RESPONSE TO THE CMA'S CONSULTATION ON REGULATED INDUSTRIES: GUIDANCE ON CONCURRENT APPLICATION OF COMPETITION LAW TO REGULATED INDUSTRIES

(CMA10CON, SEPTEMBER 2013)

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1. INTRODUCTION AND SUMMARY

1.1 Freshfields Bruckhaus Deringer LLP (***Freshfields***) welcomes the opportunity to comment on the Competition and Market Authority's (***CMA***) consultation (the ***Consultation***) on the Concurrent Application of Competition Law to Regulated Industries (the ***Guidance***). The draft CMA Strategy (*Vision, values and strategy for the CMA*, CMA13con) and Strategic Steer both indicate that regulated sectors, in particular energy and financial services, are going to be an area of focus over the next few years[1]. It is therefore important that the Government seize the opportunity presented by the Guidance to provide as much clarity and transparency as possible on the ways of working between the CMA and the sectoral regulators in order to avoid any duplication and concomitant burdens on business that might result from a strengthened concurrency regime.

1.2 Our comments are based on our experience of representing clients across a wide range merger, enforcement and market investigations conducted by the Office of Fair Trading (***OFT***), the Competition Commission (***CC***), as well as each of the sector regulators that have concurrent powers under the Competition Act 1998 (the ***CA 98***) (together, the ***Sector Regulators***). We rely on this breadth of experience to provide these comments about the most effective operation of the UK concurrency regime. Unless noted, our comments apply to the effective operation of the relationship between the CMA and each of the Sector Regulators.

1.3 We have confined our comments in this paper to overarching issues that relate to the operation of the concurrency regime as a whole, rather than issues that are specific to the operation of the concurrency regime between the CMA and one Sector Regulator. The comments in this response are those of Freshfields Bruckhaus Deringer LLP and do not necessarily represent the views of any of our clients.

1.4 We welcome the CMA's review of the concurrency regime. In particular, we welcome that the Guidance:

(a) provides greater clarity on the operation of the concurrency regime once the CMA launches on 1 April 2014;

(b) establishes a clear framework within which the CMA will take a stronger co-ordinating and leadership role in the operation of the concurrency regime, through in particular the creation of the UK Competition Network. This should:

(i) enable greater consistency on substance and process across the regulated sectors; and

[1] See, for example, paragraph 7 from the Strategic Steer, published on 1 October 2013

(ii) enable the CMA and Sector Regulators to leverage their respective knowledge-base, skills and best practices so that they can conduct efficient reviews,

with the potential for consumers to benefit provided there is minimal overlap or duplication of work; and

(c) builds on, and formalises, a number of developments in recent years, such as the use of secondments and joint working between the OFT and Sector Regulators.

1.5 However, we have some questions with certain aspects of the Guidance. In particular:

(a) **Step-in rights**: although the CMA's leadership has recognised recently that it will seldom exercise its so-called 'step-in' rights and will prefer a collaborative approach with sector regulators, that is not so far reflected in the Guidance. The description of when the CMA will exercise its right to exercise jurisdiction where a case has already been allocated to a Sector Regulator (***"step-in" rights***) provides insufficient certainty to businesses on this point and raises uncertainty and questions as to how this dual-competency will operate:

(i) the Guidance grants the CMA a wide discretion to exercise its step-in rights at any stage prior to the issue of a Statement of Objections. Thus, it remains possible that the CMA could invoke these rights some way into an investigation, potentially causing delay to a sectoral investigation already underway;

(ii) the Guidance provides very limited details on the procedural safeguards that will be put in place around the exercise of these rights. For example, the seniority of the officials taking the step-in decisions is left unclear, and there is no reference to how the CMA will review written representations made by affected parties;

(iii) it appears theoretically possible for the Sector Regulator to pursue a case as an alleged licence breach, with a parallel or recently closed CMA investigation under Competition Act powers in relation to the same industry – it would be helpful if the Guidance could clarify that such a 'double-jeopardy' type situation is not envisaged and that only a single regulator would be conducting an investigation at any one time or in relation to the same set of facts;

(b) **Primacy of competition enforcement**: under the new Enterprise and Regulatory Reform Act, sector regulators will be required to first give consideration to the exercise of their competition powers over their regulatory enforcement powers. It would be useful to understand how this balancing appraisal will be conducted and to what extent the CMA will be consulted (if at all) in relation to this decision. The Guidance does not make it sufficiently clear that the most appropriate time for Sector Regulators to consider this

balancing act as between the use of competition or sectoral powers will almost always be at or before the start of a case. After such a decision has been taken, there should be a heavy assumption against the CMA or the sectoral regulator deciding instead to using its competition powers in the absence of any material and significant change of circumstance.

(c) **Confidential information safeguards**: the Guidance does not reflect the importance of ensuring that there are robust safeguards in relation to the protection and potential transfer of confidential information between the CMA and Sector Regulators. Moreover, the Guidance does not connect the importance of confidentiality with arrangements for shared working or secondments, where these considerations should also be of the utmost importance; and

(d) **UKCN**: the composition and status of members of the UK Competition Network (***UKCN***) should be made clear in the final Guidance and, where possible, consideration should be given to the publication of UKCN meeting minutes and other key UKCN correspondence.

1.6 We note that there is considerable potential overlap between the Guidance and the Government's separate consultation on reforms to regulatory and competition appeals (*Streamlining Regulatory and Competition Appeals: Consultation on Options for Reform*, 19 June 2013). As part of that consultation, the Government proposes to remove a full merits review from many regulatory appeals. These proposals have been robustly criticised by many law firms (including us) (*Response of Freshfields Bruckhaus Deringer LLP, dated 11 September 2013).* Exceptionally, the CAT has also issued an extensive critique of these proposals.[2] Clearly, one would need to give careful consideration to the potentially significant impact that a change to the regulatory appeals framework would have to the concurrency regime – if fundamental changes are implemented, then we would recommend that the CMA should consult further on its concurrency regime in that light.

1.7 The remainder of this Response sets out in more detail our comments on specific Consultation proposals. The Annex contains our responses to the individual questions posed by the Consultation.

2. PROCEDURAL SAFEGUARDS FOR THE USE OF "STEP-IN" RIGHTS

2.1 With respect to the circumstances in which the CMA may exercise its right to exercise jurisdiction where a case has already been allocated to a Sector Regulator (***"step-in" rights***), we have a number of concerns.

2.2 Firstly, whilst the Guidance states that the "*CMA expects that the circumstances in which it would take over a case under Regulation 8 are likely to be rare*" it does not explain in what circumstances this might be justified, in particular in light of recent views from the CMA's leadership that such interventions will indeed be very rare. Moreover, the Guidance does not provide any indication of how the

[2] Available at: http://www.catribunal.org.uk/247-8143/Streamlining-Regulatory-and-Competition-Appeals.html.

CMA should apply the statutory test in Regulation 8 of the Concurrency Regulations that the exercise of the CMA's step-in rights must "*further the promotion of competition, within any market or markets in the United Kingdom, for the benefit of consumers*" (Regulation 8(1)(a)). This leaves the CMA with a wide discretion, beyond the duty to discuss the proposed decision with the Sector Regulator, the "*undertaking concerned and any other persons likely to be materially affected by the transfer at any stage before a Regulator has issued a Statement of Objections*" (Guidance, paragraph 3.26).

2.3 We think that the Guidance should provide additional clarity on this new area of practice. We would suggest that the Guidance:

(a) provides an indication of the factors that CMA must take into account before exercising its step-in rights. Within these factors, we think that the CMA must consider the *potential* harm to competition caused by the *potential* delay, the balance of convenience and what additional expense and delay may be caused and whether such expense or delay is proportionate;

(b) expand on the final sentence in paragraph 3.27 of the Guidance ("*In practice, the CMA expects that the circumstance in which it would take over a case under Regulation 8 are likely to be rare*") with a more detailed paragraph; and

(c) states that any decision that the CMA should exercise its "step-in" rights should only be made by the CMA Board.

2.4 Secondly, the Guidance risks harming parties' rights, when faced with a potentially '*quasi-criminal*'[3] finding that they have breached competition law, if the decision to do so is taken at an advanced stage in proceedings. The Guidance enables the CMA to review a draft notice, decision or Statement of Objections and then decide to initiate the use of step-in rights. Could this mean, in short, that the CMA has the ability to exercise a veto right over the Sector Regulator's decision making process?

2.5 Accordingly, the CMA will need to have robust safeguards in place to ensure that the exercise of step-in rights prior to the issue of the Statement of Objections is fair. Otherwise, the undertaking concerned or another third party could challenge any final decision for procedural unfairness. To lessen this risk, we think that the Guidance should:

(a) state clearly that the use of step-in rights will need to be proportionate, and that this will mean that, as a case moves towards the Statement of Objections stage, the CMA should need to reach a higher standard to justify the exercise its step-in rights. This would ensure that the CMA did not unnecessarily delay the use of its step-in rights, thus avoiding unnecessary cost and delay for businesses and Sector Regulators; and

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[3] See *A. Menarini Diagnostics S.R.L. v Italy*, no. 43509/08, 27 September 2011 (ECHR); *Napp Pharmaceutical Holdings Limited v Director General of Fair Trading* [2001] CAT 3 at [69]; *Aberdeen Journals Limited v Director General of Fair Trading* [2002] CAT 4 at [176].

(b) once a Sector Regulator has prepared a draft Statement of Objections, notice or decision, the CMA will only exercise its "step-in" rights in very exceptional circumstances (unless the parties consent);

2.6 Third, the Guidance does not clearly reflect the CMA's obligation to take into account written representations from the current/appointed Sector Regulator, undertaking concerned and other parties (Regulation 8(3)). The Guidance does not set out clearly the nature of the consultation that the CMA must undertake before exercising its step-in rights, merely noting that "*such a decision [may be taken] after consultation with the [Sector] Regulator, the undertaking concerned and any others likely to be materially affected*" (Guidance, paragraph 3.26).

2.7 The Guidance should explain the process by which the written representations provided by the appointed Sector Regulator, the undertaking concerned and other third parties will be judged. We would suggest that the CMA be required to respond in writing within no more than 5 working days. The Guidance should also clarify whether the undertaking concerned will be provided with copies of any representations made by other persons (and vice-versa).

2.8 Fourth, we note that step-in rights cannot unilaterally be exercised once a Statement of Objections has been issued, and the CMA must rely on the Sector Regulator's consent pursuant to Regulation 7 of the Concurrency Regulations.

3. PRIVACY OF COMPETITION POWERS OVER SECTORAL POWERS

3.1 We understand that the Sectoral Regulators now have a statutory duty to consider first the exercise of competition powers in favour of sectoral powers. However, we would suggest two amendments to the Guidance. These amendments reflect the fact that the use of competition powers in place of sectoral powers typically takes considerably longer in terms of time, thus incurring additional costs for the Government and regulated entities, and therefore businesses and consumers.

3.2 First, in paragraphs 4.3 to 4.5 of the Guidance, it should be made explicit that the most appropriate time to consider whether to use sectoral powers or competition powers will ordinarily be when the Sector Regulator is deciding to commence an investigation in its sector. In order to properly protect a company's rights of defence, they should be informed in a timely manner that there is a possibility of an investigation proceeding under competition powers rather than sectoral powers and invite representations. This amendment would be in line with the rationale for the legislative change; as noted in the Government's guidance notes, "*[t]he intention behind this change in emphasis is to encourage regulators to turn their minds to the question of whether the CA 1998 route is more appropriate at an earlier stage*".

3.3 Second, the Guidance should note that, if a case is near to its conclusion, the use of competition powers may not be the most efficient use of the Sector Regulator's time. Reflecting this principle in the Guidance would also make it clear to Sector Regulators and the CMA that they should ordinarily be considering this issue at the earliest possible opportunity in order to discharge their overriding obligations to conduct their investigation in a proportionate and efficient manner.

4. CONFIDENTIALITY

4.1 The information sharing provisions of the Guidance serve the important goal of ensuring the "*efficient and effective functioning of the United Kingdom concurrency regime*" which includes (inter alia) establishing "*transparent, cooperative and effective working practices*" (paragraph 3.40). However the Guidance does not provide sufficiently detailed guidance on the procedures and safeguards that should be put in place between the CMA and Sector Regulators for the protection and exchange of confidential information. In mergers cases, it is becoming standard practice to seek a confidentiality waiver from the parties and involve the parties in discussions around what information is disclosed, how and to whom. This important issue is instead left to "*the individual Memoranda of Understanding between the CMA and each of the [Sector] Regulators*" (paragraph 3.42).

4.2 We note that on 21 October 2013 the OFT Mergers Branch adopted a secure online system for the delivery of confidential information (Egress Switch). The system has been introduced because: "*HM Government's advice to Government Departments is that correspondence containing confidential information should only be sent electronically if the system being used is secure. Safe handling of confidential information reduces the risks associated with transmitting information brought about by cyber criminals and human error*".

4.3 As a minimum, we think that the Guidance should confirm that the transfer of information between the CMA and Sector Regulators should only take place electronically if the system being used is as secure as the CMA's system and the relevant checks and balances are in place. In addition, we would suggest that all information is exchanged on a strictly limited basis, and that the Guidance makes clear that the CMA and Sector Regulators must prepare and maintain lists of persons provided with access to any confidential information shared.

5. STATUS OF CONCURRENT REGULATORS

5.1 We broadly welcome the evolution of the Concurrency Working Party (***CWP***) into the UKCN. As noted above, we consider that the UKCN provides an appropriate framework in which the CMA can move towards achieving the Government's objectives for a more consistent and efficient concurrency regime.

5.2 We assume that the Financial Conduct Authority (***FCA***) will be a member of the UKCN now that it is to be given concurrent competition powers. However, the status of the FCA and two further bodies is unclear:

(a) the Government is proposing that a Payment Systems Regulator (***PSR***) be established from within the FCA with concurrent competition powers. Although the PSR will be independent, the narrow scope of its remit means that it is not automatically clear that it should be a member of the UKCN; and

(b) the Government is also proposing that the Prudential Regulation Authority (***PRA***) should have a secondary competition objective. We note that a footnote to the Guidance indicates that such bodies can be invited to join the UKCN.

5.3 We think that the finalised Guidance should make clear what status, if any, the FCA, PSR and PRA will have in relation to the UKCN.

5.4 Similarly, we think that the Guidance should include a summary of the different relationship between the CMA and Monitor and (possibly in the form of an annex) a summary of the provisions in the Guidance that apply differently to Monitor, for example the exclusion of the CMA's transfer and "step-in" rights.

Freshfields Bruckhaus Deringer

11 November 2013

ANNEX – RESPONSE TO CONSULTATION QUESTIONS

Question	Response
1. Do you consider that the Transition Team's proposed approach to dealing with the revised requirement that Regulators' exercise competition powers in favour of sectoral powers is clear and appropriate? Please give reasons for your view	See Section 3 above.
2. Do you consider that the Transition Team's proposed approach to allocation of cases between the CMA and Regulators, or between Regulators, is clear and appropriate? Please give reasons for your view	See Section 2 above. We consider that the Guidance needs to provide more detail on the appropriate procedure to be followed before the CMA exercises its step-in rights under Regulation 8. The Guidance needs to clarify the factors that the CMA should take into account when considering whether "*to exercise Part 1 functions in relation to a case in order to develop United Kingdom competition policy or provide greater deterrent and precedent effect for the benefit of competition and consumers, either within the relevant regulated sector, or more widely*" (Guidance, paragraph 3.21). This point applies equally to case allocation and the use of the CMA's step-in rights.
3. Do you consider that the Transition Team's proposed approach to secondments and cooperative working between the CMA and Regulators is clear and appropriate? Please give reasons for your view	As noted in Section 2, we think that the Guidance should include an explicit obligation to notify parties where the CMA and Sector Regulators (or two Sector Regulators) agree to cooperate on a case. We can envisage circumstances in which this may be the outcome of discussions between the CMA and a Sector Regulator regarding the allocation of case or (in rare circumstances) a decision by the CMA to exercise its step-in rights. Arrangements to share staff between the CMA and Sector Regulators will

Question	Response
	need to comply with employment law and protect the confidentiality of information provided to the CMA/Sector Regulators. The Guidance should provide that ordinarily the CMA should take overall responsibility for the operation of the arrangement.
4. Do you consider that the Transition Team's proposed approach to information sharing between the CMA and Regulators, or between Regulators, is clear and appropriate? Please give reasons for your view.	See Section 3 above. The Guidance should more clearly state the safeguards that should be put in place to ensure that information sharing is secure. The Guidance should also confirm the circumstances in which it will be permissible for parties to prohibit the CMA/Sector Regulators from sharing information, for example, when it is voluntarily provided.
5. Do you consider that the CMA and the Regulators should share additional categories of information, or share information of the type outlined in the Draft CMA Concurrency Guidance at different times? Please give reasons for your view	See Sections 2 and 3 above. The Guidance should include appropriate procedural safeguards to ensure that parties' rights are protected when the CMA and Sector Regulators are provided the opportunity to review advanced draft versions of any notice, decision or Statement of Objections.
6. Do you consider that the Transition Team's proposed approach to the annual concurrency report is clear and appropriate? Please give reasons for your view	We consider that the Sector Regulators should be able to request that information is removed from the draft concurrency report where they believe that it "*could jeopardise ongoing cases under Part 1 of the CA98, or the effectiveness of actual or proposed regulatory activity in any of the concurrent sectors*".
7. Do you consider that the annual concurrency report should contain categories of information that is not envisaged in the Draft CMA Concurrency Guidance? Please give reasons for your view	See Section 2 above. The annual concurrency report should also contain details of whether the CMA has exercised its "step-in" rights or a case has been transferred from the CMA to a Sector Regulator (or between two Sector Regulators).

Question	Response
8. Do you agree with the Transition Team's proposed approach to transitional arrangements to account for the changes to competition concurrency introduced by Chapter 5 of Part 4 of the ERRA13? Please give reasons for your view	No comment.