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The Competition and Markets Authority: what are its powers with regard to markets and how does it go about them?

Introduction

The Competition and Markets Authority was set up by the 2013 Enterprise and Regulatory Reform Act essentially as a single body replacement for the previous Office of Fair Trading and the Competition Commission, both of which were abolished as the CMA was established.

The CMA – whose primary duty is to promote competition, both within and outside the UK, for the benefit of consumers – has adopted the guidance issued by its predecessor organisations (largely, in the case of the Competition Commission, under the 2002 Enterprise Act) but has also acquired new powers of its own (as well as responsibilities concerning governance) under the 2013 Reform Act.

There is – as yet – no single document setting out how the CMA goes about its work: there is supplementary guidance that it has produced on its new powers (available here); and numerous documents published previously (for its general work on markets, see here). Among the previously published documents, the Competition Commission's guidelines on market investigations is perhaps the most important in this context, but it is a lengthy and technically complex document despite being written with a fair amount of plain English.

Procedure

The CMA has a number of tools at its disposal to address competition or consumer protection problems. These include **market studies** (examinations into the causes of why particular markets may not be working well, taking an overview of regulatory and other economic drivers and patterns of consumer and business behaviour); and **market investigations** (more detailed examinations into whether there is something in the market(s) for the goods or services being referred which has an Adverse Effect on Competition (AEC)). Thus, it is potentially a two-phase process, with the market study serving as the first phase where the outcome leads to a market investigation.

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The CMA is now responsible for the conduct of both (and hence the new governance requirements), on a decision (in either case) of its Board. This is a change from before 2013, when the then Competition Commission was unable to select a market for investigation on its own account but could only accept references from the then Office of Fair Trading, a sectoral regulator or, exceptionally, a government minister. Now, it does have the power to do this on its own initiative. If under a market investigation it finds that an AEC does operate, it has the power to decide what remedies should be imposed.

A market study is launched by a formal market study notice. Where the CMA then proposes to make a market investigation reference, it must begin the consultation process within six months of the publication of the notice; the timetable is the same where it does not propose holding such an investigation but has received (non-frivolous) representations subsequent to a formal notice arguing that such a reference should be made. A market study must be concluded – with a formal report – within twelve months of the publication of the market study notice.

Market investigations usually follow market studies – but it is not a pre-requisite for a study to be conducted first as long as the statutory reference threshold is satisfied. (A market study may, of course, emerge with one of a range of different outcomes, of which a market investigation is one and 'no action' is another: there is no presumption of guilt arising solely from a decision to investigate a market.) The CMA may launch such an investigation under which it is required to decide:

> *Whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of goods or services in the United Kingdom or a part of the United Kingdom.*

This is the statutory reference threshold with the outcome, determined on the basis of the balance of probabilities, essentially constituting a consideration of the existence or otherwise of an AEC. The reference may be an ordinary one, or the CMA may conduct a cross-market reference where the specific features under investigation appear in more than one market.

The implementation of a decision to run a market investigation is the preserve of a market reference group appointed by the Chair of the CMA Panel, and must consist of at least three members whose job it is to determine (by a two-thirds majority) the existence of an AEC and what remedial action is appropriate (and then to oversee the latter). The group is supported by a staff case team encompassing both inquiry management and specialist staff.

A market investigation must be completed within eighteen months of the date of reference, a period which is extendable – once – by up to six months where the CMA considers that there are 'special reasons' preventing the completion of the investigation within eighteen months; this is likely to be in complex cases, in order to ensure a thorough and fair consideration of the issues raised as well as proper engagement with the parties.

If it decides action is necessary, it may make an order and/or accept undertakings from the parties involved; this must be done within six months of the publication of its market investigation report although, again, this deadline is extendable (once) by up to four months for 'special reasons' (again, in complex cases). The CMA may also 'stop the clock' to deal with non-compliance. Any remedy must be capable of effective implementation, monitoring and enforcement; while the CMA will generally look for remedies that prevent an AEC by

extinguishing its causes, or which can be sustained for as long as the AEC is expected to endure (and there may be a sunset clause). It is likely to look for remedies that can be expected to show results over a relatively short-timeframe.

Appeals of the decisions of the CMA may be made within two months to the Competition Appeal Tribunal, which describes itself as a 'specialist judicial body with cross-disciplinary expertise'.

The UK's statutory regulators[1] may also conduct market investigations in their areas in line with sector-specific legislation and frameworks; and the Secretary of State may also, and 'rarely', direct a market investigation reference, either by the CMA alone or in conjunction with the Secretary of State in cases that raise defined public interest issues (but currently only in cases of the interests of national security, although the Secretary of State does have the power to introduce new considerations, by Order). Sectoral regulators have varying powers of intervention as a result of the findings of their own market investigations, but ultimately it is the CMA which has the greater power as regards remedies for questions of the failure of market competition.

The CMA's approach to market investigations

The years of experience since 2002, when market investigations came into play as a result of the 2002 Enterprise Act, provide some examples as to how the CMA will approach the questions raised by its considerations of what constitutes an AEC. Evidently, its approach is case-specific and even its own guidelines cannot be applied in a rigid or mechanistic way, on top of which competition and markets theory, as well as the framework legislation, develops over time.

There is no statutory benchmark, other than a general theoretical appreciation of what constitutes a 'well-functioning market', or a view of what market factors constitute an AEC; there is only custom and practice. This does not mean that the CMA will seek to establish an idealised perfectly competitive market in places where it finds an AEC. However, in such cases it will seek to establish a market that, it envisages, will operate in the absence of the factors that constitute the AEC. Reasons for a departure from this approach lie where there are features intrinsic to the market but which nevertheless have anti-competitive effects, including in cases of a natural monopoly or where the nature of competition has been defined by arrangements put in place by the government (the guidelines cite the example of rolling stock leasing).

This establishes the room for a 'flexible' (or simply loose) approach which is, as a result, therefore somewhat unpredictable.

The 2013 version of the guidelines (as amended by the recent supplementary guidance) is 116 pages long, but fortunately well-structured. The rest of this paper seeks to give a brief flavour as to what might be expected should the CMA launch a market investigation as a result of its consideration that market competition is threatened – and that the statutory reference threshold has been met; i.e. how it identifies the features of a market that 'prevent, restrict or distort competition'.

[1] i.e. Ofcom; Ofgem; Ofwat; the Northern Ireland Authority for Utility Regulation (URegNI); the Office of Rail Regulation (ORR); the Civil Aviation Authority (CAA); and Monitor.

Process

The process of a CMA investigation is structured as follows:

1. information gathering: the collection of publicly-available material; publication of the terms of reference and investigation timetable; arrangement of meetings and site visits; drafting of questionnaires and decisions over whether to conduct market surveys. This concludes with the publication of an issues statement setting out the theories of harm framing the analysis the CMA intends to pursue

2. assessment: led by inquiry group and case staff whose work is generally not disclosable although the developing approach and analysis will be communicated ahead of the publication of provisional findings. Consultations may also be held with the parties over verification, material confidentiality, etc. and a round of formal hearings will be held prior to the publication of provisional findings and notice of possible remedies where an AEC has been found. These will be the subject of public consultation – whose deadlines may be tight (the guidelines state 'no less than 21 days') – and further hearings may be held with the parties and, potentially, with key third parties. The final stage will be the production of the final report which, if it confirms the finding of an AEC, will set out the remedies in sufficient detail to provide a firm basis for implementation.

3. implementation of remedies: at this point, the CMA may accept undertakings from the parties in lieu of the remedies and/or make an order consistent with the decisions in the final report. Whether either or both routes are followed is clearly the subject of individual case factors.

The AEC test

This is the major part of the guidelines, setting out that the CMA assesses whether or not an AEC has arisen on the basis of three issues, of which (c) is the most intrinsically interesting:

a. the main characteristics of the market and the outcomes of the competitive process

b. the composition of the relevant market within which competition may be harmed

c. the market features which are harming competition, considering also possible countervailing factors, such as efficiencies, which may remove or mitigate competitive harm.

(a) Market characteristics

Here, the CMA will look at issues such as market share data over time to establish a view of market concentration but will also consider the outcomes of the competitive process in order to establish how the market works and any customer detriment.

It will examine prices (including pricing patterns; price cost margins; and price comparisons) and profitability – the latter in the context of the theoretical view that firms in a competitive

market generally earn no more than a 'normal' rate of profit, i.e. that the rate of return on capital employed equals the opportunity cost of capital for that activity.

These do not, on their own, provide conclusive evidence that the market in question could be more competitive; they are not causes of competitive harm or features for the purpose of the AEC test, but simply indicators that the market is imperfectly functioning.

More important are questions of quality and innovation – factors which are qualitative and, frequently, subjective. Negative factors here are important indicators of weak competition. The CMA cites, in particular, the Competition Commission's 2007 investigation into personal banking in Northern Ireland; and its 2009 investigation into BAA airports where, quoting at length from the guidelines:

> *The CC compared Aberdeen Airport with other regional airports and found slower development of routes; lack of ambition in development; underinvestment and poor facilities. In relation to the South-East of England airports the CC found a lack of responsiveness to the interests of airlines and passengers that would not be expected in a well-functioning market; weaknesses in the approach to planning and consulting on capital expenditure; and deficiencies in the level and quality of service.*

(b) Market definition

The CMA is concerned here to establish the degree of demand substitutability and any supply-side constraints which inhibit a well-functioning market. Factors here are mostly concerned with defining the scope and the dimensions of the market(s) being studied in terms of product (or service); geography; and customer groups – and need not detain us for too long in policy terms.

(c) Competitive assessment

This is the main area of policy interest in the guidelines since it conveys some idea of the parameters of how the CMA approaches its task, including with reference to examples of practices regarded as having an AEC and drawn from the evidence of actual investigations. Circumstances where an AEC is adjudged to apply may have their origins either in structural features (based on characteristics of the market) or they may be based on the conduct of the parties (or in combination); the CMA makes no differentiation in its examination.

The approach in general is to recognise that there are (at least) five potential sources of competitive harm. These are as follows (the list is not exhaustive, and there may be countervailing factors with positive effects – the CMA is very careful to cite in each case that these may exist):

1. Unilateral market power (including market concentration)

Here, the CMA is concerned with the level of influence a firm can have on a market as a result of factors in which demand is not a function of price or where rivals do not step up supply in conditions of a price rise in the market, or act in line with price mechanisms.

This is the case largely with (fairly straightforward) cases of monopoly supply or (slightly less straightforwardly) in cases of oligopoly, but generally where there is high market concentration as a result of market share; capacity constraints in markets where the product (or service) is relatively undifferentiated; where there is limited choice of alternative products or services leading to a lack of substitutability; and weak supply-side constraints (i.e. where rivals do not respond to price rises by expanding their own output of that product or service).

From a markets point of view, the CMA is interested on the grounds that the exercise of simple market power can suppress innovation and product development. It will focus on prices, profitability, quality and choice factors.

2. Barriers to entry and expansion

The CMA is concerned that a major source of competitive discipline is eliminated or reduced where there are formal or in practice barriers to market entry and expansion (and exit), so will focus on the ability of and the level of incentives for new firms to enter or expand in a market.

Generally, there are three types of barrier:

a. natural or intrinsic ones, where there can be concerns over economies of scale, especially where these are combined with sunk investment costs, or where switching costs are high

b. the presence of strategic or 'first mover' advantages for incumbents where investments may increase the costs of market entry to others, or where switching costs or brand loyalty is high

c. regulatory barriers including legislation (e.g. intellectual property law; planning law), voluntary or compulsory standards and codes of practice, and other applicable sectoral regulations – where these hit new entrants harder than incumbents.

The CMA will be concerned about the impact that any barriers may have had or will have in the future and will seek to assess the costs of market entry and operation at a minimum level of efficiency; the likelihood of market entry within a timescale that would have an impact on incumbent firms; the costs of market exit; and the likely response of incumbents to market entry by others.

3. Co-ordinated conduct

Companies co-ordinating their action via a cartel in order to fix prices or otherwise increase or protect profits, either explicitly or tacitly, permanently or intermittently, is a concern for the CMA although it will not judge that firms have acted unlawfully, simply on whether their actions have resulted in an AEC.

The CMA will look at a range of market outcomes in combination in order to examine whether these reflect patterns of co-ordinated behaviour. These may result either from the structural characteristics of the market or from firms' own practices and behaviours, with the

latter often produced by conditions created in the former as regards the development of the co-ordinating behaviour as well as its subsequent internal and external sustainability. There is a large number of facets to both these which the CMA will examine.

4. Vertical relationships

The CMA is concerned both with vertical integration (activities at upstream and downstream levels in the supply chain being brought under common ownership and control) as well as with 'vertical arrangements' (agreed pricing schemes or other contractual provisions between companies at different levels in the supply chain).

It is concerned here mostly with actions undertaken deliberately to bring about either of these scenarios. Nevertheless – and while recognising that vertical relationships often have effects which are beneficial to customers – the CMA is also concerned that they may lead to an AEC via a partial or total foreclosing of rivals' access to inputs and customers, or which raise their costs; or where they otherwise have a dampening effect on competition.

This is a situation evidently of sizable significance. Quoting at length from the guidance:

> *When deciding whether to supply its competitors downstream with key inputs, a vertically integrated firm may take into account how these sales would affect the profits of its own downstream division. If it has significant market power in the upstream market, the firm may have an incentive to refuse access to the input or to raise its price, and consequently increase the costs of competing downstream firms. By being subjected to higher input prices – of which an extreme form is a 'margin squeeze' – downstream competitors may be unable to compete effectively. As a result of such foreclosure effects a vertically integrated firm may be able to maintain high prices and/or increase the prices charged to customers relative to the prices obtained in the absence of vertical integration.*

In undertaking its investigations, the CMA will seek to assess the impact of vertical relationships on rivalry at different stages of the supply chain. For foreclosure to be the result, the firms involved must have significant market power within the supply chain; and they must also have both the ability and the incentive to seek to foreclose rivals. It will be heavily concerned in particular with the following examples of practice:

a. exclusive purchasing obligations requiring a customer to purchase all or a significant part of their requirements from a particular upstream supplier

b. exclusive supply obligations obliging a seller to sell all or a significant part of output to a downstream customer

c. the tying and bundling of products and services in which the sale of one product or service is made conditional on the purchase of others

d. aftermarket arrangements in which secondary products can be used with one brand of primary product but not (or not easily) with another.

5. Weak customer response

Here, the CMA is concerned that competition may be jeopardised if customers respond only weakly to competitive offers and where this is the result of the behaviour of customers, particular actions by suppliers or structural features of the market. It will, in particular, examine barriers or actions in respect of consumers' ability to access information, identify best value offers or switch suppliers. Where customers cannot do any or all of these things, this is a sign of market power in which firms may be able to sustain high prices or profits.

Inevitably, there is a wide range of actions which fall under this heading, in terms of firms increasing the costs of research by consumers; behavioural bias among consumers; information asymmetries as regards, for example, product quality; and raising the costs of switching.

Remedies

Having established an AEC, the CMA will move to the question of remedies although it must first decide whether it should take action to remedy, mitigate or prevent the adverse effect on competition concerned or any detrimental effect this has had on customers, or whether it should recommend others do so; and then what specific action should be taken and precisely what is to be remedied, mitigated or prevented. It will seek, primarily, to address comprehensively the causes of the AEC, thus significantly increasing competitive pressures in the market.

In determining next steps the CMA will address itself to the effectiveness of the remedy options; their proportionality (a proportionate remedy is one that is effective in achieving a legitimate aim; no more onerous than needed; the least onerous if there is a choice between several effective measures; and does not produce disadvantages which are disproportionate); and the impact on those most likely to be affected by it.

Possible remedy options – and which includes no action at all – are wide-ranging (the guidelines talk about the 'remedies universe'), but the CMA will be concerned with relevant customer benefits as regards addressing the AEC. Remedies may be either structural (divestiture; or connected with access to intellectual property); or behavioural (IP again; the taking of enabling measures either to remove obstacles to competition or to stimulate it; or the taking of control outcomes to prevent the exercise of significant market power).

Determining which remedy is the most appropriate is:

> *An iterative process in which a potentially wide range of remedy options are progressively narrowed down until a solution has been found that enables the CC to meet its statutory duties,*

but will always depend in each instance, and on a case-by-case basis, on the precise nature of the AEC that the CMA has established.

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