UK & EU Competition Update

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This update provides an overview of the key legal and policy developments in UK & EU Competition law in May 2011. For further information, please contact a member of our competition team or your usual Burges Salmon contact.

Commission looks for more competition on the buses

On 6 May, the Competition Commission ("CC") announced its provisional findings in its market investigation into local bus services in the UK.

Key points

- The CC is looking at ways to open up more bus markets across the country after provisionally concluding that too many operators face little or no competition in local areas.
- The CC observed that head-to-head rivalry on particular routes has resulted in destructive, short-lived *'bus wars'*.
- The CC proposes a number of possible remedies to address competition problems, such as introducing franchising. However, it has for the moment ruled out both direct price controls and selective divestment of local bus operations.

Background

The local bus industry in the UK was deregulated in the 1980s. As a consequence, the provision of local bus services is now largely in private ownership and bus operators are able to design and develop their own commercial services and set their own fares.

Having said this, it should also be noted that bus operators are regulated at local and national level. The Traffic Commissioners license bus operators and register bus services. National governments set policies for local bus services in England, Scotland and Wales, and provide direct funding support to the industry. In addition, local transport authorities ("LTAs") are responsible for setting and implementing overall strategies and policies for transport within their local areas and for tendering contracts with bus operators for supported services (i.e. those which would not be provided on a purely commercial basis).

In 2010, the UK local bus industry carried around 2.9 billion passenger journeys.

Following a market study and consultation, the Office of Fair Trading ("OFT") announced on 7 January 2010 that it had decided to refer the market for the supply of local bus services in the UK to the CC for a full market investigation. [1]

Provisional findings

Summary of concerns

Jeremy Peat, Chairman of the Local Buses Inquiry Group, emphasised the principal concerns of the CC:

> *'There are a number of towns and cities where bus operators face limited competition and little prospect of significant change. In a market that was deregulated in anticipation of widespread competition that is clearly a problem... there is little to keep local operators on their toes.*
>
> *Buses provide an essential, if unsung, daily service for millions of people in the UK… Many passengers are dependent on the bus and do not have a realistic or desirable alternative, such as getting into a car or a train, if fares rise or services deteriorate.'*

Industry structure

The CC provisionally concluded that although there are 1,245 bus companies in the UK, the great majority of routes and local areas experience a high degree of concentration. Most areas have only one or two operators with a significant share of supply. Consequently, in many local areas, the largest operator has consistently faced little or no competition.

In particular, the CC noted that 69% of local bus services are provided by one of the five largest operators: Arriva, FirstGroup,

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[1] Using powers under section 131 of the Enterprise Act 2002.

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briefing

Go-Ahead, National Express and Stagecoach ("the Large Operators"). The CC observed that it is rare for the operations of the Large Operators to overlap substantially.

Overall, the CC has concluded that a large proportion of passengers in the UK are unlikely to have a choice of operator for a particular journey.

Industry profitability

The CC has found that the Large Operators have tended to make profits above the cost of capital over the last five years.

Head-to-head competition

The CC has found evidence that where there is head-to-head competition, operators respond by improving the quality of their service and/or lowering their fares. However, as noted above, there are very few routes that overlap substantially with the route of a competing operator along a large proportion of their length. This implies a lack of head-to-head competition for passengers in many cases.

The CC also observed that, when faced with direct head-to-head competition, operators have an incentive to increase the number of services on a route to attract more passengers from their rivals, leading to oversupply on the route. This can result in a costly period of rivalry between operators which is likely to be loss-making, and so culminate in the exit of one operator. Accordingly, operators generally avoid replicating each other's routes so as to avoid such direct competition and a 'bus wars' scenario.

However, the CC has not found evidence that any bus operator has endorsed flagrant and *'cheap'* exclusionary conduct by its employees in recent years. *'Cheap exclusion'* is defined as action that is undertaken to diminish a rival's ability to offer its service but which delivers no benefit to consumers. For example, deliberately blocking or delaying a rival's services, preventing use of bus stops or signs, intimidating drivers, vandalism and removing rival's timetables.

Potential competition

Potential competition is the constraint on incumbent bus operators as a result of the threat that potential competitors (operators in or near the incumbent's area of operation) might redeploy or expand their existing services and set up directly competing services.

The CC has found evidence that incumbents take action in response to potential entry decisions by rivals. This suggests that potential competition can be a constraint.

Possible remedies

The CC proposes a number of possible remedies to address the competition concerns identified, including:

- recommendations to LTAs on how to use their powers to promote competition and improve outcomes for local consumers, including guidance on the circumstances in which it may be best to pursue Quality Contracts or other franchising models that would increase competition *'for the market'* (i.e. local bus operators would compete against each other to win a franchise to run specified bus services for a fixed period of time);
- restrictions on aggressive behaviour such as *'overbussing'* on particular routes and other obstructive behaviour aimed at reducing a rival's ability to compete (to the extent that this could not already be dealt with on the basis that it constitutes an abuse of dominance contrary to Chapter II of the Competition Act); and
- measures to increase the number of multi-operator ticket schemes; and ensuring fair access to privately owned and managed bus stations for all operators.

To the surprise of some commentators, but perhaps to the relief of the Large Operators, the CC stated that it is not currently minded to pursue consideration of requiring divestitures of local operations as a remedy option. In addition, the CC does not intend to pursue remedies which would involve taking direct control over outcomes, such as caps on fares or minimum requirements for frequency of services. The CC has serious doubts about the practicability of such remedies.

Next steps in consultation process

The CC has invited comments on its provisional findings and on the notice of possible remedies. The CC intends to issue its provision decision on remedies in September 2011. It must publish its final report by 6 January 2012.

European Commission consults on best practice for co-operation between competition authorities on multi-jurisdictional mergers

On 28 April, the European Commission published for consultation draft best practices for co-operation between national competition authorities ("NCAs") in multi-jurisdictional merger cases, which fall below the thresholds of the EU Merger Regulation but require notification in several Member States.

The best practices are intended to provide a non-binding reference framework for co-operation between NCAs and to foster and facilitate information sharing. Co-operation between NCAs can reduce the risk of conflicting outcomes in cases that raise serious or difficult analytical issues. In particular, it is recommended that NCAs involved in the same multi-jurisdictional merger aim, where appropriate, to keep each other informed of important developments related to the timing of their respective investigations, including notification, decisions to commence second phase proceedings, remedies and any final decision.

The draft best practices also notes that effective co-operation between NCAs requires the active assistance of the merging parties at all stages of the review process. Accordingly, merging parties are encouraged to contact each of the NCAs concerned and provide them with key information including:

- the name of each jurisdiction in which they intend to file;
- the date of the proposed filing in each jurisdiction; and
- the geographic areas in which they are active.

In addition, the Commission noted that there is scope for greater use of the mechanism set out in Article 4(5) of the EU Merger Regulation whereby parties to a merger that is not caught by the Merger Regulation thresholds, but is capable of being reviewed under the national competition laws of at least three Member States, may ask the Commission to review it. Accordingly, the Article 4(5) mechanism

can provide the benefit of using the Commission as a "one stop shop" instead of multiple filings with several NCAs.

The Commission aims to publish the final version of these best practices in autumn 2011.

Supreme Court refuses Safeway permission to appeal against ruling preventing recovery of fine from directors

In the December 2010 issue (issue 6) of this briefing, we reported on the Court of Appeal ruling in the case of Safeway v. Twigger[2] that OFT fines cannot be recovered from directors or employees.

Safeway subsequently applied to the Supreme Court for permission to appeal the ruling of the Court of Appeal.

On 4 April, the Supreme Court refused permission for Safeway to appeal. The Court of Appeal's judgment will stand. Accordingly, it has been confirmed that fines imposed on an undertaking under the Competition Act 1998 are "personal" to that undertaking and so that undertaking cannot recover the fines or the costs of the OFT's investigation from employees or directors who carried out the infringing behaviour.

Review of IP recommends enhanced competition role for Intellectual Property Office

In November 2010, the government launched an independent review of the UK's intellectual property ("IP") laws, to ensure that they are *'fit for the internet age.'* Amongst the issues that the review was asked to consider was the interaction of the IP and competition law frameworks. Views were requested on the extent to which the IP and competition frameworks complement or conflict with each other.

On 18 May, the final report of the independent review was published. In terms of the relationship between IP and competition, the report notes in particular that poorly designed IP rules can help established players in the market obstruct new players by impeding their access to technology and content. As IP rights grant a form of monopoly, an overly rigid and inflexible IP framework can act as a barrier to innovation. IP rights can constrain third parties wishing to access or innovate on top of this protected knowledge or contact, with potentially serious economic and social costs. By contrast, it was noted that a carefully designed and dynamic IP system can complement the spur which competition gives to innovation by enabling follow-on innovation.

Given the interaction between IP and competition, the review recommends extending the role of the Intellectual Property Office ("IPO") to include certain new functions. The current role of the IPO is largely technical. In contrast, the new functions would include:

- a duty to keep under review the impact of IP and IP rights, and market positions founded on IP rights, including adverse impacts on competition, and to report annually thereon;
- powers to prepare one off reports on specific areas or cases where there appears to be detriment to competition and consumer welfare; and
- powers to make recommendations to the competition authorities.

CAT rules that time limit for bringing follow-on damages action is not extended by appeals by other addressees of infringement decision

On 25 May, the Competition Appeal Tribunal ("CAT") ruled that a follow-on damages action brought under section 47A of the Competition Act 1998 by Deutsche Bahn and others against Morgan Crucible had been brought out of time and so should be struck out.

Back in 2003, the European Commission issued a decision finding that members of a carbon and graphite cartel, including Morgan Crucible, had infringed EU competition law by price fixing and market sharing.

Section 47A of the Competition Act gives a person who has suffered loss by virtue of an infringement decision of EU or UK competition law the right to bring a follow-on action before the CAT. Under Rule 31 of the CAT Rules 2003 such claims must be brought within the later of two years from:

- the date on which the right to bring an appeal against the relevant infringement decision expires; or
- the date on which such an appeal is determined.

The CAT ruled that the time limit for bringing the damages action expired two years after the date on which Morgan Crucible could have brought (but did not bring) an appeal against the European Commission's cartel decision against it. This time limit was not affected by the fact that other addressees of the same cartel decision had subsequently lodged appeals with the European courts.

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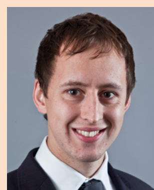

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[2] [2010] EWCA Civ 1472.

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