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HEARING ON OLIGOPOLY MARKETS

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UNITED KINGDOM

1. The UK Market Investigation (MI) regime allows the Competition and Markets Authority (“CMA”) to investigate the operation of markets as a whole. This broad-based markets tool sets it apart from other competition law investigations that are often focused only on a subset of the firms operating in the market with a view to penalising prohibited behaviour.

2. In this paper we discuss briefly four ways in which MIs have tackled issues that other instruments of competition law may find difficult to address. We provide a case illustration for each of the four. The first two relate to issues that might be thought of as part of the “oligopoly enforcement gap”, while the latter two illustrate other ways in which market-wide issues can be tackled.

- MIs enable the CMA to remedy structural and behavioural problems in markets that cannot be remedied by merger control or antitrust law either because their scope does not extend to the problems or because the remedies available are inapt to deal with them. We illustrate this use of MIs with the recent (2014) Aggregates inquiry.
- MIs can be used to “clear the air”. MIs involve a detailed, in-depth and evidence based investigation into an industry over a time limited period (now 18 months, extendable by up to 6 months). As such they can be useful for finding out the facts about a market, rather than the accepted public and political wisdom. We illustrate this with reference to the Groceries inquiry (2008).
- Where a market has come to rest in an “unhealthy” equilibrium in which customer outcomes are poor, but from which no firm has a sufficient incentive to move the market, remedies following a MI can help move the market to a new – better- equilibrium. We use the Payment Protection Insurance (PPI) inquiry (2009) as an illustration of this.
- MIs can identify markets where there is a sub-optimal market structure, for example where a state monopoly has been privatised without creating a competitive market structure in which it can operate. The investigation into British Airports Authority (2009) is a good example of this.

3. Decisions that MIs should be conducted may be made either by the CMA or other regulators or, in limited situations, government departments. To decide whether to make a MI-reference, they will generally have conducted a market study beforehand to decide whether there appear to be problems in a market and, if so, what is the most effective way of addressing them. This may be by enforcement action using competition or consumer protection law, recommendations to government, or referring the market for a full Phase II investigation. MIs are detailed and highly complex examinations of markets with a view of establishing whether there are so-called features of a market that ‘prevent, restrict or distort’ competition such that these features would result in an adverse effect on competition (AEC) in the market(s) for the goods or services referred. Such a finding does not mean the law has been broken, or enable a company or individuals to be fined which is an important distinction to antitrust. Rather, it means the CMA must decide what remedial action (if any) to make the market work in future, is appropriate. Remedies may be structural (e.g. the sale of a business or any part of it), behavioural (e.g. requiring information disclosure, price controls) or recommendations to government or other regulators for legislative or regulatory change or other action.

1. Tacit coordination: Aggregates inquiry

1.1 Facts

4. In January 2012 the Office of Fair Trading (OFT) referred the markets for the supply of aggregates, cement and ready-mix concrete within Great Britain to the Competition Commission (CC).¹ Having concluded a very thorough review of each of the markets referred the CC found that structural features of the cement market, combined with behaviour on that market that varied over time, had an adverse effect on competition in cement. The CC also concluded that there was coordination in cement markets between the three largest Great Britain cement producers, Cemex, Hanson and Lafarge (as it then was), accounting between them for about 80% of sales of cement in GB. These findings were based in the CC's analysis of the operation of the markets as a whole focusing, in cement, on market structure, outcomes (including profitability and margin analysis), and evidence of behaviour including documentary evidence. The CC found that:

- Profits were significantly and consistently above the cost of capital of the firms.
- Profit margins remained stable, or even increased, during the period 2007 to 2011, despite a substantial (more than 30%) decline in demand due to the recession. The CC found it hard to understand how, in a well-functioning market, a demand slump of this magnitude, leading to significant excess capacity in a high fixed cost market for a homogeneous product, could be consistent with profit margins not falling. The CC argued that under these conditions we should expect to see the firms engaging in vigorous price competition, thus leading to profits falling.
- Market shares were very stable over the period 2007-2012. Again, the CC thought that this fact was not consistent with a well-functioning market given the decline in demand, and hence increase in excess capacity, over the period (particularly 2007-9). The CC also found evidence of tit-for-tat behaviour with respect to changes in market shares amongst the large firms. The CC concluded that market share stability was the focal point around which coordination operated.
- Although actual prices paid by customers were not transparent, price increase announcements were transparent. The timing of price announcements by the various firms was often very similar and the announced price increases were often also very similar across the firms. In general, the CC found that announcements of price increases were followed by actual increases in prices.

5. Moreover concentration was high (the top three cement producers accounted for about 80 percent of sales of cement), the market was transparent, there were frequent interactions between the main producers, the competitive environment was not complex; the product was homogeneous and there were high barriers to entry. The implication of these characteristics was that the various producers had a good understanding of each other's behaviour and so were able to predict how their competitors would react to a change in the competitive behaviour of a firm. The CC also analysed internal documents, and found that these showed some direct evidence of coordination by Lafarge, Hanson and Cemex, and/ or a strategic approach aimed at coordinating conduct to achieve market stability. The existence of high barriers to entry ensured that any such coordination would not be undermined by external forces.

6. The CC estimated the detriment to customers had been about £30m per year over the period 2007-12, but it expected that the figure would have been higher over a full business cycle.

¹ On 1 April 2014, the OFT and CC merged to become the CMA.

7. Reflecting the structural and behavioural problems identified the CC imposed both structural and behavioural remedies in relation to the GB cement market. The structural remedy was that Lafarge (or rather Lafarge Tarmac, as it had become by then) had to divest one of its cement plants to a company not already producing cement in Great Britain, to create a new independent cement producer in Great Britain. The CC considered that an increase in the number of cement producers in Great Britain from four to five would render coordination more difficult to reach and to sustain, or, would weaken both ability and incentives to coordinate. There were two behavioural remedies to address the CC's concerns regarding transparency. First, the CC required that published competitive data was not current but was published with at least a three month time-lag. Secondly, the CC required that the firms to stop sending generic price announcement letters to their customers. They could though send customer-specific letters that included at least their current unit price and the proposed revised unit price. The CC's AEC findings and its remedies are at present subject to challenge by Lafarge in the Competition Appeal Tribunal. That action is currently stayed pending resolution of the proposal that Lafarge and Holcim should merge, a transaction that is subject to EU merger control.

1.2 Commentary

8. It is very hard to see how the combination of structural and behavioural problems identified by the CC could have been dealt with effectively under antitrust law. No finding of cartel behaviour was made. Had there been, the CC would have considered whether the matter should be referred to the OFT, which was responsible for enforcing Chapter I prohibition of the UK Competition Act (i.e. the UK equivalent of A101 TFEU) at the time. The behaviour was not exclusionary but exploitative, so one might in theory argue that it could have been treated as an excessive pricing abuse of a collective dominant position. Even here, we might doubt if bringing such a case successfully would be practicable and we are not aware of any such cases being successfully prosecuted in any European jurisdiction. Excessive pricing cases are relatively rare even with single firm dominance. Although there are some collective dominance cases under A102 TFEU, these mainly relate to exclusionary abuses, rather than exploitative abuses. At least as importantly, pursuing the case under antitrust laws (had that been an option) would have made it much harder to make the structural changes to the market and introduce the other remedies that the CC considered necessary. One could argue that this was a case where the MI regime allowed the UK authorities to intervene in a market where traditional competition law tools would not have allowed for such intervention.

2. Clearing the air: Groceries

2.1 Facts

9. The OFT referred the UK groceries market to the CC for investigation in May 2006 following widespread public concern about the practices of major UK supermarkets. The CC did find two competition concerns but dismissed most of the concerns. Thus, in effect, the CC's MI cleared the air as to some of the misconceptions held about the market.

10. In particular, the CC found two competition concerns:

- The first of these related to some local areas where the CC thought that local concentration amongst large supermarkets was high and that this led to consumers getting a poorer retail offering in terms of prices, quality and services. The CC recommended that in future new large supermarket developments should have to pass a "competition test" administered by the OFT. Specifically, the OFT would have the opportunity to stop developments that it thought would increase local levels of concentration to an extent that would harm consumers.
- The second related to concerns over the buying practices of the large supermarkets. The CC was concerned that the transfer of excessive risk and unexpected costs from supermarkets to

suppliers might damage investment and innovation by suppliers. The CC's response to this was to recommend a strengthening of the Supermarket Code of Practice and the creation of the Groceries Adjudicator in order to protect suppliers from the exercise of excessive of buyer power.

11. As noted above, the CC dismissed the following complaints:

12. There were concerns about the competitive position of small convenience stores relative to the large supermarkets. The Association of Convenience Stores was vocal that the competitive pressure from the large supermarkets was damaging the convenience store sector to the detriment of consumers. The CC found that although the convenience stores were under great competitive pressure, this was not to the detriment of consumers and so was not a competition concern.

13. Notwithstanding concerns expressed to it, based on its enquiries the CC found no evidence of tacit collusion among the supermarkets.

14. The CC found that although the competitive position of Tesco (the largest UK supermarket) was undoubtedly very strong, it was not unassailable and was not in itself a competition problem. As a post script, events over the last few years, during which Tesco's competitive position has worsened considerably, would suggest that the CC was correct.

15. Another concern that was frequently voiced by several parties was that the buyer power of the large supermarkets had the effect of raising wholesale prices for smaller stores. The argument was that manufacturers had to offer low prices to the large supermarkets and as a result raised their prices to smaller stores (i.e. a "waterbed" effect). Based on its enquiries, the CC found that there was no waterbed effect.

16. Although there were examples of below cost pricing by the large supermarkets (i.e. loss leading), the CC concluded that there was no evidence of predatory behaviour.

17. The CC found that the use of loyalty vouchers by various supermarkets, and particularly by Tesco, provided benefits to consumers and was not anti-competitive.

18. Concerns were expressed that the move by Tesco and Sainsbury into the convenience store sector was anti-competitive for two reasons. First, there were concerns that it would damage competition within the convenience store segment. Second, there were concerns that it would lessen the competitive constraint on large Tesco and Sainsbury stores from the convenience store segment. The CC concluded that neither concern was well-founded.

2.2 *Commentary*

19. At the time of the reference by the OFT to the CC there was considerable public and political disquiet about the behaviour of the large supermarkets. The list of potential concerns was long, as noted above. In the market investigation the CC was able to look at a large body of evidence, including more than 100 submissions from grocery retailers and more than 600 submissions from suppliers, consumers, local authorities and others. It held approximately 80 hearings with grocery retailers and others, conducted numerous site visits and held round-table discussions with food and drink manufacturers, primary producers and academics to discuss issues arising in the investigation. Although the CC did find some competition concerns, as a result of this thorough investigation it was able to reach a robust and evidence-based conclusion that refuted many concerns that were not substantiated by the evidence. This effectively "cleared the air" in relation to the public debate about the role of supermarkets.

3. Moving a market away from a poor equilibrium: Payment Protection Insurance inquiry

3.1 Facts

20. Following a super-complaint from Citizens Advice in September 2005, the OFT referred the PPI market to the CC in February 2007. PPI was sold to consumers who had bought credit products such as personal loans, mortgages, secured loans (“second mortgages”) and credit card debt. It was typically sold to consumers at the same time as the associated credit product was sold. There was little consumer search for alternative providers of PPI and indeed it appeared that many consumers were not aware that they could buy PPI separately from the purchase of the credit product.

21. The CC found that the PPI market in 2007 was about £3.8bn and that claims ratios were low. Only between 11% and 28% of the gross premia were paid out in claims. The result was that the market was highly profitable. The CC found that profits in excess of the cost of equity were £1.4bn in 2006 and a similar amount in 2007. PPI was significantly more profitable than the underlying credit products.

22. Despite the apparent high profitability of the market, the CC found little evidence of price competition between suppliers of PPI in order to attract new customers. It found that there were significant barriers to consumer search and switching. For instance, many customers did not know that they could search for alternative providers but instead thought they had to buy from the credit provider (resulting in a point of sale advantage for selling PPI at the same time as credit). Where customers did search, the relevant information was often hard to ascertain and the complexity of offers made comparisons difficult. Initial exclusion periods during which customers could not claim made switching more risky. Where consumers had paid a single upfront premium for their PPI, rebates if they switched were significantly lower than pro rata. There was also evidence of adverse selection effects for suppliers of PPI who were not also the providers of the credit product. They often found it hard to obtain data on the exact characteristics of the credit product they were insuring, with the result that there was evidence of higher claims ratios for standalone providers.

23. The CC concluded that PPI prices were higher and choice was lower than it would have been in a well-functioning market. In assessing the detriment to consumers from high PPI prices, the CC took into account the possibility that credit prices were lower than they would otherwise be because some of the profits made on PPI policies were competed away in the form of lower credit prices (the waterbed effect). Notwithstanding this effect, the detriment to consumers as a result was estimated as being substantial, for example:

- If all excess profits on PPI were competed away in lower credit product prices (i.e. a full waterbed effect), then the deadweight loss in 2006 was about £200m.
- If only 80% of the excess profits were competed away in lower credit product prices, then the detriment would be £440m per year.
- Both of these figures exclude any detriment from the sale of PPI for credit card debt. If this was included, the CC expected the figure for detriment to be significantly higher.

24. The CC imposed a number of remedies. These included:

- A ban on selling PPI at the credit point-of-sale: PPI cannot be sold at the same time as credit, nor within 7 days of the sale of the credit.
- A ban on single premium policies. The cost of these was typically added to the original debt and then interest was charged on these premia. As noted above, switching costs for single premium policies tended to be high.

- A number of informational remedies aimed at increasing the transparency of the market, including provision of a personal PPI Quote, an obligation to provide an Annual Review and an obligation on providers to provide comparative data to the (then) Financial Services Authority for publication on a price comparison website.

25. The CC considered that these remedies would encourage consumers to search by removing many of the barriers to searching, and in doing so would promote greater price competition among PPI providers.

3.2 *Commentary*

26. Analytically, the most interesting aspect of this case was the sense in which the market had settled into an “unhappy equilibrium” that was harmful to consumer welfare.

27. Suppose it was the case that all of the excess profits that were being earned on PPI were being competed away in the associated credit product markets. As noted above, the CC found that this would lead to detriment of about £200m per year, excluding the added detriment associated with credit card PPI. This is clearly a sub-optimal equilibrium relative to one of lower PPI prices but higher credit product prices. However, it is not clear that the market could have moved to this better equilibrium in the absence of regulatory intervention. No individual provider of credit products would have had a unilateral incentive to move to the higher credit price/lower PPI price equilibrium as they would have lost sales of credit products, due to higher prices compared to their rivals, and also have lost the associated PPI sales. The MI tool allowed the CC to try to move the market “en masse” to the better equilibrium by stopping point-of-sale selling of PPI. Once this was banned, the CC expected that standalone providers of PPI would be better able to compete. This would have two effects. First, it would put downward pressure on PPI prices. Second, and related, it would remove or reduce the incentive of sellers of credit products to “under-price” them in the expectation of making follow-on sales of PPI at above cost prices. The key point to note here is that the MI tool was used to solve a competition problem associated with considerable consumer detriment that would have existed even if the various players in the market had not been able to earn excess profits across the two linked products of credit and PPI .

28. To the extent that the pass-through of excess PPI premia was less than 100%, there was also the more standard issue of a lack of competition leading to excess profits earned by sellers. This is an issue that MIs have often been used to solve.

4. **Repairing the competitive damage following privatisation: BAA inquiry**

4.1 *Facts*

29. The UK government privatised British Airports Authority (BAA) in 1987. BAA was privatised as a single entity with all of its airports. At the time these were Heathrow, Gatwick and Stansted, all in the London area, and Edinburgh, Glasgow, Aberdeen and Prestwick, all in Scotland.² The OFT referred BAA to the CC in March 2007 over concerns that the concentration of airport capacity in the hands of BAA in the London area and Scotland was restricting competition between airports to the detriment of consumers and airlines.

30. Following its investigation, the CC found that the common ownership of Heathrow, Gatwick and Stansted did indeed restrict competition, with the result that capacity was lower than it would have been had the three airports been competing against each other and prices were likely higher (even though they were subject to economic regulation by a designated regulator, which included price control and quality of service conditions). The CC stated that

² Prestwick was subsequently sold in 1991 whilst Southampton was bought in 1991.

*“One of the main purposes of privatising BAA as a single entity was for investment in new capacity. But in terms of runway capacity, this has not happened.”*³

31. Whilst the CC noted that BAA faced significant constraints as a result of government policy and planning constraints, it concluded that

*“in our view, BAA’s common ownership of the three major airports in the London area - given its reluctance to press for more runway capacity, its sequential approach to major investments and its constraining development at one airport [Gatwick] in order not to jeopardise development at another [Heathrow] - appears to have exacerbated delays in the delivery of runway capacity, with consequent effects on service.”*⁴ and

*“in our view, BAA, as a result of its common ownership of the three BAA London airports, has itself contributed to the current shortage of capacity.”*⁵

32. In addition, the CC found that BAA did not respond to the interests of airlines and passengers to the extent that it would have expected in a well-functioning market. For example, this was evidenced in BAA’s approach to planning capital expenditure, including weaknesses in consultation and lack of responsiveness to the differing needs of its airline customers, and hence passengers, and the consequences for the quantity, quality, location and timing of investment.

33. The CC also found that competition was restricted between Edinburgh and Glasgow as a result of common ownership, whilst Aberdeen faced no competitive constraints as a result of its isolated position.

34. In order to remedy these competition concerns, the CC required divestments. This was the first time that the CC had ordered divestments in a non-merger case. Specifically, it required BAA to sell:

- Gatwick and Stansted. BAA was already in the process of selling Gatwick.
- Either Edinburgh or Glasgow.

4.2 Commentary

35. The competition problems in this market largely arose from the privatisation of BAA as a single entity with all seven of its airports. The CC found that by 2009 the situation was leading to poor outcomes for passengers and airlines. After the airline market was liberalised, the effectively monopoly ownership of the infrastructure was increasingly at odds with vibrant competition between airlines. Greater airline competition resulted in significant growth in demand and different business models, which BAA was slow to accommodate. Following the divestments, London Gatwick Airport introduced new routes, improved services and innovations. Heathrow Airport responded by improving its own service offering. The ability to use the MI regime to carry out a detailed assessment of the industry and then to require divestments, meant that the CC was able to correct the competition concerns that arose after the (ex post, at least) privatisation. This ability to impose structural change on an industry is clearly a useful and powerful tool.

36. This is also another example of how the MI tool can be used in a situation where standard competition law could not. Whilst it is probable that BAA could have been held to be dominant in a London airport market and a Scotland airport market, it is not clear what behaviour of BAA’s could

³ BAA Final Report, Summary, para. 15.

⁴ BAA Final Report, Summary, para. 16.

⁵ BAA Final Report, Summary, para. 19.

have been held to be abusive. One might argued that a failure to seek to expand capacity may harm consumers but we are not aware of it ever being found to be an abuse, even less so are we aware of it being an abuse that was remedied by divestments.

5. Conclusions

37. The UK's market investigation regime allows two aspects of the oligopoly enforcement gap to be covered. One of these is the problem of tacit coordination, which standard competition law cannot deal with outside of the environment of merger control. The other is the problem of markets that have settled in to unhealthy equilibria which damage consumer welfare but where no firm has a sufficient unilateral incentive to deviate from the equilibrium. As the CC's PPI report showed, shortcomings of competition in such markets can lead to considerable deadweight welfare losses even in the absence of firms making profits above their cost of capital (for example, if excess profits in one market are 'recycled' to consumers in another).

38. Of course, the market investigation regime is not just about solving the oligopoly enforcement gap. We have illustrated two other uses of the regime from recent UK cases. One of these is the ability to use a detailed evidence-based inquiry to shed light on public concerns around particular industries. The other is the ability to remedy competition concerns that have arisen due to (ex post) privatisation of previously state owned bodies.