

COMPETITION COMMISSION

DRAFT FOR PUBLIC CONSULTATION



GUIDELINES FOR MARKET INVESTIGATIONS

Their role, assessment, remedies and procedures

June 2012

CC3 (Revised)

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Introduction

1. Market investigations were introduced by the Enterprise Act 2002 (the Act). In June 2003, the Competition Commission (CC) published *CC3, Market Investigation References: Competition Commission Guidelines* as one of the series of documents which it is required to publish under section 171(3) of the Act. The text was drafted without the benefit of any experience in conducting investigations under the new statutory regime, (although the CC was able to draw on its experience of conducting cases under the Fair Trading Act 1973). Since 2003 the CC has learnt much from its practical experience of conducting cases, and has progressively refined its policies, practices and procedures. These Guidelines distil the lessons the CC has absorbed since the introduction of the new regime and replace the 2003 version.

2. The Guidelines are in five parts, plus two annexes:
 - [Part 1](#) outlines the nature of competition and sets market investigations within the context of the overall regime for the promotion of competition within the UK. It describes how references are made to the CC.
 - [Part 2](#) on the conduct of an investigation provides guidance on the nature of the information the CC gathers during the course of an investigation and sets out the procedures and timescales the CC applies in conducting a market investigation and, if necessary, implementing remedies.
 - [Part 3](#) lists the statutory questions the CC must address and describes how the CC interprets the key statutory terms of ‘relevant market’, ‘features’ and an ‘adverse effect on competition (AEC)’.
 - [Part 4](#) addresses the three issues the CC looks at in applying the AEC test:
 - the characteristics of the market and the outcomes of competition within it;
 - the definition of the market; and
 - the state of competition in the market; specifically, whether there are any features harming competition.

- [Part 5](#) discusses the remedial action the CC may prescribe, if it has found there to be an AEC; this may include divestiture, behavioural remedies or recommendations for action by Government or other agencies.
 - Annexes:
 - A: Measurement of: market shares and concentration; profitability.
 - B: Types of remedies.
3. The types of markets referred to the CC vary widely, making it impossible to cover in these Guidelines all issues and aspects that might be encountered during investigations. The CC's assessment of markets has inevitably to be case-specific. The Guidelines cannot therefore be applied in a rigid and mechanistic way. While the CC will always have regard to these Guidelines in conducting market investigations, it will apply them flexibly and may sometimes depart from them, explaining its reasons for doing so, if it considers that the particular circumstances of the case (including the information available and the time constraints applicable) justify doing so. Past case references are included in the Guidelines for illustrative purposes only and do not constrain the CC's approach.
4. These Guidelines reflect the views of the CC at the time of publication. Markets, economic theory, legal thinking and best practice evolve; the CC may revise the Guidelines from time to time to reflect developments and may publish new or supplemental guidance. Legislation currently being enacted to reform competition law and the competition authorities¹ may require revision of these Guidelines. The latest version is always that appearing on the CC website.

¹ The Enterprise and Regulatory Reform Bill, introduced into Parliament on 23 May 2012, will create a new Competition and Markets Authority, merging the CC and the Office of Fair Trading (OFT), and give effect to the Government's proposed reforms to some aspects of competition law.

A brief note on terminology

5. All references to statute, unless otherwise stated, relate to the Enterprise Act 2002—referred to throughout as ‘the Act’—and all references to ‘section(s)’, unless otherwise specified, relate to the Act. The term ‘referring body’ refers to the body making the reference.
6. Several terms used in the context of market investigations are ‘terms of art’, having specific and limited, rather than literal, meanings: notably, ‘theory of harm’ (see paragraph 154), ‘relevant market’ (see paragraph 81), ‘efficiencies’ (see paragraph 163) and ‘a well-functioning market’ (see paragraphs 84 and 311).
7. Throughout this publication also:
 - unless otherwise specified, the term ‘price’ is used as shorthand for all aspects of a supplier’s competitive offer; a change in price should be read as incorporating any comparable change in any element of the competitive offer;
 - the term ‘customers’ includes ‘consumers’;²
 - the term ‘products’ is used to apply to goods and/or services;
 - ‘market participants’ are sellers, buyers and intermediaries, such as distributors, agents and platforms in multi-sided markets;
 - the term ‘market power’ is used as the ability of a firm to raise price above the competitive level, or influence any other aspect of competition, without the consequent loss of sales becoming profitable (rather than in the sense of a firm earning profits above normal levels for a while); and
 - the phrase ‘to harm’ competition is often used as shorthand for the statutory language of ‘prevents, restricts or distorts’ competition.

² See [section 183](#)(1).

Part 1: The promotion of competition in the UK

8. Competition is a process of rivalry as firms seek to win customers' business. It creates incentives for firms to meet the existing and future needs of customers as effectively and efficiently as possible—by cutting prices, increasing output, improving quality or variety, or introducing new and better products, often through innovation; supplying the products customers want rewards firms with a greater share of sales. Beneficial effects may also come from expansion by efficient firms and the entry into the market of new firms with innovative products, processes and business models, and the exit of less successful ones.
9. In some instances firms compete for a market, rather than in a market, for example, by competing to be the first to claim a patent in a key area, the first to achieve scale in a new market, or to win a public procurement contract or franchise to supply a public service.
10. Vigorous competition between firms is not only in the interests of customers—who benefit from lower prices, greater choice, value and quality—but also fosters economic growth, as firms respond to competitive pressure by striving for efficiency and directing their resources to customers' priorities. Customers have an important part to play in stimulating rivalry between suppliers by making informed decisions which reward those firms that best satisfy their needs or preferences. Markets work best when both the supply side (the firms) and the demand side (the customers) interact effectively.
11. However, the full play of competitive forces is sometimes inhibited. There are many different factors which may impede competition and these may be present in a market at any one time. For example: there may be barriers to market entry or expansion, which reduce incentives to innovate; in the case of industries subject to

separate economic regulation, some firms, through earlier privatizations or as a legacy of legal monopolies, may have gained advantages of scale or technology, or a network position with customers,³ which make it hard for others to compete effectively with them; customers may lack information about what product to choose, or may be locked into one supplier and unable to switch to an alternative, or may be subject to marketing practices that confuse them; laws and regulations imposed by the State, under which all businesses must operate, will have legitimate public policy goals but may nonetheless restrict or distort competition, as may rules of conduct agreed between suppliers such as, for example, professional bodies.

Responding to the threats to competition

12. Regulators, competition authorities and governments have an important role to play in making sure competition is as effective as possible. They do so in various ways. Sometimes the Government may intervene directly in specific markets with this aim (for example, in the programme of liberalizing public utilities in the 1980s and 1990s). The merger control regime limits the ability of firms to avoid competing with their rivals by buying them. Economic regulation of certain sectors involves measures to encourage new entry and investment, promoting the emergence of competition in markets where it has been historically weak. Regulators can also intervene directly to prevent or mitigate the harmful effects of a lack of competition in the short term.
13. Legal prohibitions play a particularly important role in limiting the extent to which firms are able to restrict competition between them or win customers in non-competitive ways. Specifically, the prohibitions under the Treaty on the Functioning of the European Union (TFEU)⁴ and the Competition Act 1998 (CA98)⁵ are designed to prevent and penalize collusive conduct among rival firms or abusive practices by a

³ See paragraph 168.

⁴ Articles 101(1) and 102.

⁵ See The Chapter I Prohibition (OFT401) and Chapter II Prohibition (OFT402).

dominant firm.⁶ Enforcement of these prohibitions falls, not to the CC, but to the European Commission and the OFT together with certain ('concurrent') sectoral regulators,⁷ respectively.

The market investigation regime

14. The CC's market investigation regime sits within the broad spectrum of competition law, operating alongside other regulatory mechanisms, including prohibitions (see paragraph 13), by allowing the competition authorities the opportunity to assess whether competition in a market is working effectively, where it is desirable to focus on the functioning of the market as a whole rather than on a single aspect of it or the conduct of particular firms within it. A market investigation examines all potential competition problems and identifies the features causing them. It aims only to see if competition within the particular market under review can be improved and is not seeking to establish general rules and obligations for firms.
15. Its overarching framework allows the investigation to tackle adverse effects on competition (AECs) from any source. As well as being able to look into the directly observable conduct of firms, it can probe for indirect indicators of a lack of effective competition, such as persistently high profitability or any restrictions that impede or

⁶ The relationship between Articles 101 and 102 TFEU and national competition law is provided for in Article 3 of Council Regulation 1/2003/EC. Under paragraph 1 of that regulation, where national competition authorities apply national competition law to agreements, decisions by associations of undertakings or concerted practices within the meaning of Article 101(1) which may affect trade between member states or to any abuse prohibited by Article 102 they shall also apply Article 101 or 102 respectively. Under paragraph 2 the application of national competition law may not lead to the prohibition of agreements, decisions by associations of undertakings or concerted practices which may affect trade between member states but which are not prohibited under Article 101(1) or which fulfil the conditions of Article 101(3) or are covered by an EC block exemption, although they may prohibit or sanction unilateral conduct engaged in by undertakings which is not prohibited by Article 102. Paragraph 3 provides that, without prejudice to the general principles and other provisions of Community law, paragraphs 1 and 2 do not preclude the application of provisions of national law that predominantly pursue an objective different from that pursued by Articles 101 and 102. In the context of a market investigation these provisions do not affect the exercise by the CC of its powers of investigation, but may be relevant at the remedies stage. If during the course of its investigation the CC uncovered a potential breach of Article 101(1), it would consider whether that matter should be referred to the authorities responsible for enforcing Article 101 but would also expect to continue with its investigation and then take the application of Regulation 1 into account when determining whether to take remedial action and if so, what action to take. If the CC found evidence suggesting a breach of Article 102 it would normally continue its investigation and, when appropriate, implement remedies under the Act. The OFT would then be able to take such action into account when carrying out any Article 102 investigation it considered appropriate.

⁷ Certain sectoral regulators have concurrent powers with the OFT to apply the antitrust prohibitions and refer markets to the CC (under section 131). These are: Office of Communications (Ofcom), the Gas and Electricity Markets Authority (Ofgem), the Director General of Water Services (Ofwat), the Northern Ireland Authority for Energy Regulation (OFREG NI), the Office of Rail Regulation (ORR) and the Civil Aviation Authority (CAA).

delay new entry into the market. However, the focus of an investigation is on competition. There may be other problems in the market—‘externalities’, such as air or water pollution, the cost or benefit of which is not transmitted through prices—which fall outside the ambit of a market investigation (see paragraph 162).

16. Having established a competition problem, and identified its causes, the CC is able to impose a wide range of legally enforceable remedies that focus on making the market more competitive in the future (essentially in the interests of consumers) and make recommendations for remedial action by other public bodies.
17. The identification of anticompetitive features in a market investigation or the imposition of remedies does not mean that market participants⁸ have infringed the law. The process is investigative and inquisitorial, not accusatorial. To be required to give evidence in a market investigation or be subject to remedial action following an investigation does not imply that market participants are suspected of wrongdoing.

The making of references to the CC

18. The CC does not select markets for investigation. The referring bodies—the OFT, a sector regulator⁹ or, exceptionally, a Minister¹⁰—make market investigation references to the CC when they have reasonable grounds for suspecting that competition is not working effectively.¹¹ However, once a reference is received, the CC proceeds wholly independently of the referring body; a CC market investigation casts a ‘fresh pair of eyes’ able to look more deeply at new evidence and analysis on

⁸ See paragraph 7.

⁹ See footnote 7.

¹⁰ [Section 132](#). Ministers have the ability to make market references as a reserve power; in addition to applying the same criteria set out in the Act for the making of a reference by the OFT or other referring body, a minister must either be ‘not satisfied’ with an OFT decision not to make a reference or, having brought information to the attention of the OFT, will decide whether to make a reference in the period that the minister considers is reasonable. As at June 2012, this power had never been used.

¹¹ As at June 2012, the OFT had been responsible for 12 of the 14 references made since the Act came into force. No reference had been made by Ministers.

the market and, regardless of the views of the referring body, it may conclude that there are no adverse effects in the market.

19. Before a case reaches the CC the referring body will have looked into the market in question, either on its own initiative or in response to a complaint, which may include a 'super-complaint' from certain designated consumer bodies.¹² The Act¹³ allows the OFT to study markets that appear not to be working well for consumers. There is no statutory definition of a 'market study' but it was envisaged from the inception of the Act that the OFT should use market studies as a way to promote competition. The Enterprise White Paper *A World Class Competition Regime* (July 2001) said that the OFT 'should scrutinise markets to assess whether strong competition pressures are at work ... in some case ... it will need to refer the market to the Competition Commission for further study'. The other regulators having powers concurrently with the OFT (see paragraph 13 and footnote 7) can also study markets coming within their purview. Where the market study suggests that markets are not working well, the referring body has several options open to it. It may recommend legislation, or actions by consumers; it may proceed to investigate any suspected breaches of consumer protection legislation or the competition law prohibitions; and/or, where it has reasonable grounds for suspecting there are features which prevent, restrict or harm competition, make a market investigation reference. (But the OFT may also accept undertakings in lieu of making a reference if appropriate undertakings are offered.) Where a market study leads to a reference to the CC, it thus serves as the first phase in a two-phase investigation process.¹⁴

¹² Section 11 of the Act allows a consumer body (acting collectively on behalf of consumers), that has been designated by Ministers, to make a 'super-complaint' to the OFT about features of a market that appear to be significantly harming the interests of consumers. See: www.of.gov.uk/advice_and_resources/resource_base/super-complaints/ and www.of.gov.uk/advice_and_resources/resource_base/market-studies/.

¹³ Section 5.

¹⁴ Three market investigations—*Market investigation into supply of bulk liquefied petroleum gas for domestic use*, 29 June 2006, (LPG); *Home credit market investigation*, 28 April 2006; and *Personal current account banking services in Northern Ireland market investigation*, 15 May 2007 ('Northern Irish personal banking')—have been made to the CC without an intervening market study, the latter two emerging directly from super-complaints.

20. When faced with a choice on how to deal with a perceived competition problem, the approach the OFT or regulator takes will depend on many factors, some of which may suggest that a market investigation reference is the appropriate course:
- A market investigation might be preferred when, for example, the facts and issues underlying a perceived competition problem are complex and other forms of intervention by the Government or regulatory body might have to be too tightly focused to benefit the overall operation of the market.
 - The range of remedies available under the market investigation regime can also make a market investigation a more appropriate instrument than relying on the system of prohibitions (see paragraph 13). Prohibitions on using market power to exploit customers or exclude rivals, or on coordinating with the few rivals that remain, may not be sufficient to address issues in a market whose characteristics and structure limit the ability or incentive of firms to compete effectively. There are markets, for example, in which the root cause of a problem lies within the regulatory framework; or it may lie within the way the market operates, with weak competition resulting, for example, from network effects,¹⁵ customer inertia or imperfect information flows between market participants.

Public interest issues

21. Although market investigation references are generally only concerned with competition issues, in the first four months after a reference has been made, the Act allows ministers to ask the CC to consider the implications of its competition analysis for any public interest consideration Parliament may identify in the case. Correspondingly, in those four months, the CC is under a duty to bring to the attention of the Secretary of

¹⁵ See paragraph 168.

State any case that it believes raises a public interest consideration specified in the Act.¹⁶ (But it has not done so in any case before the issue of these Guidelines.)

Part 2: The conduct of a market investigation

22. The CC recognizes that market investigations can result in significant interventions in markets and demand a thorough and disciplined process, under the direction of an Inquiry Group of three or more CC members, of gathering evidence, hearing arguments, and examining facts and (often) complex data. It strives to make sure that its procedures for market investigations are fair and transparent.
23. The first section of this part of the Guidelines outlines the ways the CC gathers evidence and the range and depth of the analysis it conducts. The second section outlines the CC's procedures at each stage of the investigation: it explains the role of Inquiry Groups, how they are appointed, and the composition of the staff teams which support them; it then outlines the procedures typically followed in the conduct of market investigations and in the implementation of remedies.

The gathering and analysis of evidence

24. In collecting and analysing evidence on the way the market under investigation operates, the CC will particularly try to assemble evidence on the impact possible features have on the market's operation. It will use various means of collecting such evidence, including questionnaires to parties, requests for internal company documents (including management information), consumer surveys and discussions with customers, investors and other market participants. (See paragraphs 49 to 55 on the procedures for information-gathering.)

¹⁶ [Section 152\(2\)](#).

Range of analysis

25. The CC's analysis covers all relevant aspects of competition. It often assesses the ability or incentives firms have to offer better prices or terms to customers and to strive for efficiency, better ways of operating and improved products.

26. Whatever forms competition takes, the CC considers its effects and expected development over time. Although there may be circumstances in which particular forms of the analysis can be conducted only on a static basis, the CC always considers how a market may evolve. The prospect of gaining a lasting advantage over rivals can be a spur to competition, and the CC may in some circumstances consider assessing the effectiveness of competition for the market as well as, or rather than, within the market (see paragraph 9).

Quantitative and qualitative analysis

27. The CC applies a variety of analytical techniques, both qualitative and quantitative. The extent to which the CC will seek to quantify particular effects—and the degree of precision with which this is attempted—is likely to vary from case to case. Moreover, the CC will not look at quantitative evidence in isolation in conducting its detailed analysis. Relevant considerations in determining the extent and nature of quantification that the CC will carry out in a particular case may include:
 - (a) The scale of any particular effect. If it is clear from an initial assessment that a particular effect is unlikely to be material, it may not be necessary to quantify its magnitude with great precision to reach a view about the scale of any harm to competition.
 - (b) The extent to which it is possible to quantify a particular effect with any degree of accuracy. In general, it is likely to be more straightforward to estimate the effects on prices in the shorter term than to quantify the longer-term effect of possible features on dynamic and non-price competition.

- (c) The availability of reliable data and the costs in terms of time and resources; even where quantification is possible, it may require a disproportionate amount of resources to acquire and process the data, to apply a suitable methodology and to test the robustness of the results.
- (d) The value added quantification of a particular effect would bring to any assessment of the qualitative evidence.

28. The CC will seek information about all aspects of the pricing and quality of goods and services supplied in the market under investigation (see paragraph 109). It often commissions surveys at an early stage of an investigation (see paragraph 53) and also gathers qualitative information through questionnaires, scrutiny of internal corporate documents and discussions with industry participants and observers. Examples of investigations in which qualitative evidence proved crucial to the findings are given in paragraphs 127 to 129.

Depth of analysis

29. The need to base a finding on a thorough scrutiny of the relevant evidence means that the CC will form a view on the likely importance of any possible features and prioritize the use of its resources to undertake as wide and as deep analyses of these as appropriate.¹⁷ The CC will only carry out analysis that it considers necessary or proportionate to the need to reach a decision on the statutory questions.

The procedures

30. The following sections:
- A. outline the rules and statutory obligations with which Inquiry Groups must comply;
 - B. explain how Inquiry Groups and staff are assembled;

¹⁷ This imperative to focus on the bigger issues has been underlined in the CAT judgement on *Barclays Bank plc v Competition Commission* (2009), CAT 27 (paragraph 21); and *Tesco v Competition Commission* (2009), CAT 6 (paragraph 139).

- C. discuss some of the general procedural issues in conducting a market investigation;
- D. provide a stage-by-stage guide to a typical investigation.

A. Rules and statutory obligations

31. The Chairman of the CC is required to issue Rules of Procedure for market reference Groups. The current Rules of Procedure¹⁸ are published on the CC website and may be revised from time to time. The Rules require Groups to:
- (a) draw up and notify the parties of the administrative timetable for each investigation (and to prepare a revised timetable if required);
 - (b) decide the forms of hearings (public or private, joint or individual) and who should attend them;
 - (c) notify the main parties of their provisional findings on the statutory questions and allow them at least 21 days to comment on the provisional findings; and
 - (d) notify main parties of actions which may be taken to remedy the AEC and give the parties the chance to make representations about the Group's proposed actions.
32. The CC also has a statutory duty to consult on its proposed decisions on the AEC test and the remedy questions when it considers a decision likely to have a substantial impact on any parties' interests.¹⁹
33. Subject to complying with these Rules, and having regard to any guidance issued by the CC Chairman, Inquiry Groups are free to decide how they conduct a market investigation.²⁰

¹⁸ CC1, *Competition Commission Rules of Procedure*, 2006:
www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/rules_and_guide/pdf/cc1.pdf.

¹⁹ Section 169 of the Act.

²⁰ Paragraph 19, Schedule 7 of CA98.

B. Inquiry Groups and staff

34. Market investigations are performed by Inquiry Groups of independent CC members²¹ (commonly between four and six), normally chaired by the Chairman of the CC or by one of the Deputy Chairmen.²² A Group conducting an investigation provides its strategic direction, weighs the evidence and arguments from parties, both received in writing and given orally, and directs and assesses the analysis produced by the staff team. It makes the final decisions on whether or not there are features of a market that give rise to an AEC and if so on the remedies to be applied.

Appointment of Inquiry Groups

35. As soon as possible after receiving the reference, the CC Chairman identifies and appoints an Inquiry Group. The appointment is made for the duration of the investigation,²³ up to the point at which the reference is ‘finally determined’.²⁴
36. Before deciding to appoint a member to a particular Inquiry Group, the CC will consider whether there might be a risk that a member’s outside interests could affect, or could be perceived as affecting, the impartiality of the CC.²⁵ In some cases the CC may inform parties of specific interests and give them the opportunity to comment before deciding whether to make a proposed appointment. Relevant outside interests of appointed members are disclosed on the CC website. In addition, the CC may take

²¹ There are around 40 members appointed by the Department for Business, Innovation and Skills (BIS) for eight years, following open competition. They are selected for their experience, ability and diversity of skills in competition economics, law, finance and industry. All except the CC Chairman and Deputy Chairmen work part-time for the CC.

²² Occasionally, a member who is neither the Chairman nor one of the Deputy Chairmen will be asked to chair a Group conducting a market investigation.

²³ Generally a reference is finally determined when the final report is published or, if remedial action is to be taken by the CC, when the remedies are implemented (ie an Order is issued by the CC or Final Undertakings are accepted from the parties). Members may step down or be replaced if necessary or required; they may be reappointed to deal with ongoing remedy issues or litigation.

²⁴ As defined in [section 183\(3\)–\(6\)](#) of the Act.

²⁵ See guidance on outside interests on the CC website: www.competition-commission.org.uk/our_peop/members/conflicts_interest/110407_Conflicts_guidance_for_publication.pdf. The guidance categorizes the most common interests that could put the CC’s impartiality at risk as: financial interests, organizational relationships, personal relationships and prejudgement.

action to deal with any relevant and significant changes in members' interests that may arise during the course of the investigation.²⁶

Staff team

37. Each Inquiry Group is supported by a staff team. The team is led by an Inquiry Director and includes both administrative and specialist professional staff. The administrative staff are responsible for the day-to-day running of the investigation; the key point of contact at the CC for the parties is likely to be the Inquiry Manager. The specialist professional staff provide advice to the Inquiry Group in their areas of expertise (including economics, law, business and finance). They conduct the analysis on the substantive issues that arise during the investigation and develop remedies where needed.

C. Overarching procedural issues

38. No two market investigations are alike in all respects. The subjects under investigation can range in size from small, highly specialized industries to large-scale multi-faceted markets. Some references can encompass both upstream (eg manufacturing) and downstream (eg supply/distribution) markets. Moreover, the numbers of parties with an interest in the investigation may vary from a few to several hundred.

Managing investigations with a large number of parties

39. All providers of the goods and services in a market under investigation are potentially parties to an investigation. However, where there are substantial numbers of parties, the degree of each party's engagement with the CC may vary. The CC may need more information and evidence from some parties than from others. Some firms may choose to engage more with the CC than others. Differences in communication by

²⁶ If at any time during an investigation it appears to the Chairman that because of a particular interest of a member it is inappropriate for them to remain in the Inquiry Group, the Chairman may appoint a replacement. CA98, Schedule 7, paragraph 17(1)(c).

the CC with different parties may consequently reflect the different levels of party engagement. Where there are large numbers of parties, the CC may make extensive use of its website to communicate with them or to make disclosures. But while the detail of the CC's processes might vary, the CC will ensure that its procedures are fair and give parties the opportunity to participate appropriately in an investigation.

40. In addition, there will be parties which are not providers of the goods and services in the market but which may be materially affected by the investigation (including super-complainants,²⁷ consumers and consumer groups, trade and professional bodies). When determining the procedures the CC will give consideration to these parties.

Timescales

41. The Act requires the CC to publish its report on a market investigation within two years of the reference. However, while some of its largest and most complex investigations will take two years, the CC aims to complete a 'standard' investigation within 18 months and to take less time where possible.
42. While procedural timescales for a market investigation cannot be exactly prescribed, the following timetable illustrates the progressive stages of procedures for an 18-month investigation. Some of the stages may in practice overlap.

²⁷ See paragraph 19.

<i>Stage of the process</i>	<i>18-month process</i>
Reference	Pre-reference sharing of appropriate information with the CC by the referring body
Initial information requests	Months 1–2
Publication of initial issues statement (setting out theories of competitive assessment)	
Initial submissions from main and third parties	
Site visits	Month 3
Publication of working papers	Months 5–9
Possible revision/annotation of issues statement	
Hearings with parties	
Publication of provisional findings	Months 11–12
Publication of remedies notice (if relevant)	
Consideration of responses to provisional findings and consultation on remedies	Months 13–15
Publication of provisional decision on remedies (if needed)	Month 16
Publication of final report	Month 18

43. The CC draws up and publishes an administrative timetable at an early stage in the investigation. A draft is first sent to main parties for comment.²⁸ The administrative timetable is updated as necessary during the investigation.

Information provision and disclosure

44. While the time taken to conclude a market investigation depends on several factors, including the complexity of the investigation and the number of parties involved, a key factor is timely provision of information. The CC aims to be fair and reasonable in its requests for information and expects parties to meet the timescales set. The CC is

²⁸ Rule 6.4 provides that the administrative timetable should be produced having regard to the views of the main parties (CC1).

empowered legally to require information and the attendance of witnesses.²⁹ It will use its mandatory powers if necessary to ensure that its information requests are answered completely and in a timely fashion. The provision of false or misleading information to the CC is a criminal offence, regardless of whether that information has been provided voluntarily or in response to a statutory notice.³⁰

45. In pursuing its aim to conduct investigations in a fair and transparent manner, the CC discloses its key documents, mainly by publishing them (in particular an issues statement, provisional findings, provisional decision on remedies—if needed—and final report). Typically, it also publishes a large amount of other documentation, for example non-confidential versions of major submissions from parties, including their submissions on the issues statement and responses to other formal CC documents. It will also disclose or publish a range of evidence and views, including, in most cases, hearings summaries and working papers.
46. Before making a disclosure the CC has regard to the statutory provisions designed to protect confidential information relating to individuals and businesses.³¹ The CC may disclose such information under certain, specified circumstances and subject to the considerations of the Act.³² Further details are set out in the Chairman's guidance to Groups on disclosure.³³
47. Where issues arise as to the confidentiality of the data underlying a particular piece of analysis, but the CC nevertheless considers that disclosure of some sort is necessary to allow the parties to comment on the analysis, the CC may decide on some

²⁹ Section 109 of the Act, which applies to market investigations by virtue of section 176 of the Act.

³⁰ See [CC5, Statement of Policy on Penalties, June 2003](#).

³¹ Part 9 of the Act.

³² Section 244.

³³ [CC6, Chairman's Guidance to Groups, March 2006](#), paragraphs 19–26 and [CC7, Chairman's Guidance on Disclosure of Information in Merger and Market Inquiries, July 2003](#).

form of limited disclosure, for example, occasionally by setting up a data room (see paragraph 58).

D. The main stages of an investigation

48. The following paragraphs describe the main stages of a market investigation and outline the key interactions which the CC has with parties and their advisers in the course of a typical investigation. The precise timing and content of these steps will vary depending on the specifics of the case; not all the steps will necessarily follow the order set out and some may be undertaken concurrently. This procedural guidance is not intended to be binding and may be adapted to take account of the particular circumstances of an investigation, in which case parties will be notified of the reasons for departures from usual procedures.

Information gathering

49. The CC begins preparatory work on an investigation on a contingency basis immediately before the formal reference arrives. It identifies any relevant information that is publicly available and makes use of any market or company information that can be shared by the referring body³⁴ so as to avoid duplication of effort by the parties or the authorities between the first phase (typically an OFT market study) and the second-phase market investigation.
50. Once the reference has been received, the CC formally launches its investigation. The early stages of the investigation involves a period of information gathering which includes: in the first instance, a 'first day letter' from the CC Chairman to main parties with a request for initial factual information—much of it generally available 'off the shelf'—a range of specified financial information, as well as general information and guidance on the coming investigation; later, a more detailed market and financial

³⁴ After the referring body has decided internally that such a reference will be made.

questionnaire to the main parties; and, in many cases, the collection of other data from a wider range of parties. The information gathering will be informed by the developing ‘theories of harm’ (see paragraph 154). When practicable, parties are consulted on questionnaires to facilitate efficient collection of useful information whilst, as far as possible, minimizing the burden to business.

51. Parties may also choose to provide the CC with any information they consider relevant to the investigation. When making submissions involving technical economic analysis, parties should refer to the principles set out in the CC’s publication *Suggested best practice for submissions of technical economic analysis from parties to the Competition Commission*.³⁵ A joint CC/OFT good practice guide for parties wishing to submit evidence based on consumer surveys in merger inquiries³⁶ is also relevant to market investigations.
52. At an early stage, informal meetings are held between the staff team and selected main parties (and, where relevant, with the super-complainant or other party enjoying a special status).³⁷ Such meetings usually cover the procedures to be adopted for the conduct of the investigation, and often seek information and views on the market. In addition, the CC holds data meetings with appropriate main parties to discuss the organization and availability of technical data. (There may be subsequent staff meetings as the investigation progresses—see, for example, paragraph 58.)
53. The CC may decide to conduct one or more surveys as part of the information-gathering process.³⁸ If the decision is taken to conduct a survey, relevant parties are

³⁵ Suggested best practice for submissions of technical economic analysis from parties to the CC, www.competition-commission.org.uk/rep_pub/corporate_documents/corporate_policies/best_practice.pdf.

³⁶ www.competition-commission.org.uk/rep_pub/consultations/past/pdf/Good_practice_guide.pdf

³⁷ See paragraphs 19 & 40.

³⁸ The CC makes market research reports available to interested parties. If agreed by the Group, the CC may also publish the reports on its website. The CC does not release transcripts or recordings made in the course of qualitative market research, mainly to protect the anonymity of the respondents. If requested, the CC may make tables of quantitative survey results, produced for this specific purpose by the market research contractor, available to interested parties.

consulted on the draft survey design and content. In some cases, so as to construct the sample for questioning, parties may be required to provide contact details for a sample of their customers or suppliers.

54. In many cases, the CC organizes early site visits to several parties. These are designed to be helpful to both the CC and the parties involved. A site visit offers a chance for the Inquiry Group members and staff to gain a greater understanding of the party's business by visiting key facilities and meeting key operational staff. A party receiving a site visit is encouraged to organize a short presentation, and take some questions, on its business so as to explain its nature and the market context in which it is operating.

Issues statement

55. An issues statement is released by the CC at an early stage in the investigation process. This generally discusses the theories of harm framing the analysis the CC intends to investigate (see paragraph 50). Parties are invited to provide submissions commenting on the issues set out in the statement.

Assessment

56. Once relevant information has been gathered, the competition assessment gets under way. Staff prepare working papers for the Inquiry Group dealing with the issues raised by the investigation. These may cover background issues, including an overview of the operation of the market or the performance of the parties, market definition, and assessment of the relevant competition issues based on the framework set out in the issues statement.
57. Where the Inquiry Group considers it desirable to help develop its thinking or for reasons of fairness, working papers that are relevant to the development of the CC's

thinking may be disclosed (often through publication on the CC website), giving parties an opportunity to comment on their substance.

58. In some cases, working papers will include specific pieces of technical analysis which may be sent to parties for comment. The CC may sometimes decide to hold a round-table discussion with parties and their technical experts to discuss the methodology used and, possibly, the results found. Where disclosure of some sort of confidential data is considered necessary (see paragraph 47) a data room may sometimes be set up to enable the parties' external advisers to review the data concerned.³⁹
59. As the investigation progresses, further documents may be published or disclosed to the parties to enable them to comment on the developing thinking of the CC. In particular, ahead of the main party hearings (see paragraph 61), depending in part on what has been disclosed or published as working papers, the CC will generally disclose an annotated issues statement or hearing agenda giving an overview of its analysis to date whilst preserving its confidentiality.

Put-back

60. The CC may send ('put back') some working papers (or relevant extracts) to parties for the purpose of enabling them to:
- (a) verify the factual correctness of certain content (usually information supplied by them); and
 - (b) identify any confidential material, prior to publication; parties are asked to provide reasons for any requests for excisions of the material from published documents.

³⁹ In such cases, disclosure is made pursuant to the Act ([section 241\(2\)](#)) and it is an offence for any person receiving access to such data to disclose it to any other person without the CC's prior agreement. As a result, strict rules relating to access and non-disclosure, together with relevant sanctions, are applied and participants are required to sign undertakings that they will comply with the restrictions.

Hearings

61. The Inquiry Group holds a round of formal private hearings with parties (or a selection of them) ahead of the publication of its provisional findings. The primary purpose of these hearings is to enable the CC to test the evidence and explore key issues with the parties. They also provide an opportunity for the parties to explain their views in person directly to the decision-makers as their thinking is developing. They should not be viewed as an opportunity for parties to put questions about the substantive analysis to the CC.
62. Parties are usually given an opportunity to make brief opening and/or closing statements. Parties should expect to provide a concise explanation of their views and to respond to the CC's questions. A transcript of the hearing will be taken and will be sent to the relevant party for checking. A summary of the key points raised will normally be prepared by the CC. The party will be given the opportunity to comment on both content and confidentiality ahead of the summary's publication on the CC website. It will also be invited to follow up in correspondence any issue raised during the hearing.
63. Hearings conducted by the Inquiry Group are supplemented by staff-led hearings (sometimes via teleconferencing) with some parties, including some main parties when there are large numbers of them. On occasions, some members of the Inquiry Group will also participate. Transcripts or written notes are taken and sent to the relevant party for checking. A summary of the key points raised is normally prepared by the CC, and the party is given the opportunity to comment on both content and confidentiality ahead of the summary's publication.
64. The decision on which main and third parties to invite to hearings, and the sequencing of any hearings, rests with the CC.

Provisional findings and the Notice of possible remedies

65. The CC will start to gather information on possible remedies and evaluate relevant options after the basis of a possible AEC has been identified. However, the investigation of possible remedies will remain hypothetical until a decision regarding a provisional AEC finding has been made.
66. When the Inquiry Group has provisionally formed a view on whether or not there are features of the market(s) that give rise to an AEC, its provisional findings will be published and a public consultation on them of no less than 21 days will be held.
67. If an AEC has provisionally been found, the CC will publish, in addition to its provisional findings, a Notice of possible remedies (the Notice). The Notice will contain details of remedies the CC has identified as possibly addressing the AEC effectively, if implemented by the CC or others, and will provide an agenda for a discussion of remedies with the relevant parties to the investigation, including main parties, customers, competitors, any sectoral regulator and the OFT. The Notice may also outline details of remedies the CC considers unlikely to be effective and the reasons why it has reached this provisional view. The CC will normally publish the Notice on the same date as its provisional findings and will normally set the same deadline for responses to the Notice as to the provisional findings.

Response hearings and the provisional decision on remedies

68. Where the CC provisionally finds that there is an AEC, response hearings will take place with main parties and potentially with key third parties. Parties will be given the opportunity to comment orally on the provisional findings and the CC may seek clarification of particular points made in written submissions or at the hearing. However, the hearing is likely to focus on possible remedies. Transcripts of response hearings will be taken and, in most cases, summaries prepared and both will be

processed in a similar way to those relating to hearings held earlier in the investigation (see paragraphs 61 to 64).

69. Having considered the responses from parties, the CC will notify its provisional decision on remedies, normally through publication on its website, for comment before reaching its final decision. The CC will normally allow a period of at least 21 days for parties to respond to its provisional decision on remedies.

Final report

70. The CC will publish its final decision on the competition question and (if necessary) remedies together with supporting reasons and information in a final report.⁴⁰ The report will, if it confirms the finding of an AEC, contain sufficient detail on the nature and scope of remedies to provide a firm basis for subsequent implementation of remedies by the CC.
71. The publication of the final report does not necessarily end the CC's involvement in the investigation. If an AEC has been found, measures have to be put in place to implement any remedies that may be needed.
72. Moreover, parties may, during the two months following the release of the CC's findings, lodge an appeal with the Competition Appeal Tribunal (CAT) against the decisions. If a judgment of the CAT upholds an aspect of an appeal, this could lead to the investigation or a part of it being remitted to the CC for reconsideration.⁴¹ (Appeals against CAT judgments can, if allowed, go forward to the Court of Appeal and, ultimately, to the Supreme Court.)

⁴⁰ [Section 136](#).

⁴¹ Following appeals against CC decisions, the CAT ordered the CC to reconsider parts of the remedies packages in the final reports on [Groceries](#) (April 2008) and [Payment protection insurance \(PPI\)](#) (January 2009). These aspects were, respectively, the competition test applied to grocery retail planning applications and the inclusion of a prohibition of the issuing of PPI at the point of sale.

Implementation of remedies

73. Following publication of the final report, if the CC has determined to take action itself, the CC has the choice of implementing remedies by accepting undertakings from the relevant parties and/or by making an order (see paragraphs 77 and 78 for a discussion of the considerations relevant to this choice).
74. The CC publishes an administrative timetable for the implementation of those remedies where it has decided to take action itself. For straightforward remedies, the CC expects to make an order or accept undertakings within around six months of publication of its final report. The implementation of more complex remedies may take longer; though the CC expects to make an order or accept undertakings within nine months from publication of its final report, other than in exceptional circumstances. The CC consults all parties affected by the remedies in determining the required undertakings or order. This includes a period of formal public consultation.⁴²
75. The action the CC takes in implementing remedies must be consistent with the decisions in the final report unless there has been a material change of circumstances since the preparation of the report or the CC has a special reason for acting differently.⁴³
76. An Inquiry Group will normally be disbanded following its acceptance of Final Undertakings or the imposition of an order to implement remedies. Responsibility for overseeing any further implementation activity that falls to the CC, such as the implementation of any divestiture remedy, falls to either the CC's Remedies Standing

⁴² As specified in [Schedule 10](#) to the Act.

⁴³ Section 138. For example, following the Court of Appeal's judgment on 13 October 2010 to reinstate the CC's findings on the [BAA airports](#) investigation (March 2009), the CC invited representations from all interested parties as to whether there had been any developments since the publication of the CC's report which constituted a material change of circumstances or a special reason within the scope of [section 138\(3\)](#) of the Act, to the extent that it should amend the remedy package set out in the report, for example the timing of proposed airport divestitures. In its decision of July 2011, the CC found there was a material change of circumstances, although did not change the remedy.

Group or to a specifically-appointed Group.⁴⁴ A Group specifically appointed to oversee further implementation activity may include some or all members of the original Inquiry Group. The identity of the Group charged with this activity is determined in light of factors such as the availability and expertise of members, the type of remedy to be implemented and the extent to which implementation is expected to be resource- and/or time-intensive. If all remedies are being implemented by means of recommendations to other bodies, the Inquiry Group originally appointed is normally disbanded following publication of the final report. The OFT is responsible for monitoring and enforcement of behavioural remedies⁴⁵ following acceptance of undertakings or the imposition of an order by the CC. Compliance with undertakings or an order is enforceable in the courts.⁴⁶

Undertakings and Orders

77. In general, the CC's decision whether to implement remedies by means of accepting undertakings or making an order is determined by practical issues such as the number of parties concerned, and their willingness to negotiate and agree undertakings. Another consideration is the scope of the CC's order-making powers and whether the remedy it is considering falls within those powers.
78. The content of any orders made by the CC is limited by the Act.⁴⁷ In contrast, the subject matter of an undertaking is not similarly limited.⁴⁸ This, and the process involved in agreeing undertakings, can help the CC and the parties, in terms of flexibility and suitability, in implementing remedies. However, because market investigations are likely to be market-wide rather than focused on the conduct of one

⁴⁴ For more information about undertakings and orders, and the procedures that will apply when remedies are being considered, see CC4, General Advice and Information, March 2006, Parts 6 and 7.

⁴⁵ [Section 162](#).

⁴⁶ If a person fails to comply with any undertakings that it has given or any order imposed on it by the CC, compliance may be enforced by means of civil proceedings brought by the OFT or the CC ([section 167](#)). In addition to enforcement by the OFT or the CC, any person affected by the contravention of undertakings or an order who has sustained resulting loss or damage may also bring an action against the relevant party.

⁴⁷ [Schedule 8](#) sets out the types of provisions that could be included in an order and [Part 1 of Schedule 9](#) enables the CC to modify, by order, licence conditions in various regulated markets.

⁴⁸ [Section 164\(1\)](#).

firm, it may often be more practical to implement remedies by order rather than through undertakings, so as to avoid the likely delay and complexity of negotiating undertakings with several parties.⁴⁹ In regulated sectors, if the CC decides to modify licence conditions⁵⁰ to give effect to, or take account of, any provision of a proposed remedy, it will make an order.

Part 3: The statutory questions to be addressed

79. During the course of a market investigation reference, the CC 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’.⁵¹ If that proves to be the case, under the Act this constitutes an AEC.⁵²
80. Where the CC decides that there is an AEC, it is required to decide the following additional questions:⁵³
- (a) whether action should be taken by [the CC] ... for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition;
 - (b) whether it should recommend the taking of action by others for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so

⁴⁹ For example, in *Home credit* and *PPI*, the remedies applied to a large number of parties and this was a reason for implementing these measures by means of an Order. By contrast, in *Classified Directories*, the remedies applied to only one party and undertakings were preferred. In other cases (eg *Groceries*, *Rolling stock leasing market (ROSCOs)*), some measures were implemented by means of an order, while others were implemented through undertakings.

⁵⁰ Part 1 of [Schedule 9](#) to the Act.

⁵¹ [Section 134\(1\)](#).

⁵² [Section 134\(2\)](#).

⁵³ [Section 134\(4\)](#).

- far as it has resulted from, or may be expected to result from, the adverse effect on competition; and
- (c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

The key statutory terms

'The relevant market'

81. In referring a market for specified goods and services in the UK to the CC, the referring body prescribes the market(s) for investigation. Relevant market means the market or markets referred to the CC for investigation. The Act also specifies (section 134(1)) that the CC decide whether features 'of each relevant market' prevents, restricts or distorts competition in the UK. However, the CC is not bound by the referring body's market definition(s)⁵⁴ and the market it defines may not always correspond to the relevant market referred to it. In these Guidelines (as in CC market reports), the 'relevant market' is nonetheless used to denote the market defined by the CC, regardless of the parameters of the referred market.

'AEC'

82. [Part 1](#) of these Guidelines considered the nature of competition, describing it as a beneficial process by which firms or other suppliers sought to win customers' business over time by offering them a better deal.⁵⁵ An AEC may result when this process is restricted or distorted.
83. To conclude that there is an AEC in a market, the CC must identify, any 'feature, or combination of features, of a relevant market (that) prevents, restricts or distorts competition',⁵⁶ ie the *sources* of harmful effects in a market The CC interprets the

⁵⁴ [Section 134](#)(1)–(3). See also, for example, OFT guidance, *Market Investigation References* (OFT511).

⁵⁵ Other suppliers from which firms face competition might include non-commercial organizations, such as the Government.

⁵⁶ [Section 134](#)(2).

phrase ‘prevents, restricts or distorts’ in the Act broadly to cover any adverse effect, whether actual or potential. It will therefore consider features that prevent the market becoming more competitive as well as those that affect the existing market.

84. The CC recognizes that the theoretical benchmark against which to measure an AEC can never be a ‘perfectly competitive’ market. In past market investigation reports the CC has used the term ‘a well-functioning market’ in the limited sense, generally, of a market without the features causing the AEC. The criteria the CC applies in coming to a view on the existence of an AEC are discussed in [Part 4, Section 4](#), below.

‘Features’

85. The Act states that the following may be taken to be a ‘feature’ of the market:⁵⁷
- (a) the structure of the market concerned or any aspect of that structure;
 - (b) any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or
 - (c) any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.
86. The Act does not require the CC to state whether particular features of a market are to be considered structural features or some aspect of conduct. It may not always be clear in which category the feature fits. Provided the relevant feature falls within at least one of these categories, the categorization is of little practical importance.
87. The concept of a feature is broad, allowing the CC the flexibility to investigate a wide range of possible market features, each of which may have effects on competition, in both its static sense of price, cost and profit levels and its longer-term dynamic sense of, for example, innovation, differentiation and/or development of products and

⁵⁷ [Section 131\(2\)](#).

markets. Moreover, a feature need not necessarily be the immediate cause of harm to competition; in most cases, the harm results from a causal chain of factors, each of which can be identified as features.

88. As emphasized in paragraph 18, on receipt of a market investigation the CC makes no presumption that market features exist which harm competition. It has a broad range of issues to investigate, but nonetheless a CC investigation may find that no feature gives rise to an AEC in the referred market.

Structural features

89. Structural features may include high market shares, high concentration, buyer power and high entry barriers. Market concentration was identified as a feature, for example, in the market investigations into classified advertising services⁵⁸ and the supply of groceries by retailers;⁵⁹ buyer power in the case of the supply of groceries investigation; common ownership in the case of BAA airports;⁶⁰ and high barriers to entry in the cases of the supply of groceries and domestic bulk liquefied petroleum gas (LPG)⁶¹ and the ROSCOs⁶² investigations.
90. Structural features may include other aspects of market structure such as government regulations and information asymmetries. Features identified in the BAA airports investigation included aspects of the planning system, government policy and the regulatory system for airports. The planning regime was also identified as a feature in the grocery retailing market, and the current criteria supplied for the award of franchises in the rolling stock leasing market were found to be features. Information asymmetries between incumbents and entrants were a feature identified in

⁵⁸ *Classified Directory Advertising Services market investigation*, 21 December 2006.

⁵⁹ *The supply of groceries in the UK market investigation*, 30 April 2008.

⁶⁰ *BAA airports market investigation: A report on the supply of airport services by BAA in the UK*, 19 March 2009.

⁶¹ *Market investigation into supply of bulk liquefied petroleum gas for domestic use*, 29 June 2006.

⁶² *Rolling Stock Leasing market investigation*, 7 April 2009.

the home credit markets.⁶³ Point-of-sale advantage for credit providers of PPI was identified as a structural feature restricting the extent to which other providers could compete effectively.⁶⁴

Conduct features

91. Conduct features may include the conduct of any market participants (whether sellers or buyers, see paragraph 10). As stated in the Act, conduct includes any failure to act, whether intentional or not and any other unintentional conduct.⁶⁵

92. Conduct features by sellers identified in past investigations include: a failure of Northern Irish banks sufficiently to explain their charging structures and practices for personal current accounts;⁶⁶ and the failure of distributors and intermediaries in the market for PPI to try to win customers by setting competitive price or quality levels for their policies.⁶⁷ The conduct of firms which supply the market when acting in other markets can also be a feature of the market. For example, if the market investigation concerned competition to supply a particular manufactured good, the conduct of vertically integrated suppliers in the market for the input might be a conduct feature.

93. Since the behaviour of customers can sometimes limit competition between firms, such behaviour can be categorized as a conduct feature of a market. Market investigations allow the competition authorities to look at customer behaviour and customer vulnerability in relation to its implications for competition, instead of just looking at it as a consumer protection issue (see also paragraphs 287 to 309). The insensitivity of customers to measures of price other than the level of weekly repayment was found to be a feature of the home credit market.⁶⁸ Similarly, the low

⁶³ *Home credit market investigation*, 28 April 2006.

⁶⁴ *Market investigation into payment protection insurance*, 29 January 2009.

⁶⁵ Section 131(2).

⁶⁶ *Northern Irish personal banking*, 15 May 2007.

⁶⁷ *PPI market investigation*, 29 January 2009.

⁶⁸ *Home credit market investigation*, 28 April 2006.

sensitivities of customers to store card APRs⁶⁹ and late payment charges were identified as features of store card credit services.⁷⁰ A customer feature—failure to investigate alternative accounts or banks—was also found in the market for personal current accounts in Northern Ireland.⁷¹

A combination of features

94. In some circumstances, several features may in combination harm competition. In the PPI investigation,⁷² for example, features were found that encompassed aspects of both structure and conduct and together explained the underlying causes of the AEC. Competition was found to be adversely affected by several interconnected features, including barriers to search and switching, which hindered customers' ability to compare PPI policies or to switch to alternatives. Barriers to search included product complexity, the perception that taking PPI would increase a customer's chances of being given credit, the bundling of PPI with credit and the limited scale of stand-alone provision. Barriers to switching included contract terms which made switching expensive or which risked leaving customers uninsured, as well as the point-of-sale advantage credit providers enjoyed.

Terms of reference

95. The terms of reference from the referring body (as noted in paragraph 81) describe the goods or services for whose supply or acquisition competition may be harmed and will indicate the feature or features that it believes may be the cause of this harm. The reference may also require the CC to confine its investigations to the place where the goods and services are supplied or acquired, or the persons by or to whom they are supplied or by or from whom they are acquired.⁷³ However, within the

⁶⁹ Annual Percentage Rate of the Total Charge for Credit.

⁷⁰ *Store cards market investigation*, 7 March 2006.

⁷¹ *Northern Irish personal banking*, 15 May 2007.

⁷² *PPI market investigation*, 29 January 2009.

⁷³ Section 133.

terms of the reference, it will be for the CC to reach its own conclusions on the definition of the market(s) and whether there is any AEC. If it decides there is an AEC, the CC may base its conclusion on different features from any identified by the referring body.

Part 4: The AEC test

96. In coming to a finding on whether or not an AEC has arisen the CC looks at three basic issues:
- (a) the main characteristics of the market and the outcomes of the competitive process;
 - (b) the boundaries of the relevant market within which competition may be harmed (*market definition*); and
 - (c) the features which may harm competition in the relevant market (the *competitive assessment*—which the CC frames within ‘theories of harm’), considering also possible countervailing factors, such as efficiencies, which remove *or* mitigate the competitive harm of the features.
97. Analyses of these issues are not conducted as distinct chronological stages of the investigation but as overlapping and continuous pieces of work, which often feed into each other. For example, the CC may take an initial view about the scope of the relevant market but the competitive assessment may suggest that this initial view of the market was either too broad or too narrow. Evaluation of outcomes (see [Part 4, Section 1](#) below) continues throughout the investigation.
98. [Part 4](#), Sections 1 to 3, below, deal with each of these issues in turn, and are followed by a short section on the conclusion of the AEC test.

Part 4: Section 1—Market characteristics and outcomes

99. To develop robust findings on whether or not features in a market are harming competition, the CC needs to understand how a market operates and reach a view about its performance. A part of its investigation is therefore the collection and analysis of information about the main characteristics of the market referred and the outcomes of the competitive process within that market. The CC's evaluation of characteristics and outcomes goes on throughout an investigation and continuously informs its assessment of what might be causing any adverse effects in the market.

Market characteristics

100. Reviewing evidence and observations on the main characteristics of the markets that it investigates helps the CC to frame the analysis of market definition and competitive effects, as well as to assess the practicability of remedy options, should an AEC be found.
101. Any assessment of the working of competition usually begins with an overview of market structure and the implications of this structure for the conduct of the firms within the market. A range of possible markets may be looked at in this way, taking the products and areas in the terms of reference as the starting point. The CC studies the profiles and performances of the suppliers of the products.

Market share data

102. The CC calculates the market shares of the suppliers of the reference products, especially if possible their shares over several years, so as to provide background data for the assessment of the level of competition within a market (see paragraphs 165 to 177). The ways the CC calculates market shares and market concentration are set out in Annex A (The measurement of: market shares and concentration; profitability).

103. Observed changes in market share over time may sometimes give an indication of the dynamics of a market. For example, when market shares have been stable over time, especially in the face of historical changes in prices or costs, high concentration may indicate that competition within the market is weak. However, a highly concentrated market may be competitive if market shares fluctuate over short periods in response to changes in competitive offers; such volatility may indicate the existence of effective competitive constraints, such as successful entry and innovative developments.

Other market characteristics

104. The other market characteristics most relevant to the CC's investigation will vary from case to case. However, the CC normally looks at the following:

- (a) The nature and characteristics of the products or services included in the terms of reference and of any potential substitutes for these products.
- (b) The nature of the customer base—for example, whether customers are businesses or final consumers, the extent of customer segmentation in a market, the demographic profile of the customer base or, where relevant, the extent to which they are informed about the products in the market subject to investigation.
- (c) The legal and regulatory framework that applies to the reference market. Laws and regulations can determine the nature of competition within a market and may also be relevant to the CC's consideration of remedies.
- (d) Industry practices, for example the way in which products are sold and prices are communicated to customers.
- (e) The history of the market, including recent competitive developments such as any recent examples of entry, expansion or exit and any significant changes that are anticipated in the market in the foreseeable future.

Market outcomes

105. Outcomes of the competitive process in their different forms in a market—eg prices and profitability, levels of innovation, product range and quality—can also provide evidence about its functioning. Evaluating the outcomes helps the CC determine whether there is an AEC and, if so, the extent to which customers may be harmed by it, ie the degree and nature of ‘customer detriment’. This is an important factor in any later consideration of possible remedies.
106. Of the various outcomes, prices and costs are among the more observable and measurable and an analysis of these may be useful in quantifying the extent and nature of competition and can be helpful in measuring consumer detriment. However, the other, less-quantifiable factors, such as quality and innovation are no less important to customers.
107. Although the outcomes of the competitive process may differ in character, there may be linkages between them, and the CC does not therefore consider each in isolation. The extent to which prices respond to changes in costs and the question of whether those costs are at an efficient level, for example, have implications for a firm’s profitability, and the level of investment may have implications for efficiency and product or service quality.
108. The following paragraphs in this section deal in turn with:
- A. Prices and profits.
 - B. Quality, innovation and other non-price indicators.

A. *Prices and profits*

109. The types of analysis the CC may undertake on prices and profitability depend on the nature of the markets and the theories of harm the CC has postulated (see para-

graphs 154 to 160). One type of analysis considers the pattern of prices over time and pricing strategy; a second type analyses whether prices are too high by comparison with levels in other markets or by considering profitability.

Price patterns

110. In markets subject to effective competition prices are likely to respond to changing supply and demand conditions and firms will seek to win business by improving their prices and other aspects of their offer. An analysis of the pattern of prices over time can therefore be informative about the nature of competition. However, the CC recognizes that there may be several factors affecting prices and will take this into account when considering inferences from this type of analysis. For example, in the absence of other explanatory factors:
- (a) static or continually rising prices may, in the absence of other explanatory factors, indicate a lack of competition; and
 - (b) parallel pricing—ie the practice by a seller of varying prices in a similar way and at about the same time as competitors—may be a symptom of coordinated effects (see paragraphs 224 to 231).
111. The pricing strategies adopted by firms in the market can also be informative about competitive conditions. For example:
- (a) introductory discounts followed by price increases might indicate high switching costs or customer inertia (see section on weak customer response, paragraphs 287 to 309); and
 - (b) a wide range of prices for similar goods or services might indicate the presence of search costs (see section on weak customer response, paragraphs 287 to 309).

112. Another type of analysis in this category, price concentration studies, looks at the extent to which prices may vary with market concentration. This is relevant to the assessment of competition within a market (paragraphs 165 to 189). For example, if there were several local geographic markets, higher prices being charged in more concentrated areas may indicate limitations in the competitive process in those areas.⁷⁴ This type of analysis may also consider the relationship between prices, margins and concentration over time.

Price-cost margins

113. The analysis of prices will in many cases be complemented by an analysis of costs, because these may be a key reason for price changes over time or differentials between areas. Therefore when analysing patterns of prices over time or geography, the CC may consider price-cost margins.⁷⁵

114. Price-cost margins can also give a direct indication of the willingness and ability of customers to switch between alternatives, providing useful information about the effectiveness of competition in the short run (in the market for a current range of products). High price-cost margins can indicate an unwillingness or inability to switch because of, for example, switching costs, search costs, limited customer information or significant product differentiation (see section on 'weak customer response', paragraphs 287 to 309). But the CC interprets price-cost margins with caution in this context: margins may be a misleading indicator in some industries⁷⁶ and in some

⁷⁵ However, this analysis is feasible only if it is possible accurately to measure price and some version of marginal cost, usually average incremental cost.

⁷⁶ Those in which marginal cost is below average cost and capacity constraints are not binding.

circumstances⁷⁷ a gap between price and marginal cost can be consistent with robust competition.⁷⁸

Indicators that prices are too high

115. The question of whether prices are too high may be approached in the two ways indicated above (paragraph 109): first by comparison; and secondly by considering profitability.
116. Comparisons with other markets, such as markets for similar products in other countries or in markets for comparable products in the UK, are sometimes made in CC market investigations. In general it is hard in practice to draw meaningful conclusions from this type of comparison unless it can be shown that costs are also comparable. In the Home credit investigation (November 2006) the CC found that prices in that market were high in comparison with the prices of other credit products and were higher than prices in the Republic of Ireland, where market conditions appeared to be similar.

Profitability

117. The second approach to the question of whether prices are too high in a market is to consider the profitability of firms or groups of firms representing a substantial part of it. (In practice, therefore, the CC tends not to be interested in the profits of less significant firms or groups of firms.)
118. Profitability can be a useful indicator of the competitive conditions in a market. An efficient firm in a competitive market would generally be able to earn no more than a 'normal' rate of profit—the minimum level of profits required to keep the factors of

⁷⁷ Where there are no entry barriers, fixed costs are present and products are differentiated.

⁷⁸ Customers might, for example, be unwilling to switch between highly differentiated products, but nonetheless competition on the basis of development efforts to introduce new products could be robust.

production in their current use in the long run, ie its rate of return on invested capital for a particular business activity would be equal to its cost of capital for that activity.⁷⁹

119. Profitability measures may, in particular, provide evidence about entry conditions. (paragraph 218). Firms earning persistently higher profits than normal might indicate factors that inhibit the entry that would otherwise see these profits undermined by new competitors.⁸⁰
120. In its analysis the CC is concerned with economic profits and these can differ in important respects from accounting profits. More information about the CC's approach to the calculation of profitability is in Annex A (The measurement of: market shares and concentration; profitability).
121. In practice, a competitive market would be expected to generate significant variations in profit levels between firms and over time as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of the firms involved. At particular points in time the profitability of some firms may exceed what might be termed the 'normal' level. There could be several reasons, including cyclical factors, transitory price or other marketing initiatives, and some firms earning higher profits as a result of past innovation or efficiency improvements.
122. The CC will therefore be interested in whether profits have exceeded the cost of capital over a sustained period (ie persistently high profits). The CC's view about whether high profits have been persistent will be influenced by its assessment of how competition works in the market concerned. For example, the pattern of investment

⁷⁹ But an exceptionally efficient company may be able to earn a higher rate of profit for a prolonged period.

⁸⁰ But an incumbent firm in a market might earn persistently high profits over several years because of strong network effects, but early competition to become a leading platform had been intense as many firms invested—and lost—significant amounts in developing alternative approaches.

and the nature of sources of competitive advantage (advertising, R&D, more efficient production) may affect the CC's view of the relevant timescales over which it would expect to see competition playing out in the market. In some cases, for example where large and risky investments have been made, the timescales over which it would expect to see a normal level of profits restored may be relatively long.

123. The CC may also have regard to the trend in profits. Where the size of the gap between the level of profitability and the cost of capital has grown over a period the competitive situation may have worsened. Where that gap has narrowed competitive conditions may have improved. Where that gap has fluctuated the CC may consider whether, on average, profits have exceeded the cost of capital.
124. The extent to which profitability indicates limitations in the competitive process may depend on both the size of the gap between the level of profits and the cost of capital and the length of the period over which the gap persists. The CC considers that the longer that profits have exceeded the cost of capital, and the higher the amount by which they have exceeded the cost of capital, the more likely they are to indicate problems with competition.
125. The CC may find that profits did not exceed the cost of capital or did not do so for a persistent period. Such a finding would not necessarily signify that competition is not harmed. Low profitability may be concealing ineffective competition. For example, weak competition as a result of customers being unable to respond effectively to competing offers may sometimes attract so many new entrants that firms operate on an inefficiently small scale, have higher costs and set higher prices than would be the case if customers switched more readily. Alternatively, incumbent firms might be protected from new entry, but still not earn high profits because they are inefficient and operate with higher costs than would be sustainable with stronger competition in

the market (see section on ‘weak customer response’, paragraphs 287 to 309). In some cases, the CC may be able to compare actual costs with efficient costs when looking at the level of profitability achieved by firms but this may not always be practical.

Indicators—not features

126. In summary, the CC will consider prices and profitability in the context of its overall assessment of the market. While useful, findings that price-cost margins are wide or profitability is high in a market do not provide conclusive evidence that the market could be more competitive. Such findings are not in themselves causes of competitive harm—ie features of the market for the purpose of the AEC test.

B. *Quality, innovation and other non-price indicators*

127. As indicated above (paragraph 106), prices and costs are not the sole indicators of the level of competition in a market. Poor quality, lack of innovation, or unsatisfactory product ranges are prominent among other indicators of weak competition in a market. Evidence about this kind of indicator tends to be qualitative, coming particularly from surveys, questionnaires or discussions with customers, investors, or other market observers. In several past market investigations, such empirical processes have spotlighted various negative non-price factors as important indicators of weak competition.
128. In the investigation into Northern Irish personal banking, the CC chose a range of indicators on which information was readily obtainable and readily comparable and, analysing responses to questionnaires, made a comparison between banks within Northern Ireland and some of the large banks based in Great Britain. This evidence indicated several non-price indicators of a lack of competition between Northern Irish banks in relation to branch opening hours, functionality of Internet banking and

product innovation.⁸¹ In its investigation into PPI, the CC considered evidence it had obtained so as ‘to identify: any new PPI policies which had been introduced, whether there had been any innovations within existing policies, the rationale for product change or innovation, and whether, and if so how, distributors advertised and marketed their policies’. The CC concluded that there was less choice (and possibly) less innovation, as well as higher prices, ‘than would be expected in a well-functioning market’.⁸²

129. In its investigation into BAA airports, 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.⁸³

Part 4: Section 2—Market definition

130. A market is a collection of goods and services, geographic areas (and sometimes also groups of customers or common delivery times), connected by a process of competition. The process is one in which firms seek to win customers’ business over time by improving their portfolios of products and the terms on which these are offered, so as to increase demand for the products (see paragraph 8). The willingness of customers to switch to other products is the driving force of competition. The boundaries of a product market therefore principally depend on the degree of demand substitutability between products.

⁸¹ *Northern Irish personal banking*, 15 May 2007, paragraphs 4.193–4.206.

⁸² *PPI market investigation*, 29 January 2009, paragraphs 4.12 & 9.4. See also paragraphs 84 & 310.

⁸³ *BAA airports market investigation*, 19 March 2009.

The role and determinants of market definition

131. Defining the relevant market in a market investigation (see paragraph 81) assists the CC to identify the market participants and products that might be central to the identification of features that have an adverse effect on competition. It thus provides a framework for the assessment of the effects on competition of features of a market. Market definition brings discipline and structure to the investigation, allowing the CC to identify the sources of market power⁸⁴ and its effects on competition.
132. Market definition may also allow the CC to measure market shares and market concentration more accurately than initially estimated (see paragraph 102). This is not an end in itself but can, particularly if market boundaries are accurately drawn, provide a useful indicator of the relative extent of market power enjoyed by one or more firms.
133. The identification of the relevant market does not limit the factors the CC must consider in conducting its assessment of whether a feature or combination of features may give rise to an AEC. The CC may also take into account constraints outside the market, segmentation within it, or other ways in which some constraints are more important than others.

Assessing substitutability

134. While the boundaries of a relevant product market largely depend on the degree of demand substitutability between products (paragraph 130), the CC may in some cases include supply-side factors in defining the market. The nature of competition in a particular market (and the theories of harm under consideration) may require that the CC identify an additional market to that defined by demand-side considerations. There might, for example, be a possibility that firms supplying non-substitute

⁸⁴ See paragraph 7.

products may have the capabilities and assets to redirect production to goods and services that would be substitutes for those in the market.⁸⁵ (For further detail on substitutability, see paragraphs 180 to 186).

135. In the investigation into local bus services,⁸⁶ for example, the CC investigated head-to-head competition in many demand-side markets, but the CC was also interested in competition to open new routes and needed to define additional broader markets to look into this.
136. Substitutability may, moreover, be different in the longer term from the immediate possibilities. In the short run firms compete on the basis of the products in their existing portfolios and the current geographical footprint of their distribution systems. In assessing short-run competition the CC will therefore usually define markets on the basis of substitutability between existing products and areas. However, in the longer term, firms may compete by improving their product portfolios, or the geographical scope of their distribution. The CC's assessment of this sort of competition may be concerned with identifying groups of firms that have the capability to introduce new or improved substitute products, or open new outlets in a more broadly defined product category or areas.
137. As a means of assessing whether the degree of substitutability places products in the same market, the hypothetical monopolist test (HMT) has proved hard to apply rigorously in market investigations.⁸⁷ The test helps to identify the constraints that would prevent a hypothetical monopolist from exercising market power, but is less

⁸⁵ Manufacturers of fast-moving consumer goods may use their expertise in marketing and product development to compete by expanding their portfolios of products. The CC may therefore identify such a supply-side market when, for example: (a) at least some suppliers supply a range of different products in the same broad category, using the same set of assets and capabilities; or (b) these suppliers regularly introduce new products or reposition existing ones within the category.

⁸⁶ [Local bus services market investigation](#), 20 December 2011.

⁸⁷ In its initial 2003 market investigation guidelines (CC3), the CC had expected that the HMT would be applied 'wherever it is feasible to do so'. The principle behind the HMT rests on defining a market as a product, or collection of products, which the supplier of which could hypothetically impose a small but significant non-transitory increase in price.

helpful in identifying market features that may be harming competition. In merger inquiries, the HMT can normally be applied relative to prevailing prices,⁸⁸ but in market investigations, particularly if being conducted after significant market power has already been exercised, using prevailing prices can lead to defining markets too broadly and drawing an incorrect inference that significant market power does not exist.⁸⁹ In theory, the HMT could be implemented in the presence of market power using notional competitive prices, but substantial practical problems stand in the way of doing so (in particular assessing what those prices would be). There is also a risk that delineating market boundaries applying the HMT by reference to some notional competitive benchmark in effect assumes the existence of market power before the competitive assessment has been undertaken.⁹⁰

138. Rather than generally attempting to identify the narrowest set of products satisfying the HMT in precise terms when defining markets in market investigations, therefore, the CC applies pragmatic methods and the degree of precision it judges best suited to the particular investigation. Although there may be no reliable model for defining the market in every investigation, the CC is often able to draw sound conclusions about the market based on the facts and circumstances of the industry or sector being analysed.

Dimensions of the market

139. There are normally two dimensions to the definition of the market: a product dimension and a geographic dimension. Markets may also be defined by reference to customer group or temporal factors.

⁸⁸ See Merger Assessment Guidelines (CC2 Revised/OFT2540, September 2010), paragraphs 5.2.10 & 5.2.12.

⁸⁹ This problem is known as the 'Cellophane Fallacy' because it arose in a US Supreme Court case involving cellophane, in which the issue was whether the relevant market was cellophane or all flexible packaging materials.

⁹⁰ If it is clear that competitive levels are below current levels, that would be strong evidence of an AEC.

140. As stated above (paragraph 81) In considering the substitutability of goods or services or area of supply set out in the terms of reference the CC may conclude that the market definition goes wider or narrower than the 'relevant market' identified in the terms of reference.

Product market

141. The CC may consider the following types of evidence, where available, when assessing whether products are substitutes:

- (a) information about product characteristics, such as physical properties and intended use that can indicate similarities (from the purchaser's perspective) between different products;
- (b) information about relative price levels and the extent to which prices of products within the possible relevant market are correlated with each other, as compared with the prices of products outside that market;
- (c) information on prices and sales volumes over time or across areas that permit analysis of the way that customers respond to changes in prices or to firms entering or leaving the market;
- (d) responses from customers, competitors and interested and informed third parties to questions—sometimes posed in surveys—about customer behaviour; and
- (e) data on how firms view the products, drawing on internal documents such as marketing studies, consumer surveys prepared in the normal course of business, market analyses prepared for investors, and internal business analyses (eg board papers, business plans and strategy documents).

142. The existence of a market for secondary products has sometimes to be considered in fixing the dimensions of a market. Secondary (or aftermarket) products are those that are purchased only as a result of the customer having purchased a primary product. An example is the market for printer cartridges, a secondary market linked to the

primary market for printers. The CC will generally consider primary and secondary products to be in separate markets. However, it may consider the products to be in the same market where customers take into account the cost of the secondary product when purchasing the primary product (see also paragraphs 282 to 286). The choice will not determine the outcome of the CC's competitive assessment, since the competitive constraint from other suppliers will be taken into account in either case.⁹¹

Geographic market

143. Geographic markets may be based on the location of either suppliers or customers. In the case of the former, the geographic market is an area covering a set of firms or outlets which compete closely because enough customers consider them to be substitutes (as in the case of retail markets and some industrial markets). In the latter case, a geographic market is an aggregation of customers paying individually negotiated prices but enjoying sufficiently similar purchasing options (ie in effect many customers in industrial markets).
144. The geographic market: may be local, regional, national or wider. Imports may be taken into account as well as UK products. The CC may examine geographic markets at more than one level in the same investigation, eg at both national and local levels, depending in part on the theory of harm under investigation.
145. The key to defining both supplier-based and customer-based geographic markets, as to defining the product market, is the degree of substitutability, ie the extent to which suppliers can switch their areas of supply and the extent to which customers on one area may be served in another area.

⁹¹ Other types of markets are described in relation to the assessment of market power, paragraph 168.

146. In the case of supplier-based markets the geographic scope may be described as a set of competing outlets. In identifying these sets the CC may consider the following:
- (a) information about the catchment areas from which the bulk of an outlet's customers is drawn;
 - (b) information on differences in pricing, sales, advertising and marketing strategies by area;
 - (c) information about which outlets customers consider to be substitutes for each other; and
 - (d) natural experiments that show the effect on one outlet's sales arising from entry, exit or expansion by other stores nearby.
147. Where available, the CC may consider the following when identifying the boundaries of customer-based markets:
- (a) product characteristics such as perishability;
 - (b) information on differences in pricing, sales, advertising and marketing strategies by area;
 - (c) information enabling the estimation of switching costs (which can include additional delivery costs) that customers might incur in changing to products currently supplied in other geographic areas, relative to the value of the products and the length of time taken to make the switch; and
 - (d) information on flows of goods between regions or into the UK and any barriers to entry, whether legislative, natural or strategically created.

Other issues

Customer groups

148. Many markets serve a diverse customer base, for example suppliers may have both business and personal customers. One set of customers may be more affected than others by any particular feature. Where such diversity exists, and where suppliers

can charge different prices to different groups (ie price discriminate), the CC will recognize these differences. In terms of market definition, depending on the market and the evidence presented, the CC may choose either to treat these different groups as separate markets, or as segments within one market, noting the scope for price discrimination between different groups within the market.

Temporal dimensions

149. When customers are not able to substitute products between periods, there may be a temporal dimension to the market, for example seasonality, peak and off-peak services. A typical example concerns commuters and leisure travellers on trains. Commuters constrained by their hours of work have little choice but to travel at 'peak' times, during which the train companies charge more than at other times. On the other hand, leisure travellers may be less concerned about the time of travel and more willing to travel at off-peak times and are charged less. In such instances, depending on the circumstances of the case, the CC may decide to define two or more markets, or it may decide to define only one market and note the scope for price discrimination within the market, for instance identifying a market for rail travel with different prices charged to peak and off-peak travellers.

Grouping markets together

150. In some cases, depending on the theory of harm being evaluated, the CC may treat a group of products, geographic or other types of markets together for the purposes of assessing competitive effects. This can be the case where a feature manifests itself in the same way across several different markets (for example, the need for an operating licence may be an aspect of many local markets) and the CC is able to reach a view about the effects of the feature on competition across the group of markets as a

whole. In the investigation into home credit,⁹² for example, the CC was satisfied that the conditions of competition were sufficiently similar throughout the reference area to justify a conclusion that applied throughout the area, without looking at every geographic area in detail.

Effects outside the relevant market

151. A separate market (outside the relevant market in which features may be found) can be identified where features have a harmful horizontal effect on competition in that separate market. It is an important part of the competitive assessment to try to understand the harm caused by the features on substitute products outside the relevant market and its likely detrimental effects on customers.

152. The CC may also consider effects in markets which are upstream or downstream of the relevant market. For example, one firm's advantage as a buyer in an input market may protect it from competitive pressures when supplying a downstream market for manufactured goods relying on that input. If the input market has been referred to it, the CC may consider effects in the downstream output market.

Part 4: Section 3—The competitive assessment

153. In deciding whether or not there is an AEC, the CC's core task—given the statutory requirements—is to assess the effects of possible features on competition. In conducting this assessment, the CC will seek to establish whether or not any of the possible features, or any combination of them, can be expected to harm competition, compared with the situation without the features or sometimes with an alternative realistic benchmark of a well-functioning market (see paragraphs 84 and 311). The emphasis on assessing the competitive effects of features means that any AEC

⁹² [Home credit market investigation](#), 28 April 2006.

finding will be grounded in a clear understanding of why competition in a market may be harmed.

Theories of harm

154. To provide the necessary focus and structure for its assessment of the way competition is working in a market the CC sets out one or more ‘theories of harm’. A theory of harm is a hypothesis of what might be the sources of harmful effects in a market (ie the features) and of what mechanism may be leading from these sources to the observed characteristics and outcomes in the market. The use of the term does not imply any prejudgement of an AEC in a given market.
155. Focusing the competitive assessment in this way rationalizes and facilitates the conduct of the investigation both for the CC and for the parties by identifying the issues that will be addressed and pointing to the information that will be gathered.

Formulating and reviewing theories of harm

156. The starting point for formulating theories in market investigations is the work already done by the referring body, particularly the terms of reference (paragraph 95) and decision documents. These will not only include observations on the structure of the market but will also have described the products the referring body thinks are affected and the features it suspects may be the cause of harm to competition. At this stage, the CC supplements the analysis carried out by the referring body with its own initial consideration of the market and may formulate theories of harm involving other possible aspects of the market on the basis of its own analysis of the characteristics of the market (see [Part 4, Section 1](#), Market characteristics and outcomes).
157. In the market investigation into local bus services, for example, the CC noted in the issues statement (4 February 2010): ‘It appears from the OFT investigation that in

many (local bus) markets there is limited head-to-head competition. The OFT's report also suggests that concentration is high.' It went on to list hypotheses as to why this might be so, including theories derived from barriers to entry, supplier behaviour and aspects of the tendering and bidding systems.

158. Although the CC aims at the outset of an investigation to focus on those aspects of the market that appear most likely to influence competition directly, this is not always clear. At this early stage, one or more theories may often therefore be set out in broad, generic terms.
159. As the CC investigates the interlinked issues of market characteristics and outcomes, market definition and the operation of competition within that market, it reviews its theories. In the course of its investigation, some theories will be dropped and others put forward. In testing a hypothesis, the CC may, for example, discover that there are no features that, on balance, lead to an AEC.
160. Several different hypotheses may be put forward for investigation. They may not be mutually exclusive. One or more theories may be linked to different outcomes, may in combination produce a single outcome, or may relate to different markets. On the other hand, several competing theories may sometimes be advanced linking alternative features with observed market outcomes, and in that case the CC has to consider which theory best explains the outcome.

The five underlying theories

161. [Part 1](#) of these Guidelines provided some background on the nature of competition, both in its static sense of price, cost and profit levels and its longer-term dynamic sense of, for example, innovation, differentiation and/or development of products and markets. It underlined that the constraints on firms that help ensure that competition

is effective come from, first, other firms already in the market and/or, secondly, from firms that could readily enter it and, thirdly, from their customers. For the purposes of conducting its market investigations, the CC commonly bases its competitive assessment around five types of underlying theories, which hypothetically and often in combination identify the possible sources of harmful effects in a market and trace the mechanisms that may have led from the features to the observed characteristics and outcomes in that market:

- Weak rivalry within the market.
- Restrictions on entry and expansion.
- Coordinated conduct.
- Vertical relationships.
- Weak customer response.

162. As noted above, the five underlying concepts are not mutually exclusive. Single features identified in a market investigation have been associated with different underlying theories, and barriers to entry have featured in most findings on whether or not there is an AEC (see paragraphs 89 to 94). Nor are the concepts exhaustive. The CC may, in a particular case, find a feature not falling within one or other of them. Moreover, externalities (see paragraph 15) may affect the nature of competition in markets⁹³ and reinforce or supplement any of the five underlying theories affecting competition. (While not considering them in relation to an AEC, the CC will take note in its reports of any externalities encountered in its investigations.)

⁹³ There is, for example, a positive externality occurring in telephone networks which can, in some cases, act as a barrier to entry and/or expansion. Existing subscribers to a telephone network benefit from the addition of further subscribers because of the increased possibilities for communication. As a result a small rival to a larger incumbent network operator has a disadvantage in attracting customers because, even if it is more efficient and can offer lower call charges, its potential customers realize that they will be able to call only a small fraction of those they could call using the incumbent's network. The small rival is likely to stay small and this may lead to weak intra-market rivalry unless the incumbent firm is required to provide interconnection between the two networks.

Countervailing factors

163. In considering the potential negative impact on the market of theories of harm, the CC takes account of any countervailing factors that may benefit competition and operate to the benefit of customers. Such countervailing factors fall into three main categories: efficiencies, countervailing entry and countervailing buyer power.

- *Efficiencies.* Efficiencies are considered to enhance rivalry when they induce one or more firms systematically to follow a more competitive course of action to the benefit of customers (eg lowering prices or increasing innovation) in response to actual or expected actions by rivals. In some circumstances, the positive effects of rivalry-enhancing efficiencies may outweigh the harmful effects of a market characteristic that would otherwise cause an AEC. Examples of such rivalry-enhancing efficiencies are given in the sections below dealing with each of the underlying theories. The CC will normally disregard possible efficiencies which are purely speculative, might only arise at some time in the distant future or are otherwise uncertain or unsubstantiated. Should the CC decide that, despite the existence of some efficiencies that benefit customers, there is still an AEC in a market, these may be taken into account as relevant customer benefits (RCBs), when the CC considers possible remedies (see paragraphs 348 to 362).
- *Countervailing entry.* The prospect of entry can sometimes offset an AEC that would otherwise arise, notably from weak rivalry within the market, horizontal coordination or vertical relationships. Despite present adverse effects in a market, in the longer term competition may be affected as new firms enter, or market participants take actions to enhance their ability to compete against established incumbents. The issues surrounding entry and expansion are examined in paragraphs 190 to 223). So long as there are no significant barriers to entry into the market under consideration, the CC may consider there is no AEC, where either:

- actual entry is judged to be likely, of a sufficient scale and swift enough to constrain incumbent firms in the near future; or
- the CC considers that the threat of potential entry is sufficient to exercise a constraint even though no actual entry has been observed in the recent past. This could be the case when entry would be quick and costless so as to take advantage of an opportunity afforded by a price rise in the market.
- *Countervailing buyer power.* The CC may take buyer power into account in considering one or other of the theories of harm. In many markets buyers have some degree of market power and prices are in effect determined by the relative bargaining power of seller and buyers. Buyer power may sometimes be sufficient to prevent the exercise of a supplier's market power. Much depends on the relative importance to each buyer and supplier of its business with the other party. In retailing, for example, a supplier may be more dependent on its sales to a large retailer than is the retailer on its purchases from that supplier, even if the supplier has a larger share of its market than the retailer has of the retail market. However, the presence of large buyers relative to the size of the suppliers in a market does not necessarily mean that there is a countervailing buyer power in that market. The key is the strength of buyers' 'outside options', ie their alternative sources of the relevant product. Moreover, even if buyer power can offset the market power of suppliers, the benefits from the exercise of buyer power in lowering suppliers' prices are not necessarily passed on to the customers.

164. The following subsections deal with each of the five underlying theories identified above (paragraph 161) by considering first the nature of the mechanism, and secondly its potential impact on the market, including any positive efficiencies, and the CC's approach to the testing this impact.

Theory 1: Weak competition within the market

165. The CC considers competition within a market to be weak when one or more market participants⁹⁴ enjoys significant and persistent market power⁹⁵ and is hence able to influence important aspects of competition. Almost all firms have some market power; most have only a little; but some, such as natural monopolies may have persistent and excessive market power.
166. There are several reasons why one or more firms in a market may possess significant and persistent market power, intra-market competition may therefore be weak and an AEC might arise. The most common are:
- (a) high concentration (see paragraphs 171 to 177);
 - (b) capacity constraints (see paragraphs 178 and 179);
 - (c) lack of substitutability (see paragraphs 180 and 181); and
 - (d) supply-side constraints (see paragraphs 182 to 186).
167. The CC's assessment of market power may consider all of these issues, as detailed below. However, in some circumstances, the CC may observe direct indicators of market power, such as proof of high profits (see paragraphs 118), high price-cost margins (see paragraph 114), demand elasticities⁹⁶ or direct evidence of adverse effects in the form of high prices, low quality, limited choice and sluggish innovation (see paragraphs 127 to 129).
168. The assessment of market power can become more complicated in the cases of:
- network or two-sided markets providing services over a network or through a platform; customers value the network or platform more highly when it is used by a greater number of other customers; for example, in newspaper (and other

⁹⁴ See paragraph 7.

⁹⁵ See paragraph 7.

⁹⁶ A firm's level of power will be related to the market elasticity of demand for its product, and to its rivals' elasticity of supply for that product.

- media) markets both readers (or viewers, or listeners) and advertisers are served and the value of the product (eg an advertisement) to one group of customers (advertisers) is affected by the number of customers served in the other group (the number of readers of a newspaper, listeners to a radio station or viewers of a television channel);
- markets characterized by bidding and tendering processes, where firms bid on the basis of the service they can offer to supply customers with bespoke products; and
 - secondary or *after*-markets (where the products are purchased only as a result of the customer having purchased a primary product; see paragraph 142 and paragraphs 282 to 286).

169. The way a firm behaves may also give an indication of the market power it may enjoy. However, actions apparently indicative of market power may be benign or even beneficial practices. For example, if a supplier pitches prices below cost, this may be predatory action, but may alternatively be introductory offers that will expand future demand for the product and therefore increase competition in the longer term.
170. Since the impact of weak intra-market rivalry is often felt acutely in a lack of innovation and new product development—competition in its long-term dynamic sense (see paragraph 161)—a concluding sub-section examines that issue (paragraphs 187 to 189).

(a) High concentration

171. A highly concentrated market—as indicated by, for example, persistently high market shares held by some firms relative to other suppliers in the same market—can be an indicator of market power. Generally, a firm with a high market share may have less incentive to compete vigorously with its rivals (particularly if there are barriers to

entry). For example, if a price reduction aimed at new customers would also apply to existing customers, a firm with a large market share may be more reluctant to implement a price reduction than might one with a small share. The firm with a large market share may also feel no pressure to reduce price even if a smaller rival does so.

172. A large market share may also confer substantial advantages in bargaining with suppliers upstream, or buyers downstream, and a firm may be able to control prices in its favour or impose unreasonable restraints in the negotiation process. High concentration has been identified as a feature in several market investigations (see paragraph 89).
173. On the other the hand, market shares may reflect the capabilities and relative efficiency of firms in a market. A large market share tends to indicate that the firm(s) possessing it may have low costs, an attractive product, or both. It may also reflect flexibility to expand output rapidly in response to increased demand by larger absolute amounts than a small firm.
174. Moreover, high concentration does not always indicate weak rivalry within the market. For example, a company with a large market share could be vulnerable to entry and expansion which might constrain its market power.⁹⁷
175. Conversely, since a firm's level of power will be related to the market elasticity of demand for its product, and to its rivals' elasticity of supply for that product (see paragraph 167 and footnote 103), even a firm with a low share of sales of a product may have considerable power if both measures of elasticity are low.

⁹⁷ Even a monopoly can in certain circumstances and for certain periods face competition.

176. In some cases, recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm's expected competitive significance in the near future. The CC considers predictable effects of recent or ongoing changes in market conditions—for example, the spreading of new technologies, the longevity of patents and the prospective development of new products—when calculating and interpreting market share data.
177. In general, the weight the CC attributes to concentration measures depends on its confidence that market boundaries are accurately defined. Given the practical difficulties of applying the HMT (see paragraph 137), there can be a risk that observed low concentration reflects an overly broad market definition rather than an absence of market power, while observed high concentration may indicate, not high market power, but the omission of a relative constraint from the market definition.

(b) Capacity constraints

178. In markets involving relatively undifferentiated products, one or more market participants may find it profitable unilaterally to reduce output and increase the market price (eg by leaving capacity idle or diverting production to another market). Such a strategy is more likely to be profitable when any rival is limited by capacity constraints or a relatively low elasticity of demand in the market. In some markets, therefore, share of capacity may be more important than share of supply.
179. In assessing the power of a firm to suppress output unilaterally the CC focuses on the degree of spare capacity other firms in the market may possess, the ease with which these firms could expand existing capacity, and their commercial incentive to counteract any overall output shortfall.

(c) Lack of substitutability of products

180. A single firm may also enjoy market power because it controls a group of close substitute products and its customers have limited alternatives. Even in differentiated product industries, while some products can be close substitutes and compete strongly with each other, others are more distant substitutes and compete less strongly. Branding, quality, product characteristics or geographical location will have effects on the extent to which a product competes with another; one high-end product, for example, may compete more directly with another high-end product than with a low-end product.
181. Assessing the extent of direct competition between close and distant substitute products will often involve calculations of diversion ratios and of cross-price elasticities of demand.⁹⁸ The higher the cross-price elasticity of demand between two products the closer substitutes they are in the eyes of consumers (see also paragraph 175).

(d) Supply-side constraints

182. Weak rivalry within a market can also be sustained if market participants are unable to respond to a price rise by expanding their production facilities to produce the goods and services concerned.
183. Two products are considered to be supply-side substitutes if the supplier of one of the products already owns the key assets needed to produce and market the other, without incurring additional sunk costs. An incumbent firm may be able to do so, and sometimes new entrant firms, may exert a competitive constraint within the market if they can easily and rapidly begin selling in the market without incurring significant

⁹⁸ A *diversion ratio* between Product A and Product B represents the proportion of sales that would divert to Product B (as opposed to Products C, D, E etc) as customers' second choice in the event of a price increase for Product A. The *cross-price elasticity of demand* of Product A to Product B is a measure of the percentage change in the quantity of Product A sold when the price of Product B rises by 1 per cent.

sunk costs.⁹⁹ This may be the case when, for example, a firm produces the relevant product but sells it in a neighbouring geographic market—or to customers in another market. Similarly some firms, even producing relatively distant substitutes, may have access to the know-how, and may be endowed with assets (physical and human) that can be easily and rapidly adjusted to produce and distribute close substitute goods.

184. So as to assess the extent to which manufacturers of supply-side substitutes enhance competition in the market, the CC considers whether:

- there are economic incentives to engage in production of the relevant goods/services;
- the manufacturers are able to divert production, or are contractually tied to continue production of existing products; and
- they possess unused plant capacity that can be brought into production at a reasonable cost.¹⁰⁰

185. The CC will also consider whether the existence of supply-side substitutes influences the market behaviour of incumbent firms which otherwise would enjoy significant market power (seeking evidence, for example from internal documents, past episodes of successful rapid entry and exit, and from customers about the credibility of rapid entrants¹⁰¹).

186. In assessing the prospects of expansion, repositioning, and mobility, the CC will consider in particular, the timing of the likely supply response, possible legal restrictions, access to distribution channels, and commercial risks and incentives on

⁹⁹ For example, in markets for relatively homogeneous goods, a supplier with idle capacity, or readily available 'swing' capacity currently used in adjacent markets, may profitably start supplying the relevant market in response to price increases.

¹⁰⁰ The extent of intra-market rivalry may depend on whether firms' cost structures are similar, and how low-cost firms utilize this advantage.

¹⁰¹ Situations in which firms compete with products that are currently available may be distinguished from situations where firms compete by producing to order or on the basis of blueprints or where firms define their businesses in terms of the skills of their employees. In the latter situations supply-side substitution is likely to be particularly important.

account of such factors as customer loyalty, brand reputation or managerial expertise.

Innovation and new product development

187. Weak competition within a market may in particular stifle incentives on firms to innovate or invest in product development and thereby prevent the gains in productive efficiency and customer benefits that innovation or new products bring over time (see paragraph 170). When firms face competition—whether from other incumbents or from actual or potential new entrants, the possibility of generating supra-normal profits encourages them to discover new products and processes. In contrast, firms that do not face competitive pressures may choose not to invest significantly in R&D.
188. The CC recognizes that the relationship between market concentration and innovation is not always clear cut. Large incumbent firms may benefit from significant economies of scale in the innovative process.¹⁰² On the other hand, an incumbent firm with significant market power may have a lower incentive to innovate than a smaller competitor or new entrants because it has more to lose.¹⁰³ In some markets innovators may expect to benefit only to a small extent but, even in such markets innovation incentives may be strong if rivalry is intense.
189. In assessing market power in high technology industries, the CC will pay particular attention to the number of products and/or technologies that are being developed. Another useful indicator in high-technology industries is R&D spending relative to

¹⁰² Large-scale firms that undertake large amounts of R&D may be able to employ more specialized resources; they will face smaller average total costs because they can average the fixed costs of their innovative effort over a greater level of output; and they may be able to support a larger portfolio of R&D efforts, increasing the likelihood that this will develop an improved product or process likely to be applicable to at least one of its businesses.

¹⁰³ A monopolist could spend a great deal of money to make a dramatic improvement—whether by lowering cost, improving quality or creating a new product—and take over the market, only to find that it does not get much additional business because it already has most of the business in that market. If a competitor had come up with the same innovation, by contrast, it would fear more because it would expect to take away much of the business previously conducted by rival firms.

sales. High R&D spending to sales ratios provide a clear indication that competition takes place through innovation. Where R&D investment is high, market power may be vulnerable to future innovations by rivals or new entrants. Substantial shifts in market share over time are also positive signs of a high level of rivalry in innovative or high-technology industries.

Theory 2: Restrictions to entry and expansion

190. The CC will usually consider theories that restrictions on entry or expansion may be eliminating or reducing a major source of competitive discipline on market incumbents.
191. Entry¹⁰⁴ can take several forms. New firms may build new capacity or take over existing capacity to use it in new or more productive ways. Incumbent firms within the market may build new plants or capacity, develop new products or expand into neighbouring markets. Incumbent firms may invest in upstream or downstream companies to supply materials and process their output, respectively. New technology and production methods developed by incumbents may also attract new entrants.
192. Entry in its various forms (and sometimes just the threat of entry) can stimulate competition and innovation, and can negate any competitive harm flowing from other sources. (Entry must, however, be on a sufficient scale to have this impact on the the market; small-scale past entry does not demonstrate the absence of entry restrictions; see paragraphs 219 to 221.) Entry or the threat of entry can:
- upset established patterns of market conduct, particularly by making it difficult for a dominant firm to continue wielding significant market power;
 - promote efficient firms at the expense of inefficient ones;

¹⁰⁴ The terms 'entry' and 'entry barriers' are used throughout this section as shorthand for, respectively, 'entry and expansion' and any restriction on entry or expansion.

- introduce new technology and fresh approaches to product design, marketing and delivery; the impact of entry and expansion on innovation within an industry has been observed above (see paragraph 187);¹⁰⁵ and
- lead to more competitive prices as well as greater choice and quality to the benefit of customers.

193. Entry restrictions may thus may lead to an AEC because they prevent the benefits of entry materializing. The restrictions of any type can be defined as any feature of the market that gives incumbent suppliers a cost or other advantage over efficient potential entrants. The restrictions can prevent entry absolutely or can delay it for such a long period of time as to be tantamount to an absolute restriction.¹⁰⁶

194. The following sections of these Guidelines, first, outline the different types of barriers to entry and, secondly, describe the CC's approach to assessing the impact of these barriers.

Types of entry barriers

195. There are three broad categories of restrictions to entry and expansion: natural or intrinsic barriers; strategic and other 'first mover' advantages (including the endogenous costs of investing in market entry¹⁰⁷); and regulatory barriers. Other factors will also help determine an entrant's decision to move into a market, for example, the possession of the necessary production facilities, and the economic prospects for the market. Barriers to exit—the cost of exit from the market if the

¹⁰⁵ Some innovative products and processes introduced by new entrants may be easy to imitate and adopt by rivals once they have been shown to be workable. If the entrant's competitive advantage can be appropriated and quickly eroded in this way, entry may be socially desirable, but privately unprofitable. In that case public policy may have a role in encouraging entry.

¹⁰⁶ Factors that delay entry may include licensing, certification, or product registration requirements that involve little or no costs but take significant amounts of time to satisfy. Other examples include the time required to obtain contracts (ie where the market's products are sold via long-term contracts) or to gain a market share large enough to influence the behaviour of incumbents significantly.

¹⁰⁷ Endogenous costs are those located within a firm's organization—human capital, innovation, knowledge and so forth.

business venture fails—have also to be considered. Barriers to entry, exit or expansion can interact with and magnify each other's effects.¹⁰⁸

Natural or intrinsic barriers to entry or expansion

196. Natural or intrinsic barriers to entry are the unavoidable costs incurred when setting up or expanding a commercial operation. These involve the cost of putting the production process in place, gaining access to essential facilities or inputs and the acquisition of any necessary intellectual property rights (IPRs). An important consideration in evaluating the effects of such barriers is the extent to which the costs associated with them are 'sunk' (see paragraph 215).
197. Economies of scale can often constitute an entry barrier in cases where the barriers relate to the cost of getting into the market.
198. In industries where economies of scale are significant, entry or expansion on a small scale may not be profitable unless the firm is aiming at a 'niche' in the market or can develop a new production strategy which offsets the disadvantages of small-scale production. Entry or expansion on a large scale will often entail a high risk because it will generally be successful only if the firm can expand the total market significantly, or substantially replace one or more existing firms.¹⁰⁹
199. Entrant firms may also face disadvantages relative to incumbents where production costs decrease as the cumulative quantity produced increases (ie through 'learning by doing'). Similar considerations apply to economies of scope, which arise where producing two (or more) products is less costly for a single firm than for two (or more)

¹⁰⁸ Economists distinguish between 'stand-alone' and 'ancillary' barriers. The former is a cost that constitutes a barrier to entry by itself. An 'ancillary' barrier to entry is a cost that does not constitute a barrier by itself but reinforces other barriers that may be present. A group of small stand-alone barriers may constitute a significant barrier but a group of small ancillary barriers cannot do so.

¹⁰⁹ Economies of scale may constitute a particular barrier to entry if the size of the market is small relative to the minimum efficient scale.

firms each to produce the products separately. Where economies of scope are significant, a successful entrant might have to produce a range of products from the outset.

200. Natural or intrinsic barriers to entry often accrue simply because incumbents are already in the market and as a result have a cost, or demand-side, advantage over entrants (see Strategic and 'first-mover' advantages, below, paragraphs 202 to 206).
201. Network effects—where other customers committing to a particular product or service makes it more attractive to new customers (see paragraph 168)—may constitute an absolute barrier to entry.¹¹⁰ This is because incumbents with an existing customer base have an automatic advantage over entrants. However, when demand is growing fast, or innovation is rapid, the barrier might not be as high as when demand or technological change is more static.

Strategic advantages of incumbents

202. Some barriers, termed strategic, are the result of existing firms in the market acting to deter entry by reducing post-entry profitability. Incumbent firms may do so through investing:
- (a) to lower the incumbents' costs relative to those of potential entrants (for example, by increasing capacity, taking out patents, or undertaking R&D), etc);
 - (b) to alter the cost structure of rivals (for example, arranging take-or-pay contracts or vertical arrangements); and
 - (c) to alter demand conditions in their favour (for example, by conducting more advertising, proliferating brands or entering into long-term contracts with buyers, etc).

¹¹⁰ On telephone networks, for example, customers pay less to call other people on the network than they pay to contact those on other networks. If most existing customers (and therefore likely recipients of calls from new customers) are on the same network, it is harder for a rival to attract new customers.

203. Such strategic entry barriers will tend to be more important the greater the sunk costs of entry; the greater therefore the difference between the incumbent's profitability and the rival's post-entry profitability; and the greater the financial investment needed by a potential entrant the greater the risk associated with entry.
204. The existence of significant switching costs may act as a barrier to entry. These may be intrinsic to the market, but firms may also act strategically to increase them, for example by offering fidelity discounts or agreeing long-term contracts with customers accompanied by penalties for early termination. Moreover, incumbent firms producing complementary goods may tie or bundle them together, potentially raising the costs for an entrant producing only one of the complementary goods (see paragraphs 280 and 281). The incumbent firms may also be able to deter entry by signalling that they would respond aggressively to entry, including by over-investment in spare capacity, or seek to target entrants specifically to discourage them from entering the market.
205. Where strategic entry barriers have been actively created by a dominant firm, such as refusal to supply essential inputs to a downstream competitor or to grant access to an essential facility, the issues can be dealt with under CA98. Other situations may involve several incumbent firms, for example where networks of restrictive distribution agreements or information advantages are being exploited to deter the entry of new competitors, and these may be more suited to a market investigation reference.

Other 'first mover' advantages

206. Other barriers may result simply from the established position of the incumbent firms in the market. Such so-called 'first-mover' advantages may make it difficult for other firms to enter a particular industry because experience or an established reputation is necessary to compete effectively. Relevant factors in this context include customer loyalty to a particular brand, the closeness of the relationships between suppliers and

customers, and the role of promotion or advertising in the particular industry. The CC recognizes that incumbent firms will often have conducted successful marketing and advertising campaigns, not to exploit a first-mover advantage, but as part of their efforts to distribute their products to customers and, more generally, may have built market share by successfully providing customers with good service, quality and value for money.

Regulatory barriers to entry

207. The concept of regulation in the context of barriers to market entry is broader than the conventional sense and includes, for example, intellectual property law, the planning regime, voluntary or compulsory standards and codes of practice.
208. Regulations may be beneficial for a variety of reasons ranging from ensuring the stability of the financial system to protecting the environment, but they may inhibit the extent to which competition can flourish in certain circumstances. Some types of regulations may concern the production process and the characteristics of the finished product, for instance health and safety standards. Others may limit the number of competitors in the market, for example by requiring that only firms with a licence or permit may operate within it. A limitation on the number of licences and permits may act as an absolute barrier to entry.¹¹¹
209. With regard to their effect on competition, there is a distinction between regulations that impose barriers evenly on all firms and those that hit new entrants harder than incumbent firms. Subsidies, tax reliefs and preferential purchasing may raise barriers to entry in a market if potential entrants are not equally eligible for them. Similarly, planning policies and regulations can constitute a barrier or impediment to potential

¹¹¹ Sometimes in a competitive market licences and permits can be traded and a potential entrant is able to enter the market by buying a licence, depending on how frequently such opportunities arise.

entrants into a market to the advantage of incumbent firms. IPRs such as patents, trademarks and copyrights give the owners of such rights exclusive use of them and the ability to control their use by others, though the period of such exclusivity or control varies according to the nature of the property right. IPRs can act as barriers to entry when access to the rights owned by an incumbent may be vital for entry.¹¹²

210. Quality, environmental, and health and safety standards that apply to all the firms in a market may on occasions adversely affect entry despite making no distinction between incumbents and new entrants. For example, they might favour the technology the incumbent owns and therefore raise the costs of a new entrant. Some regulations may give advantage to incumbents by not requiring them to comply with the same standards as new entrants.¹¹³

Assessing the impact of entry restrictions

211. To test a theory of harm based on the effects on competition of any restrictions on entry, the CC has to assess the impact that the entry restrictions identified has had, is having or may have in the future.
212. The CC examines how competition affects the decisions of individual firms to enter or invest in that market, taking into account the advantages of established sellers. This entails examining the factors influencing entry decisions, while recognizing that these will be accorded different weights by different firms.
213. The post-entry profitability that can be expected—and therefore the degree of attractiveness to a firm of entering a market—is affected by two main factors: the intensity of competition post-entry and the extent to which entry costs are sunk.

¹¹² In some such cases it might be appropriate to assess the impact of IPRs on competition for the market rather than within it.

¹¹³ For example, existing high pollution factories often have 'grandfather' rights to pollute, which are not enjoyed by entrants, because the factory existed before the relevant regulation came into force.

214. In relation to post-entry competition, the expectation of a tough competitive regime post-entry leads entrants to anticipate lower prices, reducing the profitability of entry and making it less attractive. If, on the other hand, growth in demand is likely to be large and rapid, barriers to entry are less likely to have a lasting effect. Similarly, in markets characterized by innovation, product cycles are likely to be shorter and barriers to entry less likely to have a lasting effect.
215. High fixed entry costs can also deter entry, particularly if those costs are also sunk, ie investments that cannot be recovered upon exit and hence would serve to commit a firm or firms to staying in the market.¹¹⁴ (Non-sunk costs, in contrast, by definition are recoverable if production ceases, and do not therefore pose the same risk.) Sunk costs include, for example, some specific asset investments, advertising and R&D. In some markets, a reputation for producing quality products is needed to attract customers: the costs of acquiring such a reputation can be a form of sunk costs.
216. Entry decisions are often influenced by a range of other factors, including pay-back periods, the effect on other business segments (eg possible cannibalization, ie creation of competition to a firm's existing business), and the risk of the project. The risk will in turn be affected by various factors influencing the certainty or otherwise of forecast future cash flows: for example, the management team's level of experience, the predictability of demand, and likely competitor reactions.
217. In assessing the factors influencing entry decisions, the CC therefore seeks evidence on:

¹¹⁴ Three important aspects of sunk costs influence entry and exit decisions. First, sunk costs increase the risk of entering an industry because they cannot be recouped on exiting. Second, sunk costs create a cost asymmetry between entrants and incumbents. Once costs are sunk they are no longer a portion of the opportunity costs of production, and hence an incumbent will require a lower return on costs so as to stay in an industry than will be required to enter. Third, sunk costs can serve as a commitment by incumbent firms not to exit the industry.

- the costs involved in entry or expansion and in operating at the minimum efficient scale necessary to achieve a reasonably competitive level of costs;
- the likelihood of entry (from new entrants in related markets and/or from scratch) or expansion within such a timescale that it bears on the incentives and decisions of the existing firms in the market;
- the cost of exiting the market; and
- the likely response to entry or expansion by incumbent firms.

218. Evidence of persistent abnormal profits within the industry or among large incumbents is generally consistent with a finding that barriers are high and that entry is therefore unlikely (see paragraph 119). But it is neither a necessary nor a sufficient effect.¹¹⁵ Data showing that incumbents consistently fail to earn high profits is generally consistent with low entry barriers, but it does not prove that barriers are low and that competition is working dynamically; in the absence of a credible threat of entry there may be limited incentives for incumbents to innovate or to improve productivity.

Past and prospective entry

219. The CC will examine the history of past entry and expansion and evidence of planned entry or expansion. This assessment will include the extent to which past entrants and smaller firms have successfully gained market share (see paragraph 192) and, more generally, the cost of gaining a significant share of the defined market (usually considered as 5 per cent).

220. In considering historical evidence, the CC may consider survival rates, ie how long any entrants traded in the market; the effects that entry or expansion had on competition in the market, in particular whether past entry or expansion modified the

¹¹⁵ A government regulation might, for example, be restricting the number of firms in an industry and, although many firms were permitted to compete and did so vigorously, there will be no supra-competitive profits despite the impossibility of net entry. On the other hand, other firms may have been earning supra-competitive profits from sales of a certain product for many years because they own key patents.

pattern of behaviour and competition; and if so, whether this would be relevant for the present analysis. The CC may also consider the price effects, if any, from past episodes of entry, the viability of the entrant and its experience in trying to gain market share.

221. Although evidence of past entry (or the lack of it) can be helpful in assessing the significance of entry barriers in a market, previous episodes of entry do not prove that it was easy, that it was competitively significant, that it is likely to take place again, or that the possibility of entry is imposing a competitive constraint. Moreover, current potential entrants may not face the same market conditions that previous entrants faced. Similarly, although an absence of actual or meaningful entry in the past is consistent with the presence of substantial entry barriers, it does not necessarily prove that significant entry is unlikely in the future.

The positive effects of a restriction

222. In some circumstances restrictions on entry may have a positive impact:
- Entry restrictions may sometimes increase incentives to innovate. While new entrants can often lead to innovative competition, the effect of entry restrictions, or the prospect of creating them, may also increase the incentives for incumbents to create new products and services. IPRs, for example, are an incentive to innovate because they prevent rivals ‘free-riding’¹¹⁶ on other firms’ innovations. Given these conflicting factors, the CC will assess the incentives of incumbents relative to those of potential entrants to engage in innovative activities in the presence of entry restrictions. The CC will also sometimes assess whether or not potential technological change and innovation could affect the nature and effectiveness of current restrictions on entry or expansion.

¹¹⁶ See footnote 130.

- Some entry restrictions achieve important social goals outside the scope of competition policy (see paragraph 208). Safety regulations, for example, may make it more difficult to switch suppliers of domestic liquified gas in the UK, but the CC recognized that regulation in that industry is necessary.¹¹⁷

223. While such positive impacts may be dealt with remedially as RCBs, some may be weighed in coming to a decision of the AEC test (see paragraph 163), at which a decision might be taken that a restriction on short-run competition could be tolerated so as to preserve incentives to compete in longer-term ways.

Theory 3: Coordinated conduct by firms

224. The successful adoption by rival firms of a coordinated course of action may give rise to a third underlying theory as to how firms may be harming competition to the detriment of customers.

225. Any coordination typically involves repeated interaction, aimed at increasing or protecting profits, between firms in the market. But it can take different forms. It can be explicit or tacit and there is a wide spectrum of coordinated behaviour, its different forms often being related to the structure of the market concerned.

226. At one end of the spectrum, direct and unambiguous communication among competitors can lead to explicit agreements to fix prices, share markets or allocate customers. At the other end of the spectrum, when a market is sufficiently stable and rival firms interact repeatedly they may be able to anticipate each other's future actions allowing them tacitly to establish a coordinated course of action without resorting to direct communication or information-sharing. Such tacit coordination is most likely to emerge when competitors can easily arrive at a common perception of

¹¹⁷ [Market investigation into supply of bulk liquefied petroleum gas for domestic use](#), 29 June 2006.

the benefits of coordination or parallel behaviour, which falls short of an agreement on cooperation. Coordination does not have to be 'perfect' at all times to affect a market and may be intermittent; it is possible that periods of coordination may be interspersed with periods of competition when not all competitors see it in their interest to cooperate.

227. Cases of coordinated behaviour may fall within Article 101 of the TFEU or Chapter 1 of CA98;¹¹⁸ coordinated behaviour falling outside the scope of these provisions may also be harmful.

Impact of coordinated conduct

228. Coordination may have an impact, on any dimension of competition. In many cases, that impact will be harmful to competition and consumers. Prices may be higher than they would have been if firms had taken unilateral decisions. In other cases, it may involve limiting production or innovation. Firms may divide up the market between them, for example by geographic area or customer characteristics, or by allocating contracts between themselves. Joint action may be taken to foreclose access to markets, inputs or customers.
229. However, not all cooperation will be harmful. It may sometimes also bring about pro-competitive effects and may benefit customers.
230. In most financial markets in the UK, for example, credit providers and insurers routinely share certain data on their customers so as to improve competitive conditions in those markets. The CC found that the absence of such data sharing was a feature harming competition in the market for home credit and had

¹¹⁸ See footnotes 4, 5 & 6.

implemented a remedy requiring that lenders above a certain size provide credit agencies with full data on the payment records of customers.¹¹⁹

231. Cooperation between public transport companies can in some circumstances promote competition and benefit customers. In its investigation into local bus services, the CC found that company-specific travelcard schemes can operate as a barrier to the entry or expansion of competing services and therefore recommended legislation to give Local Transport Authorities powers to introduce mandatory multi-operator travelcard schemes.¹²⁰

Assessing coordination theories

232. The CC's statutory powers to investigate (as opposed to enforce) are not affected by the distinctions between different forms of coordination or where it lies along the spectrum from explicit to tacit coordination; it may investigate all such activities. All forms of coordination may reduce strategic uncertainty among competitors to the detriment of their customers and, depending on the degree, may result in an AEC. In practice much of the CC's investigation in this area seeks to identify structural characteristics conducive to coordinated conduct by market participants. The CC also looks at evidence of market outcomes and the actions of market participants which could be the product of coordinated conduct.

Conducive market characteristics

233. A market must exhibit certain characteristics for coordination to be possible:
- Firms need to be able to agree and monitor the terms of coordination or, in the case of tacit coordination, have sufficient awareness of each other and be able to anticipate each other's reactions.

¹¹⁹ *Home credit market investigation*, 28 April 2006, paragraphs 26, 9.36–9.40, and Appendix 2.1.

¹²⁰ *Local bus services market investigation*, 20 December 2011, paragraph 15.11 and Appendix 9.2.

- Coordination needs to be internally sustainable among the coordinating group—ie firms have to find it in their individual interests to adhere to the coordinated outcome; the firms must lack an incentive, or have a positive disincentive, to compete because they appreciate how each other will react. However, coordination does not need to be perfect or continuous to fulfil this criterion (see paragraph 226).
- Coordination needs to be externally sustainable, in that coordination is unlikely to be undermined by competition from outside the coordinating group or from the reactions of customers.

234. In testing a theory that a market's structure may facilitate coordinated conduct or that other aspects of the market may lead to coordination between firms, the CC will commonly gather and assess evidence on, in particular:

- (a) any structural characteristics of the market that may support a coherent coordination mechanism and the extent to which the characteristics apply (see paragraph 233);
- (b) the frequency of contact among competitors that allow an information exchange; coordination to any degree is unlikely in the absence of repeated interaction among competitors (or if a pattern of infrequent sales allows a lot of business to be won before rivals learn of it); and
- (c) the existence of one or more type of arrangements firms may have made, which, although in many cases benign from a competition viewpoint, can sometimes facilitate coordination.

235. Each of these factors is examined in more detail below.

(a) Structural factors

236. Structural aspects of the market—among which market symmetry and market concentration are key elements—can often determine whether firms can meet the three conditions for coordinated conduct.

- *To reach and monitor terms*

237. *A non-complex and stable economic environment* can help firms to reach a common understanding on the terms of coordination. For example: where markets are concentrated, firms are more likely to be aware of the behaviour of individual competitors; it is easier to coordinate on a price when demand and supply conditions are relatively stable than when they are continually changing. In contrast, the presence of many firms in a market, volatile demand, substantial internal growth by some firms or frequent new entry may suggest that coordination is less likely.
238. *Simple and relatively undifferentiated products* are more easily subject to the coordinated setting of prices than situations in which each firm's offering is different from the offerings of its rivals. Coordination becomes more complex—and may be more difficult to sustain—if important characteristics of the product are changed over time or if new products are introduced.
239. However, coordination through, for example, *simple pricing rules* may overcome problems stemming from complex economic environments. One example of such a rule is the setting of only a small number of pricing points. The more complex the market environment the more transparency or communication is needed to reach a common understanding of coordination arrangements.
240. *Customers with easily identifiable characteristics* help firms coordinate by way of market segmentation (based on geography or customer type or simply on customers who typically buy from one supplier).
241. Firms that are relatively *symmetric*, especially in terms of costs structures, market shares or capacity levels, can more easily respond to incentives to reach a common

understanding with rivals. Firms with cross-shareholdings or participating in joint ventures may also do so.

242. Other structural features that may facilitate coordination arrangements include evidence of a long-term market commitment by firms, and the existence of institutions and practices facilitating the sharing of information (eg trade associations or certain regulations).
- *To sustain coordination internally*
243. A *concentrated market* is the foremost factor in helping to sustain coordination internally. It allows deviations to be spotted quickly. In a less-concentrated market with many companies coordinating, deviation may be more likely because a larger market share can be gained through undercutting.
244. *Market transparency* allows the coordinating firms to monitor whether one or more of them are deviating from the coordinated outcome. The degree of transparency often depends on how transactions are conducted; there will, for example, be a high level of transparency on a public exchange, but a low level where transactions are negotiated confidentially and bilaterally (see paragraphs 253 to 256).
245. *Transparency* in the market affects the speed, and hence effectiveness, of a deterrent mechanism used against a deviating firm or helps firms' ability to anticipate each other's conduct. *Excess capacity* may make coordination easier because firms could use the spare capacity as a credible threat against deviation. Retaliation need not necessarily take place in the same market as the deviation, and if the coordinating firms have commercial interaction in other markets, these may offer various methods of retaliation, such as cancellation of joint ventures or selling shares in jointly-owned companies.

- *To sustain coordination externally*
246. *Barriers to entry or expansion* facilitate coordination. If barriers to entry or expansion are low, the threat of entry or expansion by non-coordinating competitors will tend to undermine any degree of coordination.
247. *The number and size* of the non-coordinating (or fringe¹²¹) rivals, their *cost* and *profit margins* and (critically) their scope to *expand output* in relation to their current levels and to the output of the coordinating firms will determine the extent to which non-coordinating firms act as a competitive constraint.
248. *Significant excess capacity* held by one or more firms in the market can reinforce the credibility of retaliation should any firm deviate from the coordinating group. In this way, it can strengthen the incentive to sustain coordination.
249. If, on the other hand, a firm has the capacity to take significant share from any group of firms that tried to coordinate without its participation but also has substantially different incentives from those of the coordinating group, it can undermine a coordination strategy. (Such a firm is sometimes referred to as ‘a maverick’.) For example, a firm might value having a reputation for offering the lowest price in the market, and might consider itself likely to sacrifice profits in the long term if it were to lose that reputation by coordination.
250. *Countervailing buyer power* of customers (see paragraph 163) can undermine the stability of coordination. For example, by concentrating its purchases on one supplier or by offering long-term contracts, a large buyer may destabilize a coordination strategy by tempting one of the coordinating firms to break ranks to gain substantial new business.

¹²¹ The term ‘competitive fringe’ is often used by economists to describe a group of relatively small firms in a market containing larger firms.

- *Investigation findings of conducive characteristics*

251. While the specific findings in its investigation into local bus services were not of tacit coordination, the CC was nonetheless able to conclude that the three prior conditions for tacit coordination could be sustained in the market and to confirm therefore that ‘conditions facilitating tacit coordination exist across the reference area, and so explicit actions on the part of operators may not be required for geographic segregation to be achieved’.¹²² In its investigations into the groceries¹²³ and liquefied petroleum gas¹²⁴ markets, the CC also found that the conditions for tacit collusion existed but did not find evidence that it had occurred.

252. In addition to investigating characteristics of the market that may be conducive to coordination and outcomes that might be indicative of coordinated conduct, the CC will look at whether would-be competitors have taken any actions¹²⁵ to reach, sustain or enhance tacit coordination. Such actions may involve exchanges of information or specific types of arrangements.

(b) Information about competitors

253. The existence of means of obtaining information commonly facilitates coordination, particularly in markets where structural characteristics make monitoring of deviation difficult. Information exchanges increase transparency or help competitors interpret the choices competitors have made. They can have an adverse effect on competition in three alternative but not mutually exclusive ways. They can:

¹²² [Local bus services market investigation](#), 20 December 2011 (paragraphs 8.239–8.243 and 8.261). In investigating the market the CC had hypothesized—and ultimately identified as a conduct feature of the market—that ‘operators avoid competing with other operators in “Core Territories” (certain parts of an operator’s network which it regards as its “own” territory) leading to geographic market segregation’ (final report, paragraph 5). The CC found evidence of contacts between operators and actions which had the effect of segregating areas of operation. These behaviours will reduce or eliminate head-to-head competition and diminish the constraint from potential competition. Finding conditions facilitating tacit coordination caused the CC to be concerned that geographic market segregation might be a more widespread feature than was identified.

¹²³ [The supply of groceries in the UK market investigation](#), 30 April 2008.

¹²⁴ [Market investigation into supply of bulk liquefied petroleum gas for domestic use](#), 29 June 2006.

¹²⁵ Equivalent, in economic parlance, to ‘facilitating practices’.

- generate mutually consistent expectations among rival firms regarding their conduct and beliefs, making it easier for firms to reach a common understanding on the terms of coordination;
- give an indication of rivals' past and present conduct and enable rival firms to monitor deviations and, potentially, to retaliate; and
- by increasing transparency, make it easier for coordinating companies to monitor where and when other companies are trying to enter the market, allowing the coordinating companies to target the new entrant.

254. The means by which companies may obtain or exchange information include most-favoured customer clauses (MFCs, see paragraphs 257), voluntary publication of information, announcements, or information gained through trade associations. Cross-directorships, joint ventures and similar arrangements may also make monitoring and retaliation easier.
255. The CC will also look for any indirect means and practices which may increase the transparency or predictability of the environment in which firms operate; the adoption of rules of conduct, ethics codes, product standardization, joint marketing or buying agreements, price computation manuals, R&D joint ventures, etc. Many of these practices may be justifiable on efficiency or customer-benefit grounds, but they could nonetheless create market conditions favourable for coordination.
256. The likely effects of an information exchange on competition are analysed by the CC on a case-by-case basis. The assessment compares the likely effect of the information flow with the competitive situation that would prevail in its absence.

(c) Arrangements made by firms

257. The specific types of arrangements firms make, which, although in many cases benign from a competition viewpoint, can sometimes facilitate coordination, include:
- *Best price policies* (or low-price guarantee);¹²⁶ they can increase transparency, facilitating consensus and the detection and punishment of cheating.
 - *MFC clauses*;¹²⁷ although generally benign, these provisions can in exceptional circumstances deter competitive price cutting, reduce the incentive to deviate from established terms of coordination, and deter a firm from offering discounts to its smaller customers.
 - *Minimum advertised price agreements*¹²⁸ can be conducive to coordination at both retail and manufacturing levels since they can control the pricing strategies of several competing retailers and are visible to competing manufacturers.
 - *Resale price maintenance (RPM)*¹²⁹ can be used to facilitate coordination between suppliers and retailers, making it easier to detect whether a supplier deviates from a coordinated price; strong or well-organized distributors may be able to use RPM to influence one or more suppliers to fix their resale price above the competitive price. However, depending on the circumstances, manufacturers can use RPM to promote effective competition by preventing 'free-riding'¹³⁰ at the distribution level.

Theory 4: Vertical relationships

258. Some theories may suggest that an outcome the CC observes in the market results from vertical integration or other vertical arrangements within the market (collectively known as 'vertical relationships').

¹²⁶ Best price policy is a commitment made by a firm (frequently a retailer) either to match or beat the lower price charged by other firms—a price matching guarantee (PMG) and price beating guarantee (PBG)—or by the same firm to other current or future customers—MFC clause. Such policies may be adopted unilaterally or through agreement or they may simply become accepted practice.

¹²⁷ An MFC clause is a provision in a sales contract, under which the seller agrees to give the buyer the benefit of any more favourable contract terms it may later negotiate with some other purchaser.

¹²⁸ Under minimum advertised price agreements, the manufacturers set the price of a product and the distributor enforces it; retailers may spend cooperative advertising allowances they receive from the product manufacturers.

¹²⁹ RPM is the practice whereby a manufacturer and its distributors agree that the latter will sell the former's product at certain prices.

¹³⁰ 'Free-riding' is where other parties benefit from the provision of a good or service without paying for its provision.

- ‘Vertical integration’ means that activities at adjacent levels of the supply chain have been brought under common ownership and control.
- ‘Vertical arrangements’ fall short of vertical integration and may involve agreed pricing schemes or other contractual provisions between companies at different levels of the supply chain.

Vertical relationships: rationale and types

259. Vertical relationships will often have been established when upstream and downstream firms in a trading relationship recognize that it is more efficient and economical for transactions to be organized within firms than to rely on market interactions. Supply contracts between upstream and downstream firms are often imprecise, incomplete or difficult to enforce and in practice may give one of the contracting firms leverage over the other. To mitigate this risk one or other of the firms may decide to bring the transaction ‘in house’, either through internal growth or external acquisitions. Alternatively, firms may make vertical arrangements with each other, either via legally enforceable contracts or via commitments by each firm not to behave opportunistically against the interests of the other. By restricting each other’s actions, vertical arrangements may give both parties the mutual incentive to invest in their relationship.
260. A wide variety of vertical arrangements employed by firms may lead to an AEC. It is not possible to deal comprehensively with all of them but the following are among the most prominent:
- *Exclusive purchasing*: An exclusive purchasing obligation is one which requires a customer to purchase exclusively or to a large extent only from a particular upstream supplier. Obligations such as stocking requirements, that appear to fall short of requiring exclusive purchasing, may in practice lead to exclusivity.

- *Exclusive supply obligations*: an exclusive supply obligation requires a supplier to sell exclusively (or to a large extent) to an incumbent downstream firm. Exclusive supply incentives may have similar effects—an incumbent firm with significant buyer power may, for example, offer to pay a higher price if the supplier sells it a higher percentage of its output, or a supplier may be required to pay a lump sum so as to get its goods onto the shelves of the incumbent buyer.
- *Pricing relationship arrangements*: arrangements, such as MFC and RPM, (paragraph 257) which commit the firms to dampen rivalry in certain respects.
- *Tying and bundling*:¹³¹ tying and bundling are common commercial practices and often have no anticompetitive consequences. However, they can sometimes lead to adverse competitive effects (see paragraphs 280).
- *Secondary product market arrangements*: adverse competitive effects can also sometimes arise in situations in which a customer purchases secondary (or aftermarket) products as a consequence of having purchased a primary product (see paragraph 282 to 286).

261. Normally relating to competition between different brands (inter-brand competition), vertical arrangements can sometimes also affect competition between the same brand sold in different outlets (intra-brand competition). Under exclusive territorial arrangements, for example, some retailers are given guarantees by the manufacturer that no other retailer within their geographical area will be supplied by that manufacturer.

¹³¹ Tying occurs when a supplier makes the sale of one product (the tying product) conditional upon the purchase of another distinct product (the tied product) from the supplier or someone designated by the latter. Only the tied product can be bought separately. Bundling refers to situations where a package of two or more goods is offered in fixed proportions. Tying and bundling may also be achieved in indirect ways (eg by a firm not acknowledging guarantees unless customers use its components, consumables or services).

Impacts and assessment of vertical relationships

262. Vertical relationships can have beneficial effects through the better coordination of activities at different stages of the supply chain and savings in transaction and inventory costs (for example, helping guarantee stability of supplies, improve coordination on product design, production process and the way in which the products are sold). With vertical integration, this is achieved by internalizing activities which would otherwise be carried out in separately-owned businesses.¹³² With other vertical arrangements it is achieved by a closer alignment of the incentives of, for instance, the supplier and its distributor, towards the achievement of complementary objectives. Vertical relationships within a supply chain may also help to resolve the 'free-rider' problem¹³³ in markets where suppliers need their distributors to incur certain necessary costs if advice and other pre-sale services are to be provided on a sustained basis.
263. Since vertical relationships involve complementary products, services or activities, each firm would like the other to lower the price of its product. Such a relationship can therefore have the effect of lowering prices that would be charged to consumers if the firms acted independently and in this way can in some cases benefit consumers.
264. However, despite their potential to enhance productivity and consumer welfare, vertical relationships can also sometimes have an AEC in a market, particularly by allowing the firms to foreclose rivals' access to inputs and customers.

¹³² In the absence of vertical coordination, if both producers and distributors add markups over their costs, the resulting 'double' markup—or 'double marginalization'—may lead to inefficiently high prices. This is because each partner, when setting its price (the wholesale price for the producer and the retail price for the distributor) takes no account of the effect of this price on the other's profit. By aligning incentives, vertical integration or vertical restraints may lead to a coordinated reduction of the markups at different levels in the supply chain, both increasing firms' profits and benefiting consumers.

¹³³ See paragraph 257 and footnote 130.

Foreclosure

265. For a vertically related firm, foreclosure is achieved by practices that (a) restrict or raise rivals' costs of access to essential inputs or (b) limit rivals' ability to acquire sufficient customers to benefit from economies of scale, learning effects or network effects (see paragraph 168), particularly in intermediate good markets.
266. Foreclosure can be total (where rivals are forced to exit the market or are prevented from entering) or partial (where rivals—whether incumbents or potential entrants—are disadvantaged and consequently compete less effectively).
267. 'Input foreclosure', in particular, may lead to a reduced competitive constraint on a vertically related firm. When deciding whether to supply its competitors downstream with inputs, a vertically integrated firm may take into account how these supplies 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 the costs of competing downstream firms. By being subjected to such price discrimination—of which the most extreme form is a 'margin squeeze'¹³⁴—downstream competitors are charged such a high price for the upstream input that they cannot compete downstream since their operation costs plus the wholesale prices exceed retail prices. As a result of such foreclosure effects a vertically integrated firm may therefore be able to maintain inefficiently high prices or increase the prices charged to consumers relative to the prices obtained in the absence of vertical integration.

Testing for overall foreclosure effects

268. For vertical relationships to result in foreclosure of rivals, the firms involved must have significant market power in one or more markets along the supply chain. They

¹³⁴ A margin squeeze occurs when downstream competitors are charged such a high price for the upstream input of the upstream firm that they cannot compete downstream since their operation costs plus the wholesale prices exceed retail prices.

will also need to have both the ability and an incentive to seek to foreclose rivals, and the CC recognizes that this will not necessarily be the case, even if the firms enjoy significant market power; for instance, an upstream monopolist may have limited incentive to leverage its upstream power to monopolize the downstream market since monopoly profits can be taken only once along a vertically linked chain; moreover, suppliers normally have an incentive to expand their distribution networks and to expand sales.

269. In reaching a judgement on whether a particular vertical relationship has an adverse effect on competition, the CC will evaluate its overall impact on competition, taking into account rivalry-enhancing, as well as adverse, effects. This will normally require an assessment of the impact of the vertical relationship on rivalry at different stages of the supply chain. Vertical restraints can be used to reduce both inter-brand competition (competition between different brands) and intra-brand competition (competition between the same brand sold in different outlets), potentially leading to an AEC. The CC is more likely to identify an AEC if a vertical relationship results in a reduction of inter-brand competition, than if it only affects intra-brand competition.
270. In conducting its assessment of the overall impact of vertical relationships on competition, the CC will look at a variety of evidence. The CC may use economic modelling to provide a framework for testing a hypothesis under which a vertical relationship may have harmed the evolution of competition against an alternative where the relationship has proved benign or pro-competitive. The CC will also assess the conduct and strategic interactions of relevant market participants. This may involve comparing relevant industry characteristics and firm behaviour over time and across geographical locations, making comparisons with other similar sectors or examining and drawing inferences from any observed natural experiment, where available.

271. Analysis of profitability and trading figures can help indicate whether or not non-participation (or increased input prices) in the upstream market would have been credible for an integrated firm with market power or whether, on the contrary, the firm found it profitable, taking account of the cost to the profits of its upstream division, to undercut the input prices of upstream rivals.
272. The profitability of input foreclosure will depend on:
- (a) the integrated firm's ability to refuse to supply or to increase the price of an essential input, or limiting access to an asset, facility or platform;
 - (b) the competitiveness of upstream and downstream markets (lower competition leads to higher profitability);
 - (c) the size of cost asymmetry it can create on the downstream market (higher cost asymmetries lead to higher profitability), ie if the costs of the affiliated downstream firm are significantly higher than those of downstream rivals, it may not make commercial sense for the upstream firm to supply its downstream affiliate;
 - (d) the capacity of downstream rivals to integrate into the upstream market;
 - (e) counter-measures by rivals such as vertical integration or switching costs, which could reduce the profitability of foreclosure.

Exclusive purchasing obligations

273. Exclusive purchasing obligations (paragraph 260), may in practice lead to exclusivity to such an extent that they effectively require the customer to purchase all or a significant part of its requirements from the dominant supplier. If the customers make up a large part of the market, this has the effect of foreclosing the upstream supplier's competitors from the market. Similar foreclosure effects may derive from conditional rebates and other inducements that levy switching costs on any buyer seeking to switch from an incumbent. Exclusive purchasing may thus be used in

some situations as a substitute for vertical integration and have similar effects as a refusal to deal.

274. The CC will consider that foreclosure leading to an AEC arises where, without the exclusive purchasing obligations, an important competitive constraint could be exercised by competitors that either were not present in the market at the time the obligations were concluded, or that were not in a position to compete for the full supply of the customers.
275. In general, the longer the duration of the obligation, the stronger the likely foreclosure effect, in particular if new entrants are affected. Foreclosure will be more likely if the exclusive purchasing obligation has been tied selectively to buyers of particular relevance to new entrants. In such cases an anticompetitive foreclosure effect may result even though the market share involved is modest.
276. The existence of exclusive purchasing arrangements in a market does not necessarily suggest that competition is harmed. An upstream supplier, having made an exclusive purchasing agreement may need to compensate buyers, in whole or in part, for the loss in choice resulting from the possible foreclosure. Such compensation could, for instance, take the form of lower prices or other benefits.
277. Moreover, competitors may have counter-strategies at their disposal allowing them to protect themselves against exclusive purchasing strategies and to prevent any harm to competition. Such counter-strategies could, for instance, include: (a) concentrating their sales on certain customers; (b) building up stronger 'ex-ante' competition for the customers, as foreclosure is less likely if customers, before entering into exclusive purchasing obligations, have had access to several alternative competitive offers;

and (c) ensuring new entry in the downstream market, either by sponsoring entry or by integrating vertically.

Exclusive supply obligations

278. Exclusive supply obligations (paragraph 260) may also be used to try to foreclose the downstream market to new entry if an incumbent downstream firm has significant market power to induce all input suppliers to make such arrangements. Exclusive supply obligations may be found to lead to an AEC if they have tied most of the efficient input suppliers, and rival buyers have been unable to find alternative sources of input supply. The foreclosure effect would be likely to be stronger if there are significant scale economies or network effects in the downstream market (see paragraph 168) or if there are significant entry restrictions for input suppliers.

Pricing relationship arrangements

279. Vertical arrangements, particularly pricing relationship arrangements, such as MRC and RPM (see paragraph 257), may also sometimes dampen horizontal competition directly by encouraging anticompetitive coordination among rivals at the same level of the supply chain (see paragraphs 224 to 256) In some industries a commitment to apparently less vigorous conduct will lead rivals to see that their best interest lies in allowing prices to rise. Such practices have greatest impact when the vertical arrangements have been adopted by most or all of the firms in an industry.

Tying and bundling

280. Tying and bundling might also sometimes be used, if a firm has significant power in the tying market, to foreclose the tying market (if it constrains market entry by rivals) and, indirectly, also the tied market (if it leads to less competition for customers interested in buying the tied good but not the tying good), The CC would expect to find evidence of failed attempts to enter the tying market to support an AEC finding.

281. In assessing the extent of the foreclosure effect of tying and bundling in a market, the CC considers several factors:
- (a) The tied percentage of total sales on the tied market—the higher this percentage, the larger is the foreclosure effect.
 - (b) The overall strength of the tying firm on both the tying and the tied markets.
 - (c) The identity of the tied customers—for example, some customers may be important from an entry-deterring point of view.
 - (d) The growth rate of a market with network effects—a growing share may be problematic even if is still fairly low.
 - (e) The likely lasting effect of tying and bundling—the risk of foreclosure is greater where the tying firm can commit to making its tying or bundling strategy a lasting one, for example through technical bundling¹³⁵ which is costly to reverse.
 - (f) In the case of bundling the number of products a firm is bundling—the greater the number of products in the bundle, the stronger the likelihood of foreclosure (particularly if the bundle is difficult to replicate by other firms).
 - (g) The number of firms engaged in tying—a large number can make entry difficult (although widespread participation in tying may indicate that it is efficiency enhancing).
 - (h) The level of sales of the tied product to customers who do not buy the tying product—a relatively low level of customers in the tied market buying both products indicates that tying may pose a low risk, since the practice may remain contained to a limited part of the market.

Aftermarket arrangements

282. In those aftermarkets (see paragraph 142) where secondary products can be used with one brand of primary product but not easily with another brand (although the primary products may be substitutable), the supplier of the primary product may

¹³⁵ 'Technical bundling' occurs when the tied product is physically integrated in the tying product.

reserve the secondary product for itself by excluding competitors, for example through tying or a refusal to deal (eg to supply necessary information, licences, IPRs or spare parts). In other cases, the supplier of the primary product may have a point-of-sale advantage in relation to the secondary product that restricts the ability of other potential suppliers of the secondary product to serve its customers.¹³⁶

283. The interaction between primary and secondary markets may, however, constrain, or in some cases remove, the extent of any market power enjoyed in the secondary market by the supplier of the primary product. In particular, if the primary market is competitive and if customers anticipate the likely cost of secondary products when making decisions about which primary product to buy, competition in the primary market may constrain suppliers' ability to raise prices of the secondary product. Competition in the primary market may in this way ensure that the overall price of the 'bundle' of goods and services comprising the primary product and the secondary product(s) is set at a competitive level.
284. In judging whether there are features of a secondary market that give rise to an AEC, the CC therefore considers the nature of the relationship between the primary and secondary products, including whether competition in the primary market constrains the prices of secondary products and/or whether high aftermarket prices may lead to lower primary product prices.
285. The amount of information available to customers, together with the use customers make of this information when buying a primary product are important factors in assessing the extent to which customers calculate the overall cost of the bundle over the expected life cycle of the primary product. For this competitive constraint from the

¹³⁶ For example, in its investigation into PPI, the CC found that suppliers of credit (the primary product) enjoyed a point-of-sale advantage in relation to the supply of PPI (the secondary product) to their own credit customers and that, in combination with other features, this feature of PPI markets harmed competition.

primary market to function effectively, a sufficient number of customers must engage in life cycle cost calculations, and the supplier(s) concerned must not be able to discriminate between customers that make such calculations and those that do not.

286. Even if customers have not based their choice on accurate life cycle calculations, suppliers in the primary market may make their own assessment of the profitability of a customer relationship over the life cycle of a product and may compete vigorously in the primary market so as to enjoy profits on subsequent aftermarket sales.¹³⁷ The CC may consider the extent that customers benefit from lower prices of the primary product as part of its assessment of RCBs (see paragraphs 348 to 362 to).¹³⁸

Theory 5: Weak customer response

287. Competition (as emphasized in [Part 1](#), paragraph 10) may be threatened if customers are likely, for one reason or another, to respond weakly to competitive offers. A market investigation is well placed among competition policy instruments to analyse and remedy undesirable patterns of consumer behaviour which are either caused by, or result in, a lack of competition.¹³⁹

Impacts and assessment of weak customer response

288. To drive effective competition customers need to:
- (a) access information about the various offers available in the market;
 - (b) assess these offers; and
 - (c) act on this assessment by purchasing the good or service that offers the best value for them.

¹³⁷ This pattern of low pricing for primary products and high pricing for secondary products is sometimes referred to as a 'waterbed effect'.

¹³⁸ This was the approach adopted in [PPI](#), 29 January 2009.

¹³⁹ While strengthened competition plays an important role in solving some consumer problems, others can only be tackled by means of consumer protection policies.

Theories of harm that competition in a referred market is adversely affected by weak customer response are therefore generally examined in relation to these three issues.

(a) Lack of access to information

289. When customers face significant impediments and costs in their search for, and comparison of, alternatives, sellers may be able to charge prices with limited regard to competition. Firms can enjoy some market power if customers cannot switch easily or effectively because of the cost (or opportunity cost) of finding better deals. Limited information can lead to the charging of a higher price in what would otherwise be a competitive market.¹⁴⁰ Firms may be able to charge non-competitive prices even where some customers search for information, but many uninformed customers with high search costs remain; the seller's profit foregone by losing informed customers who buy elsewhere is more than offset by the increase in profits accruing from uninformed customers who do not shop around.¹⁴¹
290. The level of prices in the market tends to increase with the cost of acquiring information (although there is no general formulation for the relationship between prices and customers' search costs). This is because the higher the search costs, the lower the gain for customers from searching for a lower price and the higher the degree of market power that firms can exploit. Reducing customers' search costs therefore reduces the firms' market power (and thus the level of prices). An increase in the percentage of informed customers increases the level of effective competition in the market.

¹⁴⁰ If, for example, one store raises its price for a commonly-available good above the level of other stores, and all customers know it, that store loses all its business. In contrast, if some or all customers do not know that other stores charge lower prices, the store can raise its price without losing all its sales, ie the store has some degree of market power.

¹⁴¹ For example, markets serving both tourists (with high search costs) and local residents (with low search costs).

291. The CC will consider the possible reasons why buyers—in particular end-consumers—may have imperfect knowledge of substitutes or of the quality and prices of the products on offer. These reasons might include:
- information may vary in reliability or may become dated;
 - information may be costly to collect;
 - customers can remember and readily recall only a limited amount of information;
 - asymmetries in information between customers and suppliers can hinder customers' ability to make adequate choices or suppliers' ability to target customers effectively; and
 - customers may face limitations on their capabilities to search and compare alternatives.

Search costs

292. Customers will find it hard to identify the best available product for them when:
- The cost of obtaining information is substantial; in this situation, customers may not search the market but simply choose a firm randomly; firms may respond by charging a monopoly price to these customers. Search costs are likely to be substantial in cases where the information that could possibly affect purchasing decisions is relatively complex and difficult to obtain or process.
 - Learning is slow and customers cannot evaluate or communicate their purchase decisions even after purchase—a particular problem where, for example, goods are purchased infrequently.
 - Customer sensitivity or embarrassment about a product limits the search.
293. High search costs might arise for several reasons:
- Advertising, while a 'free' resource reducing buyers' search costs to some degree, is unlikely to tell customers what they want or need to know about a product.

- Firms may sometimes engage in practices that increase search costs so as to obtain market power (or fail to engage in practices that would reduce search costs). For example:
 - charging different prices for the same good at various locations or under different brand names, making it difficult to find the low-priced brand;
 - not clearly displaying prices or referring to some prices (eg special offers) which are not always available to all customers; and
 - failing to make available all the product information needed by customers to make an informed choice, in particular of one-off purchases.¹⁴²
- Producers of information about products (online price comparison sites or organizations conducting product reviews, etc) have a legitimate commercial interest in protecting the IPRs to the information they collect and distribute—for example, to prevent its use to publicize only the ‘bottom’ line (eg which brand is most or least reliable overall) or to benefit those who have not produced or paid for information.¹⁴³

294. The large fixed costs associated with the creation of information and the small marginal costs of distributing it prevent fully efficient pricing and may give sellers an incentive to limit the information they produce.

(b) Assessing offers in a well-reasoned way

295. The assessment of offers is handicapped by two main factors: the behavioural bias of some customers and the asymmetry of information between the knowledge of the customer of the price and quality of the good or service and that of the provider.

¹⁴² For example, in the case with many financial products, extended warranties on electrical products, certain professional services and some consumer durables.

¹⁴³ The ‘positive externalities’ associated with the provision of information in consumer markets affect both buyers and sellers: buyers because, for example, search by some individuals tends to improve the market for all customers; and sellers because, for example, advertised information that applies to more than a single brand may help sellers of competing brands or even competing products.

Behavioural bias

296. There are many theoretical explanations of the biases customers apply when making purchasing decisions. The main biases identified in the literature on the subject¹⁴⁴ are:

- a lack of processing power, eg choice overload and overuse of rules of thumb;
- ‘framing biases’, eg in relation to past actions and the placement of goods on lists;
- ‘time inconsistencies’, eg customers expect that they will feel the same tomorrow as they feel today or overestimate how often they will use a product; and
- ‘loss aversion bias’, eg customers attach value to products they have owned before.

297. In practice it can be difficult to predict how a customer will react in a particular situation. Empirical evidence is normally required to identify behavioural biases and the possible impact on competition in individual markets. The persistence of a bias is also hard to predict. Customers can learn from their biases and become more sophisticated, for example in markets where they make frequent purchases (or can benefit from the learning of others via word of mouth).¹⁴⁵ Advisers, intermediaries, consumer organizations and the media can also act as catalysts in improving consumer decision-making, where there are consumer biases. The reach and effectiveness of intermediaries have been greatly extended with the advent of the Internet and price-comparison websites and the ability to compare prices and terms across different sellers.¹⁴⁶

¹⁴⁴ There is a wide economic literature on the influence of bias—cognitive, emotional or reflexive—on economic decision-making. See, for example, Steffen Huck, Jidong Zhou and London Economics (Charlotte Duke), *Consumer Behavioural Bias in Competition: a Survey* (OFT1324), OFT, 2011.

¹⁴⁵ When purchases are infrequent or large value (for example, when entering into a sale and rent back arrangement), learning may not provide the constraint required. There will also be circumstances where biases are hardwired (for example, limits to computation capabilities, cannot be overcome) or where customers cannot learn from others.

¹⁴⁶ However, there may be cases when incentives of the intermediaries are not always aligned with customers. For example, when firms pay intermediaries for their advice to customers their impartiality may be questioned.

298. As well as influencing purchasing decisions, the behavioural biases of customers can have a bearing on firms' behaviour. Where such biases exist, firms can act to exploit them, at every stage in the decision-making process. They can potentially increase their profits by playing to these biases in certain ways, for example, unilaterally or jointly restricting the information provided to customers or by failing to highlight the add-on costs of a service.
299. In some markets there will be a proportion of 'active' customer who recognize their biases and correct for them and a proportion of more 'passive' customers who do not. This will have the effect of promoting some competition. The greater the proportion of 'active' customers with the ability to discriminate the more likely that competition will work effectively.

Information asymmetries

300. Information asymmetries, particularly when search costs are high, may result in customers not knowing which supplier sells a good or service at the lowest price or how quality varies across brands and services. Such imperfect consumer information may enable even small firms to set their prices above marginal cost, or lead to a variety of prices being charged for relatively undifferentiated goods. Rivalry would not be having the desired effects and firms may consequently have an incentive to reduce the flow of information to customers.
301. Information asymmetries might have adverse effects on competition even when other structural features such as the number of firms and entry conditions suggest that the market may be competitive. This may particularly be the case in markets for services where customers are not able to gauge the quality of a service when acquiring it.

302. In many markets, buyers do not know how quality varies across brands. Markets where customers are often unsure about quality include those for professional services, used goods and complex mechanical or electronic products. When customers as a result of information asymmetries consistently underestimate the probability of product failure, even a competitive market will operate inefficiently. Imperfect quality information is a particularly severe problem for infrequently purchased goods or goods the quality of which cannot be verified even after purchase.
303. Asymmetric information about quality can lead to specific AECs in at least two ways:
- (a) Only the lowest-quality product (a 'lemon') may be sold and a true market may not exist.
 - (b) If firms cannot fully capture the value of producing higher-quality goods, they have an incentive to produce goods of relatively low quality. This is because if customers cannot differentiate high- and low-quality products the seller must split the benefits of its high-quality product with sellers of lower-quality products by raising the average price to all.
304. These two problems are commensurate with the degree of asymmetry: the greater the asymmetry of information, the greater the problem. To the extent that sellers and buyers have similar information, or neither has any at all, any AECs are of lesser significance.
305. However, the effects of asymmetric information may be mitigated in various ways:
- The Government, consumer groups, industry groups or others may provide information in the form of standards (defining a metric, or scale, for evaluating a particular product) and certification (that a particular product has been found to

meet a standard)—for example, relating to the licensing of new drugs, car safety regulations and rules for financial fund managers.

- Liability laws may serve the same function as explicit warranties, forcing the manufacturer to make good any defective products.
- Professional bodies can regulate entry into the profession and require that practitioners obtain certain qualifications, thus guaranteeing quality of service to some degree.
- A disinterested expert may be able to provide customers with reliable information, for example, a mechanic in the case of a used car.
- Warranties or guarantees may eliminate problems due to limited information or could act as a signal of the item's quality at the time of purchase, for example 'satisfaction guarantees' might be offered by holiday providers.

(c) Purchasing the best-value good or service

306. The costs of switching from one supplier or provider to another may make it difficult for customers to respond to attractive offers.

Switching costs

307. Switching cost allow firms potentially to charge high prices to 'captive' customers, or even if the firm is unable to discriminate between 'captive' and new customers, sometimes to charge higher prices in what would otherwise be a competitive market.

308. On the other hand, the presence of switching costs may intensify the competition for new customers, particularly if there is scope to charge different prices to new as opposed to existing customers (stimulating the so-called 'bargain and rip-off' cycle). The overall effect on competition will depend on the balance between the negative and positive effects.

309. Among the reasons for high switching costs the CC may consider are:

- inconvenience and administrative obstacles: the CC's report on banking services to small and medium-sized enterprises¹⁴⁷ identified the 'hassle in moving direct debits, standing orders etc and a fear that crucial payments could be missed whilst a switch was in progress' as a factor discouraging switching between banks;
- lack of information on the part of the customer about alternative products; in some markets the customer may be unaware of the existence of competing products, possibly because of a lack of access to information or high search costs (see paragraph 293 above). The latter in particular magnify switching costs;¹⁴⁸
- the presence of network effects (see paragraph 168), which give rise to collective switching costs, locking customers into existing standards and the firms that control them;
- if customers have made a large investment in a piece of equipment or in product-specific skills they may be deterred from switching if it involves a further substantial investment;¹⁴⁹ the CC found that such high switching costs were features harming competition in the markets for domestic liquefied petroleum gas¹⁵⁰ and PPI¹⁵¹ (while technical standards can lower switching costs by ensuring the compatibility of different suppliers' products, they may discourage market entry if standards favour incumbents); and
- marketing devices, such as loyalty cards, and negative advertising can have the effect, respectively, of increasing switching costs or influencing switching decisions.

¹⁴⁷ *The supply of banking services by clearing banks to small and medium-sized enterprises* (SMEs), CC, 2002 under the Fair Trading Act 1973.

¹⁴⁸ In purchasing durable goods, for example, the customer needs information on the availability and costs of spare parts, other aftermarket services and maintenance. A competition problem can arise where customers are unable to factor into their purchase decisions all the aftermarkets costs of the product or where the aftermarket is not competitive.

¹⁴⁹ However, such a cost may not reduce competition if customers are able to make a fully informed choice about the lifetime costs of all the alternatives at the time of the initial investment.

¹⁵⁰ *Market investigation into supply of bulk liquefied petroleum gas for domestic use*, 29 June 2006 (see, for example, paragraphs 4.47–4.52.)

¹⁵¹ *PPI market investigation*, 29 January 2009 (see paragraphs 5.58–5.78).

Part 4: Section 4—Concluding the AEC test

310. Having considered evidence of all kinds, weighing their value and significance, using them to assess the merits of alternative theories of harm, as well as counter-arguments submitted by parties, the CC comes to a rounded judgement on the problems (if any) in a market, their sources and how these sources have given rise to the problems. On the basis of this judgement the CC will reach a finding on whether there is a feature, or combination of features, of a relevant market that prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or part of the UK. If so, it will find that there is an AEC.
311. As explained above (paragraph 84), the CC recognizes that it is generally unrealistic to seek a theoretical measure of the functioning of a 'perfect' market. In identifying some features or combination of features of the market that may give rise to an AEC the CC will find a benchmark against which to determine how the market is performing and how it could be more competitive. In previous cases, the CC has defined such a benchmark as 'a well-functioning market'. The benchmark will generally be the market envisioned without the features.¹⁵² But it can vary and there may sometimes be reasons to depart from that general concept. In these circumstances, the CC has to find a realistic alternative benchmark for the market in question.
312. In forming its judgement the CC will apply a 'balance of probabilities' threshold to its analysis, ie it addresses the question: is it more likely than not that features or a combination of features lead to an AEC?

¹⁵² For example, in its report on PPI. Referring to this in its judgment in *Barclays Bank v CC* (October 2009) the CAT wrote (paragraph 104):

On a fair reading, the Commission concluded that a well-functioning market for PPI (ie a market without the AEC) was consistent with the continuation of some incumbency or POSA being enjoyed by distributors and intermediaries. There is, in our view, a clear distinction between a properly functioning market unaffected by an AEC and an ideal market, in which every potential supplier of the relevant product competes on a precisely level playing field.

313. If the CC decides that there are features in the market leading to an AEC, it moves on to devise appropriate remedies.

Part 5: Remedial action

314. When identifying and implementing a remedy to an AEC the CC may have to intervene directly in the structure of established markets and/or address the conduct of firms and their customers. Identification of the right remedy is highly dependent on the facts and context of the investigation and requires the exercise of judgement by the Inquiry Group conducting the reference.¹⁵³ The starting point for the CC's remedies assessment is its finding of features that give rise to an AEC and the related findings of fact. More broadly, the CC will have developed, through the course of its investigation, a detailed understanding of the market and an appreciation of the way in which it is capable of working.
315. In choosing a remedy the CC will normally have to consider the interaction of a range of legal, factual and economic considerations relevant to the development of a more competitive market. In doing so, it will seek to minimize the scope for unintended consequences and to take account of interactions between the market (or markets) in which an AEC is found and other markets, as well as the timescale over which remedies will have effect.
316. This part first sets out the framework for consideration of remedies (paragraphs 317 to 362). It then provides an overview of the different types of remedy and their characteristics (paragraphs 363 to 373) before setting out some of the main considerations that go into the selection of remedies from the options available (paragraphs 374 to 385). A more detailed discussion of particular types of remedy is included in Annex B.

¹⁵³ See paragraph 34 for information on Inquiry Groups.

Framework for consideration of remedies

The remedy questions

317. Where the CC decides that there is an AEC, it is required to decide the following additional questions:¹⁵⁴

- (a) whether action should be taken by [the CC] ... for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition;
- (b) whether it should recommend the taking of action by others for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition; and
- (c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

318. A detrimental effect on customers is defined as one taking the form of:¹⁵⁵

- (a) higher prices, lower quality or less choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or
- (b) less innovation in relation to such goods or services.

319. Whether action should be taken therefore involves consideration of both the action the CC can take and the action the CC can recommend others to take. The CC may act itself through exercising its order-making powers or through accepting

¹⁵⁴ [Section 134\(4\)](#).

¹⁵⁵ [Section 134\(5\)](#). The reference to customers includes future customers.

undertakings from parties (see paragraphs 77 and 78). Alternatively or in addition, the CC may recommend that remedial action should be taken by others, such as government, regulators and public authorities. Such recommendations do not bind the person to whom they are addressed, although the UK Government has committed to respond to any recommendation within 90 days of publication of the CC's final report.¹⁵⁶ When deciding on certain remedial actions in regulated sectors the CC has to have regard to the relevant statutory functions of the sectoral regulator concerned.¹⁵⁷ In all cases, the CC will state the action that should be taken and what it is designed to address.

320. In practice, the CC may decide to take several discrete actions itself and/or make several discrete recommendations. This combination of measures is often referred to as a 'package' of remedies. Unless otherwise specified, reference to a remedy or a remedy option in this section encompasses the package of actions the CC is taking and/or recommending.
321. The Act requires the CC, in considering these questions, 'in particular to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effects on customers so far as resulting from the adverse effect on competition'.¹⁵⁸
322. When deciding whether any remedial action should be taken and, if so, what that action should be, the CC will consider how comprehensively possible remedy options address the AEC and/or its detrimental effects, and whether they are reasonable and practicable.

¹⁵⁶ The Enterprise White Paper, *A World Class Competition Regime*, Department of Trade and Industry, July 2001 Cm 5233, p12.

¹⁵⁷ [Section 168](#).

¹⁵⁸ [Section 134\(6\)](#).

A comprehensive solution to the AEC and/or detrimental effects

323. Remedies can remedy, mitigate or prevent the AEC or its detrimental effects on customers. The clear preference of the CC is to deal comprehensively with the cause or causes of AECs wherever possible, and by this means significantly increase competitive pressures in a market within a reasonable period of time.
324. AECs are likely to result in costs to the UK economy in general and to customers in particular. Remedies that are effective in generating competition in markets are likely to deliver substantial benefits, by driving down prices and costs and increasing innovation and productivity and thereby increasing the quality and diversity of choice available to customers.
325. In deciding what action to take, the CC will typically consider whether tackling some or all of the features it has identified (see paragraphs 85 to 94) will remedy, mitigate or prevent the AEC. In some situations, for example where an AEC arises from a combination of features, it may be necessary to devise a package of complementary remedies to address the AEC. Conversely, the remedy that is ultimately selected need not directly address every feature identified.
326. Where it is not feasible for the CC to introduce measures which improve the functioning of markets by addressing the causes of the AEC, the CC will consider introducing measures which mitigate the harm to customers created by competition problems.¹⁵⁹ Such measures to control outcomes may be able to reduce the harm to customers associated with high prices, for example, but are unlikely to generate the dynamic benefits, such as innovation, that are normally associated with competitive

¹⁵⁹ [Section 138\(6\)](#). However, the CC is prevented from taking action to address future detrimental effects on customers if no detrimental effects on customers currently exist and the CC is not remedying the AEC (that is, the source of the problem).

markets. These measures are therefore likely to represent a less comprehensive remedy to the AEC and any detrimental effects.

Effectiveness and practicability

327. The CC will assess the extent to which different remedy options are likely to be effective in achieving their aims including whether they can be made to work in practice (ie whether they are practicable).
328. The effect of any remedy is always uncertain to some degree. In evaluating the effectiveness of potential remedies, the CC will consider the risks associated with different remedy options and will tend to favour remedies that have a higher likelihood of achieving their intended effect. Assessing the effectiveness and practicability of a remedy may involve consideration of several dimensions discussed further below.
329. First, a remedy should be capable of effective implementation, monitoring and enforcement. To facilitate this, the operation and implications of the remedy need to be clear to the persons to whom it is directed and also to other interested persons. Other interested persons may include customers, other businesses that may be affected by the remedy, sectoral regulators, and the OFT (and/or any other body) which has responsibility for monitoring compliance. The effectiveness of any remedy may be reduced if elaborate monitoring and compliance programmes are required.¹⁶⁰ Remedies regulating behaviour generally have the disadvantage of requiring ongoing monitoring of compliance and may also constrain beneficial aspects of competitive rivalry.

¹⁶⁰ The CC will also consider the costs of compliance as part of its assessment of the impact of remedies and their proportionality (see paragraph 344).

330. Second, the timescale over which a remedy is likely to have effect will be considered. The CC will generally look for remedies that prevent an AEC by extinguishing its causes, or that can otherwise be sustained for as long as the AEC is expected to endure. The CC will also tend to favour remedies that can be expected to show results within a relatively short time. Some remedies will have an almost immediate impact, while the effects of others will be delayed.
331. The CC will consider whether to specify a limited duration—for example, by means of a long-stop date in a ‘sunset clause’—for individual measures, where these are designed to have a transitional effect.¹⁶¹ This might occur if the CC expects an AEC to be time-limited, for example because a specific future event is expected to bring it to an end, or if a particular element of a remedy package is intended to be a temporary arrangement to deliver improvements in the short term, while other longer-term measures take effect.
332. However, the period used for any long-stop or review date will depend on the circumstances of the case. The duration of an AEC, in the absence of an intervention by the CC, cannot normally be predicted during the course of an investigation and there will normally be some uncertainty about the precise timescale over which remedies will take effect. For these reasons, the CC will generally rely on parties applying for variation or cancellation of remedies on the basis of a change of circumstances¹⁶² or possibly recommend that the OFT reviews (or considers reviewing) the continued need for particular measures at some future date.¹⁶³ Alternatively, the OFT

¹⁶¹ For example, in the report on *Veterinary Medicines* (April 2003) under the Fair Trading Act 1973, the package of remedies included an obligation on veterinary surgeons not to charge for writing prescriptions for a period of three years.

¹⁶² For example, in 2011, the CC has made minor changes to the Orders for *Store cards* and *Home credit* (July 2006 and September 2007, respectively) and more substantial changes to the *Northern Ireland Personal Current Account Banking Order* (2008), following the introduction of new European Directives.

¹⁶³ For example, in the 2002 report on *The supply of banking services by clearing banks to small and medium-sized enterprises* under the Fair Trading Act 1973, the CC recommended that, three years after implementation of the remedies, the OFT should review whether further measures were needed or, on the other hand, in the light of market developments, whether any or all of the measures in the CC’s package of remedies could be modified or discontinued. Following a review by the OFT, the CC decided in 2007 to release the UK’s four largest clearing banks from most of the Transitional Undertakings given by them in 2002.

might identify a change of circumstances following a review conducted on its own initiative.

333. Third, remedies may need to take account of other legislation applying to the parties or that is expected to be introduced in the near future. Such other legislation may include competition legislation or other relevant laws or regulations (eg health and safety, data protection), including proposed EU regulations or directives. Where there is a tension between existing laws or regulations and the actions that the CC considers necessary to achieve an effective remedy, the CC may make recommendations to the body responsible for the laws or regulations in question.
334. Fourth, where more than one measure is being introduced as part of a remedy package, the CC will consider the way in which the measures are expected to interact with each other. As a general rule, measures which have a shared aim of introducing, or strengthening competition within a market will tend to be mutually reinforcing. For example, where market-opening measures are being introduced that increase customer choice by facilitating entry or removing barriers to switching, these may be accompanied by information remedies that help customers choose the best product available to them.¹⁶⁴

Reasonableness and proportionality

335. The CC will consider the reasonableness of different options to remedy an AEC and/or resulting customer detriment. In doing so the CC will have regard to the proportionality of different remedy options.
336. The CC's assessment of proportionality will depend on the particular facts and circumstances of the case. It often depends on what other remedy options are also

¹⁶⁴ For example, the packages of remedies in the market investigations into [Home credit](#) (November 2006), [Liquefied petroleum gas](#) (June 2006) and [PPI](#) (January 2009) each included a combination of market-opening measures and information remedies.

being considered and on judgements about the respective merits of each option, including whether or not a remedy option is likely to be effective in practice.

337. In making an assessment of proportionality, the CC is guided by the following principles. A proportionate remedy is one that:
- (a) is effective in achieving its legitimate aim;
 - (b) is no more onerous than needed to achieve its aim;
 - (c) is the least onerous if there is a choice between several effective measures; and
 - (d) does not produce disadvantages which are disproportionate to the aim.¹⁶⁵
338. Applying these principles to the circumstances of particular cases will involve consideration of remedy options relative to each other and also relative to taking no action.
339. The CC will apply these principles to the evaluation of individual measures within a package of remedies as well as to the package taken as a whole. The CC will seek to ensure that each element of a package of remedies contributes to remedying the AEC and/or resulting customer detriment and that the design of individual measures is no more onerous than is necessary to achieve their aim.
340. Where the CC is considering whether to modify licence conditions in a regulated sector would be proportionate it will have regard to the relevant statutory functions of the regulator concerned.¹⁶⁶

¹⁶⁵ These principles have been referred to by the CAT in recent judgments including *Tesco v CC* (4 March 2009) and the PPI appeal (*Barclays and others v CC*, 16 October 2009). See *Tesco* judgment, paragraph 137:

A useful summary of the proportionality principles is contained in the following passage from the judgment of the ECJ in Case C-331/88 *R v Ministry of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte Fedesa* [1990] ECR I-4023, paragraph [13], to which we were referred by the Commission: 'By virtue of that principle, the lawfulness of the prohibition of an economic activity is subject to the condition that the prohibitory measures are appropriate and necessary in order to achieve the objectives legitimately pursued by the legislation in question; when there is a choice between several appropriate measures recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued'.

¹⁶⁶ [Section 168](#).

Assessing the impact of remedies

341. In reaching a judgement about whether to proceed with a particular remedy, the CC will consider its potential effects—both positive and negative—on those persons most likely to be affected by it. The CC will pay particular regard to the impact of remedies on consumers. The CC will also have regard to the impact of remedies on those businesses subject to them and on other affected parties, such as other businesses (eg potential entrants, or firms active in upstream or downstream markets), government and regulatory bodies, the OFT and other monitoring agencies.
342. The CC will explain what effects it expects to result from a remedy option and will form a view of their significance. As in its assessment of competition in a market (see paragraph 24 to 28), the CC may take into account a variety of evidence and use a variety of techniques—both qualitative and, where appropriate, quantitative—to analyse effects of remedy options. Similarly to its prioritization of resources in conducting the AEC test, the level of detail in which the CC investigates particular effects of a remedy will be influenced by their importance to the CC's overall assessment. For example, if it is clear that the costs of a particular remedy are likely to be very small—both in absolute terms and relative to its likely benefits—the CC may not seek to establish these costs with greater precision.¹⁶⁷
343. The extent to which the CC will seek to quantify particular effects of remedies—and the degree of precision with which such quantification is attempted—is likely to vary from case to case. The CC will not carry out quantitative analysis that it considers unnecessary or otherwise not justified by the need to identify a remedy that meets the statutory tests. The general principles the CC follows in its use of evidence are set out in paragraphs 24 to 28. The CC will consider the potential beneficial effects of its interventions. In considering how markets may develop with remedies in place, the

¹⁶⁷ For further discussion of this principle, see the judgments of the CAT in *Tesco*, paragraph 139, and *PPI*, paragraph 21.

CC will consider both benefits that are relatively easy to quantify (such as lower prices) and benefits that are more difficult to quantify (for example, the dynamic benefits of increased rivalry on productivity and innovation). Both are important. The more an AEC reflects longer-term and structural problems within a market, the greater the significance the CC is likely to accord to the long-term development of competition in the market and to the less quantifiable consequences of an improvement in the competitive pressures in the market.¹⁶⁸ Conversely, if addressing the AEC requires a remedy focused on achieving relatively predictable changes to outcomes in the shorter term, then quantification of these changes is more likely to be a material aspect of the CC's assessment of the beneficial effects of the remedy.

344. Similarly, the CC will consider the potential negative effects of a remedy including the costs to business. Such negative effects may arise in various forms, for example:

- (a) A remedy may result in unintended distortions to market outcomes. This is more likely to be the case where behavioural remedies are used which intervene directly in market outcomes, especially over a long period. Such distortions may reduce economic efficiency and adversely affect the economic interests of consumers over the longer term.
- (b) A remedy may result in implementation costs (for example, modifying a distribution system), ongoing compliance costs (for example, providing the OFT with periodic information on prices or reporting to the OFT on other aspects of compliance), and monitoring costs (for example, the costs of the OFT or other agencies in monitoring compliance). The CC will normally collect information from parties about the potential cost of implementing and complying with its remedies. In evaluating such information, the CC will bear in mind that it has less

¹⁶⁸ For example, in the [BAA airports](#) market investigation (March 2009), the CC concluded that the main benefits from the divestitures of Gatwick and Stansted airports would result from the dynamic aspects of competition, for example in relation to the delivery and allocation of airport capacity. While it was not possible to quantify the benefits of divesting these airports, given among other things the interaction with the regulatory regime, the CC was confident that the expected benefits would outweigh the costs of divestiture.

information than the parties have about how such potential costs have been estimated and that there might be incentives for parties to overstate the cost of those remedies that they do not support. The CC is likely to place most weight on estimates of implementation and compliance costs where parties have provided a clear explanation of how the estimate was reached, together with supporting evidence as to the assumptions used to derive those estimates.

(c) If remedies extinguish RCBs, the amount of RCBs foregone may be considered to be a relevant cost of the remedy (see discussion of RCBs, paragraphs 348 to 362).

345. To avoid imposing unnecessary burdens on business, the CC will seek to ensure that its remedies are no more onerous than is necessary to remedy the AEC it has identified. In selecting and designing remedies, the CC will also have regard to the potential for more competitive markets to create profitable opportunities for new and innovative competitors as well as the cost of remedial measures on established businesses. However, where businesses have been found to be earning profits persistently in excess of their cost of capital as a direct result of a feature of the market, and are likely to continue to do so in the absence of intervention, the CC will not usually give any significant weight to the anticipated reduction of such profits as a negative effect of a remedy.

Possible remedy outcomes

346. In reaching a decision on what remedial action to take, the CC will (as stated above) take into account several factors including comprehensiveness, practicability and reasonableness.

347. The CC will seek a comprehensive solution to the AEC and resulting customer detriment. In so doing, it will have regard to the need for the solution to be both

reasonable and practicable. A consequence of balancing these considerations is that there may be circumstances where the CC judges, for example on the basis of considerations of proportionality, that it should not pursue a remedy option that is potentially available to it. There may also be rare cases where the CC chooses not to take any remedial action, for example:

- (a) Where there are no practicable remedy options available to the CC, including any possible recommendations to others.
- (b) Where the cost of each practicable remedy option is disproportionate compared with the extent that the remedy option resolves the AEC. This might be the case, for example, if the market in which the AEC was found was small in relation to the costs of each practicable remedy option and/or if it was only practicable to mitigate some of the negative consequences of an AEC and the costs of doing so were prohibitively high.
- (c) Where RCBs accruing from the market features are both large in relation to the AEC and would be lost as a consequence of any practicable remedy (see paragraphs 348 to 362).

Relevant customer benefits

348. The CC, in deciding the question of remedies, may in particular 'have regard to the effect of any action on any relevant customer benefits of the feature or features of the market concerned'.¹⁶⁹

349. As noted in paragraph 163, in reaching a judgement about a particular theory of harm, the CC will evaluate its overall impact on rivalry, taking into account rivalry-enhancing as well as adverse effects.

¹⁶⁹ [Section 134\(7\)](#).

350. It would normally be expected that market features that have been found to adversely affect competition would also have detrimental effects on customers. For example, one usual consequence of a failure of competition is that prices will be higher than they would otherwise be. Nevertheless, it is possible that features that adversely affect competition could result in beneficial effects on customers, either in the market in which competition is adversely affected, or in other related markets. The potential loss of such beneficial effects on customers may therefore be taken into account by the CC in its consideration of remedies.
351. RCBs are limited to benefits to relevant customers in the form of:¹⁷⁰
- (a) lower prices, higher quality or greater choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or
 - (b) greater innovation in relation to such goods or services.
352. The Act provides that a benefit is only an RCB if the CC believes that:
- (a) the benefit has accrued as a result (whether wholly or partly) of the feature or features concerned or may be expected to accrue within a reasonable period of time as a result (whether wholly or partly) of that feature or those features; and
 - (b) the benefit was, or is, unlikely to accrue without the feature or features concerned.¹⁷¹
353. In considering potential RCBs, the CC will therefore need to ascertain that the market feature(s) with which it has been concerned does, or is likely to, result in lower prices, higher quality, wider choice or greater innovation, and that such benefits are unlikely to arise in the absence of those features. The CC will tend to disregard proposed RCBs that are purely speculative, might only arise at some time in the distant future

¹⁷⁰ Section 134(8)(a).

¹⁷¹ Section 134(8)(b).

or are otherwise uncertain or unsubstantiated. RCBs may include benefits to customers in the market in which the CC has found an AEC and to customers in other markets within the UK,¹⁷² provided these benefits meet the criteria set out in paragraph 352.

Possible relevant customer benefits

354. Whether a particular claimed benefit to customers is found to be an RCB will depend on the facts of the case and the characteristics of a particular market. In the following paragraphs, examples of possible RCBs are given. In all instances the CC will need to consider whether the criteria set out in paragraphs 351 and 352 are met.
355. Aspects of market structure that could adversely affect competition, such as a high level of concentration, might enable economies of scale to be obtained that would not be available if there were a larger number of firms in the market. Scale economies would only be of benefit to customers if they meant that the customer offer would be superior than if there were more firms competing in the market. Whether scale economies would constitute an RCB in a particular case would therefore depend partly on the extent to which, in practice, any cost economies were being passed on to customers as lower prices, improved quality, greater innovation or more choice.
356. Similarly, on the demand side, network effects (see paragraph 168) may lead to barriers to entry and sustained market concentration, but may also bring benefits to customers of being able to participate in a larger and/or better integrated network.¹⁷³ In determining whether a particular form of network effects constitutes an RCB, the CC will consider whether customers benefit in practice from such effects and whether

¹⁷² For example, in the [PPI](#) market investigation (January 2009), the CC found that credit prices, and credit cut-off scores, were lower than they otherwise would be because of PPI income generated at the credit point of sale and that this was an RCB.

¹⁷³ For example, in the [Stagecoach/Preston Bus](#) merger inquiry the CC identified an RCB associated with integrated ticketing brought about by the merger.

such benefits are unlikely to arise in the absence of the AEC resulting from the network effects.¹⁷⁴

357. Generally, customers are unlikely to enjoy any benefits as a direct result of entry barriers. However, some entry barriers may indirectly secure other kinds of benefit (see paragraph 222). For example, regulations that limit entry to persons of proven competence or with adequate capital resources may lead to an improvement in product or service quality. Likewise regulations that protect IPRs, while potentially restricting access to markets, may lead to improvements in innovation by enabling innovative companies to benefit from the new ideas that they generate. The CC will generally have regard to the wider purpose of such regulations in considering their effects on customers. In the absence of clear, countervailing customer benefits from a restriction of entry, the CC would normally expect customers to benefit from any reduction of entry barriers as this would be expected to facilitate dynamic competition and better market outcomes (see paragraphs 187 and 192).
358. Where an AEC has arisen from vertical relationships within a market (see paragraphs 262 to 286), the CC will consider whether these relationships have resulted in RCBs and whether these RCBs would outweigh any foreclosure or competition-dampening effects on customers.
359. The CC will similarly consider, when AECs have arisen from the many forms of business conduct that can also have either positive or negative effects, depending on the context, whether these conducts have resulted in RCBs and whether these RCBs would outweigh any competition-dampening effects on customers. Tie-in sales or product bundling (see paragraph 280), for example, may sometimes be convenient to customers, reduce transaction costs or provide quality assurance.

¹⁷⁴ For example, it may be possible for network benefits to be preserved through requiring interoperability between competing networks.

Relevant customer benefits and remedies

360. If the CC is satisfied that there are RCBs deriving from a market feature that also has AECs, the CC will consider whether to modify the remedy that it might otherwise have imposed or recommended. The CC will consider several factors including the size and nature of the expected RCB, what proportion of the benefit will be preserved through the modification, and how long the RCB may be sustained. The CC will also consider the different impacts of the features on different customers or groups of customers.
361. It is possible that the RCBs are of such significance compared with the effects of the market feature(s) on competition that the CC will decide that no remedy is called for (see paragraph 347). This might occur if no remedies can be identified that are able to preserve the RCBs whilst also remedying or mitigating the AEC and/or the resulting customer detriment. This situation has not arisen on a market investigation to date.
362. Alternatively, the CC, as a result of identifying RCBs, may choose a different remedy, for example a behavioural remedy rather than a structural remedy (see paragraph 364 for an explanation of this distinction). In this case, the CC will have to weigh the disadvantage of a less comprehensive solution to the competition problem against the preservation of the RCBs that result from the feature concerned.¹⁷⁵

¹⁷⁵ For example, in the [Macquarie UK Broadcast Ventures/National Grid Wireless Group](#) merger inquiry (March 2008), the CC required the merged company to agree a package of measures with the CC, including price reductions for customers on new and existing contracts and the appointment of an adjudicator to resolve disputes. The CC decided that these measures would be effective in addressing the adverse effects of the acquisition, whilst preserving the RCBs that could arise from the acquisition, including reducing the risks associated with the digital switchover process and passing back cost savings to customers.

Choice of remedy

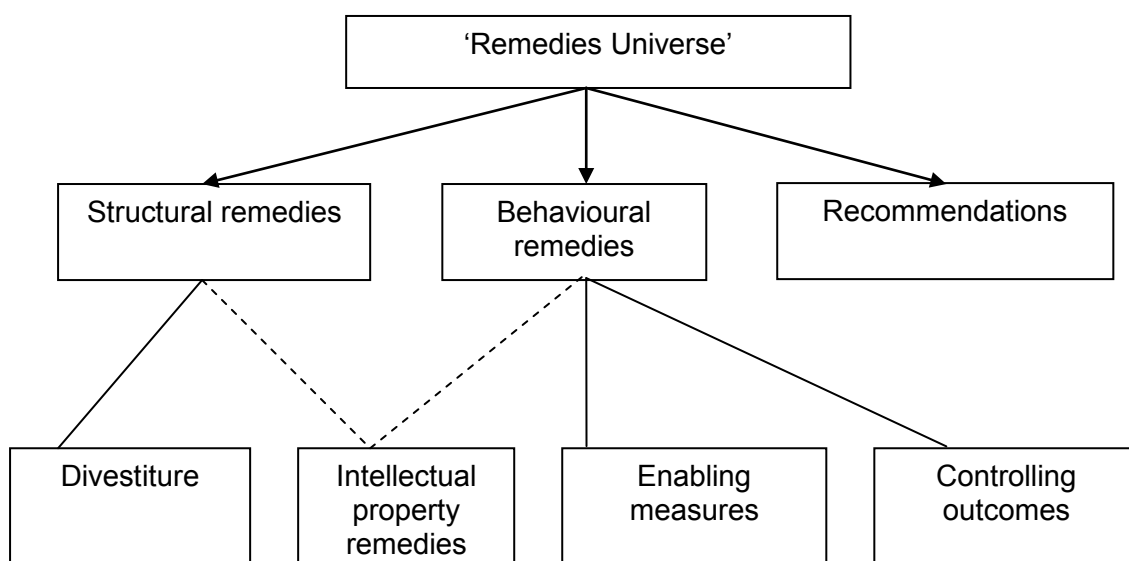
363. Paragraphs 364 to 373 provide an overview of the various types of remedy and their characteristics. Paragraphs 374 to 385 consider the selection from these types of remedy by applying the decision framework (outlined in paragraphs 314 to 362).

Remedies universe

364. A diagrammatic representation of the universe of possible remedies is shown in Figure 1. Remedies are conventionally classified as either structural or behavioural. Structural remedies are generally one-off measures that seek, in market investigations, to increase competition by altering the competitive structure of the market. Behavioural remedies are generally ongoing measures that are designed to regulate or constrain the behaviour of parties in a market and/or empower customers to make effective choices. Some remedies, such as those relating to access to IPRs, may have characteristics of structural or behavioural remedies depending on their particular formulation. Likewise, recommendations to others may be either structural or behavioural in nature, depending on their content. Further discussion of the different categories of remedy may be found in Annex B.

FIGURE 1

Overview of the universe of possible remedies



Divestiture

365. The aim of divestiture in market investigations is to address competition problems resulting from structural features of a market.¹⁷⁶ This may be done by either creating a new source of competition through disposal of a business or assets to a new market participant, or by strengthening an existing source of competition through disposal of a business or assets to an existing market participant that is independent of the divesting party (or parties).
366. A successful divestiture will address at source the lack of rivalry resulting from structural features of a market. Divestiture remedies will generally not require detailed ongoing monitoring beyond the completion of the disposal of the business or assets in question, although, in some cases, an effective divestiture may require supplementary behavioural measures for an interim period (eg to secure supplies of an essential input or service from the divesting party to the divested business). The requirements for design and implementation of divestiture remedies are considered in detail in Annex B, paragraphs 3 to 30.

Intellectual property remedies

367. A remedy that provides access to intellectual property (IP) by licensing or assignment of those rights may be viewed as a specialized form of divestiture remedy.¹⁷⁷ The aim of such a remedy is that the party or parties acquiring the IPRs should thereby be able to compete effectively with other companies in the market. Where the terms of an IP remedy result in a material ongoing link between the original owner of the IP and the parties gaining the IP (eg providing access to new releases or upgrades of technology) an IP remedy may take on some of the characteristics of a behavioural commitment, which may require ongoing monitoring and enforcement. Consider-

¹⁷⁶ For example, in the [BAA airports](#) market investigation (March 2009), the CC required the divestiture of Gatwick and Stansted airports and a Scottish airport as part of its package of remedies.

¹⁷⁷ The CC has not used an IP remedy in any of the market investigations to report to date. The package of remedies applied in the [Nufarm/AH Marks](#) merger inquiry (February 2009) had some characteristics of an IP remedy.

ations regarding the design and implementation of IP remedies are outlined in Annex B, paragraphs 31 to 36.

Enabling measures

368. Certain forms of behavioural remedy operate principally to enable competition by removing obstacles to competition or stimulating actual or potential competition.
369. Within the category of enabling measures, there are further distinctions between:
- (a) market-opening measures, which are intended to open up a market to new sources of competition by removing or reducing barriers to entry, expansion or switching. Such measures may, for instance, limit parties' ability to require their customers to enter into long-term or exclusive contracts or to otherwise create switching costs for customers (see Annex B, paragraphs 46 to 60).¹⁷⁸
 - (b) informational remedies, which are aimed at giving customers information to help them make choices and thereby increase competitive pressure on firms in the market (see Annex B, paragraphs 64 to 71).¹⁷⁹ Where an AEC results from coordinated effects (see paragraphs 224 to 257), the CC may consider remedies that prevent the sharing of information between firms, if sharing such information has been found to facilitate coordination; and
 - (c) remedies that restrict the adverse effects of vertical relationships (see 258 to 286). Such measures may include restriction of access to confidential information ('firewall provisions'), or obligations to provide access to facilities on fair,

¹⁷⁸ For example, the remedies introduced following the *Liquefied petroleum gas* market investigation (June 2006) included measures designed to facilitate the transfer of tank ownership when a customer wishes to switch supplier and other measures to make the switching process easier.

¹⁷⁹ For example, the remedies introduced following the *Home credit* market investigation (November 2006) included an obligation to publish price and other information on a comparative website www.lenderscompared.org.uk.

reasonable and non-discriminatory (FRND) terms (see Annex B, paragraphs 72 to 85).¹⁸⁰

370. Enabling measures are generally likely to require ongoing intervention and monitoring. In some instances this may involve complex issues, for instance the pricing of access to facilities that are subject to rapid technological change. Further considerations regarding the design and implementation of enabling measures are outlined in Annex B, paragraphs 46 to 85.

Controlling outcomes

371. Certain forms of behavioural remedy seek to prevent the exercise of market power and thereby control the detrimental effects arising from an AEC. For example, price caps, supply commitments and service level undertakings all control the way a business can operate to limit any possible detrimental effects on a customer.¹⁸¹ Such measures are often used in regulated sectors, where it may not be feasible to introduce effective competition. However, this type of behavioural remedy can be complex to implement and monitor, given informational asymmetries between the parties and the authorities and the associated risk of circumvention. There is also a risk that such controls create market distortions, particularly if they are kept in place over a long period. Ensuring that measures to control outcomes remain fit for purpose in the light of market developments may involve costs for monitoring and enforcement agencies as well as for the parties subject to them. Further considerations regarding this type of remedy are outlined in Annex B, paragraphs 86 to 93. .

¹⁸⁰ In the local bus services market investigation, the CC decided to introduce by means of an Order a requirement for bus operators to provide access on FRND terms to privately-owned and operated bus stations. This type of remedy is also sometimes used in merger cases. For example, the *Centrica/Dynegy Storage* merger inquiry (2003) provides an example of a case in which firewall provisions and an access remedy were introduced to restrict the adverse effects of vertical relationships following a merger.

¹⁸¹ In the *Classified Directories* market investigation, the CC found that prices of Yell, the largest provider, had been largely constrained by an existing price cap rather than competition. Were it not for the price cap, customers of Yell would be paying more for advertisements in Yellow Pages than they would if the market was functioning well. However, the CC expected that growing competition would increasingly constrain Yell's prices and that Yell would feel more pressure due to the Internet. The CC's remedies included a revised price control to prevent Yell from exploiting its market power and other measures designed to preserve developing competition from actions that could be targeted at competitors.

Recommendations

372. The CC can decide to make recommendations to other bodies, rather than taking action itself. Such recommendations can be thought of as falling into one of two categories:

- (a) In some cases, the legal framework, regulations or conduct applicable to a market may be a structural feature giving rise to an AEC; for example, planning or certification requirements may inhibit entry or restrict market outcomes (see paragraph 207 to 210). In such cases the CC may recommend modifications of these requirements to the Government or other controlling body to help address the AEC or control its detrimental effects. For example, the CC may recommend the removal or reform of regulatory requirements that have been found to constitute a barrier to entry.
- (b) The CC may also make recommendations in situations where it is more practicable, or otherwise preferable, to implement a remedy by means of a recommendation.¹⁸²

373. It will, of course, be for the Government or other person to whom a recommendation is addressed to decide whether to act on the recommendation and the CC will consult with the relevant body prior to making the recommendation. Further considerations regarding this type of remedy are outlined in Annex B, paragraphs 94 to 102.

Selection of remedies

374. As set out in paragraph 325, in deciding what remedial action should be taken, the CC will first look for a remedy that would effectively address the causes of the AEC directly and thereby deal with any detrimental effects on customers of the AEC.

¹⁸² For example, in the local bus services market investigation the CC decided to make a series of recommendations (eg in relation to multi-operator ticketing schemes) which would enable the implementation of these measures to take account of specific local conditions.

375. The type of action that will be effective in increasing competition will depend on the nature of the AEC concerned. The range of potential competition problems that may be identified as giving rise to an AEC is wide, as is the range of potential remedies. The relative merits of different remedy options will be determined by the facts of the case and, in particular, the nature of the underlying competition problem that gives rise to the need for remedial action.
376. Table 1 illustrates some possible approaches to remedying some of the different types of competition problem that may give rise to an AEC.

TABLE 1 Illustration of possible remedy approaches to different types of competition problem

<i>Example of problem arising</i>	<i>Possible remedy approaches</i>
<p>Restrictions on competitive entry or expansion reduce dynamic competition and slow technological progress and introduction of new products.</p>	<ul style="list-style-type: none"> • Market-opening measures to reduce barriers to entry and promote dynamic competition. • Recommendations to Government or regulatory bodies to address any barriers to entry which are caused or created by government laws or regulatory actions (eg planning rules).
<p>Concentrated market structure means that the market is dominated by one, or a small number of players, whose position is protected by high barriers to entry and/or expansion.</p>	<ul style="list-style-type: none"> • Structural measures (eg divestiture, IP licensing) to create directly a less concentrated market structure. • Market-opening measures (eg reduction of entry barriers) to increase the competitive constraint from entry, addressing market structure indirectly and thereby increase competitive threat to incumbents. • Recommendations to Government or regulatory bodies to address regulatory barriers to entry or expansion. • Measures to control outcomes (eg price caps) possibly on an interim basis to mitigate the harm to customers until market opening measures become effective. Measures to control outcomes might also be used if market concentration is very difficult or very costly to alter in practice (eg in a natural monopoly) and/or if concentration gives rise to very substantial RCBs (eg network effects) that would be lost in a more fragmented market structure and market-opening measures are unlikely to be successful.
<p>Coordination between rivals means that competition is restricted and customers are made worse off.</p>	<ul style="list-style-type: none"> • Structural measures (eg divestiture, IP licensing) to make it harder to achieve, monitor and sustain a coordinated outcome, by increasing the number of significant market participants. • Market-opening measures (eg reduction of entry barriers) to increase the competitive constraint from entry and thereby increasing competitive threat to incumbents. • Restrictions on supplier conduct or other market features that have the effect of facilitating coordination—for example, remedies might be aimed at limiting the availability of information held by suppliers about their rivals. • Recommendations to Government or regulatory bodies to ensure that government laws or regulatory actions do not facilitate coordination or cause unnecessary barriers to entry or expansion.
<p>Vertical effects. Competition problems can arise where a single firm operates at a number of levels of the supply chain or where there are other vertical arrangements between firms active at different levels of a supply chain.</p>	<ul style="list-style-type: none"> • Structural measures—for example, to separate ‘natural monopoly’ activities from potentially competitive activities, or to reduce horizontal market power at one or other stage of the supply chain. • Remedies to restrict the effects of vertical relationships to ensure access to key services, products or facilities; prevent discrimination; or prohibit vertical arrangements that restrict competition. • Measures to control outcomes—for example, to mitigate the detrimental effects in ‘natural monopoly’ activities and/or if vertical relationships give rise to substantial RCBs (eg network effects) that would be lost with other measures.
<p>Information shortfalls and behavioural biases. Competition can be weak, when customers find it hard to identify good value products in a market or switch between providers, or are subject to behavioural biases.</p>	<ul style="list-style-type: none"> • Market-opening measures to address the source of switching costs and/or encourage entry and expansion by firms with incentives to reduce search costs (eg by advertising). • Informational remedies to make it easier for customers to find out about products in the market and to facilitate comparisons; to address ‘customer’ barriers to switching (eg inertia, or lack of familiarity with the switching process) and/or to encourage whole-life costing (eg upfront disclosure of ‘hidden’ charges). Such measures might involve an element of product regulation to simplify the choices facing customers and/or to protect customer interests, where customer search for information on a particular aspect is unlikely to occur.

Source: CC.

377. As Table 1 shows, structural remedies such as divestiture are a potential solution where horizontal market concentration, coordinated effects or vertical integration are among the principal market features that give rise to an AEC (see Annex B, paragraphs 3 to 30). Likewise, IP licensing may be used to remedy AECs that result from highly concentrated markets, if, by virtue of an IP remedy, new or expanding suppliers would be able to provide an effective competitive constraint on powerful incumbents (see Annex B, paragraphs 31 to 36).
378. An alternative approach to remedying structural problems may be to pursue measures that impact on market structure indirectly. Such enabling measures may include introducing market-opening measures that remove or reduce barriers to entry (see Annex B, paragraphs 47 to 60)) or measures to restrict the adverse effects of vertical relationships (see Annex B, paragraphs 72 to 85).
379. In choosing between structural remedies and enabling measures that impact on market structure indirectly, the CC will consider whether the market response to these measures will be timely and of sufficient scale to represent a comprehensive solution to the AEC. Structural remedies such as divestitures are likely to have some important advantages over other measures to remedy competition problems arising from market structure. Once implemented, structural remedies may be expected to increase competitive constraints on the behaviour of firms in the market within a short timescale and without requiring ongoing detailed monitoring by the OFT and/or any other body such as the relevant sector regulator.
380. However, in some circumstances, structural remedies may not address the features giving rise to the AEC and behavioural remedies are likely to be preferred. An important difference between remedies in merger and market investigations is that structural remedies, even if they are available in a market investigation, may not

always be an appropriate solution to a particular AEC because of the wide range of features, including non-structural features that can give rise to an AEC. For example, enabling measures are likely to be chosen where:

- (a) the conduct of firms has given rise to an AEC—for example, by raising barriers to entry or facilitating coordination. In such situations the CC may consider restrictions on firms' behaviour that constrain firms' future ability to engage in such conduct (see Annex B, paragraphs 49 to 53);
- (b) switching costs or barriers to entry or expansion are among the features that give rise to an AEC. Here, the CC may consider market-opening measures that address the main barriers to switching, entry or expansion that it has identified (see Annex B, paragraphs 54 to 60); or
- (c) search costs and other information shortfalls are among the features giving rise to an AEC. In such situations, informational remedies that make it easier for customers to search and switch may be an appropriate response (see Annex B, paragraphs 61 to 71).

381. Remedial action may also be required to address customer detriment directly, for example where effective remedies aimed at introducing competition by addressing the AEC are unavailable or will not bear fruit for some time (see Annex B, paragraphs 86 to 93). Price controls are the most obvious example. However, such measures to control outcomes are not likely, by their nature, to provide a solution to the underlying problem and may also give rise to distortion risks, if retained over a long period. For these reasons, remedial action to control outcomes will not generally be preferred as a long-term solution.

382. As stated in paragraph 372, recommendations may be considered where an aspect of regulation or government behaviour is itself giving rise to an AEC or where it would be more practicable (or otherwise preferable) for the CC to implement a remedy by

means of a recommendation rather than taking action itself. This may include situations in which other bodies have powers that are unavailable to the CC or where a recommendation enables a remedy to be better integrated with existing interventions in a sector.¹ It may also include cases where a remedy to increase competition in a market has the potential to come into conflict with other important public policy objectives and it is more appropriate for Government, rather than the CC, to balance these conflicting objectives.²

383. In deciding whether to make a recommendation rather than take action itself, the CC will form a view as to the likelihood that the recommendation will be acted upon and, if so, over what time period. In reaching this view, the CC will have regard both to the stated policy of the body to which the recommendation is to be directed and to the possibility that that stated policy may change, either in light of the CC's recommendation or subsequent events (see Annex B, paragraphs 94 to 102).

384. In looking for remedies that would be likely to increase competition in the relevant market(s), the CC will give attention to the time period within which the remedy can be expected to show results. If a remedy is not likely to have rapid results, the CC may choose an alternative remedy or implement additional remedies such as measures to address the detrimental effects on customers during the interim period. Otherwise, not only might there be uncertainty as to whether the beneficial effects of the remedy would materialize, but, in the meantime, customers would continue to suffer from the consequences of the AEC.

¹ For example, in the *PPI* market investigation, the CC made a recommendation to the Consumer Financial Education Body—now known as the Money Advice Service—to publish information on its existing price comparisons website, rather than requiring the creation of a new price comparisons site.

² For example, in the *ROSCOs* market investigation, the CC made recommendations in relation to the operation of the rail franchising system to increase competition in the supply of rolling stock. In making these recommendations, the CC was mindful of the Government's wider public policy objectives in relation to rail franchising.

385. The CC's experience to date suggests that remedies in market investigations may take the form of a 'package' of measures, rather than the implementation of a single measure. This may be because there are several features giving rise to an AEC, and consequently an individual measure may be incapable of addressing the AEC in its entirety. For example, to deal with problems associated with a lack of customer switching it may be necessary both to remove contractual barriers to switching and also to put in place informational remedies that raise customer awareness of the potential benefits of switching. Where more than one measure is being introduced, the CC will consider the way in which the measures are expected to interact with each other. As a general rule (as stated in paragraph 334), measures which share the aim of introducing competition into a market will tend to be mutually reinforcing.