**EXPLANATORY MEMORANDUM TO**

**THE COMPETITION ACT 1998 (OFFICE OF FAIR TRADING'S RULES) ORDER 2004**

**2004 No. 2751**

**1.** This explanatory memorandum has been prepared by the Department for Trade and Industry ("the Department") and is laid before Parliament by Command of Her Majesty.

## 2. Description

2.1 By this Order, the Secretary of State approves the Rules made by the Office of Fair Trading ("the OFT") set out in the Schedule to this Order. The Rules concern procedural and other matters relating to the investigation and enforcement functions of the OFT under the Competition Act 1998 ("the 1998 Act"). This Order also revokes the Competition Act 1998 (Director's rules) Order 2000 (SI 2000/293) ("the Director's Rules Order") by which the Secretary of State approved an earlier version of the Rules.

## 3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

## 4. Legislative Background

4.1 The 1998 Act provides for the control of anti-competitive agreements and conduct in the UK. Part 1 of the 1998 Act provides the OFT with powers to investigate and enforce competition law in the UK. Under section 51(1) of the 1998 Act, the OFT may make such rules about procedural and other matters in connection with the carrying into effect of the provisions of Part 1 of that Act as it considers appropriate. Section 51(3) provides that if the OFT is preparing rules under that section it must consult such persons as it considers appropriate. Section 51(5) provides that no rule made by the OFT under that section may come into operation until it has been approved by an order made by the Secretary of State.

4.2 The 1998 Act has recently been amended by the Competition Act 1998 and Other Enactments (Amendment) Regulations 2004 (2004/1261) ("the Amendment Regulations"). The Amendment Regulations make provision for implementing Council Regulation (EC) No. 1/2003 of 16th December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (OJ L 001, 04.1.03, P. 1-25) ("the EC Competition Regulation") and for the alignment of the domestic competition regime in the 1998 Act and the new European competition regime provided for in the EC Competition Regulation. The Amendment Regulations and the EC Competition Regulation both came into force on 1 May 2004.

4.3 The nature of the changes to Part 1 of the 1998 Act made by the Amendment Regulations are such that the OFT has needed to make new procedural rules under section 51 of that Act. In particular, these changes mean that the OFT has new powers

under Part 1 of the 1998 Act to investigate and enforce European competition law in the UK as well as domestic competition law. In addition, the insertion by the Amendment Regulations into the 1998 Act of a new Part 2A has provided the OFT with new powers to assist competition authorities in other Member States in investigating and enforcing European competition law. A new section 75A(1) (also inserted into the 1998 Act by the Amendment Regulations) provides that the OFT may make such rules about procedural and other matters in connection with the carrying into effect of the provisions of Part 2A of the 1998 Act as it considers appropriate. Section 75A(2) provides that if the OFT is preparing rules under that section it must consult such persons as it considers appropriate. Section 75A(3) provides that no rule made by the OFT under that section may come into operation until it has been approved by an order made by the Secretary of State.

4.4 This Order is made under sections 51 and 75A of the 1998 Act. It revokes and effectively replaces the Director's Rules Order, which was the first order made under section 51. This Order is the second order made under section 51 and the first order made under section 75A. In preparing the rules that are set out in the Schedule to this Order ("the Rules"), the OFT have carried out a full public consultation in compliance with sections 51(3) and 75A(2).

4.5 The OFT intends to publish advice and information under section 52 of the 1998 Act on how certain procedures set out in the Rules will be applied in practice. In particular, the OFT intends to explain how it will give effect to the requirement to give a person a reasonable opportunity to inspect documents under rule 5(3) of the Rules and its approach with regard to the classification and disclosure of documents for this purpose.

## 5. Extent

5.1 This statutory instrument applies to all of the United Kingdom.

## 6. European Convention on Human Rights

Not applicable.

## 7. Policy Background

7.1 In November 2002, the European Council of Ministers approved the draft text of the EC Competition Regulation (see paragraph 4.2 above), which radically overhauls the framework of European competition law. This "modernisation" of competition law aims to strengthen enforcement of competition law by expanding the role of national courts and competition authorities. The EC Competition Regulation also ensures that business can compete on a level playing field in the Single Market by ensuring that competition is not distorted and that European competition law is applied effectively and consistently across all Member States. The Amendment Regulations (see paragraph 4.2 above) make provision for the implementation of the EC Competition Regulation and for the alignment of the domestic and European competition regimes. For most undertakings, the measures introduced by the EC Competition Regulation and the Amendment Regulations should prove deregulatory.

7.2 The Amendment Regulations were made following the consideration of representations received by the Department from two public consultations. In April 2003, the Government published a consultation document: "Modernisation – a consultation on the Government's proposals for giving effect to Regulation 1/2003 EC and for re-alignment of the Competition Act 1998". This document explained how the Government intended to give effect to the EC Competition Regulation and discussed subsequent changes needed to the UK competition regime for the purpose of harmonising the general principles of the domestic system. It did not address the issue of exemptions and exclusions which were the subject of a second consultation document published in June 2003: "Modernisation – a consultation on the Government's proposals for exclusions and exemptions from the Competition Act 1998 in the light of Regulation 1/2003 EC". Copies of both documents are available at http://www.dti.gov.uk/ccp/archive/consultations.htm.

7.3 A detailed Government response to these consultations was published in January 2004. This covered all proposals in both consultation documents with the exception of the proposal to repeal one of the exclusions. A full Government response was published in March 2004. A copy is available at http://www.dti.gov.uk/ccp/archive/consultations.htm.

7.4 An additional public consultation on the Rules and associated Guidance and Guidelines was held by the OFT between April and June 2004. The further representations received as a result of this consultation exercise have also been taken into account in drafting this statutory instrument. A copy of this consultation is at http://www.oft.gov.uk/business/legal+powers/modernisation/modconsult.htm.

## 8. Impact

8.1 A full Regulatory Impact Assessment (RIA) was completed for the Amendment Regulations. A copy of the RIA is attached as Annex A to this memorandum. All the key principles covered in the Rules were accepted during the Modernisation debates and have therefore been cleared by the full Parliamentary process. These additional alterations to how the OFT operates will not involve any additional costs or burdens nor impact on business by requiring them to do something other than they do at the moment.

8.2 The impact on the public sector was also considered in the previous RIA. The impact is limited to costs on the OFT and sectoral regulators associated with training staff to implement the revised Rules. Such training is part of an on-going process.

## 9. Contact

Steve Davies at the Department of Trade and Industry (Tel: 020 7215 5548 or e-mail: steve.davies@dti.gsi.gov.uk) can answer any queries regarding the instrument.

# REGULATORY IMPACT ASSESSMENT

# GIVING EFFECT TO COUNCIL REGULATION 1/2003

## 1. PURPOSE AND INTENDED EFFECT OF MEASURE

### Objective

1.1 This proposal gives effect to Regulation 1/2003, which implements the EC Treaty Articles on competition (Articles 81 and 82)[1]. It also ensures that UK national competition authorities (NCAs) will be able to act consistently whether they are applying Articles 81 and 82 or the prohibitions of the Competition Act 1998 ('the Competition Act').

### Devolution

1.2 This proposal will affect the law in England, Wales, Scotland and Northern Ireland**.**

### Background

1.3 The EC Treaty Articles on competition (Articles 81 and 82)[2] are currently implemented by Council Regulation 17/62. Under this present system, companies must formally notify their commercial agreements to the Commission in order to receive an exemption and certainty of validity under competition law. Without such an exemption, companies run the risk that their agreements could be void if successfully challenged in the courts. Only the Commission can offer such an exemption following notification and significant Commission resources have therefore been allocated to handling notifications instead of rooting out serious infringements of competition law such as hard-core cartels. Inefficiencies in European competition law enforcement have led to the modernisation of the EC system through Regulation 1/2003 ('the Regulation') which comes into force on 1st May 2004. The Regulation modernises the implementation of Articles 81 and 82 by:

- replacing the current notification system with a "legal exception" regime[3];
- devolving much of the enforcement of Community competition law to National Competition Authorities(NCAs) and courts of Member States; and
- requiring these authorities to apply Community law to all cases capable of affecting trade between Member States (although this may be in parallel to proceedings under national law if the Member State wishes).

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[1] Regulation 1/2003 also amends Regulations (EEC) No. 19/65, (EEC) No. 1017/68, (EEC) No. 2821/71, (EEC) No. 2988/74, (EEC) No. 4056/86, (EEC) No. 3975/87, (EEC) 3976/87, (EEC) 1534/91 and (EEC) 479/92.

[2] Article 81 of the EC Treaty prohibits all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the Single Market. Article 82 prohibits any abuse by one or more undertakings of a dominant position within the Single Market or a substantial part of it insofar as such abuse may affect trade between Member States.

[3] Under a legal exception regime, agreements are lawful at the outset if they do not infringe the prohibition in Article 81(1) or if they meet the conditions of Article 81(3). Agreements which infringe the prohibition in Article 81(1) and do not meet the conditions in Article 81(3) are unlawful at the outset.

1.4 In addition to redirecting the Commission's enforcement efforts away from handling notifications, the Regulation will bring enforcement of EC law closer to the markets concerned by expanding the role of national courts and authorities. The Regulation will also ensure that business can compete on a level playing field in the Single Market, by ensuring that commercial agreements are assessed consistently across all Member States. For most undertakings, the measures should prove deregulatory.

1.5 The new Regulation will be directly applicable in the UK, although some provisions require implementing measures. The Competition Act and European competition law are closely aligned. The Regulation will create significant mis-alignment and this proposal will re-align the two legal systems, with substantial benefits, such as applying consistent procedures to both UK and EC substantive law.

1.6 If we did not align the two systems, some agreements or types of conduct would be treated differently under UK and EC law. The correct law to apply depends on whether the agreement or conduct may "affect trade between Member States" – a concept that can be difficult to apply for both Regulators and business. There are many examples of this now – an agreement can be excluded from the Competition Act, yet be subject to EC law. The problem is that, with an expanded role for the Office of Fair Trading ('the OFT') and sectoral regulators, the same competition authorities that are barred from investigating a particular agreement under UK law, may be required to apply EC law.

1.7 Consequently, agreements and conduct should be treated similarly under EC and UK law wherever possible. Not aligning would cause greater legal uncertainty, higher costs and a higher regulatory burden on business. This proposal therefore minimises the differences between EC competition law and the Competition Act.

**Risk Assessment**

1.8 The Regulation addresses three main risks. Firstly, anti-competitive agreements, such as serious cartels, and unilateral conduct that cause serious harm to the economy. Secondly, weak enforcement, owing to the European Commission being over-burdened with cases, and remote from the markets it oversees (likely to be exacerbated by enlargement of the EU). Thirdly, ineffective competition, reduced innovation, efficiency and productivity in the Single Market and higher prices for consumers, caused by a lack of a common approach to enforcing EC competition rules. The Regulation aims both to strengthen enforcement and to reduce certain barriers to cross-border competition in the EU, thereby promoting effective competition.

1.9 The package of Statutory Instruments [4] ('the SIs') which give effect to the Regulation and align the UK competition regime will address the risks that NCAs applying two separate legal frameworks could:

- increase compliance burdens on business because business must consider two sets of rules rather than one

[4] The Competition Act 1998 and other enactments (Amendment) Regulations 2004 and The Competition Act 1998 (Determination of Turnover for Penalties) Order 2004

- lead to inequitable treatment of agreements
- generate disputes about whether the correct legal framework is being applied and;
- as a consequence, reduce the efficiency and effectiveness of competition law enforcement, leading to less effective competition, and an increase in the detriments to the economy from anti-competitive behaviour.

## 2. OPTIONS CONSIDERED

2.1 With increasing levels of cross-border activity and the enlargement of the Community, the present system of competition law is unworkable. Without amendment, the Commission will face increasing numbers of notifications of benign agreements and even less of its resources will be available to address competition infringements and the economic detriment they create. Even the notification system does not properly serve its purpose: the Commission is currently able to provide formal exemption to only a handful of notifications each year and in most cases issues "comfort letters" instead of individual exemptions. The alternative approach is therefore to replace the notification system with a legal exception regime, and this is what the Regulation does.

2.2 In its 1999 White Paper[5], the Commission considered simplifying and speeding up the present procedural regime, but found that this would not achieve its reform objectives of "rigorous enforcement of competition law, effective decentralisation, simplification of procedures and uniform application of law and policy development throughout the EU"[6]. The Regulation therefore abolishes the notification system and, with it, the Commission's monopoly on the application of Article 81(3). It also capitalises on the enforcement potential of national courts and NCAs.

2.3 The Regulation itself will be directly applicable in Member State law. However, some measures will be necessary to give it full effect including:

- designation of UK NCAs;
- specification of procedures governing investigations, powers to make interim measures directions and the acceptance of binding commitments[7] during investigations under Articles 81 and/or 82;
- application of financial penalties for infringement of Articles 81 and 82 and enforcement measures to secure compliance with investigations and directions; and
- rights of redress including for third parties.

2.4 The Regulation stipulates that, in applying the Treaty Articles, Member States may act under procedures in their national law[8]. It is therefore possible to apply existing procedures to investigations, penalties, interim measures or rights of appeal under Articles 81 and 82. UK NCAs are also already specified in the Competition

[5] White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty, Commission Programme no. 99/027, 1999
[6] as above: page 5
[7] Articles 8 and 9 respectively of the Regulation
[8] See for example Article 22(1) of the Regulation on powers of investigation

Act. It is therefore not necessary to consider options for these aspects of implementation.

2.5 However, the Government has the option to align further the operation of the two systems in the UK, to align in part or to leave the domestic regime untouched.

**Option A – no alignment**

2.6 The option of leaving the domestic regime untouched is unattractive. OFT estimates that at least 50% of its cases will be considered under EC law after 1st May 2004 rather than under the Competition Act. Inconsistencies in approach would result in a greater compliance burden for business, as firms would need to understand two different sets of procedures and parameters applied by the same authorities. This option is likely to result in appeals to the Competition Appeal Tribunal and potentially to the High Court over whether NCAs have applied the correct law and procedures leading to additional costs to both business and NCAs. Appeals of this kind will significantly delay the progress of an investigation, which will, in turn, delay a decision either that the behaviour or agreement under consideration is acceptable under competition law or that there has been an infringement. Where there is a delay in stopping and remedying an anti-competitive practice there will be a corresponding increase in the level of detriment to the economy and a negative impact on the effectiveness of competition enforcement in the UK.

**Option B – Alignment**

2.7 Aligning the application of the Treaty Articles and the Chapter I and II prohibitions would create a coherent, more equitable and easily understandable system. It would be consistent with the approach taken by Ministers, and accepted by Parliament at the time of the passage of the Competition Bill, that the domestic system should reflect the operation of the system at Community level as far as possible to minimise compliance burdens on business overall.

2.8 To facilitate alignment, the Government is proposing to:

- remove the domestic notifications system[9];
- remove provisions in the Competition Act that enable the inclusion of "opposition procedures" (a kind of "fast-track" notification for agreements which fall marginally outside the scope of a block exemption) in a Block Exemption Order;
- harmonise the domestic maximum financial penalty for infringements with the maximum penalty applied by the Commission and by a number of other Member States;
- extend the current requirement under the Competition Act for UK NCAs to take penalties or fines levied in other Member States into account when applying penalties subsequent to infringement decisions under EC law[10];
- place current administrative practice on a statutory footing by including an equivalent power in the Competition Act to the power to accept binding commitments in Article 9 of the Regulation[11];

[9] Although note - OFT will provide "Opinions" on novel points of law at its own discretion
[10] Section 38(9) of the Competition Act 1998

- require NCAs to obtain a warrant to search domestic premises under the Competition Act 1998[12];
- make explicit the powers of NCAs to seal premises during investigations[13] and
- remove exclusions under the Competition Act 1998 where agreements governed by the exclusion might be subject to scrutiny by UK NCAs under Articles 81 and 82 and where there is no direct EC equivalent to the UK exclusion. These include:
    - the domestic exclusion for vertical agreements ('the verticals exclusion')[14]
    - the exclusion for the rules, guidance and practices of recognised supervisory or qualifying bodies for Statutory Audit and the related competition scrutiny regime ('the regime for Statutory Audit') under the Companies Act 1989 ('the Companies Act')[15]
    - the exclusion for agreements given clearance under section 21(2) of the Restrictive Trade Practices Act 1976 ('the RTPA exclusion')[16]
    - the power to exclude from the Competition Act 1998 Producer Responsibility Schemes under the Environment Act 1995. The corresponding scrutiny regime, which was first introduced in 1997 was repealed two years later[17].

2.9 Only a few of these measures have any impact on business. The proposals that do have some impact are the removal of notifications, the verticals exclusion, the RTPA exclusion and the regime for Statutory Audit. The RIA discusses these provisions in detail but only discusses other provisions in the package of measures where they would exacerbate the costs of not aligning.

**Statutory Audit**

2.10 Under the Companies Act, the Secretary of State has powers to formally "recognise" bodies authorised to ensure the proper training of registered auditors (Recognised Qualifying Bodies or RQBs) and to ensure the appropriate supervision of audit firms (Recognised Supervisory Bodies or RSBs). The Companies Act also provides for the Secretary of State to seek competition advice from the OFT before deciding whether to recognise a RSB or RQB. There is a corresponding exclusion

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[11] *There is no domestic equivalent so we need to provide for a power to accept commitments generally in UK law.*

[12] Article 21(3) requires that the Commission seek prior authorisation from a national judicial authority before domestic premises may be searched. The Competition Act contains no equivalent requirement.

[13] Section 28(2) (d) of the Competition Act includes a power to take "any other steps which appear to be necessary" for the purpose of taking possession of documents appearing to be relevant to an investigation – this would include temporary sealing.

[14] The Competition Act 1998 (Land and Vertical Agreements Exclusion) Order 2000, SI 2000/310. Only the exclusion for vertical agreements will be removed. The exclusion for land agreements will be retained.

[15] Schedule 14, paragraph 9 to the Companies Act 1989 as amended by the Competition Act 1998, Schedule 2, Part II, paragraphs 2(1) and 2(2)

[16] Schedule 3, paragraph 2 to the Competition Act 1998

[17] The Producer Responsibility Obligations (Packaging Waste) Regulations 1997 SI 1997/648 and the Producer Responsibility Obligations (Packaging Waste) (Amendment) (No 2) Regulations 1999 SI 1999/3447, which repealed regulations 31-33 of the previous Regulations.

from the Chapter I prohibition of the Competition Act for agreements and practices scrutinised under the separate regime in the Companies Act.

2.11 The Government has no real option but to remove the regime for Statutory Audit. The Government's preliminary view is that the rules of RQBs and RSBs are already caught by EC law[18]. The regime for statutory audit will therefore have limited value after 1st May 2004 and it is inappropriate for these rules to be excluded from the Competition Act when the OFT must consider them under Article 81.

2.12 In addition, in the wake of the high profile collapses of Enron, WorldCom and Arthur Andersen, the Government intends to devolve all the powers of the Secretary of State to the Professional Oversight Board of the Financial Reporting Council (FRC), an independent regulator. Retaining the regime for statutory audit would effectively provide a form of notification for audit firms that, in the context of the removal of the more general notification system, would amount to special treatment for these firms. Parliament removed the special regime for the professions in the Competition Act[19] during the passage of the Enterprise Bill. Retaining a special regime for RQBs and RSBs of this kind would therefore run counter to Parliament's intention to ensure the professions are fully within the scope of the Competition Act. The regime for statutory audit is only discussed further in the context of the costs of alignment.

**Maximum Financial Penalties**

2.13 Provisions to harmonise maximum financial penalties have no impact on legitimate business that does not engage in anti-competitive agreements or conduct. Financial penalties only affect the minority of businesses who infringe competition law. Changes to the maximum penalty have a limited impact on overall fines since the "relevant market" affected by the infringement will remain a key element in OFT's calculations. Maximum financial penalties are however one area where a lack of alignment may exacerbate the risk of dispute over whether the correct legal framework is being applied. These penalties are only discussed subsequently in this RIA in this context. The provision requiring NCAs to take fines levied in other Member States into account when applying penalties subsequent to infringement decisions under EC law also only impacts on the minority of businesses who infringe competition law and is a necessary safeguard. It is not discussed further.

**Sealing and powers of entry to domestic premises**

2.14 Formalising NCAs' powers to seal parts of premises during an investigation and amending powers to enter domestic premises have no impact on business. Powers to seal are already available as part of a warrant to search and sealing is usually acceded to voluntarily by businesses when NCAs are exercising powers of peaceable entry. It is less burdensome for a business to accept the application of seals than to have large numbers of documents removed for extended periods of time. NCAs already have powers to enter domestic premises and the addition of a requirement for a warrant is an additional safeguard to the parties concerned. Neither sealing nor powers to enter domestic premises is discussed further in this RIA.

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[18] See for example Wouters, Savelberghand, Price Waterhouse Belastingadviseurs BV v Algeme Raad van de Netherlandse Orde van Advocaten, Case C-309/99 and Pavel Pavlov v Stichting Pensionfonds Medische Specialisten, Case C-180 to 184/98[2000] ECR -16451

[19] Schedule 4

**Opposition procedures**

2.15 Provisions in the Competition Act that enable the inclusion of "opposition procedures" in a Block Exemption Order have never been used. Their removal will have no impact on business and they are therefore not discussed further here. There are no regulations currently governing Producer Responsibility Schemes and the removal of the power in the Environment Act will have no effect. It is also not discussed further.

**Binding Commitments**

2.16 Introducing a new power to accept binding commitments formalises an existing informal practice of NCAs and has a benign impact on the very small minority of businesses under investigation by the competition authorities. Commitments are voluntarily offered by undertakings and, where accepted, may result in a reduction in business costs as they will lead to earlier termination of an investigation. This should reduce the legal fees that might otherwise be associated with a lengthy investigation and potential appeal following a decision by a NCA. However, binding commitments will only be accepted in certain types of cases[20] and the OFT expects only a small minority of investigations to be terminated by acceptance of binding commitments. This means that the savings to business and to the OFT associated with this area of the policy are likely to be minimal and the impact therefore negligible. It is not therefore discussed further.

**Exclusions**

2.17 The alignment option does not consider exclusions from the Competition Act that relate to agreements or conduct where there is only a minor risk that such agreements or conduct might fall to be considered under the EC Treaty Articles on competition. Nor does it deal with exclusions from the Competition Act that closely follow equivalent exclusions at EC level. The Government sees no reason to remove exclusions where either of these two conditions pertains[21].

**Option C – Partial Alignment**

2.18 It would be possible to align the two systems in part, accepting some measures and not others. However, this would not address the risks identified above in paragraph 1.9. Partial alignment would not create the desired level of coherence between the two systems and would not relieve some of the additional compliance

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[20] They will not be accepted in cases involving agreements or concerted practices or decisions which concern price fixing, bid rigging (collusive tendering), establishing output restrictions or quotas, market sharing and/or market dividing. Nor will binding commitments be accepted in cases involving serious abuse of a dominant position.

[21] *We have also not addressed certain exclusions in Schedule 2 and Schedule 3 to the Competition Act in relation to broadcasting and financial services and powers of the Secretary of State to exclude on grounds of exceptional and compelling reasons of public policy or avoidance of conflict with international obligations. The exclusions concerning broadcasting and their corresponding competition scrutiny regime will become the responsibility of Ofcom. The Financial Services regimes are the responsibility of Her Majesty's Treasury, which is considering how the regimes will operate after May 1st 2004. The powers of the Secretary of State to exclude can be applied only to agreements with no effect on trade between Member States after 1st May 2004 so as to ensure Ministerial obligations under Article 10 EC (not to frustrate the objectives of the EC Treaty) are discharged.*

and other costs for business. Not aligning on some measures will have other effects. In particular:

**Notifications**

2.19 If the UK system of notifications were retained there is a risk that undertakings might seek to notify agreements or conduct to OFT to obtain comfort in relation to Article 81 and 82. This is especially true of non-UK undertakings whose agreements might appreciably affect trade within the UK. Section 60 of the Competition Act requires that, in general, consistent treatment be given to corresponding questions arising under Chapter I and II and under Articles 81 and 82. Undertakings might therefore assume that a UK notification would provide some comfort about the position of those agreements or conduct under EC law. This is not the case and notifications of this kind could result in the diversion of NCAs' resources to dealing with cases of only limited relevance to the UK[22]. The removal of domestic notification systems in other countries may exacerbate this problem.

**Penalties**

2.20 If UK NCAs applied current UK maximum financial penalties when enforcing Articles 81 and 82, the penalties would not take into account the effects of the infringement in another Member State. This could seriously hamper the ability of UK NCAs to operate effectively within the European Competition Network by making it more difficult for them to fulfil the ECN case allocation criteria[23]. Penalties applied for infringements of EC law must also be effective, dissuasive and proportionate. Aligning with UK penalties might not fulfil these criteria, would increase the range of sanctions available across Europe and could raise the risk of "forum shopping" (e.g. selecting where to lodge a competition complaint on the basis of the Member State with the toughest penalties).

**Vertical Agreements**

2.21 Vertical agreements are agreements made between undertakings operating at different levels in the supply chain, for example between manufacturers and wholesalers or retailers. Typical vertical agreements include distribution agreements and franchise agreements.

2.22 Whilst there is no requirement to remove the Verticals exclusion under the Regulation, the option of keeping it is problematic for several reasons. The Verticals exclusion was drafted to cover the period between the coming into force of the Competition Act and the EC Block Exemption Regulation (BER) for vertical agreements. The BER has parallel effect in the UK by virtue of section 10 of the

[22] Under the new system these would face investigation, and where relevant, enforcement action by the competition authorities of other Member States

[23] The Notice on co-operation within the Network of Competition Authorities states in particular that "An authority can be considered to be well placed to deal with a case if the following three cumulative conditions are met: the agreement or practice has substantial direct actual or foreseeable effects on competition within its territory, is implemented within or originates from its territory; the authority is able to effectively bring to an end the entire infringement i.e. it can adopt a cease and desist order the effect of which will be sufficient to bring an end to the infringement and it can, where appropriate, sanction the infringement adequately; it can gather; possibly with the assistance of other authorities, the evidence required to prove the infringement."

Competition Act[24] and UK firms can therefore continue to rely on the provisions of the BER to remove them from the scope of both the UK and EC regimes.

2.23 When it was introduced, Ministers stated that they intended to review the Verticals exclusion when the new system had settled in place. Both business and the competition authorities now have more experience of how the Act is applied in practice, and the Government believes it is right to review whether the Verticals exclusion remains the appropriate regulatory approach.

2.24 The BER more precisely reflects current economic thinking on the treatment of vertical agreements between Member States. Vertical agreements are generally benign except where they are accompanied by market power or have network effects and the terms of the BER reflect this approach more closely than the Verticals exclusion. Furthermore, the value of the Verticals exclusion after modernisation will also be limited by the OFT's obligation to apply Article 81 to the same agreement where there is an effect on inter-state trade and this will lead to an increased risk of conflict between the two legal frameworks. The Government's view is that the same authority will be treating similar agreements differently depending on whether they are caught by EC law or domestic law and that this is unfair. The Government believes that the better regulatory option is to remove the Verticals exclusion while retaining the BER.

2.25 Lastly, the Verticals exclusion does not provide as much legal certainty for vertical agreements as has been perceived. The OFT can both seek information from firms about excluded agreements from undertakings and withdraw the benefit of the exclusion where it considers that the agreement will, if not excluded, infringe the Chapter I prohibition and that it would be unlikely to be granted individual exemption. Although the OFT has not yet exercised the "claw-back" power, it has considered doing so on at least two occasions. The Verticals exclusion was never intended to shelter anti-competitive agreements and the Government is concerned that business is therefore ignoring the requirement to comply with the prohibition of anti-competitive agreements because the Verticals exclusion is wrongly perceived to offer "blanket" protection.

**Competition Scrutiny Regime for Statutory Audit**

2.26 As discussed above (see paragraphs 2.11 and 2.12), the Government's preliminary view is that the rules and guidance of RQBs and RSBs may be caught by EC law and therefore the existing competition scrutiny regime may fall into disuse after 1st May 2004. Nor would it be consistent with Parliament's intention in repealing the special regime for the professions. Partial alignment could not therefore exclude the repeal of the competition regime for statutory audit.

**Agreements given prior clearance under section 21(2) of the Restrictive Practices Act**

2.27 At the time of the Competition Bill, a large number of agreements existed which had been given prior clearance under section 21(2) of the Restrictive Trade Practices Act 1976 ('RTPA'). To ease the transition between the competition regime

[24] Section 10 provides that "an agreement is exempt from the Chapter I prohibition if it does not affect trade between Member States but otherwise falls within a category of agreements which is exempt from the Community prohibition by virtue of a Regulation".

under the RTPA and the prohibitions-based approach of the Competition Act, the Government excluded such agreements.

2.28 The problems associated with keeping the RTPA exclusion are similar to those of the other exclusions discussed here. An agreement, which benefits from a section 21(2) direction excluding it from the Competition Act, may affect inter-state trade[25]. In this case the OFT will be required to look at the agreement under Articles 81 and 82 after modernisation and the domestic exclusion will be of limited value. As with the Verticals exclusion, the RTPA exclusion does not currently provide absolute legal certainty for undertakings. The OFT can issue a direction to withdraw the benefit of the exclusion (a "claw back") and an agreement also ceases to be excluded if it is materially varied.

## 3. COSTS AND BENEFITS

**Business sectors affected**

3.1 The Regulation applies to undertakings (broadly defined as organisations acting commercially) in all sectors of the economy, except agriculture, third country aviation and tramp shipping[26], if the agreement or behaviour in question may affect trade between EU Member States to an appreciable extent. It will thus tend to apply more to larger undertakings, but SMEs may occasionally be caught where they are significant players in niche markets.

3.2 The SIs will both amend the domestic competition framework and give effect to the Regulation. Amendments to the domestic system will therefore apply to all undertakings in the UK to the extent that their agreements appreciably affect trade within the UK and to the extent that they are dominant in UK markets. As with the Regulation, changes to domestic law will tend to affect larger rather than smaller undertakings.

3.3 The removal of the exclusions from the Competition Act will not affect all undertakings. The exclusions do not in practice help businesses whose agreements or conduct are caught by, and must therefore already comply with, European competition law. The European Court of Justice has adopted a wide definition of what may affect inter-state trade[27]. As a result, Articles 81 or 82 already catch many of the agreements and the conduct of a proportion of UK firms. Removal of the exclusions will affect those undertakings whose agreements or conduct affect trade only within the UK.

**Vertical Agreements**

3.4 Vertical agreements may occur in almost all sectors of the economy. However they are prevalent in the newspaper and magazine industry, the retail sector,

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[25] Analysis of a random sample of 150 registrations under S21(2) of the RTPA indicated that 11% had cross-border effects.

[26] It maintains the limited exemptions for the transport sector established by the Regulations (2988/74, 4056/86 and 3975/87) that brought transport within the scope of Articles 81 and 82 (these are that both technical agreements and agreements involving scheduled services within the transport sector are exempt from the prohibition of Article 81(1)).

[27] Draft Commission Notice, Guidelines on the effect on trade concept in Articles 81 and 82 of the Treaty

broadcasting and media related sectors and sectors where franchising arrangements are common. The vast majority of vertical agreements are not restrictive of competition and will therefore not be prohibited. Removing the Verticals exclusion and retaining the BER[28] will retain a "safe harbour" for the majority of UK vertical agreements.

3.5 Repeal will affect primarily those undertakings, whose agreements appreciably affect trade within the UK, and whose market share exceeds the threshold of the BER (30%) and falls below the threshold at which dominance is generally found under the Competition Act (40%[29]). Businesses whose agreements contain any of the hard-core restrictions identified in the BER will also be affected[30]. However, these agreements are exactly those that OFT might wish to claw back using its power under the Verticals exclusion. It is also possible that networks of vertical agreements could be considered under the market investigation powers in the Enterprise Act. It is therefore very difficult to assess how many businesses will have agreements newly open to competition scrutiny by NCAs owing to the removal of the Verticals exclusion.

3.6 The possible effects of the repeal of the verticals exclusion on the newspaper and magazine industry require particular consideration. Some publishers, distributors and wholesalers are concerned that the distribution agreements between them may fall outside the BER. There are 8 leading newspaper publishing groups[31] and fourteen major[32] and several hundred minor magazine publishers[33]. Almost two thirds of magazines are distributed through three major firms; Market Force, Frontline and COMAG. Three wholesalers dominate wholesaling of national newspapers and consumer magazines: WH Smith News (WHS News), John Menzies and Surridge Dawson. There are approximately 100 independent wholesalers.

3.7 How far these firms are affected by removal of the Verticals exclusion is not clear. The network of distribution agreements between the firms may affect trade between Member States (for example because the barriers to entry are sufficiently high to foreclose the UK market) and therefore may fall under EC law. If so, the Verticals exclusion provides no benefit to these agreements and removal would therefore have no effect. At present, the OFT and the EC Commission have indicated that they cannot exclude the possibility that EC law applies. The Verticals exclusion

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[28] The BER applies to the Chapter I prohibition by virtue of section 10 to the Competition Act.
[29] The OFT considers it unlikely that an undertaking will be individually dominant if its market share is below 40%, although dominance could be established below that figure if other relevant factors provided strong evidence of dominance. OFT guide 415, "Assessment of Market Power", paragraph 2.11
[30] These hard-core restrictions are: resale price maintenance; restrictions concerning the territory into which or the customers to whom the buyer may sell; restrictions on the sales to end-users by authorized distributors in a selective distribution network; restrictions on authorized distributors in a selective distribution network selling or purchasing from other members of the network; and restrictions preventing the sale of components as spare parts by the manufacturer of the component to end-users, independent repairers and service providers.
[31] News International, MGN, Daily Mail & General Trust, United Newspapers, Telegraph, Guardian, Financial Times and Independent
[32] IPC, EMAP, Bauer, BBC, Future, National Magazines, Haymarket, DC Thompson, Northern & Shell, Attic Futura, Hello, Dennis, G&J and Conde Nast
[33] The Periodical Publishers Association has almost 300 members

provides protection only from the Chapter I prohibition of the Competition Act. It is also possible that several larger firms (and smaller firms in niche markets) may be dominant in certain markets[34] and their supply arrangements could be considered therefore under the Chapter II prohibition. Equally, the sector has been considered by the Monopolies and Mergers Commission in the past and could be subject to further consideration under the Market Investigation powers in the Enterprise Act. The distribution agreements could therefore be considered in this context. However, the removal of the Verticals exclusion does enable the industry distribution agreements to be challenged by third parties in the courts under the Chapter I prohibition.

3.8 Opening up the agreements to scrutiny does not necessarily result in the agreements becoming void under competition law. The agreements may fulfill the conditions for exemption under the Competition Act or under Article 81. If so, the agreements will be lawful without prior notification after May 1st 2004. The industry has already begun discussions with the OFT aimed at determining whether the sector distribution agreements meet the conditions for exemption. Any amendments, which may be necessary to ensure that they are fully competition compliant, could be made during the renewal process.

**Competition Scrutiny Regime for Statutory Audit**

3.9 The bodies affected by the removal of the competition scrutiny regime under the Companies Act and related exclusion from the Competition Act are those currently "recognised" as RSBs or RQBs. These are the Association of Chartered Certified Accountants, Institute of Chartered Accountants in England and Wales, Institute of Chartered Accountants in Ireland, Institute of Chartered Accountants of Scotland, Association of International Accountants and the Association of Authorised Public Accountants. However, the removal of the regime does not mean that the rules, guidance and practices of the respective bodies are appreciably restrictive of competition.

**Agreements given prior clearance under section 21(2) of the RTPA**

3.10 The removal of the RTPA exclusion will affect only those businesses, which still have a valid agreement in operation that benefits from a direction under section 21(2) of the RTPA, and does not affect trade between Member States. Only these agreements are currently excluded from the Competition Act. It is not known precisely how many of these agreements still exist[35]. However, OFT estimates suggest that approximately 10,000 directions were given between 1978 and 1998[36] (subject to a 30% margin of error, resulting in an estimate of between 13,500 and 7,250).

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[34] News International and WH Smith News have shares of the overall publishing and wholesaling markets respectively in excess of 30% (Source: "The Impact of Proposed National Distribution Developments on the UK Magazine and National Newspaper Markets" - Professor Paul Dobson, Loughborough University, August 2000)

[35] The OFT have a database of cases which arose under the RTPA. However, the data we are able to extract from this is probably only 70-90% accurate due to inconsistencies in the way data was entered. Also the data only includes registrations. It does not indicate whether agreements are still in existence or whether they have been materially varied thereby losing the benefit of the exclusion.

[36] Directions under section 21(2) of the RTPA could not be given after 8th November 1998, the date the Competition Act gained Royal Assent.

3.11 The information we have gathered from the OFT's RTPA database suggests that of these 10,000 registrations, fewer than 4,500 may still be live (the range could be between 3,100 and 5,750 registrations). This estimate derives from registrations concerning categories of agreements that were likely to be of long duration e.g. co-operation agreements, distribution agreements, dealership framework agreements, franchises, licences, management agreements, service and other supply agreements, codes of conduct and trade association rules[37]. The vast majority of these agreements are vertical agreements (as many as 94%) and are likely to fall squarely into the BER for vertical agreements. To the extent that they do so, they will fulfil the conditions for exemption from the Competition Act and will be lawful.

3.12 It is very difficult to ascertain exactly how many of these registrations actually relate to live agreements. Analysis of a random sample of 150 registrations given clearance between 1993 and 1998[38] indicated that 46% had already expired and 51% would have expired before repeal of the RTPA exclusion takes effect on 1st May 2007. 7% of registrations would expire beyond this date and 42% of registrations had no expiry date and therefore might be live after repeal. More than half of the registrations with no fixed term were licences, agency agreements, franchise agreements, management agreements, service and supply agreements which supports the overall approach taken to analysis of the OFT data. Almost all of these are vertical agreements which would remain protected under the BER for vertical agreements once repeal took effect. A further third were share purchase agreements, management buy-outs or joint ventures that have no relevance to the Competition Act prohibitions.

3.13 The remaining live agreements were mainly co-operation agreements, in particular the voluntary codes, rules and regulations of various industry associations. Some of these were potentially significant, either because of the nature and scale of the industry concerned or because they affected trade between Member States. Some were insignificant but could nevertheless fall to be considered under the Competition Act if they appreciably restricted competition. In sum, of a sample of 150 registrations, less than 7% were live and likely to fall to be considered under the Competition Act.

3.14 Co-operation agreements and the voluntary codes of industry associations are most likely to be affected by repeal of the RTPA exclusion. 1,400 registrations exist for such agreements in the RTPA database (range could be 1,000 to 1,800), although it is unlikely that this is a true representation of the numbers of live agreements because the longer ago the agreement was made the stronger the likelihood that such agreements will have expired. Analysis of the random sample of 150 agreements suggested that of the 16 co-operation agreements in the sample, a third had already expired and none was made before 1993. It is reasonable to assume that only a handful of registrations relate to co-operation agreements with a duration of between 15 and 25 years. If we assume that 90% of agreements made in the period 1978 – 1988 have expired and that 50% of the agreements made between 1988 and 1998 have expired then approximately 400 agreements or voluntary codes will still be live when repeal takes effect (range 530 – 290).

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[37] The figures excluded sale and purchase agreements, joint ventures, management buy-outs, sponsorship agreements and various types of rationalisation agreement.

[38] covering over 400 individual agreements given section 21(2) clearance

3.15 However, the data and assumptions above do not take account of the number of registrations that will have lost the benefit of the exclusion because they have been materially varied. We have no data on the frequency of material variation because there was no statutory requirement for firms to provide such data. It is reasonable to assume that the longer the duration of the registration the greater the likelihood that if the agreements concerned have not expired, they have been materially varied. We have made no assumptions about possible rates of material variation and have not therefore altered the data on numbers of registrations affected. However, we believe that the numbers of registrations that could be live represents the upper limit of registrations affected by repeal of the RTPA exclusion. Nor do the figures represent the number of businesses affected. Larger businesses often have multiple registrations. Therefore the number of businesses affected may be somewhat lower again than the number of registrations affected.

**Benefits**

3.16 The overall benefits of the new Regulation are:

**Stronger enforcement**

3.17 Being able to focus resources on serious infringements will allow the Commission and NCAs to enforce EC competition law more efficiently. The RIA produced for the Enterprise Bill estimated that the consumer detriment caused by cartels operating solely in the UK is £1,120 million over a seven-year period or £160 million per annum. Therefore, resources aimed at improving enforcement both in the UK and the EC will have potentially large consumer detriment savings. Decentralisation will bring enforcement closer to the markets concerned. This will increase the deterrent effect of EC competition rules and ensure more widespread compliance, which will contribute to more effective competition in the Single Market.

3.18 Under the present EC system, companies (assisted by their legal advisers) evaluate their proposed business transactions for compliance with Articles 81 and 82 based on existing case law and practice, and on Commission guidelines and Notices, and decide whether or not to notify their agreements to the Commission[39].

3.19 Under the new regime, businesses will no longer need to incur the cost of notification to benefit from an exemption. This will be highly beneficial for those agreements that are clearly lawful, but greater care will be needed in self-assessment by businesses, the closer their agreements come to the scope of the prohibition in Article 81(1). In some such cases the costs of legal advice may reach the level of notification costs. However, in particularly difficult cases (that raise novel or unresolved points of law) businesses will be able to avoid excessive legal costs by being able to request a written opinion from the Commission to clarify the status of their agreement.

3.20 It is difficult to estimate the savings generated by the new regime. In consultation with the Joint Working Party on Competition of the Bar and Law Society, we have established that the current cost of notifying an agreement to the

[39] In doing so they must weigh the risks entailed by legal invalidity of their agreements in the absence of an exemption against the cost, duration and likely outcome of the notification procedure.

Commission, is between £30,000 - £100,000, depending on the complexity of the deal. 66 companies from the UK notified their agreements to the Commission in the three years to December 2002.

3.21 Based on these figures, the total saving to UK business of not having to notify agreements to the Commission over an equivalent period would be between £1.98m and £6.6m, or between £660,000 and £2.2m per annum. This will be at least partly offset by the cost of legal advice to enable proper self-assessment under the new regime, but given the above we expect that the cost of this advice will be less than the cost of notification, and we expect an overall reduction in the compliance costs for business.

3.22 Effective competition is the best guarantor of efficient allocation of resources; it raises productivity and lays the foundations for economic growth. Competitive pressure forces companies to adapt by reducing costs, implementing new techniques, innovating and striving to increase productivity, which in turn leads to lower prices, greater choice and higher quality of goods and services for consumers. Competition is also essential for the maintenance of open and competitive markets, which ensures the competitiveness of UK business overall.

**A common competition standard for business co-operation across Europe**

3.23 This will encourage further market integration, enhancing the ability of UK businesses to enter new markets and encouraging inward investment into the UK. The requirement for Member States to apply EC law when they apply national competition law to anti-competitive agreements or conduct that may appreciably affect inter-state trade would also remove the possibility of action by one over-zealous Member State leading to a de facto prohibition of an EU-wide agreement or conduct that is acceptable to the Commission and all other Member States.

3.24 The benefits of alignment are:

**A single set of rules**

3.25 Aligning the operation of the Competition Act prohibitions and the Treaty Articles enhances the coherence of the system, creating greater clarity for business, their legal advisers and enforcers alike. It will remove the scope for expensive disputes over pure points of law.

3.26 Abolishing the domestic notification system would result in some savings to business. Since the Competition Act came into force in March 2000, only 23 companies have notified their agreements to the OFT[40]. Of these, 8 were notifications for guidance and 15 were notifications for a decision. The pure application costs of the 23 notifications based on the OFT fees would total £235,000. In discussion with competition lawyers working in private practice, we have established that the costs of legal advice underpinning a notification range from £20,000 to £60,000 per notification. Total costs to business of notifying to date are therefore between £695,000 and £1.62m. In reality, most undertakings currently assess their own agreements for compliance with the Competition Act. This is demonstrated by the paucity of notifications in the UK. The OFT has also provided informal advice in over

[40] OFT figures as at 13/11/03

250 cases since the Competition Act came into force. The removal of the notifications system is likely to result in savings to business of £1m or less.

3.27 Removing exclusions from the Competition Act aligns more closely the scope of UK and EC competition law and will result in one set of rules to follow instead of two. It will ensure more equal treatment of agreements under competition law irrespective of whether they affect trade between Member States and irrespective of whether they were considered under an earlier system of competition law. In the context of dynamic markets and a competition system based on economic analysis of the market effects of agreements or conduct, this will be fairer for all businesses. It will also provide greater operational efficiency for national competition authorities, which in turn will provide more rapid analysis and decision-making. Removing exclusions that are perceived to offer "blanket" protection will ensure that firms do not ignore their obligations to comply with competition law. This should have positive benefits for firms operating in the same sector.

3.28 Concerning the Verticals exclusion, trade associations representing small retailers of newspapers and magazines[41] (and some small retailers themselves) have suggested that its removal will improve competition between newspaper and magazine wholesalers. They have also suggested that this will in turn lead to downward pressures on carriage charge service charges (charges levied by wholesalers for delivery of publications, which the trade associations say have increased from £10m to £75m over the last ten years) as well as promoting innovation and improvements in service.

3.29 Overall the effects of the Regulation and aligning the domestic and EC regimes should be deregulatory; removing the requirement for business to notify agreements for formal exemption to ensure they are lawful, creating a system to ensure the consistent treatment of commercial agreements across 25 Member States and bringing enforcement of competition law closer to national markets.

**Policy costs of the Regulation**

3.30 There are no policy costs associated with the Regulation which aims to improve the enforcement of existing competition law. There are no policy costs associated with the majority of measures required to implement the Regulation either, as these will be provided by extending existing domestic procedures.

**Implementation costs of the Regulation**

3.31 Implementation costs will mostly be associated with the introduction of the new regime, such as the need for staff training. We expect this burden would fall mainly on legal firms (and also lawyers employed by non-legal firms), many of which regularly consider issues of competition law and are engaged in programmes of continuous professional development. We therefore believe the costs to business generally should be relatively small.

[41] The National Federation of Retails Newsagents (NFRN) and the Association of News Retailers (ANR).

**Policy costs of Option A – no alignment**

3.32 The Policy costs of not aligning mainly stem from the inefficiencies in enforcement that arise from dual regulatory systems applied by a single authority. The greater the degree of disparity between the two systems, the higher the compliance burden on business.

**Notifications**

3.33 The Regulation does not require the UK to abolish the domestic notification system. But to retain a UK notification system when the Commission is abolishing its own risks increasing the number of notifications received by the OFT (see paragraph 2.19). The costs to undertakings of notifying are expected to be greater than the compliance costs in a legal exception regime. Currently, undertakings pay fees to the OFT for notifications: £5000 for guidance and £13,000 for a decision and incur legal costs for drafting the notification. Total costs to business of notifying (estimated at between £695,000 and £1.62m.) would not be saved and we would expect to see costs increase with an increase in notifications. The legal fees incurred by notification are almost certainly greater than the fees for advice on the application of a legal exception regime, even in complex cases.

**Penalties/ Vertical agreements/Agreements given section 21(2) clearance under the RTPA**

3.34 The Regulation requires neither the repeal of the exclusions nor the harmonisation of maximum financial penalties. One option is to apply different penalties to infringements of UK and EC competition law and to retain exclusions for agreements that do not affect trade between Member States despite the difference this creates with the EC regime.

3.35 This option avoids any implementation costs. However, there are likely to be substantial ongoing costs arising from litigation over whether the OFT has applied the correct rules. For example, if there is doubt about whether a vertical agreement affects trade between Member States, there will be doubt about whether the Verticals exclusion or EC BER applies (the scope of the two differs). This leaves OFT open to challenge. Different maximum penalties in particular may cause parties to challenge NCAs over whether the correct law has been applied.

3.36 Such a challenge raises substantial costs for undertakings. OFT has estimated that of the 60 cases each year that reach section 25 Competition Act stage, early litigation may arise in between 20 and 30 cases if the two regimes are not aligned. In addition, a further 2 – 4 cases may be challenged subsequent to a finding of infringement on the same grounds. Based on these estimates, the cost of litigation for business in the first year could be of the order of £11.25 million. This is based on an appeal involving 2-3 month's work.

3.37 As the case-law on inter-state trade builds up we would expect that a reduction in the numbers of these appeals and a corresponding decrease in overall costs. However OFT considers that they would be unlikely to disappear entirely for some years.

3.38 Non-alignment also delivers no savings to business arising from the exercise by a NCA of the claw-back provisions in either the Verticals exclusion or the RTPA exclusion. Where a claw-back is exercised and the benefit of the exclusion is withdrawn, the undertaking will probably wish to make representations to the OFT, to re-examine its agreement and to consider its strategy. The costs to business include:

- External and internal legal advice for dealing with OFT and making representations
- Use of economic experts in complex markets
- Management time.

3.39 These costs are likely to be substantial, and start from the cost of legal advice to review a single agreement of £3,000 to £10,000, but with the extra work described above, total costs could easily rise to £50,000 in each case.

**Implementation Costs of Option A – no alignment**

3.40 There are no implementation costs for this option. Businesses must already consider whether their agreements or conduct might be considered under EC law and are already familiar with the current system of UK competition law.

**Policy Costs of Option B – alignment**

3.41 There are no policy costs associated with alignment. Alignment ensures NCAs can act consistently irrespective of whether EC or UK law applies and delivers a more coherent and efficient enforcement system. It also reduces the compliance burden on business by instituting one set of rules rather than two.

**Implementation Costs of Option B – alignment**

3.41 Implementation costs arise in relation to the transition from a notifications regime, the removal of exclusions and understanding the new regime.

**Notifications**

3.42 The only cost which might arise would be where undertakings notify their agreement to the OFT and the OFT is not able to give guidance or a decision on it before 1st May 2004, in which case the notification will lapse, and the undertakings will have to switch to self-assessment (and receiving informal advice from OFT). The OFT will refund the notification fee. It is not clear to how many undertakings this cost will apply, but based on the paucity of notifications since March 2000, it is unlikely to be many. OFT is continuing to process its notifications caseload as usual up to 1st May 2004 and existing individual exemptions will remain in force until they expire. We therefore expect very few notifications to lapse as at 1st May 2004.

**Verticals Exclusion**

3.43 There are no ongoing costs associated with aligning the UK and EC treatments of vertical agreements. When agreements come up for renewal, or when new agreements are drafted, they need to be made compliant with substantive competition law. Presently, vertical agreements are excluded from the Chapter I prohibition of the

Competition Act 1998, unless they are clawed back under Article 7 of the Verticals exclusion. This means that for each vertical agreement, it is possible that the benefit of the exclusion can be removed, leaving that agreement open to challenge either by OFT or by third parties in the courts. An undertaking must therefore consider whether a vertical agreement is appreciably restrictive of competition even if it does currently benefit from the Verticals exclusion. With alignment this would not change. Alignment engenders a transitional cost for businesses with vertical agreements. The transitional cost arises out of the pervasive but inaccurate belief that the Verticals exclusion offers complete immunity from competition law.[42] As noted above, removing the exclusion does not create a new cost that was not previously there – technically speaking, it has always been necessary to assess whether a vertical agreement appreciably restricts competition. However, removing the exclusion does bring this issue to the forefront of many businesses' considerations, and some businesses will review their agreements, often with the assistance of external legal advice, to ensure that they comply with competition law.

3.44 It is not possible to estimate how many vertical agreements are likely to fall outside the BER, nor can we estimate how many businesses are likely to review their agreements because the Verticals exclusion is being removed. We can estimate that legal advice for a single agreement might cost between £3,000-10,000. It would not be accurate to extrapolate from this that the transitional cost would be £3,000 - £10,000 multiplied by the number of vertical agreements falling outside the BER, as:

- An undertaking might be party to numerous agreements in the same market. Since market analysis is a major constituent of legal advice, the pro rata cost of analysing several agreements in the same market is lower, possibly between £1,500 and £5,000 per agreement.
- Not all undertakings will seek to review their agreements; and
- Before the repeal takes effect, numerous agreements will come up for renewal and the cost of advice on renewal is not attributable to repeal.

3.45 Vertical agreements in the newspaper and magazine distribution sector are likely to be re-assessed in the light of repeal, and the potential costs are estimated below.

3.46 Data from the Association of Newspaper and Magazine Wholesalers (ANMW) suggests that newspaper and magazine wholesalers have 189 distribution contracts with national newspaper publishers, 348 contracts with publishers of regional newspapers, and 950 contracts with magazine publishers (total 1487 agreements).[43] Data from the Periodical Publishers' Association and the Newspaper

[42] This pervasive belief often overlooks the possibility that the exclusion does not provide any benefit to agreements that affect trade between Member States, as these are potentially open to scrutiny under Article 81. Further, any agreements where one party is dominant are potentially subject to review under the Chapter II prohibition of the Competition Act 1998.

[43] Source: ANMW data. ANMW points out that these data are accumulated as follows: there are three large multiple wholesalers (Dawson's, John Menzies and WHSmith News) and each contract with a single publisher is counted separately, regardless of the number of branches of that company. Furthermore, the data includes all contracts, regardless of paperwork and level of formality between them and the relevant publisher – whether they are lengthy legal documents, or implied contracts. ANMW points out that these data will differ from NPA and

Publishers' Association respectively suggests that there are between 600 –1000 magazine distribution agreements and 134 newspaper distribution agreements (total up to 1134 agreements).

3.47 Most of the agreements contain provisions that are standard to the industry and only some of these may raise competition issues. The industry trade associations have already begun a dialogue with OFT seeking advice on certain provisions and have advised that the costs to them of providing the necessary economic and market information to OFT is £60,000. Depending on OFT's advice, there will either be no transitional cost for the sector because the agreements are already competition compliant or each individual agreement will need to be amended to ensure compliance. The same market definition will apply at each level of the supply chain and, once this is established with advice from OFT, a large element of the cost of reviewing individual agreements is removed. Costs for each firm will also reflect the number of agreements to which they are party.

3.48 Costs will primarily fall on publishers and, in the magazine market, also on distributors. News International (NI) has approximately 100 distribution agreements whilst other newspaper publishers will have between approximately 5 and 12 each (range based on difference between ANMW data and NPA data). Costs per agreement could be between £1,500 and £5,000 once market definition is established. Costs to newspaper publishers could therefore be between £7,500 and £60,000 each except for NI. NI has an in-house legal team and could not supply information on likely costs although we would expect these to be lower than those of external advisers. Other publishers may also have in-house legal departments so industry costs could be lower still than these estimates. However, assuming the same level of costs, NI costs could be of the order of £150,000 to £500,000. Legal costs to the national newspaper industry of reviewing every agreement could therefore be between £202,500 and £920,000.

3.49 There are also 348 regional newspapers, which may have agreements with one or more distributors. These agreements if reviewed could cost between £522,000 and £1.7m. Total costs to the newspaper industry could be between £725,000 and £2.6m.

3.50 There is less disparity between ANMW and PPA estimates of the number of magazine industry distribution agreements (around 1000). With 14 major magazine publishers and around 300 minor publishers, on average each publisher must have three agreements, which equates exactly to the number of magazine distributors. Costs per publisher of reviewing their agreements could be of the order of between £4,500 and £15,000. Costs to the magazine publishing industry as a whole could range between £1.4m and £4.7m.

3.51 Overall costs to both industries of reviewing might therefore be of the order of between £2.1m and £7.3m. However, this figure does not take into account whether any of the agreements to distribute newspapers and magazines will come up for renewal before 1st May 2005. The cost of the renewal process, including taking into account any advice on competition law, is not strictly attributable to the proposed

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PPA sources as ANMW includes all contracts with publishers, but not all publishers are represented in NPA and PPA.

repeal. The transitional costs to the industry of the repeal of the Verticals exclusion may, in reality, be considerably smaller than suggested above.

3.52 It has been claimed that repealing the Verticals exclusion would either engender third party litigation against the lawfulness of their agreements or create a degree of uncertainty in the sector such that the commercial environment would not favour agreements in their current form. Either would lead, it is argued, to the collapse of the newspaper and magazine distribution system, with the loss of its key consumer benefits: distribution of newspapers (a time-critical and perishable product) to retail outlets for the start of the day, to all parts of the country, at a uniform and competitive cover price.

3.53 In support of this a report by Professor Paul Dobson in October 2000[44] on the possible effect of the move by major retailers to national distribution for magazines, initiated by WHSmith Retail and Tesco[45] has been cited. Professor Dobson argued that national distribution would be likely severely to undermine the present wholesaling system by which magazines and newspapers are distributed. Costs would rise by an estimated £20 million p.a., because dual systems would operate to serve different retail outlets, leading to reduced retail terms and/or higher carriage service charges. Such higher carriage service charges would lead to many retailers withdrawing from the market, with the loss of between 6000 - 8000 outlets, rising to 9,000 -12,000 outlets if national distribution extended also to newspapers. In turn, this would lead to substantially reduced sales of magazines and newspapers of up to £53 million (at retail sales value) for magazines, and £97 million for newspapers. This fall in sales would be accompanied by higher unit costs, leading to higher cover prices, reduction in titles and job losses among journalists.

3.54 The Government believes it is highly unlikely that the removal of the Verticals exclusion would lead to the effects listed by Professor Dobson. Professor Dobson reported on how plans by WH Smith and Tesco to move to national distribution might affect the current system. The Dobson report does not fully analyse the likely responses of the industry (notably the publishers) to such a move. Nor does it provide analysis on the long-term future of the market without such a move. Also the report did not set out to consider the effect of removing the Verticals exclusion. For the analysis to be persuasive here, a causal link would need to be shown between the removal of the Verticals exclusion and a move to national distribution.

3.55 Firstly, there is no evidence that the removal of the Verticals exclusion will necessarily lead to national distribution. It is however the case that greater awareness of competition law, coupled with the removal of the exclusion, may encourage some undertakings to litigate or to seek to avoid their contracts, claiming that they infringe the Competition Act. Under a legal exception regime, agreements are either lawful or unlawful, without the need for prior approval. If an agreement fulfils the conditions for exemption in section 9 of the Competition Act, then it will be lawful[46]. It is also

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[44] The Impact of Proposed National Distribution Developments on the UK Regional Press Industry.

[45] Owing to opposition at the time, the move to national retailing of magazines, and by extension, newspapers, did not take place. Some publishers and wholesalers argue that removing the UK verticals exclusion is likely to promote similar further attempts to move to national distribution.

[46] The exemption criteria are set out in section 9 of the Competition Act as follows: contributes to improving production or distribution or promoting technical or economic progress, while allowing

true that the risk of litigation starting will depend partly on the claimant's perception of its chances of success. A high risk of litigation would seem to be broadly commensurate with a higher chance of success for the claimant. At first view it seems possible that the agreements between parties in the newspaper and magazine sectors have significant public benefits. It is therefore far from clear that initiating litigation against these agreements would succeed in proving that they are unlawful.

3.56 Secondly, there is no evidence that a "climate of uncertainty" will of itself cause the system to collapse, without a viable alternative being put in place. Newspaper publishers currently sell approximately 70% of their sales volume through small retail outlets and it would not be a credible response to move to national distribution, to the claimed detriment of small retail outlets, hence mutual agreement to terminate contracts is unlikely. Moreover, it is not the publishers but the wholesalers that decide which retailers to serve. The issue of ensuring widespread availability would falls to be covered by the contracts between publishers and wholesalers.

3.57 Thirdly, it is not clear that the Verticals exclusion currently provides a clear benefit to the agreements in the newspaper and magazine distribution sector. Neither OFT nor the Commission is able to exclude that the wholesale distribution agreements, taken together, may affect trade between Member States and therefore fall within the scope of EC law. The agreements of dominant players are already open to scrutiny by the OFT and by the courts under the Chapter II prohibition and if the industry distribution agreements infringe the Competition Act, they are at risk of scrutiny by OFT on its own initiative or at the instigation of a complainant.

3.58 Finally, the proposed one-year transition period will allow all players in the sector to examine their agreements so that the legal and commercial position is clear when the Verticals exclusion ceases to have effect.

**Exclusion for agreements given prior clearance under section 21(2) of the RTPA**

3.59 Based on the estimates set out in paragraphs 3.8 and 3.9, we assume there are approximately 400 agreements or voluntary codes that will still be live when repeal takes effect (although owing to margin of error in the data the range could be between 290 and 530) and in all probability this figure is lower because of material variation. In the course of considering the impact of removing the RTPA exclusion we contacted over 75 large organisations with registered agreements. Only 17 businesses responded. Of these 6 indicated that their agreements were no longer in existence and one indicated that all but three of their registrations were no longer operational. 5 did not know how many agreements still benefited from the RTPA exclusion, or were unable or unwilling to quantify.

3.60 9 organisations indicated that their agreements were unlikely to be problematic in competition terms or were already caught by EC law. 5 businesses indicated the costs of reviewing their registrations and estimates varied between £300 per

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consumers a fair share of the resulting benefit; but does impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives, or afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.

registration to £10,000. Other estimates we received suggest a figure of between £1,500 and £5,000 per registration. 1 business where the registered agreement was fundamental to the nature and operation of the group indicated to us that the costs of reviewing and ensuring competition compliance of their agreement was between £150,000 to £200,000 for legal costs. However, we have uncovered only 2 such registrations since we consulted on the policy and believe these registrations to be highly unusual. Neither registration covers agreements, which, at first view, appear to be of competition concern (although, in a regime based on the effects of the agreement in the current market context, this can never be ruled out).

3.61 Few RTPA registered agreements are likely to present competition concerns. Those businesses whose agreements contain restrictive provisions under the terms of the Competition Act have ignored the risk that the agreements could be clawed back by the OFT. If we assume that around 50% of companies will not review their agreements because they perceive them to be innocuous, and assuming a cost of between £1,500 and £5,000 per registration, then the total transitional cost to business of the repeal of the RTPA exclusion could be between £300,000 and £1m. (based on 400 registrations of live agreements or voluntary codes as calculated in paragraphs 3.8 and 3.9) but could range between £217,500 and £1.3m. (based on between 290 and 530 agreements). If these costs are enlarged by an estimate of the costs to the two organisations with a registered agreement fundamental to the nature and operation of their organisation (£300,000 to £400,000) this could give a total transitional compliance cost of between £700,000 and £1.4m. with a range of between £617,500 and £1.7m.

3.62 In the three years before repeal takes effect, these costs may be reduced if organisations are able to consider any registered agreements in the context of other work.

**Regime for Statutory Audit**

3.63 As previously stated, the Government's preliminary view is that the rules of RQB's and RSBs are already caught by EC law. As such, the professional accountancy bodies themselves should already have been considering whether their rules were compliant with EC law. However, since the Secretary of State has a role in approving the rules of RQBs and RSBs and since she is also under a duty not to frustrate the objectives of EC law[47], the bodies might have some reason to assume that the status of the rules under EC law had been considered. This is not so. The Government considers it is unlikely that the rules of RQBs and RSBs will raise concerns under EC competition law. However, the bodies may wish to consider whether they do and to amend the rules if necessary.

3.64 There are 6 professional accountancy bodies recognised by Secretary of State. 4 of these bodies are both RQBs and RSBs[48]. The Association of International

[47] Under Article 10 of the Treaty establishing the European Community, Member States must take all appropriate measures to ensure fulfilment of the obligations arising out of the Treaty or resulting from action taken by the Community. They are also obliged to abstain from any measure which could jeopardise the attainment of the objectives of the Treaty

[48] Association of Chartered Certified Accountants, Institute of Chartered Accountants in England and Wales, Institute of Chartered Accountants in Ireland and Institute of Chartered Accountants in Scotland

Accountants is a RQB only and the Association of Authorised Public Accountants is a RSB only. For bodies that are recognised as both RQBs and RSBs, the costs for reviewing the rules may be between £4,500 and £15,000. For bodies that are only recognised as either a RQB or a RSB, the costs may be between £3,000 and £10,000. The overall transitional cost of removing the regime for statutory audit is therefore between £24,000 and £80,000. There are no ongoing policy costs for these bodies as the rules will already comply with competition law unless amended. When considering an amendment, the bodies will need to ensure ongoing compliance with EC law as now.

**Understanding the new regime**

3.65 All companies will need to understand the interaction between the EC and UK regimes as applied by our domestic NCAs. As with measures needed to implement the Regulation, implementation costs will mostly be associated with the introduction of the parallel domestic regime such as the need for staff training. We expect this burden to fall mainly on legal firms (and lawyers employed by non-legal firms), many of which are regularly considering issues of competition law and are engaged in programmes of continuous professional development. We would not expect alignment to increase these costs over and above those required to implement the Regulation.

**Policy Costs of Option C – partial alignment**

3.66 The costs for Option C are highly dependent on which elements of the alignment package are adopted. If maximum financial penalties are not aligned, costs of handling disputes as to whether NCAs are acting under the correct legal framework will be incurred. There may some scope for dispute if the Vertical and RTPA exclusions from the Competition Act are not repealed but this is likely to be minimal because only a minority of agreements are affected. If the notifications system is retained, again costs specified above in paragraph 3.21 will remain and would be expected to increase as numbers of notifications increase.

**Implementation Costs of Option C – partial alignment**

3.67 Implementation costs of this option will again depend on which elements are aligned and which are not. If the Verticals, RTPA and statutory audit exclusions are repealed then implementation costs related to those provisions will still be incurred. If not they will be saved. Under this option, business will still need to familiarise itself with aspects of the regime which have changed but as with alignment, costs will fall primarily on legal firms and business in-house legal advisers who are engaged in continuous professional development and we would not expect costs to be incurred over and above those required to implement the Regulation.

## 4. ISSUES OF EQUITY AND FAIRNESS

4.1 As with all competition legislation, the Regulation and implementing SIs address the inherent unfairness of consumers and businesses of having to pay artificially high prices as the result of cartel activity or other anti-competitive behaviour. With very limited exceptions, the provisions of both the Regulation and the Competition Act apply to all businesses and organisations trading commercially. However, only those that engage in anti-competitive practices falling within the scope of the prohibitions are at risk of investigation and sanctions.

4.2 Aligning the two systems addresses the inherent unfairness of different treatment being applied to similar agreements or conduct by UK companies depending on whether their agreements or conduct fall to be considered under EC law.

## 5. IMPACT ON SMALL BUSINESS

**Article 81**

5.1 SMEs, like all undertakings, will be affected by Article 81 only if they are not covered by a block exemption regulation (exemptions exist for: vertical agreements between businesses with a combined market share of less than 30% in the relevant market; horizontal R&D agreements between businesses with a combined market share of less than 25% in the relevant market; and horizontal specialisation agreements between businesses with a combined market share of less than 20% in the relevant market) or by the De Minimis Notice (which stipulates that the aggregate market share held by all participating undertakings in the relevant market must exceed 10% for horizontal agreements and 15% for vertical agreements for Article 81 to apply) and if their activities appreciably affect trade between Member States.

**Article 82**

5.2 The same holds true for Article 82. A SME, like any business, would have to be dominant in its market to be caught by Article 82. What constitutes dominance will not be identical in each case, but it usually requires, in the case of single firm dominance, that businesses have a market share of near to or greater than 40%, a level at which it is often possible to infer market power[49]. The companies most affected by Article 82 will in general be companies that have some degree of market power. These are generally the larger companies, and will only rarely be SMEs.

**Competition Act**

5.3 A similar position exists under the Competition Act. SMEs will be affected by the Chapter I prohibition only if their agreements have an appreciable effect on trade within the UK and they do not fall within any remaining domestic exclusion or exemption. SMEs will benefit from EC block exemption regulations which apply to the Competition Act prohibitions by parallel application. As for appreciability, from 1st May 2004 the OFT is likely to use the same market share thresholds that the European Commission describes in its "De Minimis" Notice when the OFT is assessing under the Chapter I prohibition whether an agreement has an appreciable effect on competition within the United Kingdom. The OFT's approach to dominance is the same as that of the Commission and therefore only rarely will SMEs be caught.

5.4 Regarding the proposed repeal of the Verticals exclusion (while retaining the BER), SMEs will mostly benefit from the protection offered by the BER. They will not benefit if their agreements contain one of the listed hard-core restrictions, if they

[49] Assessment of Market Power, OFT 415, September 1999, paragraph 1.2: "As a matter of convenience, however, this guideline usually refers to market power as the ability to raise prices consistently and profitably above competition levels. This is not to suggest that market power is solely about increasing prices. For example, an undertaking with market power as defined above would also be able to supply goods of a lower quality, or restrict output to a lower level than would be supplied in a competitive environment."

have a large share of a niche market, or they are party to an agreement with a larger firm whose market share exceeds the 30% threshold of the BER. As regards the newspaper and magazine sector, whilst some publishers argue that small and especially rural newsagents may close if repeal of the Verticals exclusion results in national distribution, the main retailers' trade associations dispute this. Indeed, the NFRN in part attributes the current decline in small retailers to the lack of competition in the sector ( NFRN says it has lost 6,787 members to bankruptcy or business closure between 1992 and 2001[50]).

**Regime for Statutory Audit**

5.5 Repealing the competition scrutiny regime for Statutory Audit and the corresponding exclusion from the Competition Act is unlikely to have an adverse effect on small accountancy and audit businesses or on the small firms they serve. However, there may be SMEs whose agreements have been cleared under section 21(2) of the RTPA. They are unlikely to be affected by the removal of the exclusion from the Competition Act if they do not appreciably affect competition.

**Financial penalties**

5.6 In order to avoid the prohibition regime being unduly burdensome on small businesses, SMEs that infringe the prohibitions under the Competition Act are protected from financial penalties if they fall below certain turnover thresholds[51]. NCAs may withdraw these immunities where hard-core restrictions such as price fixing are found. Whilst immunities do not apply to infringements of Articles 81 or 82, cases in which an agreement, to which a UK SME is party, affects trade between Member States or in which a SME is dominant in a niche market across Member States, will be extremely rare.

**Complaints and litigation**

5.7 SMEs which are victims of anti-competitive behaviour within the meaning of Article 81 or 82 will benefit from the facilitation of complaints and litigation in the new regime. SMEs will also benefit from the direct effect of Article 81(3).

## 6. COMPETITION ASSESSMENT

6.1 The removal of the notification system will enable businesses to automatically enforce their agreements, provided they are pro-competitive, without being required to notify them under the Competition Act or without any other type of formal prior decision. This should reduce the regulatory burden placed on them. In addition, a key aspect of the proposals is to align, as far as possible, national procedural rules for the application of the Competition Act and Articles 81 and 82. This should result in clarity and simplicity of procedures, whether for the application of European or

[50] "Ending Anti-competitive Practices in the National Newspaper Industry" – National Federation of Retail Newsagents

[51] Sections 39 and 40 of the Competition Act provide immunity from penalties for small agreements and conduct of minor significance respectively. The Competition Act 1998 (Small Agreements and Conduct of Minor Significance) Regulations 2000 defines the category of small agreements as being all agreements between undertakings, the combined applicable turnover of which does not exceed £20m in the business year preceding one in which the infringement occurred. Conduct of Minor Significance is defined as that by an undertaking, the applicable turnover of which, in the business year preceding one in which the infringement occurred, does not exceed £50m.

national competition law, which in turn will increase predictability for business. Thus we do not believe that either of these changes will impact adversely on competition.

6.2 The proposal to repeal the Verticals exclusion and to remove the exclusion for agreements given clearance under the RTPA may improve competition by opening up some restrictive agreements to scrutiny and to third party action.

## 7. OTHER COSTS

**Option A – no alignment**

7.1 Failing to align will have major implications for enforcement authorities as well as for business. OFT estimates that disputes will arise in a large number of cases leading to an appeal on whether the correct legal framework is being applied. OFT estimates that appeals could be taken in between 20 and 30 cases that have reached the stage where formal investigation powers are used. OFT's estimated costs for defending an appeal in such cases are between £145,000 and £250,000 per case leading to an increase in enforcement costs of between £2.9 and 7.5m in the first year. Were OFT to lose the appeal, costs would be payable to the other party of between £20,000 and £200,000. Were the OFT to be successful at such an appeal, it would be unlikely to obtain a costs order in its favour. In addition, OFT would expect between 2 and 4 cases to be appealed for the same reasons at point of formal infringement. The costs of this are likely to be less since they will probably represent only part of the grounds for appeal. Since the Competition Act also allows for an appeal on a point of law, it is possible that infringing parties who are dissatisfied with the judgment of the Competition Appeal Tribunal may wish to appeal to the High Court. In this instance costs would again be of the order of £145,000 to £225,000.

**Option B – alignment**

7.2 If the two regimes are aligned, the scope for dispute about whether authorities have applied the correct legal framework is minimised. With alignment, the new regime should not entail any significant increase in enforcement costs for UK competition authorities. The OFT estimates that the additional costs of the new regime are unlikely to substantially exceed the savings resulting from the ending of notifications under the Competition Act. The new costs will be incurred by:

- taking on cases previously dealt with by the Commission (the OFT estimates 5 to 10 new cases per annum);
- preparing guidance for the new regime; and
- participating in the network of competition authorities.

**Option C – partial alignment**

7.3 Additional costs for this option depend on degree of alignment. The scope for dispute is likely to be particularly significant if maximum financial penalties are not aligned and costs to OFT would be as described above in paragraph 7.1. A decision to align penalties but not repeal RTPA would have a lesser effect as only a minority of mostly innocuous agreements are affected by repeal.

## 8. RESULTS OF CONSULTATION WITH BUSINESS

8.1 Following the publication of both the Commission's 1999 White Paper, and the draft Regulation on 27th September 2000, the DTI consulted a wide range of key stakeholders (legal practitioners, consumers' organisations, the top 50 UK companies and the Joint Working Party of the Law Society and the Bar).

8.2 Broadly speaking, all supported the goals of reducing bureaucracy and focusing more on serious infringements of competition law but some consultees expressed concern about:

- How companies will obtain the legal certainty they require on co-operation agreements, particularly for larger transactions;
- How companies will avoid multiple litigation without a single exemption decision valid across the EU that was provided by the notification system;
- The interface between the Commission and the national courts; and
- How consistency in the decisions of the courts of 15 Member States could be ensured.

8.3 Most respondents and several professional industry bodies supported greater involvement of national authorities and courts in the enforcement of the competition rules, as they would be closer to the markets concerned. They also felt that the application of common rules would help to foster a common competition culture across the Community. Legal practitioners felt that detailed guidance and the provision of uniform procedural rules by the Commission would be essential to the success of the new regime. Some respondents also stressed the value of continued access to Commission officials for guidance.

8.4 UK business expressed its support for the Single Market benefits of having a level playing field in EC competition rules. It was concerned about the potential lessening of legal certainty for businesses under the new legal exception regime, but accepted that the commitment of the Commission to allow companies to seek written opinions from the Commission when a case involves novel or unresolved points of law will contribute to legal certainty for business. UK business has also been supportive of a strict requirement for the exclusive application of EC law in antitrust cases that affect trade between Member States, which they feel would contribute to the consistent application of Community competition law and would enhance legal certainty by ensuring that there would be only one applicable law for cross-border cases. No response was received from the representatives of small business in the UK.

8.5 In developing policy on alignment of the two systems within the UK post-modernisation, DTI has sought views informally from the CBI, representatives of small business, the National Consumer Council and several legal practitioners including the Joint Working Party of the Law Society and the Bar.

8.6 During 2003 DTI has also conducted two formal consultations:
" Modernisation – a consultation on the Government's proposals for giving effect to Regulation 1/2003 and for re-alignment of the Competition Act 1998" ('the first consultation') and "Modernisation – a consultation on the Government's proposals for exclusions and exemptions from the Competition Act 1998 in light of Regulation 1/2003" ('the second consultation').

8.7 Almost all respondents to the first consultation were in favour of removing the domestic notification system thereby creating a legal exception regime. They were similarly in favour of the UK NCAs operating a non-statutory system of written opinions in cases that raise genuine uncertainty because they present novel or unresolved questions of law under the Competition Act or Articles 81 and 82.

8.8 The overwhelming majority of respondents to the consultation favoured the proposals to change the existing powers to enter domestic premises (to require a warrant in every case) and to give the OFT an express power to seal during inspections concerned with both Articles 81 and 82 and the Competition Act.

8.9 All respondents who expressed a view were in favour of the extension of section 38(9) of the Competition Act[52] to also apply when the OFT is considering breaches of Articles 81 and 82 to prevent double jeopardy. Respondents were also in favour of aligning the maximum penalties for breaches of Articles 81 and 82 and Chapter I and II with the maximum penalties.[53] Several concerns were raised about the calculation of a penalty – in particular that the starting point for the NCA's calculation of a penalty should remain the relevant market. The OFT will consult on its guidance on the appropriate penalty. Subject to that consultation, the OFT proposes that the starting point will have regard to the seriousness of the infringement and the relevant turnover of the undertaking.

8.10 Most respondents were in favour of NCAs adopting the formal practice of accepting binding commitments, and thought that binding commitments should operate in a similar manner to the approach adopted by the European Commission. They were also overwhelmingly in favour of making binding commitments enforceable by court order. The views of respondents were however mixed on the question of whether rights of redress should be afforded to third parties, and it was only after much further discussion with OFT and the CAT that it was decided to introduce a third party right of review to the CAT.

8.11 There was wide support amongst respondents for OFT to have the power to be able to order interim measures directions in relation to investigations under Articles 81 and 82 in the same way as it currently does under section 35 of the Competition Act, and that these directions should be enforceable by court order.

8.12 Responses to several of the proposals in the second consultation, on exclusions and exemptions from the Competition Act, were clearly in favour. All respondents who expressed a view were in favour of the proposal to remove the power in section 7 of the Competition Act to introduce opposition procedures into Block Exemption Orders. There was similar unanimity in favour of the proposal to repeal the provisions of the Environment Act that allow for the creation of a separate competition scrutiny regime for the Producer Responsibility Schemes and for the

[52] Section 38(9) provides that "If a penalty or a fine has been imposed by the Commission, or by a court or other body in another Member State, in respect of an agreement or conduct, the Director, an appeal tribunal or the appropriate court must take that penalty or fine into account when setting the amount of a penalty under this Part in relation to that agreement or conduct".

[53] 10% of an undertaking's worldwide turnover for the previous business year available to the Commission for breaches of Articles 81 and 82.

exclusion of such schemes from the Competition Act. Respondents who expressed a view were also overwhelmingly in favour of the proposal to repeal the separate competition scrutiny regime for statutory audit services and the consequential exclusion from the Competition Act.

8.13 Responses to the proposal to remove the Verticals exclusion were more diverse – 42% were in favour, 14% were mixed and 44% were opposed. Those opposed to repeal argued that it was not required by the Regulation, that the Verticals exclusion had only been introduced recently, that the claw-back provisions were sufficient to address any competition concerns and that the Government knew the shape of the BER at the time the Verticals exclusion was introduced and chose not to follow it. Concerns were expressed that the terms of the BER were more difficult to understand and that it contained provisions that could not be successfully applied in the context of domestic competition law.

8.14 Those supporting repeal argued that it was preferable to reduce as far as possible the substantive and procedural differences between the Competition Act and EC competition law and that the proposal to remove the Verticals exclusion was consistent with that aim. One respondent argued that there was no justification to retain such blanket exclusion for vertical agreements, that vertical restraints were a prominent feature of certain markets where competition concerns had arisen and that the claw-back had proved inadequate to ensure that potentially anti-competitive agreements would be scrutinised. Several respondents identified specific problems which repeal of the Verticals exclusion would help to resolve whilst others thought that the proposal had limited impact on businesses that were already competing fairly.

8.15 The proposal to remove the RTPA exclusion received a mixed response. Of those who responded, more were opposed to the proposal (58%) than were in favour (38%). Respondents who were opposed to repeal argued that it was not necessary as OFT had already done a competition assessment of the agreements under the RTPA and business could legitimately expect that the agreements given clearance were competition compliant. Also the provisions withdrawing the benefit if the registered agreement is materially varied and enabling NCAs to claw back the benefit of the exclusion if there are competition concerns were sufficient to ensure competition compliance. Respondents were also concerned about exposure to civil actions and the costs of reviewing agreements.

8.16 Respondents in favour of repeal argued that the relevance of the RTPA exclusion was, in any case, diminishing over time and that there was no case for maintaining distinctive arrangements for a minority of historic agreements. These respondents argued that since the vast majority of these agreements had no appreciable effect on competition, the removal of the exclusion would have limited effect in practical terms.

8.17 Informal consultation on the proposals to remove some of the domestic exclusions from the Competition Act has been undertaken with other Government departments and the OFT and with selected businesses and trade associations. Our policy position has been reached in agreement with these departments.

**Previous consultation on the treatment of vertical agreements**

8.18 In 1999, the DTI consulted representatives of businesses, lawyers and trade associations on the draft Verticals exclusion. At this point the final shape of the EC block exemption was unknown and the UK opted to put its own exclusion in place to cover the gap between the Competition Act coming into force and the coming into force of the BER[54], to avoid precautionary notifications of large numbers of essentially benign agreements. However, many of the respondents to the consultation suggested that it was sensible to align closely with the European regime, and the current proposal reflects this.

8.19 In 2001, the proposal to repeal the Verticals exclusion was put forward in the "Productivity and Enterprise" white paper[55]. Slightly less than half the respondents to the White paper commented on the proposal. Of those that did (30), responses were almost evenly split between those endorsing removal and those opposing it. One concern that was raised was that OFT would be flooded with notifications of vertical agreements if the exclusion were removed. This is now of limited relevance in light of the support for the proposal in the first consultation to remove the domestic notification regime.

8.20 In considering these previous responses it is important to note that the Competition Act has now been in force for more than 3 years and few notifications have been made to OFT. Businesses have a better understanding of how the regime works and are much better placed to decide whether their agreements are lawful or not. OFT has been seen to operate in a proportionate manner. Regulation 1/2003 changes the position by transferring powers to apply EC law from the Commission to our domestic competition authorities. This is a key reason for seeking to eliminate as many differences in scope and application of the EC system as possible.

8.21 Informal consultation on the proposals to remove some of the domestic exclusions from the Competition Act has been undertaken with other Government departments and the OFT and with selected businesses and trade associations. Our policy position has been reached in agreement with these departments.

## 9. SUMMARY & RECOMMENDATIONS

9.1 The Regulation will benefit UK business overall and strengthen the Single Market. Decentralising enforcement of EU competition rules and focussing it on serious infringements, providing a common competition standard for industrial co-operation across the EU, and reducing bureaucracy on enforcers and on business, will contribute to more effective competition in the Single Market.

9.2 Aligning the Competition Act to produce, as far as possible, a single set of procedures and sanctions irrespective of legal base will benefit business by creating greater consistency and clarity. It will reduce the risks of dispute and ensure greater compliance with the principles of competition law than now. It will also ensure efficient and effective enforcement by NCAs against the most serious infringements, resulting in a reduction in economic detriment. Benign agreements and commercial

[54] March 2000 and June 2000 respectively
[55] "Productivity and Enterprise – A World Class Competition Regime" Cm5233. Available on-line at www.dti.gov.uk/ccp/topics2/ukcompref.htm

behaviour from those businesses that compete fairly will become lawful at inception without a direction from the competition authorities.

**Summary of Benefits and Costs**

| | **Benefits** | **Policy Costs** | **Implementation Costs** | **Other Costs** |
|---|---|---|---|---|
| **The Regulation** | Improvement in competition enforcement leading to reduction in consumer detriment (cost of cartels operating solely in UK is £160m. per annum).<br>Stronger competition leads ultimately to lower prices, more choice and higher quality goods and services for consumers<br>Standard approach to commercial agreements across Europe<br>Agreements lawful at outset without prior notification.<br>£660,000 to £2.2m. saved per annum by removal of notifications although partially offset by increased costs of self-assessment of agreements | No policy costs – Regulation is deregulatory in effect and no policy costs associated with measures to implement | Mainly staff training on changes to new regime<br>Burden mainly falls on legal firms and in-house lawyers who are generally engaged in programmes on continuous professional development. Costs to business relatively small (c.£1m - £2m.) | NCAs will incur minor costs related to staff training, taking on cases previously dealt with by the Commission, preparing guidance for the new regime and participating in the network of European Competition authorities<br><br>Costs of this will be offset by savings of alignment Option B |
| | **Benefits** | **Policy Costs** | **Implementation Costs** | **Other Costs** |
| **Option A – No alignment** | No change from current system under the Competition Act with which business is already familiar. | No savings from notifications and agreements not certain of validity without | Limited implementation costs as businesses must already consider their agreements under EC law. | OFT estimates its costs to be £2.9m. to £7.5 m. in the first year . These could be higher if OFT |

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|---|---|---|---|---|
| | | notification. Total cost to business currently £695,000 - £1.62m. but costs expected to increase if notifications made for purposes of seeking clarity under EC law.<br>Risk of dispute (20 – 30 cases initially) could cost c£11.25 million in first year, declining as case-law builds up<br>No savings from OFT exercising claw-back on Verticals or RTPA exclusions. Not clear if this will occur but costs to business could be £50,000 per case. | Costs arising from need for business to understand interaction between two systems of law. Burden of staff training will fall mainly on legal firms and in-house lawyers who are generally engaged in continuous professional development. Costs as above for the Regulation. | must pay costs following OFT losing an appeal and higher again if a case were appealed to the High Court (£145,000 - £225,000 per case). |
| **Option B - Alignment** | One set of rules to follow – simpler system<br>Lower compliance burden on business overall<br>Less scope for dispute over whether correct law applied<br>Agreements legal without prior notification – deregulatory in effect<br>Removing notifications results | No direct policy costs – alignment ensures NCAs can act consistently under both EC and UK law. Lower compliance burden on business from unitary system | Repeal of Verticals exclusion estimated at £3,000 - £10,000 for a single agreement. It's not possible to estimate how many vertical agreements are likely to be affected, nor is it accurate to extrapolate that the transitional cost would be this estimate | No significant increase in enforcement costs as additional costs offset by savings resulting from end of notifications system. |

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|---|---|---|---|---|
| | in savings to business of £1m. or less | | multiplied by the number of agreements affected.<br>Overall costs to the newspaper and magazine industries estimated at between £2.1m and £7.3m (not taking into account whether any agreements will come up for renewal before 1 May 2005).<br>Repeal of RTPA exclusion estimated at £700,000 - £1.4m. (but could be in range of £617,000 - £1.7m.)<br>Repeal of regime for Statutory Audit estimated at between £24,000 and £80,000 assuming bodies review agreements | |
| **Option C – Partial Alignment** | Few – business will be required to understand some changes but not others<br>If notifications is retained in Competition Act, business will be able to notify<br><br>If Verticals or RTPA exclusions retained businesses with agreements covered by the | Depends which elements are not aligned. No savings from notifications and agreements not certain of validity without notification. Total cost to business currently £695,000 - £1.62m. but costs expected to | Again depends on which elements are not aligned. Limited implementation costs unless exclusions not aligned.<br><br>Costs arising from need for business to understand interaction between two systems of law as above. | NCA costs also dependent on which elements are not aligned. Failure to align maximum financial penalties in particular could generate dispute. OFT estimates its costs to be £2.9m. to £7.5 m. in the first year . These |

| | | | | |
|---|---|---|---|---|
| | exclusions will retain the protection of exclusion under the Competition Act. | increase if notifications made for purposes of seeking clarity under EC law.<br>Risk of dispute (20 – 30 cases initially) could cost c£11.25 million in first year, declining as case-law builds up (especially if penalties not aligned)<br>No savings from OFT exercising claw-back on Verticals or RTPA exclusions. Not clear if this will occur but costs to business could be £50,000 per case. | Costs of repeal of Verticals, RTPA and Statutory Audit exclusions as above. | could be higher if OFT must pay costs following OFT losing an appeal and higher again if a case were appealed to the High Court (£145,000 - £225,000 per case).<br>Failure to align exclusions may also cause dispute but less critical as only a minority of agreements affected by repeal. |

## 10. ENFORCEMENT, SANCTIONS AND REVIEW

10.1 The Regulation obliges national competition authorities to apply Articles 81 and 82 and empowers national courts to hear Articles 81 and 82 cases. Therefore enforcement of the new regime in the UK will fall to the NCAs and national courts as well as the Commission and Community courts. However, the Regulation leaves it to national law to determine the appropriate sanctions for Article 81 or 82 infringements. In light of our consultation responses we are introducing a maximum penalty which is the same as that currently available to the Commission.

10.2 The Regulation includes a requirement for the Commission to report to the European Parliament and the Council on the functioning of the regulation five years after it comes into force (i.e. on 1st May 2009). The emphasis of the report will be on how well the Commission's power to initiate proceedings relates to the use by NCAs of their powers to apply Articles 81 and 82[56], and on the functioning of the Commission's power to investigate sectors of the economy and types of agreements[57]. Based on the report the Commission will decide whether it would be appropriate to propose revisions of the Regulation to the Council.

10.3 The UK Competition Act has been reviewed in the course of both this work and the development of the Enterprise Act. It will also be subject to a review in the second half of 2007, three years after this statutory instrument implementing modernisation comes into force.

[56] Regulation, Article 11(6)
[57] Regulation, Article 17