rate—a price-related issue—plays a key role in the dispute in case.

Hence, it is not difficult to see that the draft SAIC IPR Regulation—as a measure with the broad aim to regulate in the interface between antitrust and IPR without specific regard to the price v. non-price dichotomy—could be interpreted as an attempt of jurisdictional expansion.

Beyond the AML and its implementing regulations, SAIC's pre-existing jurisdiction under the AUCL also gives rise to potential jurisdictional conflicts. As noted, under the AUCL, SAIC has powers to enforce antitrust-related provisions. Some of them relate to non-pricing conduct—in particular, exclusive dealing (by public service enterprises and statutory monopolists) and tying.⁴³ But some of them explicitly relate to pricing conduct. First, Article 11 contains a prohibition of predatory *pricing*. Hence, both NDRC (under the AML and the Price Law) and SAIC (under the AUCL) have jurisdiction over predatory pricing, and the various applicable rules diverge to an extent. Second, Article 15 of the AUCL prohibits bid-rigging, and explicitly outlaws pricing manipulation.

b. Cases

There are a number of cases where NDRC and SAIC have ventured out of their price-related v. non-price related jurisdiction straight-jackets.

(i) NDRC Expansion

On the NDRC side, the prime example of an expansive interpretation of jurisdiction is the *Hubei Salt* case.⁴⁵ In 2010, the Price Bureau of Hubei province—NDRC's local office—investigated a salt company, the Wuchang branch of the Hubei Salt Industry Group ("Hubei Salt"), for tying edible salt—where the company enjoyed an exclusive right of distribution—and washing powder in sales to grocery stores. In short, *Hubei Salt* is an abuse of dominance case, where the objectionable conduct was clearly (and only) tying (by way of directly requiring buyers to purchase salt and washing powder together). In other words, this was a case of pure bundling, and no financial incentives such as discounts were involved.

Against this background, given that no pricing elements were involved, one would have expected SAIC to have jurisdiction over Hubei Salt's conduct.⁴⁶ Indeed, Article 6 of the SAIC Abuse of Dominance Regulation implements the AML's tying prohibition, while NDRC's Anti-Price Monopoly Regulation does not refer to tying or bundling at all. In that sense, the NDRC decision could be interpreted as a jurisdictional grab under the AML.

Yet, other explanations are possible. For example, edible salt is a heavily regulated product. In China, only government-appointed companies are entitled to distribute edible salt.⁴⁷ Most, if not all, of these companies are state-owned enterprises whose right to distribute covers a specified region in China.⁴⁸ In addition to granting exclusive rights to sell salt in a given region, the government also decides the prices at which edible salt can be put onto the market. The authorities responsible for setting the salt prices are the Price Bureaus at the provincial level.

Coming back to the *Hubei Salt* case, this means that the authority that investigated Hubei Salt under the AML was the same authority that had set the prices that the company could charge for the edible salt (under the Price Law framework).⁴⁹ This may have been the reason why the Price Bureau exerted jurisdiction

over Hubei Salt's tying conduct under the AML. But, to be sure, there is no such explanation in the press release by the Price Bureau in the *Hubei Salt* case.

(ii) SAIC Expansion

On the SAIC side, there is the *China Southern* case, mentioned above. In that case, SAIC's local office in Hunan found the airline to have engaged in conduct equivalent to exclusive dealing by way of setting up a complex scheme of loyalty discounts.

As mentioned, this case pre-dates the AML. Under the AML, price-related anticompetitive conduct including abuses of dominance falls under NDRC's purview. As mentioned above, NDRC claims jurisdiction over loyalty discounts under the Anti-Price Monopoly Regulation.

But even after the AML's entry into effect, local AICs have brought cases against predatory pricing⁵⁰ and bid-rigging.⁵¹

2. Parallel Jurisdiction

As noted above, by "parallel jurisdiction" I do not mean that the authorities expand their jurisdiction beyond the *san ding* notices. What I mean is that the conduct at stake has several aspects, some of which are related to pricing and some of which are not.

The background to this situation is, again, that different types of conduct can achieve the same result in economic terms—that is, their impact on the market is the same.

Looking back at the cases in the first six years of AML enforcement, there are quite a few where the conduct at stake has both pricing and non-pricing elements. The cases include both monopoly agreement and abuse of dominance cases.

a. NDRC Expansion

On the NDRC side, we have several monopoly agreements cases that merit attention.

On the horizontal agreements level, for instance, the *LCD panels* case is a good example, even though that the case was decided under the Price Law, not the AML.⁵² In January 2013, NDRC announced that it had imposed fines of close to U.S. \$56 million upon six liquid crystal display ("LCD") makers from Korea and Taiwan for manipulating prices of LCD panels from 2001 to 2006.

LOOKING BACK AT THE CASES IN THE FIRST SIX YEARS OF AML ENFORCEMENT, THERE ARE QUITE A FEW WHERE THE CONDUCT AT STAKE HAS BOTH PRICING AND NON-PRICING ELEMENTS

The descriptive part of NDRC's decision (essentially, a short press release) published online essentially focuses on price-fixing and information exchanges related to prices, which of course are related to pricing. In contrast, the much longer European Commission decision in the same case a few years earlier describes a more varied pattern of conduct of the companies involved, including "a regular and punctual exchange of information on prices, demand, production and capacity for the past, the present and the future."⁵³

Even NDRC's own decision gives an indication that other, non-pricing forces were at play in *LCD panels*. Although there were no explanations whatsoever about these points, the orders imposed by NDRC to remedy the anticompetitive conduct did not only include a prohibition to fix prices and pay the fine, but also contained two additional orders: the companies had to commit, first, to provide the latest LCD technology to China and, second, to extend the warranty period during which they could be held liable vis-à-vis the TV makers using the LCD panels from 18 to 36 months.

As the NDRC decision did not describe the rationale behind these orders, it is not clear whether or not the underlying (competition) problems were related to pricing. The first of the additional remedies implies that NDRC might have thought that the LCD panel makers had not used the latest state-of-the-art technology in China, and took issue with it. The problem with regard to the second additional remedy seemed to be that TV makers themselves had a warranty obligation of 36 months *vis-à-vis* end consumers, while the warranty obligation of the LCD panel suppliers was shorter (18 months). Hence, there might have been a gap of liability that TV makers needed to assume even if any defect were attributable to the LCD panels, not their own fault.⁵⁴ These are the possible concerns NDRC *might* have had. As the descriptions show, the possible concerns are not related to pricing conduct as such.

On the vertical agreements level, the *White liquor* cases provide a good example of the "parallel jurisdiction" risk potential. In 2013, the local offices of NDRC in Guizhou and Sichuan imposed large fines on two manufacturers of Chinese traditional white liquor, Maotai and Wuliangye, for resale price maintenance ("RPM").

The description in the public decision (in the form of press release) in the *Wuliangye* case is somewhat longer than in the *Maotai* case, and hence this case provides more insights.⁵⁵ The decision by NDRC's local office in Sichuan province clearly states that Wuliangye had not only imposed RPM on its distributors, but also allocated exclusive territories: In 2012, Wuliangye had punished its 14 distributors for "improperly selling Wuliangye at low prices, outside the territory and through other channels." Yet the NDRC decision did not challenge the territorial restrictions but mentioned them in passing when discussing the methods of how the company had implemented RPM.

In principle, the fact that NDRC focused on RPM only makes sense, as it has jurisdiction over price-related anticompetitive agreements. In addition, at this point in time, neither the AML, nor any AML implementing rules, state that territorial or customer restrictions are illegal under the AML below the dominance level. However, if in the future vertical restraints other than RPM were to be held illegal under the AML, the *White liquor* cases would be an example to remember on how pricing and non-pricing elements can

be intertwined in this field.⁵⁶

In the abuse of dominance area, NDRC closed its investigation of InterDigital in May 2014. The case was closed through NDRC's acceptance of the commitments proposed by InterDigital, which were published on NDRC's website⁵⁷ alongside some explanations on what the regulator's concerns were.⁵⁸

The explanations in the NDRC press release were very succinct. However, NDRC still gave three examples of suspected anticompetitive conduct that InterDigital was alleged to have engaged in: (1) demanding excessively high licensing fees, (2) requiring free cross-licenses, and (3) bundling the licensing of standard essential patents ("SEPs") with non-SEPs.⁵⁹

The last type of purported anticompetitive conduct—bundling—does not seem to be directly related to pricing.⁶⁰

b. SAIC Expansion

On the SAIC side, at the beginning of the AML enforcement area, the regulator seemed to focus on cartels, mainly local in nature. Generally speaking, SAIC and its local counterparts focused on market allocation conduct by the cartelists.

MOFCOM'S MERGER CONTROL POWERS CAN IN PRINCIPLE OVERLAP WITH THOSE OF NDRC/SAIC IN BOTH THE MONOPOLY AGREEMENT AND ABUSE OF DOMINANCE AREAS

However, in several cases, the cartel conduct also included bread-and-butter price-fixing. For instance, in the *Anyang second-hand cars* case, the AIC of Henan province imposed fines on a cartel among 11 second-hand cars suppliers in the city of Anyang in January 2012.⁶¹ The AIC found that the suppliers partitioned the second-hand car market in Anyang, but the agreements also included price-fixing.

Similarly, in the *Liaoning cements* case, in March 2012, the AIC of Liaoning province penalized a cartel led by a local industry association that agreed to reduce cement output volumes during wintertime.⁶² The AIC's decision mentioned that the cartel also fixed the minimum unit price, but this aspect was not further analyzed in the decision.

Furthermore, in December 2012, the AIC of Zhejiang province fined three concrete companies in Jiangshan for entering into an agreement to divide up the market.⁶³ The AIC found that the cartel agreement also fixed prices.

As the description above shows, there are a range of cases where the conduct of the companies in breach of antitrust rules had both pricing and non-pricing elements.

B. *The Division Of Jurisdiction Between MOFCOM And NDRC/SAIC*

In general, MOFCOM's jurisdiction under the AML is more neatly delimited as a matter of principle. However, there is still some scope for potential conflict.⁶⁴

As under Section III (A), we can broadly distinguish between instances of concurrent jurisdiction between MOFCOM and NDRC/SAIC and parallel jurisdiction between them.

1. Concurrent Jurisdiction

MOFCOM's merger control powers can in principle overlap with those of NDRC/SAIC in both the monopoly agreement and abuse of dominance areas.

a. Monopoly Agreements

For monopoly agreements, I can see two broad issues. First, MOFCOM at times makes an (overly) broad definition of what constitutes a "concentration between business operators," which triggers the merger filing obligation (if the thresholds are met). In a way, a broad definition expands the application of merger control rules into areas where in other jurisdictions only the monopoly agreement rules would apply.

The reasons for the expansive interpretation of the concentration concept are in part due to the legal provisions and in part due to MOFCOM's practice. Strictly legally speaking, in China the only two criteria for a transaction to trigger the merger filing obligation are that (1) we have a concentration and (2) the sales revenue thresholds are met.⁶⁵

Other jurisdictions like the European Union and many of its Member States have an additional criterion for joint ventures, namely that they are "full-function." This essentially means that the joint ventures must operate as independent market players on their own right for the merger filing obligation to be triggered. This criterion is absent in Chinese law.

For example, a joint venture between two companies that is extremely limited in scope—say, only includes joint research—is notifiable in China if there is a legal entity being created in which both companies have a controlling right (which constitutes a "concentration"). Many relatively loose forms of cooperation that do not need merger notification in the European Union—and hence are to be examined under the agreement rules—fall under the merger control regime in China. The *P3* case is a telling example.

On June 17, 2014, MOFCOM blocked the proposed alliance among AP Møller-Maersk A/S, Mediterranean Shipping Company and CMA CGM—three container shipping lines operating on the Asia-Europe trade routes.⁶⁶ MOFCOM found that competition on those trade routes would have been restricted due to: (i) the relatively high aggregate market share of the parties (46.7 percent), and (ii) the negative

impact on shippers and ports, etc. Interestingly, the P3 cooperation did not amount to a concentration under European Union competition rules because the three parties had taken measures to ensure that the cooperation's main focus was that of sharing ships and associated services through a "network center" to be established in England, while the parties were to keep price, sales, marketing, and customer service functions separate. Hence, under European Union rules, the criterion of full functionality was not fulfilled and the cooperation was not deemed a concentration. In China, by contrast, given the absence of full function criterion, the transaction was notified to MOFCOM under the merger control rules.

In that sense, MOFCOM's wide interpretation of the merger filing criteria means that—in a way—its jurisdiction ventures in the turf of the monopoly agreement rules, where NDRC's and SAIC's jurisdictions would kick in.

It is possible that MOFCOM and other authorities such as NDRC would have had discussions on which authority should examine certain borderline cases but, if that was the case, there is no information available to the public.

In addition to this more systemic issue discussed above, I can think of another, more limited area where MOFCOM has taken an expansive approach to its merger control jurisdiction. In *Inbev/Anheuser-Busch and MediaTek/MStar*, MOFCOM imposed conditions that—essentially—expanded its powers to review future transactions by the merging parties even where those transactions would not qualify as "concentrations."

Inbev/Anheuser-Busch was MOFCOM's first conditional clearance decision.⁶⁷ The remedies required the merged entity "not to increase" existing shareholdings in two Chinese domestic brewers (in which it already had a minority stake) and not to acquire any shares, it seems, in two other domestic brewers. If the merged entity nonetheless intended to acquire shares in these four companies, it would need to seek MOFCOM's prior approval. In essence, this means that the merged entity needs to obtain MOFCOM clearance for future acquisitions with regard to these companies, even for acquisitions of just a handful of shares. In *MediaTek/MStar*, a transaction between two semiconductor companies from Taiwan, as one of the conditions for clearance, MOFCOM required the merging parties to obtain its approval before acquiring any competitor in the LCD TV control chip market (where MOFCOM identified competition concerns) in the future.⁶⁸

CONVERSELY, THERE IS ARGUABLY ALSO A RISK OF ENCROACHMENT OF MONOPOLY AGREEMENT RULES INTO THE MERGER CONTROL DOMAIN

To the extent that future transactions do not give rise to an acquisition of a "controlling right" or "decisive influence"—which are the criteria for merger control⁶⁹ (in addition to the revenue thresholds)—MOFCOM would not have jurisdiction. In contrast, any acquisition below a controlling stake could still be interpreted as a monopoly agreement, where NDRC or SAIC might attempt to assert jurisdiction.⁷⁰

Conversely, there is arguably also a risk of encroachment of monopoly agreement rules into the merger

control domain. The risk I refer to is that there is nothing in the law, or NDRC's and SAIC's implementing rules, that would prevent the authorities from examining a merger under the monopoly agreement rules.

The sale and purchase agreements, joint venture agreements, and other transactional documents that are the basis of a merger, are—technically speaking—agreements as understood in the AML. Yet there is nothing in the law that states that a transaction that qualifies as a concentration—or even a concentration reviewed and approved by MOFCOM—is not subject to the AML's monopoly agreement rules. Of course, it would make no sense if NDRC or SAIC started to examine a transaction that had already been approved by MOFCOM—which means or implies that MOFCOM considered the transaction not to have negative effects on competition—but the rules on the book would not explicitly preclude such action by NDRC or SAIC.

Luckily, to the best of my knowledge, there have been no such actions so far, and I have not heard any chatter that the authorities have any plans in that regard.

b. Abuse of Dominance

In the abuse of dominance area, the main issue is the following: merger control is essentially an analysis of prospective behavior. MOFCOM's review takes place before the transaction is implemented, yet MOFCOM

WHAT MAY BE DIFFERENT IS THAT MOFCOM MAY BE MORE SKEPTICAL THAN FOREIGN ANTITRUST AUTHORITIES OF WHAT MERGING PARTIES MAY OR MAY NOT DO IN THE FUTURE

needs to analyze what the competitive situation is likely to be after implementation of the transaction. Now, in some instances, MOFCOM's analysis shows concerns that, after the transaction, the merged entity would have a dominant position, which it could use to anticompetitive ends.

In a number of transactions, the abuse of dominance concern was implicitly featured in MOFCOM's decision. For example, in *Henkel/Tiande Chemical*, *ARM/Giesecke & Devrient/Gemalto*, and *General Electric/Shenhua*, the issue was that, post-transaction, the merged entity would have a very strong market position⁷¹ and the competition concern MOFCOM expressed essentially revolved around conduct that might resemble an abuse of dominance. The specific concern was different in the various cases—discriminatory treatment and excessive pricing (*Henkel/Tiande Chemical*), discriminatory treatment (*ARM/Giesecke & Devrient/Gemalto*), and tying (*General Electric/Shenhua*). In *Microsoft/Nokia*, one of MOFCOM's concerns was that Nokia would abuse its patent rights by (i) refusing to license, (ii) increasing royalties, or (iii) engaging in discriminatory treatment in relation to its patent licensing practices.⁷² In that case, MOFCOM's assessment was very much forward-looking, focusing on conduct Nokia would engage in after the transaction.

To sum up, it seems conceivable that the competition concerns MOFCOM had in a number of transactions could have been dealt with through enforcement of the AML's abuse of dominance rules after the transaction, if the suspected conduct were to materialize.

The issue of pre-merger (merger control) v. post-merger (abuse of dominance) enforcement is not

unique to China. What may be different is that MOFCOM may be more skeptical than foreign antitrust authorities of what merging parties may or may not do in the future. While foreign authorities often make an economics-based assessment, including of the incentives the merging parties have after the transaction, MOFCOM often seems to understand the arguments behind the assurances of the parties, yet may still insist in obtaining commitments that put the assurances into formal commitments.

Conversely, there is a potential for encroachment of abuse of dominance enforcement into the merger field. For example, in the European Union, the European Commission applied the abuse of dominance rules to anticompetitive acquisitions by dominant companies.⁷³ Nothing similar has happened, nor am I aware of any significant academic discussion on this point, in China. In a way, there has not been any encroachment upon MOFCOM's merger powers by NDRC or SAIC using their jurisdiction under the abuse of dominance rules.⁷⁴

2. Parallel Jurisdiction

As with the division of jurisdiction between NDRC and SAIC discussed in Section III(A) above, there are some areas where the conduct of market players have multiple elements, some of which fall under merger control and some of which could fall under the monopoly agreement rules.⁷⁵

“Ancillary restraints” essentially represent an example of such parallel jurisdiction. In the European Union, ancillary restraints are defined as “restrictions directly related and necessary to the implementation of the concentration.”⁷⁶ Typical examples of ancillary restraints are non-compete clauses, licensing agreements, and purchase and supply obligations. As can be seen from these examples, although the restrictions are deemed “directly related and necessary” for the implementation of the transaction, they are still at somewhat of a distance from the core content of the transaction (*e.g.*, the sale of shares, establishment of a joint venture, etc.).

Now, in the European Union such ancillary restraints form part of the merger review process and are covered by the merger clearance decision. In China, the case is less clear.

In China, there are no explicit rules on how to deal with ancillary restraints in the merger control context. Potentially, therefore, both the merger control and the monopoly agreement rules of the AML could apply to ancillary restraints. In short, at this stage in China's antitrust development, it is not clear how to resolve the issue of parallel jurisdiction over ancillary restraints.

C. Problems Brought About By These Potential Jurisdictional Conflicts

As explained above, there is not insignificant potential for concurrent or parallel jurisdiction between the antitrust authorities. The above analysis has focused much on the law, yet—as widely known—policies play an important role in China.

In the antitrust field, at times, policies other than competition policy guide antitrust enforcement. These other policies can be high-level policies—*e.g.*, access to technology—informing the actions of the Chinese government or the Communist Party. To the extent that such high-level policies inform specific antitrust enforcement cases, the jurisdiction of the various antitrust authorities would become (more) blurred, and the risk of overlap may increase further.

In any event, this situation with potential jurisdictional conflict creates a few problems, both in the framework of actual cases and outside it.

1. Problems in Actual Enforcement Cases

One of the most obvious negative effects that the unclear jurisdictional situation could have is that the antitrust authorities conduct simultaneous investigations into the same conduct.⁷⁷ This could result in a frontal clash.

From the perspective of the authorities, a major downside associated with duplicate investigations is that the same law (essentially, the AML) or similar provisions in different laws (*e.g.*, the AML, the Price Law, and the AUCL) are applied inconsistently in the same, specific cases. This could undermine the credibility of the authorities in the long run.⁷⁹

So far, I am not aware of any cases where there have been direct clashes. However, there are two strings of cases that came relatively close. Both relate to instances of parallel jurisdiction exercise by NDRC and SAIC.

The first string relates to the car insurance cases in 2012. SAIC was relatively more active in these cases. In November and December of 2012, the AIC of Hunan province completed separate investigations against

ADDING A BIT OF DRAMA, THIS WAS A NEAR MISS—ONE COULD ARGUE THAT THE AUTHORITIES CAME CLOSE TO COLLISION IN THESE INVESTIGATIONS

four car insurance cartels in four different cities in Hunan: Yongzhou, Zhangjiajie, Changde, and Binzhou.⁸⁰ The facts in these four cases were very similar: they all involved market allocation among insurance companies for their car insurance services through so-called “new car centers.”

In three out of the four cases, the local insurance industry association played a key role as cartel organizer. In the Yongzhou case, the AIC decision mentioned that the cartel also prohibited the new car center from offering any discount. In the Zhangjiajie case, the agreement among insurance companies also included the “plan of regulating and controlling insurance fees.” In the Changde case, the cartel agreement required that the variances among the prices offered by the insurance companies should not be more than 3 percent.

At around the same time, at the end of December 2012, the local office of NDRC in Hunan province—the Price Bureau—fined a local insurance association and 11 insurance companies in Loudi city for monopolizing the new car insurance market through a new car center.⁸¹ The Price Bureau found that the

illegal conduct included the fixing of discount rates, collective boycott, and market allocation.

From the above we can see that during the final months of 2012 both NDRC's and SAIC's local offices in the same province (Hunan) investigated the same type of conduct (car insurance cartels). Mostly, SAIC's offices investigated the market allocation element of the cartels, while NDRC's office appeared to focus primarily on the price-fixing element (discounts).

Adding a bit of drama, this was a near miss—one could argue that the authorities came close to collision in these investigations.⁸² Based on the publicly available data, it seems that the conflict was averted as there seem to have been many isolated, local cartels and the NDRC and SAIC offices investigated cartels in different localities in Hunan.

The second string of cases with high potential for jurisdictional conflict concerns cartel conduct in the tourism sector in Yunnan province, a popular tourist destination in China. In 2013, both SAIC's and NDRC's offices in the province launched anticartel investigations.

In April 2013, the AIC in Yunnan penalized the participants in two cartels in the tourism industry.⁸³ Two local tourist associations were found to have entered into monopoly agreements with tourist agencies, hotels, tourist attractions, and bus companies. The agreements required that the tourist agencies use a specifically designated “tourist information management system” to provide tourist services, and choose only from the hotels and tourist attractions within that system. The agreements also fixed the prices of hotels rooms and admission tickets to tourist attractions, as well as transportation fees. Interestingly, the AIC's decision explicitly found the price-fixing to be illegal: “the parties organized the conclusion of the Self-discipline Agreement [among] tourist agencies, hotels and tourist attractions, and fixed the prices to enable the previously competitive tourist service companies to form a price alliance. [Such practice] is of strong anti-competitive nature.”

NOW, IF THE RULES OF NDRC AND SAIC ARE DIFFERENT AND IT IS NOT CLEAR WHICH AUTHORITY WILL HAVE JURISDICTION, THEN COMPANIES DO NOT KNOW WHICH RULES TO ABIDE BY

Later that year, in September 2013, just a few days before the start of the week-long Chinese “golden week” holiday around National Day (October 1), NDRC issued a press release on its decision to impose sanctions on 39 companies in the tourism industry.⁸⁴ The contested practices of the companies mainly related to the preceding golden week holiday around Chinese New Year in February 2013. Part of the NDRC actions concerned business practices in Yunnan. In Lijiang, an ancient city in Yunnan, NDRC found eight travel agencies to have engaged in price-fixing of hotel rooms and meal vouchers. The companies reportedly met 24 times in 2011 and 2012 under the auspices of a local industry association. They also entered into a written contract that fixed prices and discounts and allocated market shares to each of the participants.

To a large extent, the cartel investigations against practices in the tourism industry in Yunnan had the potential of a head-on jurisdictional clash between NDRC and SAIC.

From the perspective of the companies subject to parallel investigations by NDRC and SAIC, one of the most significant risks would be that they are subject to two investigations and, potentially, two sets of fines and sanctions. Such a scenario would lead to a violation of the double jeopardy principle in Chinese administrative law.⁸⁵

2. Problems Beyond Actual Cases

There are important differences in the rules of the Chinese antitrust authorities, even between NDRC and SAIC. The differences concern both rules of substantive and procedural law, both within the AML framework and outside.

On the substance, the NDRC and SAIC rules show some important differences. There are various examples. A particularly good example is that of the “valid reasons” that can justify potentially illegal abuses of dominance under the AML.

In the AML, except for excessive pricing, all the types of abusive conduct listed – namely, predatory pricing, refusal to deal, exclusive dealing, tying and unreasonable conditions, and discriminatory treatment—can be justified by valid reasons.

However, the approaches which NDRC and SAIC have taken to flesh out the AML rules are very different. Without going into excessive detail, it suffices to say that the format is different: NDRC provides specific examples of valid reasons for each different type of abuse. For example, the justification reasons for predatory pricing are different from those for loyalty discounts. In contrast, the SAIC regulation provides a set of relatively high-level principles that apply to all the types of abuses covered by the regulation.⁸⁶

These differences in the substantive rules present a very significant challenge for companies operating in China. Companies want to conduct their business in compliance with the law. Now, if the rules of NDRC and SAIC are different and it is not clear which authority will have jurisdiction, then companies do not know which rules to abide by. Of course, companies can try to comply with both NDRC’s and SAIC’s rules. However, as the discussion on the valid reasons point above has shown, the rules are not always structured in the same way and may not always be fully consistent.

On the procedural side, NDRC and SAIC rules also diverge—for example, in the leniency program area. Indeed, both NDRC and SAIC have leniency programs based on the general principles outlined in the AML, but their programs have important differences.⁸⁷ A company wishing to self-report through a leniency application does not have a clear understanding on which authority will take on the case. This can in itself be a problem for the company. If the company submits the leniency application to the wrong authority, it might be deemed not to have submitted such application. To the best of my knowledge, there is

THIS PARTICULAR PROBLEM CAN BE RESOLVED, TO A LARGE EXTENT, IF THE AUTHORITIES ALIGN THE SUBSTANTIVE RULES THEY WORK WITH

no clear established system whereby NDRC and SAIC would transfer leniency applications internally.

IV. IDEAS TO DIFFUSE POTENTIAL JURISDICTIONAL CONFLICTS

There are number of ways how the potential for jurisdictional conflict can be reduced; below, I discuss the alignment of rules and the establishment of a detailed cooperation system as possible ways.

The cleanest, but also most radical, solution to reduce conflict risks would be to merge the three existing antitrust authorities in China in one way or another, and create a single antitrust authority. A slightly less radical solution going into the same direction would be to have two authorities—one for merger, and one for non-merger enforcement—as the largest potential for jurisdictional conflict is between NDRC and SAIC (the two non-merger authorities). However, the topic of authority restructuring is beyond the scope of this paper, and I will therefore not further discuss it.

A. *Alignment of Rules*

As noted above, from companies' perspective, a major problem with the current institutional system is that the rules of the authorities diverge on important aspects. Hence, if it is difficult to anticipate which authority will exercise jurisdiction, it will be difficult to know what set of rules apply. This can be an obstacle to effective compliance.

This particular problem can be resolved, to a large extent, if the authorities align the substantive rules they work with. To the extent that the applicable rules are the same, companies know which obligations they have and can orient their compliance efforts toward them. The U.S. experience in this regard may be very useful.⁸⁸ In the past years, perhaps decades, there has been a substantial degree of convergence between the Department of Justice and the Federal Trade Commission as to the substantive rules of antitrust enforcement.⁸⁹

THE CHINESE ANTITRUST AUTHORITIES
NEED AN INSTITUTIONAL MECHANISM
TO REACH AGREEMENT, AND
RESOLVE DISAGREEMENT, ON THEIR
JURISDICTION

The advantage of this approach is that no change in the institutional structure is required to achieve an alignment on the substance of the applicable law. And, given the similarity of their powers, rule alignment would be particularly important for NDRC and SAIC.

B. *Cooperation System*

The second way to reduce the potential for jurisdictional conflict would be to increase the degree of institutional cooperation between China's antitrust authorities. Ideally, the cooperation would be structural—the best would be to create a proper “cooperation system.”⁹⁰ This system should include both substantive and procedural elements.

1. Cooperation on Substance

In terms of the substantive element, the authorities should establish clear rules on how to allocate jurisdiction in grey areas. The starting point of the division of jurisdiction between NDRC and SAIC must, of course, be the *san ding* notices.

Going back to the main risks of conflict between NDRC and SAIC discussed in Section 3—concurrent and parallel jurisdiction—these two scenarios may require different rules.

For concurrent jurisdiction, the risk of jurisdictional conflict could be reduced by agreeing to focus on the category of the conduct involved (that is, the goal the conduct attempts to achieve), not the method of implementation. For example, the goal of loyalty discounts could well be exclusive dealing, which is generally recognized to be non-price related and hence to fall under SAIC's purview.

For parallel jurisdiction, the principle for reducing the risk of jurisdictional overlap could be to determine the central focus of the anticompetitive conduct, perhaps similar to international tax rules allocating jurisdiction. For instance, where a cartel includes price-fixing, output reduction, and market partitioning, the authorities would examine whether the price-related aspect (price-fixing) or the non-price related aspect (output reduction and market partitioning) is more important. Detailed implementing rules would be needed to help the authorities guide through this potentially difficult exercise.⁹¹

2. Cooperation on Procedure

Whatever the substantive principles for jurisdictional division, there is always a potential for conflict.

Hence, a procedural—in fact, an institutional—set-up is required to deal with potential conflict issues. The Chinese antitrust authorities need an institutional mechanism to reach agreement, and resolve disagreement, on their jurisdiction.

At this point in time, both NDRC and SAIC officials at conferences and other occasions often state that the key principle of their jurisdictional carve-up is the “first come, first serve” principle. Unfortunately, this principle is high-level, and not very operative.

China might be tempted to look at foreign jurisdictions with more than one antitrust authority. For example, in the United States, the so-called “clearance process” between the Department of Justice and the Federal Trade Commission provides a detailed procedure of how to solve jurisdictional questions. As both the Department of Justice and the Federal Trade Commission have concurrent jurisdiction to review almost all antitrust investigations, in order to avoid duplication

GOING FORWARD, WE SHOULD EXPECT THE JURISDICTIONAL CARVE-UP ISSUE TO GAIN IN PROMINENCE, AS THE ANTITRUST AUTHORITIES CONTINUE TO SHIFT THEIR FOCUS TOWARDS ENFORCEMENT (AWAY FROM NORMATIVE AND OTHER TASKS) AND SOME OF THE ENFORCEMENT TEAMS AT THE AUTHORITIES CONTINUE TO GROW IN NUMBERS

enforcement efforts, the authorities decided between themselves which authority would conduct an investigation of a particular transaction. This is accomplished through the clearance process, whereby one of the authorities requests the power to investigate a case from the other authority, which clears the request. The clearance process applies to both merger and non-merger investigations.⁹² However, the process is clearly not perfect, and has been consistently criticized by some practitioners and scholars.⁹³ Given these insufficiencies, it is clear that, if the Chinese authorities were to look at the U.S. model, they would need to learn from both the ups and the downs of the clearance process.

A procedural mechanism on jurisdiction (and other issues) between Chinese antitrust authorities could be worked out on a bi- or trilateral basis. Equally, it would be possible to channel it through the Anti-Monopoly Commission. Indeed, the AML already empowers the Anti-Monopoly Commission with the task of “coordinating the administrative anti-monopoly enforcement.”⁹⁴ Related to that, the antitrust authorities could decide whether or not to provide for an escalation possibility in case the issue could not be resolved among them. The natural choice for an appeal instance would be the Anti-Monopoly Commission.⁹⁵

Any cooperation agreement between Chinese antitrust authorities, in particular NDRC and SAIC, should also cover other, practical aspects—for example, if an authority decides that the other authority has jurisdiction, how the file of the matter should be transferred, etc.

Finally, an important point about any cooperation between antitrust authorities is that the rules (whether high-level principles, detailed implementing rules, or both) should be made public so that market players can obtain certainty about substance and process.

V. CONCLUSION

China’s particular institutional regime with three antitrust authorities is, to a large extent, a legacy of the past. Each of MOFCOM, NDRC, and SAIC had antitrust enforcement powers under laws and regulations other than the AML even before the latter’s entry into force.

By taking over pre-existing structures, some of their tensions and potential for conflict have been imported into the AML framework.

Over the six years of AML enforcement, we have not witnessed a major, public clash among the three authorities. There have been a few near misses in the *Hunan car insurance* and *Yunnan tourism cases*, where there were simultaneous investigations in the same sectors and geographical regions, though it seems direct overlap and jurisdictional conflict was just about averted.

However, that does not mean that all has been fine. To the contrary, compliance costs are high for businesses, given the manifold and—at times—inconsistent rules issued by the different authorities. Furthermore, it is possible that the multiplicity of rules and uncertainty of institutional dynamics may have led to compliance over-deterrence, by encouraging companies to take the lowest denominator as the

benchmark for business practices, leading to a stifling of their competitiveness as well as business innovation.

Going forward, we should expect the jurisdictional carve-up issue to gain in prominence, as the antitrust authorities continue to shift their focus towards enforcement (away from normative and other tasks) and some of the enforcement teams at the authorities continue to grow in numbers.

Unless higher-ranked authorities such as the State Council push for more radical solutions such as creating a single authority, it will in principle be up to the three antitrust authorities themselves to come up with a more structured, institutionalized, and transparent *modus operandi* to clarify the boundaries of their powers and give the much-needed certainty to market players. ▲

¹ Partner, Hogan Lovells Beijing; lecturer Peking University Law School. The author would like to thank Qing Lyu, Sonny Sun, and Haoyang Zhuo for their valuable support in putting together this paper, and Allan Fels, Hao Qian, and D. Daniel Sokol for their comments on an earlier draft. A version of this paper will appear in *INSTITUTIONAL CHANGE AND COMPETITION AUTHORITIES* (Philip Lowe, Mel Marquis, & Giorgio Monti, eds., Forthcoming).

² Anti-Monopoly Law of the People's Republic of China, [2007] Presidential Order No. 68, Aug. 30, 2007.

³ See Ministry of Commerce, *MOFCOM legal department official introduced updates on the enactment of the Anti-Monopoly Law*, Jan 11, 2005, available at www.mofcom.gov.cn/article/ae/ai/200501/20050100331588.shtml.

⁴ See Draft Anti-Monopoly Law, [2004] art. 40, available at http://article.chinalawinfo.com/Article_Detail.asp?ArticleId=30676.

⁵ Price Law of the People's Republic of China, [1997] Presidential Order No. 92, Dec. 29, 1997.

⁶ Anti-Unfair Competition Law of the People's Republic of China, [1993] Presidential Order No. 10, Sep. 2, 1993.

⁷ The Chinese language does not distinguish between plural and singular as such.

⁸ Hao Qian, *The Multiple Hands: Institutional Dynamics of China's Competition Regime*, CHINA'S ANTI-MONOPOLY LAW – THE FIRST FIVE YEARS, 20-21 (Adrian Emch & David Stallibrass, eds. 2013).

⁹ Adrian Emch & Hao Qian, *The New Chinese Anti-Monopoly Law – An Overview*, eSapience Center for Competition Policy, 21 (Nov. 2007).

¹⁰ Hao Qian, *supra* 8, at 21-22.

¹¹ *Id.*, at 24-27. See, also, Li Huiying, *Conflict and Coordination Between Sectoral Regulation and Competition Law Enforcement in the Information Industry*, 1(1) CPI ANTITRUST CHRON. (Jan. 25, 2012).

¹² For a somewhat more detailed discussion, see Hao Qian, *supra* 8, at 20.

¹³ Provisional Regulation on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, [2006] Ministry of Foreign Trade and Economic Cooperation, State Administration of Taxation, State Administration for Industry and Commerce, China Securities Regulatory Commission and State Administration of Foreign Exchange Order No.10, Aug. 10, 2006, as last amended by Regulation on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, [2009] MOFCOM Order No. 6, Jun. 22, 2009.

- ¹⁴ Hao Qian, *supra* 8, at 18.
- ¹⁵ Guidelines for the Anti-Monopoly Notification of Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, [2007] MOFCOM Order No. 11, Mar. 8, 2007.
- ¹⁶ *Id.*
- ¹⁷ See Tencent report, *The Ministries' competition behind the Anti-Monopoly Law* (March 7, 2005), available at <http://view.news.qq.com/a/20070826/000022.htm>.
- ¹⁸ Notice of the General Office of the State Council on Issuing the Provisions on the Main Functions, Internal Bodies and Staffing of the Ministry of Commerce, [2008] General Office of the State Council No. 77, Jul. 11, 2008.
- ¹⁹ See Ministry of Commerce, *Important functions*, Jun. 13, 2011, available at <http://fdj.mofcom.gov.cn/article/gwym/200809/20080905756026.shtml>.
- ²⁰ Price Law of the People's Republic of China, [1997] Presidential Order No.92, Dec. 29, 1997 art. 14.
- ²¹ Provisional Regulation on the Prohibition of Price Monopoly Conduct, [2003] NDRC Order No. 3, Jun.18, 2003.
- ²² Anti-Price Monopoly Regulation, [2010] NDRC Order No. 7, Dec.29, 2010, art. 29.
- ²³ Notice of the General Office of the State Council on Issuing the Provisions on the Main Functions, Internal Bodies and Staffing of the National Development and Reform Commission, [2008] General Office of the State Council No. 102, Jul. 15, 2008.
- ²⁴ See National Development and Reform Commission, *Institutional settings*, available at <http://jjs.ndrc.gov.cn/jgsz/>.
- ²⁵ By administrative decision in 2008, NDRC authorized the price departments at the provincial level to investigate and sanction conduct in breach of the AML.
- ²⁶ Anti-Unfair Competition Law of the People's Republic of China, [1993] Presidential Order No. 10, Sep. 2, 1993, arts. 6, 11, 12, and 15.
- ²⁷ Hao Qian, *supra* 8, at 30.
- ²⁸ See Competition Law, *The 21 years of history of Anti-Monopoly Law in China* (Jul. 29, 2008), available at <http://www.competitionlaw.cn/show.aspx?id=3984&cid=13>.
- ²⁹ Notice of the General Office of the State Council on Issuing the Provisions on the Main Functions, Internal Bodies and Staffing of the State Administration for Industry and Commerce, [2008] General Office of the State Council No. 88 [2008], Jul. 11, 2008.
- ³⁰ See State Administration for Industry and Commerce, *Institutional settings*, available at <http://www.saic.gov.cn/fldyfbzdjz/jgsz/>.
- ³¹ WANG XIAOYE, THOROUGH COMMENTS ON CHINESE ANTITRUST LAW 72 (2008).
- ³² International competition law analyses may use the terms of “concurrent” jurisdiction (application of the same law) and “parallel” jurisdiction (application of different laws) differently. See, for example, International Competition Network, Antitrust Enforcement in Regulated Sectors Working Group, Subgroup 3: interrelations between antitrust and regulatory authorities, Report to the third ICN Annual Conference, Seoul, at 7 (April 2004)
- ³³ Anti-Price Monopoly Regulation, [2010] NDRC Order No.7, Dec. 29, 2010, arts. 13 and 14.
- ³⁴ Regulation on the Prohibition of Conduct Abusing a Dominant Market Position, [2010] SAIC Order No. 54, Dec. 31, 2010.

- ³⁵ See case 85/76, *Hoffmann-La Roche v. European Commission*, [1979] ECR 539, ¶ 89.
- ³⁶ SAIC FAIR TRADE BUREAU & CHINA ACADEMY OF SCIENCE INTERNATIONAL LEGAL STUDY CENTRE ED., *SELECTED ANTI-MONOPOLY CASES AND THE INVESTIGATION AND ANALYSIS ON THE CHINESE ANTI-MONOPOLY ENFORCEMENT* 33-37 (2007).
- ³⁷ Anti-Monopoly Law of the People's Republic of China, [2007] Presidential Order No. 68, Aug. 30, 2007, art. 17(6) (emphasis added).
- ³⁸ Regulation on the Prohibition of Conduct Abusing a Dominant Market Position, [2010] SAIC Order No. 54, Dec. 31, 2010, arts. 7(2) and (3).
- ³⁹ Draft Regulation on the Prohibition of Conduct Eliminating or Restricting Competition by Abusing Intellectual Property Rights, [2014] SAIC release, Jun. 11, 2014.
- ⁴⁰ *Id.*, art. 20. In fact, when SAIC started drafting the normative text for a document regulating anticompetitive conduct involving IPRs, the initial plan was to draft "guidelines." However, the plan was later changed, and now SAIC opts for a regulation. Reportedly, the reason for this change was that the guidelines might have been adopted in the name of the Anti-Monopoly Commission, and hence they would have been applicable to all three antitrust authorities. Rumors had it, not all antitrust authorities agreed. Hence, SAIC now plans a regulation, which is in fact an "administrative regulation" that only binds itself.
- ⁴¹ *Id.*, arts. 7-11.
- ⁴² *Id.*, arts. 12-15.
- ⁴³ Anti-Unfair Competition Law of the People's Republic of China, [1993] Presidential Order No. 10, Sep. 2, 1993, arts. 6 and 12.
- ⁴⁴ Adrian Emch & Gregory K. Leonard, *Predatory Pricing in China—In Line with International Practice?*, *LEGAL ISSUES OF ECONOMIC INTEGRATION*, 305-316 (2010).
- ⁴⁵ Hubei Price Bureau, *Wuchang Salt Company is fined for tying sales*, Nov. 15, 2010, available at http://www.sdpc.gov.cn/fzgggz/jggl/zhd/201011/t20101115_380425.html.
- ⁴⁶ Adrian Emch, *Abuse of Dominance in China—The First Cases*, *CAPACITY BUILDING FOR THE ENFORCEMENT OF COMPETITION LAW* 165 (Wang Xiaoye, ed. 2012).
- ⁴⁷ Measures on the Monopoly of Edible Salt, [1996] State Council Order No. 197, May 27, 1996.
- ⁴⁸ *Id.*
- ⁴⁹ Administrative Regulation on Edible Salt Prices, [2003] NDRC Order No. 27, Jan. 3, 2003, art. 5.
- ⁵⁰ See China Consumers Association, *Xinyu AIC announced ten typical cases*, Mar. 23, 2011, available at <http://www.cca.org.cn/web/xfts/newsShow.jsp?id=51497>.
- ⁵¹ Administrative Penalty Decision of Zhejiang Province Pinghu Administration for Industry and Commerce, [2011] Ping Gong Shang Jian Chu Zi No. 154, Aug. 29, 2011, available at <http://www.phaic.gov.cn/ReadNews.asp?NewsID=894>; and Administrative Penalty Decision of Ningbo Administration for Industry and Commerce, [2013] Ningbo Administration for Industry and Commerce, Jul. 31, 2013, available at http://www.nbaic.gov.cn/art/2013/7/31/art_224_36672.html.
- ⁵² National Development and Reform Commission, *Six LCD panels companies are fined for price-fixing conduct* (Jan. 17, 2013), available at http://www.sdpc.gov.cn/fzgggz/jgjdyfld/jjszhdt/201301/t20130117_523206.html; and National Development and Reform Commission, *NDRC officer responded to LCD price-fixing case* (Jan. 17, 2013), available at http://www.sdpc.gov.cn/fzgggz/jgjdyfld/jjszhdt/201301/t20130117_523207.html.

⁵³ European Commission decision, COMP/39.309 LCD (*Liquid Crystal Displays*), Dec. 8, 2010.

⁵⁴ See, *Domestic TV maker saves 400 million RMB due to extended warranty of LCD companies*, BEIJING NEWS (Jan. 5, 2013), available at <http://tech.qq.com/a/20130105/000013.htm>.

⁵⁵ Sichuan Development and Reform Commission, *Sichuan NDRC fines Wuliangye Group 202 million RMB for its pricing conduct* (Feb. 22, 2013), available at <http://www.scdrc.gov.cn/dir25/159074.htm>.

⁵⁶ The *White liquor* cases were not the only AML case where both RPM and territorial restrictions were imposed by manufacturers on distributors. Indeed, in *Johnson & Johnson*, a court case, the same occurred. See Shanghai High People's Court, *Beijing Ruibang Yonghe Science and Technology Trade Company v. Johnson & Johnson Medical (Shanghai) Ltd., Johnson & Johnson Medical (China) Ltd.*, Aug. 1, 2013, [2012] Hu Gao Min San (Zhi) Zhong Zi No. 63.

⁵⁷ National Development and Reform Commission, *NDRC suspends the investigation into IDC for price-monopoly conduct* (May, 22, 2014), available at http://www.ndrc.gov.cn/gzdt/201405/t20140522_612466.html.

⁵⁸ National Development and Reform Commission, *Press conference the supervision of pricing conduct and anti-monopoly work* (Jan. 19, 2014), available at http://www.sdpc.gov.cn/xwzx/xwfb/201402/t20140219_579522.html.

⁵⁹ In the *Qualcomm* case, too, the bundling of SEPs and non-SEPs also seems to have been an area of focus of the NDRC investigation. See National Development and Reform Commission, *Qualcomm CEO came to NDRC for the anti-monopoly investigation for the third time*, available at http://www.ndrc.gov.cn/fzgggzl/jgdyfld/jjszhdt/201407/t20140711_618478.html.

⁶⁰ The case before NDRC was likely factually very similar to the court cases in *Huawei v. InterDigital*, where the Shenzhen Intermediate People's Court at first instance and the Guangdong High People's Court on appeal each issued two judgments. See Shenzhen Intermediate People's Court, *Huawei v. InterDigital*, [2011] Shen Zhong Fa Zhi Min Chu Zi No. 857 and No. 858; and Guangdong High People's Court, *Huawei v. InterDigital*, Oct. 21, 2013, [2013] Yue Gao Fa Min San Zhong Zi No. 305 and No. 306. In their judgments, both courts held that InterDigital's conduct amounted to excessive pricing and tying (SEPs and non-SEPs), in violation of the AML. When analyzing the excessive pricing element of the conduct, the courts actually stressed several aspects that were not price-related. In particular, the courts at both instances found that the filing of lawsuits by InterDigital before the District Court and the International Trade Commission in Washington, D.C. was a means by InterDigital to put undue pressure on Huawei with the ultimate goal to obtain higher, excessive royalties for the patent licensed to Huawei. See Ye Ruosi, Zhu Jianjun, & Chen Wenquan, *Determination of Whether Abuse of Dominance by Standard Essential Patent Owners Constitutes Monopoly: Comments on the Antitrust Lawsuit Huawei v. InterDigital*, 3 ELECTRONIC INTELLECTUAL PROPERTY 46-52 (2013). The filing of a lawsuit is in principle not related to pricing. Viewed from that perspective, it is not difficult to imagine that SAIC would argue it could have jurisdiction over SEP cases; for example, on the grounds that the lawsuit before the International Trade Commission would be equivalent to a refusal to deal.

⁶¹ Administrative Penalty Decision of Henan Administration for Industry and Commerce, [2012] Yu Gong Shang Chu Zi No.1, Jan. 4, 2012, available at http://www.saic.gov.cn/zwgk/gggs/jzjf/201307/t20130726_136758.html.

⁶² Administrative Penalty Decision of Liaoning Administration for Industry and Commerce, [2012] Liao Gong Shang Chu Zi No. 2, Aug. 13, 2012, available at

http://www.saic.gov.cn/zwgk/gggs/jzzf/201307/t20130726_136746.html.

⁶³ Administrative Penalty Decision of Zhejiang Administration for Industry and Commerce, [2012] Zhe Gong Shang An No. 16, Dec. 14, 2012, *available at*

http://www.saic.gov.cn/zwgk/gggs/jzzf/201307/t20130726_136765.html.

⁶⁴ WANG JIAN & ZHU HONGWEN, RESEARCH ON IMPLEMENTATION OF ANTITRUST LAW 16 (2013).

⁶⁵ Anti-Monopoly Law of the People's Republic of China, [2007] Presidential Order No. 68, Aug. 30, 2007, art. 21.

⁶⁶ *Maersk/MSK/CMA CGM*, [2014] MOFCOM Public Announcement No. 46, June 17, 2014.

⁶⁷ *Inbev/Anheuser-Busch*, [2008] MOFCOM Public Announcement No. 95, Nov. 18, 2008.

⁶⁸ *MediaTek/MStar*, [2013] MOFCOM Public Announcement No. 61, Aug. 26, 2013.

⁶⁹ Anti-Monopoly Law of the People's Republic of China, [2007] Presidential Order No. 68, Aug. 30, 2007, art. 20.

⁷⁰ A related issue is that MOFCOM rules allow for voluntary notification even if the sales revenue thresholds are not met. Measures on the Notification of Concentrations between Business Operators, [2009] MOFCOM Order No. 11, Nov. 21, 2009, art. 16. However, the law itself in principle only allows voluntary notification for "concentrations between business operators," and hence MOFCOM should in principle not accept a notification for a transaction that does not qualify as a "concentration."

⁷¹ In *Henkel/Tiande Chemical*, the MOFCOM decision mentioned the market share upstream. One of the parent companies (Tiande Chemical) had a market share at, or close to, the dominance presumption threshold of 50 percent. *Henkel/Tiande Chemical*, [2012] MOFCOM Public Announcement No. 6, Feb. 9, 2012. In *ARM/Giesecke & Devrient/Gemalto* and *General Electric/Shenhua*, the MOFCOM decisions did not indicate the precise level of market shares. However, it is possible or even likely that the market share of at least one of the merging parties was above 50 percent. Indeed, ARM has a very strong IPR portfolio, and the European Commission decision in the same case mentions high market share figures. Similarly, MOFCOM's decision in *General Electric/Shenhua* indicates that both General Electric (as one of only three players) and Shenhua were found to be the largest players in the two affected markets. *ARM/Giesecke & Devrient/Gemalto*, [2012] MOFCOM Public Announcement No. 87, Dec. 6, 2012; and *General Electric/Shenhua*, [2011] MOFCOM Public Announcement No. 74, Nov. 10, 2011.

⁷² *Microsoft/Nokia*, [2014] MOFCOM Public Announcement No. 24, Apr. 8, 2014.

⁷³ See case 6/72 *Europeemballage Corporation and Continental Can v. European Commission*, [1973] ECR 215.

⁷⁴ NDRC's involvement in the MOFCOM merger control process as a stakeholder that is often consulted is another matter, which is beyond the scope of this paper.

⁷⁵ MOFCOM also has jurisdiction over antitrust-related fields under rules outside the AML framework, where potential overlaps with NDRC and SAIC are possible. For example, in the technology licensing space, MOFCOM has certain powers under the Foreign Trade Law and its implementing rules, which can overlap with the monopoly agreement and abuse of dominance rules in the AML for cross-border licensing agreements. See Foreign Trade Law of the People's Republic of China, [2004] Presidential Order No. 15, Apr. 6, 2004, art. 30; and Regulation of the People's Republic of China on the Administration of Import and Export of Technologies, [2001] State Council Order No. 331, Dec. 10, 2001, art. 29. However, I will not

discuss this issue further in this paper.

⁷⁶ European Commission Notice on restrictions directly related and necessary to concentrations, [2005] OJ C 56, ¶ 2.

⁷⁷ JIN FUHAI, RESEARCH ON DIFFICULT ISSUES IN ANTITRUST LAW 23 (2010).

⁷⁸ There have been discussions in this sense in a slightly different situation. As noted above, there were court cases brought by Huawei against InterDigital that ended in two judgments at both the first instance stage in Shenzhen and the appeal stage in Guangzhou. After the appeal judgments had already been out for some time—finding that InterDigital had breached the AML—NDRC issued its decision on supposedly very similar facts. However, the NDRC decision did not find an infringement. It was a decision accepting InterDigital's commitments, which means that the NDRC only talked about "suspected" anticompetitive practices by InterDigital but never clearly found that the company's conduct was illegal. Before the NDRC decision against InterDigital, there had been some criticism in the Chinese academic community. The concerns were mainly that there is public inconsistency if the courts find conduct to be illegal, while an administrative authority settles the case without a finding of illegality.

⁷⁹ Wang Xiaoye, *Several issues on China's anti-monopoly enforcement agencies*, 28(1) DONG YUE TRIBUNE, 33-41 (2007). The negative implications for authority credibility are also present if the factual scope of the investigations by multiple regulators is different (e.g., different target companies), but the legal allegations are the same or similar.

⁸⁰ Administrative Penalty Decision of Hunan Province Administration for Industry and Commerce, [2012] Xiang Gong Shang Jing Chu Zi No. 2, Dec. 3, 2012, *available at* http://www.saic.gov.cn/zwgk/gggs/jzzf/201307/t20130726_136762.html; Administrative Penalty Decision of Hunan Province Administration for Industry and Commerce, [2012] Xiang Gong Shang Jing Chu Zi No. 4, Dec. 3, 2012, *available at* http://www.saic.gov.cn/zwgk/gggs/jzzf/201307/t20130726_136763.html; and Administrative Penalty Decision of Hunan Province Administration for Industry and Commerce, [2012] Xiang Gong Shang Jing Chu Zi No. 3, Dec. 3, 2012, *available at* http://www.saic.gov.cn/zwgk/gggs/jzzf/201307/t20130726_136764.html.

⁸¹ Hunan Price Bureau, Pricing monopoly among Loudi insurance companies (Dec. 28, 2012), *available at* <http://www.priceonline.gov.cn/jianduju/Shownews.asp?ID=149735>.

⁸² See Xu Liu, *Improvements of the functions of the State Anti-Monopoly Commission and reform of anti-monopoly law enforcement mechanisms under the background of ministry reform* (Nov. 15, 2013), *available at* <http://law.tongji.edu.cn/index.php?classid=2434&newsid=3836&t=show>; and State Administration for Industry and Commerce, *Improvements to Chinese anti-monopoly law enforcement*, Nov. 26, 2013, *available at* http://www.saic.gov.cn/gsxh/ktyj/xsdt/201312/t20131206_140265.html.

⁸³ Administrative Penalty Decision of Yunnan Province Administration for Industry and Commerce, [2013] Yun Gong Shang Jing Zheng Chu Zi No. 1, (Apr. 7, 2013), *available at* http://www.saic.gov.cn/zwgk/gggs/jzzf/201307/t20130726_136768.html.

⁸⁴ National Development and Reform Commission, *Illegal pricing conduct among travelling agencies sanctioned* (Sep. 29, 2013), *available at* http://www.sdpc.gov.cn/fzgggz/jgjdyfld/jjszhd/201309/t20130929_560780.html.

⁸⁵ Law of the People's Republic of China on Administrative Penalties, [2009] Presidential Order No. 63,

Aug. 27, 2009, art. 24.

⁸⁶ Regulation on the Prohibition of Conduct Abusing a Dominant Market Position, [2010] SAIC Order No. 54, Dec. 31, 2010, art. 8.

⁸⁷ Adrian Emch, *The antitrust enforcers' New Year resolutions*, CHINA LAW & PRACTICE 20, 22 (February 2011). See Anti-Price Monopoly Regulation, [2010] NDRC Order No. 7, Dec.29, 2010, art. 14; Regulation on the Prohibition of Monopoly Agreement Conduct, [2010] SAIC Order No. 53, Dec. 31, 2010, arts. 11-13; and Regulation on the Procedure for the Handling of Cases Involving Monopoly Agreements and Abuses of a Dominant Market Position, [2009] SAIC Order No. 42, Jun. 5, 2009, art. 20.

⁸⁸ WANG XIAOYE, COMPETITION LAW 409 (2007).

⁸⁹ See, for example, William E. Kovacic, *Downsizing antitrust: is it time to end dual federal enforcement?*, ANTITRUST BULL., 532 (Fall, 1996).

⁹⁰ WANG JIAN & ZHU HONGWEN, RESEARCH ON IMPLEMENTATION OF ANTITRUST LAW 19-21 (2013).

⁹¹ Of course, ultimately, the goal of most if not all cartelists and other companies engaging in anticompetitive practices is to obtain higher revenues—hence, all anticompetitive conduct is in principle “price-related.”

⁹² U.S. Department of Justice, Division Manual Chapter VII, *Antitrust Division Relationships with Other Agencies and the Public*, available at <http://www.justice.gov/atr/public/divisionmanual/chapter7.pdf>; and see, also, Harry First, Eleanor M. Fox, & Daniel E. Hemli, *Procedural and Institutional Norms in Antitrust Enforcement: The U.S. System*, New York University Law and Economics Working Papers, Paper 303 (2012).

⁹³ See, for example, Kovacic, *supra* note 89, at 515.

⁹⁴ Anti-Monopoly Law of the People's Republic of China, [2007] Presidential Order No. 68, Aug. 30, 2007, art. 9(1)(4).

⁹⁵ The Legislation Law stipulates that if a regulation enacted by a central-level ministry is in conflict with another regulation of the same rank, such conflict can be escalated to the State Council. Legislation Law of the People's Republic of China, [2000] Presidential Order 30, 1 July 2000, art. 86(3). In a sense, the Anti-Monopoly Commission is an “extended arm” of the State Council.

Designing Competition Law Under Financial Crisis—Indonesia and Thailand Compared

BY R. IAN MCEWIN¹

The 1997 the Asian Financial Crisis was the impetus for the introduction of competition law in both Indonesia and Thailand. The crisis upset cozy pre-existing government-business relations and led to the collapse of some financial empires. There was a belief in both countries that anticompetitive practices, sanctioned by government, contributed to the crisis and so this proved to be a catalyst for the introduction of competition law in 1999 in both Indonesia and Thailand. While the International Monetary Fund imposed, as a condition for financial support, a requirement that Indonesia introduce a competition law, it did not impose the same condition on Thailand despite the fact that, arguably, Thailand was in worse economic shape prior to the AFC than Indonesia. However, despite the common causal factor, Indonesia and Thailand each designed different competition laws and institutions and both have quite different enforcement records. Why? This is a difficult question, but we present several answers, leading to the realization that while the world has changed in Indonesia and competition is more important there now, the same cannot be said for Thailand—yet.

I. INTRODUCTION

Government is inseparable from big business networks in Southeast Asia. Small political elites (who gain individual political and economic power from their official positions) or oligarchs (who gain individual political and economic power directly from their material wealth, not their position) control the politics and economies of all countries in Southeast Asia—and so all countries in the region are best described as plutocracies. Of course, elites and oligarchs are often inseparable and oligarchs can use their wealth to buy official or political positions, and often do.

Cozy relationships between government and business limit competition and innovation in many important markets. Government-provided exclusive licenses, preferential lending (often from state-owned banks), elite and oligarchic control of state-owned enterprises (“SOEs”) that compete with the private sector and government tolerance of anticompetitive practices not only provide the elite and oligarchs with considerable financial rewards but also prevent entry by more efficient firms—particularly foreign firms.

Given these circumstances it is hard to envisage that competition law would be introduced at all given that political power and incumbent wealth has been derived from excluding competition. After all

GIVEN THESE CIRCUMSTANCES
IT IS HARD TO ENVISAGE THAT
COMPETITION LAW WOULD BE
INTRODUCED AT ALL GIVEN THAT
POLITICAL POWER AND INCUMBENT
WEALTH HAVE BEEN DERIVED FROM
EXCLUDING COMPETITION

oligarchy is all about the politics of wealth defense²—which would include preventing the introduction of competition law. In democracies, pressure for microeconomic reform and the introduction of competition law is likely to come from a middle class who benefit from the lower prices resulting from more competition or improved market access through reduced

entry barriers and control of dominant firms. Southeast Asian economies have grown considerably in the last twenty years and so the size of the middle class has also grown, increasing pressures on government for a more “level playing field.” However, the size of the middle class was still relatively small in both Indonesia and Thailand when competition law was introduced in both countries in the late 1990s.

In the World Economic Forum’s Executive Opinion Survey when asked: “In your country, to what extent does anti-monopoly policy promote competition” Indonesia ranked 43 and Thailand 69 out of 148 countries in the Global Competitiveness Report 2013-14.³ But do executive opinions reflect proper perceptions of competition law? Or do they simply reflect vague impressions of competition policies including privatization, tariff policies, etc.? As will be seen Thailand does not enforce its competition law at all so it is hard to understand its relatively high ranking.

DESPITE THE COMMON CAUSAL FACTOR, INDONESIA AND THAILAND EACH DESIGNED DIFFERENT COMPETITION LAWS AND INSTITUTIONS AND BOTH HAVE QUITE DIFFERENT ENFORCEMENT RECORDS

The 1997 the Asian Financial Crisis (“AFC”) was the impetus for the introduction of competition law in both Indonesia and Thailand. The crisis upset cozy pre-existing government-business relations and led to the collapse of some financial empires. There was a belief in both countries that anticompetitive practices, sanctioned by government, contributed to the crisis and so this proved to be a catalyst for the introduction of competition law in 1999 in both Indonesia and Thailand. While the International Monetary Fund (“IMF”) imposed, as a condition for financial support, a requirement that Indonesia introduce a competition law, it did not impose the same condition on Thailand despite the fact that, arguably, Thailand was in worse economic shape prior to the AFC than Indonesia.

Despite the common causal factor, Indonesia and Thailand each designed different competition laws and institutions and both have quite different enforcement records. Why? This is a difficult question to answer. Both are essentially civil law countries (although Thailand has elements of the common law). Because judges are trusted less in civil law countries than in common law countries, civil law countries in Southeast Asia tend to spell out in detail what is prohibited, if not in the legislation (including market-share thresholds for example) then in detailed decrees or guidelines. If these details are not provided, it is unlikely that competition law provisions will be implemented either by civil law regulators or the courts.

Undoubtedly, the design of a competition law and competition regulator depends on a number of factors that are difficult to disentangle empirically. Factors that influence the design outcome can include: (i) pre-existing network relationships; (ii) the extent to which foreigners are involved in the process, including the amount of foreign aid being provided; (iii) the structure of business including its competitiveness and the extent to which underlying important monopolistic practices exist; (iv) political circumstances, including the extent to which big business groups control government and parliament; (v) the extent to which the state (including the army and royalty) is involved in business; and (vi) the adjudication institutions, such as the legal system and traditions, and their history of independence and enforcement effectiveness in each country.

Big business is similar in both Indonesia and Thailand—small numbers of very rich oligarchs (mostly of Chinese ethnic origin) control conglomerates that dominate each economy. So it could be expected that elites and their networks in each country would have the same kinds of interests to protect and so would want similar kinds of competition laws that limit the impact on their wealth. With control of the political process, it would be expected that elites and conglomerates would not want regulators to be independent, instead preferring them to be within government ministries they can influence politically directly or indirectly through control over the appointment of regulators. Judicial discretion, similarly, would want to be minimized.

However, despite the fact that both countries had weak coalition governments around the time of the introduction of competition law, Indonesia and Thailand have vastly different competition laws. Competition law is complex in Indonesia and has an independent regulator. Thailand’s competition law is relatively simple, derived from competition laws in Northeast Asia and Europe, but its regulator is located within a ministry. The difference can be explained, at least partially, by the fact that competition law in Thailand was drafted by technocrats within the civil service, while in Indonesia it was mainly a political compromise between in-house parliamentary groups.

At the time of the AFC Thailand was saddled with weak coalition governments that resulted in considerable policy dithering due to interest group bickering. But Thailand already had a competition law—the *Price Control and Anti-Monopoly Act 1979*—which was not enforced. This was replaced by the *Competition Act 1999*. Interestingly, despite the military being involved in business in Thailand, both Acts were the result of military-installed governments—which may explain the harshness of the penalties. At the moment Thailand still only has criminal penalties although there are proposals to introduce civil penalties.

Indonesia, by contrast, at the time of the AEC, had just replaced a strong, centralized government under the dictator Soeharto. This was a government with a long history of cronyism and backroom deals and increasingly unpredictable policies. After Soeharto’s fall, to counter the economic power of future presidents, the competition law was written by groups within Parliament (with some input from the executive) who were suspicious of elite and oligarchic domination of the economy under Presidents Sukarno and Soeharto in conjunction with the military. Being a compromise of competing interest groups within Parliament,

THE DIFFERENCE CAN BE EXPLAINED, AT LEAST PARTIALLY, BY THE FACT THAT COMPETITION LAW IN THAILAND WAS DRAFTED BY TECHNOCRATS WITHIN THE CIVIL SERVICE, WHILE IN INDONESIA IT WAS MAINLY A POLITICAL COMPROMISE BETWEEN IN-HOUSE PARLIAMENTARY GROUPS

the resulting Act is complex and internally inconsistent as it was driven by an attempt to cover every conceivable kind of anticompetitive and unfair practice. In order to prevent the executive from assuming the control over business it had previously enjoyed, the Indonesian regulator (“KPPU”) was made the first independent regulator in Indonesia—with staff recruited from outside the civil service and so not enjoying civil service benefits such as permanency.

Given the above it could be expected that with a relatively clearly written act in Thailand—the product of extensive research within the bureaucracy—there would be a greater level of enforcement in Thailand.

Yet not one case has proceeded to a sanction. While several major cases were investigated during the first year, including those involving a cable television monopoly and a whisky tied sales case, enforcement effectively stopped with the election of the Thai Rak Thai party in 2000, led by Thaksin Shinawatra. Thaksin had built a considerable base of electoral support, particularly among the poor in the North and Northeast, but led a party dominated by big business and which competed with other elites groups in the opposing Democrat Party. Cases recommended for prosecution by the Trade Competition Commission to the Attorney-General have usually been returned to the Commission stating that more evidence was required to meet the standard for a criminal prosecution.

THE LACK OF SUCCESSFUL PROSECUTIONS IS NOT ONLY DUE TO ELITE OR OLIGARCHIC INTERFERENCE AT THE INVESTIGATING STAGE AND PROBLEMS OF MEETING THE CRIMINAL STANDARD OF PROOF, BUT ALSO DUE TO THE FACT CRIMINAL CONVICTIONS MEAN CONSIDERABLE LOSS OF FACE IN THAILAND

The lack of successful prosecutions is not only due to elite or oligarchic interference at the investigating stage and problems of meeting the criminal standard of proof, but also due to the fact criminal convictions mean considerable *loss of face* in Thailand. So cases may have had an indirect impact on the Attorney-General's network relationships—not just the direct business interests of those involved. Recent proposals to allow for civil penalties (which mean less loss of “face”) may lead to a greater level of enforcement.

On the other hand, face does not seem to be quite so important in Indonesia. Many cases have been investigated and action taken by the KPPU. While many have been lost on appeal in the courts, many have also succeeded. So the level and quality of enforcement have been much greater in Indonesia than in Thailand.

II. THE ASIAN FINANCIAL CRISIS

The AFC crisis began in Thailand in July 1997 (sometimes called the *Tom Yum Goong Crisis*—that is, hot, spicy but sour) when the Thai baht was allowed to float. In Thailand close government-business ties usually meant that favored businesses felt protected from government and so immune from sudden changes in economic policy. However, a weak coalition government failed to respond to early signs of the impending crisis and the sudden float of the Thai baht in 1997 upset longstanding business expectations that they would be protected.

Before the AFC the Thai Finance Ministry had guaranteed the creditworthiness of Thai financial institutions. The float of the baht arose as a result of the appointment of a new finance minister in Thailand in June 1997. The Thai Finance Ministry, under the previous minister, had sought data on the amount of foreign reserves held by the Central Bank but could not get a reply. In frustration, Prime Minister Chevalit Yongchaiyudh appointed Thanong Bidaya (who has a PhD in management from Northwestern University) as the new finance minister. Bidaya went to the Central Bank to inspect their records and to his dismay he discovered that reserves would only cover Thai imports for two days—whereas the Bank was required to hold reserves for 60 days. One reason was that the Central Bank had lent about U.S. \$8 billion to local banks who were in difficulty. As Haley, Haley, & Tan put it:

The Central Banks's officers had not reported the true state of affairs six months earlier to the government and public because the officers would have lost face.⁴

Presumably their network friends would also have lost considerable amounts of money. However, U.S. authorities knew about the foreign reserve problem. Timothy Geithner wrote that Thai authorities refused to listen to the IMF's warnings about short-term foreign currency borrowing coupled with a fixed exchange rate. Geithner said that Thai authorities claimed to have U.S. \$20 billion in foreign exchange reserves but "we knew the real number was closer to zero; the Thai central bank had sold its dollars in the forward market to conceal the depth of its problems."⁵

AS OFTEN HAPPENS WITH ECONOMIC
CRISES, SUBSEQUENT POLITICAL
TURMOIL LED TO IMPORTANT
POLITICAL CHANGES

Thailand reached a standby arrangement with the International Monetary Fund in August 1997. Indonesia did the same in November. However, Soeharto's initial commitment to reform as part of the IMF bailout was followed by backpedalling due to business pressures. Soeharto's backpedalling may account for why the IMF insisted on a formal commitment to introduce competition law.

The crisis had significant political impact as well as financial. Business and government have always been close in Southeast Asia and politically well-connected businesses suffered considerable reductions in income and wealth due to the floating of their currencies, as foreign borrowings had usually not been hedged—the government had been "trusted" not to float without advance notice. At the same time, normal citizens suffered considerably and blamed the crisis on political corruption and business-government links. As often happens with economic crises, subsequent political turmoil led to important political changes.⁶ The Asian Financial Crisis led to the end of the Soeharto regime in Indonesia and the Chavalit government in Thailand.

IN SOUTHEAST ASIA, NETWORKS HAVE
BEEN TRADITIONALLY IMPORTANT
BECAUSE, UNTIL RECENTLY, LEGAL
INSTITUTIONS HAVE NOT DEVELOPED
TO REGULATE BUSINESS RELATIONSHIPS

III. SOME GENERAL FEATURES OF BIG BUSINESS IN SOUTHEAST ASIA

Wealth is highly concentrated in families in all Southeast Asian countries. For example:

The largest ten families in Indonesia and the Philippines control more than half the corporate assets (57% and 52.2% respectively). The concentration of control in the hands of large families is also high in Thailand (46.2%) and Hong Kong (32.1%). A quarter of the corporate sector in Korea, Malaysia and Singapore is controlled by the largest ten families. In contrast, family control in Japan is insignificant, as the largest 15 families own only 2.8% of listed corporate assets.⁷

Businesses tend to share a number of common characteristics, which include the importance of networks (both domestically and across countries), the use of business groups, and a concern with control over

the distribution chain.

A. *Networks*

In general, loyalty and trust form the basis for most networks and so every country develops its own business networks where legal institutions are weak. In Southeast Asia, networks have been traditionally important because, until recently, legal institutions have not developed to regulate business relationships, including the enforcement of contracts, etc. So it is not surprising that immigrant Chinese families and clan groups, for self-protection against governments and indigenous networks, formed ethnic business networks during the 19th and 20th in all countries in Southeast Asia. These networks usually extended beyond individual countries.

DRAWING THE LINE BETWEEN *GUANXI*—
USED TO DEVELOP LONG-TERM
RELATIONSHIPS IN AN UNCERTAIN
WORLD THAT REDUCE TRANSACTION
COSTS—AND CORRUPTION AND/
OR ANTICOMPETITIVE PRACTICES IS
DIFFICULT

In Southeast Asia, most big business is dominated by the Overseas Chinese. In Thailand, one exception is the *Crown Property Bureau*, which is at the heart of the network monarchy that dominates many significant Thai economic sectors. Not much is written about the Bureau, probably due to a fear that anything critical will breach *lese majeste* laws. One exception is a work by Porphant Ouyyanont, who describes the initial source of the Bureau's wealth as follows:

In 1890, as part of the overall modernisation of administration ... royal expenses were formally separated from the government budget and placed under the management of a revamped Privy Purse Bureau (PPB) within the Ministry of Finance. Around 15% of total government revenue was assigned to the PPB.⁸

After paying for household expenses, there was a surplus which was invested and serves as the basis for the monarchy's extensive investments in Thailand today, particularly in real estate, banking (the Siam Commercial Bank ("SCB")), and business (the Siam Cement Company—which had a monopoly on cement production at a time of considerable urban expansion). After the absolute monarchy was abolished in 1932, the PPB's assets were divided into three: those belonging to the King personally; state property including the palaces; and the assets used to fund the monarchy as an institution—which included the SCB and Siam Cement—which were then controlled by the Crown Property Bureau and which came under the Ministry of Finance with directors appointed by the government. However, in 1948 the *Crown Property Act* established the Crown Property Bureau as a juristic person and gave control back to the monarchy.

The CPB has its own website and provides an annual report⁹ which does not include financial statements. Porphant Ouyyanont estimated the total worth of the CPB in 2005 to be about 1.1 trillion baht, which is about U.S. \$34.4 billion at current exchange rates. While the CPB is not given an explicit exemption from competition law, given the importance of the monarchy network in Thailand it is highly unlikely the CPB would be investigated for alleged competition law offenses.

Overseas Chinese place great value on connections (*guanxi*) and because they believe in putting family first, necessarily see relations outside the family as being potentially opportunistic. Gifts are seen as a way of developing trustworthy relations outside the family in societies where the ability to enforce contracts is limited. Trust developed through goodwill over time helps to expand the number of people one would otherwise deal with outside the family. Drawing the line between *guanxi*—used to develop long-term relationships in an uncertain world that reduce transaction costs—and corruption and/or anticompetitive practices is difficult. Adding to the complexity is that, for survival, Overseas Chinese developed close links with indigenous rulers, often collecting taxes for them and otherwise helping to develop their businesses—which also gave them the ruler’s protection against often hostile indigenous competitors.

BUT A SOLE CONCERN WITH OWNERSHIP MASKS ISSUES OF CONTROL, WHICH ARE PARTICULARLY IMPORTANT IN BUSINESSES IN ASIA.

Haley et al.^{10,11} summarize the types of Overseas Chinese business networks as follows: Clan grouping (by family surname); locality group (by locality of origin in China); dialect grouping (e.g. Hokkien, Teochew); guild grouping; and trust grouping (based on experience or recommendation). One of the advantages of the Overseas Chinese business networks is the ability to discuss matters openly, without fear that what is communicated will be used against them (i.e. no fear of loss of “face”). While this openness allows for better decision-making, it also allows for the possibility (or probability) for potentially anticompetitive matters to be discussed, such as price-fixing and exclusionary boycotts. Overseas Chinese business networks allow for the network to transmit information about prices, changing economic conditions, and the trustworthiness of those within and without the network. These networks also allow for long-term co-operation and “network co-ordination” of prices, targeting of businesses to exclude, and agreements not to compete with each other—hence competition law should take an interest in such networks.

B. Business Groups

For most competition law purposes, corporate form is not considered relevant. Companies are assumed to have widely dispersed ownership and corporate governance is there to overcome agency problems between shareholders as principals and management as their agents. But a sole concern with ownership masks issues of control, which are particularly important in businesses in Asia.

La Porta, Lopez-de-Silanes, & Shleifer¹² examined the ownership structure of the 20 largest publicly traded firms in 27 of the richest countries in the world, where the likelihood of widely dispersed ownership is high. They found, particularly in countries that have poor minority shareholder protection, that even large firms tend to have controlling shareholders, with control held sometimes by the state but mostly held by a family (either the founder or his—invariably male—descendants). Usually, controlling shareholders have a degree of control over company assets greater than their rights to the cash flows or assets of the firm. This is achieved through the use of pyramid structures or dual class shares.

Furthermore, the Overseas Chinese family businesses often “expand by acquiring an ever-increasing number of companies rather than by expanding existing companies. The overall business group may be large,

but its individual components may be relatively small. This means that ethnic Chinese feature strongly in lists of the wealthiest families or entrepreneurs, but are under-represented in lists of the biggest companies.”¹³

Claessens, Djankov, & Lang found that corporate control is usually enhanced through the use of pyramid structures and cross-holdings among East Asian firms.¹⁴ Pyramid control is fairly common in continental European countries and in Asia but not in the United Kingdom and the United States. Pyramids are usually created through a holding company that has a controlling interest in another holding company that has, in turn, a controlling interest in an operating company.

Because both dual-class shares and corporate pyramids are mechanisms to separate cash flow rights and voting rights, they allow a party to control corporate assets while contributing only a small proportion of equity capital. Once established, control can be increased through rights issues. Funds are sought from existing shareholders, with those that contribute increasing their relative ownership share. As a strategy, rights issues can be used to dilute the shareholding of non-network shareholders.

WHILE THE EXERCISE OF MARKET POWER MAY BE SIMILAR, A DISTINCTION SHOULD BE MADE BETWEEN CONGLOMERATES AND BUSINESS GROUPS

The economic basis for exercising control through dual-class shares and pyramids is essentially the same as for “trust networks”—they can achieve efficiencies but also increase market power. They may bring efficiencies where institutions, such as equity markets, are undeveloped. For example, the business group

IMPORTANTLY, FOR COMPETITION LAW PURPOSES, LARGE BUSINESS GROUPS ALSO FACILITATE THE EXERCISE OF MARKET POWER

can serve as an internal financial market where cash from profitable firms within the group support those firms that are struggling. Just as importantly, where legal institutions are undeveloped (and thus contracts are difficult to legally enforce) then a business group, conglomerate, or corporate pyramid

can substitute internally for outside contracting—thereby bypassing outside markets and networks. A recent empirical study of business groups concluded that “their emergence and early establishment often occur under very difficult institutional conditions and that they played a pivotal role in the early stages of many countries’ and regions’ economic development.”¹⁵

Importantly, for competition law purposes, large business groups also facilitate the exercise of market power. Pyramidal group, allow for centralized control of interrelated markets. This enables, for example, one group member to secretly tie the products of network members, or to provide below cost inputs to another member company, allowing the downstream firm to drive competitors out of business. For example, suppose A owns 51 percent of shares in Company X, a monopolist. A also owns 100 percent of shares in Company Y. Company X sells an input to Company Y. A could direct Company X to sell the input to Company Y at a 30 percent discount compared to other buyers. This increases A’s overall profits (A receives only 50 percent of profits from Company X, but 100 percent of profits from Company Y). Company Y gets a competitive advantage in the downstream market and may be able to drive out his/her other competitors or force the others to join a cartel. If the business group operates across countries, a competition regulator will have difficulty proving predatory pricing, in particular where the chain of companies includes private companies

that operate with few records or public scrutiny.

While the exercise of market power may be similar, a distinction should be made between conglomerates and business groups. Conglomerates typically are a corporate group, with a parent company and subsidiaries. For example:

Many successful ethnic Chinese families in the region have modernised their business interests along similar lines. Typically, their companies are formed into a squat pyramid format, with a private holding company at the apex, a second tier holding the most prized assets which are usually privately held, and a third tier comprising the group's publicly-listed companies. Such a structure makes it easier for the families to implement the maxim: 'what is profitable is 100 per cent mine; what is not is mostly not mine.' Should there be a desire to do so, it also makes it easier to raise funds at the bottom of the pyramid from shareholders in the group's public companies, then pass these up the pyramid.¹⁶

Business groups are an intermediate type of organization lying between market contracting and common-ownership conglomerates. A business group is a collection of legally distinct firms that do business with each other on favorable terms. While they may resemble conglomerates, the companies in a business group are legally independent, i.e., there is no formal control. However, despite this independence they coordinate their long-term strategies. Despite the formal lack of control there is still, however, a high degree of informal control within business groups; for example, by:

BECAUSE BUSINESS GROUPS CONTROL MUCH OF THE WEALTH IN SOUTHEAST ASIA THEY MAY REPRESENT A PARTICULAR CHALLENGE FOR COMPETITION LAW

- a family (e.g., ethnic Chinese groups in Indonesia, Malaysia, the Philippines, and Thailand, or the Bumiputera groups in Indonesia and Malaysia);
- the State (e.g., government-linked groups in Singapore or Vietnam, the military in Thailand or Indonesia); or
- a financial institution.

Why are business groups so pervasive and important in Southeast Asia? The usual explanation for business groups, as mentioned above, is efficiency. That is, they arise due to market failures or "institutional voids," similar to the economic explanation for networks. But as institutional deficiencies are rectified with increasing standards of living, it would be expected that they would be no longer needed. However, business groups are still important in Southeast Asia, even with high levels of economic development, which casts doubt then on the "institutional voids" hypothesis and suggests that creation of the market power may be, now, more, important.

Many business groups in Southeast Asia are state-created. Often, following the end of colonial rule, the state monopolized capital and used it to assist specially selected small groups of local entrepreneurs to

WHERE THE STATE DOES NOT PROVIDE CONTRACT LAW OR DOES NOT ENFORCE IT, THEN BUSINESSES “DEVELOP REPUTATION-BASED ALTERNATIVES TO OBTAIN THE CRUCIAL PREDICTABILITY IN COMMERCIAL TRANSACTIONS

buy the assets of the departing colonists, or the state simply nationalized them and transferred control to indigenous entrepreneurs linked to government. Usually, this state-led strategy was accompanied by the grant of domestic monopolies and protection from foreign competition (both by import protections and restrictions on foreign ownership).

Because business groups control much of the wealth in Southeast Asia they may represent a particular challenge for competition law. Reasons include: (i) close relations with government (this is more of a problem in the civil law countries where there are usually fewer private remedies available, because state regulators do not act on complaints about anticompetitive conduct); (ii) common anticompetitive practices such as collusion between members of the same business group; and (iii) abuse of market power achieved through coordination of policies and resources (e.g., impeding entry or driving competitors out by obtaining preferential prices or terms for inputs from other members of the group, including preferential financing or favorable distribution through cheaper retail outlets).

As far back as 1995, the Australian East Asia Analytical Unit noted that:

A growing phenomenon among many prominent ethnic Chinese-controlled companies, particularly in South-East Asia, is the degree to which they move together in their quest to jointly dominate markets. This occurs at an international level, emphasising that senior ethnic Chinese business people often treat the region as a single, borderless market.¹⁷

C. Control of Distribution

The Overseas Chinese originally concentrated in trading due to the comparative advantage given them by their networks in many Asian countries. Additionally, they have a very high savings rate and tend to keep much of their wealth in liquid form. Investments are spread across many different industries again reflecting an underlying (deserved) concern with misappropriation by indigenous rulers or other businessmen due to a lack of contract law enforcement. Haley, et al.¹⁸ suggest that:

... the Overseas Chinese prefer to maintain control over distribution of their goods. Perhaps this practice originates through their historical role in trade and distribution of goods; regardless of the reason, most goods sold in Southeast Asia go through the hands of Overseas Chinese intermediaries at some point in their passage between manufacturers and end user.

This “historical role” partly resulted from the lack of legal contract enforcement in China and Southeast Asia. Douglass North¹⁹ stressed that economic growth depends on “How effectively contracts are enforced.” But in Imperial China, the law did not facilitate commercial transactions but rather was designed

and enforced to promote state interests. As a result, merchants in China avoided the formal legal system. Where the state does not provide contract law or does not enforce it, then businesses “develop reputation-based alternatives to obtain the crucial predictability in commercial transactions.”²⁰ The practice of relying on family, extended families, and clans was carried by Overseas Chinese to Southeast Asia (where legal systems were underdeveloped) and served them well.

NETWORK DISTRIBUTION PRACTICES ALSO EXPLAIN WHY A NUMBER OF ASIAN COUNTRIES, BOTH IN NORTHEAST AND SOUTHEAST ASIA, INCLUDE “BUSINESS CONSUMER PROTECTION” PROVISIONS IN THEIR COMPETITION LAWS THAT DEAL WITH BARGAINING RELATIONS BETWEEN THE BUSINESS SUPPLIER AND THE BUSINESS BUYER

Klein & Murphy²¹ provide a general model where a manufacturer induces a dealer to provide those services:

through a private enforcement mechanism by which active monitoring and the threat of manufacturer termination assures dealer performance. Within this framework, the manufacturer uses vertical restraints to decrease the short-run gain to non-performing dealers (by limiting their ability to expand output) and to increase the long-run gain to performing dealers (by creating a quasi-rent stream).²²

So vertical restraints by firms without market power are simply part of efficient transacting rather than being anticompetitive. But with market power and substantial financial resources, these restraints may be used for anticompetitive purposes.

The network distributional practices built up historically in Southeast Asia in the absence of effective contract law enforcement explains, at least partly, why Singapore’s competition law does not apply to vertical restrictions unless imposed by a dominant firm. If vertical restraints are possibly imposed to overcome

BIG BUSINESS INFLUENCES, PARTICULARLY THROUGH THEIR NETWORKS, CONSIDERABLY AFFECTED LEGISLATIVE OUTCOMES, REGULATION, AND RESULTING LEGAL PROCESSES IN BOTH INDONESIA AND THAILAND

contractual problems, rather than for anticompetitive reasons, then there is a lesser case to prohibit them when the firm imposing the vertical restriction does not have market power. Another reason is that vertical restrictions are difficult to analyze for a new competition agency and it was felt it was better to focus on more likely egregious conduct, at least to begin.

Network distribution practices also explain why a number of Asian countries, both in Northeast and Southeast Asia, include “business consumer protection” provisions in their competition laws that deal with bargaining relations between the business supplier and the business buyer. These provisions, while mainly concerned with unfairness in business-to-business contracting and distribution arrangements, can also deal with competition issues such as price discrimination between business buyers.

Apart from contracting efficiency, another explanation for establishing distribution networks is to limit competition. Networks allow members to act together to engage in exclusionary conduct. Outsiders aware of network connections will not enter. Networks can price discriminate, giving other members

discounts to enable them to survive when facing new entry. Network members can collectively or individually subsidize predatory conduct by members against non-members. Conglomerates make this easier to accomplish. Anticompetitive motives are likely to be an important reason for the persistence of networks and conglomerates—particularly given their inefficiencies.

IV. THE INTRODUCTION OF COMPETITION LAW

Big business influences, particularly through their networks, considerably affected legislative outcomes, regulation, and resulting legal processes in both Indonesia and Thailand. This is partly due to the fact that in Southeast Asia (with the exception of Singapore) “all are governed by states that claim to be strong and lay wide claims but whose capacities are low.”²³ Many of the relationships are informal and so difficult to capture. While the awarding of licenses to families and friends is usually obvious, the true degree of cooperation between government and business is not transparent. As a result, determining the true forces supporting or opposing the introduction of competition law is difficult to determine.

In Indonesia, business-government relations were controlled by President Soeharto and were accompanied by the three sins of “corruption, collusion (or cronyism) and nepotism” (“KKN”). Soeharto used his presidential decree powers to benefit a limited number of cronies and members of his family; this small number of people controlled a considerable portion of the Indonesian economy. Indeed, the financial crisis in 1997 was largely blamed on KKN.

IN RETURN GOVERNMENTS ‘REPAID’ FINANCIAL SUPPORTERS FROM THE PUBLIC PURSE —AND IN THE PROCESS REDUCED BUREAUCRATIC CHECKS AND BALANCES

However, Chinese-Indonesians had come to dominate big business following on from the economic liberalization in the 1980s and ‘90s. Chinese-Indonesians, who had formerly suffered considerable discrimination and violence, sought political alliances for protection, including with the military. But their minority status and wealth made them reluctant to engage publicly with politicians—instead relations were personal and non-transparent²⁴—further underpinning the widespread perception that their relationships with politicians were a major contributing factor to the impact of the AFC in Indonesia.

And while Soeharto mainly developed alliances with Chinese-Indonesians, he also selectively favored the local *pribumi* Malays through preferential bank lending, the awarding of government contracts, and the promotion of strategic industry initiatives.

DESPITE INDONESIA BEING IN A BETTER FINANCIAL POSITION BEFORE THE CRISIS THAN OTHER SOUTHEAST ASIAN COUNTRIES, INCLUDING THAILAND, THE IMPACT OF THE CRISIS WAS GREATER IN INDONESIA

particular, the Chinese-Thai developed clientelistic rent-seeking relationships with the military and bureaucrats—and, similar to Indonesia, also to obtain political protection.²⁵ Chinese-Thais assimilated into Thai society to a much greater degree than in Indonesia. Part of this was due to religion—Chinese could more

easily accept Buddhism. Thai politicians increasingly turned to Chinese-Thai businessmen for financial support in running for election. In return governments ‘repaid’ financial supporters from the public purse²⁶—and in the process reduced bureaucratic checks and balances.

A. *The Introduction of Competition Law in Indonesia*

Hal Hill argues that there is a “deep-seated mistrust of market forces, economic liberalism and private (especially Chinese) ownership in many influential quarters of Indonesia.”²⁷ A former Chairman of the KPPU, Syamsul Maarif says that Indonesians are “trapped in harmony” which is associated with togetherness and sharing and not competition and individually winning.²⁸ So why introduce competition law?

Before 1999, competition provisions were included in certain statutes and several attempts were made to introduce competition law in the mid 1980s. In 1992 the Indonesian Democratic Party published a draft law called *Stimulation of Economic Competition Law*, but it never went to Parliament. These attempts were designed to curb the power of the Soeharto family and the conglomerates, but Soeharto’s dominance of politics meant the attempts had little chance of success.

Despite Indonesia being in a better financial position before the crisis than other Southeast Asian countries, including Thailand, the impact of the crisis was greater in Indonesia. In August 1997 the rupiah was floated and in October the IMF called in. The 1997 Asian Financial Crisis, together with allegations of election fraud and repression of the opposition, had led to the rupiah falling considerably against the U.S. dollar. As a result, domestic prices increased considerably, production fell, and many banks were at risk of failing. The Soeharto regime was blamed for the crisis by allowing the growth of large conglomerates (controlled by the Soeharto family and Chinese-Indonesians) and for allowing corrupt SOEs to become inefficient.

BUT AFTER 1997, THE PARLIAMENT, WITH A NEW-FOUND CONFIDENCE AFTER MORE THAN 30 YEARS OF RUBBER-STAMPING BILLS FROM THE EXECUTIVE, ASSERTED ITS POWERS AND STARTED TO INITIATE AND PASS LAWS INCLUDING A COMPETITION LAW

As a result, the IMF and Indonesian Government agreed on a *Letter of Intent* and a *Memorandum of Economic Policies* on July 29, 1998. However, Soeharto tried to protect his cronies from the impact of the financial crisis and the IMF policy recommendations; for example, by trying to use the central bank’s credit facility to prop up crony banks. Negotiations with the IMF for a new program began and, on September 11, 1998, in a new *Letter of Intent* the Indonesian Government committed to “submit to Parliament a draft law on competition policy” by the target date of December 31, 1998.²⁹ But as Haggard puts it:

The ease with which the second program was negotiated should have given the international financial institutions pause. Even more than the first one, the program cut deeply into the patronage networks that Soeharto had built up: the government agreed to essentially all of the IMF’s proposals.³⁰

The Ministry of Trade and Industry began to prepare a competition bill. Under the New Order regime,

SMALL BUSINESS NOT ONLY OBJECTED TO THE PREFERENCES GIVEN TO LARGE BUSINESS GROUPS BUT ALSO TO THE WAY THESE LARGE COMPANIES BEHAVED ANTICOMPETITIVELY WITH IMPUNITY

the Indonesian Parliament had simply been a rubber stamp. But after 1997, the Parliament, with a new-found confidence after more than 30 years of rubber-stamping bills from the executive, asserted its powers and started to initiate and pass laws including a competition law, which was drafted within Parliament with input from the executive.

It is important to understand the background of business development in Indonesia before 1997. While Soekarno had tried to control business-government relations, Soeharto had gone further and established Kadin in 1968 as the only business organization accepted by his “New Order” government between 1968 to 1998.³¹ This was formalized in Law No 1 of 1987 that designated Kadin as the sole (monopoly) representative of the business community in Indonesia. Kadin was used by the government to control business participation in government.

While big business, including the Sino-Indonesian conglomerates, maintained close links with government independently of Kadin, Kadin was still the sole official business representative. It covered many competing interest groups including small and big business and indigenous businessmen and the dominating Chinese business groups.

Under Soeharto, large Chinese-Indonesian business groups flourished, particularly during the 1980s when they obtained exclusive import licenses, etc. as a result of close relations with Soeharto. Indigenous business was not so lucky in gaining state protection and subsequently saw conglomerates as the most important contributor to the Asian Financial Crisis in 1997-98.

Small business not only objected to the preferences given to large business groups but also to the way these large companies behaved anticompetitively with impunity. For example, nine large cement companies formed a cartel through an industry association called the ASI. The forestry association was given the monopoly rights to export timber. One of Soeharto’s sons, Tommy, was given the monopoly right to control village co-operatives, and was also given exclusive contracts to distribute two chemical products from Pertamina—the state-owned oil and gas conglomerate.

Loughlin, et al. argued that the anticompetitive government intervention was largely justified by the government on the basis of overall public welfare:

Government intervention in the Indonesian economy is very extensive, and is justified by the Constitution of 1945, which declares that the state will control economic activities that can affect the welfare of the general public. This has been interpreted liberally by government throughout Indonesian history, often for its own political interest. During the Old Order it was used as justification for nationalizing foreign-owned enterprises. During the New Order it was used to justify the mixed-economy idea of government intervention, in which government intervenes not only to promote macroeconomic stability but also for economic planning purposes.

The latter rationale for government intervention has led to most of the government interventions that have distorted competition.³²

FOLLOWING SOEHARTO'S RESIGNATION, ONE OF PARLIAMENT'S FIRST PRIORITIES WAS TO DRAW UP A COMPETITION LAW, DUE TO THE WIDESPREAD PERCEPTION THAT MANY OF THE ECONOMIC PROBLEMS WERE THE RESULT OF THE CONGLOMERATES THAT HAD GROWN UNDER THE CORRUPT SUKARNO AND SOEHARTO REGIMES

As the sole business organization, Kadin sometimes argued for the introduction of competition law. In an interview in 1987, Kadin's Chairman Sukamdani had called on the government to introduce an antimonopoly law. In 1989 the new chairman of Kadin, Sotion Ardjannggi, again called for an antimonopoly law and again at Kadin's national assembly in 1991. But, in general, doubts were expressed about the ability of Kadin to stand up to Soeharto.

In 1994, a new Kadin Chairman, Aburizal Bakrie argued that pribumi and small businessmen should be given preferential treatment and argued for control over conglomerates. In particular he was concerned with the vertical control by conglomerates of production processes from inputs to retail. So Kadin called for control of collusive business practices by Chinese conglomerates. However, Kadin failed in arguing for a competition law that was against the Soeharto's regime preferential treatment of (mainly Chinese) conglomerates and its tolerance (and encouragement) of anticompetitive practices.

DURING THE 1970S A GROUP OF MIDDLE-RANKING OFFICERS (TRAINED BY THE UNITED STATES AND WHO HAD FOUGHT IN VIETNAM) CAME TO THE FORE—THEY WERE ANTICOMMUNIST AND ANTICAPITALIST (BECAUSE THEY BELIEVED BUSINESSMEN MANIPULATED ELECTIONS)

Between 1993 and 1994, the Indonesian Department of Trade, together with the Faculty of Law at the University of Indonesia produced a draft law "Healthy Business Competition." The Indonesian Democratic Party ("PDI") produced a draft competition law in 1995—but nothing came of either. Before Law No 5 of 1999, there were several laws that had contained elements of competition law or unfair competition law. For example, Article 392 bis of the Indonesian Criminal Code said:

Whomsoever engages in an act of deception to mislead the public or a certain individual with the purpose of establishing or prospering his/her merchandise or his/her own company or the property of another person, will be sentenced for unfair competition, with imprisonment for a maximum of one year and four months or a fine of Rp. 13,500 if such an act might give rise to his/her own competition or the competition of any other person.³⁴

Article 7 of Basic Law of Industry No. 5 of 1984 stated that:

"[t]he Government shall regulate, guide and develop industries in order to: . . . (2) develop fair and healthy competition and prevent unhealthy competition . . ."³⁵

In addition Article 1365 of the Civil Code allowed for compensation as follow:

Each act that is unlawful and causes loss to other parties shall obligate the person causing such loss by their fault to compensate for such loss.”³⁶

Following Soeharto’s resignation, one of Parliament’s first priorities was to draw up a competition law, due to the widespread perception that many of the economic problems were the result of the conglomerates that had grown under the corrupt Sukarno and Soeharto regimes—conglomerates that were mainly controlled by Chinese-Indonesian’s and members of the Soeharto family. There were also considerable concerns about inefficient state-owned enterprises. Greater business opportunities were sought by pribumi but this was impeded by many anticompetitive practices, often sanctioned by government, such as the many (exclusionary) cartels, exclusive licenses, etc. So the stage was set when, on July 29, 1998 the government of Indonesia signed a Letter of Intent with the IMF promising that the draft of a monopoly law would be submitted to parliament before the end of 1998.³⁷

B. The Introduction of Competition Law in Thailand

In the late 1950s, the US brought together the military, businessmen and royalists – the three forces that had tussled since 1932 – in a powerful alliance. Together they resurrected and embellished the vision of a dictatorial strong state, demanding unity in order to achieve development and to fight off an external enemy – in this era, ‘communism’.³⁸

Considerable economic and social changes occurred in Thailand during the 1960s and 1970s due to the extensive involvement of the United States during the American War in Vietnam, and afterwards. The U.S. involvement meant a shift towards a liberal market economy. Trade and financial market liberalization fuelled industrialization and urbanization together with the other Asian “tiger economies.” Bangkok and the middle class grew rapidly—and became more vocal politically.

PARLIAMENT BECAME A PLACE TO DO
BUSINESS RATHER THAN REPRESENT
CONSTITUENTS

Thailand has been ruled by the military for most of its history since the introduction of a constitutional monarchy in 1932. During that time the generals and the bureaucratic elite organized to ensure social harmony and to “guide democracy” from above. During the 1970s a group of middle-ranking officers (trained by the United States and who had fought in Vietnam) came to the fore—they were anticommunist and anticapitalist (because they believed businessmen manipulated elections). They also:

believed that the problem of communism stemmed from capitalism because ‘some groups have been able to take advantage and build up monopolistic power which inflicts social injustice and material hardship on the people’.³⁹

To overcome these problems a “guided democracy” was needed to eliminate social injustice and curb monopoly power. A *Price Fixing and Anti-Monopoly Act* in 1979 was designed to control prices. The antimonopoly provisions were used to identify sectors to be brought under price control. This gave the bureaucrats considerable power and options for corruption. Importantly, the sanctions introduced were

criminal (fines and imprisonment) together with personal liability for managing directors and managers of corporations. Similar penalties were introduced for the Competition Act in 1999.

During the 1980s and 1990s there were continual battles between the military and business to control Parliament. By 1988 businessmen comprised two-thirds of the lower house of parliament. Business resented both the appointments of generals to SOEs and the amount of the budget allocated to the military rather than for promoting economic growth. While, initially, most of these business-politicians came from Bangkok, over time Parliament came to be dominated by provincial businessmen. Parliament became a place to do business rather than represent constituents. About this time the World Bank recommended that Thailand liberalize its financial system. Thai bureaucrats agreed, believing that access to capital would allow for new businesses to grow and compete with existing powerful conglomerates.

CHUAN'S GOVERNMENT MADE NO FORMAL COMMITMENT TO THE IMF REGARDING INTRODUCING A COMPETITION LAW. INSTEAD THEY AGREED TO PROMOTE GREATER COMPETITION BY PRIVATIZING MONOPOLY SOES, ETC

Another coup in 1991 was intended to stop the alleged corruption and “money politics” resulting from the increased importance of provincial businessmen—politicians who were encroaching on the interests of the established wealth in Bangkok—including that of the military. The coup was supported by Bangkok businessmen who resented the rise of their provincial competitors. At the same time, there was also some concern among some rich Thais in Bangkok about the fact that European luxury car manufacturers had established national exclusive distribution arrangements—local businesses wanted to be able to buy these cars overseas and use local dealers for servicing, etc. Some important people felt that competition law should be introduced to stop these exclusive dealing arrangements.

Following the 1991 coup, the military appointed Mr. Anand Punyarachoon as Prime Minister, who introduced a number of free market economic reforms during his short tenure from March 1991 to April 1992. A draft competition law was approved by his Cabinet and submitted to the Parliament for deliberation, but before it could be passed a brutal crackdown on protestors in 1992 led to Parliament being dissolved and new elections called.

THAI ECONOMY SLOWED IN 1996 IN PART DUE TO A WIDENING CURRENT ACCOUNT DEFICIT AND CONCERNS WITH THE RECENTLY LIBERALIZED FINANCIAL SECTOR

The Democrat Party won the 1992 election (led by Chuan Leekpai). Appealing to businessmen, the middle class in Bangkok, and urban populations in the South, the Democrats proposed to modernize the Thai economy including their “law and institutions.”⁴⁰ In 1992, due to the lack of success of the 1979 price-control legislation and a recognition that economic circumstances were changing, the Chuan Government set up yet another Working Party to look at competition law under the Ministry of Commerce. However, no action was taken during his term of office from September 1992 to May 1995.

Arguments between the various factions continued. Bureaucrats argued that parliament was too

powerful and inefficient and had reduced the proper role and importance of the bureaucracy. However, following a land scandal in Phuket the Democrat party led coalition government fell in 1996 to be replaced by a coalition led by the Chart Thai Party (Prime Minister Banham Silpa-archa—a second generation Chinese who had initially made his money from a monopoly on the sale of chlorine for the water supply in his province). Following further elections in 1996, Chavalit Yongchaiyudh became Prime Minister leading yet another coalition government. MacIntyre notes the Chevalit government:

was subject to mounting vilification for immobilism, indecisiveness and corruption. Justified though these criticisms were, they were nothing new. Chavalit's government was not unusually incompetent, divided or corrupt. With some slight differences from one to the next, this broad characterisation applies to all fully elected governments in Thailand.⁴¹

Following a long period of strong economic growth fuelled by foreign capital, the Thai economy slowed in 1996 in part due to a widening current account deficit and concerns with the recently liberalized financial sector. The problems in the financial sector lay mostly with the finance companies, not the banks. The government failed to respond to increased speculation against the baht and continued to defend the pegged exchange rate against the U.S. dollar. However, the baht suffered a massive speculative attack on July 2, 1997, the fixed exchange rate was abolished, and so the AFC began.

PERHAPS IRONICALLY, GIVEN THAT THAILAND WAS NEVER COLONIZED AND MAINTAINS A HIGHLY INDEPENDENT POLICY STANCE ON MOST ISSUES, IT WAS THAILAND WHO MORE CLOSELY FOLLOWED INTERNATIONAL NORMS IN DESIGNING ITS COMPETITION LAW

The AFC led to a loss of faith in Chavalit's government and, in the middle of the crisis in November 1997, he was replaced by Chuan Leekpai. Chuan's Democrat Party led coalition government introduced a program of economic austerity and reforms in line with IMF recommendations. However, he was criticized for pandering to the big financial institutions and for being too welcoming of foreign investment. While the Democrat-led government accepted the IMF proposals:

For big business, which had come to expect government to provide a generally protective and friendly environment, this amounted to treachery ... Thailand's big business had big interests to protect ... after the 1997 crisis, it was motivated to control the state – in order to recover the protection the Thai state had traditionally provided for big business and to manage globalisation.⁴²

Chuan's government made no formal commitment to the IMF regarding introducing a competition law. Instead they agreed to promote greater competition by privatizing monopoly SOEs, etc.⁴³ The Chuan Government was seen as relatively less corrupt than other Thai governments, and responding to criticisms that the 1997 AFC had been caused by crony capitalism, his Cabinet in 1998 approved the previous 1992 *Competition Act* draft, which ultimately led to

WHILE THIS ALLOWS FOR GREATER FLEXIBILITY IN THE RECRUITMENT OF PEOPLE WITH COMPETITION LAW EXPERTISE, THEIR EMPLOYMENT ON RELATIVELY SHORT-TERM CONTRACTS MEANS GREATER UNCERTAINTY BOTH FOR STAFF AND FOR THE KPPU

the enactment of the Competition Act on April 30, 1999.⁴⁴

V. A COMPARISON OF THE COMPETITION LAWS, INSTITUTIONS, & ENFORCEMENT

A. *The Laws*

Given that (i) the AFC crisis prompted the introduction of competition law, (ii) the fact that wealth is heavily concentrated in both countries though networks closely linked to government, and (iii) the influence of the IMF, it could be expected that both countries would introduce similar competition laws. This was not the case. Perhaps ironically, given that Thailand was never colonized and maintains a highly independent policy stance on most issues, it was Thailand who more closely followed international norms in designing its competition law. Appendix 1 lists the details of Indonesia's competition laws; Appendix 2 lists Thailand's.

INDONESIA HAS HAD MANY CASES; HOWEVER, ALMOST HALF THE CASES DECIDED BY THE KPPU HAVE BEEN OVERTURNED ON APPEAL

concentrated in both countries though networks closely linked to government, and (iii) the influence of the IMF, it could be expected that both countries would introduce similar competition laws. This was not the case. Perhaps ironically, given that Thailand was never colonized and maintains a highly independent policy stance

B. *The Institutions*

In developing countries, competition law and economics expertise is limited.

1. Indonesia

Article 30 sets up the KPPU and states that: “(2) The Commission shall be an independent institution free from the influence and authority of the government and parties” and “(3) shall be accountable to the President.” Members of the Commission are appointed for fixed five-year terms and can only be re-appointed for one term. Because all Members are appointed at the same time, there are no overlapping periods and so, at least in theory, all commissioners could be replaced at the same time. The Chairman and Vice-Chairman are elected annually by the Members.

EXEMPTIONS FROM THE TRADE COMPETITION ACT WERE GIVEN TO CENTRAL, PROVINCIAL, AND LOCAL GOVERNMENTS; STATE ENTERPRISES; FARMER'S CO-OPERATIVES, ETC.; AND BUSINESSES EXEMPTED BY MINISTERIAL REGULATION

The KPPU staff are not designated as “public servants” who are appointed through a central government employment agency. Instead, the KPPU appoints their own staff. While this allows for greater flexibility in the recruitment of people with competition law expertise, their employment on relatively short-term contracts means greater uncertainty both for staff and for the KPPU, particularly given higher salaries in the private sector.

In a review of Indonesia's competition law and policy, the OECD in 2012 noted that despite a rapid increase in staff (from 100 in 2006 to 450 in 2011):

... the KPPU remains constrained by insufficient resources, particularly insufficient qualified staff. The requirement to investigate all complaints imposes a heavy

requirement on the organisation's resources. Together with the prioritisation of enforcement, especially fighting bid-rigging in public procurement (a focus that the OECD strongly endorses) this leaves little available for advocacy or other non-enforcement work. Given the size and population of Indonesia, 450 is not a large number of people to work in the competition agency.⁴⁵

2. Thailand

The Competition Act was a political compromise; for example, the regulator—the Trade Competition Commission (“TCC”)—is not an independent agency. The Chairman is the Minister of Commerce. Ex-officio members are senior bureaucrats (for example, the Secretary-General of the TCC is the Director-General of the Department of Internal Trade) and the staff of the TCC are officials of the Department of Internal Trade. There are also between eight and twelve “qualified persons” with backgrounds in law, economics, commerce, business administration, or public administration. Qualified persons must not be political officials or holders of political positions in a political party. The appointment of outside (part-time) Members must be approved by Cabinet, with a two-year term of office. Private sector experts are nominated by two trade associations (the Federation of Thai Industries and the Thai Chamber of Commerce)—dominated by big business.

The Commission works by appointing specialized sub-committees comprising between four and six persons, qualified in the various areas, to consider conduct relating to Sections 25, 26, 27, 28, 29 and mergers under Section 37. Criminal prosecutions are recommended to the public prosecutor.

The Office of the Competition Commission was established under the Department of Internal Trade, with the Director-General of the Department of Internal Trade as Secretary-General. The Office's powers include carrying out the work for the committees appointed by the Commission, monitoring the conduct of business operators, and conducting business studies. Certain officials have the power to issue written summons requiring persons to produce statements, etc. and to enter premises to search for evidence without a search warrant where offenses are “evidently being committed in the place.”

BIG BUSINESS EFFECTIVELY STOPPED THE INTRODUCTION OF THE ABUSE OF DOMINANCE PROVISION BY PREVENTING THE GOVERNMENT FROM INITIALLY ISSUING A MARKET DOMINANCE THRESHOLD FIGURE

Exemptions from the *Trade Competition Act* were given to central, provincial, and local governments; state enterprises; farmer's co-operatives, etc.; and businesses exempted by Ministerial Regulation. However, export and import cartels are not exempt, nor are depression or small business cartels. Sakda Thanitcul notes that the exemption of state enterprises was the most controversial provision (as they competed with private companies in important sectors such as the electricity, telecommunication, and railway sectors).

C. Enforcement

1. Indonesia

Indonesia has had many cases; however, almost half the cases decided by the KPPU have been overturned on appeal. The KPPU has been affected by the successful conviction of Muhammad Iqbal, a Commissioner (and

former Chairman) of the KPPU for accepting bribes. Iqbal was sentenced to 4 ½ years in prison and a fine of about U.S. \$22,000 for taking a bribe to let Direct Vision, a subsidiary of First Media, have an exclusive right to broadcast the English Premier League in 2008 (affirmed by the Supreme Court).⁴⁶

The KPPU has dealt with the difficult issue of business groups, using the single economic entity doctrine to extend the law to foreign firms.⁴⁷ The KPPU held in 2007⁴⁸ that Temasek constituted a single economic entity with two Indonesian companies because Temasek was: (i) involved in the management of both companies, (ii) was authorized to appoint directors or commissioners, and (iii) had access to confidential information. Subsequently, the position has become much clearer in Indonesia with the introduction of Government Regulation No. 57 of 2010, which provides that an entity is regarded as having control over another entity:

- If there is ownership or control of shares or voting rights above 50%; or
- If ownership is below 50%, the test revolves around whether a company has the ability to influence or determine management policy or actual management.

Undoubtedly, this seems to be a sensible recognition of the potentially anticompetitive conduct of business groups and conglomerates in Southeast Asia.

2. Thailand

The Act has not been effectively implemented, due to: (i) network politics, (ii) exemptions given to the large number of SOEs, and (iii) the fact that all penalties are criminal, which means that the Trade Competition Commission has to recommend to the Attorney-General to take action (the criminal standard of proof has meant the Attorney-General has never taken action, always asking for more evidence from the Trade Competition Commission).

It is difficult to know to what extent pressure from big business has had on decisions taken by both the Trade Competition Commission and Attorney-General. However, Poapongsakorn⁴⁹ argues that corporate lobbying and political intervention characterized early investigations. Big business effectively stopped the introduction of the abuse of dominance provision by preventing the government from initially issuing a market dominance threshold figure. In 2000 the TCC proposed a dominance market share threshold of 33.33 percent and one billion sales revenue in the relevant market. The Federation of Thai Industries opposed the percentage figure and argued for 50 percent. The domination threshold was finally set from February 2007 as follows:

AND, AS THE CRITERIA FOR MERGERS HAS NOT BEEN SET, OF COURSE THERE HAVE BEEN NO COMPLAINTS IN THIS AREA

introduction of the abuse of dominance provision by preventing the government from initially issuing a market dominance threshold figure. In 2000 the TCC proposed a dominance market share threshold of 33.33 percent and one billion sales revenue in the relevant market. The Federation of Thai Industries opposed

1. Business operator, in any goods or services, with market share in the previous year over 50 percent and at least 1,000 million baht turnover; or

2. The top three business operators, in any goods or services, with combined market share in the previous year over 75 percent and at least 1,000 million baht turnover.

A business operator with market share less than 10 percent, or turnover less than 1,000 million baht in the previous year, is exempted.⁵⁰

In a paper funded by the World Bank, Suriyasai Takasila & Rajitkanok Chitmunchaitham⁵¹ found considerable conflict-of-interest problems among the commissioners. As Deunden Nikomborirak summarizes:

The authors found that one of the commissioners considering the tied-sale case of whisky and beer in the year 2000 was a director of a company affiliated with the powerful whisky conglomerate. The conglomerate is known to be one of the largest contributors to all political parties, charities, and sports events and it is staffed with high-ranking retired bureaucrats that have strong links with the relevant regulatory authorities. Another commissioner was found to be a director of a company affiliated with the cable television monopoly accused of bundling cable services and charging excessive monthly fees. There is no evidence that these commissioners ever declared their conflict of interest and recused themselves from meetings during which these cases were discussed.⁵²

From October 1999 until August 2013 there were 18 complaints of abuse of a dominant position (s 25), 22 restrictive agreements complaints (s 27), and 52 unfair trade practices complaints (s 29). However, there has not been a single successful prosecution. And, as the criteria for mergers has not been set, of course there have been no complaints in this area.

In 2010, the government starting examining ways to improve the TCC. However, as the review period closed in 2011, it appears little had changed. Nikomborirak explains why (in 2006), despite seven years of the Act's operation, enforcement has not been impressive:

The performance of the TCC has been dismal, especially after the January 2001 installment of the new government dominated by large businesses. The Committee met only nine times in six years, four of which took place during the inaugural year. The latest meeting took place on May 14, 2004.⁵³

In the early days the TCC website provided details of complainants, etc. Now only the number of complaints is published. A number of early cases have been discussed including, Case *Whisky*, etc.⁵⁴

But what of more recent cases? In the last five years there have been only four abuse of dominance complaints, five restrictive agreements complaints, and no unfair trade practices complaints. No official information is provided on their outcomes. But Dr. Jeffrey Race provides a good description of what happens to complaints by people with

HE WAS TOLD "WELL YOU COULD GO TO COURT BUT EVEN IF YOU WIN YOU WILL LOSE."

little status against those with power in Thailand. Dr. Race is fluent in Thai and has frequently appeared in Thai courts "in a variety of capacities and proceedings." While his comment below applies to foreigners, it also

applies to Thais without status as well:

A foreigner is usually treated with courtesy in the Thai law enforcement system, understood to include police, prosecutors, and courts. In litigation with a nobody he may expect justice; if with a state body or with the well-connected, that prospect recedes. Many find that complaints of even grave abuses are cheerfully ignored.⁵⁵

To illustrate, this was the experience of a Thai restaurant company when making a complaint under Section 29—the unfair trade practices section of the *Competition Act*. The case involved a restaurant lease renewal. The tenant had signed a three plus three plus three tenancy agreement. The tenant was one of the first restaurants in the shopping center in Phuket and expected to make losses for 1-2 years as the spaces were mostly not yet tenanted. Losses were in fact made in the first two years but the restaurant started to do well and became profitable in the third year (in 2010). The shopping center sent a letter to the tenant in early 2010 asking whether the tenant wanted to renew. The tenant said yes and then asked for approval to renovate the restaurant, which was then given and the renovation carried out. The tenant then asked for the new lease several times as his restaurant license could not be renewed without the lease. The shopping center ignored the request. In November, business improved considerably. In December the tenant received a notice of termination allegedly because he had not paid rent since September. In fact two monthly rental payments had been made since September. The lease was not renewed—as it turns out because one of the other tenants close by (a wealthy family from Bangkok) wanted the space.

The tenant sought advice from his lawyer in Bangkok. He was told “well you could go to court but even if you win you will lose.” Essentially, there was little chance of winning in court due to his relatively low status. The owner of the shopping center is a Singaporean billionaire, Quek Beng Leng (who was on the Singaporean Economic Review Committee that recommended the introduction of competition law) and its honorary Chief Executive Officer is M.R. Chatu Mongkol Sonakul—a second-generation prince from one of Thailand’s most noble families. Sonakul was the also the Permanent Secretary for finance during the period from October 1, 1995 to July 28, 1997 but was subsequently dismissed by the Chavalit Yongchaiyudh government soon after AFC and the Thai devaluation in July 1997. During the Democrat-led government that followed, Sonakul was then appointed Governor of the Bank of Thailand, Thailand’s central bank. After the 2006 military coup his name was mentioned publicly as a potential prime minister. A powerful network indeed.

BACKED BY THE PALACE, THERE IS GREATER STABILITY IN NETWORK POLITICS IN THAILAND THAT HAS RESULTED IN NO COMPETITION LAW ENFORCEMENT. ELITE INSTABILITY IN INDONESIA, ON THE OTHER HAND, HAS MEANT THAT EVEN ELITES WANT COMPETITION LAW

Following this legal advice the tenant complained to the TCC. The complaint was heard over nearly two days. Months later the tenant was informed that there was no breach—no explanation was given except insufficient evidence. Networks win even in competition law enforcement in Thailand.

VI. CONCLUSIONS

Without doubt Indonesia has been far more successful in introducing competition law than Thailand.

Although almost half of the KPPU's decisions have been overturned by the courts, the KPPU has grown in size and professionalism and has had some success, particularly in public bid-rigging. However, the weak Indonesian court system continues to undermine the KPPU's effectiveness.

In Thailand the act has proved to be non-effective, partly due to the numerous exemptions accorded to state-owned companies and, de facto, to companies owned by influential individuals, as well as the lack of enforcement of the Act due to pressure from big business and lack of concern by government. The absence of non-government organizations advocating competition has meant it has not been an issue for much public policy discussion.

Nikomborirak concludes that there is no “clear political mandate” to enforce the law. Because of an absence of rules and regulations to ensure transparency, the limited enforcement in Thailand “tends to be selective and arbitrary.” In particular, she characterized competition law as a “paper tiger” that “could not stand against the powerful lobbying of large businesses that have more recently become involved in politics.”⁵⁶ Major companies dominate the local economy and are protected and do not have a “competition culture.”

Another explanation for the relative success of competition law amounts to the stability of elite networks. Backed by the palace, there is greater stability in network politics in Thailand that has resulted in no competition law enforcement. Elite instability in Indonesia, on the other hand, has meant that even elites want competition law—if only to protect themselves against times when a competing elite is in power. As one of Indonesia's richest men (who made most of his wealth from exclusive licenses under Soeharto) told me over coffee several years ago, when I asked him why he supported competition law, said—the world has changed in Indonesia, competition is more important now and I need to know how to deal with it. Unfortunately, the world has not changed in Thailand, yet.

APPENDIX 1: INDONESIA COMPETITION LAW

Prohibited practices can be divided into three kinds:

(a) Chapter III—Prohibited Agreements, which include: oligopoly, price-fixing, territorial division, boycotts, cartels, trusts, oligopsony, vertical integration, closed agreements (resale conditions) and agreements with foreign parties. The test for illegality is mainly that the agreement not “lead to monopolistic practices or unfair business competition;”

(b) Chapter IV—Prohibited Activities such as monopoly, monopsony, market control, and conspiracy; and

(c) Chapter V—deals with a dominant position including general provisions dealing with restricting technology, obstructing new entrants, etc. and preventing directors or commissioners of companies from assuming the same role in competing companies or owning a majority of shares in companies in the same market, multiple positions and share ownership. The section also deals with mergers, consolidations and acquisitions that “lead to monopolistic practices and or unfair business competition.”

Included in the Chapters are market-share thresholds and presumptions (unlike in Thailand where thresholds are left to separate government determination). For example, business agents are deemed to jointly control the “production and or marketing of goods and services” in the sections dealing with oligopoly and oligopsony if two or three “business actors” control over 75 per cent of the market (Article 4(2));

For monopoly or monopsony the threshold is if one “business actor” controls over 50 percent of the market (Articles 17(2)C and 18 (2)). For a dominant position the tests are whether one “business actor” controls over 50 percent or if two or three “business actors” control over 75 percent for a group of firms (Article 25(2)).

The tests are unusual in that the law makes horizontal agreements such as price-fixing, market division, and bid-rigging subject to what can loosely be called a rule of reason (that “may lead to monopolistic practices and or unfair business competition”) while making much of unilateral conduct *per se* illegal (“shall be prohibited”) including price discrimination, exclusive dealing, tying, and abuse of dominant position. This suggests the law was directed mainly at conglomerates.

However, the KPPU has been selective in enforcement. For example, “price discrimination is illegal *per se*. But in eight years, the KPPU has brought no case of price discrimination. Predatory pricing has been treated similarly.” (UNCTAD 2009, p. 4)

The Indonesian law is complex. Many of the articles dealing with similar kinds of anticompetitive conduct are in different sections. This means that all parts of the Act need to be examined in relation to

specific conduct as more than one article may deal with the same conduct. For example, Article 4 dealing with “oligopolies” says that:

Entrepreneurs are prohibited from making any agreements with other entrepreneurs with the intention to jointly control the production and/or the marketing of goods and services that can cause monopolistic practices and/or unfair business competition.

Obviously *intention* plays an important role in this prohibition. As well, market shares are used to define “control” as follows:

Any entrepreneur can be suspected or considered as jointly controlling production and/or marketing of goods and services ... if two or three entrepreneurs or groups of entrepreneurs own more than 75% ... of the market share of one type of certain goods or services.

Article 5 deals with price-fixing but only prohibits “any contract with other competing entrepreneurs in order to fix prices ...”. The use of the term “contract” makes enforcement difficult when combined with the KPPU’s lack of power to conduct raids on the premises of suspected infringers. Courts have been reluctant to accept circumstantial evidence because it is not considered to be “hard evidence.”

Article 11 has a separate cartel offense that prohibits entrepreneurs “from making any agreements with other competing entrepreneurs with the intention to influence the price by determining production and/or marketing of goods and/or services, that can cause monopolistic practices and/or unfair business competition.” This is a particularly troublesome section as it does not, like competition law in most other countries, judge agreements in relation to a competition test, such as with and without the agreement. It is not clear how an agreement can “cause monopolistic practices” and causing “unfair business competition” does not necessarily imply a bad economic outcome.

Vertical agreements are dealt with in Article 14, which says that:

entrepreneurs are prohibited from making any agreements with other entrepreneurs with the intention to control production of several products belonging to a chain of certain goods and/or services production in which each chain of production is a result of the continued process, either in one direct or indirect chain, which can cause unfair business competition and/or damages to the public.

Indonesia distinguishes between monopoly and abuse of a dominant position. In Article 17, monopolists are prohibited “from controlling any production and/or marketing of goods and/or services that can cause monopolistic practices and/or unfair business competition.”

Controlling production and/or marketing is “suspected or considered” where there are no substitutes or entry is not possible or if “one entrepreneur or one group of entrepreneurs controls more than 50%

... of the marketing share of one type of certain goods or services.” Article 19 deals in similar terms with monopsony.

Article 20 prohibits the supply of goods and services “without making any profits or by setting a very low price with the intention to eliminate or end their competitor’s business in the relevant market, thus causing monopolistic practices and/or unfair business competition.” Article 20 comes under Part 3 entitled “Market Controlling” rather than Part One “Monopoly” which incorporates Article 17. There is no market power requirement except for the indirect market power requirement in effect of ‘causing monopolistic practices and/or unfair business competition.’”

Article 25 deals with a dominant position. Using similar language to that of the Australian Competition Act “entrepreneurs are prohibited from taking advantage of their dominant position” to imposing terms with the intention to stop consumers from buying competitive products, restricting the market and the development of technology, preventing potential competitors from entering. Entrepreneurs are deemed dominant if they control 50 percent or more of market share “on one type of goods or services” (i.e. not relevant market) or two or more entrepreneurs control 75 percent or more of market share.

Articles 28 and 29 deal with mergers and acquisitions “that can potentially result in a monopoly practice or unfair business competition.”

There are a number of other provisions not normally found in other competition laws including: Article 16 deals with agreements with foreigners “that can cause monopolistic practices and/or unfair business competition.” Article 21 states “Entrepreneurs are prohibited from cheating in setting the production cost and other expenses which is part of the goods “and/or services” component, that can cause unfair business competition.”

Articles 22-24 deal with conspiracies to win tenders, obtaining competitors’ business secrets, and reducing supplied amounts.

Art. 26 prohibits interlocking directorates (i.e. directors or commissioners of companies) competing in the same market, or a closely related in the “field and/or type of business” or can jointly control the market share of certain goods and/or services, which could cause monopolistic practices and/or unfair business competition.” This article is clearly directed towards business groups and conglomerates.

APPENDIX 2: THAILAND COMPETITION LAW

The *Trade Competition Act* includes a prohibition of the abuse of dominant position (Section 25); overly concentrative mergers (Section 26); horizontal and vertical restraints (Section 27), and various unfair trade practices (Section 29).

Abuse in Section 25 includes *exploitative* conduct (i.e. setting high prices), a number of vertical restraints, and interfering with other business operations. Section 25 is modeled on the South Korean MRFTA due to an assumption that the South Korean economy was similar to that of Thailand. Section 25 states that a dominant firm abuses its position by:

1. Unfairly fixing or maintaining the levels of sale or purchase prices of goods or services;
2. Setting conditions which, directly or indirectly, unfairly compel other business operators who are customers of the Business Operator to limit the provision of services, production, purchase or distribution of goods, or their opportunity to choose to buy or sell goods, accept or provide services, or obtain credit from other business operators.
3. Suspending, reducing, or limiting services, production, purchase, distribution, delivery, or importation in (Thailand) without reasonable grounds, to destroy or damage goods in order to reduce supply to less than market demand
4. Interfering with the business operations of other people without reasonable grounds.

Sections 3 and 8 authorize the TCC, with the approval of Cabinet, to prescribe the market share and sales turnover that presumes a firm to have a dominant market position. In January 2007, the Cabinet approved a new definition of dominant market position under the Act, so that a dominant market position occurs:

when a business operator sells any product or provides any service, the former having had a market share of 50% or more in the previous year, and whose sale proceeds amounted to 1 billion baht or above, or when the first three ranked business operators of any product or service, during the previous year, had a market share of 75% or more and, whose sales proceeds were 1 billion baht or more. This excludes a business operator whose market share in the past year was less than 10%, or a business operator whose sales proceeds in the past year were less than 1 billion baht.

Section 26 deals with mergers and is modeled after Article 6(1) of the Taiwan FTL. The TCC regulates business combinations, including mergers and the purchase of assets or shares. The Working Party intended that this provision would only apply to large business combinations. The TCC is authorized by Sections 26 and 28 to prescribe the criteria for a large business combination. The TCC has still not prescribed the criteria

as yet.

Section 27 prohibits certain horizontal and vertical agreements, in particular those which: fix sales or purchase prices, enter into an agreement to control or take over a market, bid-rigging, imposing certain geographical restrictions, tying, fixing output levels, maintaining or raising price while reducing quality, appointing sole distributors, and fixing conditions or methods of operation in the purchase or distribution of goods and services. Firms may seek authorization for some of these practices. This section combines the provisions dealing with undue collaborative activities in the South Korean MRFTA and Taiwan's prohibition of non-price vertical restraints and exclusionary practices.

Section 28 contains an unusual and unique provision. It says:

A business operator who has business relation[s] with business operators outside the Kingdom, whether it is on a contractual basis or through policies, partnership, shareholding or any other similar form, shall not carry out any act in order that a person residing in the Kingdom and intending to purchase goods or services for personal consumption will have restricted opportunities to purchase goods or services directly from business operators outside the Kingdom.

The provision was introduced to allow wealthy Thais to buy luxury cars directly from foreign manufactures without having to go through local Thai dealers. It effectively allows for parallel imports and so promotes competition by preventing foreign producers from price-discriminating against consumers in Thailand.

Section 29 is a “catch-all” provision dealing with unfair business practices—which can also cover exclusionary conduct and appears to be based on Article 24 of Taiwan's FTL. It provides that:

A business operator shall not carry out any act which is not free and fair competition and has the effect of destroying, impairing, obstructing, impeding or restricting business operation of other business operators or preventing other persons from carrying our business or causing their cessation of business.

This section is broad and could seek to achieve other objectives such as the protection of small businesses rather than economic goals such as efficiency. Section 29 does not require market dominance, but it does cover practices where there is unequal bargaining power. Again the provision appears to borrow from South Korean law:

The South Korean MRFTA focuses primarily on regulating the behavior of the thirty largest Korean chaebols, but it also aims to regulate the unfair trade practices of a number of medium-sized firms. Article 23 of the MRFTA (Prohibition of Unfair Trade Practices) is patterned closely on the Japanese Anti-Monopoly Law. Between 1981 and 1990, there were only eleven complaints of abuses of market dominant firms while there were 22, 592 complaints against unfair trade practices.⁵⁷

It should be noted that Section 29 is probably too vague to be effectively enforced. In contrast, the Japanese Antimonopoly Act and the South Korean MRFTA require the Japan Fair Trade Commission and the Korean Fair Trade Commission to specify the unfair trade practices. Currently, 16 kinds of business practices have been officially specified by the JFTC and 8 by the KFTC. The Thai Act is silent on this requirement.

Action taken by the Trade Competition Commission under Section 29 rather than Section 25 against Honda (who allegedly had an 80 percent market share and engaged in exclusive dealing by preventing retailers from selling competing brands), suggested that:

[t]he fact that this case was handled differently from the whiskey and beer abuse of dominance case raised [the] suspicion of selective enforcement of the competition law in favor of powerful local businesses and against foreign companies with little or no political connections.⁵⁸

A controversial exemption from the *Trade Competition Act* was given to SOEs, which included SOEs that compete with private companies in the electricity, telecommunication, and railway sectors. Government ministries were opposed to the application of competition law to SOEs partly on public policy grounds (they were often subsidized) but also because they provided considerable profits to the Ministries and those who controlled them via well paid directorships. etc. Nikomborirak & Lertmanphainond note that SOE's and the affiliated companies "contribute to 52 per cent of the Stock Exchange of Thailand (SET) market capitalisation."⁵⁹

No specific exemption is given to the monarchy's investment vehicle, the *Crown Property Bureau*, but it is extremely unlikely that any of its companies (particularly Siam Commercial Bank and Siam Cement Group) would be touched by competition law. In a country where status is everything a lowly Department within a Ministry would not dare. "So what exactly is the CPB? Ah, therein lies a mystery", as the book explains. "It is not part of the palace administration, nor is it a government agency, nor is it a private firm. It is a unique institution." Got that? Crucially, the bureau pays no business tax, and nor does Thailand have a land tax. Its tax-exempt status is enshrined in law. Yet it's not a charity or a public agency (or a sovereign wealth fund). ▲

¹ Ian McEwin is Khazanah National Chair of Regulatory Studies at the Malaysian Centre of Regulatory Studies (UMCoRS), University of Malaya and a visiting professor at Chulalongkorn University in Bangkok, Thailand.

² Jeffrey A. Winters, *Oligarchs and Oligarchy in Southeast Asia*, ROUTLEDGE HANDBOOK OF SOUTHEAST ASIAN POLITICS (Richard Robison, ed. 2014).

³ GLOBAL COMPETITIVENESS REPORT 2013-14, at 472.

⁴ GEORGE T. HALEY, C.V. USHA, & CHIN TIONG TAN, *NEW ASIAN EMPERORS: THE BUSINESS STRATEGIES OF THE OVERSEAS CHINESE* (2009) (hereinafter "Haley et al.") at 20.

⁵ TIMOTHY GEITHNER, *STRESS TEST: REFLECTIONS ON FINANCIAL CRISIS* (2014).

⁶ See STEPHEN HAGGARD, *THE POLITICAL ECONOMY OF THE ASIAN FINANCIAL CRISIS* (2000) (hereinafter "Haggard").

- ⁷ S. Claessens, S. Djankov, & L. Lang, *The Separation of Ownership and Control in East Asian Corporations*, 58 J. FIN. ECON. 81-112, 108 (2000) (hereinafter “Claessens, et al.”)
- ⁸ Porphanth Ouyyanont, *The Crown Property Bureau in Thailand and the Crisis of 1997*, 38(1) J. CONTEMPORARY ASIA 38, 166-189 at 167 (Feb. 2008).
- ¹⁰ See http://www.crownproperty.or.th/public/upload/media/Annual%20Report/Annual_Report2013.pdf.
- ¹⁰ Haley, et al. *supra* note 4 at 16.
- ¹¹ *Id.*
- ¹² Rafael La Porta, Florencio Lopez-de-Silanes, & Andrei Shleifer, *Corporate Ownership Around the World*, 54(2) J. OF FIN. (1999).
- ¹³ EAST ASIA ANALYTICAL UNIT, at 153.
- ¹⁴ Claessens, et al., *supra* note 7 at 81-112.
- ¹⁵ Michael Carney, Eric Gedajlovic, Pursey Heugens, Marc Van Essen, and J. (Hans) Van Oosterhout., *Business Group Affiliation, Performance, Context and Strategy: A Meta-analysis*, 54(3) ACADEMY OF MGMT. J. 437, 454 (2011).
- ¹⁶ EAST ASIA ANALYTICAL UNIT, *supra* note 13, at 159.
- ¹⁷ EAST ASIA ANALYTICAL UNIT, *supra* note 13, at 161.
- ¹⁸ Haley, et al., *supra* note 4 at 27.
- ¹⁹ Douglass North, *Institutions, Ideology and Economic Performance*, 11 CATO J. 477-87 (1991).
- ²⁰ Tom Ginsberg, *Review Essay: Does Law Matter for Economic development? Evidence from East Asia*, 34(3) LAW & SOCIETY REV. 829-856 at 834 (2000).
- ²¹ Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, (31(2) J. L. & ECON. 265-297 (1988).
- ²² *Id.* at 267.
- ²³ Frank B. Tipton, *Southeast Asian Capitalism: History, Institutions, States and Firms*, 26 ASIA PAC. J. MANAG. 401-434 at 401 (2009).
- ²⁴ Andrew MacIntyre, *Political Institutions and the Economic Crisis in Thailand and Indonesia*, Graduate School of International Relations and Pacific Studies, University of California, San Diego, Working Paper Series Vol. 99-8, page 6. (April 1999)
- ²⁵ Richard R. Doner, & Ansil Ramsay, *Thailand: From Economic Miracle to Economic Crisis*, ASIAN CONTAGION: THE CAUSES AND CONSEQUENCES OF A FINANCIAL CRISIS (Karl Jackson, ed. 1999).
- ²⁶ P. PHONGPAICHT & P. SUNGSIDH, *CORRUPTION & DEMOCRACY IN THAILAND*, 2nd Ed. (1996).
- ²⁷ HAL HILL, *THE INDONESIAN ECONOMY* 95 (2000).
- ²⁸ SYAMSUL MAARIF, *COMPETITION LAW AND POLICY IN INDONESIA* (28 March 2001), *available at* https://www.jftc.go.jp/eacpf/02/indonesia_r.pdf
- ²⁹ <http://www.imf.org/external/np/loi/091198.htm>.
- ³⁰ Haggard, *supra* note 6 at 68.
- ³¹ This part is based on Adelbertus Irawan Justiniarto Hartono, *State-Business Relations in Post-1998 Indonesia: The Role of Kadin*, UNIVERSITY OF GRONINGEN THESIS IN ECONOMICS AND BUSINESS, Ch. 5 (2011).
- ³² C. Loughlin, S. Marks, A. Shauki, & N. Sirait, 1999, *Report on Competition Policy in Indonesia*, ELIPS project, USAID project 04970372, 34 (1999).

- ³³ See Hikmahanto Juwana, *An Overview of Indonesia's Antimonopoly Law*, Symposium: APEC Competition Policy and Economic Development 1(1) WASHINGTON UNIV. GLOBAL STUDIES L. REV. (2002).
- ³⁴ Kitab Undang-Undang Hukum Pidana Serta Komentar-Komentarnya Lengkap Pasal Demi Pasal [Criminal Code With Comprehensive Commentary] art. 382bis (1976).
- ³⁵ Law of the Republic of Indonesia, No. 5 of 1984, Law Concerning Industrial Affairs, 22 Lembaran Negara [State Gazette] art. 7 (1984).
- ³⁶ Indonesia Civil Code, Art. 1365
- ³⁷ See Juwana, *supra* note 33 at 186, and Maarif, *supra* note 28 at 33.
- ³⁸ C. BAKER & P. PHONGPAICHT, A HISTORY OF THAILAND, 168 (2005)
- ³⁹ *Id.* at 233.
- ⁴⁰ *Id.* at 247.
- ⁴¹ Andrew MacIntyre, *Political Institutions and the Economic Crisis in Thailand and Indonesia*, Graduate School of International Relations and Pacific Studies, University of California, San Diego, Working Paper Series Vol. 99-8, page 6. (April 1999).
- ⁴² PASUK PHONGPAICHT & CHRIS BAKER, THAKSIN: THE BUSINESS OF POLITICS IN THAILAND, 17 (2004).
- ⁴³ The Letters of Intent of the Thai Government describe the policies that Thailand intended to implement in the context of its request for financial support, and are available from the IMF at <http://www.imf.org/external/np/loi/022498.htm> (1999) and <http://www.imf.org/external/np/loi/052698.htm> (May 26 1998).
- ⁴⁴ See Deunden Nikomborirak, *The Political Economy of the Competition Regimes in Thailand and South Korea: A Comparison*, in BUILDING NEW COMPETITION LAW REGIMES: SELECTED ESSAYS (David Lewis, ed. 2013) and Sakda Thanitcul, *Competition Law in Thailand: A Preliminary Analysis*, WASHINGTON UNIV. GLOBAL STUDIES L. REV. (2002).
- ⁴⁵ OECD, OECD REVIEWS OF REGULATORY REFORM: INDONESIA, 46 (2012).
- ⁴⁶ Available at <http://www.thejakartapost.com/news/2010/02/09/court-rejects-former-kppu-commissioner-appeal.html>.
- ⁴⁷ R. Ian McEwin, *Business, Politics and Competition Law in Southeast Asia*, WILLIAM E. KOVACIC: AN ANTITRUST TRIBUTE LIBER AMICORUM – VOLUME II (N. Charbit, E. Ramundo, A. Chehtova, & A. Slater, eds. 2014).
- ⁴⁸ Case 07/KPPU-L/2007.
- ⁴⁹ N. Poapongsakorn, *The New Competition Law in Thailand: Lessons for Institution Building*, 2 REV. INDUS. ORG. 185-204 (2002).
- ⁵⁰ See <http://otcc.dit.go.th/otcc/upload/Criteria%20for%20Market%20Domination.pdf>
- ⁵¹ Originally cited at www.info.tdri.or.th/unpublished, but no longer available.
- ⁵² Deunden, *supra* note 44 at 8.
- ⁵³ Deunden Nikomborirak, *The Political Economy of Competition Law: The case of Thailand*, 26 NORTHWESTERN J. INT'L L. & BUS. 597 (2006).
- ⁵⁴ See MARK WILLIAMS, THE POLITICAL ECONOMY OF COMPETITION LAW IN ASIA (2013).
- ⁵⁵ *The Rule Of Law In Thailand: Are Thailand And The United States Ready For A Free Trade Agreement?* Testimony of Dr. Jeffrey Race before the Trade Policy Staff Committee of the Office of the United States Trade Representative Washington DC March 30, 2004.

56

Id.

57

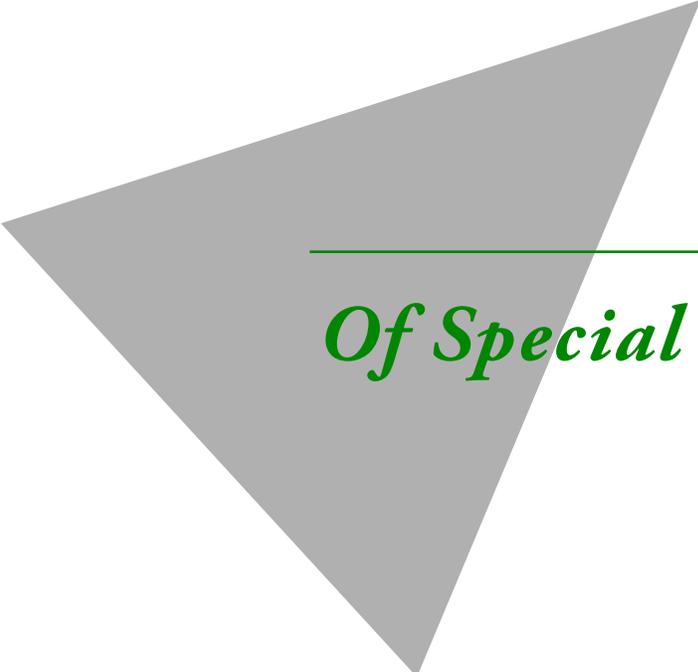
Supra note 47.

58

Supra note 53.

59

Deunden Nikomborirak & Sirikarn Lertmanphainond, *Monopolies and Economic Equality*, 9, paper presented to the Thailand Development Research Institute Annual Academic Conference, Bangkok, (November 29-30, 2009).



Of Special Interest

Assessing Unfair Pricing Under China's Anti-Monopoly Law for Innovation-Intensive Industries

BY DAVID S. EVANS, VANESSA YANHUA ZHANG, & XINZHU ZHANG¹

China, like a number of other antitrust jurisdictions, has a law concerning unfair pricing. This article develops an economic framework for applying the unfair pricing law in China. The framework draws on the experience of courts and competition authorities in other jurisdictions and the writings of various commentators, particularly economists, on unfair pricing in those jurisdictions. It shows that virtually all jurisdictions have decided to consider unfair pricing claims only in exceptional circumstances, and rarely, if ever, in innovation-intensive industries. For those cases that pass this screen and receive consideration, the courts and competition authorities then, under the leading test, insist on substantial evidence that the price is significantly higher than cost **and** is unfair given the value provided to the buyer. This article shows that the exceptional circumstances screen and the rigorous unfair pricing test are motivated by a recognition, supported by substantial empirical evidence, that successful firms must have the assurance of receiving significant rewards to induce them to invest time and capital in highly risky innovation that is the source of economic growth and welfare. It concludes by showing that this approach is consistent with modern Chinese economic policy.

I. INTRODUCTION

Article 17(1) of China's Anti-Monopoly Law ("AML") prohibits dominant firms from "selling commodities at unfairly high prices or buying commodities at unfairly low prices."² Many jurisdictions have similar laws. The European Union, for example, prohibits dominant firms from "imposing unfair purchase or selling prices."³ As a result there is an extensive body of decisions by courts and regulatory authorities that the

MANY JURISDICTIONS HAVE FOUND THAT THE THORNIEST ISSUES CONCERNING PRICING BY DOMINANT FIRMS ARISE IN INDUSTRIES IN WHICH INNOVATION IS A SIGNIFICANT DRIVER OF FIRM SUCCESS AND COMPETITIVE DYNAMICS

National Development and Reform Commission ("NDRC") and courts in China can draw on in considering how to shape the application of Article 17 in China. In addition, the United States, Canada, Australia, and many other jurisdictions have chosen not to adopt unfair pricing laws. Their reasons for not doing so are informative as well.

Many jurisdictions have found that the thorniest issues concerning pricing by dominant firms arise in industries in which innovation is a significant driver of firm success and competitive dynamics. They have recognized that they must consider the impact of excessive pricing prohibitions on innovation. Moreover, economists have also found that determining whether prices are "too high" is a very complex question in innovation-intensive industries.

This article describes economic evidence that the NDRC and courts, as well as the parties before them, could consider in evaluating whether prices are too high under the AML and, in the case of the NDRC, to pursue an unfair pricing investigation in the first place.⁴ We focus on situations in which innovation has

been or continues to be an important element of the dynamic competitive process. We take a broad view of innovation. It always begins with human ingenuity but often entails taking considerable personal and financial risk. Some innovative industries tend to rely on using intellectual property rights to protect their efforts. Others do not and sometimes cannot.

Our analysis synthesizes the learning of courts, competition authorities, and economists that have considered unfair pricing and its relationship to innovation. It concludes that innovators take large risks *ex ante* because of the possibility for earning large rewards *ex post*. Robust involvement by antitrust regulators in adjudicating “unfair” or “excessive” prices can distort—or even eliminate—the very incentives that drive innovation to begin with. This provides sound economic justification for antitrust regulators’ traditional hesitation to interfere with the determination by markets of what constitutes a “fair” price.

We recognize that, as China develops its approach to excessive pricing cases under the AML, it will need to take into account the particular circumstances of China.⁵ Those circumstances support the application of the principles discussed above.

THE SPECIFIC SITUATION IN CHINA
IMPLIES THAT IT SHOULD ACT
CONSISTENTLY WITH INTERNATIONAL
NORMS IN RARELY, IF EVER, USING
UNFAIR PRICING LAWS TO IMPOSE
PRICE CAPS ON FIRMS IN INNOVATION-
INTENSIVE INDUSTRIES

China has moved rapidly since the late 1970s towards relying on a decentralized market mechanism to drive the economy forward and improve the lives of consumers. Reforms in the last three decades have created a surge of entrepreneurship and innovation in various sectors in China. This includes entrepreneurs starting businesses, state-owned and private enterprises initiating innovation (encouraged and sponsored by the government), and foreign companies entering China and bringing in additional technology and know-how.

This has resulted in part from policies that enable entrepreneurs to secure rewards for the risks they take by allowing them to charge what the market will bear for their product. As a result, China has been one of the most dynamic market economies in the world. Innovation by Chinese companies has grown significantly, and the Chinese economy is increasingly innovation-driven.⁶

In this environment the authorities have powerful reasons not to impose price regulation on innovation-intensive industries, since that would eliminate or reduce the incentive to innovate. In fact, recognizing this, China has, as a matter of government policy, decided to rely mainly on the market to determine prices and has, under the leadership of the NDRC, gradually eliminated most price regulation during the process of reforms. This policy is particularly critical for innovation-intensive industries for which price regulation would distort economic efficiency and eliminate or reduce the incentives to innovate, incentives which have been responsible for rapid economic growth in the past thirty years. Therefore, the specific situation in China implies that it should act consistently with international norms in rarely, if ever, using unfair pricing laws to impose price caps on firms in innovation-intensive industries.⁷

The article is organized as follows:

Section II describes the role of unfair pricing in competition policy in jurisdictions around the world. It shows that antitrust authorities, including all major ones, rarely, if ever, initiate unfair pricing cases and that the courts impose very stringent tests for the few unfair pricing cases that reach them. One of the authorities' primary concerns in adopting this approach is that regulating prices of dominant firms discourages the innovation and risk taking that is the key to economic progress.

Section III presents the economic rationales for competition authorities and courts taking this extremely cautious approach towards pricing by dominant firms. It documents the critical role of new products and technologies in economic growth. It shows that most of the firms which try to create new products and technologies fail and that limiting the rewards to the few entrepreneurs who succeed at innovation *ex post* reduces the number of entrepreneurs who make risky investments *ex ante*. Limiting the returns of the winners thereby depresses the flow of new products and technologies and slows economic progress.

THE EUROPEAN UNION HAS DEVELOPED A NOTABLY CAUTIOUS APPROACH TO UNFAIR PRICING CLAIMS

Section IV summarizes the two-part test for unfair pricing that has been adopted by the European Union and other jurisdictions. The first prong considers whether a price is high in the sense that it enables the seller to earn a supra-competitive profit. If it does, then the second prong considers whether a price is high relative to the value provided to the buyer. The courts and competition authorities have recognized that developing evidence for both prongs of the test entails many difficulties. This section shows that it is much more difficult to assess unfair pricing in innovation-intensive industries, thereby providing another significant reason for taking an extremely cautious approach towards claiming unfair pricing by dominant firms in these industries.

Section V presents an economic framework for assessing excessive pricing claims in innovation-intensive industries in China. It suggests that the unfair pricing regulations⁸ already adopted by the NDRC encompass many pricing practices that are common in competitive markets and ultimately good for consumers, but that the NDRC should consider a more targeted approach similar to that used in other jurisdictions. As a special case it considers industries in which intellectual property rights are important. It argues that interventions in the context of excessive pricing concerning intellectual property should be limited to situations in which a dominant firm uses intellectual property rights to eliminate or exclude competition, as required under Article 55 of the AML.

Section VI presents brief conclusions.

II. THE ROLE OF UNFAIR PRICING IN COMPETITION POLICY

We consider the European Union first. It has the most well-developed body of law on unfair pricing by dominant firms. The law itself is more than half a century old. The European Court of Justice issued a seminal decision in 1978 that has influenced the decisional practice and court cases at the European Commission and at national

competition authorities. We then turn to the United States that, at more than 120 years, has one of the longest histories of antitrust enforcement. We conclude with a summary of a survey of 24 jurisdictions that participated in the OECD Roundtable concerning excessive pricing laws in 2011.⁹

A. *European Union*

The European Union has developed a notably cautious approach to unfair pricing claims. The 1957 Treaty of Rome, which is the original constitutional basis for the European Union, prohibited dominant firms from engaging in what are now termed “exclusionary abuses,” such as exclusive dealing, predatory pricing, and tying. It also prohibited them from engaging in “exploitative abuses,” such as unfair pricing and the imposition of unfair trading conditions.¹⁰ At the time, few countries outside of the United States, Australia, and Canada had antitrust laws.¹¹ None of those countries prohibited unfair pricing and other exploitative abuses by dominant firms.¹²

The European Commission decided to use its powers to regulate unfair pricing sparingly. By the early 1970s the European Commission had made it clear that “measures to halt the abuse of dominant position cannot be converted into systematic monitoring of prices.”¹³ The Commission was more explicit in 1994. It indicated that:

The existence of a dominant position is not itself against the rules of competition. Consumers can suffer from a dominant firm exploiting this position, the most likely way being through prices higher than would be found if the market were subject to effective competition. However, the Commission in its decision-making practice does not normally control or condemn the high level of prices as such.¹⁴

Instead, the Commission said it would focus on regulating practices against competitors or new entrants taken by the dominant firm to preserve its position.¹⁵ The Commission explained its reasoning in a 2011 submission to the OECD:¹⁶

It is nonetheless important to recognise that high profits may often be the result of superior innovation and risk taking, which should not be penalised as this would work as a disincentive to innovate and invest.... [T]his does not mean that intervention against exploitative conduct should necessarily be totally excluded but it indicates that it may be better to tilt the balance in favour of addressing exclusionary conduct.

In the nearly 60 years since the adoption of a European competition law, the European Commission

THE EUROPEAN COURTS HAVE ALSO TAKEN A SKEPTICAL VIEW OF THE FEW UNFAIR PRICING CASES THAT THEY HAVE REVIEWED

has held to this policy and brought few excessive pricing cases. It has reached only six formal decisions concerning excessive pricing between 1957 and 2013, barely one per decade.¹⁷ By way of comparison, the Commission had reached 50 decisions concerning abuse of dominance by 2004.¹⁸

The European courts have also taken a skeptical view of the few unfair pricing cases that they have reviewed. According to Motta & de Streel (2007), the European courts had rendered opinions in about 15 cases as of the mid-2000s.¹⁹ They note that most of these cases involved unfair prices that resulted in the exclusion of competitors and the remainder involved firms, such as the post office, which had legal monopolies or were dominant firms in regulated industries such as energy.²⁰ The only case in which the European courts rendered an opinion on an excessive pricing abuse that did not have an associated exclusionary abuse *and* in which the firm did not have a legal or regulated monopoly was *United Brands*, in which the European Court of Justice found the Commission's evidence lacking.²¹

LIMITING THE FREEDOM TO SET PRICES MAY WELL CONFLICT WITH THE UNDERLYING PREMISE OF ANTITRUST POLICY, I.E. PROMOTING A ROBUST COMPETITIVE PROCESS THAT PRODUCES HIGH-QUALITY, INNOVATIVE GOODS AT LOW PRICES

This review shows that the European Commission has used its discretion in rarely reaching decisions that find the dominant firms to have engaged in unfair pricing and that the European courts thus uphold unfair pricing decisions only in special situations.

B. United States

Courts and antitrust authorities in the United States have gone even further than those of the European Union in seeking to protect market-driven innovation incentives from interference. The antitrust laws of the United States do not have any provisions that would limit the prices which firms with significant market power could charge their customers. From their inception in the late 19th century, the U.S. antitrust laws have permitted firms, including those with monopoly power, to charge prices that would enable them to earn significant, including arguably supra-competitive, profits.²² Writing in 1945 in *U.S. v. Alcoa*, Judge Learned Hand presented what has become the classic explanation for the U.S. approach.²³

[A] strong argument can be made that, although the result may expose the public to the evils of monopoly, the Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: *finis opus coronat* [the end crowns the work]. The successful competitor, having been urged to compete, must not be turned upon when he wins.

The U.S. Supreme Court affirmed this view in its decision in *Verizon v. Trinko* in 2004. Writing for the unanimous Court, Justice Scalia noted:²⁴

The opportunity to charge monopoly prices—at least for a short period—is what attracts “business acumen” in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct.

In summarizing the state of U.S. law on excessive pricing the U.S. Department of Justice in their

submission to the OECD Roundtable noted:²⁵

U.S. antitrust law allows lawful monopolists, and a fortiori other market participants, to set their prices as high as they choose. This central tenet of U.S. antitrust law is well supported by court decisions that have held, for example, that “[a] pristine monopolist...may charge as high a rate as the market will bear” and that “[a] natural monopolist that acquired and maintained its monopoly without excluding competitors by improper means is not guilty of ‘monopolizing’ in violation of the Sherman Act...and can therefore charge any price that it wants,... for the antitrust laws are not a price-control statute or a public utility or common-carrier rate-regulation statute.”

According to the U.S. Department of Justice, “limiting the freedom to set prices may well conflict with the underlying premise of antitrust policy, i.e. promoting a robust competitive process that produces high-quality, innovative goods at low prices.”²⁶

C. Other Jurisdictions

Other jurisdictions have adopted a similar skepticism towards excessive pricing theories. Twenty-three countries plus the supra-national European Union made submissions regarding their practices to the OECD in 2011.²⁷ Four of those jurisdictions have competition laws that do not treat unfair pricing by dominant firms as a possible abuse: Australia, Indonesia, Mexico, and the United States. Nineteen of those jurisdictions have competition laws that do treat unfair pricing by dominant firms as a possible abuse. These include Brazil, Chile, India, Indonesia, Israel, Russia, South Korea, Switzerland, Chinese Taipei, and Turkey, as well as nine EU member states that apply EU law (Bulgaria, the Czech Republic, Denmark, Finland, Germany, Greece, Hungary, Lithuania, and the United Kingdom).

All of the countries that have excessive pricing prohibitions appear to take an “exceptional circumstances” approach based on their submissions to the OECD. They bring few cases, and only in

THERE IS A CONSENSUS AMONG JURISDICTIONS AROUND THE WORLD THAT COMPETITION LAWS SHOULD RARELY, IF EVER, LIMIT THE PRICES THAT DOMINANT FIRMS CAN CHARGE THEIR CUSTOMERS

special circumstances.²⁸ As the OECD notes, “In general, excessive price cases are conducted infrequently even within those jurisdictions that prohibit and enforce excessive price provisions.” Some, such as Brazil and India, have excessive pricing laws but have never brought a case.

III. THE ECONOMIC BASIS FOR THE EXCEPTIONAL CIRCUMSTANCES SCREEN FOR UNFAIR PRICING

There is a consensus among jurisdictions around the world that competition laws should rarely, if ever, limit the prices that dominant firms can charge their customers. Jurisdictions are reticent to use antitrust laws to impose price caps on dominant firms, as we have seen from the quotes in the previous section, primarily because of the impact that this would have on the incentives for individuals and firms to make the risky

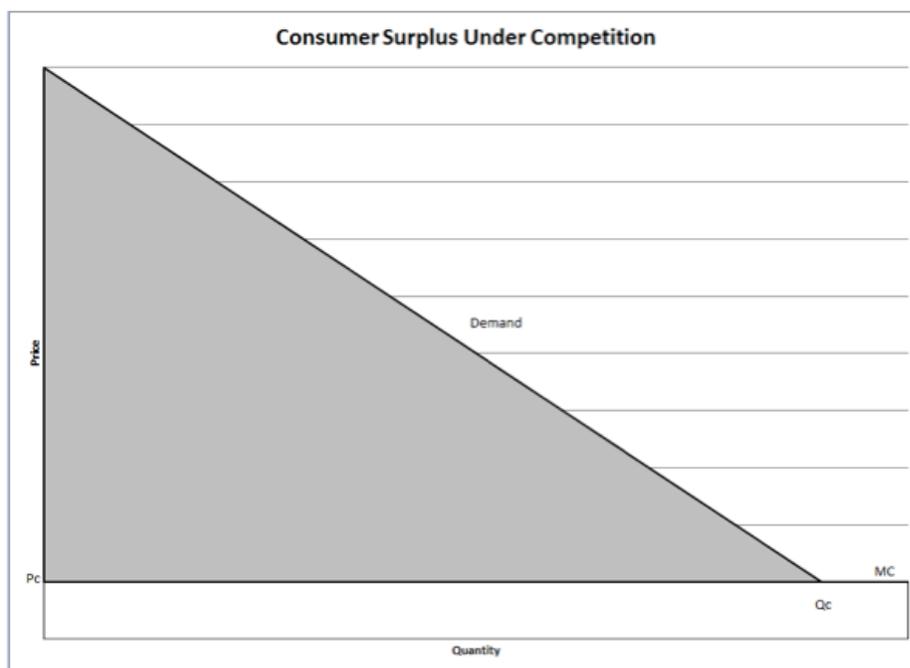
investments of time and capital that are the source of innovation and, ultimately, economic growth. They are also hesitant because the determination of prices through market forces has empirically proved more efficient than having the government set prices. All these concerns are heightened when it comes to innovation-intensive industries and especially those involving intellectual property.

A. Consumer Welfare; Static Competition Models Are Unreliable

Economists have developed a simplified model to show how firms would set their prices in a hypothetical perfectly competitive industry and ignoring any dynamic aspects of competition. This model is sometimes cited as part of a justification for regulating the prices of dominant firms. It is therefore useful to explain this model and the assumptions behind it. As shown below, the model does not account for risk taking, innovation, and other dynamic behavior, which has rightly led competition authorities and courts to recognize that this elementary model does not provide a sound basis for the application of prohibitions on “excessive” or “unreasonably high” prices.

According to the basic textbook model, shown in Figure 1, consumers get the greatest welfare when firms expand output to the point where price equals the marginal cost of production including a competitive rate of return. Welfare is measured by the large shaded triangle. In this basic model, competition generally drives firms to produce and price at that level.

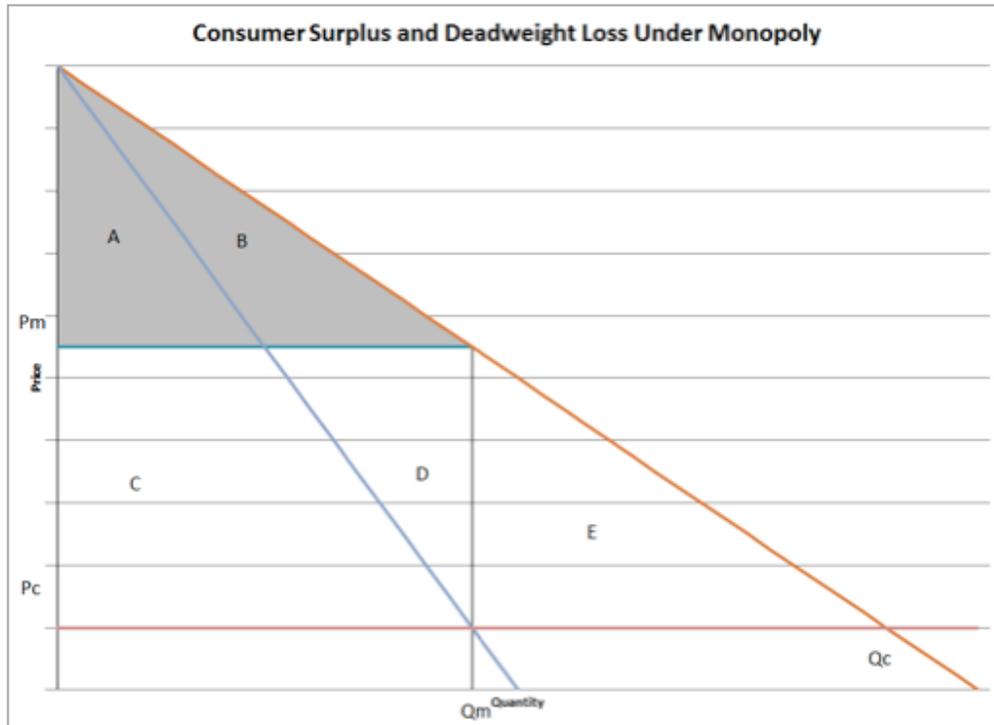
Figure 1



Firms with significant market power, however, can earn more profit by charging higher prices and producing less output. A monopoly, for example, would increase price and reduce output as shown in Figure

2. As a result consumers would pay more for a smaller amount of output (and therefore lose the area shown by C+D) and not get the QC-QM units of output that they valued by the amount shown by E. Under this simplified model consumers lose the areas C+D+E.

Figure 2



This textbook model of competition provides an obvious, although highly simplistic, definition of an excessive price. It would imply that any price greater than marginal cost—the competitive level that maximizes consumer welfare—is excessive and unfair to consumers.²⁹ If we could force dominant firms to lower price to marginal cost then consumers would get more welfare in this simple static model—at least on the blackboard.

Although this simplified model is useful for teaching basic concepts, it is not properly applied to determine if prices are “excessive.” That is because the emphasis on marginal cost fails to account for the critical reality that firms assume costs and risks when jumping into the competitive fray. Profits need to reward them for doing so and compensate for the fixed costs of setting up a business. As we document below, eliminating those profits takes away the incentives that firms have for participating in a battle that most will not survive. Market prices, moreover, are signals that other firms consider when deciding whether to enter the market—either because there is demand or because they can operate more efficiently than existing firms. Competition authorities have resisted employing a competition policy that would set prices through marginal-cost pricing for the same reasons that countries globally, including China, have moved from government to market-based price setting for virtually all goods and services.

COMPETITION AUTHORITIES HAVE RESISTED EMPLOYING A COMPETITION POLICY THAT WOULD SET PRICES THROUGH MARGINAL-COST PRICING FOR THE SAME REASONS THAT COUNTRIES GLOBALLY, INCLUDING CHINA, HAVE MOVED FROM GOVERNMENT TO MARKET-BASED PRICE SETTING FOR VIRTUALLY ALL GOODS AND SERVICES

B. Innovation, Rewards, and Economic Progress

There is considerable empirical economic support for this policy. First, there is substantial empirical evidence that economic progress and long-term social welfare are driven by innovation that leads to the creation of new products and services, new technologies that facilitate the introduction of new products and services, and the creation of more efficient ways to produce goods and services.³⁰ Second, there is substantial empirical evidence that this innovation results from dynamic competition in which most entrepreneurs, inventors, and firms that try their hands at innovation fail to succeed.³¹ Third, there is substantial empirical evidence that the

NEW TECHNOLOGIES ARE EXTREMELY VALUABLE BECAUSE THEY FACILITATE THE INTRODUCTION OF MANY NEW PRODUCTS

process of innovation and dynamic competition that results in new products and technologies is driven by a reward structure in which the few that succeed get highly compensated and the preponderance that do not succeed get little, if anything.³²

These three empirical findings have an immediate implication for government policies towards prices in innovation-intensive industries.³³ Interventions that reduce the prices innovators may charge for their new inventions have the effect of reducing the incentives to undertake risky investments in innovation. These interventions thereby slow economic progress and reduce long-term social welfare.

1. New Products

The most well-developed empirical work on the value of innovation concerns new products. We begin with the theory. Assume that a firm creates a new product. Consider the extreme case in which the firm has a monopoly over the new product. Figure 2, above, shows the standard monopoly pricing model in which, to maximize profit, the firm produces out to the point where marginal revenue equals marginal cost and charges what the market will bear for this amount. Before the firm introduced the new product, consumers obviously were not obtaining any consumer welfare from it. After the firm introduces the new product, consumers obtain consumer surplus shown by the difference between what they are willing to pay and the price the monopoly charges. That area is shaded in the diagram.

Economists have done many studies of the value generated by new products. These studies take into account the fact that new products substitute in part for existing products. They calculate the net increase in consumer welfare after accounting for this substitution.

The classic study in this area examined the value created when General Mills, which had produced an oat-based cereal called Cheerios since 1941, introduced Apple Cinnamon Cheerios in 1988. As the name suggests, General Mills added apple and cinnamon flavoring to their basic cereal. Professor Jerry Hausman found through a careful econometric study that this “new product” generated \$66.8 million per year of additional consumer value.³⁴ Subsequent studies have found that other new products generate significant consumer value.³⁵

These empirical studies confirm and quantify what is obvious from our experience with innovation in our daily lives. New products and services such as smart mobile phones, micro-blogging, e-commerce, and search engines have provided tremendous value. In China, these new products and services in information communications and technology industries have promoted industrial upgrading and transformation, helping China's industrial structure change from labor-intensive to knowledge-intensive.³⁶

New technologies are extremely valuable because they facilitate the introduction of many new products. Consider mobile communication technologies. These technologies have supported the creation of a vast array of projects ranging from the most basic mobile handset working on a 2G network to SMS communication methods, such as weibo, to mobile payments. Moreover, these technologies were the foundation of the hundreds of thousands of applications, many of which are themselves new products, that run on smart phones. China's Ministry of Industry and Information Technology ("MIIT") found that in the first three years of its introduction the 3G technology standard used for smart mobile phones in China created 1.23 million new jobs and RMB 211 billion in direct GDP growth.³⁷ Many other technologies, ranging from the internet in recent times to electricity long ago, have similarly provided the foundation for the creation of many valuable new products.

IT REFLECTS THE COMMON FINDING CONCERNING INNOVATION: RETURNS ARE HIGHLY SKEWED WITH MOST INNOVATIONS EARNING NOTHING AND A FEW EARNING A LARGE AMOUNT

Let us return, though, to the simple new product example. One could argue that the monopoly is short-changing consumers because it is not producing at marginal cost and therefore imposing the losses shown in Figure 2. That argument is wrong for two reasons. First, the economically correct comparison is between the welfare consumers had before the introduction of the new product and afterwards. Their welfare has improved by the shaded area. Second, taking away the reward for innovation would reduce the amount of investment and effort that go into innovation and thereby reduce future benefits consumers would receive from new products and technologies.

A NUMBER OF STUDIES DONE IN THE UNITED STATES SHOW THAT CREATING NEW PRODUCTS, TECHNOLOGIES, AND OTHER INNOVATIONS, IS SIMILAR TO A LOTTERY IN TERMS OF THE REWARD STRUCTURE

is short-changing consumers because it is not producing at marginal cost and therefore imposing the losses shown in Figure 2. That argument is wrong for two reasons. First, the economically correct comparison is between the welfare consumers had before the introduction of the new product and afterwards. Their welfare has improved by the shaded area. Second, taking away the reward for innovation would reduce

2. Success and Failure Rates for Innovation

A number of studies done in the United States show that creating new products, technologies, and other innovations, is similar to a lottery in terms of the reward structure. Innovators, entrepreneurs, and firms compete in races to create new categories of products and services for consumers. Almost all of the participants in the competitive process fail. The few that survive often obtain significant rewards—the crown described by Judge Hand—for their efforts. Almost everyone else loses the capital they have invested as well as the opportunity cost of their time.

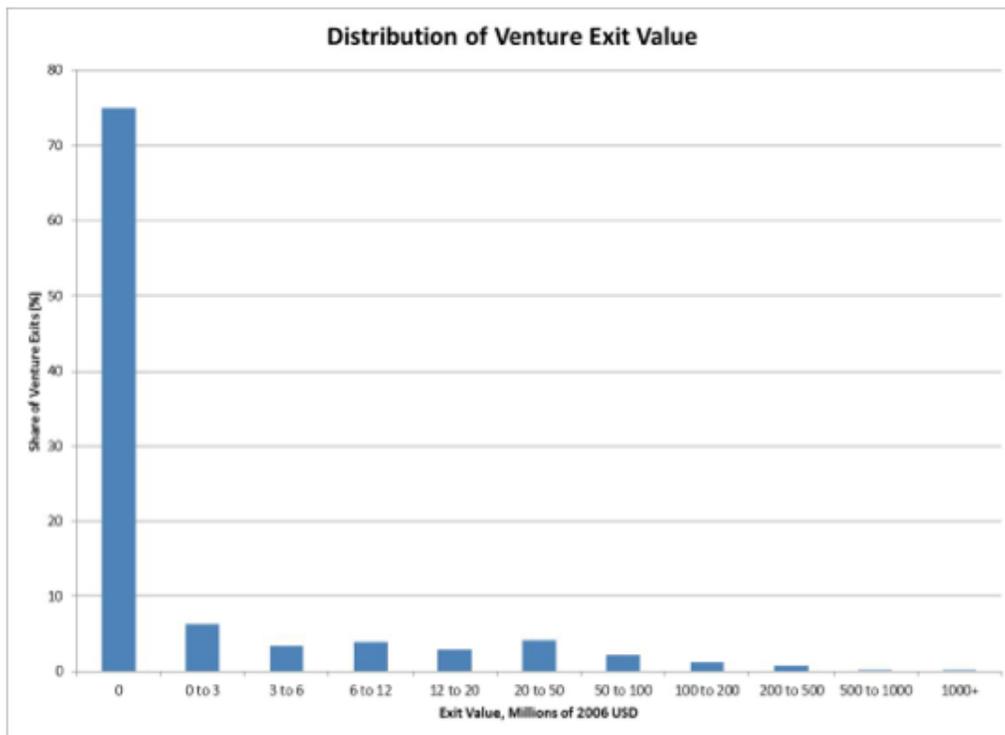
Gort & Klepper, for example, examined the development of industries for 46 new products in the United States.³⁸ They found that dozens (or in a couple of cases, hundreds) of firms entered these industries in the early years. Many of these firms imitated early innovators. Over time many of these firms exited the industries. The competitive process revealed the firms that could operate most efficiently and provide the greatest benefits to consumers.

Other studies have documented that most entrepreneurs that start businesses fail within four years. Recent studies for the United States have found that about half of all new businesses, weighted by employment, exit less than four to five years after entry.³⁹ Studies for other countries have reached similar conclusions. A study of manufacturing startups in the Netherlands found that less than 70 percent had survived after three years.⁴⁰ A study of startups in the western states of Germany found that less than 65 percent survived after two years and that less than 50 percent had survived after five years.⁴¹ Another study of startups in the German state of Baden-Württemberg found that 20 percent failed after two years and 40 percent had failed after five years.⁴²

Hall & Woodward, to take another example, studied the experience of entrepreneurs who received venture funding between 1987 and 2008 in the United States. Venture capital firms invest in very few of the proposals that are presented to them.⁴³ As a result, the entrepreneurs considered by these authors had already gone through a rigorous screening process. They found that over a third of these ventures exited with a value of zero within five years. About 75 percent of entrepreneurs that exited before the end of their data (and about 50 percent of all entrepreneurs) received nothing from their efforts.⁴⁴ Figure 3 shows the distribution of exit values received by entrepreneurs. It reflects the common finding concerning innovation: Returns are highly skewed with most innovations earning nothing and a few earning a large amount.

Some studies have examined the success of R&D efforts by pharmaceutical companies. These companies are interesting because they invest in large numbers of discrete chemical compounds every year. It is therefore possible to track the success of these bets.⁴⁵ In the United States, a chemical compound being investigated for possible medical use must undergo a series of tests before being approved.⁴⁶ In Phase I, researchers test the compound in a small group of people for the first time to evaluate its safety, determine a safe dosage range, and identify side effects.

Figure 3 Distribution of Venture Exit Value



Source: Robert E. Hall & Susan E. Woodward, *The Burden of the Nondiversifiable Risk of Entrepreneurship*, 199 (3) AMER. ECON. REV., 1163-1194 (2010).

In Phase II, the compound is given to a larger group of people to see if it is effective and to further evaluate its safety. In Phase III, the compound is given to large groups of people to confirm its effectiveness, monitor side effects, compare it to commonly used treatments, and collect information that will allow it to be used safely. A drug can be rejected in any phase, and can only be approved for sale after passing Phase III.⁴⁷ One study tracking investigational compound success rates found only 71 percent of compounds that began Phase I testing advanced to Phase II testing, only 31.4 percent of those that began Phase I testing advanced to Phase III testing, and only 15.2 percent of those that began Phase I testing were approved for marketing.⁴⁸ Another study found an even lower rate, with only 11 percent of chemicals beginning Phase I receiving approval.⁴⁹ Moreover, only a small fraction of new chemical compounds in which pharmaceutical companies invest research and development expenditures even make it to Phase I.

Finally, beginning with the classic work by Ariel Pakes, economists have examined the economic value of patents.⁵⁰ Companies and individuals spend money on research and development to generate ideas that they patent. These studies find that few patents provide a significant return. Pakes' 1986 study found that the median patent in France was valued at less

INDIVIDUALS AND FIRMS WOULD NOT WILLINGLY ASSUME THE RISKS OF INVESTING IN NEW PRODUCTS, SERVICES, OR TECHNOLOGIES IF THEY BELIEVED THAT THE PRICES THEY COULD CHARGE FOR SUCCESSFUL INNOVATIONS WOULD BE SUBJECTED TO ARTIFICIAL CAPS

than U.S. \$550 over its lifetime, and that the top five percent of patents accounted for more than 45 percent of total patent value. In the United Kingdom, the median patent was valued at just over U.S. \$1,500 over its lifetime and the top five percent of patents accounted for more than 35 percent of total value. In Germany, the median patent was valued at just over U.S. \$6,250 and the top five percent of patents accounted for over 30 percent of patent value. These results show that the returns to patents are highly skewed.

Individuals and firms would not willingly assume the risks of investing in new products, services, or technologies (or less costly means of providing existing products or services) if they believed that the prices they could charge for successful innovations would be subjected to artificial caps.

Table 1: Percentiles and Lorenz Curve Coefficients from the Distribution of Realized Patent Values

	France		United Kingdom		Germany	
Percentile	Value (USD)	Cumulative Value Share	Value (USD)	Cumulative Value Share	Value (USD)	Cumulative Value Share
25th	75.23	0.544%	355.55	0.544%	1,999.60	2.249%
50th	533.96	1.833%	1,516.84	3.247%	6,252.93	7.341%
75th	3,731.35	8.087%	7,947.55	16.369%	19,576.26	25.288%
85th	10,292.06	19.575%	15,357.09	31.721%	32,428.14	41.001%
90th	17,423.11	31.261%	22,206.21	44.257%	44,241.87	52.672%
95th	31,609.59	52.461%	34,740.07	62.960%	65,753.61	69.223%
97th	42,905.78	65.514%	43,889.95	73.640%	78,299.01	78.348%
98th	51,215.84	73.729%	51,277.22	80.072%	94,842.63	83.800%
99th	66,515.40	84.011%	65,075.08	87.858%	118,354.78	90.330%
Maximum	259,829.27	-	374,028.70	-	419,217.55	-
Mean	5,631.03	-	7,357.05	-	16,169.48	-

Source: Ariel Pakes, Patents as *Options: Some Estimates of the Value of Holding European Patent Stocks*, 54(4) *ECONOMETRICA* 755-784 (1986).

3. The Role of Rewards in Stimulating Investment and Effort at Innovation

Investing time and effort in innovation is therefore a gamble. To be sure, those engaged in innovation are not literally playing a game of chance. Their odds of success increase if, through their efforts, they can come up with a clever idea that results in new technologies, products, or savings in deploying or making existing technologies or products. Nevertheless, the analogy to a lottery helps explain the relationship between risk and reward.

IT IS EASY, AFTER THE FACT, TO QUESTION THE WEALTH OBTAINED BY THE SUCCESSFUL INNOVATOR

Consider a lottery in which people pay one Yuan for an entry. Only one person wins. If the lottery sells

ten million tickets then, in order for a person to have fair odds when they purchase a ticket, the reward must be ten million Yuan.⁵¹ After the lottery selects a winner, 9,999,999 people will have spent one Yuan each with nothing in return. They have each lost one Yuan. One person wins ten million Yuan and makes a profit of 9,999,999 Yuan after deducting the cost of the ticket.

This lottery example shows the impact of imposing *ex post* rules on *ex ante* investments. Suppose people were just willing to spend one Yuan per ticket for the lottery described above. If the lottery reduced the payout to 9,000,000 Yuan, economically rational and risk-neutral people would not buy a ticket. Likewise, if the government imposed a special “excessive lottery tax” of 50 percent on lottery earnings they would not buy tickets either. Any change in the amount of the reward has an impact on the willingness to participate in

THIS LOTTERY EXAMPLE SHOWS THE IMPACT OF IMPOSING *EX POST* RULES ON *EX ANTE* INVESTMENTS

the lottery in the first place. *Ex post* regulation of the winners of the contest has a chilling effect on the *ex ante* incentives of those considering the next contest.

Human nature is no different in the case of investments in innovation. Entrepreneurs, venture capitalists, and companies all require the opportunity to earn an *ex post* reward sufficient to compensate them for the risk they bear *ex ante*. Consider, for example, the entrepreneurs in the Hall-Woodward study. On average these entrepreneurs probably did not recover the opportunity cost of their time. Slightly more than two percent of the entrepreneurs received more than \$100 million upon exit. Suppose there was a special tax of 50 percent on earnings of \$100 million or more from selling a startup. *Ex post*, that tax would have no effect since the entrepreneurs had already expended the effort. But if entrepreneurs expect that tax *ex ante*, then the overall returns to entrepreneurs would be reduced by approximately 43.5 percent since entrepreneurs with payouts of \$100 million or more accounted for 87 percent of the overall returns.

4. The Innovation Process and Price Regulation

The competitive process is built on rewards. Those rewards induce a massive amount of innovative effort by inventors, entrepreneurs, and firms. Investors often back those efforts with risk capital. Most everyone fails. They are quickly forgotten. Their efforts and the money behind them is all for nothing. A few succeed. They get the prize in the form of profits for their efforts. The public gets a prize, too, in the form of valuable new products and services that would not have existed but for these successful innovators.

It is easy, after the fact, to question the wealth obtained by the successful innovator. Sometimes people argue that the innovator would still have made his contribution with a smaller reward. That is like saying that a lottery winner would have bought the ticket for an even smaller reward. The claim is obviously true if the lottery winner knew he would win. It ignores, however, the incentives needed to motivate participation

CHINESE POLICY MAKERS REALIZED THAT A BROAD REGULATION OF PRICING WOULD NOT HELP IMPROVE CITIZENS' LIVING STANDARDS

in the lottery in the first place because of the highly uncertain outcome. No one knows when entering a lottery whether they will win. Similarly no one knows whether an innovation they are pursuing will succeed in the marketplace. In fact,

innovation is a large numbers game. Only by having many try will success emerge.

Competition authorities and courts throughout the world have avoided regulating the prices that emerge from the competitive process because doing so reduces the very rewards that induce the massive innovative effort that drives economic progress and thereby benefits consumers.

C. Prices, Signals, and the Competitive Process

Modern economists and policymakers have come to recognize the critical role that prices play in guiding economies and promoting growth. The dynamic competitive process is highly decentralized. Businesses, investors, and consumers make individual decisions. These decisions are coordinated largely through the price system. Prices help ration the use of scarce resources and the products made from these resources to those who value those resources and products most highly. Prices signal businesses and investors to enter or expand production in various industries. More generally, prices are the way in which knowledge about resource allocation issues gets diffused in society.⁵²

SEVERAL ECONOMISTS HAVE ALSO PROPOSED SPECIFIC “EXCEPTIONAL CIRCUMSTANCES” SCREENS FOR EXCESSIVE PRICING

In principle it would be possible to collect information centrally and then make decisions on production and allocation based on that information. Many countries have attempted that approach to varying degrees at various points in their histories. The problem with that policy is that it seldom works in practice. The market relying on price signals has empirically proven to be capable of responding more nimbly and accurately to new information. Recognizing this, many market-oriented economies have reduced the role of price setting even further by virtually eliminating the small amount of price regulation that once existed. Most countries have dismantled large-scale price controls in the last two decades and have unleashed significant competition as a result.

Chinese policy makers realized that a broad regulation of pricing would not help improve citizens' living standards. They therefore initiated a gradual price reform process starting in 1979. The deregulation of prices accelerated following the adoption of the 1997 Price Law. By the end of 2005, less than five percent of the retail sales value of consumption goods was subject to price regulation.⁵³ This price liberalization has been a significant driver of the rapid growth of China's economy and success of China's transition to a market-oriented economy.⁵⁴ The Plenary Session of the Communist Party recently affirmed this policy:⁵⁵

Perfect a mechanism where prices are determined by the market. Any price that can be affected by the market must be left to the market. Push ahead with price reforms of water, oil and natural gas, electricity, transportation and telecommunication. Areas in which the government sets prices will be confined to public utilities, public service and areas that are naturally monopolized.⁵⁶

The reluctance to regulate prices extends to competition authorities and courts. Summarizing the

reactions of competition authorities to pursuing excessive pricing cases, the OECD noted:⁵⁷

More generally, the submissions for the Roundtable suggest that many competition authorities themselves harbour concerns with respect to aggressive competition law enforcement against excessive prices, premised on the belief that competition authorities are ill-equipped to function as price regulators: competition authorities seek to facilitate or preserve competition in the market, rather than dictate its terms.

The European Union, the United States, and most market-oriented countries have therefore adopted antitrust laws to make sure that firms do not interfere in the competitive process by colluding to fix prices or to exclude rivals. They otherwise rely on the competitive process to determine prices and other terms of trade, except in rare cases. They have done so explicitly, as we showed in the previous section, because they recognize that this approach will result in the greatest long-run welfare.

D. The Exceptional Circumstances Screen

In light of the concerns over competition policy regulating prices, jurisdictions with antitrust laws that prohibit excessive pricing by dominant firms have adopted various kinds of “exceptional circumstances” screens to narrow the situations in which they intervene to rare cases. No matter the details of these tests, the practical result in all jurisdictions has been to allow the market to set prices for products, services, and technologies and to limit the ability of dominant firms to set their own prices only in rare and extreme cases.

1. An Overview of Exceptional Circumstances Screens

According to the OECD’s review the “most prominent screen is the need for **high and non-transitory barriers to entry**” such as laws that establish monopoly industries like the post office or public utilities in some countries.⁵⁸ This criterion is substantially different than a firm having dominance in a market. Competition authorities generally do not pursue excessive pricing cases against dominant firms even though those firms often earn considerable profits. High and non-transitory barriers to entry involve circumstances in which one or a few entities are essentially immune from any competition. That often entails the firm having a

THE DETAILS OF THE EXCEPTIONAL CIRCUMSTANCES SCREEN VARY ACROSS JURISDICTIONS, COMPETITION AUTHORITIES, COURTS, AND COMMENTATORS

legal or regulated monopoly over a national industry. In these cases high prices cannot provide signals to induce investments in entry and innovation.

Several economists have also proposed specific “exceptional circumstances” screens for excessive pricing. Motta & de Strel proposed, as a starting point, a four-factor screen that was consistent with the European case law:⁵⁹

1. high and non-transitory barriers to entry leading to a monopoly or near monopoly,
2. this (near) monopoly being due to current or past exclusive or special rights,

3. no effective means to eliminate the entry barriers, and
4. no sector regulator being competent to regulate the excessive prices.

The authors then go on to limit intervention to cases in which competition authorities and courts are confident that the position was not the result of risky investment and innovation but was, instead, essentially bestowed on its holder by the government or happenstance. Moreover, the barriers contemplated by Motta & de Stree, and the degree of monopoly power bestowed by these barriers, go well beyond the ordinary notion of dominance. They must be close to super dominance, according to these authors.⁶⁰ They envision situations in which it is virtually impossible for entry to erode this super-dominant position. Then, even in the case in which a firm has close to a super-dominant position that was not the result of significant efforts on the part of the firm, Motta & de Stree would look for interventions to encourage entry before considering price regulation through antitrust.

SEVERAL COMMENTATORS HAVE CONCLUDED CORRECTLY THAT THE CONCEPT OF EXCESSIVE PRICING IS ANTITHETICAL TO THE PURPOSE OF INTELLECTUAL PROPERTY RIGHTS

Evans & Padilla advocate a more restrictive screen:⁶¹

1. The firm enjoys a (near) monopoly position in the market.
2. The monopoly position is not the result of past investments or innovations.
3. The monopoly position is protected by insurmountable legal barriers to entry.
4. The prices charged by the firm widely exceed its average total costs inclusive of a return for risky investment.
5. There is a risk that those prices may prevent the emergence of new goods and services in adjacent markets.

Their reasoning is that using competition policy to regulate prices imposes a significant loss in dynamic efficiency and that excessive pricing cases should therefore be pursued only when the benefits are clear and significant. The new product prong of the test—which is similar to the European Court of Justice’s exceptional circumstances test for refusal to supply intellectual property—is designed to limit findings of excessive pricing to situations in which the prices deter the creation of a new market that could be immensely valuable for society.⁶²

ONE COULD ARGUE WHETHER COMPETITION AUTHORITIES OR COURTS SHOULD EVER DEFINE AN ANTITRUST MARKET THAT CONSISTS OF A SEP GIVEN THE STATIC AND DYNAMIC COMPETITION AMONG STANDARDS

The details of the exceptional circumstances screen vary across jurisdictions, competition authorities, courts, and commentators. There appears to be a consensus, however, on

the part of competition authorities that cases should be brought rarely and only in extreme situations. There also appears to be a consensus among the courts that firms should be found to have engaged in an abuse of dominance as a result of charging a high price only in very limited situations. There is considerable support for the view that antitrust law should not prevent firms in innovation-intensive industries from profiting from their risky investments except in the most extreme circumstances, and perhaps never.

2. Exceptional Circumstances Screen and Intellectual Property

The above conclusion applies in particular to industries involving intellectual property such as patents and copyrights. The marginal cost of selling or licensing intellectual property is often small and, in the case of electronic distribution, essentially negligible.⁶³ Yet it costs something—perhaps quite a bit—to invent. Creating intellectual property to make money is a gamble. Out of all that are created, only a few books, songs, movies, video games, and patents are successful. The top 20 percent of movies earn 80-85 percent of box-office revenue,⁶⁴ and more than 70 percent of movies generate negative returns at the box office.⁶⁵ At online bookstores, the top five percent of titles account for more than 60 percent of sales, and the distribution is even more skewed at bricks-and-mortar bookstores. For music albums, the first year sales of an album at the 90th percentile is more than ten times the first year sales of the median album.⁶⁷ The top five percent of patents account for 30 to 47 percent of total patent value.⁶⁸ These businesses therefore follow the economics of lotteries discussed earlier. Since most entries lose, the few that win must receive ample rewards.

THIS REINFORCING PROCESS OF INNOVATION AND REWARD IS THE ENGINE BEHIND ECONOMIC PROGRESS

Competition authorities and courts have found excessive pricing involving holders of intellectual property rights very infrequently.⁶⁹ Indeed, several commentators have concluded correctly that the concept of excessive pricing is antithetical to the purpose of intellectual property rights, which are granted expressly under the laws of many countries for the purpose of providing firms and individuals with rewards for making risky investments in creativity. For example, Motta & de Streel conclude “any good or service protected by Intellectual Property Rights should in principle not be subject to an excessive prices action.”⁷⁰ Likewise Fletcher & Jardin conclude “There should be no intervention under Article 82 against the high prices of an innovative product within its patent period.”⁷¹ Consistent with this view, as we discuss below, Article 55 of China’s AML exempts intellectual property rights from antitrust scrutiny except to the extent that they are abused in order “to eliminate or restrict market competition.”

Quite unlike legal monopolies over industries there is significant competition for creating patents and copyrights. Nothing prevents firms from entering that race. That situation is unlike state-owned enterprises, for which competition is barred, and previously state-owned companies that have been the beneficiaries to prior entry barriers together with significant network effects. Moreover, there is often competition among patents and copyrights. There are often numerous ways of creating products using alternative

COMPETITION AUTHORITIES AND COURTS AROUND THE WORLD HAVE LARGELY REJECTED THE SIMPLE STATIC MODEL IN WHICH ANY PRICE THAT EXCEEDS COST IS DEEMED TOO HIGH

patents. And consumers can substitute between different music, books, videogames, and movies even though each is subject to a copyright.

That point is also true for Standard Essential Patents (“SEPs”). An SEP covers a technology that a Standard Setting Organization (“SSO”) has incorporated in a standard. One could argue whether competition authorities or courts should ever define an antitrust market that consists of an SEP given the static and dynamic competition among standards. But regardless of market definition SEPs do not establish permanent barriers to entry into an industry like a postal monopoly would. At any point in time different standards compete with each other. Over time innovation and entry displace standards. For example, in mobile communications technologies having an SEP on 2G does not protect the holder from competition from 3G; and having an SEP on 3G does not protect the holder from 4G competition. Further, standards are updated and modified on a continuing basis. Owning an SEP on 3G today does not mean that a company will own a SEP on a future version of 3G since a newer, better, or less costly technology may replace the company’s technology. Firms compete to get their technologies incorporated into standards. The fact that certain of their technologies have been adopted for one standard does not mean that any of their technologies will be adopted for subsequent standards.

There is another reason for competition authorities and courts to abstain from regulating the prices for intellectual property. Economics provides some guidance for regulating industries in which there is a close relationship between prices and the cost of production. For example, regulators of basic telecommunications services can rely on elaborate models that show the prices that telecommunication providers need to receive to compensate them for costs and a competitive rate of return.

There is no such guidance for intellectual property. On the one hand, it is a virtually impossible task for economists, or for competition authorities and courts, to determine how much reward innovators should receive to promote the right amount of innovation. The competitive process, on the other hand, does this well. The few successful innovators get rewards. Those rewards induce more innovators to try and more entry to occur. This reinforcing process of innovation and reward is the engine behind economic progress.

PRACTICAL APPROACHES TRY TO INTRODUCE REAL-WORLD CONSIDERATIONS INTO THE PRICE-COST COMPARISONS TO MAKE THEM MORE ACCURATE

IV. THE ECONOMIC FRAMEWORK FOR ASSESSING WHETHER AN UNFAIR PRICING ABUSE HAS OCCURRED

Competition authorities and courts have used the exceptional circumstances test to winnow the situations in which they consider whether a dominant firm has committed an unfair pricing abuse. For the rare cases they do consider, competition authorities and courts must then assess whether the dominant firm under consideration has, in fact, engaged in unfair pricing. This section considers the economics of analyzing whether a dominant firm has engaged in an excessive pricing abuse in the exceptional circumstances in which competition authorities and courts consider such abuses at all.

Competition authorities and courts around the world have largely rejected the simple static model in which any price that exceeds cost is deemed too high. The European Court of Justice has put forward the

THE FOURTH ISSUE IS THAT THE PRICE-COST RELATIONSHIP IS NOT NECESSARILY A MEANINGFUL INDICATOR OF EXCESSIVE PRICING FOR A CONSIDERABLE PART OF THE ECONOMY

most influential economic approach for assessing unfair pricing claims. Of course, this approach is widely used by competition authorities and national courts in the European Union. Courts and competition authorities in other countries such as Israel and Turkey have also adopted this approach, and other countries such as South Africa have been influenced by it.⁷²

The European Court of Justice in *United Brands* developed a two-prong economic test for whether the prices charged by a dominant firm are excessive.⁷³

The questions therefore to be determined are whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative, whether a price has been imposed which is either unfair in itself or when compared to competing products.

The first prong is based on a “price-cost” test that essentially determines whether the dominant firm is marking its prices up over cost too much and thereby earning significant profits. The second prong is based on the “value” of the product or service to buyers, as we will explain below.

The European Court of Justice and other courts have observed that this test faces significant empirical and evidentiary challenges in practice. In fact, the European Court of Justice and national courts have often found that competition authorities have failed to meet their burden of proof that either prong is satisfied. These difficulties are most severe in innovation-intensive industries.

MOREOVER, MANY MODERN INNOVATION-INTENSIVE INDUSTRIES, PARTICULARLY THOSE INVOLVING INFORMATION COMMUNICATIONS AND TECHNOLOGY, INVOLVE MULTI-SIDED PLATFORMS

A. *Price-Cost Test*

The price-cost prong of the Court’s test would be straightforward if markets worked like the textbook model that underlies Figure 1. Under perfect competition firms should charge prices equal to marginal cost. Any price significantly greater than marginal cost would therefore be “excessive.” Of course the textbook model is based on very special assumptions and applies in fact to few, if any, real-world markets. Moreover, if competition authorities and courts applied the textbook model they would find that prices exceed marginal cost for most

A KEY ISSUE IS THAT ACCOUNTING METHODS FOR DEPRECIATING RESEARCH AND DEVELOPMENT, ADVERTISING, AND OTHER INVESTMENTS WITH FUTURE PAYOFFS CAN LEAD TO SIGNIFICANT BIASES IN THE RATE OF RETURN

firms in most industries regardless of whether the firms are dominant within the meaning of competition policy. Practical approaches try to introduce real-world considerations into the price-cost comparisons to make them more accurate. The extent to which this can be done in practice varies across industries and

is most difficult in innovation-intensive ones.

1. Comparing Prices and Costs to Determine Excessive Pricing

The first difficulty with a straightforward comparison of price to marginal cost is that most firms incur fixed costs of operation. In the long run firms must be able to recover these fixed costs to remain in business and they must expect to be able to recover these fixed costs to enter a business. A price equal to marginal cost will not enable firms to recover these fixed costs. Consider a simple firm that has annual fixed costs of 10 million Yuan and marginal costs of 10 Yuan a unit. If it only charged 10 Yuan a unit it would not make enough profit to cover the 10 million Yuan fixed cost. One way to address this issue in practice is to calculate the margin based on the difference between price and average total cost or to calculate the economic profits (the difference between total revenue and total economic costs) instead of margins.

THERE IS SOME INFORMATION AVAILABLE TO ASSESS WHETHER VERY HIGH PROFITS ARE TRULY GREATER THAN THE RETURNS NECESSARY TO ATTRACT RISKY EFFORT AND CAPITAL

The second issue concerns measuring the competitive rate of return. To attract capital, firms must secure at least a normal rate of return. In practice, most firms face varying degrees of risk in entering industries and in competing against known and unknown rivals. These firms and their investors need to be compensated for that risk. The degree of risk varies widely across firms and industries. Risk is greatest for inventing and then marketing completely new technologies and products. Risk is smallest for mature industries with routine production and well-developed business models. For example, a survey of the cost of capital for broad U.S. industries shows that the cost of capital for a relatively high-risk industry such as semi-conductor equipment was about 2.5 times the cost of capital for a low-risk industry such as electric utilities.⁷⁴

The third and related issue is that a significant portion of the economy consists of businesses that are based almost entirely on intellectual property such as software, music, and patent licensing. The IP-based firms have low marginal costs of production and high fixed costs. Accounting for fixed costs is therefore important for them. More importantly, firms in IP-based industries encounter significant risk since the preponderance of creative efforts ultimately fail for all intents and purposes.

The fourth issue is that the price-cost relationship is not necessarily a meaningful indicator of excessive pricing for a considerable part of the economy. A large portion of modern economies consists of multi-sided platforms that serve multiple distinct groups of customers.⁷⁵ Economists have shown as a matter of theory and empirical fact that to coordinate the demands on the multiple sides of the platforms these firms may charge one customer group prices lower than marginal cost and other customers prices higher than marginal costs.⁷⁶ Newspapers, for example, often charge readers less than the marginal cost of printing and distributing the newspaper and charge advertisers more than the marginal cost of inserting ads. Many internet platforms provide services free to individuals and make all of their money from advertising.⁷⁷ For platforms, margin analysis must take into account the prices and costs for all customer groups related to the platform and should

not consider just one.

In principle economics can address each of these issues by incorporating fixed costs, risk, and multi-sided pricing into the analysis. In practice, data limitations make this difficult. Courts have often rejected cases

HOWEVER, IF A FIRM HAS A RATE OF RETURN ON CAPITAL THAT EXCEEDS ITS COST OF CAPITAL THAT DOES NOT IMPLY THAT ITS RETURNS ARE EXCESSIVE

brought by competition authorities because of their failure to produce reliable evidence of price-cost differences. That was the case, for example, with the United Brands case in the European Union, the *Attheraces* case in the United Kingdom, and the *Mittal* case in South Africa.⁷⁸

The issues we have described are most severe in innovation-intensive industries. These industries typically involve significant fixed-cost investments and high degrees of risk. That is particularly true for industries in which intellectual property rights are important. Moreover, many modern innovation-intensive industries, particularly those involving information communications and technology, involve multi-sided platforms.

2. Risk Adjusted Profits

The price-cost comparison discussed above is a rudimentary attempt at assessing whether a firm is charging more than the competitive level. A more sophisticated approach, though still problematic, involves examining whether a firm is earning a supra-competitive profit on its investments after accounting for risk. For a company as a whole, a common approach for measuring the profitability of investments is to compare the return on capital to the cost of capital. A firm makes an “above-normal” profit if the return on capital exceeds the cost of capital after adjusting for risk. However, this approach encounters several issues.

THE OTHER WAY TO ASSESS ECONOMIC VALUE IS RELATED TO THE VALUE FOR THE BUYER

First, in measuring the return on capital economists have found that the typical accounting approaches for doing this—while perfectly suitable for the usual accounting and corporate governance purposes for which they are used—do not provide accurate or consistent measures of the economic rate of return that could be used for comparing different companies or against a competitive benchmark. A key issue is that accounting methods for depreciating research and development, advertising, and other investments with future payoffs can lead to significant biases in the rate of return. Economists have proposed a number of methods for dealing with these problems.⁷⁹

Second, in assessing whether the firm is earning supra-competitive profits it is in fact not correct, as a matter of economics, to compare the rate of return to the cost of capital for the reasons we discussed earlier. *Ex post* successful firms will necessarily have rates of return on capital that exceed their risk-adjusted cost of capital. Unsuccessful firms will necessarily have rates of return on capital that are below their risk-adjusted cost of capital and often will have no return on capital at all.

Consider a competition to develop a new technology for gene splicing. There are 100 firms. Each invests one million Yuan a year over 10 years to develop the technology. Each firm therefore invests 10 million Yuan. Together over 10 years they have invested one billion Yuan. Only one firm succeeds. Thus, there is a 99 percent chance of failure and a one percent chance of success.

Let us suppose that to bear the risk—that there is a 99 percent chance of losing 10 million Yuan and a one percent chance of winning—each firm would need to expect at the beginning that they would earn 15 million Yuan or a 50 percent rate of return. In other words they would need to believe that they have a one percent chance of winning 15 million Yuan. The cost of capital is 50 percent since that is the minimum return that covers the risk. To participate in this technology contest, each firm must believe that the winner will earn

THEY DO, HOWEVER, SUGGEST THREE SCREENS FOR ASSESSING EXCESSIVE PRICING CLAIMS THAT COURTS AND COMPETITION AUTHORITIES COULD USE

1.5 billion Yuan. That is, in order to have a one percent chance of winning 15 million Yuan, the prize must be 100 times 15 million or 1.5 billion Yuan. That 1.5 billion Yuan is therefore the minimum prize necessary for inducing these 100 firms to try.

Now consider the winner. Suppose the winner has earnings of exactly 1.5 billion Yuan. It incurred investment costs of 10 million Yuan. Its return is 150 times its investment and its rate of return is 15,000 percent. That is much higher than its cost of capital of 50 percent. Yet this is the competitive outcome. There is no excessive profit since if the winner earned less than 1.5 billion Yuan, none of the firms, if acting rationally, would have entered the race in the first place. Accordingly, if firms knew in advance that authorities would apply excessive pricing laws to cap their profits below that level, no technology would have been created. Moreover, even if firms believed there was a **possibility** of such a ruling, that risk and uncertainty would discourage investment.⁸⁰

There is some information available to assess whether very high profits are truly greater than the returns necessary to attract risky effort and capital. Some venture capital lore indicates that VCs in the United States typically seek a 5-to-10 times return on their investment. That is, when they consider making an investment, they examine whether, if it is successful, they will be able to increase their investment 5-to-10 times.⁸¹ They do not expect that each investment will return this amount. Rather, they insist on this upside to their investment because they recognize that most of their investments will return little if nothing.

Some companies approve investments in new initiatives only if there is a business case that they will recoup their investment in 3-7 years.⁸² That implies a significant rate of return. They require this because they are accounting for the fact that many of the investments they make will not work out.

In all these cases the “successful investments” appear to have high rates of return. For example, the compound annual rate of return on a \$10 million VC investment in year one that yields a payout of \$100 million in year 10 is nearly 26 percent a year. That is more than eight times higher than a risk free rate of return such as the 10-year U.S. Treasury note (currently with an annual yield around three percent), which is a

good proxy for the competitive rate of return for a perfectly competitive company that faces no risk. However, that 26 percent rate of return is not excessive because it was necessary in order to induce the venture capitalist to make investments in the many other ventures that failed.⁸³

To determine whether a firm has a rate of return that exceeds the competitive level after accounting for risk involves two major steps. The first step involves determining the rate of return that the firm has obtained for investments in the product in question. That involves collecting data on the time pattern of

APPLYING THIS SCREEN BRINGS EXCESSIVE PRICING INTO THE MAINSTREAM OF ANTITRUST BY FOCUSING ON THOSE WELL-UNDERSTOOD CASES IN WHICH BUSINESS PRACTICES HAVE THE POTENTIAL OF HARMING THE COMPETITIVE PROCESS

investments and returns and dealing with the economic biases resulting from the treatment of R&D, advertising, and other investments. If the firm has a rate of return that is less than its risk-adjusted cost of capital (50 percent in the example above) then it is clear that its return on capital has not even compensated it for the risk it occurred.

However, if a firm has a rate of return on capital that exceeds its cost of capital that does not imply that its returns are excessive for the reasons we have just discussed. In the context of an innovation race, the second step needs to determine whether the winners of the race have earned more than the minimum prize that the participants in the race required to enter the race in the first place.

As a practical matter, completing the second step of this analysis, and possibly even the first step, is likely to be quite difficult. That is the main reason that assessing excessive pricing in innovation-intensive industries is very difficult to conduct with any degree of reliability.

B. Economic Value and Unfair Prices

The second prong of the *United Brands* test is whether the price is “unfair.” A number of courts, authorities, and commentators have concluded that the Court intended the second prong of the test to account for the value of the product to the buyer.⁸⁴ The European Court of Justice stated that a firm in a dominant position would commit an excessive pricing abuse if the price it charged bore “no reasonable relation to the economic value of the product.” One way to assess economic value is the cost of producing the product. That forms the first prong of the test. The other way to assess economic value is related to the value for the buyer. That, according to the European Commission in *Scandlines* and the U.K. Court of Appeal in *Attheraces*, is the purpose of the second prong.

WHILE THE SIGNIFICANT VALUE SCREEN IS USEFUL FOR IDENTIFYING CASES IN WHICH THE PRICE IS NOT EXCESSIVE WITHIN THE MEANING OF THE UNFAIR PRICING LAW, IT IS NOT NECESSARILY USEFUL FOR IDENTIFYING CASES IN WHICH THE PRICE IS UNFAIR

Scandlines complained that the Port of Helsingborg was charging an excessive price. The Commission concluded that:

even if it were to be assumed that there is a positive difference between the price and the production costs exceeding what Scandlines claims as being a reasonable margin (whatever that may be), the conclusion should not necessarily be drawn that the price is unfair, provided that this price has a reasonable relation to the economic value of the product/service supplied. The assessment of the reasonable relation between the price and the economic value of the product/service must also take into account the relative weight of non-cost related factors.

Attheraces complained that the British Horseracing Board (“BHB”) charged it excessive prices for certain horse racing information. BHB argued the “economic value of a product ... reflects the ‘revenue-earning potential to the person who acquires it.’” The Court insisted that the price would have to be sufficiently high to interfere with the ability of Attheraces to compete:⁸⁵

We appreciate that this theoretical answer leaves the possibility of a monopoly supplier not quite killing the goose that lays the golden eggs, but coming close to throttling her. We do not exclude the possibility that this could be held to be abuse, not least because of its potential impact on the consumer. But Article 82 ... is not a general provision for the regulation of prices. It seeks to prevent the abuse of dominant market positions with the object of protecting and promoting competition. The evidence and findings here do not show [Attheraces’s] competitiveness to have been, or to be at risk of being, materially compromised....

The Court found that, even if BHB took 50 percent of the profit that Attheraces earned from using BHB’s information in the downstream market, BHB’s price would not necessarily be unfair. The Court insisted that it would want further evidence that the price distorted competition in the downstream market.

These approaches do not lead to a bright-line economic test for the second prong. They do, however, suggest three screens for assessing excessive pricing claims that courts and competition authorities could use. These screens can be used to identify situations in which there is little reason to believe that prices are unfair and therefore help competition authorities and courts eliminate cases at an earlier stage, before having to reach the much more difficult inquiry concerning whether the situation involves one of the rare circumstances in which a price should be regulated under the antitrust law.

1. Significant Value Screen

The first screen is whether the buyer is obtaining a significant value from purchasing the product. In economic terms the surplus for the buyer is the difference between the most the buyer is willing to pay for a product (the buyer’s willingness to pay) and the price the buyer actually does pay for a product. If a buyer were willing to pay 1000 Yuan for a product but only had to pay 700 Yuan, then the buyer has surplus of 300. There is no

THE COURTS THAT HAVE SUGGESTED
THE POSSIBLE USE OF PRICE
COMPARISONS HAVE THEMSELVES
RECOGNIZED THE DIFFICULTY IN
APPLYING THEM IN PRACTICE

objective measure of “significant value” but one could argue that the price becomes less fair when it leaves little surplus for the buyer. The advantage of the significant value screen is that it ensures that the seller captures a significant portion of the

surplus of the product as profit thereby providing an incentive for making risky investments while leaving something left over for the buyer. The court or competition authority would find unfair pricing only if the buyer was not receiving some meaningful value after paying for the product.

Several sources of empirical evidence can help assess whether the buyer is receiving significant value over and above the price it is paying. In the case of consumers it is possible to estimate their demand schedule, which incorporates their willingness to pay, from consumer surveys or from econometric estimates based on observed data over time or across geographic markets. In the case of businesses, it may be possible to assess the additional profit that the buyer earns from the input. The final type of evidence is the comparative evidence, discussed below, which can be used to determine how willing buyers and sellers ordinarily split the gains from trade. The fact that other buyers have paid the price sought by the seller also confirms the value of the product.

THE COST TO SOCIETY OF FALSE POSITIVES IS ALMOST CERTAINLY FAR GREATER THAN THE COST TO SOCIETY OF FALSE NEGATIVES IN INNOVATION-INTENSIVE INDUSTRIES

One drawback of the significant value screen involves situations in which the buyer and seller cannot reach terms. In all markets, including highly competitive ones, some consumers decide they do not want to pay for a product. In a business-to-business market a business buyer may decide that an input costs too much because it cannot make enough profit at that cost. That may be because the buyer is not as efficient as other producers or for many other reasons. Therefore, while the significant value screen is useful for identifying cases

THEY HAVE ALSO DETERMINED THAT THE ADMINISTRATIVE COST OF REGULATING THE PRICES OF DOMINANT FIRMS IS VERY HIGH

in which the price is not excessive within the meaning of the unfair pricing law, it is not necessarily useful for identifying cases in which the price is unfair.

2. The Harm to Competition Screen

The second screen is whether the seller's price results in harm to competition in the same or a downstream market as a result of excluding rivals and thereby raising prices. There are some situations, for example, in which upstream firms may have incentives to extend their market power from an upstream market to a downstream market.⁸⁶ In these cases excessive prices could be part of an exploitative strategy, such as a margin squeeze⁸⁷ or a constructive refusal to deal,⁸⁸ designed to eliminate downstream competition. There could also be some situations in which an upstream firm may have an incentive to limit the emergence of downstream competitors because they could evolve into upstream competitors. Of course, these anticompetitive effects are only possibilities. Upstream firms have strong incentives to encourage competition in the downstream market. By encouraging lower overall prices and sales they can increase the size of the market for the input they supply.

The advantage of this second screen is that it limits excessive pricing cases to those in which there is a potentially significant economic benefit from limiting behavior that harms competition and destroys significant value for consumers. For example, excessive prices could be used to prevent the emergence of a new product which, as Evans & Padilla argue, could be one of the exceptional circumstances that could warrant

intervention over excessive prices.⁸⁹

Without this screen, excessive pricing cases may merely result in the transfer of wealth between a buyer and a seller. Scandlines and Attheraces were simply looking for better prices for themselves. Ruling for them would have mainly increased their profits at the expense of their sellers without necessarily increasing consumer welfare.

There are well-developed methods in competition policy for examining whether these possible anticompetitive effects are likely to occur and outweigh any pro-competitive benefits.⁹⁰ Applying this screen brings excessive pricing into the mainstream of antitrust by focusing on those well-understood cases in which business practices have the potential of harming the competitive process.

3. The Normal Price Screen

The “normal price screen” considers whether the seller is charging the buyer a price that is similar to the price that it is charging other buyers, or prices that similar companies are charging other buyers for similar goods or services.⁹¹ If many businesses are able to compete at the price being charged by the firm that is the subject of the unfair pricing inquiry for its input, then that suggests the input price is not interfering with competition and reflects the value of the product. These price comparisons are therefore useful for identifying situations in which a firm’s price is not unfair under the second prong of the tests.

MOREOVER, HOLDERS OF INTELLECTUAL PROPERTY RIGHTS SHOULD NEVER BE SUBJECT TO AN UNFAIR PRICING CHARGE IF THAT IS THE ONLY CLAIM OF ABUSE

The similarity requirement is critical. In the real world, companies sell products that are differentiated from each other. They try to do so in part to appeal to particular groups of customers that might prefer that particular combination. Consequently, the fact that a seller charges a higher price to one buyer than another is not sufficient evidence of unfair pricing. As a practical matter, it is difficult to compare prices across producers because there are many differences that need to be considered, including differences in the products and, even when the products are similar, differences in the buyers. These difficulties are compounded when considering the price for a technology in an innovation-intensive industry where alternative technologies may provide fewer benefits to the consumer, require higher costs of implementation by the manufacturer, or involve higher transactions costs in negotiating.

The courts that have suggested the possible use of price comparisons have themselves recognized the difficulty in applying them in practice. Those courts generally have not found excessive pricing based on simple price comparisons. For example, in *United Brands* the European Court of Justice did not find it persuasive by itself that United Brands charged less for bananas in Ireland than elsewhere.⁹² It is also important to note that it is routine business practice in a competitive market for commercial terms that a company negotiates with customers to differ significantly across customers for legitimate pro-competitive reasons.⁹³

C. *The Error Cost Framework and Excessive Prices*

Courts and competition authorities have taken an extremely cautious approach towards pursuing excessive pricing cases. The error cost framework helps explain why.⁹⁴ Suppose that courts and competition authorities could calculate exactly the benefits of lower prices today and the costs of discouraging risky investment in innovation over time from reducing rewards. Then it would increase economic welfare if the net benefits of pursuing excessive pricing cases exceeded the administrative costs of doing so.

As we have seen in this section, however, the courts and competition authorities have struggled to develop a sound definition of excessive pricing. They have also recognized that the various measures that could be considered for determining whether prices are excessive are quite difficult to implement accurately in practice. At the same time it is difficult to forecast the impact of forcing successful firms to charge lower prices on the incentives to make risky investments and, therefore, on the pace of innovation and economic progress.

In any particular case, courts and competition authorities could make two kinds of mistakes. They could find that a price is excessive even though the harm to long-run innovation outweighs the long-run benefits of lowering it. That is known as a “false positive” test result. Alternatively, they could find that a price is not excessive even though the benefits of lowering it would exceed the harm to long-run innovation. That is known as a “false negative” test result.

THIS CONTEXT MAKES “UNFAIR” PRICING CLAIMS PARTICULARLY TREACHEROUS AND FARFETCHED

These mistakes are unlikely to balance out. The cost of a false positive can be quite significant. The reduced incentives to innovation could reduce the flow of new innovative technologies, new products, and cost-savings innovations. As we saw earlier, those innovations generate significant value. The cost of a false negative is twofold. It causes some deadweight loss as a result of the dominant firm restricting output. And it causes a transfer of surplus from consumers to the dominant firm. In business-to-business transactions that transfer is from one producer to other producers.

AS A GENERAL MATTER CHINA'S ECONOMIC HISTORY AND POLICIES REINFORCE THE CASE FOR APPLYING THE UNFAIR PRICING LAW ONLY IN EXCEPTIONAL CIRCUMSTANCES

The cost to society of false positives is almost certainly far greater than the cost to society of false negatives in innovation-intensive industries. False positives can prevent the emergence of new products and new technologies that support many new products. As we explained earlier, the value of these new products and technology to society is vast. False negatives result in some deadweight losses from underproduction; but such losses are much smaller than the losses from the suppression of new products and technologies, as we discussed earlier.

It is difficult as a practical matter to put numbers on the magnitude of the costs imposed by these false positives and false negatives and the likelihood of their occurring under various alternative implementations

of the excessive pricing test. However, courts and competition authorities that have considered this issue have generally reached two conclusions. The first is that they should find excessive pricing rarely because of the possible harm to innovation and economic progress. Their decision to seldom pursue excessive pricing cases is consistent with their having concluded that the cost of false positives is much higher than the cost of false negatives. The second is that they should be especially cautious because it is hard to identify excessive prices in practice. The likelihood of making mistakes is high because of the lack of a sound definition and the difficulty of developing accurate empirical information. They have also determined that the administrative cost of regulating the prices of dominant firms is very high.

V. IMPLEMENTING THE UNFAIR PRICING PROVISIONS OF THE AML FOR INNOVATION-INTENSIVE INDUSTRIES

In devising the AML, China looked around the world at the competition laws, policies, and institutions adopted by other countries, including the United States and the European Union. Since then, Chinese judges and officials have made great efforts to study international best practices for competition policy. Of course, the Chinese competition authorities and courts are also making sure to develop antitrust policy that fits with the specific circumstances of China, which are unique in a number of dimensions. This section considers how

CHINESE FIRMS ARE RAPIDLY BECOMING STRONGER IN IP AND MAY BECOME WORLD LEADERS IN SOME INDUSTRIES

to adapt what we have learned about the approaches towards excessive pricing to the unique circumstances of innovation-intensive industries in China.

A. *Best Practices for Assessing Excessive Pricing in Innovation-Intensive Industries*

In the previous sections we have described the standard international best practices concerning excessive pricing in innovation-intensive industries and have shown that, at a general level, these practices are consistent with sound economic analysis designed to promote economic growth and welfare. These best practices can be divided into two categories: (1) the circumstances under which investigation of unfair pricing claims should be considered for innovation-intensive industries and (2) evaluating whether an unfair pricing abuse has occurred for those cases that are considered. It is useful to provide a brief summary before we consider whether, and to what extent, China should adopt these international practices.

1. The Exceptional Circumstances Screen

Based on standard international best practices, unfair pricing cases should be brought rarely, if ever, against firms in innovation-intensive industries. The cost associated with chilling the creation of new technologies and products vastly outweighs the benefits of lowering short-run prices.

Moreover, holders of intellectual property rights should never be subject to an unfair pricing charge if that is the only claim of abuse. Any claims concerning pricing abuse should be related to an **exclusionary** abuse under which the intellectual property rights (“IPRs”) holder has excluded competitors from being able to

participate in the market and thereby harmed competition. It is contrary to the purpose of intellectual property right grants to limit the reward that successful creators can receive. Moreover, it is also more difficult than in other cases—and practically impossible—to assess whether the prices charged by an IPR holder are excessive.

In considering both of these principles, it is important to recall that competition authorities and courts generally consider unfair pricing cases only in exceptional circumstances. The point above is that, relative to those exceptional circumstances, unfair pricing cases should hardly ever be brought in innovation-intensive industries and never as a pure unfair pricing claim against firms that hold intellectual property rights.

2. Identifying an Unfair Pricing Abuse

The second issue concerns how competition authorities and courts should evaluate whether a dominant firm has committed an unfair pricing abuse in an innovation-intensive industry in those rare circumstances in which they consider these cases.

The standard test, together with the economic analysis of the rewards for innovation, show that there needs to be a determination that the price is excessive relative to the award that successful firms would need to receive in order to make socially desirable risky investments in innovation. In

WITHOUT REQUIRING AN ANTICOMPETITIVE EFFECT, IT IS POSSIBLE THAT UNFAIR PRICING CLAIMS COULD BE MAINLY EMPLOYED BY BUYERS TO SHIFT PROFITS FROM SELLERS

other words, the assessment of whether a price is excessive must take into account the many failures in such innovation-intensive industries and ensure that there are adequate rewards available for the few firms that are successful to motivate the many to try. This is a necessary condition for determining whether prices are unfair.

There then needs to be a further determination that the price is not consistent with the value received by the buyer. For innovation-intensive industries assessing this value requires considering the role of new technologies and products. In these cases, the buyer would not have been able to obtain any value in the absence of the innovation. The new technology or product would not even have existed. This context makes “unfair” pricing claims particularly treacherous and farfetched.

B. Applying Best Practices to the Specific Circumstances of China

China has already made a policy decision to deregulate prices and let most prices be determined by the market. Historically, China had a centrally planned economy in which prices were set by the central government. In 1992, at the 14th National Congress of the Communist Party of China, China officially set a market-oriented economy as the target of its economic reform.⁹⁵ As part of this process it gradually removed government control over most prices in favor of letting market forces determine prices.

The NDRC under the Price Law has used its discretion primarily to regulate the prices of certain commodities and services that are deemed essential to consumers. Table 2 lists the leading products and

services subject to NDRC price regulation, which was published in the NDRC Public Notice No.11.⁹⁶ Notably, the table shows that the NDRC normally regulates the prices of products and services only in areas where market mechanisms cannot achieve effective results. The NDRC has rarely regulated the prices of a product or service provided by what we would characterize as an innovation-intensive industry.⁹⁷

Having come to the policy conclusion that China should primarily rely on the market to determine prices it would be contradictory, and inconsistent with China’s overall path towards economic growth, to use the AML to regulate prices except in unusual cases. Therefore, as a general matter China’s economic history and policies reinforce the case for applying the unfair pricing law only in exceptional circumstances. Furthermore, the decision by Chinese policymakers to encourage innovation and permit entrepreneurs to earn significant rewards for their creations is consistent with not applying the unfair pricing law to innovation-intensive industries. There are no sound policy reasons for using antitrust to return to an intrusive, regulatory approach to pricing in industries where China has removed those controls.

China has no special situation that would suggest that it should apply the unfair pricing law to industries for which intellectual property rights are significant. As we have argued, the costs of reducing the *ex-ante* incentives to create intellectual property through *ex post* regulation are high—the result of reduced benefits to consumers and slower economic growth. China in particular has benefited enormously from technologies based on intellectual property rights, ranging from mobile communications to internet, pharmaceutical, and biotechnology that have generated many new products that have produced massive social value.

RELIABLE PRICE COMPARISONS
MUST COMPARE LIKE-TO-LIKE AND
THEREFORE ACCOUNT FOR AT LEAST
THREE SOURCES OF DIFFERENCES

the *ex-ante* incentives to create intellectual property through *ex post* regulation are high—the result of reduced benefits to consumers and slower economic growth. China in particular has benefited enormously from technologies based on intellectual property rights, ranging from mobile

Table 2: Products and services subject to NDRC price regulation

Products and services	
1.	Important central reserve materials
2.	State monopoly tobacco
3.	Salt and industrial blasting equipment
4.	Certain chemical fertilizers
5.	Certain important medicines
6.	Natural gas
7.	Important specialized services including financial settlement and financial transaction services, engineering investigation and design services and certain intermediary services
8.	Electricity
9.	Military supplies
10.	Important transportation services
11.	Basic telecommunication service
12.	Basic postal service
13.	Water supply from state-run or interprovincial water projects

Source: NDRC (2001)

In theory, one could argue that, as a matter of economic policy, China could apply excessive pricing regulation to intellectual property rights because non-Chinese firms hold most of these rights. The argument would be that Chinese businesses and consumers could benefit from lower prices in the near term, while China would feel only a portion of the effects of reduced innovation since it provides only a partial source of the rewards. Such a policy would be short sighted. Chinese firms are rapidly becoming stronger in IP and may become world leaders in some industries.

Indigenous innovation is one of the main policy goals in the Twelfth Five-Year Plan.⁹⁸ Many Chinese companies have spent and will continue to spend heavily on R&D. Tremendous investment in R&D has fueled the rapid growth of China's technology industry. R&D spending in China is expected to reach U.S. \$284 billion in 2014, up 22 percent from 2012. Compared with China, the growth forecast in the United States is just four percent to \$465 billion for the same period. China is expected to surpass Europe in R&D spending by 2018 and the United States by 2022. Imposing caps, particularly low ones, on what innovators may charge for their intellectual property would not only slow economic progress, but would also discourage Chinese innovators from participating in just this sort of research and development.

Moreover, as the size of China in world markets increases, Chinese policies that reduce the rewards from innovation will have a larger impact on China itself. China now accounts for 40 percent of the global smartphone market in 2013, and enjoys the highest shipment growth rate in the world.⁹⁹ China's pharmaceutical market is expected to continue to grow at a pace of more than 20 percent annually.¹⁰⁰ The biotech sector is expected to grow at an average annual rate of more than 20 percent from 2013 to 2015 as

THE NDRC'S REGULATIONS "PROVE TOO MUCH" IN THE SENSE THAT THEY WOULD FIND VERY COMMON MARKET PRICING PRACTICES UNFAIR

planned by the State Council.¹⁰¹ If the rewards from innovation were to be discounted, the momentum of those R&D-intensive industries would significantly decrease. That would ultimately have a negative impact on the nation's employment rate and consumer welfare.

The drafters of the AML appear to have anticipated that the unfair pricing law—without more ado—would not apply to intellectual property rights. Article 55 of the AML says that:

This Law does not govern the conduct of business operators to exercise their intellectual property rights under laws and relevant administrative regulations on intellectual property rights; however, business operators' conduct **to eliminate or restrict market competition** by abusing their intellectual property rights shall be governed by this Law. (Emphasis added.).

That is, the unfair pricing law applies to intellectual property only if the unfair pricing has an anticompetitive effect as a result of excluding competition and harming the competitive process.

In fact, the European Union has tended to limit the application of the unfair pricing law to situations in which there is just such an exclusionary effect. We believe NDRC and the courts should adopt that policy not just for intellectual property but also for all innovation-intensive industries. As a matter of economic policy there are several reasons for restricting unfair pricing claims to cases where the unfair pricing is part of a strategy that includes abusive exclusionary behavior that would distort the competitive process and harm consumers. First, preventing the distortion of the competitive process is more likely to create benefits that would outweigh the adverse effect on innovation than shifting profit from seller to buyer. Second, without requiring an anticompetitive effect, it is possible that unfair pricing claims could be mainly employed by buyers to shift profits from sellers. That could result in rent-seeking behavior by businesses that would invest in trying to persuade courts and the NDRC to give them a better deal.¹⁰²

THE INTERDIGITAL MATTER IS THE ONLY CHINESE COURT CASE TO OUR KNOWLEDGE THAT HAS INVOLVED AN APPLICATION OF THE UNFAIR PRICING LAW TO AN INNOVATION-INTENSIVE INDUSTRY

C. *The NDRC's Unfair Pricing Test*

The NDRC has adopted guidelines for assessing unfair pricing that appear to differ from the standard test based on *United Brands* that is used in other jurisdictions. According to Article 11 of the Anti-Price Monopoly Regulations that the NDRC issued on December 29, 2010 and that took effect in February 2011:¹⁰³

in determining if prices are unfairly high or low, the enforcement agency must consider: (i) whether the sales price or purchase price is markedly higher or lower than the price at which other business operators sell or purchase the same type of commodities; (ii) where costs are essentially stable, whether the sales price was raised or the purchase price lowered beyond the normal range; (iii) whether the level of the price increase for the sale of commodities is markedly higher than the cost increase range, or whether the range of the price reduction for the purchase of commodities is markedly greater than the transaction counterparty's cost reduction range; and (iv) other related factors.

The first factor considered by NDRC focuses on price comparisons. As we discussed earlier, such price comparisons can be helpful for assessing whether the price charged is significantly greater than cost and whether it reflects economic value provided by the seller. However, it is common in competitive markets for prices to differ between firms for pro-competitive reasons.¹⁰⁴ That is particularly true in business-to-business markets for intermediate goods in which the parties engage in private negotiation and prices are not public.

THIS CHINESE COURT IS NOT THE FIRST TO FIND THIS TOPIC CHALLENGING | Such price differences are common in China.¹⁰⁵ Reliable price comparisons must compare like-to-like and therefore account for at least three sources of differences: (1) Price comparisons must consider differences between the products and services offered by different sellers. (2) Price comparisons must account for differences between buyers including size and bargaining power. (3) Price comparisons must account for differences in the terms of trade and contract details between different buyers, since some buyers may pay higher prices but either get greater value from the seller or impose more costs on the seller than other buyers.

In competitive markets, bargaining between buyers and sellers results in some buyers securing lower prices than other buyers. An antitrust policy that required the seller to extend the discount it is offering one firm to all other firms could prevent the seller from offering or agreeing to this discount for anyone. That could harm consumers. Suppose, for example, that a large buyer insists on a discount for the higher volume and the greater revenue certainty it brings the seller. An antitrust policy that required the seller to extend the same discount to the larger firm that it offers to other firms could prevent the seller from offering this discount, resulting in less production and higher consumer prices than is otherwise necessary. It could also give the seller additional negotiating power by arguing that government policy prevents it from offering a discount.

The second two factors focus on the relationship between price and cost. As we noted earlier, in many markets there is not a close correspondence between prices and costs, especially marginal costs. That is particularly true in innovation-intensive industries, those based on intellectual property, and those based on multi-sided platforms including many internet-based companies. In those situations there are no competitive reasons why prices and costs should strictly follow each other.

The second two factors also do not consider the possibility that prices may change because of demand and the value that buyers place on the product. They therefore ignore two important aspects of the price system. First, prices help allocate scarce resources to their highest valued use. When demand increases without a corresponding increase in supply, prices rise so that the buyers who value the product most highly obtain the limited supply. Without the price increase there would be the queues and rationing that arose under certain centralized price settings. Second, prices provide signals for entry and innovation. Prices signal firms to enter and for innovators to consider substitute products and cost-saving innovations. If prices were not allowed to adjust, this signaling function of the price system would be lost.

The NDRC's regulations "prove too much" in the sense that they would find very common market pricing practices unfair. The NDRC has so far followed international practice in bringing few unfair pricing claims under the AML and has maintained the long-standing policy of letting markets decide prices. The NDRC's regulations could be improved, and made consistent with its overall reliance on markets, by explicitly incorporating the economic value prong of the *United Brands* test, acknowledging the importance of the demand side of the market in determining prices, and recognizing that the price comparisons must compare like-to-like (and therefore account for differences). The NDRC may intend to consider these issues, as well as the specific complications associated with innovation-intensive industries and the presence or absence of exclusionary conduct, under the final provision in the regulations addressing "other relevant factors."¹⁰⁶

D. Excessive Pricing Enforcement Under the AML

Thus far unfair pricing under the AML has made just two limited appearances on the antitrust stage in China. The decisions in both cases depart from the best practices followed in most leading antitrust jurisdictions.

The Guangdong Price Bureau, following the NDRC regulations and guided by them fined two

companies that were under common ownership for charging unfairly high prices for “river sand.”¹⁰⁷ River sand is a type of sand from riverbeds that is used for construction material such as plaster and mortar. The Guangdong Price Bureau compared the prices charged by these two companies with companies in other river sand markets and found that their prices were higher. It also found that they had increased their prices by almost three times their increases in costs (54.4 percent versus 20 percent).

We do not have access to the Guangdong Price Bureau’s decision or knowledge of its reasoning. Based on what is in the public record it does not appear that the “circumstances” identified by the Guangdong Price Bureau are “exceptional.” It is common for dominant firms to charge more than other dominant firms in other markets. Dominant firms raise their prices more than increases in costs for a variety of reasons, including increases in demand. It would not seem that there are permanent barriers to entry into the business because of legal or regulatory reasons. The Guangdong Price Bureau may have focused on the river sand industry for general economic policy reasons and added the AML claim for emphasis or it may have had other reasons that we do not know about.

For our analysis of innovation-intensive industries *Huawei vs. InterDigital* is the more relevant matter.¹⁰⁸ InterDigital develops wireless technologies and licenses its patents on these technologies. The Shenzhen Intermediate Court heard two separate cases. There was an antitrust case in which Huawei claimed that InterDigital was offering a license to its SEPs at rates that were discriminatory and excessive, imposed unfair trading conditions, and engaged in tying and refusal to deal. There was also a contract case in which Huawei claimed that InterDigital breached its obligation to provide a fair reasonable and non-discriminatory (“FRAND”) license under its agreement with the relevant SSO.

The Shenzhen Intermediate Court ruled against InterDigital in both cases. The court did not publish its decisions because of confidential information but the judges who decided the case have published two articles that briefly summarize their analysis and findings. In the antitrust case the court found, among other things, that InterDigital had offered its patents at excessive prices to Huawei in violation of Article 17(1) and at discriminatory prices in violation of Article 17(6) of the AML.¹⁰⁹ In the FRAND case the court found that the appropriate FRAND rate was a small fraction of what InterDigital had asked Huawei to pay.¹¹⁰ The antitrust and FRAND decisions were both upheld by the Guangdong High People’s Court.¹¹¹ The parties settled the matter and there were no further appeals.¹¹²

The InterDigital matter is the only Chinese court case to our knowledge that has involved an application of the unfair pricing law to an innovation-intensive industry. It is difficult to conclude much about the direction that the Chinese courts will take on the application of Article 17(1) to IPR given that: the unfair pricing claim was just one of several antitrust claims, much of the analysis of prices themselves occurred in the FRAND contract case, the decisions themselves have not been published, and the decisions have not been heard by the Supreme People’s Court. Moreover, InterDigital does not seem to have submitted sufficient evidence about its licensing agreements to permit the court to make a fully informed analysis.

Subject to these caveats, one interesting aspect of the decision is that it does not appear to have expressly addressed Article 55 of the AML, which exempts the exercise of IPRs from antitrust scrutiny unless those rights are used to eliminate or restrict market competition. It may be that the court concluded that the extreme disparities it found in rates charged to different licensees had such an anticompetitive effect, but that is not clear from the information about the case that is publicly available.¹¹³ If the court did not make such a finding, it would be hard to reconcile the decision with Article 55. In that case, the court's approach would also be inconsistent with the approach in most other jurisdictions of limiting excessive pricing cases regarding IPRs to situations in which a firm pursued an exclusionary strategy.¹¹⁴

Nevertheless, the judges for the Shenzhen Intermediate Court made a conscientious effort to address a set of difficult issues concerning negotiating FRAND royalty rates for SEPs. This Chinese court is not the first to find this topic challenging. We are therefore optimistic that the Chinese courts will find the approach towards unfair pricing followed in other jurisdictions, and in particular towards innovative-intensive industries, helpful in shaping the case law on the application of Article 17(1).

VI. CONCLUSIONS

China is at the very beginning of developing the best way to apply its new antitrust laws to its economy. Chinese courts and regulators should certainly not simply parrot the practice of other countries, but China can learn from the many decades of experience and numerous cases considered by courts and competition authorities, particularly the large ones in the European Union and the United States. China carefully modeled its laws from elements of these jurisdictions, and the courts and competition authorities are looking at international practice. It therefore makes sense, in the case of unfair pricing, to consider how competition case law and policy has evolved in other jurisdictions. Both the practice of other jurisdictions and sound economic analysis recommend that China should rarely if ever apply the unfair pricing law to innovation-intensive industries unless the unfair pricing is related to an exclusionary practice that has an anticompetitive effect. For the same reasons, and as apparently required under Article 55 of the AML, the experience of other jurisdictions and sound economic analysis strongly suggests that the unfair pricing law should not apply to intellectual property except when the unfair price is part of an exclusionary abuse. ▲

¹ David S. Evans is Chairman, Global Economics Group; Executive Director, Jevons Institute for Competition Law and Economics; Visiting Professor, University College London; and Lecturer, University of Chicago Law School. Vanessa Yanhua Zhang is a Director at Global Economics Group. Xinzhu Zhang is Director at Research Center for Regulation and Competition, Chinese Academy of Social Sciences and Professor at Jiangxi University of Finance and Economics. We would like to thank Howard Chang and Angela Zhang for helpful comments and Qualcomm for research support.

² See Anti-Monopoly Law of the People's Republic of China, [2008] Presidential Order No. 68, August 30, 2007. The Chinese version is *available at* http://www.gov.cn/jffg/2007-08/30/content_732591.htm; an unofficial translation of the AML is *available at* http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Oct07_Bush10_18f.authcheckdam.pdf.

³ See, *Consolidated Version of the Treaty on the Functioning of the European Union* (TFEU), Article 102(a),

Mar. 25, 1957, C 326/89.

⁴ Whenever we use the term “unfair price” in this article we are referring to an “excessive price” that is “too high.” We therefore do not consider the other application of the unfair pricing law that concerns when prices are “too low,” including the situation in which a firm with buyer power insists on “low prices.”

⁵ See generally, David S. Evans, *Why Different Jurisdictions Do Not (and Should Not) Adopt the Same Antitrust Rules*, 10 CHI. J. INT’L L. 161 (2009).

⁶ See Juro Osawa & Paul Mozur, *The Rise of China’s Innovation Engine*, WALL ST. J., (January 17, 2014), available at <http://online.wsj.com/news/articles/SB1000142405270230381970457932054423139616>.

⁷ See JEAN-JACQUES LAFFONT & CLAUDIA SENIK-LEYGONIE, PRICE CONTROLS AND THE ECONOMICS OF INSTITUTIONS IN CHINA (1997).

⁸ Article 11 of the NDRC Anti-Price Monopoly Regulations, NDRC Order No. 7, December 29, 2010, available at http://www.gov.cn/jfjfg/2011-01/04/content_1777969.htm.

⁹ European Commission, *Article 102 and Excessive Prices*, in OECD Policy Roundtables: Excessive Prices (2011), 309-322, available at, <http://www.oecd.org/competition/abuse/49604207.pdf>.

¹⁰ Consolidated Version of the Treaty on the Functioning of the European Union (TFEU), Article 102(a), Mar. 25, 1957, C 326/89.

¹¹ Xavier Vives, *Competition Policy in Europe*, COMPETITION POLICY IN THE EU: FIFTY YEARS ON FROM THE TREATY OF ROME, 1 (Xavier Vives, ed. 2009).

¹² The origin of the prohibition against unfair pricing in the Treaty is not known. The prohibition is, however, consistent with the influence of the German Ordoliberal School on the formation and early years of European Community competition law. The Ordoliberal School argued that dominant firms should be forced to behave “as if” they were competitive firms. One way of doing that, in the view of this school of thought, was to force these firms to charge the prices that competitive firms would charge. See Christian Ahlborn & Carsten Grave, *Walter Eucken and Ordoliberalism: An Introduction from a Consumer Welfare Perspective*, 2 COMPETITION POLICY INT’L 197 (2006) and Michal Gal, *Monopoly Pricing as an Antitrust Offense in the U.S. and the EC: Two Systems of Belief About Monopoly?* 49 ANTITRUST BULL. 343-384 (2004). The scientific understanding of how competition works to advance the economy and the role of antitrust in promoting competition (and how poorly antitrust enforcement can hamper competition) has advanced considerably since the Treaty was written. The European Commission and courts, like authorities and courts in other jurisdictions, have adjusted their approach to competition issues in light of new learning.

¹³ 38th Annual Report on Competition Policy, paragraph 3 (1975).

¹⁴ XXIVth Annual Report on Competition Policy (1994).

¹⁵ *Id.*

¹⁶ European Commission, *Article 102 and Excessive Prices*, in OECD POLICY ROUNDTABLES: EXCESSIVE PRICES 309-322, at 311 (2011), available at <http://www.oecd.org/competition/abuse/49604207.pdf>.

¹⁷ *Id.*, and Massimo Motta & Alexandre de Streel, *Excessive Pricing in Competition Law: Never say Never*, THE PROS AND CONS OF HIGH PRICES 30 (Arvid Fredenberg & Niklas Strand, eds. 2007). According to the 2011 report submitted by the Commission to OECD, Rambus is the only case considered by the Commission since 2007 that alleged excessive prices. In this case Rambus was accused of having engaged in deceptive practices during the standard setting process. This is therefore a case in which the excessive pricing abuse was accompanied by anticompetitive behavior. Rambus entered into a series of commitments with the Commission and the Commission did not render a final decision concerning whether Rambus had abused

a dominant position. Commission Decision of 9.12.2009 Relating to a Proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement (Case COM/38.636 - Rambus), OJ (2010) C 30/17.

¹⁸ Martin Carree, Andrea Gunster, & Maarten Pieter Schinkel, *European Policy 1957-2004: An Analysis of Commission Decisions*, 36(2) REV. INDUS. ORG. 110 (2010).

¹⁹ Motta & de Streel, *supra* note 17 at 31. That number is greater than the number of Commission decisions because many of the cases considered by the European courts involved requests for guidance on the application of EU competition law from national courts of EU Member States.

²⁰ As we discuss in more detail below, the focus on legal monopolies addresses situations in which a single company has government-established control over an entire industry; it does not refer to government grants of intellectual property. There is a consensus that unfair pricing law should generally not be applied to intellectual property except insofar as it is related to an exclusionary abuse.

²¹ According to the European Commission, “The case law described above shows that the Commission and European Courts addressed the question of excessive prices only in markets with an entrenched dominant position where entry and expansion of competitors could not be expected to ensure effective competition in the foreseeable future. In *General Motors* and *Deutsche Post* there was a legal monopoly, in *Bodson* the dominant position was based on an accumulation of exclusive concessions which shielded a significant part of the market from competition, in *SACEM* a national monopoly based on network effects, in *Helsingborg* a kind of natural monopoly and in *Rambus* a dominant position based on a lock-in effect once an industry standard has been adopted. The only exception is the *United Brands* case, which concerned the market for (green) bananas, but in the end the Court did not find excessive prices in this case.” European Commission, *Article 102 and Excessive Prices*, in OECD POLICY ROUNDTABLES: EXCESSIVE PRICES, 309-322 at 317 (2011), available at <http://www.oecd.org/competition/abuse/49604207.pdf>. In the *Rambus* case, even the lock-in effect was not enough; *Rambus* was accused of engaging in deceptive practices which thereby distorted the competitive process of determining whether it would secure inclusion in a standard. Commission Decision of 9.12.2009 Relating to a Proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement (Case COM/38.636 - Rambus), OJ (2010) C 30/17.

²² David S. Evans & Keith N. Hylton, *The Lawful Acquisition and Exercise of Monopoly Power and its Implications for the Objectives of Antitrust*, 4 COMPETITION POLICY INT’L 203 (2008).

²³ *United States v. Alcoa*, 148 F.2d 416 (2d Cir. 1945).

²⁴ *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 407 (2004).

²⁵ U.S. Federal Trade Commission and Antitrust Division of the U.S. Department of Justice, *Excessive Prices*, OECD POLICY ROUNDTABLES: EXCESSIVE PRICES 299-308 at 299 (2011) available at <http://www.oecd.org/competition/abuse/49604207.pdf>.

²⁶ *Id.*, at 2.

²⁷ OECD POLICY ROUNDTABLES: EXCESSIVE PRICES (2011), available at <http://www.oecd.org/competition/abuse/49604207.pdf>

²⁸ For example, the competition authority in the United Kingdom, much like the European Commission, has had a policy of not pursuing excessive pricing cases except when the excessive pricing is associated with an exclusionary practice. See, for example, J. VICKERS, HOW DOES THE PROHIBITION OF ABUSE OF DOMINANCE FIT WITH THE REST OF COMPETITION POLICY? (6 June 2003), available at

<http://www.oft.gov.uk/NR/rdonlyres/660C15CB-6F9E-41F5-A370-61F6EE022CB3/0/spe0303.pdf>, (July 22, 2004).

²⁹ A slightly more complex model would recognize that there are fixed costs and that the marginal firm must get a price at least equal to its average total cost inclusive of a competitive rate of return.

³⁰ For a general discussion of the evidence on innovation and economic growth see ROBERT J. BARRO & XAVIER SALA-I-MARTIN, *ECONOMIC GROWTH* (2nd ed.) Ch. 6-7 (2004).

³¹ Gerben van der Panne, Cees van Beers, & Alfred Kleinknecht, *Success and Failure of Innovation: A Literature Review*, 7(3) INT'L J. INNOVATION MGMT. 309-338 (2003).

³² F.M. Scherer & Dietmar Harhoff, *Technology Policy for a World of Skew-Distributed Outcomes*, 29 RESEARCH POL'Y 559-566 (2000).

³³ Although we focus on innovation-intensive industries these principles apply broadly to market economies since innovation can potentially disrupt any industry and in fact might be most likely to disrupt industries in which innovation is lethargic. Modern communication innovations such as IMS, SMS, and micro-blogging have, for example, created value by disrupting postal monopolies and monopoly or dominant firms in basic land-line telecommunications.

³⁴ Jerry A. Hausman, *Valuation of New Goods Under Perfect and Imperfect Competition*, THE ECONOMICS OF NEW GOODS (Timothy F. Bresnahan & Robert J. Gordon, eds. 1996).

³⁵ Christian Broda & David E. Weinstein, *Globalization and the Gains from Variety*, 121(2) Q. J. ECON. 541-585 (2006) (the value to U.S. consumers of the expanded import varieties between 1972 and 2001 was 2.6 percent of U.S. GDP); Abe Dunn, *Drug Innovations and Welfare Measures Computed from Market Demand: The Case of Anti-cholesterol Drugs*, 4(3) AMER. ECON. J.: APPLIC. ECON. 167-189 (2012) (the introduction of new varieties of anti-cholesterol drugs between 1996 and 2007 in the U.S. led to a 27 percent drop in a constant-quality price index); Matthew Gentzkow, *Valuing New Goods in a Model with Complementarities: Online Newspapers*, 97(3) AMER. ECON. REV. 713-744 (2007) (The existence of the online newspaper post.com generates \$45 million per year in consumer surplus); Austan Goolsbee & Peter J. Klenow, *Valuing Consumer Products by the Time Spent Using Them: An Application to the Internet*, 96(2) AMER. ECON. REV. 108-113 (2006) (the consumer surplus from the Internet is equal to 2 percent of annual full-income in the U.S.); Austan Goolsbee & Amil Petrin, *The Consumer Gains from Direct Broadcast Satellites and the Competition with Cable TV*, 72(2) ECONOMETRICA 351-381 (2004) (in the United States, direct broadcast satellites generate welfare gains of \$2.5 billion per year for consumers who get television using them and an additional welfare gain of \$3 billion per year for cable TV subscribers who benefit from reduced prices due to competition from direct broadcast satellites); Jerry Hausman, *Mobile Telephone*, HANDBOOK OF TELECOMMUNICATIONS ECONOMICS, VOL. 1: STRUCTURE, REGULATION, AND COMPETITION (Martin E. Cave, Sumit K. Majumdar, & Ingo Vogelsang, eds. 2002) mobile phones in the U.S. generated consumer surplus of \$24.2 to \$49.8 billion in 1994 and \$52.8 to \$111 billion in 1999); Donghun Kim, *Estimation of the Effects of New Brands on Incumbents: Profits and Consumer Welfare: The U.S. Processed Cheese Market Case*, 25(2) REV. INDUS. ORG., 275-293 (2004) (the introduction of three new brands of low-fat cheese in the United States between 1988 and 1992 led to an increase in consumer welfare of \$43.2 million in 1992); Ariel Pakes, *A Reconsideration of Hedonic Price Indexes With An Application to PC's*, AMER. ECON. REV. 1578-1614 (2003) (if the U.S. price index for PC's is adjusted to reflect welfare gains from new model introductions, then U.S. PC prices declined by 15-19 percent per year over 1995-1999, rather than remaining basically the same); Amil Petrin, *Quantifying the Benefits of New Products: The Case of the Minivan*, 110(4) J. POL. ECON. 705-729 (2002) (the

introduction of minivans in the U.S. increased consumer welfare by a total of \$2.8 billion over 1984-1988); Manuel Trajtenberg, *The Welfare Analysis of Product Innovations, with an Application to Computed Tomography Scanners*, 97(2) J. POL. ECON 444-479 (1989) (the welfare gains for U.S. customers that bought CAT Scanners in 1974 from having the 1974 choice set rather than the 1973 set was \$9.8 billion in 1982 US\$).

³⁶ Ping Li, Feitao Jiang, & Hongwei Wang, *Industrial Upgrading and Innovation in the Information Age*, 5(2) J. ENG. STUDIES, (June 2013).

³⁷ MIIT Press Release, MIIT Explains the Issuance of 4G Operation Licenses, December 4, 2013, available at www.miit.gov.cn/n11293472/n11293832/n11293907/n11368223/15748225.html.

³⁸ Michael Gort & Steven Klepper, *Time Paths in the Diffusion of Product Innovations*, 92(367) ECON. J. 630-653 (1982).

³⁹ John Haltiwanger, Ron S. Jarmin, & Javier Miranda, *Who Creates Jobs? Small Versus Large Versus Young*, 95(2) REV. ECON. & STAT. 347-361, at 358 (2013) (“...the cumulative employment weighted exit rate derived from figure 5 implies that about 47% of the jobs created by start-ups are eliminated by firm exits in the first five years.”). Note that this figure is employment-weighted. Since smaller firms are more likely to exit, the unweighted exit rate would be higher. Another study reported that only 44 percent of new businesses still existed after four years. Amy E. Knaup, *Survival and Longevity in the Business Employment Dynamics Data*, 128(5) MONTHLY LABOR REV. 51-52 (2005).

⁴⁰ David Audertsch, Patrick Houweling, & Roy Thurik, *Firm Survival in the Netherlands*, 16(1) REV. INDUS. ORG. 5 (2000). The authors note that their data sample under-samples the smallest firms, and that this means that that survival times will be biased upwards. *Id.*, at p. 3.

⁴¹ Michael Fritsch, Udo Brixy, & Oliver Falck, *The Effect of Industry, Region, and Time on New Business Survival: A Multi-Dimensional Analysis*, 28(3) REV. INDUS. ORG. 292-295 (2006). This study also found that manufacturing startups failed less frequently during the first few years than service startups, which may explain the lower survival rates than in the Dutch study.

⁴² Harald Strotmann, *Entrepreneurial Survival*, 28(1) SMALL BUS. ECON. 91-92 (2007).

⁴³ Dixon (1989) surveyed U.K. venture capital funds and reported that 3.4 percent of proposals were funded. Robert Dixon, *Venture Capitalists and Investment Appraisal*, NATIONAL WESTMINSTER BANK QUARTERLY REVIEW, 2-21 (1989). More recently, a Forbes column reported that venture capitalists finance 1-2 percent of proposals. Dileep Rao, *Why 99.95% Of Entrepreneurs Should Stop Wasting Time Seeking Venture Capital*, FORBES.COM, (July 22, 2013), available at <http://www.forbes.com/sites/dileeprao/2013/07/22/why-99-95-of-entrepreneurs-should-stop-wasting-time-seeking-venture-capital/>.

⁴⁴ These figures are likely to understate the rate of entrepreneurial failure for two reasons. First, at least some of the firms which had not exited with a zero value by the end of their data would have done so in the following years. Second, some of the ventures which exited with a positive value would have returned less than the amount invested in the startup, for an overall negative return.

⁴⁵ See Henry Grabowski, John Vernon, & Joseph DiMasi, *Returns for 1990s New Drug Introductions*, 20(3) PHARMACOECONOMICS (2002); Henry Grabowski & John Vernon, *Returns to R&D on new drug introductions in the 1980s*, J. HEALTH ECON. 13 (1994).

⁴⁶ U.S. National Library of Medicine, *FAQ: ClinicalTrials.gov – Clinical Trial Phases*, available at <http://www.nlm.nih.gov/services/ctphases.html>.

⁴⁷ After the drug has been marketed, it may be subject to phase IV, in which further studies are done to

gather information on the drug's effect in various populations and any side-effects associated with long-term use. U.S. National Library of Medicine, *FAQ: ClinicalTrials.gov – Clinical Trial Phases*, available at <http://www.nlm.nih.gov/services/ctphases.html>.

⁴⁸ Joseph DiMasi, Ronald Hansen, & Henry Grabowski, *The Price of Innovation: New Estimates of Drug Development Costs*, (22) J. HEALTH ECON. 158, 162 (2003).

⁴⁹ Ismail Kola & John Landis, *Can the Pharmaceutical Industry Reduce Attrition Rates*, 3 NATURE REVIEWS: DRUG DISCOVERY, 711-715 at 712 (2004).

⁵⁰ Ariel Pakes, *Patents as Options: Some Estimates of the Value of Holding European Patent Stocks*, 54(4) ECONOMETRICA 755-784 (1986). See also Mark Schankerman & Ariel Pakes, *Estimates of the Value of Patent Rights in European Countries During the Post-1950 Period*, (96) ECON. J. 1052-1076, at 1067-1068 (1986); Mark Schankerman, *How Valuable Is Patent Protection? Estimates by Technology Field*, 29(1) RAND J. ECON. 77-107 at 79, 93-94 (1998); Dietmar Harhoff, Francis Narin, F.M. Scherer, & Katrin Vopel, *Citation Frequency and the Value of Patented Inventions*, 81(3) REV. ECON. & STATS. 511-515, at 512 (1999); Dietmar Harhoff, Frederic M. Scherer, & Katrin Vopel, *Exploring the Tail of Patented Invention Value Distributions*, ECONOMICS, LAW, AND INTELLECTUAL PROPERTY: SEEKING STRATEGIES FOR RESEARCH AND TEACHING IN A DEVELOPING FIELD, 279-310, at 302 (Ove Granstrand, ed. 2003).

⁵¹ We assume that people are risk neutral. If they are risk averse the reward must be great and if they like risk the reward could be smaller.

⁵² U.S. Federal Trade Commission and Antitrust Division of the U.S. Department of Justice, *Excessive Prices*, in OECD POLICY ROUNDTABLES: EXCESSIVE PRICES 299-308 (2011) available at <http://www.oecd.org/competition/abuse/49604207.pdf>; for the classic discussion of this point see also F.A. Hayek, *The Use of Knowledge in Society*, 35(4) AMER. ECON. REV. 519-530 (1945).

⁵³ The percentage of market-determined prices was 95.6 percent as measured by consumption goods retail sales amounts, 91.9 percent as measured by raw materials sales amounts, and 97.7 percent as measured by agricultural procurement amounts. See Wentong Zheng, *Transplanting Antitrust in China: Economic Transition, Market Structure, and State Control*, 32(2) UNIV. PA. J. INT'L L. (2010).

⁵⁴ See Jean-Jacques Laffont & Claudia Senik-Leygonie, *Price Controls and the Economics of Institutions in China*, Development Centre Studies, OECD Development Centre, Paris (1997).

⁵⁵ See the Decision of the CCCPC on Some Major Issues Concerning Comprehensively Deepening the Reform, November 12, 2013, available at http://www.china.org.cn/chinese/2014-01/17/content_31226494.htm; See also the Communique of The Third Plenary Session of the 18th Central Committee of the CPC, November 12, 2013, available at http://www.china.org.cn/chinese/2014-01/16/content_31213800.htm.

⁵⁶ The regulation of telecommunication prices focuses on basic telecommunication services. With vibrant, fresh, and dynamic market competition, the prices of mobile communication services have been well below the price caps set by the NDRC.

⁵⁷ OECD Secretariat, *Excessive Prices: Background Paper by the Secretariat*, OECD POLICY ROUNDTABLES: EXCESSIVE PRICING 9-196 at 10 (2011), available at <http://www.oecd.org/competition/abuse/49604207.pdf>.

⁵⁸ *Id.*, at 11.

⁵⁹ Massimo Motta & Alexandre de Stree, *Excessive Pricing in Competition Law: Never say Never*, THE PROS AND CONS OF HIGH PRICES 14 (Arvid Fredenberg & Niklas Strand, eds. 2007).

⁶⁰ *Id.* at 23.

⁶¹ David S. Evans & Jorge Padilla, *Excessive Prices: Using Economics to Define Administrable Legal Rules*, 1(1) J. COMPETITION L. & ECON. 97-122 at 119 (2005).

⁶² Also see Amelia Fletcher & Alina Jardine, *Toward an Appropriate Policy for Excessive Pricing*, EUROPEAN COMPETITION LAW ANNUAL 2007: A REFORMED APPROACH TO ARTICLE 82 EC 4-5 (Claus-Dieter Ehlermann & Mel Marquis, eds. 2007); Lars-Hendrik Roller, Exploitative Abuses, *id.* at 2-3; Bruce Lyons, *The Paradox of the Exclusion of Exploitative Abuse*, THE PROS AND CONS OF HIGH PRICES 74-75 (Arvid Fredenberg & Niklas Strand, eds. 2007).

⁶³ For example, it used to cost a modest amount to stamp out a CD to distribute music or software; now is essentially costless to make music and software downloadable over the Internet.

⁶⁴ Alan Collins, Chris Hand, & Martin C. Snell, *What Makes a Blockbuster? Economic Analysis of Film Success in the United Kingdom*, 23(6) MANAGERIAL & DECISION ECON. 343-354 (2002); Arthur De Vany & W. David Walls, *Bose-Einstein Dynamics and Adaptive Contracting in the Motion Picture Industry*, 106(439) ECON. J. 1493-1514 (1996).

⁶⁵ W. David Walls, *General Stable Models of the Rate of Return to Hollywood Films*, 2(1) ADVANCES AND APPLICATIONS IN STATISTICAL SCIENCES 19-36 (2010).

⁶⁶ Erik Brynjolfsson, Michael D. Smith, & Yu (Jeffrey) Hu, *Consumer Surplus in the Digital Economy: Estimating the Value of Increased Product Variety at Online Booksellers*, 49(11) MGMT. SCIENCE 1580-1596 (2003); Judith Chevalier & Austan Goolsbee, *Measuring Prices and Price Competition Online: Amazon.com and barnesandnoble.com*, 1(2) QUANTITATIVE MARKETING & ECON. 203-222 (2003).

⁶⁷ Ken Hendricks & Alan Sorensen, *Information and the Skewness of Music Sales*, 117(2) J.POL. ECON. 324-369 (2009).

⁶⁸ Ariel Pakes, *Patents as Options: Some Estimates of the Value of Holding European Patent Stocks*, 54(4) ECONOMETRICA 755-784 (1986).

⁶⁹ The main exception to this statement concerns excessive pricing cases involving music collecting societies. In some cases domestic legislation authorizes a single society to administer copyright licenses on behalf of music writers and publishers while in other cases a natural monopoly emerges. Music collecting societies are horizontal combinations of music writers and publishers. Unless authorized by law these combinations can function only with an exemption under Article 101(3) TFEU. In most countries there is a single music collecting society that represents all of the music writers and publishers. They are therefore industry-wide monopolies in most countries. See, for example, Ernst-Joachim Mestmäcker, *Collecting Societies*, THE INTERACTION BETWEEN COMPETITION LAW AND INTELLECTUAL PROPERTY LAW (Claus-Dieter Ehlermann & Isabela Atanasiu, eds. 2006). The competition authorities and courts have heard a number of claims that these national music-collecting societies have charged excessive prices.

⁷⁰ Massimo Motta & Alexandre de Streel, *Excessive Pricing in Competition Law: Never say Never*, THE PROS AND CONS OF HIGH PRICES 26 (Arvid Fredenberg & Niklas Strand, eds. 2007).

⁷¹ Amelia Fletcher & Alina Jardin, *Towards an Appropriate Policy for Excessive Pricing*, Working Paper presented at the 12th Annual Competition Law and Policy Workshop (2007), available at <http://www.eui.eu/RSCAS/Research/Competition/2007%28pdf%29/200709-COMPed-Fletcher-Jardine.pdf>. In discussing the problems with excessive pricing intervention they note that, "Intellectual property rights are specifically designed to provide innovating firms with a degree of market power, and to stimulate upfront R&D investment through the 'prize' of higher than normal future profits. Any reduction in future profits—or

a greater risk of these profits being regulated—could clearly jeopardize such incentives.”

⁷² Israel Antitrust Authority, *Excessive Prices*, in European Commission *Article 102 and Excessive Prices*, OECD POLICY ROUNDTABLES: EXCESSIVE PRICES 261 (2011), available at <http://www.oecd.org/competition/abuse/49604207.pdf>; Turkish Competition Authority, *Excessive Prices*, in European Commission *Article 102 and Excessive Prices*, OECD POLICY ROUNDTABLES: EXCESSIVE PRICES 281, available at <http://www.oecd.org/competition/abuse/49604207.pdf>, at p. 281; Mittal Steel South Africa Ltd & Macsteel International BV and Macsteel Holdings (pty) Ltd vs. Harmony Gold Mining Company Ltd and Durban Rooderpoort Deep Ltd, Case No. 70/CAC/Apr07, available at <http://www.comptrib.co.za/assets/Uploads/Case-Documents/70CACApr07.pdf>.

⁷³ Case 27/76, *United Brands Company and United Brands Continentaal BV v. Commission of the European Communities*, 1978 E.C.R. 207. The Court said there could be other ways to determine excessive pricing and therefore did not exclude the possibility that other tests could be employed.

⁷⁴ Aswath Damodaran, *Cost of Capital by Sector*, (January 2014), available at http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/wacc.htm.

⁷⁵ David S. Evans & Richard Schmalensee, *The Antitrust Analysis of Multisided Platform Businesses*, OXFORD HANDBOOK ON INTERNATIONAL ANTITRUST ECONOMICS (Roger Blair & Daniel Sokol, eds. forthcoming); David S. Evans, *The Consensus Among Economists on Multisided Platforms and Its Implications for Excluding Evidence That Ignores It*, 6(1) CPI ANTITRUST CHRON. (2013).

⁷⁶ Jean-Charles Rochet & Jean Tirole, *Two-Sided Markets: A Progress Report*, 37(3) RAND J. ECON. 645-667 (2006); Mark Armstrong, *Competition in Two-Sided Markets*, 37(3) RAND J. ECON. 668-691 (2006).

⁷⁷ David Evans, *Attention Rivalry among Online Platforms*, ELECTRONICS INTELLECTUAL PROPERTY, MIIT CHINA, vol. 9, 30-41(in Chinese) (2013).

⁷⁸ Case 27/76, *United Brands Company and United Brands Continentaal BV v. Commission of the European Communities*, 1978 E.C.R. 207; *Attheraces Ltd. v. British Horseracing Board Ltd.*, [2007] EWCA (Civ) 38, [2007] UKCLR (CA) 309; Mittal Steel South Africa Ltd & Macsteel International BV and Macsteel Holdings (pty) Ltd vs. Harmony Gold Mining Company Ltd and Durban Rooderpoort Deep Ltd, Case No. 70/CAC/Apr07, available at <http://www.comptrib.co.za/assets/Uploads/Case-Documents/70CACApr07.pdf>.

⁷⁹ Franklin M. Fisher & John J. McGowan, *On the Misuse of Accounting Rates of Return to Infer Monopoly Profits*, 73(1) AMER. ECON. REV. 82-97 (1983); Morris G. Danielson & Eric Press, *Accounting Returns Revisited: Evidence of their usefulness in Estimating Economic Returns*, 8(4) REV. ACCOUNTING STUDIES 493-530 (2003); Morris G. Danielson & Eric Press, *When Does R&D Expense Distort Profitability Estimates?*, 15(2) J. APPLIED FIN. 76-92 (2005); Paul A. Grout & Anna Zalewska, *Measuring the Rate of Return for Competition Law*, 4(1) J. COMPETITION L. & ECON. 155-176 (2007); Matthew J. Holian & Ali M. Reza, *Firm and Industry Effects in Accounting Versus Economic Profit Data*, 18(6) APPLIED ECON. LETTERS 27-529 (2011); J.K. Kapler, *Measuring the Economic Rate of Return on Assets*, 17(4) REV. IND. ORG. 457-463 (2000); Michael A. Williams, Kevin Kreitzman, Melanie Stallings Williams, & William M. Havens, *Estimating Monopoly Power with Economic Profits*, 10(2) U.C. BUSINESS L. J. 125-150 (2010).

⁸⁰ This analysis does not mean that excessive profits are *never* possible in innovation-intensive industries. For example, the winning firm in the example we have just described could have earned 3 billion Yuan. It is possible, though not necessarily the case, that the excess of 3 billion Yuan over 1.5 billion Yuan could be,

at least in part, a supra-competitive profit resulting from the unanticipated ability to erect entry barriers or to otherwise secure more market power than the competitors for winning this technology race anticipated. However, for the reasons we explain, making this determination, after the fact, is an extremely difficult exercise that carries substantial risk for reducing innovation and penalizing innovators.

⁸¹ DERMOT BERKERY, *RAISING VENTURE CAPITAL FOR THE SERIOUS ENTREPRENEUR*, at 23, 70 (2008) (“the entrepreneur needs to convince the investors ... the opportunity is big enough for early investors to get a 10 to 20 times multiple return on their investment.” ... “While investors might be hoping for a 10 to 20 times multiple on an exit, they will not complain with a 3 to 5 times multiple.”).

⁸² Susanne Espenlaub, Arif Khurshed, & Abdulkadir Mohamed, *The Exit Behavior of Venture Capital Firms*, Working Paper, at 36 (2010).

⁸³ Yet between 1987 and 2000 venture capitalists in the United States only had an annual return of 15 percent, which was slightly lower than the S&P 500 annual return of 15.9% over this same period. John Cochrane, *The Risk and Return of Venture Capital*, 75(1) J. FIN. ECON. 3-52, at 17-19 (2005). The explanation for the difference is straightforward. The high return on the occasional successful businesses compensates for the low returns on the many unsuccessful ones. Conceptually, this is the same as the lottery. The high earnings for the winner offset the lack of winnings for the vast number of unsuccessful ticket purchasers.

⁸⁴ Case COMP/A.36.750/D3, *Scandlines Sverige AB v. Port of Helsingborg* [2006] 4 CMLR 23; Nihls Wahl, *Exploitative High Prices and European Competition Law—A Personal Reflection*, THE PROS AND CONS OF HIGH PRICES, (Swedish Competition Authority, ed. 2007); *Attheraces Ltd. v. British Horseracing Board Ltd.*, [2007] EWCA (Civ) 38, [2007] UKCLR (CA) 309.

⁸⁵ *Attheraces Ltd. v. British Horseracing Board Ltd.*, *Id.*

⁸⁶ DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION*, 4th edition, at 406-411 (2005); MASSIMO MOTTA, *COMPETITION POLICY: THEORY AND PRACTICE*, at 347-377 (2004).

⁸⁷ See Zhiguo Li, *Margin Squeeze in Telecom Industry: New Trend in Determining Margin Squeeze in EU's Telecom Industry*, CHINA TELECOMMUNICATION TRADE, Vol. 12 (2009).

⁸⁸ See Yanbei Meng, *Analyze the Issue of Refusal to Deal in Tying Conduct: the Kodak (1992) Case*, J. RENMIN UNIV. CHINA, Vol. 6 (2008).

⁸⁹ See Evans and Padilla, *supra* note 61.

⁹⁰ See European Commission, *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, OFFICIAL J. EUR. UNION (2009); Office of Fair Trading, *Assessment of market power: Understanding competition law*, COMPETITION LAW GUIDELINE (2004).

⁹¹ In the next section we will see that the NDRC has adopted a version of the normal price screen as part of its guidelines for assessing unfair pricing abuses.

⁹² Case 27/76, *United Brands Company and United Brands Continentaal BV v. Commission of the European Communities*, 1978 E.C.R. 207, at 241-242.

⁹³ It is well known that it is common in competitive markets to have price differences across customers. William J. Baumol & Daniel G. Swanson, *The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power*, 70(3) ANTITRUST L.J. 661-685 (2003).

⁹⁴ Frank H. Easterbrook, *The Limits of Antitrust*, 63(1) TEX. L. REV. (1984); Steven C. Salop & Craig R. Romaine, *Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft*, 7 GEO. MASON L. REV. 7 at

617, 659 (1999).

⁹⁵ See Dan Zhu, *Historical Milestones: Socialism Market Economy*, PEOPLE DAILY, (October 11, 2007), available at <http://cpc.people.com.cn/GB/104019/104740/8150356.html>.

⁹⁶ NDRC of People's Republic of China Public Notice No. 11, Effective on August 1st, 2001, *available at* http://www.ndrc.gov.cn/zcfb/zcfbl/zcfbl2003pro/t20050707_27540.htm

⁹⁷ Government regulated prices do not necessarily mean simply controlling or reducing the price of products. In some industries in Table 2, prices are actually set jointly by government guidance and market mechanism. See State Planning Commission, *The Options to Reform the Price Management of Medical Services*, (July 20, 2000), *available at* <http://www.moh.gov.cn/zhuzhan/wsbmgz/201304/2565dbbdefeb4a5199c4fc7c8f9306b0.shtml>.

⁹⁸ See State Council Notice on Indigenous Innovation in the Twelfth Five Year Plan. The Chinese version is *available at* http://www.gov.cn/zwggk/2013-05/29/content_2414100.htm.

⁹⁹ See Gao Yuan, *China Now World's Biggest Smartphone Market*, CHINA DAILY, (November 6, 2013), *available at* http://www.chinadaily.com.cn/business/2013-11/06/content_17086026.htm.

¹⁰⁰ See IMAP, *Pharmaceuticals & Biotech Industry Global Report-2011*, *available at* http://www.imap.com/imap/media/resources/IMAP_PharmaReport_8_272B8752E0FB3.pdf.

¹⁰¹ See Xinhua, *China to Boost Biotech Industry*, (January 6, 2013), *available at* http://news.xinhuanet.com/english/sci/2013-01/06/c_132084198.htm.

¹⁰² This also presents the courts and the NDRC with a conundrum. Since unfairly low prices are also unlawful under Article 17 they would need to consider whether the buyer is using its market power, perhaps together with pursuing claims before the court and regulator, to secure an unfairly low price.

¹⁰³ See Anti-Price Monopoly Regulations, NDRC Order No. 7, December 29, 2010, *available at* http://www.gov.cn/flfg/2011-01/04/content_1777969.htm.

¹⁰⁴ See MASSIMO MOTTA, *COMPETITION POLICY: THEORY AND PRACTICE* 493-498 (2004); See also Michael E. Levine, *Price Discrimination without Market Power*, 19 YALE J. REGULATION 1 (2002); William J. Baumol & Daniel G. Swanson, *The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power*, 70(3) ANTITRUST L.J. 661-685 (2003).

¹⁰⁵ For example, large retail stores such as Walmart get discounts from suppliers which make it possible for Walmart to offer consumers lower prices and better quality in China. See, *Walmart Shopping Mall Ignite Business in Yanqing*, SINA (September 1, 2009), *available at* <http://travel.sina.com.cn/news/2009-09-01/1007104419.shtml>. To take another common example, parks and museums offer discounted prices to senior citizens, students, and other special group of consumers. See China National Tourism Administration, 2012 Benefit Program of China Tourism Day: Discount Prices to Senior Citizen, Students and Special Consumer Groups, May 17, 2012, *available at* http://www.cnta.com/html/2012-5/2012-5-17-15-40-91650_1.html.

¹⁰⁶ Article 26 of the NDRC's Anti-Price Monopoly Regulations reiterates the sensitivity to the exercise of intellectual property rights reflected in Article 55 of the AML. It states: "These Rules are not applicable to conduct of undertakings to exercise their intellectual property rights in accordance with the intellectual property laws and relevant administrative regulations however these Rules are applicable to monopolistic pricing conduct of undertakings that abuse their intellectual property rights **to eliminate or restrict market competition.**" (emphasis added).

¹⁰⁷ NDRC, *Guangdong Punished Sea Sand Price Monopoly Case to Guarantee the Smooth Proceeding of National Important Project Construction*, (October 26, 2012) available at http://jjs.ndrc.gov.cn/gzdt/t20121026_510834.htm. The Guangdong Price Bureau's river-sand case is the only application of Article 17(1) of the AML by the Chinese price bureaus or by the NDRC itself that we have identified.

¹⁰⁸ There were two decisions regarding the abuse of dominance claim and the FRAND claim respectively. The case involving the abuse of dominance claim is Shenzhongfazhiminchuzi No. 857 (2011), and the case involving the FRAND claim is Shenzhongfazhiminchuzi No. 858 (2011). Neither decision is public.

¹⁰⁹ See Ye Ruosi, Zhu Jianjun, & Chen Wenquan, *Determination of Whether Abuse of Dominance by SEP Owners Constitutes Monopoly: Comments on the Antitrust Lawsuit Huawei v. InterDigital*, 3 ELECTRONICS INTELLECTUAL PROPERTY (2013). See also the decision summarized in the InterDigital's annual report. InterDigital 2013 Annual Report filed Feb. 26, 2013, available at <http://ir.interdigital.com/secfiling.cfm?filingID=1405495-13-10&CIK=1405495>.

¹¹⁰ See Ye Ruosi, Zhu Jianjun, & Chen Wenquan, *The Implementation of FRAND in the Litigations Involving SEP's Royalty Rates: Comments on SEP Royalty Lawsuit Huawei v. InterDigital*, 4 ELECTRONICS INTELLECTUAL PROPERTY (2013).

¹¹¹ See Zhu Jianjun, *Determination of Whether Abuse of Dominance by SEP Owners Constitutes Monopoly: Comments on the Antitrust Infringement Case Huawei v. InterDigital*, CHINA INTELLECTUAL PROPERTY NEWS (December 5, 2013), available at <http://www.cipnews.com.cn/showArticle.asp?Articleid=29779>.

¹¹² *InterDigital Settles with Huawei*, WIPR, January 7, 2014, available at <http://www.worldipreview.com/news/interdigital-settles-with-huawei>.

¹¹³ The existence of such disparities would not by itself, however, demonstrate that competition was eliminated or excluded in handset manufacturing.

¹¹⁴ InterDigital also did not have a monopoly over an entire industry like the post office. It was one of a number of entities that had SEPs over mobile wireless technologies.



What Can We Learn from Bazaarvoice?

BY PETER J. LEVITAS & KELLY SCHOOLMEESTER¹

On January 8, 2014, Judge Orrick of the Northern District of California found that a consummated merger between Bazaarvoice and PowerReviews violated Section 7 of the Clayton Act.² The Department of Justice challenge to this transaction and the court's ruling have been much analyzed, and for good reason—the case provides significant insights into how the agencies approach merger challenges, how courts view those challenges, and how effective the agencies may be in challenging mergers post-consummation.

I. BACKGROUND

Bazaarvoice and PowerReviews were the only two major third-party providers of ratings and review (“R&R”) platforms, which provide online shoppers the opportunity to comment on purchases and allow prospective buyers to see how other consumers rated products. On March 24, 2012, Bazaarvoice entered into a contract

IN AND OF ITSELF THE CONCLUSION THAT A MERGER TO MONOPOLY VIOLATES THE CLAYTON ACT MAY NOT BE SURPRISING, BUT THE RESULT OF THIS CASE WAS PERHAPS NOT AS OBVIOUS AS THAT FACT ALONE MIGHT SUGGEST

to purchase PowerReviews for \$151 million.³ The deal was not reportable under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (“HSR Act”) because the 2011 assets of PowerReviews did not meet the applicable “size of the parties” requirement under the HSR Act.⁴ The transaction was consummated on June 12, 2012,⁵ and the Department of Justice Antitrust Division (“DOJ”) launched an investigation

into the merger two days later.⁶ DOJ ultimately sued on January 10, 2013, alleging that the transaction violated Section 7 of the Clayton Act. Its complaint stated:

As a result of Bazaarvoice's acquisition of PowerReviews, customers will lose critical negotiating leverage. The elimination of PowerReviews has significantly enhanced Bazaarvoice's ability and incentive to obtain more favorable contract terms. Accordingly, many retailers and manufacturers will now obtain less favorable prices and contract terms than Bazaarvoice and PowerReviews would have offered separately absent the merger.⁷

After a three-week trial the court issued its ruling, finding that DOJ established a *prima facie* case of likely competitive harm and Bazaarvoice failed to rebut it.⁸ After post-trial briefing on remedies issues, the parties agreed that Bazaarvoice would sell all the acquired PowerReviews assets to a divestiture buyer, provide syndication services to the buyer, waive breach of contract claims for customers who switch to the new company, waive trade secret restrictions for employees who join the new company, and permanently license to the divestiture buyer all patents and applications related to review platforms.⁹

In and of itself the conclusion that a merger to monopoly violates the Clayton Act may not be

surprising, but the result of this case was perhaps not as obvious as that fact alone might suggest. Bazaarvoice was not without some reasons for optimism as the litigation began—most important, even after the transaction had been closed and the companies had merged there was no evidence of price effects and little customer opposition to the deal. These normally would be facts difficult for the government to surmount, but it appears to have done so with relative ease in this case. For those reasons alone the court’s opinion is worth further consideration, and the case also provides important insights into a number of other significant issues that frequently arise in antitrust litigation.

II. CONSUMMATED DEALS ARE ANALYZED IN THE SAME WAY AS UNCONSUMMATED DEALS

Since the HSR Act was passed in 1976 most of the transactions challenged by the antitrust agencies have been challenged pre-consummation; indeed, the primary justification for the HSR Act was to provide DOJ and the Federal Trade Commission (“FTC”) with advance notice of transactions so that they could address potential antitrust issues before the merger took place.¹⁰ This pre-closing notice period would allow the antitrust agencies to avoid the problems inherent in challenging consummated mergers, i.e., the difficulty in restoring competition when the market has already been altered by a combination.¹¹ It would also allow companies to move forward with their transactions, after review, comfortable that the agencies were unlikely to later challenge those deals.

BAZAARVOICE, HOWEVER, ARGUED THAT CONSUMMATED MERGERS SHOULD BE ANALYZED UNDER A DIFFERENT STANDARD THAN DEALS CHALLENGED BEFORE CLOSING

Although it is widely acknowledged that the HSR Act has succeeded in achieving these goals, the agencies may still pursue a Clayton Act challenge at any point and challenges of consummated mergers still occur with some frequency. For example, between March 2009 and March 2012 the FTC alone took enforcement action against nine consummated mergers,¹² which made up a full 20 percent of the FTC’s total merger challenges during that period.¹³ Even relatively small or old transactions are not immune from agency action. In recent years the DOJ has sought to unwind a merger valued at merely \$3 million¹⁴ and the FTC took action against a deal eight years after it closed.¹⁵

Indeed, the agencies have been clear that they will review even non-reportable consummated transactions and take action against those that they believe raise competitive concerns.¹⁶ They have also consistently taken the view that the same substantive standards apply to challenges of consummated deals, though of course the procedural posture is different and often the evidentiary record is more developed.¹⁷

Bazaarvoice, however, argued that consummated mergers should be analyzed under a different standard than deals challenged before closing. Bazaarvoice cited *U.S. v. Syufy Enterprises*¹⁸ and argued that *Syufy* established three “important principles for post-merger analysis,” revolving around the notion that post-acquisition evidence must be given special attention. In particular, Bazaarvoice asserted that:

1. Changes in “market structure” (such as aggressive discounting from re-positioned competitors) are dispositive evidence that the transaction has not caused competitive harm;
2. Customer testimony that reveals no concerns about the merger weighs strongly against a finding of anticompetitive effects; and
3. Traditional merger analysis may be skipped entirely when it is evident that new entrants can defeat any attempt to raise prices.¹⁹

Bazaarvoice argued that because each of these three principles weighed in its favor, the court need not engage in an “extended traditional analysis” and the government’s challenge should fail.²⁰

However, the *Bazaarvoice* court rejected the notion that post-acquisition evidence should receive special consideration. Instead, Judge Orrick specifically declined to credit post-consummation evidence

MORE GENERALLY, THE COURT REJECTED THE IDEA THAT CONSUMMATED DEALS SHOULD BE REVIEWED UNDER DIFFERENT STANDARDS AND INSTEAD HEWED TO THE COMMONLY HELD POSITION THAT CHALLENGES TO CONSUMMATED TRANSACTIONS ARE REVIEWED UNDER THE SAME SUBSTANTIVE STANDARDS AS ARE UNCONSUMMATED MERGERS

of price increases or decreases.²¹ The court was unwilling to consider this evidence because of its concern that post-merger pricing decisions were arguably subject to manipulation by the merged entity and thus could not be relied on to demonstrate the effect of the merger on the market.²² In particular, the court was concerned that Bazaarvoice, which was aware of the DOJ investigation almost immediately after the deal closed, had consciously avoided price increases in order to avoid antitrust risk.²³

More generally, the court rejected the idea that consummated deals should be reviewed under different standards and instead hewed to the commonly held position that challenges to consummated transactions are reviewed under the same substantive standards as are unconsummated mergers. Judge Orrick found that “Supreme Court authority predating the enactment of the HSR Act establishes and affirms the burden-shifting framework for analyzing Section 7 cases and applies equally to pre- and post-merger cases.”²⁴

The court specifically addressed and dismissed respondent’s argument that *Syufy* required an “alternative methodology” for post-merger cases.²⁵ Rather, Judge Orrick found the *Syufy* analysis consistent with the usual approach employed by courts. As he described the approach of the *Syufy* court, it had relied on traditional factors such as low barriers to entry and based its decision, in part, on the fact that post-merger entry had actually increased the level of competition in the market.²⁶ Judge Orrick thus distinguished *Syufy* on the grounds that in that case, unlike this one, new competitors had quickly entered the market and prevented the alleged monopolist from maintaining the market share briefly held at the time of the acquisition.²⁷

THE DOJ BUILT ITS CASE AROUND THE DOCUMENTS OF BAZAARVOICE EXECUTIVES, AND THE STRATEGY PROVED HIGHLY SUCCESSFUL

Thus, the *Bazaarvoice* opinion gives additional legal support to the view of the agencies—that consummated and unconsummated deals are subject to the same level of legal scrutiny and will be evaluated under the same legal standards.

III. ORDINARY COURSE DOCUMENTS CAN BE DISPOSITIVE

Party documents are increasingly a cornerstone of agency merger challenges, whether against consummated deals or unconsummated deals, and the *Bazaarvoice* case is one of the most vivid examples of this approach. The DOJ built its case around the documents of Bazaarvoice executives, and the strategy proved highly successful. DOJ argued that the intent of the deal was to create a monopoly by eliminating the company’s primary competitor and then raising prices, and it offered dozens of pre-merger ordinary course party documents to support that argument.

STILL, THE COURT’S HEAVY RELIANCE ON THE DOCUMENTS AND ITS REPEATED REFERENCES TO THE SPECIFIC PHRASES USED BY THE EXECUTIVES IS NOTABLE

In its defense, Bazaarvoice relied on executive testimony to the effect that: (1) the R&R market included numerous significant competitors (and thus even after this transaction the market would be sufficiently competitive to avoid consumer harm) and (2) the rationale for the deal was that the R&R market was becoming commoditized and thus Bazaarvoice needed to merge with PowerReviews to gain the scale necessary to begin competing in a broader E-commerce market.

The court was almost entirely unconvinced by the Bazaarvoice defense. Judge Orrick found that pre-merger ordinary course documents contradicted both of these contentions and went to great lengths in his opinion to emphasize that finding and make it clear that he did not find the executive testimony credible. Although the court accepted, to some extent, the notion that Bazaarvoice might be interested in entering the broader E-commerce market, he flatly rejected the notion that this new business strategy was the justification for the deal. To that end, Judge Orrick cited a long string of documents from Bazaarvoice executives demonstrating that Bazaarvoice’s primary rationale for acquiring PowerReviews was to eliminate its main competitor.

For example, prior to the merger Bazaarvoice’s then-CFO acknowledged that the company had “literally no other competitors”²⁸ besides PowerReviews. The court cited to other documents stating that the benefit of the merger would be “‘monopoly in the market’²⁹ and the ‘possibility of reducing the discounting . . . seen in the marketplace.’”³⁰ One of the most colorful documents, widely discussed by commentators and also referenced by the court, claimed that the merger would “‘avoid market erosion’ caused by ‘tactical knife-fighting over competitive deals.’”³¹ The court credited these documents and not the respondent’s trial testimony to the contrary.

This is not a fundamentally surprising outcome. It is always difficult to contest ordinary course documents with testimony, and Bazaarvoice found itself in the unenviable position of needing to deny or explain away an unusual number of exceptionally damning documents. Still, the court’s heavy reliance on the documents and

its repeated references to the specific phrases used by the executives is notable. Reading the opinion one comes away with the impression that the stark language and great number of “bad” documents impacted the court’s evaluation of all the other evidence, making it even more difficult for Bazaarvoice to withstand the government challenge.

IV. CUSTOMER TESTIMONY IS NOT ALWAYS PERSUASIVE

Customer testimony is a critical component of the investigations conducted by both the DOJ and the FTC. Both agencies routinely seek out and evaluate customer views as part of their assessment of the competitive effects of a deal; in fact, most practitioners have found that if customers are not concerned about a transaction, the agencies will often stand down, even if the staff has misgivings about a deal. Public merger data released by the FTC confirm the importance of customer reaction,³² and the DOJ also has acknowledged the role

SO CUSTOMER VIEWS ARE VERY SIGNIFICANT TO THE AGENCIES, BUT IN THIS CASE THE DOJ APPEARS TO HAVE MADE ITS AFFIRMATIVE CASE WITHOUT THE BENEFIT OF SUBSTANTIAL CUSTOMER SUPPORT

customers play in investigations: “A large percentage of all Federal antitrust investigations results from complaints received from consumers or people in business by phone or mail or in person.”³³ Further, the 2010 Horizontal Merger Guidelines (the “Guidelines”) themselves note that the agencies value input from customers, even indirect customers.³⁴

So customer views are very significant to the agencies, but in this case the DOJ appears to have made its affirmative case without the benefit of substantial customer support. Bazaarvoice, in contrast, emphasized customer reaction (which seemed to range from neutral to supportive) to make its point that the merger had not created any consumer harm and had instead provided competitive benefits. Indeed, this is one aspect of the case where it appeared that Bazaarvoice had a decided advantage, and it took great pains to make the point that DOJ had presented very little evidence that customers were opposed to the transaction: “More than 90 customers testified that they had no concerns with the acquisition. The government will present at most only [redacted] customers who claim to have no options aside from Bazaarvoice and PowerReviews.”³⁵

Customer reaction might normally be considered particularly instructive in a post-merger context, where the market has already changed and customers have already been exposed to any competitive effects, good or bad, but Judge Orrick was not impressed. On this issue also he sided with the DOJ. He disregarded a substantial amount of testimony from customers who stated that they had not been harmed by the merger and instead found that such testimony was mostly uninformed. “Post-merger customer testimony is entitled to limited weight given the customer’s narrow perspective Many of the customers had paid little or no attention to the merger; and each had an idiosyncratic understanding of R&R based on the priorities of their company.”³⁶

IT IS DIFFICULT TO PREDICT WHETHER THE COURT’S ALMOST COMPLETE DISREGARD FOR CUSTOMER TESTIMONY IN THIS CASE IS INDICATIVE OF A LARGER TREND

This decision echoes the approach taken in *Oracle*, in which the court also discounted customer trial

testimony (in that case attacking the merger as anticompetitive) for largely the same reasons.³⁷ Judge Orrick’s approach to the customer testimony in this case has drawn some criticism from commentators expressing the view that the opinions of customers who use and pay for a product are normally entitled to more weight than was given them by Judge Orrick.³⁸ It is difficult to predict whether the court’s almost complete disregard for customer testimony in this case is indicative of a larger trend, but it is clear that the agencies are at least sometimes willing to go to court without significant customer support—particularly in a merger to monopoly—and that limited customer concern about a transaction is not necessarily fatal to a merger challenge.

V. DEMAND SUBSTITUTION FACTORS MAY BE SUFFICIENT TO DEFINE THE MARKET

The economic experts (Carl Shapiro for the government and Ramsey Shehadeh for Bazaarvoice) took opposing positions on whether the definition of the product market required consideration of supply-side substitution. The DOJ position, as expressed through the testimony of Professor Shapiro, tracked the Guidelines and focused on demand for the product.³⁹ Dr. Shehadeh argued that supply substitution should also be considered at the market definition stage, and Bazaarvoice pointed to a 9th Circuit case, *Rebel Oil*,⁴⁰ in support of that position.⁴¹

Although there is also support for this position in other case law,⁴² Judge Orrick disagreed. He found instead that the holding of *Rebel Oil* was limited to instances in which suppliers can swiftly and easily switch production facilities to take advantage of supra-competitive pricing by a monopolist—and this was not such a situation: “*Rebel Oil* merely instructs that where a supplier can “easily”—i.e., “at virtually no cost”—start

WHILE THE COURT DID NOT ACTUALLY REJECT THE NOTION THAT SUPPLY-SIDE SUBSTITUTION SHOULD BE PART OF MARKET DEFINITION, IT EFFECTIVELY SIDED WITH THE GOVERNMENT AND ADOPTED THE DEMAND-SIDE APPROACH OF THE GUIDELINES

supplying the product at issue to the relevant geographic market, that supplier should be included in the market definition. Nothing in *Rebel Oil* states that this will necessarily be the case in all mergers.”⁴³ While the court did not actually reject the notion that supply-side substitution should be part of market definition, it effectively sided with the government and adopted the demand-side approach of the Guidelines.

VI. BEING IN THE HIGH-TECH MARKET DOES NOT PROTECT YOU AGAINST ANTITRUST ENFORCEMENT

In recent years, some support has developed for the notion that the antitrust laws are not well-suited to high-tech markets.⁴⁴ Some of this criticism is based on the notion that these markets evolve too quickly, so that enforcers will always be a step or two behind or will not correctly understand the market,⁴⁵ and some of the criticism is based on the notion that even dominant positions are not safe in the face of aggressive and sudden competition from new entrants.⁴⁶ Not surprisingly, the antitrust agencies have resisted the notion that antitrust cannot effectively police high-tech markets⁴⁷ and instead have emphasized the

THE BAZAARVOICE TRIAL DEFENSE HAD ECHOES OF THE ARGUMENT THAT HIGH-TECH MARKETS SHOULD RECEIVE SPECIAL CONSIDERATION UNDER THE ANTITRUST LAWS

harm that unchecked consolidation in those markets might cause. As the court noted in this case: “In recent years, the Antitrust Division has repeatedly alleged that mergers involving high-technology companies likely would harm competition by reducing innovation.”⁴⁸

GIVEN THE ECONOMIC SIGNIFICANCE OF HIGH-TECH MARKETS AND THE ONGOING DEBATE ABOUT THE PROPER ROLE OF ANTITRUST ENFORCEMENT IN THOSE MARKETS, THE COURT’S OPINION ON THIS ISSUE MAY STAND AS THE MOST SIGNIFICANT ASPECT OF THE DECISION, AT LEAST FROM THE POINT OF VIEW OF THE ANTITRUST AGENCIES

The Bazaarvoice trial defense had echoes of the argument that high-tech markets should receive special consideration under the antitrust laws. Bazaarvoice claimed that companies such as Google, Facebook, and Amazon had sufficient resources and technological ability to enter the market rapidly and therefore constrained any potential price increases. It thus argued that these firms should be considered as part of the product market and no antitrust violation could be found.

This argument, however, was rejected in its entirety. The court noted instead that there was “no evidence that any company had made even preliminary analyses of the viability of joining the market.”⁴⁹ Judge Orrick then addressed the larger issue of how to assess the competitive significance of large, sophisticated, and well-funded high-tech firms, and emphasized that their mere existence could not, in and of itself, justify consolidation in specific market segments that were not specifically the focus of their entry plans:

Companies do not simply enter any market they can—they will only do so if it is within their strategy to do so and they have the requisite ability to do so To conclude otherwise would give eCommerce companies carte blanche to violate the antitrust laws with impunity with the excuse that Google, Amazon, [and]Facebook . . . stand ready to restore competition to any highly concentrated market.⁵⁰

Given the economic significance of high-tech markets and the ongoing debate about the proper role of antitrust enforcement in those markets, the court’s opinion on this issue may stand as the most significant aspect of the decision, at least from the point of view of the antitrust agencies. After Judge Orrick’s opinion issued, the DOJ re-affirmed its view that antitrust analysis in high-tech industries should be conducted in the same fashion as in any other industry:

Bazaarvoice is important reading for technology companies and their counsel, as well as those who question the applicability of the antitrust laws in the high-tech space The decision confirms that merger analysis in high-tech markets, as in other markets, is highly fact specific. High-tech mergers do not get a free pass, and their impact on competition must be evaluated on a case-by-case basis.⁵¹

VII. REMEDIES

Remedies in a case involving a consummated merger are often difficult to construct; the lapse in time between the merger and the decision allows the parties to integrate, and other changes in the market may also shift the competitive landscape, which makes it difficult to restore competition to its pre-merger state. The

Bazaarvoice court acknowledged this difficulty. It found that the government is “entitled to an injunction that requires Bazaarvoice to divest PowerReviews,” but also noted that such a divestiture is “not a simple proposition 18 months after the merger.”⁵² It is not surprising that the government has had a mixed record in obtaining substantial relief in other consummated merger cases.⁵³

THE DIFFICULTIES INHERENT IN CONSTRUCTING POST-CONSUMMATION REMEDIES HAVE NOT CHANGED THE BASIC GOALS OF THE AGENCIES—IN CONSUMMATED DEALS, AS IN OTHERS, THE AGENCIES GENERALLY PREFER STRUCTURAL REMEDIES

The difficulties inherent in constructing post-consummation remedies have not changed the basic goals of the agencies—in consummated deals, as in others, the agencies generally prefer structural remedies. As an FTC official has stated: “If the acquired assets are well integrated, crafting an effective divestiture to eliminate the anticompetitive effects may be problematic, but it nonetheless may be necessary to undo the illegal effects of the merger.”⁵⁴

IN BAZAARVOICE, HOWEVER, THE GOVERNMENT WAS FAR MORE SUCCESSFUL IN OBTAINING A REMEDY THAT APPEARS IN LARGE PART TO RESTORE THE MARKET TO ITS PRE-MERGER STATE

But the realities of the market often dictate that complete divestiture remedies are not obtainable. *Phoebe Putney and Whole Foods*⁵⁵ are high-profile examples of situations where the agency won the case but was unable to secure a substantial remedy for the conduct that generated the litigation. Similarly, in the *Evanston* hospital case, the FTC found that a divestiture remedy was impossible to administer adequately because of the

complete integration of the merging parties during the years between the close of the merger and the end of litigation. The FTC was also unwilling to sacrifice a few significant post-merger improvements that the parties had implemented, which the agency feared would not survive any substantial divestiture.⁵⁶ Instead, the agency required the Evanston hospital system to set up a process whereby insurance companies and other payors were entitled to negotiate contracts for the acquired hospital with a separate negotiating team. The Commission noted at the time that this result was “highly unusual.”⁵⁷

In *Bazaarvoice*, however, the government was far more successful in obtaining a remedy that appears in large part to restore the market to its pre-merger state. This outcome, negotiated with Bazaarvoice, may have been a function of the fact that the deal was consummated in the relatively recent past, or perhaps Bazaarvoice felt its bargaining position was relatively weak in light of the court’s strong condemnation of the deal.⁵⁸ Whatever the reason, the remedy includes almost everything DOJ requested in its post-trial briefing. Bazaarvoice is required to divest all assets acquired in the PowerReviews transaction and, to resolve Bazaarvoice’s network effects advantage, provide four years of syndication services, which will allow users of the divestiture buyer’s software to view ratings and reviews posted on the Bazaarvoice platform. Bazaarvoice also is required to allow any of its customers to switch to the divestiture buyer without

THE APPOINTMENT OF THE MONITOR MAY BE THE ASPECT OF THE REMEDY THAT HAS THE MOST CONSEQUENCE FOR DEFENDANTS IN FUTURE CASES

penalty, refrain from soliciting any customers of the buyer for six months, and lift non-compete clauses and trade secret restrictions for any employees hired by the buyer. Any patents and applications must be freely licensed to the buyer. Finally, a monitor trustee was appointed to monitor Bazaarvoice's compliance for four years.⁵⁹

The appointment of the monitor may be the aspect of the remedy that has the most consequence for defendants in future cases. The agencies are often interested in utilizing monitors to assist with implementation and oversight of remedies. Both the DOJ and the FTC have recently issued remedies guides discussing compliance monitoring. The DOJ notes that it “may opt to appoint a monitoring trustee to review a defendant’s compliance . . . especially when effective oversight requires technical expertise or industry-specific knowledge. A monitoring trustee with industry experience can reduce the burden on the Division and the parties while ensuring that the parties adhere to the decree.”⁶⁰ Similarly, the FTC remedies guide indicates that it believes compliance monitors can be helpful when judgment requirements are highly complex or technical.⁶¹

The government has been successful in obtaining monitor appointments in other recent cases, such as *U.S. v. Anheuser-Busch*⁶² and *Polypore*,⁶³ but defendants almost always resist the appointment of a monitor and the issue often creates some controversy. DOJ obtained a long-term monitor in *U.S. v. Microsoft*,⁶⁴ and it has been widely debated whether the existence of the monitor and the overall culture of compliance created around that decree affected Microsoft’s competitive vigor.

More recently, Apple litigated against the DOJ regarding the need for and appropriate duration of compliance monitoring.⁶⁵ In that case, a civil action, Apple was found to have facilitated a price-fixing conspiracy regarding e-books. Initially, the DOJ proposed installing a monitor trustee for 10 years following the entry of judgment.⁶⁶ Apple objected, arguing first that no compliance monitor was necessary because the consent decrees it entered into made it impossible to repeat the conduct at issue.⁶⁷ Further, it contrasted the DOJ proposal for a 10-year compliance program with the outcome in *AU Optronics*, a criminal case in which the defendant was required to accept compliance monitoring for only three years.⁶⁸ Finally, Apple argued that the imposition of a monitor would undermine the free-market competition that DOJ sought to protect and hinted that such harm had been created by the Microsoft monitor: “Requiring Apple to employ an external compliance monitor . . . will place bureaucratic tentacles around Apple’s . . . business, stifling the company’s

THE FACT THAT BAZAARVOICE AGREED TO THE APPOINTMENT OF A MONITORING TRUSTEE FOR FOUR YEARS WILL BE USED AS A POINT OF REFERENCE IN FUTURE NEGOTIATIONS OR LITIGATION ON THIS ISSUE AND WILL LIKELY AID THE GOVERNMENT IN ANY EFFORTS TO OBTAIN A MONITOR

ability to innovate and compete Observers have pointed to such negative effects arising out of Microsoft’s consent decree, which lasted for nearly ten years.”⁶⁹ The DOJ amended its proposal to seek a five-year term⁷⁰ and the court eventually approved a two-year term.⁷¹

Because of the controversy surrounding the appointment of monitors and the fact-specific nature of the issue, any disputes between the government and respondents regarding the need for and duration of a monitor

arrangement rely heavily on precedent. The fact that Bazaarvoice agreed to the appointment of a monitoring trustee for four years will be used as a point of reference in future negotiations or litigation on this issue and will likely aid the government in any efforts to obtain a monitor.

VIII. CONCLUSION

The outcome of this case was about as favorable as possible for the government. While one might expect the DOJ to successfully challenge a merger to monopoly, this case posed some notable difficulties—in particular, the lack of demonstrable price effects and very few complaining customers. The government successfully utilized a strategy of relying on party documents to overcome these obstacles, effectively rebutted jurisprudential attacks regarding the enforcement of antitrust in a high-tech market, and obtained a robust remedy for a consummated transaction, including the appointment of a monitor to oversee the settlement. This case raised a number of important antitrust issues, and DOJ seems to have won them all. ▲

¹ Peter J. Levitas is a Partner in the Antitrust Practice Group at Arnold & Porter LLP, in Washington, D.C. He counsels clients on a range of antitrust issues, with a particular focus on resolving merger and conduct investigations by the U.S. Department of Justice Antitrust Division and the Federal Trade Commission (FTC). Mr. Levitas served for over four years in the role of Deputy Director in the Bureau of Competition at the Federal Trade Commission (2009-2013), where he was responsible for the Mergers 1, Health Care and Anticompetitive Practices divisions, as well as the FTC's Northeast Regional Office in New York.

Kelly Schoolmeester is an associate in the Antitrust Practice Group at Arnold & Porter. Mr. Schoolmeester is admitted only in Maryland, and is practicing law in the District of Columbia during the pendency of his application for admission to the D.C. Bar under the supervision of lawyers of the firm who are members in good standing of the D.C. Bar.

This article reflects solely the views of the authors, and does not reflect the views of Arnold & Porter, its partners, or its clients.

² U.S. v. Bazaarvoice, Case No. 13-cv-00133-WHO (N.D. Cal. Jan. 8, 2014).

³ Anthony Ha, *Bazaarvoice to Acquire PowerReviews for 151M*, TECHCRUNCH (Mar. 24, 2012), <http://techcrunch.com/2012/05/24/bazaarvoice-acquires-powerreviews/>.

⁴ 15 U.S.C. § 18a (a)(2)(B)(ii)(II) (2014) (Filing must be made if “any voting securities or assets of a person not engaged in manufacturing which has total assets of \$10,000,000 (as so adjusted and published) or more are being acquired by any person which has total assets or annual net sales of \$100,000,000 (as so adjusted and published) or more.”). Whether or not a company meets the relevant threshold is a function of the last full year of revenues or assets. In 2012 the \$10 million threshold had been adjusted for inflation to \$13.6 million.

⁵ *Bazaarvoice*, slip op. at 4.

⁶ *Id.*

⁷ Complaint, U.S. v. Bazaarvoice, Case No. 13-cv-00133-WHO (N.D. Cal. Jan. 10, 2013).

⁸ U.S. v. Bazaarvoice, Case No. 13-cv-00133-WHO (N.D. Cal. Jan. 8, 2014).

- ⁹ Stipulation and [Proposed] Order, U.S. v. Bazaarvoice, Case No. 13-cv-00133-WHO (N.D. Cal. Apr. 24, 2014).
- ¹⁰ FTC Premerger Notification Office, *What is the Premerger Notification Program?*, (March 2009), available at <http://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide1.pdf> (“The Program was established to avoid some of the difficulties and expense that the enforcement agencies encounter when they challenge anticompetitive acquisitions after they have occurred. In the past, the enforcement agencies found that it is often impossible to restore competition fully once a merger takes place. Furthermore, any attempt to reestablish competition after the fact is usually very costly for the parties and the public. Prior review under the Program enables the Federal Trade Commission . . . and the Department of Justice . . . to determine which acquisitions are likely to be anticompetitive and to challenge them at a time when remedial action is most effective.”).
- ¹¹ *Id.*; see also Richard Feinstein, Director, Bureau of Competition, FTC, Negotiating Merger Remedies: Statement of the Bureau of Competition of the Federal Trade Commission n.6 (January 2012) (noting one purpose of HSR Act was to avoid the problem of “unscrambling the eggs.”).
- ¹² J. Thomas Rosch, Comm’r, FTC, Consummated Merger Challenges - The Past is Never Dead 2 (Mar. 29, 2012).
- ¹³ *Id.*
- ¹⁴ Complaint, U.S. v. George’s Foods, LLC, Case No. 5:11-cv-00043 (W.D. Va. May 10, 2011).
- ¹⁵ Complaint, In the Matter of Graco, Inc., No. 101 0215, 2013 WL 1840931 (F.T.C. Apr. 17, 2013).
- ¹⁶ See, e.g., J. Thomas Rosch, Comm’r, FTC, Consummated Merger Challenges - The Past is Never Dead 2 (Mar. 29, 2012).
- ¹⁷ See, U.S. Department of Justice & Federal Trade Commission, Horizontal Merger Guidelines (2010) § 2.1.1 (“A consummated merger may be anticompetitive even if such effects have not yet been observed, perhaps because the merged firm may be aware of the possibility of post-merger antitrust review and moderating its conduct. Consequently, the Agencies also consider the same types of evidence they consider when evaluating unconsummated mergers.”); Renata Hesse, Deputy Assistant Attorney General for Criminal and Civil Operations, Antitrust Division, Department of Justice, At the Intersection of Antitrust & High-Tech: Opportunities for Constructive Engagement 8 (Jan. 22, 2014) (“There is no specific legal standard or alternative methodology for analyzing consummated mergers.”).
- ¹⁸ 903 F.2d 659 (9th Cir. 1990).
- ¹⁹ Defendant’s Pre-Trial Brief (Redacted), U.S. v. Bazaarvoice, Case No. 13-cv-00133-WHO, (N.D. Cal. Sep. 20, 2013).
- ²⁰ *Id.*
- ²¹ *Bazaarvoice*, slip op. at 108 (quoting *Chicago Bridge and Iron Co. v. FTC*, 534 F.3d 410, 435 (5th Cir. 2008)).
- ²² *Id.*
- ²³ DOJ introduced a document at trial, written by the Bazaarvoice Director of Communications in response to a news article speculating that post-merger prices would rise, indicating that “[w]hatever we come up with will need to be vetted by legal so we avoid any anti-trust gotchas.” *Id.*
- ²⁴ *Bazaarvoice*, slip op. at 140 (N.D. Cal. Jan. 8, 2014).
- ²⁵ U.S. v. Syufy Enterprises, 903 F.2d 659, 665-9 (9th Cir. 1990).

²⁶ *Bazaarvoice*, slip op. at 139.

²⁷ *Id.*

²⁸ *Id.* at 30.

²⁹ *Id.* at 34.

³⁰ *Id.* at 30.

³¹ *Id.* at 29.

³² See Horizontal Merger Investigation Data, Fiscal Years 1996-2011, at 19-20; 29-30. <http://www.ftc.gov/reports/horizontal-merger-investigation-data-fiscal-years-1996-2011>.

³³ U.S. Department of Justice, *Antitrust Enforcement and the Consumer 5* available at http://www.justice.gov/atr/public/div_stats/antitrust-enfor-consumer.pdf.

³⁴ U.S. Department of Justice & Federal Trade Commission, *Horizontal Merger Guidelines (2010)* §§ 2.2.2-2.2.3.

³⁵ Defendant's Pre-Trial Brief (Redacted), U.S. v. Bazaarvoice, Case No. 13-cv-00133-WHO, (N.D. Cal. Sep. 20, 2013).

³⁶ *Bazaarvoice*, slip op. at 138.

³⁷ U.S. v. Oracle Corp., 331 F.Supp.2d 1098, 1131 (N.D. Cal. 2004) ("If backed by credible and convincing testimony of this kind or testimony presented by economic experts, customer testimony of the kind plaintiffs offered can put a human perspective or face on the injury to competition that plaintiffs allege. But unsubstantiated customer apprehensions do not substitute for hard evidence.").

³⁸ See, e.g., Muris, Tim and Wilson, Christine, *Muris and Wilson on Bazaarvoice*, ANTITRUST & COMPETITION POLICY BLOG (Jan. 27, 2014) http://lawprofessors.typepad.com/antitrustprof_blog/2014/01/muris-and-wilson-on-bazaarvoice.html.

³⁹ *Bazaarvoice*, slip op. at 53-58; See, U.S. Department of Justice & Federal Trade Commission, *Horizontal Merger Guidelines (2010)* § 4 ("Market definition focuses solely on demand substitution factors, i.e., on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service.").

⁴⁰ Rebel Oil Co., Inc. v. Atlantic Richfield Co., 51 F.3d 1421, 1436 (9th Cir. 1995).

⁴¹ *Bazaarvoice*, slip op. at 126.

⁴² See, e.g., Virtual Maintenance, Inc. v. Prime Computer, Inc., 11 F.3d 660, 665 (6th Cir. 1993) ("The relevant product market cannot be determined without considering the cross-elasticity of supply.") and Twin City Sportservice, Inc. v. Charles O'Finley & Co., 512 F.2d 1264, 1274 (9th Cir. 1975) ("To determine the relevant market in which this buyer operates we must, as already indicated, examine the cross-elasticity of supply.").

⁴³ *Bazaarvoice*, slip op. at 126.

⁴⁴ See Geoffrey A. Manne & Joshua D. Wright, *Google and the Limits of Antitrust: The Case Against the Case Against Google*, 34 HARV. J.L. & PUB. POL'Y 171 (2011), David McGowan, *Between Logic and Experience: Error Costs and United States v. Microsoft Corp.*, 20 BERKELEY TECH. L.J. 1185 (2005).

⁴⁵ Manne, 34 HARV. J.L. & PUB. POL'Y at 187 ("The combination of (1) the antimarket bias in favor of monopoly explanations for innovative conduct that courts and economists do not understand, and (2) the increased stakes of antitrust intervention against innovative business practices is problematic from a consumer welfare perspective."); see also *id.* at 186 ("[A] significant portion of important antitrust cases can

be characterized as interventions undertaken under uncertainty, in the face of a novel business practice or product, relying on fundamentally flawed or misapplied economic analysis, later demonstrated to have been mistaken. In some cases the courts correct the error of the initial enforcement or litigation decision; in most cases they do not.”)

⁴⁶ Peter T. Barbur, Kyle W. Mach, Jonathan J. Clarke, *Market Definition in Complex Internet Markets*, 12 SEDONA CONF. J. 285, 292 (2011) (“Market shares in markets characterized by dynamic competition tend to be unstable, and new entrants to the market may rapidly capture large shares if they introduce a superior product.”).

⁴⁷ Renata Hesse, Deputy Assistant Attorney General for Criminal and Civil Operations, Antitrust Division, Department of Justice, *At the Intersection of Antitrust & High-Tech: Opportunities for Constructive Engagement* 7 (Jan. 22, 2014) (“High-tech mergers do not get a free pass”).

⁴⁸ *Bazaarvoice*, slip op. at 3 (citing Complaint, *Bazaarvoice*, at ¶54; Complaint, *U.S. v. H&R Block, Inc. et al.*, 833 F.Supp.2d 36 (D.D.C. 2011) (1:11-cv-00948) (filed May 23, 2011); Second Amended Complaint, *U.S. v. AT&T et al.*, ¶48 No. 11-01560 (D.D.C) (filed Sept. 30, 2011)). In *Bazaarvoice* specifically the DOJ raised concerns based in part on documents stating that Bazaarvoice and PowerReviews had “pushed each other to innovate in ways that helped consumers and retailers.” *Id.* at 4.

⁴⁹ *Bazaarvoice*, slip op. at 133.

⁵⁰ *Id.*

⁵¹ Renata Hesse, Deputy Assistant Attorney General for Criminal and Civil Operations, Antitrust Division, Department of Justice, *At the Intersection of Antitrust & High-Tech: Opportunities for Constructive Engagement* 5-8 (Jan. 22, 2014).

⁵² *Bazaarvoice*, slip op. at 10.

⁵³ *Compare, e.g., Polypore Int’l, Inc. v. FTC*, 686 F.3d 1208 (11th Cir. 2012) (upholding divestiture order requiring complete divestiture of Microporous, including an out-of-market manufacturing plant), *and Chicago Bridge & Iron Co. v. FTC*, 534 F.3d 410 (5th Cir. 2008) (upholding order requiring firm to split into two divisions and divest one), *with, e.g., FTC v. Phoebe Putney Health System, Inc.*, 133 S.Ct. 1003 (2013) (state action doctrine did not prevent antitrust enforcement, but subsequent consent order did not order separation of the entities, merged since 2010), *and FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028 (D.C. Cir. 2008) (merger violated Section 7 and subsequent consent order required Whole Foods to sell Wild Oats brand name and 32 stores, but buyers were only found for 3).

⁵⁴ Richard Feinstein, Director, Bureau of Competition, FTC, *Negotiating Merger Remedies: Statement of the Bureau of Competition of the Federal Trade Commission* 4 (January 2012). *See also*, Bill Baer, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, *Remedies Matter: The Importance of Achieving Effective Antitrust Outcomes* 4-5, Remarks as Prepared for the Georgetown Law 7th Annual Global Antitrust Enforcement Symposium (Sep. 25, 2013) (“Where parties have already begin the integration of assets it may be necessary for the merged firm to ‘unscramble the eggs’ to create an effective, stand-alone competitor. . . . We look to remedy an unlawful consummated deal in a fashion that restores a meaningful competitor and deprives the acquirer of unlawfully obtained market power.”); J. Thomas Rosch, Comm’r, FTC, *Consummated Merger Challenges - The Past is Never Dead* 15 (Mar. 29, 2012) (“A divestiture remedy is more likely to restore competition than a conduct remedy and does not entail long-term monitoring of the respondent.”).

⁵⁵ See, *supra*, n. 53

⁵⁶ Opinion of the Commission at 88-91, Evanston Northwestern Healthcare Corp., Docket No. 9315 (Aug. 6, 2007) (holding that post-merger development of a cardiac surgery program and a state-of-the-art electronic records program would not survive divestiture and relying instead on conduct remedies).

⁵⁷ *Id.* at 11.

⁵⁸ A similar dynamic plays out in the consent negotiation context as well, where the result of the negotiations is routinely driven by the strength of the evidence and the perceived ability of the relevant agency to obtain the desired relief. See, Deborah Feinstein, Director, Bureau of Competition, DOJ, The Significance of Consent Orders in the Federal Trade Commission's Competition Enforcement Efforts (September 17, 2013) ("The stronger the evidence of likely competitive harm or the more predictable the needed remedy, the more likely parties are willing to discuss options to resolve our concerns.").

⁵⁹ Stipulation and [Proposed] Order, *U.S. v. Bazaarvoice*, Case No. 13-cv-00133-WHO, (N.D. Cal. Jan. 8, 2014) (parties have stipulated to the proposed order pending a Tunney Act hearing).

⁶⁰ U.S. Department of Justice, Antitrust Division, *Antitrust Division Policy Guide to Merger Remedies* 26 (June 2011).

⁶¹ Richard Feinstein, Director, Bureau of Competition, FTC, Negotiating Merger Remedies: Statement of the Bureau of Competition of the Federal Trade Commission 16 (January 2012).

⁶² Final Judgment, *U.S. v. Anheuser-Busch InBEV SA/NV*, Case No. 13-cv-00127-RWR, (D.D.C. Oct. 24, 2013) (appointing a monitoring trustee for a three year period).

⁶³ In the Matter of Polypore International, Inc., Federal Trade Commission, Docket No. 9327 (appointing a compliance monitor for five years).

⁶⁴ Final Judgment, *U.S. v. Microsoft Corp.*, No. 1:98-cv-01232-CKK (Docket No. 746) (D.D.C. Nov. 12, 2002) (appointing a three-person technical committee to monitor compliance).

⁶⁵ Plaintiff United States' Final Judgment and Plaintiff States' Order Entering Permanent Injunction, *U.S. v. Apple, Inc.*, Case No. 12-cv-02826-DLC, (S.D.N.Y. Sep. 5, 2013).

⁶⁶ Memorandum in Support of Plaintiffs' Revised Proposed Injunction, *U.S. v. Apple, Inc.*, Case No. 12-cv-02826-DLC, (S.D.N.Y. Aug. 23, 2013) (revising term from 10 years to 5).

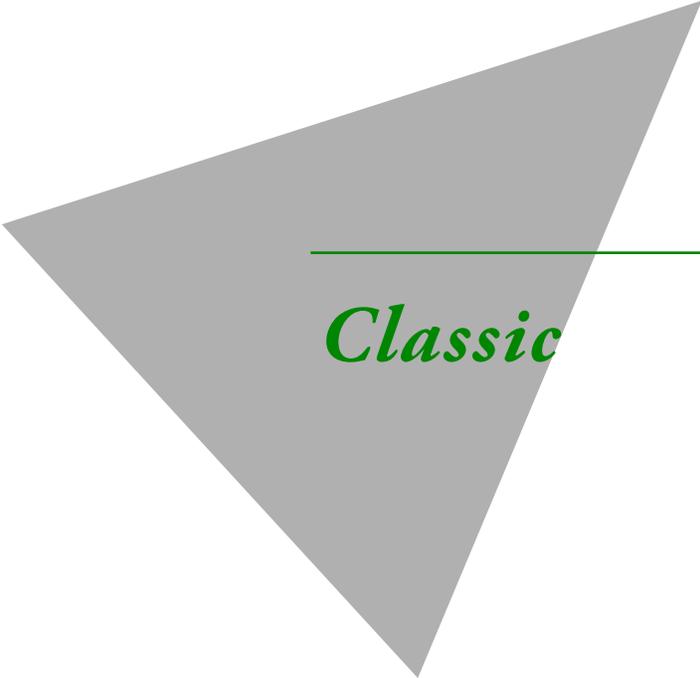
⁶⁷ Apple Inc.'s Memorandum of Law in Response to Plaintiff United States' Proposed Final Judgment and Plaintiff States' Proposed Order Entering Permanent Injunction, *U.S. v. Apple, Inc.*, Case No. 12-cv-02826-DLC, (S.D.N.Y. Aug. 2, 2013).

⁶⁸ *Id.* at 12 (citing *U.S. v. AU Optronics Corp.*, No. 3:09-00110, (N.D. Cal. Oct. 2, 2012)).

⁶⁹ *Id.*

⁷⁰ Memorandum in Support of Plaintiffs' Revised Proposed Injunction, *U.S. v. Apple, Inc.*, Case No. 12-cv-02826-DLC, (S.D.N.Y. Aug. 23, 2013) (revising term from 10 years to 5).

⁷¹ Plaintiff United States' Final Judgment and Plaintiff States' Order Entering Permanent Injunction, *U.S. v. Apple, Inc.*, Case No. 12-cv-02826-DLC, (S.D.N.Y. Sep. 5, 2013).



Introduction to *The Design of Competition Policy Institutions for the 21st Century—The Experience of the European Commission and DG Competition*

In 2008, when he wrote this article, Philip Lowe was the Director-General of the Directorate-General for Competition at the European Commission, a position he held from 2002 to 2010. Lowe had joined the European Commission in 1973 and, before heading DG Comp, had served in senior posts as Head of Cabinet and Director in numerous fields, including regional development, agriculture, transport, and administration. He is currently Director-General of the Energy DG as well as a Non-Executive Director of the Competition and the U.K. Markets Authority Board.

The timing of this article—it was published in DG Comp’s *Competition Policy Newsletter* March 2008—makes it a particularly interesting historical document. It predates the acceleration of the global economic crisis that occurred later that year. The Treaty of Rome had not yet been supplanted by the Treaty of Lisbon. But most importantly, global competition policy had grown explosively in the previous years, with the number of global competition authorities passing the 100 mark by 2004, and countries representing more than 85 percent of the world’s population implementing some form of competition rules.

The primary driver for this growth occurred as country after country started relying more on markets, rather than central planning and government enterprise, to spur economic growth. In addition, for some countries looking for economic support, the IMF and World Bank required those countries to adopt competition laws and establish competition authorities. As a result of this growth—whatever its source—international expertise in competition law and principles became almost mandatory for both private and public players. With cross-border economic interests and investments becoming more prevalent, corporate attorneys struggled to learn the new rules, while members of competition authorities needed to learn how to work with their counterparts.

To help manage the sheer number of new competition regimes, a strong drive developed to establish best practices and ways to encourage common global approaches. This movement was evidenced by work done (and continuing to be done) at such organizations as the International Competition Network and the Organization for Economic Cooperation and Development, as well as at numerous conferences and in commonly read publications.

Philip Lowe’s 2008 article represents part of that trend towards achieving commonality. Speaking as the head of one of the most respected authorities in the world, Lowe takes an instructor’s role and asks a vital question: “What should a modern competition authority try to achieve?” And despite the upheaval caused by subsequent events, including the anti-market furor raised by the 2008 global economic collapse, his answers to that question remain strongly applicable to the competition world of today.

Indeed, presenting strong evidence for the paper’s continuing relevance is this final principle for designing a well-functioning authority that Lowe restates in his conclusion:

In order to fulfil their role effectively these institutions must constantly assess and re-assess their mission, objectives, structures, processes and performance. It is only through realising and adapting to changes in their environment and through carrying out the corresponding improvements that their competences, powers, budget and ultimately existence can be justified before a wider public.

Lindsay McSweeney, Senior Editor, Competition Policy International

The Design of Competition Policy Institutions for the 21st Century—The Experience of the European Commission and DG Competitionⁱ

BY PHILIP LOWEⁱⁱ

I. INTRODUCTION

All competition policy and enforcement systems consist of essentially two components: the legal instruments ('rules') governing both substance, competences and procedure, and the administrative structures and processes through which the legal instruments are implemented. Each of these is necessary for the success of the system as a whole. Good rules remain a dead letter if there is no efficiently run organisation with the processes to implement them. Conversely an efficiently managed authority cannot compensate for fundamental flaws in the rules which it is to implement.

The analysis and design of these components are also interdependent. The management of the processes within the organisation has to be adapted to the rules which it has to apply. And the rules must be shaped in a way that they can be implemented within the real world constraints to which the organisation is subject—such as limited resources.

Academic attention focuses mainly on the legal instruments and not so much on the organisational side. One reason for this is probably that competition policy and enforcement is still mainly a subject for lawyers. Another reason could be that it is not easy for outsiders to obtain detailed and comprehensive information about the interior workings of a competition authority. Finally, it is perhaps assumed that the management of a competition authority does not pose any different challenge than the management of other public or private institutions with a comparable mission and size.

Before starting I need to make a preliminary point that will be obvious to many, but which is none the less important. The competition authority in the European Union is not DG Competition, but the European Commission. The European Commission is a collegiate institution composed of 27 Commissioners from the 27 Member States of the European Union. It is this College of Commissioners that, on a proposal of the Commissioner for Competition, adopts final decisions in individual competition cases as well as on policy documents such as guidelines and notices, and legislative proposals to the Council. On the basis of a delegation of powers from the College (so-called empowerment), the Commissioner for Competition can herself directly adopt certain preparatory or intermediary acts such as a Statement of Objections, as well as final decisions in less important cases, such as a merger dealt with under 'simplified' procedure. The decisions taken by the College and the Commissioner are prepared and implemented by one of the departments of the Commission, in the case of competition, the Directorate General for Competition, which currently has around 800 staff.

I do not intend in the remaining sections of this article to give further attention to the classical institutional issue of the degree of independence of a competition authority, and in particular of the

Commission as a competition authority. However some remarks on our general approach to this question may be useful.

The European Commission finds itself in a substantially different position to a national authority. In the first place, its institutional independence should not be in question. As reflected in the EU treaties, its independence from national and political interests is fundamental to its mission of promoting the ‘common interest’ of the European Union as a whole.

Secondly, the Commission has delegated fully its powers to investigate a case, and manage the due process, to DG Competition. The Commissioner for Competition is in addition empowered to take decisions on cases and problems which raise no significant policy issue. These arrangements offer a solid guarantee of the integrity and impartiality of investigations and their conclusions, while reserving all key decisions on cases and policy for the college of Commissioners as a whole.

Thirdly, a competition authority certainly needs to be independent and impartial. But it should not be isolated or uninformed. It needs to be fully aware of the market and regulatory environment around competition law enforcement. And it needs to be in a position to influence legislators and regulators, particularly when competition problems can be better addressed by new or amended regulation. This only underlines the advantage for EU competition policy of having the work of the Competition Commissioner and DG Competition fully embedded within the Commission. Finally it is worth underlining again that the Commission as an institution, and not just DG Competition, retains the role of Europe’s competition authority.

II. HOW TO DESIGN A MODERN COMPETITION POLICY AND ENFORCEMENT SYSTEM

Independently of whether we speak about merger control, antitrust or State aid control, a competition authority should ideally intervene at the right time, on the right markets, in relation to the right problems and with the correct remedies. At the same time, its intervention should be predictable, correct, and have a measurable positive impact.

In the real world, however, external constraints—resulting from limited resources and the institutional context—often disrupt this ideal. No competition authority has the resources to do all possible cases. Some form of prioritisation is necessary.

Moreover, there are inevitable trade-offs, for example, there may be a need to resolve a competition problem in a given market quickly to bring some form of anti-competitive conduct to an end. But there is obviously a parallel pressure to achieve correct (no error) outcomes in each and every case. Similarly, hard and fast per se rules provide a higher degree of predictability of outcomes, but can lead to more type 1 or type 2 errors when compared to effects-based rules.

Against this background what should a modern competition authority try to achieve? I see several basic requirements:

(1) Policy, rules and individual enforcement actions must be based on sound law, economics and market knowledge. Legally, enforcement must be—and be seen to be—subject to the rule of law, due process requirements, and effective judicial control. As to economics, the long-term legitimacy of any competition enforcement system rests on the economic story which it tells in each case. Any competition enforcer should be able to explain why and how its enforcement actions contribute to the wider public interest, and in particular to consumer welfare, whether in the short or longer term. As regards market knowledge, the authority must have effective investigative powers to gather relevant data and to set priorities and focus its use of its legal instruments accordingly.

(2) The enforcement system must be designed in a way that guarantees coherence and predictability for business: coherence ensures equal treatment. Predictability allows firms to plan for compliance. To achieve this, ex-ante rules and individual enforcement decisions should be based on a common methodology, clear and publicised enforcement objectives and an in-depth knowledge of how markets function. Again, there is a certain trade-off between predictability and the need to deal with each case on its merits. Based on empirical evidence, some structures or conducts have almost always produced outcomes which are harmful to competition and to consumers. As a result it may be possible to establish some clear ex-ante rules which offer a high level of predictability. However, where past evidence is mixed, the most that can be done to provide a degree of predictability is to indicate what assessment methodology will be used. Usually, an effective enforcement system will be based on a mix of ex-ante (per se) rules and an analytical framework for a case-by-case effects-based analysis.

(3) The system should allow the competition authority to concentrate its limited resources on specific priorities. The authority must be able to determine those priorities on the basis of the expected direct and indirect effects of its action. The system should make it possible to concentrate resources on the potentially most harmful conducts and on precedent-setting cases. This depends crucially on knowledge of markets and the capacity to focus on key issues without the need for repetitive indepth investigations on individual cases.

Notification thresholds, block exemptions, de minimis rules and graduated decision-making procedures must allow the authority to deal quickly, and with limited resources, with unimportant and simple cases.

(4) As to the length of investigation procedures, any effective competition system must enable a public agency to take decisions in a time-frame which is relevant to the problem it is supposed to remedy. Being well-informed on market developments before cases arise is again important here. Precedents must also be set at a moment when they still have the intended wider policy impact. This means that procedural rules and internal best practices should ensure timely investigation and rapid internal decision making.

(5) Last but certainly not least, enforcement must always go hand-in-hand with an effective communication of its benefits, for consumers and for business. Public intervention cannot depend on some abstract rule or unsubstantiated theory of problems, but must explain why and how it contributes to the wider public interest.

III. MODERNISATION OF THE LEGAL INSTRUMENTS

Although the fundamentals of competition law set out in the Treaty of Rome have essentially remained the same for the past fifty years, the legal instruments implementing them have been continually reassessed and amended.

A. *Antitrust*

The substantive antitrust rules have been progressively reviewed in order to reflect developments in economic thinking, reduce the regulatory burden on companies and improve the speed and efficiency of enforcement. In addition to legislative rules, the Commission has adopted various non-regulatory documents such as notices and guidelines, explaining in more detail the policy of the Commission on a number of issues and interpreting legislative antitrust rules.

On 1 May 2004, a new enforcement system for Articles 81 and 82 EC of the Treaty entered into force, abolishing the notification system and empowering national competition authorities and courts to participate fully in the application of Articles 81 and 82 EC. It also introduced new and more effective ways of addressing competition problems, such as the possibility for the Commission to make commitments binding on undertakings, when such commitments meet the concerns expressed by the Commission in antitrust proceedings. Regulation 1/2003 also gave the Commission wider investigative powers by expanding its inspection rights.

As a complement to Regulation 1/2003, the Commission adopted the ‘modernisation package’ consisting of a new Regulation on details of its antitrust procedures and six Notices aimed at providing guidance on a range of issues. In parallel, the Commission increased the transparency of competition procedures and expressed its commitment to due process and the parties’ rights of defence. In 2001 it strengthened the role of the Hearing Officer by attaching it directly to the Competition Commissioner and by making its report available to the parties and publishing it in the Official Journal of the EU. In 2005, it revised its rules for access to the Commission’s files by parties involved in its merger and antitrust cases by updating its previous notice from 1997. The revised Notice also increased procedural efficiency by confirming that access to the file can be granted either electronically or on paper.

Evaluating procedural and substantive rules is, and should be, a permanent task.

For example, the Commission has earlier this year introduced a form of direct settlements for cartels through which companies that acknowledge their responsibility in a cartel infringement can benefit from a

shorter administrative procedure and receive a reduction in the amount of fines. This settlement procedure opens up the prospect of more rapid prosecution of cartels and a more effective use of scarce enforcement resources.

Similarly, facilitating private enforcement would help ensure that those damaged by infringements of EC competition law can exercise their right to compensation, as well as adding to overall sanctions and deterrence, as a complement to public enforcement. As a follow-up to its Green Paper of 2005, the Commission published a White Paper on antitrust damages actions.

Finally, work is ongoing on the review of Article 82 EC with the dual aim of strengthening the legal and economic underpinning of unilateral conduct cases as well as providing greater policy coherence and predictability.

B. Merger control

The Merger Regulation, first adopted in 1989, created a one-stop shop where companies apply for regulatory clearance for mergers and acquisitions above certain worldwide and European turnover thresholds. The recast Merger Regulation, adopted in 2004, introduced some flexibility into the investigation timeframes, while retaining a much praised degree of predictability. It reinforced the ‘one-stop shop’ concept, and clarified the substantive test so that the Commission now has the power to investigate all types of harmful scenarios in a merger, from dominance by a single firm to coordinated and non-coordinated effects in oligopolistic markets.

The 2004 Regulation also introduced a new streamlined referral system in order to put in place a more rational corrective mechanism of case allocation between the Commission and Member States. It ensured that the authority or authorities best placed to carry out a particular merger investigation should deal with the case. Amendments to the referral system have been complemented by a new Notice on the principles, criteria and methodology upon which referral decisions should be based.

Furthermore, a set of best practices were adopted on the conduct of merger investigations to provide guidance for interested parties on the day-to-day conduct of EC merger control proceedings. These best practices were designed to streamline and make more transparent the investigation and decision-making process, ranging from issues of economic indicators to rights of the defence.

The 2004 Merger Regulation was complemented by Guidelines on the assessment of horizontal mergers. These Guidelines set out the analytical approach the Commission takes in assessing the likely competitive impact of mergers and reflect the re-wording of the substantive test for the competitive assessment of mergers in the 2004 Merger Regulation. The objective was to provide guidance to companies and the legal community alike as to which mergers may be challenged.

In addition, with the aim of providing guidance to undertakings, a 2001 Notice on remedies describes

the main types of commitments that have been accepted by the Commission, the specific requirements which proposals of commitments need to fulfil in both phases of the procedure, and the main requirements for the implementation of commitments. A revised Remedies Notice has been adopted recently that adapts the 2001 Notice in the light of an extensive study undertaken by the Commission into the implementation and effectiveness of remedies, recent judgments of the European Courts and the 2004 Merger Regulation.

In 2007 the Commission also approved Guidelines for the assessment of mergers between companies that are in a so-called vertical or conglomerate relationship. The Guidelines provide examples, based on established economic principles, of where vertical and conglomerate mergers may significantly impede effective competition in the markets concerned, but also provide 'safe harbours', in terms of market share and concentration levels below which competition concerns are unlikely to be identified.

C. State aid control

Following reforms of legal and interpretative instruments in the field of antitrust and mergers, the Commission engaged in the first comprehensive modernisation of both substantive and procedural rules in the area of State aid control. The State Aid Action Plan (SAAP), launched in 2005, aims at an increased efficiency of State aid control. It is based on four guiding principles: i) less and better targeted State aid, ii) a refined economic approach, iii) more effective procedures, better enforcement, higher predictability and enhanced transparency and iv) shared responsibility between the Commission and Member States.

Since 2005 a number of legislative and interpretative instruments have been adopted that reflect the new approach to State aid policy, including a package on Services of General Economic Interest, guidelines for Regional aid, Risk Capital, R&D, Innovation aid short-term export-credit insurance.

A General Block Exemption Regulation has been adopted with the aim to simplify and consolidate into one text five existing block exemptions for aid to SMEs, research and development aid in favour of SMEs, aid for employment, training aid and regional aid. The new Regulation also allows the block exemption of three new types of aid: environmental aid, aid in the form of risk capital and R&D aid also in favour of large enterprises. This comprehensive review of the substantive rules will be accompanied by improvements in the way the Commission deals with the State aid notification procedures. Procedural reforms should aim at shortening procedures, improving transparency, ensuring that State aid is duly notified or recovered if implemented illegally and improving administrative efficiency, among others, by allowing an easier collection of relevant sectoral information.

IV. RESOURCE AND CHANGE MANAGEMENT INSIDE DG COMPETITION

In parallel to the reforms of the legal instruments, over the last years DG Competition has changed its mission, internal structures and processes to align it more closely with the requirements of a modern framework for competition policy.

A. *Past culture and traditions*

For the years up to around 2000, the mission of DG Competition was essentially defined as ‘promoting competition, thereby promoting an efficient allocation of resources’. Enforcement was necessarily reactive, as it was driven largely by notifications and complaints. This was also reflected in the internal structures and processes of the DG.

Work was focused on the development of the various legal instruments, with lower priority given to economic analysis and market knowledge. With the exception of the Merger Task Force, resources were mostly allocated on a unit by unit basis within each directorate, often resulting in ring-fencing of staff within the boundaries of both the legal instrument and the market sector concerned. There were very few examples of a case-handler in the telecoms antitrust unit working on either a telecoms merger case, or a media antitrust case.

In addition, there was limited priority-setting or planning of cases and other initiatives. Negative priorities—Drucker’s ‘posteriorities’—were almost non-existent. Without positive and negative priorities, it was difficult to deploy resources effectively. This led to some very lengthy antitrust and State aid investigations which stretched out well after the moment at which the final decision on the case would have had most impact.

DG Competition also had a reputation for a rather inward-looking culture vis-à-vis the rest of the Commission and national competition authorities. Although a high value was placed on professionalism, intellectual rigour and integrity, there was at least a perceived tendency towards a monopoly of the truth in external relationships. The DG rarely involved itself in an analysis of competition issues in the work of other Commission departments.

Around 2002 there were signs that the platform on which DG Competition was operating needed to be stabilised. A series of merger prohibitions were reversed by the Court of First Instance for inadequate legal reasoning and economic analysis by the Commission and procedural errors. Outside criticism targeted the DG’s formalistic approach, as well as the lack of transparency and long delays in State aid control.

B. *Change management*

There are a number of general success parameters that are key to managing change effectively in any organization such as DG Competition (be it a public body or a private undertaking).

Most importantly, there is the need to establish objectives. The role, mission and core values of the organization need to be clearly defined. Competition authorities should not shy away from regularly reassessing their role as a public institution and from redefining their mission in light of changes to the environment. Debate about the mission also helps to devise a clear strategy. Multi-annual forward looking strategic planning is essential to the success of the organization and the system as a whole. The strategy, in

turn, should translate into operational objectives together with planning and monitoring of results to be achieved. Strategic goals have to be broken down into operational objectives that can be planned in advance, monitored during their execution, and evaluated afterwards.

Secondly the organizational structure should target resources towards these objectives. Such structure should reflect the core values of the organization and help mobilize resources to achieve the objectives.

Thirdly the organization needs people with the right skills and experience. The biggest asset of a competition policy institution is its staff. An efficient management and development of people is fundamental.

Fourthly, an organizational culture must be created which promotes values crucial to the success of the organization such as ethical standards, integrity, intellectual rigour, objectivity, public- and client-service culture, and results-orientation.

Finally, within every organizational structure there is a need to establish the right processes which help make things happen. These can include, for example, decision-making procedures, 'liturgies' of meetings or IT systems.

C. *Defining objectives*

1. A new mission: making markets work better

If competition policy is to make a significant contribution to a policy of sustainable economic growth, a narrow law enforcement and instrument-based approach which focuses only on the preservation of existing competition is not sufficient.

Competition policy must therefore act on a number of fronts at the same time. First, it must enforce competition law whenever there are harmful effects on Europe's citizens or businesses. But second, it must also ensure that the regulatory environment fosters competitive markets. It needs to screen proposed and existing legislation. Thirdly, it must help shape global economic governance through promoting the convergence of substantive competition rules, strengthening cooperation with other jurisdictions and promoting a shift of emphasis from trade regulation to competition regulation in the WTO. Finally, it must develop a competition culture in the society in which it operates. This is in itself one of the principal elements which can guarantee the competitiveness of an economy in the longer term.

Ultimately competition policy must make markets work better for consumer and businesses in Europe.

2. Consumer and social welfare objectives

Competition policy institutions must also make clear, in economic terms, whose interest they are there to

protect.

In the Commission's view, the ultimate objective of its intervention in the area of antitrust and merger control should be the promotion of consumer welfare. Under EU antitrust and merger control the aim is to ensure that consumers are not harmed by anti-competitive agreements, exclusionary and exploitative conduct by one or more dominant undertakings, or by mergers that significantly impede effective competition. A good example is the Commission's prohibition decision in the Ryanair/Aer Lingus merger case, which prevented a reduction in choice and, most likely, higher prices for more than 14 million EU passengers using one of the 35 routes operated by both parties.

However, a consumer welfare standard cannot be transposed directly to the world of State aid. In fact, beyond any justification it may have in terms of allocative efficiency, State aid can be justified on the basis of non-economic grounds such as reducing social disparities which consumer welfare does not measure. Whether the rationale for State aid is efficiency or equity, the correct welfare standard for State aid policy—expressed in economic terms—would seem to be the social welfare of the European Union, which is equivalent to the notion of common interest found in Article 87(3) of the Treaty.

The concept of consumer welfare should also be interpreted dynamically in the sense of the effects of any structure or conduct on price, choice, quality and innovation in the short and long term. Sometimes these effects are immediate and measurable. However, often the effects are difficult to quantify and the only way to protect consumer welfare in the longer term is by safeguarding the process or dynamic of competition on the markets. In this sense, there is convergence between the German and Anglo-Saxon antitrust traditions.

Most theories of harm do not require sophisticated econometric or simulation modelling. Usually the economic 'story' behind a case is simple to explain and simple to test against the evidence drawn from a market investigation. It is also sometimes impossible to carry out indepth analysis within the confines of the legal deadlines of a merger investigation. However, in some cases, detailed econometric tests have been applied with success.

3. A more economic and effects-based approach

Following the legislative and policy changes described in more detail above, the Commission now uses an 'effects-based approach' both in merger control and in antitrust, which focuses on the actual and likely effects on consumer welfare. This means that a framework is needed to establish a theory of consumer harm, and this framework should also come up with hypotheses which can be tested. For example in the Oracle/ PeopleSoft merger case in 2004, we examined with econometrics the extent to which Oracle's bidding behaviour was affected by the specific identity of the rival bidders in the final rounds of a given bidding contest.

In line with the State aid Action Plan, the Commission is also moving towards a more economic approach in State aid policy. Assessing the compatibility of State aid is fundamentally about balancing the

negative effects of aid on competition and trade with its positive effects in terms of the ‘common interest’. However, economic analysis in State aid cases is more challenging than in antitrust and mergers: first it is not just concerned with competition between firms, but also with negative effects of an aid on trade within the EU Single Market, or location decisions and secondly equity considerations (jobs, benefits for the environment) need to be balanced against efficiency considerations.

4. Focusing limited resources on the most harmful practices in key sectors

The objective of making markets work better requires, in the first place, carefully selected priority sectors. DG Competition’s action therefore focuses on sectors that are key for the functioning of the internal market and for the Lisbon agenda for growth and jobs. For example, public monopolies established to provide telecommunications, post, energy and transport services have not always proved efficient and able to satisfy consumers’ needs in the best possible way. Gradually opening up these markets to competition and making sure that they remain open not only allows consumers to benefit from new, cheaper and more efficient services but also reduces significant input costs for companies. The Commission’s antitrust decisions against Deutsche Telecom and Wanadoo in 2003, against Telefónica in 2007 and its ongoing investigations following the sector inquiry into the gas and electricity sector are but a few examples of this focus.

The more harmful anti-competitive practices for the European economy and consumers are, the greater the need there is for competition policy to intervene. As cartels are clearly the most harmful restrictions of competition, high priority is given to the prevention and deterrence of cartels, as evidenced by the imposition of fines in excess of €3.3 billion in 2007. Similarly, abuses of dominant position with a clear negative effect on consumer welfare must remain in the spotlight of enforcement. Finally, erecting barriers to market entry through special or exclusive rights, granting distortive State aid or restricting take-overs of national companies often result in serious restrictions of the competitive process and therefore also warrant priority.

There may also be alternative ways or remedying a market failure. Proper priority setting should be based on a ‘competition obstacle’ approach. This approach is based on identifying the main competition problems in a sector and subsequently selecting the most effective instrument(s) to tackle those problems. These instruments may be i) competition enforcement by the Commission, by national competition authorities or by both, ii) the adoption, modification or abolition of legislation at the Community level, at the national level or at both levels, iii) action by a sectoral regulator, iv) self-regulation by the industry or v) a combination of these. The way the Commission has been challenging unjustified public obstacles to takeovers, for example in the E.On/Endesa case, jointly through its competition and internal market rules is a good example of this ‘competition obstacle’ approach.

D. Reforming the structures

1. Two major reorganizations of DG Competition in 2003 and 2007

Against this background of the progressive reorientation of EU competition policy, there have been two major reorganizations of the structure of DG Competition, complemented by a number of other incremental changes in between.

In 2003/2004 we created for the first time a matrix structure by integrating Merger Units with antitrust units in directorates dedicated to enforcement action in key sectors of the EU economy such as energy, telecoms, transport, financial services and information technology. The 2007 reorganisation goes one step further and integrates State aid units with antitrust and merger teams in five 'market and cases' directorates.

The advantages of this more sectoral organization are evident. It pools and increases market knowledge so that investigations are more informed and effective. It allows for more flexible use of staff across the policy instruments (antitrust, mergers, State aids) and helps spread best practices. It establishes closer links between competition policy and other EU sectoral policies and allows for more effective competition advocacy. It also makes sector enquiries easier to organise and run. Finally it helps the dialogue with other DGs within the Commission and with national competition authorities and national regulators both within and outside the EU.

On the other hand, there are areas where market knowledge is not as important as instrument knowledge and where therefore an instrument based organization is more effective. The Cartel Directorate, created in 2005 and specifically dedicated to the enforcement and development of competition policy in relation to cartels, remains instrument based. This structure brings economies of scale and consolidates the Commission's cartel expertise in one directorate. Similarly, the content and procedures of horizontal state aid work, such as regional aid or aid for R&D&I, are more difficult to integrate into sectoral directorates and warrant an instrument-based directorate.

2. Creation of a Chief Competition Economist function

In line with the objective of strengthening the economic assessment of cases and new policy initiatives, a Chief Competition Economist function was created in 2003. The Chief Competition Economist reports directly to the Director General and is assisted by a team of 20 PhD economists. First of all he provides guidance on the economic methodology in competition investigations. Secondly, he also gives guidance in individual competition cases from their early stages. Thirdly, he provides detailed guidance in key competition cases involving complex economic issues, in particular those requiring sophisticated quantitative analysis. Fourthly, he contributes to the development of general policy instruments.

In addition, the creation of the Chief Competition Economist function has contributed to the wider dissemination of economic expertise in DG Competition. He acts as a focus for economic debate within DG Competition, in liaison with other Commission services and in association with the academic world. Members of his team organise training sessions on economic issues and give advice on studies of a general economic

nature, as well as on market monitoring.

3. Project-based allocation of resources

Setting priorities has no meaning unless priorities determine the use of scarce staff resources. Resources need to be flexibly allocated to cases or other projects. But the Commission's administrative structure (Directorate General composed of directorates which are themselves composed of units) can create rigidities. So it has become standard practice in DG Competition to allow for 'décloisonnement' of staff to be assigned to any priority project with a 'case manager', reporting directly to a Director, who may come from any unit within a directorate. In addition, case teams can be created by bringing together staff from different directorates but who are skilled in antitrust merger or state aid investigations. It is also becoming general practice to assign to a case team a secretary who is specialized in the type of investigation concerned (mergers, antitrust or State aids), who is given overall responsibility for the case's administrative aspects of the case.

So project-based resource allocation is used both within a Directorate (each member of the Cartel Directorate can work for different case-managers under the single authority of a Director) and across Directorates (a member of a merger unit can work with colleagues from a merger unit from another Directorate within the 'Merger Network'). This project-based approach is applied not only for case work, but also for policy projects requiring the participation of staff having different sector- or instrument-specific expertise.

E. Reforming the processes

1. Introducing a two-stage procedure in antitrust

Following the entry into force of Regulation 1/2003 and as a part of the efforts to streamline and increase the efficiency of the working methods in the field of antitrust, in 2005 we introduced a two-stage procedure. The goal of this procedure is to allow the Commission to discriminate quickly and effectively between those few cases that deserve an in-depth investigation and to which resources should be allocated and the other cases that are not a priority and that should be closed as soon as possible and with the least use of resources. The procedure is also designed to properly plan investigations in order to achieve results within specific target deadlines.

As a result, all antitrust cases now start with a first-phase investigation of usually no more than 4 months, after which a decision is taken as to the theory of harm identified and whether there are reasons to regard the case as a priority for the Commission. If the case is considered a priority, in principle a Commission decision to initiate proceedings is adopted and an in-depth investigation is carried out.

The theory of harm on which an eventual investigation is based must be robust and there must be prima facie, facts-based indications of the alleged infringement. This solid foundation reduces the risk of

subsequent delays in the procedure.

The criteria on the basis of which it is decided whether there are sufficient grounds to carry out an in-depth investigation include, among others, the extent and likelihood of consumer harm, the strategic nature of the policy area or the sector concerned, the significance of the impact on the functioning of competition in the internal market, the extent or complexity of the investigation required, the possibility for bringing the case before a national court in a Member State and whether the potential infringement investigated has terminated or is still ongoing.

2. Focus on investigative techniques

Given the increased focus on effects, investigations are becoming more fact-intensive and case files are growing bigger. This requires new approaches and skills in the handling of antitrust, merger and **State** aid cases. DG Competition is constantly trying to improve its practices in collecting evidence and presenting facts in decisions.

Efficient investigative techniques (i.e. how to best gather reliable evidence) are essential for the success of any antitrust procedures. In order to focus investigations and reduce case handling time, we try to plan the details of the investigation at an early stage of the proceedings, i.e. i) the quality and quantity of evidence needed to prove the case, ii) the identification of possible sources where the evidence is located, and iii) the resources to be assigned to this task.

Best practices in drafting (i.e. how to best present evidence to construct a sound decision) are another important tool. In order to discharge the burden of proof imposed on the Commission, case teams must thoroughly and accurately incorporate the results of the investigation into the final decision, demonstrating that the standards of proof are met. The final decision must address all the relevant issues the Commission investigated during the proceedings, incorporate all the relevant evidence gathered during the investigation, and lay down the reasoning of the Commission in a clear and consistent fashion.

3. Organising Peer Review Panels

In order to ensure the quality of its interventions, DG Competition applies a particular form of scrutiny for major antitrust, merger or State aid cases, from their factual basis through the legal reasoning to economic analysis. It consists of organizing a Peer Review Panel at key points during the investigation, e.g. after the sending of the Statement of Objections and the hearing, where a peer review team looks at all aspects of a case with a ‘fresh pair of eyes’.

The primary objective of this exercise is to provide assistance to the case team in particularly complex cases with a view to ensuring that the foundations of the case are robust. The Peer Review Panel may identify areas where further work is necessary to sustain an objection and how this might be carried out.

4. **Advocacy and competition screening of legislative proposals by other Commission departments**

As a result of internal advocacy and communication efforts competition policy and our objective of making markets work better for the benefits of consumers and businesses play an increasing role in Commission overall economic policy.

A competition test was included in the Commission's revised Impact Assessment Guidelines of 2005. All legislative and policy initiatives included in the Commission's annual work program must pass this test.

The basic 'competition test' applied in the context of competition policy screening involves asking two fundamental questions at the outset. First: what restrictions of competition may directly or indirectly result from the proposal (does it place restrictions on market entry, does it affect business conduct, etc.)? Second: are less restrictive means available to achieve the policy objective in question? This screening exercise may result in the choice of less restrictive regulatory or market-based methods to achieve certain policy objectives, thereby helps avoid unnecessary or disproportionate restrictions of competition.

V. **CURRENT MANAGEMENT CHALLENGES**

A. *Measuring performance and impact*

It is impossible to know whether objectives are correctly set, whether the institutional structures and processes are well defined and ultimately whether the actions of a competition authority produce the desired outcome if the performance of the institution is not measured in one way or another.

Working back from the overall objective of making markets work better for the benefit of consumers and business, we intend to use for the measurement of our performance the following three performance dimensions:

Productivity: this dimension tries to measure the efficiency of the organisation; it indicates whether we are successful in coping with the incoming workload, in minimising inputs and in maximising output. For that purpose we compare on a regular basis on the one hand workload (incoming cases) and inputs (resources,...) with, on the other hand, outputs (decisions, texts adopted,...)

Quality: for a competition enforcer such as DG COMP to achieve its public interest objectives, the quality of its output is arguably at least as important as productivity. There are different sub-dimensions to that. We look at (a) the legal and economic soundness of our enforcement, (b) the timeliness of our procedures, (c) compliance with due process, and (d) how well we communicate on our enforcement.

Impact: in order to really know whether we achieve our ultimate objective of making markets work better, we need to measure the impact of our decisions on those markets. For that purpose we intend to

distinguish between the measurement of the direct impact of our action on markets and on the different stakeholders (consumers, competitors...) and of the indirect effects (precedent effect, deterrence ...).

As a first step, a Unit dedicated to the ex post evaluation of DG Competition's enforcement activity was set up in 2007 as a part of the Policy and Strategy Directorate of DG Competition.

B. Demonstrating the added value to citizens

Closely linked with measuring performance is the challenge of demonstrating the added value of competition policy to ordinary people. It is not sufficient to know what the impact of competition policy action is: the benefits need to be communicated effectively.

We have recognized that communication is core business. Communicating effectively about our work has a preventive effect. We can explain the law and highlight the penalties for not respecting the law. In addition, explaining what DG Competition, entrusted with public resources and powers, does, ensures its accountability. Communication is also about good policy making. Through dialogue, DG Competition can learn to re-evaluate the things it is communicating about. Finally, external communication on concrete actions of competition policy can demonstrate a Europe of results.

These simple principles are the core of our proactive communication strategy for which we have also recently created a dedicated Communications Policy unit.

C. Resources

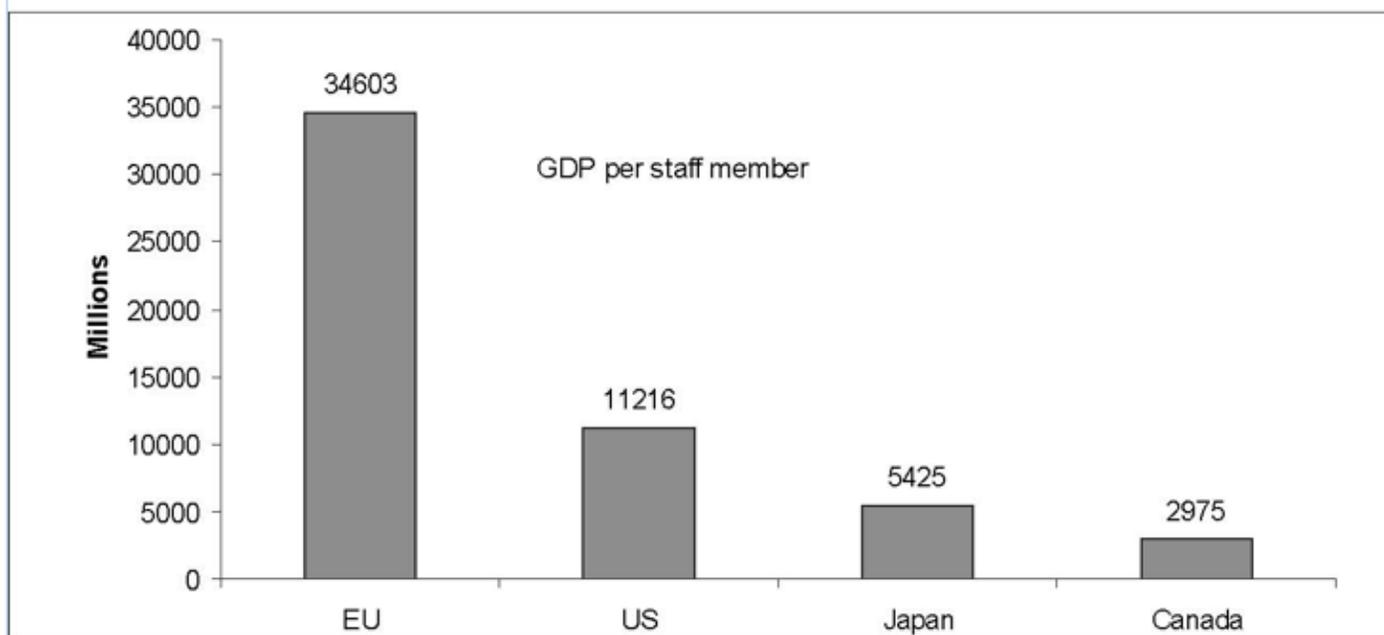
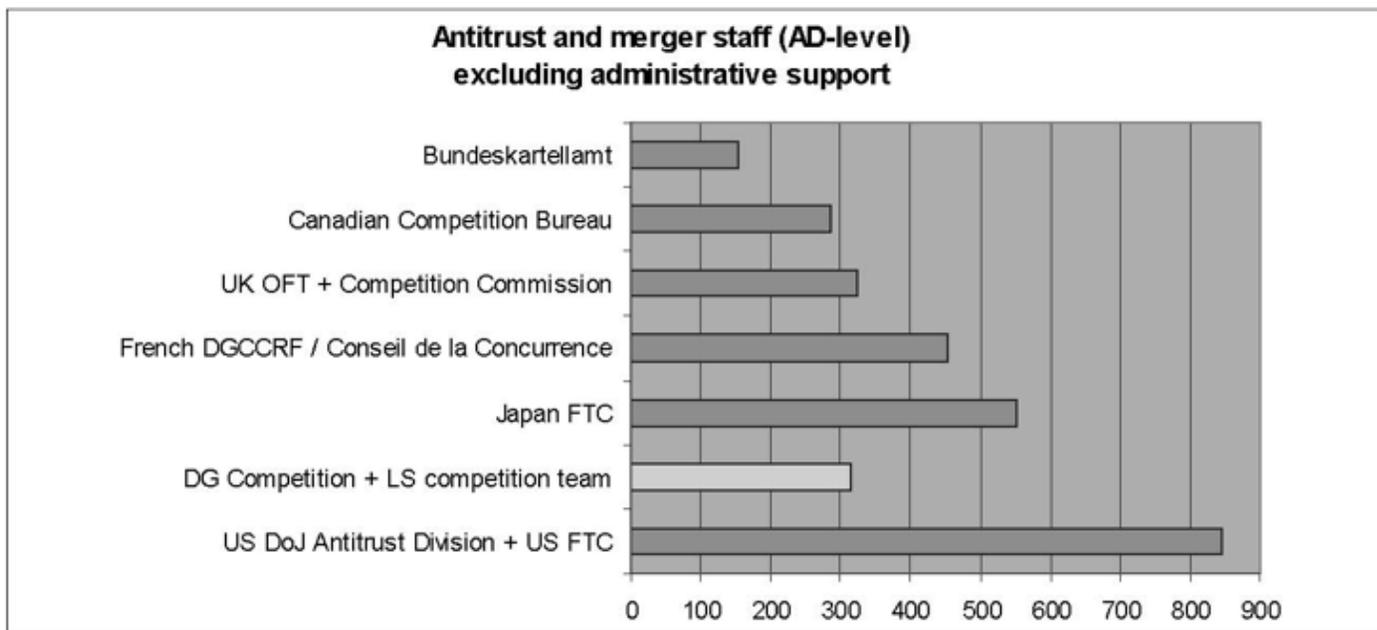
1. The COMP 2010 project

In 2006 Commissioner Kroes and I set up an internal working group to take stock of where the Commission's competition policy, as well as DG Competition's organization and resources stand now, and where they should go in the medium term, i.e. until 2010. The working group produced a report which (i) provided the Commissioner and the management of the DG with a detailed picture of current work and output, (ii) identified relevant trends for the next years, (iii) determined the likely impact of those trends on work and output and (iv) discussed options how the challenges can be addressed.

The working group found that the enforcement architecture and internal organization stemming from the 2003 and 2007 reforms produce reasonably good results in terms of focusing resources where DG Competition can bring the greatest added value.

However, based on the analysis of expected trends that influence competition policy and on comparisons with other competition agencies, it identified a resource gap between what DG Competition should, and will have to, do in the future and what it is able to do on the basis of its current resources.

One of the main findings is that DG Competition is understaffed when compared to other competition authorities, such as the US Department of Justice and Fair Trade Commission or the Japan Fair Trade Commission. The understaffing is even more evident if account is taken of DG Competition’s responsibility for State aid issues.



2. Human Resource Strategy

The issue of resources is not only about mechanically increasing staff numbers. It is more and more challenging to attract, improve and keep talent. DG Competition is focusing on very specific staff, i.e. lawyers specializing in competition law and economists specializing in industrial organisation. For both of these categories, DG

Competition is competing on the labour market with law firms and economic consultancies which are offering salary packages much higher than the Commission can do. Organising Commission competitions for higher entry level grades could somewhat reduce this salary gap, at least during the first years of the career. Organising Commission competitions specifically addressed to candidates having the right profile (i.e. not lawyers or economists in general, but having a specific competition background) could also improve recruitment. Accelerating recruitment procedures is a further challenge.

It is essential to ensure that staff recruited continues to have the skills and competences required to meet DG Competition's quality standards. This is guaranteed by a training programme adapted to real needs. Knowledge areas that are strategically relevant for DG Competition and hence should be the focus of training programmes are law and procedures, economics and accountancy, sectoral knowledge, investigative techniques, drafting, communication, languages and IT. The process of training, the internal training offers of DG Competition and the use of external resources must continue to be improved.

Finally, keeping talent is only possible through a transparent and motivating career development system. Within the constraints of Commission-wide staff regulations, we currently plan to introduce additional systems of recognition of expertise (through, for example, job titles for experienced case handlers and assistants), to activate a Career Guidance Function within DG Competition to give factual information to staff on career opportunities and to facilitate the identification and building of career paths. It is particularly challenging to find a correct balance between promoting staff mobility to sustain motivation and the needs of DG Competition to guarantee the stability and continuity of its activities.

3. Managing knowledge better

One of the key assets of DG Competition is its accumulated knowledge of the markets as well as its expertise in applying the legal instruments at its disposal. Managing knowledge, so as to keep it up to date and accessible to all those who need it, is a major challenge for the DG. This will be of key importance if DG Competition is to better contribute its market knowledge to policies developed in other DGs within the Commission.

The organizational structure which has been described earlier is instrumental in fostering exchange of knowledge between colleagues. However, further action will be required to improve the management of in-house knowledge through updating the existing document management systems and case management applications.

VI. CONCLUSION

The growing number of competition policy institutions in the world reflects the need for public institutions to safeguard and promote competition in an economy that is becoming increasingly global. In order to fulfil their role effectively these institutions must constantly assess and re-assess their mission, objectives, structures,

processes and performance. It is only through realising and adapting to changes in their environment and through carrying out the corresponding improvements that their competences, powers, budget and ultimately existence can be justified before a wider public. ▲

ⁱ This article was published in (3) Competition Policy Newsletter (2008). The original article notes that it is an abridged version of an article that was published in Competition Policy in the EU: Fifty Years On from the Treaty of Rome, (Professor Xavier Vives, Ed., 2009).

ⁱⁱ At the time, this article was written Philip Lowe was Director General of the Directorate-General for Competition at the European Commission. The original article notes that “The views expressed are personal to the author and do not necessarily reflect those of the European Commission.”