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Assessing the EC's new competition tool

FW discusses how to assess the EC's new competition tool with Justin Coombs, John Davies, Jorge Padilla and Rameet Sangha at Compass Lexecon.

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FW: Could you outline the reasons behind the perceived need to change current European Union (EU) competition rules? What key weaknesses or shortcomings have been identified in existing rules?

Padilla: Competition agencies are tasked with ensuring that markets work effectively in the interests of consumers. In particular, they are required to ensure that companies with market power do not enter into agreements that distort competition and harm consumer welfare, and do not engage in unilateral conduct that disrupts the competitive process to the ultimate detriment of consumers. Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU) empower the European Commission (EC) and the competition authorities and courts of member states to intervene in order to deter such practices. As a matter of economics, however, there are many other practices that could disrupt the competitive process and harm consumers. For example, firms operating in concentrated markets may stop competing aggressively without the need of a tacit collusion agreement. Non-dominant firms may be able to monopolise markets to the detriment of consumers in the long run using strategies that do not reflect efficiencies or superior business acumen. Firms with limited market power may unilaterally enter into parallel agreements with their customers which, when taken together, end up foreclosing competition at the expense of consumers. These practices are currently left unchecked. These gaps

in current enforcement may be more relevant now than ever, given the increase in concentration in many markets across the EU. They are indeed one important reason to support the adoption of the new competition tool (NCT), but not the only one. Another reason is that the available tools, especially Article 102 of the TFEU, appear to be not fit for purpose in fast-moving, winner-takes-all, digital markets in which, by the time the agencies are ready to act, the distortion of the competition process is beyond repair.

FW: The new competition tool sounds a lot like the UK's Market Investigation Regime. In your experience, how effective has that legislation been in promoting more competitive markets in the UK?

Davies: The UK's Market Investigation Regime (MIR) is different from most other competition regimes. In a market investigation in the UK, a panel considers whether an "adverse effect on competition (AEC)" arises from "features or combinations of features of the market" that "prevent, restrict or distort competition". That phrase is of course familiar from EU competition law, but the concept of a 'feature' is very broad, not limited to the conduct of a dominant firm. The Competition and Markets Authority (CMA) panel has impressive remedial powers under the MIR, either to remedy the adverse effect on competition itself or its effects. These powers include the ability to impose orders as behavioural remedies and even forced divestment, as well as recommending legal or regulatory changes to other public bodies. These powers might seem alarming, combined with the rather broad definition of an AEC. However, there are procedural safeguards. Remedial action can only be taken if it would effectively remedy the AEC or its effects, with a strong focus on whether consumers would be better off. As for effectiveness, the picture is rather mixed. Everyone focuses on the powers to force divestment but in practice, these have been used only once, when the UK's main airports operator was forced to sell three airports. This market structure was the result of the way the industry was privatised. The CMA and its predecessors have not imposed any divestment remedies to correct a purely private sector outcome, such as high concentration simply emerging, as we see in platform industries. Most remedies have either been recommendations to government or regulatory interventions akin to consumer protection, especially in financial services. They may well have done good, but neither necessarily requires a competition investigation.

Coombs: The great advantage of the MIR has been the ability to investigate markets where competition does not work well but there is no illegal behaviour. The most common situation is perhaps an oligopolistic market where there are only a small number of competitors but no dominant firm. Examples have included a wide range of diverse industries including banking, auditors, supermarkets and cement. While the UK authorities have been able to investigate these markets and identify competition problems, the key challenge has been to come up with effective remedies. Divestment has virtually never been used. Instead, remedies have focused either on changing firms' behaviour or, more challengingly, changing how customers behave – such as encouraging consumers to switch bank accounts, and firms to switch auditors, more often. Have these remedies worked? One sign that maybe they have not is the number of times the authorities have investigated the same industries, small-business banking in 2002 and then again in 2016, supermarkets in 2000 and again in 2008, for example.

FW: On the basis of your experience with the UK MIR, do you have any advice for companies that might experience the EU version, if it is implemented? Is there anything companies should be thinking about right now?

Sangha: MIR investigations are resource intensive for the companies involved – both in terms of data requirements, and management time and effort. They affect all industry participants that fall within the scope of the investigation, both large and

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small. From our experience, key questions to address prior to an MIR investigation are the following. First, what are the areas where outcomes for consumers could potentially be improved? Second, how in practice could these improvements occur? This probably requires industry-wide action, because if an individual firm could profitably make changes that would improve outcomes, it could already do so. Third, what are the advantages and disadvantages of different remedies? Industry participants' views might diverge on this, as costs and benefits may fall differently, for example on larger versus smaller firms, or more established firms versus new entrants. Finally, do any potential remedies also present positive opportunities for industry participants?

Coombs: The key lesson is that firms need to start at the end and work backwards. What outcome would they like to achieve and what evidence do they need to present to achieve that outcome? There is a natural tendency for firms to see these investigations as a threat to their business. They take up large amounts of management time and remedies can significantly disrupt existing business models. But they can also be an opportunity, especially for firms that are not market leaders and may benefit from more opportunities to challenge market leaders as well as for firms that are customers or suppliers.

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FW: To what extent do certain markets – such as dominant technology platforms, for example – require more than case-by-case enforcement of competition law?

Davies: The EC's focus is clearly on technology platforms. In fact, this is not the only important development. In parallel, DG CONNECT is consulting on a separate 'ex ante' regulatory tool that would subject technology platforms to a set of pre-existing rules, which might, for example, include a 'blacklist' of activities they cannot undertake. However, it is notable that the UK's MIR has not in any way been used to address competition problems in the tech sector. The CMA recently conducted a study of digital advertising, in which it explicitly considered and rejected the use of its market investigation tool, preferring to recommend government regulation. This could simply reflect the difficulty of dealing with global platforms in a national jurisdiction, which would be of less concern to the EU, but as of now there is no direct evidence that broader competition powers provide a good tool for dealing with platform dominance in the tech sector.

FW: The EC has made clear there will be no fines. What kind of remedies do you think we are likely to see if this new tool is introduced?

Padilla: The remedy depends on the nature of the intervention trigger. It seems that the NCT will only be applied in markets exhibiting "structural competition problems" that Articles 101 and 102 cannot effectively address. Thus, the remedies adopted would have to address the structural problems in question, once those problems have been established to the requisite standard. If the problem is that competition is not possible because a key input or asset, such as data, is controlled by a few competitors, then the remedy should involve mandating access to the input and assets that are necessary to compete. If the problem is that vertically integrated companies acting as gatekeepers to downstream customers provide an unjustified advantage to their own upstream subsidiaries, then the remedy may be to force vertically integrated companies to unbundle their operations. What matters is that the remedies effectively address the structural competition problem that triggered the intervention. Generally, that would require the use of structural remedies, since the problem that is meant to be solved is not transactional or behavioural. Of course, in some instances, the costs of implementing a structural remedy – both in terms of transaction costs and efficiencies – may be disproportionate, so that behavioural remedies may be contemplated. But that should be rare, since the NCT's goal is not to deter anticompetitive conduct, but to foster competition by removing manifest structural impediments to rivalry.

Sangha: Remedies and interventions can take numerous forms, both structural and behavioural. From the UK's experience, the CMA's open banking remedy helps illustrate the possible range of market-wide remedies. Nine UK banks funded an entity set up by the CMA in 2016 called open banking, to deliver the application programming interfaces (APIs), data structures and security architectures that would make it easy and safe for customers to share their financial records. Open banking allows individuals and businesses to share data from their bank with authorised third parties, to enable innovation, transparency and competition in UK banking.

FW: What are your hopes for a new EC competition tool, if and when it is introduced, to benefit, enhance and preserve market competition?

Davies: There do appear to be gaps in existing competition law. A new tool is needed, but I would also add some cautionary words. The EC scope of actions needs to be broader than it is under its current approach, but not so broad that it starts trying to tackle problems with this tool that really have nothing to do with competition – relating to consumer protection, privacy or media plurality, for example. Tackling those broader questions requires a different approach and a different mindset. The EC's existing enforcement powers are about identifying and penalising wrongful conduct. However, the new tool can deal with situations where firms are not necessarily consciously behaving badly, but the structure of the market or the incentives provided by regulation, for example, lead to bad outcomes. The focus should be on making competition work better, not on penalties for bad guys.

Coombs: The main expected benefit will be to tackle problems that cannot be dealt with under Articles 101 and 102, for example in oligopolistic markets where there is no dominant firm, or problems that can be solved only by structural remedies rather than prohibiting abusive behaviour. To achieve maximum benefit the EC will need to adopt a different mindset from its traditional role of catching firms that have broken the law. There is a risk that the tool is used simply to target behaviour where the EC is unable to establish dominance under Article 102. While that may produce some benefits, it may also be a missed opportunity. I would hope that the EC goes beyond this and uses the tool to investigate competition problems that do not result from the actions of firms but instead result from other reasons, such as the structure of a market, the economics of an industry or even the way consumers behave. There is an opportunity to go beyond the traditional approach of defining a market, examining its structure and analysing how firms in that market behave. Instead, the tool could hopefully be used to examine problems that transcend individual markets and, in particular, competition problems that are not caused by how firms behave but instead by factors that may be beyond the control of individual firms. ■