SLAUGHTER AND MAY

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The CMA needs you: a review of current literature on the deterrent effect of competition enforcement to stimulate further research

On 7 September 2017 the Competition and Markets Authority (CMA) published a **literature review** entitled "The deterrent effect of competition authorities' work" that considers current research on the indirect benefits that consumers receive as a result of competition authorities' interventions and, more importantly, how such benefits can be quantified.

The background to the current benefit approach

In 2007 the CMA's predecessor (the Office of Fair Trading) agreed a performance target requiring it to deliver direct financial benefit to consumers at least five times greater than the taxpayer costs of funding the authority. Direct benefits include decreases in prices and monetised improvements in quality and time savings.

With the inception of the CMA, the direct benefit target was increased to a ratio of 10:1 which the CMA has comfortably achieved (this year **reporting** a direct benefit to cost ratio of 18.6:1).

The tip of the benefit iceberg?

Despite providing a strong endorsement for the CMA, the authority has been quick to point out the target's limitations. Crucially, no credit is given for indirect benefits, namely deterrence of would-be offenders. According to the CMA, in a perfect enforcement system all wrongdoing would be deterred without the need for investigation. Without pondering on the potential issues of 100 per cent deterrence (such as the realistic dangers of false negatives), the CMA demonstrates the shortcomings of the current test by noting that in this 'perfect' system the direct benefit score would be zero.

Further, direct benefit analysis distorts the comparison between different types of enforcement. Market investigations, which typically cover whole markets such as retail energy, score highly (with an annualised benefit of £887 million). By contrast merger investigations, which only deal with a small number of firms

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directly but may also deter or modify many other potential mergers, only achieve a yearly direct benefit of £143 million. It is clear therefore that only quantifying direct benefits results in warped assessments.

Indirect effects

Incorporating deterrence into the current benefits test is, however, not straightforward. The key takeaway from the literature review, which looks at enforcement worldwide, is that there is no known way to quantify this deterrence value. Current literature is also undeveloped in other respects:

(i) The interrelation of different types of enforcement: there is little analysis on how different types of enforcement interrelate (for example, the CMA speculates that a stricter merger regime would lead to fewer dominance issues under Chapter II of the Competition Act 1998).

(ii) The Atlantic divide: the CMA points out that a large proportion of the literature is based on US markets and competition policy and is therefore less relevant to the UK/EU.

The numbers and conclusions

Currently, the most comprehensive literature studying deterrence focuses on cartels. Based on survey analysis, the CMA estimates that between 4.6 and 28 cartels are deterred for each one detected. Though useful, the CMA highlights that these figures derive from its analysis in reports conducted in **2007** and **2011** and may therefore no longer reflect current reality.

Despite the age of some of the data, the CMA is confident that indirect benefits actually outweigh direct benefits. From assessment of the literature, the CMA estimates that around 50 per cent of cartel harm is deterred as a result of the existence of competition enforcement, with remaining cartels having less stability and durability. The strongest deterrent effect appears to be in relation to overcharge.

The CMA also notes literature which suggests that detecting a cartel can deter others in unrelated markets. Interestingly, research as to the deterring effect of leniency schemes was mixed to the point that the CMA acknowledged it was difficult to draw conclusions.

For mergers, the CMA estimates that between 4 and 18 per cent of potential mergers are abandoned and between 2 and 15 per cent are restructured as a result of the presence of an enforcement regime.

Despite these figures, there is no consistent evidence that increasing the severity of enforcement outcomes increases deterrence. Further there is little research as to which outcome deters most (for example, remedies or prohibitions). The CMA also sets out the potential pitfalls of stricter enforcement, such as greater error costs (being the costs of investigating a false positive). In terms of the funding of merger controls, the CMA welcomed further research on optimum spending.

Beyond cartels and mergers, the literature review found little on key areas of competition enforcement including in relation to vertical agreements and abuse of dominance (though the **2007** and **2011** reports listed above do suggest that between four and ten abuses are deterred by each abuse of dominance decision). The CMA notes that, given the large amount of resources that are allocated to such enforcement, this is a gap in the literature that should be addressed.

The need for further research

This literature review provides a welcome reflection on current practice. Having the ability to accurately measure both the direct and indirect effectiveness of enforcement is crucial to developing regulation.

While the current literature supports the existence of deterrence as a result of the CMA's work, further research may enable the CMA to quantify such deterrence more accurately and develop new consumer benefit targets.

Other developments

Merger control

ECJ rules that only 'full-function' joint ventures need EU clearance

On 7 September 2017 the European Court of Justice (ECJ) issued a preliminary ruling in the case of *Austria Asphalt GmbH & Co OG* v *Bundeskartellanwalt*[1] that, to qualify as a 'concentration' under the EU Merger Regulation (EUMR), a joint venture must exist as a full-functioning and autonomous entity. The **ruling** comes in response to a request from Austria's Supreme Court in May 2016 for the ECJ to clarify the interpretation of Article 3 of the EUMR.

Article 3(1)(b) of the EUMR stipulates that a concentration arises where "*a change of control on a lasting basis results from… the acquisition,…by one or more undertakings,…of direct or indirect control of the whole or parts of one or more other undertakings*". However, Article 3(4) of the EUMR states that "*the creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity shall constitute a concentration within the meaning of paragraph 1(b)*".

The **referral** comes in the context of Austria Asphalt's proposed acquisition of 50 per cent of the shares in the asphalt mix plant, Mürzzuschlag, from sole owner Teerag-Asdag. The joint venture was not intended to create a full-functioning entity; it was intended to supply asphalt predominantly to its parent companies rather than to third parties. Austria's cartel court determined that the transaction would need to be notified to the European Commission (instead of being reviewed at national level) as it falls within the definition of a 'concentration' under Article 3(1)(b) of the EUMR, by virtue of the fact that Austria Asphalt would be acquiring joint control of Mürzzuschlag. Austria Asphalt appealed against that decision before the Supreme Court on the ground that, under Article 3(4) of the EUMR, the creation of a joint venture results in a concentration only where it is full-function. As the Supreme Court found no clear interpretation of these provisions in EU rules or case law, it referred to the ECJ the question of whether Article 3 of the EUMR must be interpreted as meaning that a move from sole to joint control of an existing undertaking constitutes a concentration only where that undertaking performs on a lasting basis all the functions of an autonomous economic entity.

The ECJ agreed with this interpretation, noting that where a textual approach to interpreting a provision of EU legislation does not allow its precise scope to be defined, interpretation must be based on the provision's purpose and general structure. Accordingly, as the EUMR is concerned with preventing mergers and acquisitions from causing lasting damage to competition within markets, transactions will be caught to the extent that they entail significant structural changes the impact of which on the market goes beyond the national borders of a Member State. As regards joint ventures (both those newly created and those where a solely-controlled undertaking existed before the transaction), only those that operate on a lasting basis and are full-function will have a lasting effect on market structure and therefore be caught.

[1] Case C-248/16 *Austria Asphalt GmbH & Co OG* v *Bundeskartellanwalt*, judgment of 7 September 2017.

The ECJ also flags that joint ventures that do not constitute a concentration under the EUMR but could lead to anti-competitive behaviour may fall to be considered under Article 101 or 102 of the Treaty on the Functioning of the European Union or the equivalent national regimes.

CMA publishes updated guidance on merger process

On 5 September 2017 the CMA published guidance on the use of initial enforcement orders, amended its merger notice template and made some minor amendments to the guidance on its merger intelligence function. The changes follow on from consultations on the CMA's merger process and are intended to streamline the CMA's process and reduce the burden the merger review places on companies.

The CMA can impose an initial enforcement order on merging parties to prevent them from integrating in a way which might prejudice the outcome of the CMA's ongoing investigation or impede the CMA's ability to take remedial action. The **guidance** aims to clarify: (i) the circumstances in which an initial enforcement order will typically be imposed; (ii) the form that it will typically take; (iii) the types of derogations that the CMA is likely to grant; and (iv) the timeframes for initial enforcement orders and associated derogations. Examples of where the CMA has previously granted derogations include allowing the buyer to provide back-office support services to the target on asset sales where those back-office services are not being transferred as part of the sale, and allowing the buyer to fill vacant staff roles at the target company.

The merger notice template that parties use to notify the CMA of a merger has also been changed with the intention of reducing the amount of information that businesses need to provide. The consultation **response** sets out some of the most notable changes, which include additional direction that parties do not need to provide all of the information in the template in every case, a new question relating to share of supply data and a new section consolidating all third party contact details.

The CMA's guidance on its merger intelligence function is intended to assist lawyers advising their clients on whether they should notify the CMA of a merger and for third parties considering whether to inform the CMA of an as yet unnotified merger. The updated **guidance** addresses the question of when merging parties, who do not intend to notify the CMA of their merger, should submit a briefing note. The CMA stipulates that generally a briefing note should only be submitted after a merger agreement has been signed by the parties.

Antitrust

Six Chinese PVC manufacturers fined by the NDRC for price fixing

Six Chinese polyvinyl chloride (PVC) manufacturers have been fined by the National Development and Reform Commission (NDRC) for price fixing in the market for PVC. They are **Yibin Tianyuan Group** (RMB 16.01 million), **Sichuan Jinlu Group** (RMB 10.21 million), **Ningxia Younglight Chemicals Co.** (RMB 7.91 million), **Inner Mongolia Juzheng Energy and Chemical Group** (RMB 29.48 million), **Elion Clean Energy Co** (RMB 20.6 million), and **Inner Mongolia Eerduosi Resources Co.** (RMB 19.37 million). The NDRC has yet to make any formal announcement in relation to its penalty decision in this sector. However, the six companies announced details of the fines in announcements made to the Shenzhen and Shanghai Stock Exchanges in September 2017.

The case concerned the manufacturers' participation in the 'Western China PVC Association' conference in 2016, and the exchange of price information and agreements to fix the sale prices of PVC products

through group chats on WeChat, a Chinese messaging application. In early 2017 the NDRC conducted an investigation into several PVC manufacturers and found the exchange of price information and price fixing agreements to be in breach of China's Anti-Monopoly Law (AML), since such conduct severely limited market competition, damaged fair market order and harmed downstream companies and consumers.

Ningxia Younglight Chemicals **announced** that it would exercise its right to raise a defence under Article 32 of the Administrative Penalty Law, so as to not let its penalty reduce its profits, but the other five companies have no plans to seek reviews of their respective penalty decision. This would be an interesting development as the NDRC's decisions under the AML have rarely been challenged (if at all) in practice.

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