

# ENTERPRISE ACT 2002

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## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

#### Part 4: Market Investigations

##### Introduction

##### *Chapter 1: Market investigation references*

296. **Chapter 1** (sections 131-138) sets out the substantive framework for decision-making in market investigation cases (except for those cases where the public interest intervention regime is engaged, which are covered by sections 139-153). In particular, it deals with the statutory criteria to be applied by the OFT or other referring body when making references and by the CC when investigating markets; it prescribes what the CC must cover in its report; and it sets out the CC's duty to remedy the competition problems that it identifies.

##### Making of references

##### *Section 131: Power of OFT to make references*

297. This section describes the criteria on which the OFT and certain sectoral regulators may make a market investigation reference. In order to make a reference, the OFT must have reasonable grounds for suspecting that one or more 'features' of a market are preventing, restricting or distorting competition in the supply or acquisition of specified goods or services.

298. *Subsection (2)* provides that, for the purposes of Part 4, the following are to be considered features of a market: (a) its structure (or any aspect of its structure); (b) the conduct of persons supplying or acquiring goods or services who operate within it; and (c) the conduct of such persons' customers.

299. The distinction between 'structure' and 'conduct' in a market is commonly made in economic analysis, and is intended to provide the framework for a wide-ranging inquiry into how firms compete in a market and the economic context in which they operate.

300. Some of the main elements that it is anticipated might be included in an analysis of market structure are outlined below:

- *Market definition*: the starting point for an analysis of the structure of a market is market definition: the process of deciding what goods or services are included in the product market (e.g. ice creams bought from convenience outlets on the spur of the moment rather than from a supermarket) and what the geographic extent of this market is (e.g. is it local, regional, UK-wide, European, or global).
- *Measures of market shares and concentration* can provide a rough indication of the competitive strength of those operating in a market, although they will seldom in themselves provide an unambiguous indication of market power and the state

*These notes refer to the Enterprise Act 2002 (c.40)  
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of competition in that market (e.g. the fact that three firms each have 30 per cent of a market now does not mean that the market is uncompetitive: it may be that their respective shares a year ago were quite different, or that, although their shares remain broadly stable over time, there is a great deal of customer 'churn' between them).

- *Barriers to entry and expansion in a market:* these are factors that place actual or potential entrants into a market at a competitive disadvantage compared with established suppliers, or make it difficult for new entrants or existing smaller players to grow and thus act as an effective competitive constraint on larger incumbents. High barriers to entry and/or expansion are often a cause of competition problems in a market because they remove a competitive constraint, thus allowing the incumbents to raise prices above the competitive level, secure in the knowledge that new entrants cannot enter the market, undercut them, and win market share. Barriers to entry and expansion arise from a wide variety of causes; for example:
  - laws and regulations (e.g. where only a certain number of licences is issued to operate in a market);
  - sunk costs (investment costs of entering the market that cannot be recovered if the entrant subsequently exits the market) and economies of scale (which make it inefficient to operate in a particular market below a certain scale) will tend to increase the risks and difficulty of entry;
  - information constraints (e.g. where it is difficult or impossible for new entrants to gain the information that they need to compete, or where it is difficult and costly for consumers to gain sufficient knowledge to switch to a new product);
  - the strategic behaviour of incumbents (who may, for example, have positioned themselves so as to be able to take retaliatory action to eliminate any competitive threat posed by an entrant);
  - the likelihood or rate of market growth (a growing market is more likely to be attractive to new entrants than a declining one).
- *The degree of vertical integration and vertical links:* the extent to which suppliers in a market are also active in upstream and downstream markets, or are linked with suppliers on upstream and downstream markets, may influence their competitive behaviour (as well as having an impact on the ease of entry into the market).
- *The cost or difficulty of switching from one supplier to another:* such costs can act as a disincentive to vigorous competition either between incumbents or on the part of new entrants.
- *Buyer power:* the strength of customers' bargaining position relative to that of suppliers can have a significant impact on competition in a market and on the ease of entry into it.
- *Information asymmetries:* the participants in a market will rarely all have the same information. The asymmetry of information between different participants buying or selling a product can have a significant impact on the nature and extent of competition in the market for that product. For example, in some markets consumers are poorly informed about the product in comparison with sellers (e.g. used cars); in others, sellers are poorly informed about consumers, and this may affect how they price their products (e.g. car insurance). Information asymmetries can feed in to other aspects of market structure (in particular, they may constitute a barrier to entry or a barrier to expansion, for example if information asymmetries make consumers unwilling to switch supplier). They can also play a part in the analysis of conduct where individual suppliers exploit or

create informational asymmetries, for example through branding or through price discrimination (charging different prices to different customers).

301. The term 'conduct' includes any acts and omissions, whether intentional or unintentional, of the persons referred to in *subsections (2)(b) and (c)*. By the decisions they take, the way in which they make decisions, and how they respond to their rivals and potential entrants, those operating within a market can prevent, restrict or distort not only competition within that market, but also competition in the markets in which their immediate suppliers (upstream) or customers (downstream) operate, and in complementary markets (e.g. the conduct of suppliers in a market for one of a pair of complementary markets, such as printers and printer cartridges, may prevent, restrict or distort competition in the market for the other product). The conduct of consumers and other customers, as well as that of the businesses that supply them, can also affect the conditions of competition in a market, and it is therefore included in the definition of features of a market in *subsection (2)(c)*.
302. In some cases, it will be open to debate whether a given feature of a market is structural or an aspect of conduct (for example, information asymmetries and barriers to entry arising from the behaviour of incumbents could equally well belong in either category). However in indicating the range of features of a market which the competition authorities may take into account, the separate references to structure and conduct in section 131 do not require either the OFT under section 131 or the CC under section 134 to identify particular features of markets that are the subject of a reference as falling entirely within the terms of one of subsections (a), (b) or (c) to the exclusion of the others.
303. In considering whether it has reasonable grounds to suspect that features of a market are preventing, restricting or distorting competition, the OFT will have to evaluate the evidence available to it in each case. In some cases, it will be possible for a reference decision to be justified wholly or partly on the basis of indirect evidence, such as the prevailing levels of prices charged for goods or services in a market, or the prevailing levels of profitability or productivity of firms operating in that market (particularly when observed over time, or when compared to another market, in the UK or elsewhere, for similar or related products).
304. The OFT will be obliged to consult before making a reference decision, and to give reasons justifying its decision both before and after it is made (see further sections 169 and 172).
305. The power to make market investigation references is a discretionary one. The OFT is not obliged to make a reference where it has reasonable grounds for suspecting that the reference criteria are satisfied (unlike in the merger regime, where the provisions of Part 3 place it under a duty to refer in certain circumstances). Since potential market investigation cases will often raise many complex issues, the section sets no limits to the matters that may be taken into account in deciding whether or not to make a reference, once the OFT has reasonable grounds to suspect that the reference criteria are satisfied. For example, there could be circumstances in which the reference criteria were satisfied, but the competition problems in the market concerned were of a kind that it was more appropriate for the OFT to address using its powers under CA 1998. Or the OFT might take the view that the competition problems in a market that it had the power to refer were likely only to be temporary, or were too trivial for it to be likely that the costs and burdens of a CC investigation would be justified by any likely outcome of such an investigation.

### ***Section 132: Ministerial power to make references***

306. Under FTA 1973, the Secretary of State (acting alone or jointly with other Ministers) and the DGFT each have independent powers to make monopoly references. Certain sectoral regulators have concurrent powers of reference with the DGFT conferred by the relevant utility statutes in respect of the areas that they regulate. However, the DGFT's

and sectoral regulators' powers of reference are subject to exclusions in certain sectors (in which references may only be made by Ministers) and a limited power of veto on the part of the Secretary of State. Under the market investigations regime, there will be no such limitations on the OFT's power of reference, and the Secretary of State (acting alone or jointly with other Ministers of the Crown (*subsection (5)*)) retains the ability to make market investigation references only as a reserve power.

307. *Subsections (1)-(3)* set out the circumstances in which this reserve Ministerial power of reference may be used. Like the OFT and sectoral regulators (section 130), Ministers must have reasonable grounds for suspecting that a feature or combination of features of a market are preventing, restricting or distorting competition in the supply of specified goods or services before they can make a reference (*subsection (3)*). However, Ministers must additionally either be dissatisfied with the OFT's decision not to make a reference (*subsection (1)*); or they must be satisfied that the OFT is aware of whatever evidence has led them to form a suspicion and is not likely to reach a decision as to whether or not to make a reference within a reasonable period of time (*subsections (2) and (3)*).
308. *Subsection (5)* provides that references may be made by more than one Minister of the Crown acting jointly, so long as the Secretary of State is one of the Ministers making the reference.

### ***Section 133: Contents of references***

309. This section prescribes what a reference made under section 131 or section 132 must contain and provides for the goods or services that are the subject of a reference to be described in such a way as to focus the CC's investigations on particular areas of concern that the referring authority has identified. Any authority making a market investigation reference must also publish its reasons for doing so (see further section 172).

### **Determination of references**

#### ***Section 134: Questions to be decided on market investigation references***

310. This section sets out the questions that the CC must answer in the course of conducting a market investigation under Part 4.
311. *Subsections (1)-(3)*: the CC is to consider what market or markets exist in connection with the supply or acquisition of the goods or services described in the reference (the 'relevant market(s)'), and then to determine whether any feature or combination of features of the relevant market(s), prevents, restricts or distorts competition in connection with the supply or acquisition of goods or services in the UK: where this is the case, there is an 'adverse effect on competition'. Depending on the circumstances, more than one adverse effect on competition may be found (e.g. where there is more than one relevant market).
312. *Subsection (4)-(5)*: where the CC identifies one or more adverse effects on competition, it must further decide what action should be taken to remedy, mitigate or prevent it or them, whether by the CC itself, or by others (including those operating in the market concerned, Ministers - who may, for example, be able to introduce changes to existing laws, so as to remove a regulatory barrier to entry - and other public authorities). The CC must also consider what action it or others should take to remedy, mitigate or prevent any 'detrimental effects on customers' (in the form of higher prices, lower quality or less choice of goods or services, or less innovation in relation to goods or services in any UK market) in so far as they have resulted from, or may be expected to result from, any adverse effect on competition that it has identified.
313. *Subsection (6)*: in deciding what steps should be taken under subsection (4), the CC is to have regard to the need to achieve as comprehensive a remedy as is reasonable and practicable. Thus, all other things being equal, a remedy that, for example, removes an adverse effect on competition will be considered more comprehensive than one that

only removes detrimental effects on customers resulting from that adverse effect, since by removing the adverse effect, the CC will also (at least so far as is within its power) remove the detrimental effect on customers. To that extent, there is a presumption in favour of remedial action that deals directly with adverse effects on competition over action that is directed specifically at detrimental effects on customers. The requirement to have regard to reasonableness and practicability means, *inter alia*, that the CC must, in relation to each proposed remedy, consider what effect it will have on the future conduct of those operating in the market, how it will interact with any other proposed remedies, and whether the adverse effect(s) or customer detriment(s) that it was designed to address are sufficiently serious for their removal or mitigation to justify whatever costs and disruption to businesses and others will be involved in the implementation of that remedy.

314. *Subsections (7) and (8)*: in considering what steps should be taken under subsection (4) the CC may further have regard to any customer benefits (in the form of lower prices, or higher quality or greater choice of goods or services, or greater innovation in relation to goods or services in any UK market) arising from the relevant feature or features of the market that have given rise to adverse effects on competition, provided that the benefit has accrued, or may be expected to accrue within a reasonable time, and was or is unlikely to accrue without the feature or features concerned.

### ***Section 135: Variation of market investigation references***

315. This section allows the authority that has made a market investigation reference, after consultation with the CC, to widen or narrow the scope of the CC's investigation while it is in progress. The CC itself may ask the OFT or other referring authority to vary the market investigation reference (for example, where it finds that the terms of reference are wider or narrower than are justified by its own view of the market or markets concerned, and the operation of competition within it or them). A variation will be effective immediately and any variation made to the market reference will have no impact on the statutory timetable for the investigation – i.e. the CC must still conclude their investigation within two years of the date on which the original reference was made (see further section 137).

### ***Section 136: Investigations and reports on market investigation references***

316. This section prescribes that the CC must publish a report on a market investigation reference within two years of the date on which the reference was made. *Subsection (2)* prescribes what the report must contain.
317. *Subsections (4)-(5)* provide that, as well as publishing its report, the CC must give a copy of it to the OFT and to the appropriate Minister if he made the reference. Where the reference was made by the OFT or by the appropriate Minister but could have been made by a relevant sectoral regulator the report is also to be given to them.
318. *Subsections (7) and (8)* list the sectoral regulators who have concurrent powers to make market investigation references on the same basis as the OFT in the areas that they regulate ('relevant sectoral regulators') and the provisions of 'relevant sectoral enactments' that (as amended by Part 2 of Schedule 9) confer these concurrent powers on them. Information obtained by relevant sectoral regulators in connection with the exercise of any function under this Act is protected by the information disclosure provisions in Part 9. The provisions governing concurrency between the OFT and relevant sectoral regulators, which are to be found in the sections of the relevant sectoral enactments, are essentially the same as under the FTA 1973 monopolies regime: in particular, the OFT and the relevant sectoral regulator concerned must consult each other before either makes a reference.

***Section 137: Time-limits for market investigations and reports***

319. This section sets out the statutory maximum period for a market investigation. Initially this is to be set at two years. A market investigation report shall be prepared and published within the statutory maximum period after the reference is made. *Subsection (3)* gives the Secretary of State a power to alter the statutory maximum by order, but not to extend it beyond two years. The making of such an order by the Secretary of State will not affect the statutory maximum period applicable to any investigation that is the subject of a reference made before the date of the order.

***Section 138: Duty to remedy adverse effects***

320. This section provides that, where the CC has published its report within the statutory time-limit and has found one or more than one adverse effect on competition, it must take such action as it considers reasonable and practicable to remedy, mitigate or prevent that adverse effect and/or any detrimental effect on customers so far as it may have resulted from, or may be expected to result from, each adverse effect on competition. The duty to remedy expressed here is qualified by the same considerations (comprehensiveness, reasonableness and practicability, and discretionary consideration of customer benefits) as the analysis of remedies prescribed by section 134.
321. *Subsection (3)* provides that, unless there has been a material change of circumstances since the preparation of the CC's report, or unless it has special reason for deciding otherwise, any action taken by the CC must be consistent with the course of action decided on under section 134(4)(c), and set out in its report under section 136.
322. *Subsection (6)* provides that, where the CC has found that a detrimental effect on customers may be expected to result from a particular adverse effect on competition, but that no detrimental effect on customers has yet resulted from that adverse effect, then the CC may only take action to remedy, mitigate or prevent the detrimental effect that may be expected to arise if it remedies, mitigates or prevents the adverse effect on competition.