# This document contains two blogs by Bruce Lyons criticising the March 2019 proposals of CMA Chair Andrew Tyrie

**Why the CMA is wrong in its proposals for reform and what should be done instead**

(by Bruce Lyons) The Chairman of the CMA, Lord Tyrie, has written a 44-page letter (including annex) to the Secretary of State for Business, Greg Clark, setting out a long list of legislative proposals.[1] Two motivations are given: "First, the growth of new and rapidly-emerging forms of consumer detriment, caused in part by the increasing digitalisation of the economy, requires more rapid intervention, and probably new types of intervention… Second, there are increasing signs that the public doubt whether markets work for their benefit." I agree with the spirit of these points and that they require action. However, I disagree with some of the CMA's key proposals. Lord Tyrie appears particularly frustrated with the lengthy appeals system which limits his ability to act firmly and swiftly. Unfortunately, the overall package of proposals would reverse hard-won progress in competition policy over the last 20 years and lead to a paternalistic, arbitrary and unrestrained Consumer Interest Authority. In this blog, I briefly explain some of my concerns. I then set out two alternative proposals that would more directly and appropriately address public concerns over unfair pricing and result in better decisions without prolonged appeals.

**The CMA Proposals**

There are nine sections to the proposed legislative changes, but I focus on three: a) "consumer interest" to replace competition as an "overriding statutory duty" [p.10]; b) new powers to impose legally binding interim remedies during a phase 1 market study, which would also "enable the CMA more effectively to influence the conduct of those businesses whose practices raise concerns, without the need for formal work in the form of market studies or market investigations." [p.17]; c) more limited standard of review for CA98 cases (illegal agreements and abuse of dominance [p.36].

***The consumer interest as an overriding statutory duty***

I am a great fan of the old OFT strapline of "making markets work well for consumers".[2] It captures both the fundamental importance of competitive markets and the regulator's focus on who markets should benefit. The regulator's job was to ensure that consumers have a competitive range of opportunities to choose from, and then leave them to make their own choices. Cutting out the role of markets/ competition and fast-tracking to "the consumer interest" risks a wide-ranging and paternalistic determination of what is the consumer interest. This echoes the language and problems of previous "public interest" tests. There is a worrying absence of any discussion in the Tyrie letter of how the consumer interest will be determined. What exactly is the consumer interest other than in relation to what the market provides?

If the proposed overriding statutory duty is to be consumer interest, what does this mean for intermediate business customers? It might be tempting to interpret the consumer to include business customers were it not for the single mention of business-to-business relationships in the 44 pages. This is buried in footnote 23 on

p.14 where we learn, amongst other things, that the CMA has been considering "introducing an explicit prohibition on unilateral conduct that exploits economic dependence or inequality of bargaining power, even in the absence of an established dominant market position". This indicates a particular concern for business suppliers over business customers. It does not suggest that the CMA equates business customers with consumer interest.

***Anticipated use of interim measures in the markets regime***

The markets regime provides the CMA with uniquely strong powers to intervene in markets where firms are not suspected of illegal practices, but where markets do not seem to be working well for consumers. Market investigations have been used recently to promote competition through demand-side remedies which help consumers become better informed and better able to switch suppliers (e.g. energy, retail banking). It is quite right for Lord Tyrie to observe that the markets regime can be a very lengthy process and I agree that interim measures could be part of the solution. However, my concern is with the combination of interim measures and an unspecified consumer interest. Without clear principles to guide business compliance, they would be left to wait for a tap on the shoulder from the Consumer Interest Authority.

The aim seems to be to incentivise firms to cooperate before a market study has to be opened, and the arbiter of consumer interest will tell them what to do: "Weighing on the minds of management in deciding whether to cooperate with the CMA would be the alternative: direct intervention, in the form of legally-binding requirements. … Many of these exchanges would occur in private. Early public communication of problems in markets, and sources of consumer detriment, could also encourage improvements to behaviour. For instance, an announcement that the CMA was concerned about certain practices or markets, and minded to investigate, might in itself be sufficient to secure engagement with firms and improve standards…. Legal protections may also be required to ensure that the CMA is adequately protected from defamation liability…" [pp.17-18]. The CIA, possibly guided by media or political opinion, would decide which firms and in which markets pricing should be controlled – without the necessity for either an investigation or an objective definition of consumer interest.[3]

***Limited standard of review for CA98 enforcement cases***

The CMA's complaint is that the "merits" standard of review by the CAT in CA98 cases (Ch.1 anticompetitive agreements and Ch.2 abuse of dominance cases) is over-burdensome. It is less worried about appeals in markets and merger cases, which are subject to a more limited "judicial review". The CMA asserts that the solution to lengthy appeals is to change the standard for CA98 to judicial review (or similar standard). However, the letter shows no appreciation of why the different standards currently exist and so of what needs to be the quid pro quo for such a change.

As the letter points out: "Market investigations are led by independent 'panels', comprising individuals from a variety of backgrounds (law, economics, public sector, business); the panels are supported by CMA staff but the independent panel members are the sole decision-makers -not the CMA Board, or CMA staff." [p. 13 footnote 20]. In contrast, CA98 cases are decided by Case Decision Groups, which are dominated by internal

staff, albeit not those who conducted the initial investigation. A just system requires a level of review appropriate to the degree of intervention and the independence of prior scrutiny a decision has received. Despite claiming to the contrary, CDGs do not provide sufficient challenge and independence to justify the lesser standard of judicial review.[4] The CMA's power would be insufficiently restrained if the standard of review was reduced without appropriately changing decision making.

**My Alternative Proposals**

I have previously proposed two reforms that would much more directly address the causes of the problems highlighted in the Tyrie letter, and do so without the dangerously negative side-effects of the CMA's own proposals. First, the CMA should develop a coherent, objective and enforceable set of ethical principles of unfair pricing to guide business compliance and fill the gap between consumer policy and competition policy. Second, the CMA should accept that its inconsistent decision-making structures, squeezed together as a compromise at the time of the merger of the OFT and CC, need wholesale reform. The former would help address public and political concerns about market outcomes, especially with the growth of default renewal contracting and digital markets. The latter would speed up the appeals system without undermining the quality of decisions.

***Proposal 1: Adoption of explicit principles of unfair pricing***

The CMA has recently responded to a super-complaint by Citizens Advice on the Loyalty Penalty. It talks a lot about fairness and unfairness, and makes many important observations. It still needs to distinguish more clearly between fairness and efficiency. Most importantly, it stops short of developing principles that can be used by business for compliance and by the CMA for intervention. The FCA has attempted to take such a step in its consultation on Fair Pricing in Financial Services.

In our response to the FCA, Bob Sugden and I agree that it is right to think about what fairness means in practice, even though we are critical of some of their specific proposals. We argue that there is a gap between consumer law and competition law, which permits pricing practices that most people would consider unfair. We root our approach in ethical principles, but we also think that unfair pricing undermines public faith in markets, encourages arbitrary interventions, incentivises expensive avoidance strategies, and so reduces the overall efficiency of a market economy.

There is no space to develop those principles in this blog but we distinguish separate concepts of *distributional unfairness* (where pricing practices are biased against the poor) and *transactional unfairness*(where the information and/or framing for purchase decisions is biased, whatever the consumer's wealth). We also suggest a simple, first-look, intuitive ethical test:

*Can the firm provide a reasonable explanation of its pricing practice, locating it as part of a business model based on mutual benefit, and would the firm be willing to give this explanation to its customers and expose it to public debate?*

We illustrate our approach to identify unfair price discrimination using a three-stage test that considers: a) the basis for discrimination (e.g. misleading or suppressed information, characteristics of purchaser), b) the effect of discrimination (e.g. higher prices to poorer or more vulnerable consumers, expensive avoidance strategies by others), and c) pro-competitive justifications (e.g. efficiency, competition).

The CMA should propose and consult on a set of such principles of unfairness, which may or may not require new legislation to enforce.

***Proposal 2: a) A genuinely independent expert panel system to decide all cases (market investigations, phase 2 mergers, illegal agreements, abuse of dominance); b) the CAT to apply judicial review to all cases first decided by such a panel***

I first made this proposal in 2011, when the merger of the OFT and CMA was being considered and before the CMA was formed. I repeated the arguments last year in my submission to the Competition Law Reviewbeing conducted by BEIS. Only when Proposal 2a) is in place can Proposal 2b) be justified, and so facilitate more rapid review. To be clear, there is absolutely no reason to have two different decision-making structures at the CMA other than haste and compromise in negotiating an institutional merger rooted in very different histories: i) the OFT was initially set up on the lines of a European Directorate General, and ii) the Competition Commission had its roots as a Royal Commission of independent experts. It is very long overdue to have a single system of independent experts making decisions. This is not to say that the current system of independent panels for markets and mergers has got it right. Unlike the present system, a panel should not be involved in the general conduct of the inquiry or editing of staff working papers, though it should continue to conduct hearings. There should also be a smaller set of rotating members, each with greater time commitment to the role.

The Tyrie letter is silent on reform of decision-making but, unfortunately, there is reason to believe that the CMA may be waiting to propose a move further *away from* decision making by independent panels.[5] The outgoing Chairman of the CMA flagged the direction of travel in his Beesley Lecture in November 2018. He argued that the CMA is caught in a vice between, on the one hand, the rise of litigation, with firms challenging decisions through appeals processes that are “over-elaborate and over-done”, and on the other hand, political pressure for fast, effective intervention. To tackle these, he argued for reform in both the appeals process and the structure of decision-making at the CMA. The Tyrie letter adopts a similar position on the former but is silent on the latter, so I rely on Lord Currie’s thoughts. Lord Currie complained that the CMA Board was in a position of ‘responsibility without power’. He was particularly concerned that the Chairman and Chief Executive should be given greater influence. In my formal Beesley response to his lecture, I argued exactly the opposite. More than ever, we need an independent system that cannot be accused of caving into either political pressure or institutional groupthink.

END

[1] “The proposals are the product of careful consideration by senior CMA staff, and discussion at Executive and Board level.” [p.6]

[2] Though Andrew Motion, then Poet Laureate, once suggested to me that the institutional aim would sound better if it was "making markets work wonderfully"!

[3] There is even a suggestion that the markets regime may be made "simpler and more effective" by removing the crucial check against groupthink that is currently provided by a market investigation [p.14].

[4] I will write a separate blog about two "factual" claims in the Tyrie letter that serve to reinforce concerns about drawing conclusions and imposing remedies on the basis of unchallenged evidence.

[5] The Tyrie letter does offer the prospect of removing the distinction between the two stages of the markets regime but says only that decision-making "would need to be carefully considered". In the wider context of the letter, the suspicion must be that he has in mind elongating the first stage which has internal decision-making and possibly new powers to impose interim measures. The tone of the letter does not suggest a desire to jump to stage two with independent panels.

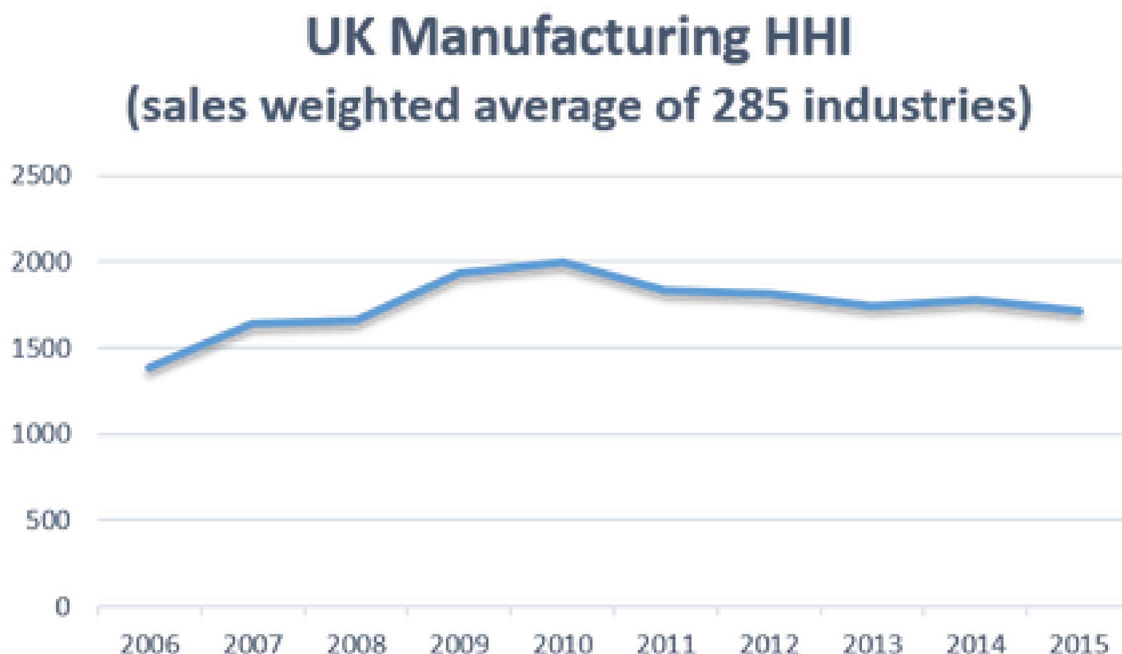
**“Facts” from thin air in the CMA Chairman’s letter requesting greater powers?**

(by Bruce Lyons) I recently posted a blog commenting on the CMA’s proposals for reform. I was sympathetic with the aims of eliminating unfair pricing and inefficient decision processes. However, I was highly critical of the CMA’s direction of travel and the worrying side effects of their proposals. I suggested two alternative proposals that would directly address the aims without the harm. In this short blog, I pick up two “facts” used by Lord Tyrie, Chairman of the CMA, to motivate the need for reform. These are particularly important because they relate to exactly the type of statistical evidence relied on by the CMA in its daily competition analysis: concentration and margins.

The CMA writes[1]: “the growth in market power – reflected in ***rising concentration and profitability*** across a number of sectors – may well enable large firms to collect excess rents” [p.4]. An attached footnote says: “In the UK, ***economy-wide profit margins have risen from around 1.2 in 1980 to close to 1.7 today***.” [Emphasis added] I note that there is a caveat about “a number of sectors” but the claim reads as a general growth in market power – not one where growth in market power in some sectors is balanced by decline in market power in others. There is no reference to check these assertions, so what does published data show?

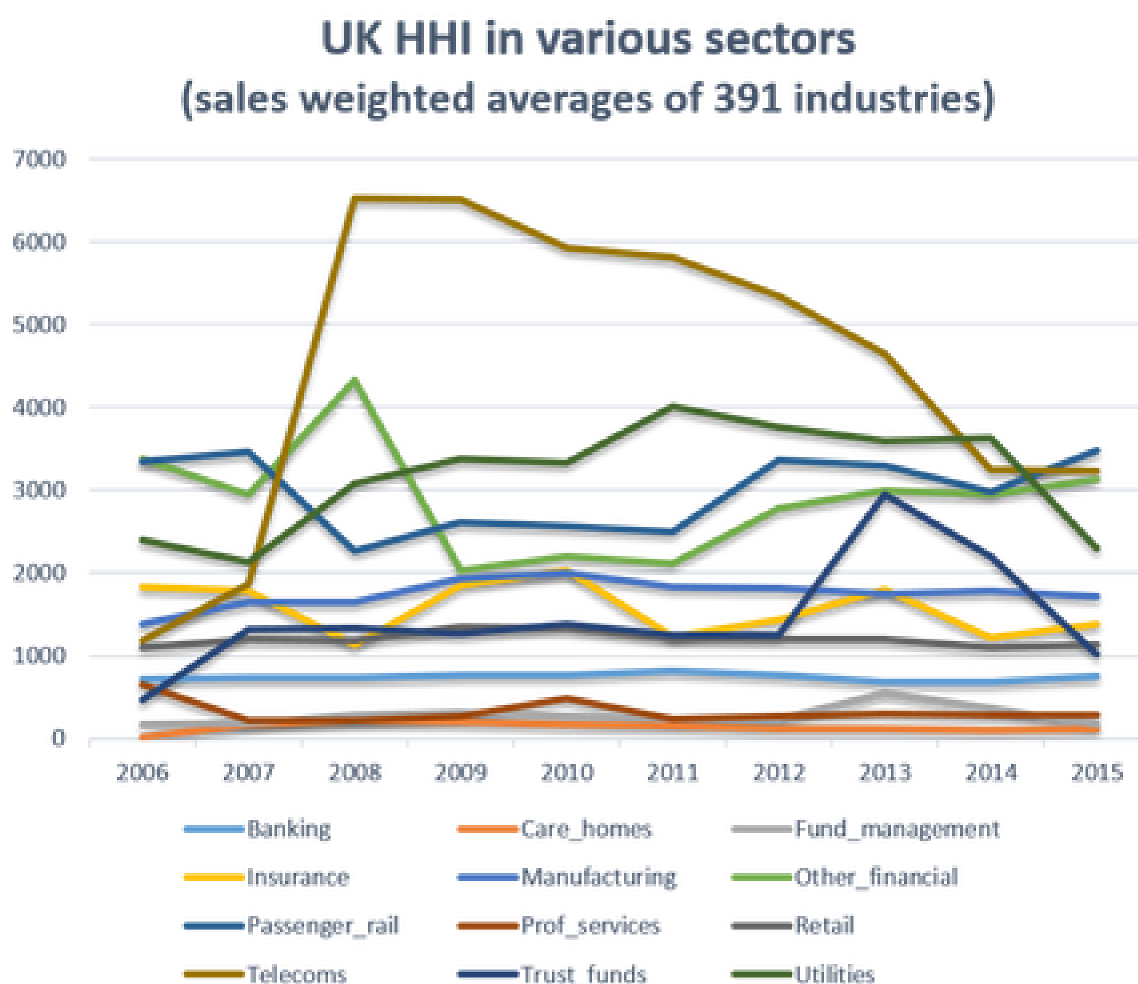
***Rising concentration?***

Concentration data is no longer routinely published, so I use the latest available national statistics on the HHI. These were published by the Department for Business using ONS data until 2015. They use 4-digit industry definitions (with some 3-digit and some 5-digit). The first graph (below) shows the average trend for manufacturing, which rose from 2006-10 but then fell from 2010-15. This does not justify a panic response to rising concentration, especially as the first half of the period was of rapid European and global integration, followed by the financial crisis.



*Source*: my own graph using data from BIS analysis of key sectors (by SIC2007)

What about non-manufacturing sectors? The following graph displays a wide variety of experiences but no discernible trend in *any* sector.




*Source*: my own graph using data from BIS analysis of key sectors (by SIC2007)

***Economy-wide profit margins***

I am not sure what is meant by an economy-wide margin of 1.2 or 1.7. If this was a percentage margin, it would be remarkably small. I presume it is not, as the context of the letter implies that this has become large. It may have something to do with national accounts figures on shares of net output or gross value added, or maybe the ratio of corporate revenues to some measure of their variable costs. Of course, all this is pure speculation in the absence of any explanation or reference in Lord Tyrie's letter. I can, however, make two general observations that apply to any comparison of margins over the 40 years between 1980 and 2019.

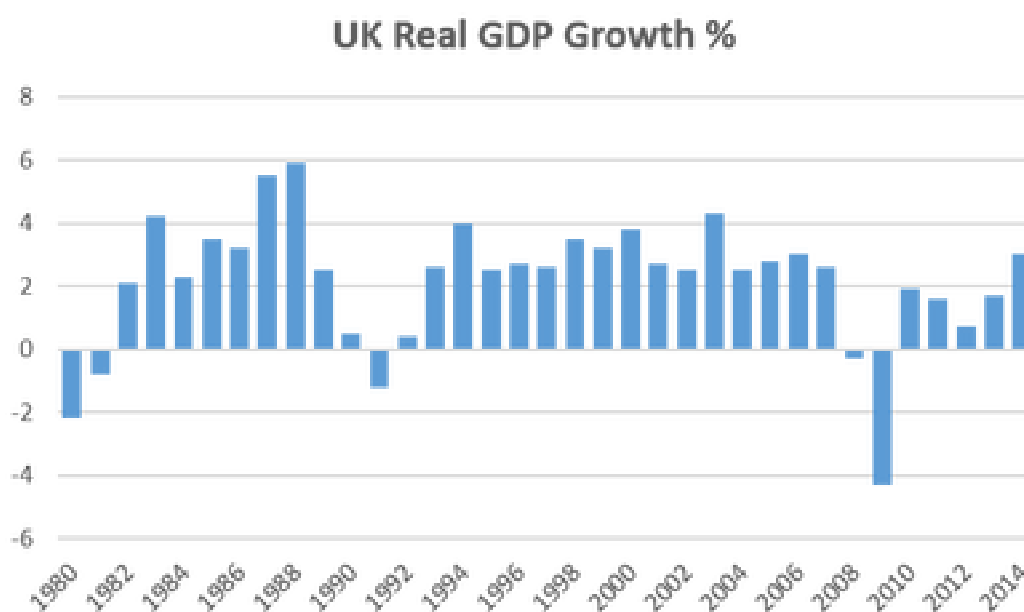
First, as shown in the graph at the end, 1980 was exceptional. It was a year of major recession with price and wage inflation both running at around 20%, Bank of England interest rate at 17%, monetary policy pushing the

pound up to a painfully uncompetitive US$2.4 to £1, and the start of a sharp rise in unemployment. It is hardly a great comparator year.

Second, there have been enormous changes in industrial composition, new industries, product quality, automation, the invention of IT, internet, single market, globalisation, etc over the last 40 years. For example, in 1980, the structure of the market for personal communications was a nationalised monopoly of fixed-line telephones. Today, there is no space to list the mobile, text, e-mail, social network, skype and other products in what was then a single product personal communications market. The cost structure of many newer industries typically has much higher fixed costs and lower marginal costs as compared with 1980. For example, many digital markets have effectively zero marginal costs, in which case any positive price is an infinite margin. For these reasons, I suspect that properly measured margins are indeed rising, driven by many factors including traditional capital intensity, technology intensity, quality competition, R&D, investment in technology platforms, and winner-takes-all competition. What we don't know is if there is a separate influence of changing market power. All we can truly say is that trends in economy-wide margins cannot simply be implied to relate to trends in market power over such a period.

***My real concern***

My own view that these statistics tell us little or nothing about the growth in market power. They are much more aggregated than would be used in practice to understand competitively relevant markets, and they mask all sorts of trends that really do matter. However, my concern is much broader. ***Casual assertions masked as facts, particularly facts of a type used to make important competition decisions, are reputationally damaging for the CMA***. They will no doubt go viral in the debate about market power, but they do not generate confidence in the CMA's responsible use of substantial new powers and weaker standards of review.




Source: ONS Trends in the UK economy (27 February 2015)

[1] Lord Tyrie says “The proposals are the product of careful consideration by senior CMA staff, and discussion at Executive and Board level.” [p.6]