



Guidelines for market investigations: Their role, procedures, assessment and remedies

April 2013



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Introduction

1. Market investigations were introduced by the Enterprise Act 2002 (the Act). In June 2003, the Competition Commission (CC) published *CC3, Market Investigation References: Competition Commission Guidelines* as one of the series of documents which it is required to publish under section 171(3) of the Act. Since the inception of the regime the CC has learnt much from its practical experience of conducting cases, and has progressively refined its policies, practices and procedures. These Guidelines distil the lessons the CC has absorbed since the introduction of the new regime and replace the 2003 version.
2. The Guidelines are in four parts, plus two annexes:
 - [Part 1](#) outlines the nature of competition and sets market investigations within the context of the overall regime for the promotion of competition within the UK. It describes how references are made to the CC and the statutory questions the terms of reference put to the CC.
 - [Part 2](#) provides guidance on the way the CC gathers evidence and the range and depth of its analysis, and outlines the processes and procedures the CC typically follows in conducting a market investigation and, if necessary, implementing remedies.
 - [Part 3](#) addresses the three issues the CC looks at in applying the AEC test:
 - the characteristics of the market and the outcomes of competition within it;
 - the definition of the market; and
 - the state of competition in the market; specifically, whether there are any features harming competition.
 - [Part 4](#) discusses the remedial action the CC may prescribe, if it has found there to be an AEC; this may include divestiture, behavioural remedies or recommendations for action by Government or other agencies.
 - Annexes:
 - A: Market characteristics and outcomes:
 1. Measuring market shares and concentration.
 2. Measuring profitability.
 - B: Remedial action.
3. The types of markets referred to the CC vary widely, making it impossible to cover in these Guidelines all issues and aspects that might be encountered during investigations. The CC's assessment of markets has inevitably to be case-specific. The Guidelines cannot therefore be applied in a rigid and mechanistic way. While the CC will always have regard to these Guidelines in conducting market investigations, it will apply them flexibly and may sometimes depart from them, explaining its reasons for doing so, if it considers that the particular circumstances of the case (including the information available and the time constraints applicable) justify doing so. Past case

references are included in the Guidelines for illustrative purposes only and do not constrain the CC's approach.

4. The Guidelines reflect the views of the CC and the competition regime in place at the time of publication. However, markets, economic theory, the legal background and best practice may develop and these Guidelines may be revised from time to time to reflect such developments.

Enterprise and regulatory reform

5. The enactment of reforms along the lines proposed in the Enterprise and Regulatory Reform Bill, introduced into Parliament on 23 May 2012, will have a significant impact on the structure of the competition regime, especially by transferring functions of the CC and the Office of Fair Trading (OFT) to a new body, the Competition and Markets Authority (CMA).
6. The prospective legislation, as introduced in parliament, would bring some changes to the market investigation regime. The CMA could be asked to investigate issues that affect different markets ('cross-market practices') and the Secretary of State would be able to ask it to consider defined public interest considerations during market investigations by the CMA. Some changes are also contemplated to the CC's remedy powers. The time limits for investigations would be tightened, with a proposed time limit of 18 months for investigations (with the possibility of a six-month extension) and statutory time limits for remedies implementation (see paragraph 89). In due course, these Guidelines will be updated to reflect these legislative changes.

A brief note on terminology

7. All references to statute, unless otherwise stated, relate to the Enterprise Act 2002—referred to throughout as 'the Act'—and all references to 'section(s)', unless otherwise specified, relate to the Act. The term 'referring body' refers to the body making the reference (see paragraph 22).
8. Several terms used in the context of market investigations are 'terms of art', having specific and limited, rather than literal, meanings: notably, 'theory of harm' (see paragraph 163), 'relevant market' (see paragraph 26), 'efficiencies' (see paragraph 174) and 'a well-functioning market' (see paragraphs 30 and 320).
9. Throughout this publication also:
 - unless otherwise specified, the term 'price' is used as shorthand for all aspects of a supplier's competitive offer; a change in price should be read as incorporating any comparable change in any element of the competitive offer;
 - the term 'customers' includes 'consumers';¹
 - the term 'products' is used to apply to goods and/or services;
 - 'market participants' are sellers, buyers and intermediaries, such as distributors, agents and platforms in multi-sided markets;

¹ See [section 183\(1\)](#).

- the term ‘market power’ is used to denote the ability of a firm to influence aspects of competition (see paragraphs 178 to 204: unilateral market power); there are gradations of market power, with many firms having limited or transitory market power but only some having ‘significant market power’ which endures over time and gives them the ability to maintain prices above the competitive level, or restrict output or quality below competitive levels, without the consequent loss of sales becoming unprofitable; and
- the phrase ‘to harm’ competition is often used in the Guidelines as shorthand for the statutory language of ‘prevents, restricts or distorts’ competition.

Part 1: The promotion of competition in the UK

10. Competition is a process of rivalry as firms seek to win customers’ business. It creates incentives for firms to meet the existing and future needs of customers as effectively and efficiently as possible—by cutting prices, increasing output, improving quality or variety, or introducing new and better products, often through innovation; supplying the products customers want rewards firms with a greater share of sales. Beneficial effects may also come from expansion by efficient firms and the entry into the market of new firms with innovative products, processes and business models, and the exit of less successful ones.
11. In some instances firms compete for a market, rather than in a market, for example, by competing to be the first to claim a patent in a key area, the first to achieve scale in a new market, or to win a public procurement contract or franchise to supply a public service.
12. Vigorous competition between firms also fosters economic growth, as firms respond to competitive pressure by striving for efficiency and directing their resources to customers’ priorities. Customers have an important part to play in stimulating rivalry between suppliers by making informed decisions which reward those firms that best satisfy their needs or preferences. Markets work best when both the supply side (the firms) and the demand side (the customers) interact effectively.

Threats to competition

13. There are many different ways—and combinations of ways—competition may be impeded in a market. Some instances are given in the following two paragraphs.
14. One or more firms may exhibit significant market power² when the market is highly concentrated, potentially adversely affecting not only price, cost and profits levels but also competition in the more dynamic sense of innovation and product development. There may be barriers to entry and expansion of various kinds, giving incumbent firms an advantage over potential market entrants as a result of, for example, scale economies, technological expertise, a strong customer network or regulatory requirements.
15. Other ways in which competition can be threatened include: rival firms may adopt, in some cases only tacitly, a coordinated approach to the market; vertical relationships among firms may enable them to foreclose markets or customers to rival firms, or otherwise to exert a dampening effect on competition; and customers may lack

² See paragraph 9.

information about what product to choose, may not be able to judge between different products on offer or may be locked into one supplier and unable to switch to another.

Responding to the threats to competition

16. Regulators, competition authorities and governments have an important role to play in making sure competition is as effective as possible. They do so in various ways. Sometimes the Government may intervene directly in specific markets with this aim (for example, in the programme of liberalizing public utilities in the 1980s and 1990s). The merger control regime limits the ability of firms to avoid competing with their rivals by gaining control of them. Economic regulation of certain sectors involves measures to assist customers to make informed choices and to encourage new entry and investment, promoting the emergence of competition in markets where it has been historically weak. Regulators can also intervene directly to prevent or mitigate the harmful effects of a lack of competition in the short term.
17. Legal prohibitions play a particularly important role in limiting the extent to which firms are able to restrict competition between them or win customers in non-competitive ways. Specifically, the prohibitions under the Treaty on the Functioning of the European Union (TFEU)³ and the Competition Act 1998 (CA98)⁴ are designed to prevent and penalize collusive conduct among rival firms or abusive practices by a dominant firm.⁵ Enforcement of these prohibitions falls, not to the CC, but to the European Commission and the OFT together with certain ('concurrent') sectoral regulators,⁶ respectively.

The market investigation regime

18. The CC's market investigation regime sits within the broad spectrum of competition law, operating alongside other regulatory mechanisms, including prohibitions (see paragraph 17), by allowing the competition authorities the opportunity to assess whether competition in a market is working effectively, where it is desirable to focus on the functioning of the market as a whole rather than on a single aspect of it or the conduct of particular firms within it. A market investigation may examine any competition problem and identify the feature causing the problem. It aims only to see

³ Articles 101(1) and 102.

⁴ See The Chapter I Prohibition (OFT401) and Chapter II Prohibition (OFT402).

⁵ The relationship between Articles 101 and 102 TFEU and national competition law is provided for in Article 3 of Council Regulation 1/2003/EC. Under Article 1 of that regulation, where national competition authorities apply national competition law to agreements, decisions by associations of undertakings or concerted practices within the meaning of Article 101(1) which may affect trade between member states or to any abuse prohibited by Article 102 they shall also apply Article 101 or 102 respectively. Under Article 2 the application of national competition law may not lead to the prohibition of agreements, decisions by associations of undertakings or concerted practices which may affect trade between member states but which are not prohibited under Article 101(1) or which fulfil the conditions of Article 101(3) or are covered by an EC block exemption, although they may prohibit or sanction unilateral conduct engaged in by undertakings which is not prohibited by Article 102. Article 3 of the regulation provides that, without prejudice to the general principles and other provisions of Community law, Articles 1 and 2 do not preclude the application of provisions of national law that predominantly pursue an objective different from that pursued by Articles 101 and 102. In the context of a market investigation these provisions do not affect the exercise by the CC of its powers of investigation, but may be relevant at the remedies stage (ie the CC would have to consider whether it was limited or prevented from taking remedial action). If during the course of its investigation the CC uncovered a potential breach of Article 101(1), it would consider whether that matter should be referred to the authorities responsible for enforcing Article 101 but would also expect to continue with its investigation and then take the application of Regulation 1 into account when determining whether to take remedial action and if so, what action to take. If the CC found evidence suggesting a breach of Article 102 it would normally continue its investigation and, when appropriate, implement remedies under the Act. The OFT would then be able to take such action into account when carrying out any Article 102 investigation it considered appropriate.

⁶ The following bodies have concurrent powers with the OFT in designated areas to apply and enforce CA98 and Articles 101 and 102 of the TFEU: Office of Communications (Ofcom) (communications); Water Services Regulation Authority (Ofwat) (water and sewerage in England and Wales); Office of Rail Regulation (ORR) (railways); Gas and Electricity Markets Authority (Ofgem) (gas and electricity); Northern Ireland Authority for Utility Regulation (NIAUR) (gas and electricity in Northern Ireland); Civil Aviation Authority (CAA) (air traffic services); and Monitor (healthcare services in England).

if competition within the particular market under review is working well or can be improved and is not seeking to establish general rules and obligations for firms.

19. Its overarching framework allows the investigation to tackle adverse effects on competition (AECs) from any source. As well as being able to look into the conduct of firms, the CC can probe for other causes of possible AECs, such as structural aspects of the market (including barriers to entry and expansion) or the conduct of customers. However, the focus of an investigation is always on competition. There may be other problems in the market—for example, ‘externalities’, such as air or water pollution, the cost or benefit of which is not transmitted through prices—which fall outside the ambit of a market investigation.
20. Having established a competition problem, and identified its causes, the CC is able to impose a wide range of legally enforceable remedies that typically focus on making the market more competitive in the future and make recommendations for remedial action by other public bodies.
21. The identification of anticompetitive features in a market investigation or the imposition of remedies does not mean that market participants⁷ have infringed the law. The process is investigative and inquisitorial, not accusatorial. To be required to give evidence in a market investigation or be subject to remedial action following an investigation does not imply that market participants are suspected of wrongdoing.

The making of references to the CC

22. The CC does not select markets for investigation. The referring bodies—the OFT, a sector regulator⁸ or, exceptionally, a Minister⁹—make market investigation references to the CC when they have reasonable grounds for suspecting that a feature or combination of features of a market in the UK is preventing, restricting or distorting competition.¹⁰ However, once a reference is received, the CC proceeds wholly independently of the referring body; a CC market investigation casts a ‘fresh pair of eyes’ able to look more deeply at new evidence and analysis of the market. Regardless of the views of the referring body, it may conclude that there are no adverse effects in the market.
23. Before a case reaches the CC the referring body will have looked into the market in question, either on its own initiative or in response to a complaint, which may include a ‘super-complaint’ from certain designated consumer bodies.¹¹ The Act¹² allows the OFT to study markets that appear not to be working well for customers. There is no statutory definition of a ‘market study’ but it was envisaged from the inception of the Act that the OFT should use market studies as a way to promote competition. The Enterprise White Paper *A World Class Competition Regime* (July 2001) said that the OFT ‘should scrutinize markets to assess whether strong competition pressures are

⁷ See paragraph 9.

⁸ The powers of the concurrent regulators (see footnote 6) apply also to the making of market investigation references under [section 131](#) of the Act.

⁹ [Section 132](#). Ministers have the ability to make market references as a reserve power; in addition to applying the same criteria set out in the Act for the making of a reference by the OFT or other referring body, a minister must either be ‘not satisfied’ with an OFT decision not to make a reference or, having brought information to the attention of the OFT, will decide whether to make a reference in the period that the minister considers is reasonable. As at the date of publication of these Guidelines, this power had never been used.

¹⁰ As at the time of publication of these Guidelines, the OFT had been responsible for 13 of the 15 references made since the Act came into force.

¹¹ [Section 11](#) of the Act allows a consumer body (acting collectively on behalf of consumers), that has been designated by Ministers, to make a ‘super-complaint’ to the OFT about features of a market that appear to be significantly harming the interests of consumers. See: www.of.gov.uk/advice_and_resources/resource_base/super-complaints/ and www.of.gov.uk/advice_and_resources/resource_base/market-studies/.

¹² [Section 5](#).

at work ... in some cases ... it will need to refer the market to the Competition Commission for further study'. The other sectoral regulators having powers concurrently with the OFT (see paragraph 22) can also study markets coming within their purview. Where a market study suggests that a market is not working well, the referring body has several options open to it. It may recommend legislation, or actions by customers; it may proceed to investigate any suspected breaches of consumer protection legislation or the competition law prohibitions; and/or, where it has reasonable grounds for suspecting there are features which prevent, restrict or harm competition, make a market investigation reference. (But the referring body may also accept undertakings in lieu of making a reference if appropriate undertakings are offered.) Where a market study leads to a reference to the CC, it thus serves as the first phase in a two-phase investigation process.

24. When faced with a choice on how to deal with a perceived competition problem, the approach the OFT or sectoral regulator takes will depend on many factors, some of which may suggest that a market investigation reference is the appropriate course:¹³
- A market investigation might be preferred when, for example, the facts and issues underlying a perceived competition problem are complex and other forms of intervention by the Government or regulatory body might have to be too tightly focused to benefit the overall operation of the market.
 - The range of remedies available under the market investigation regime can also make a market investigation a more appropriate instrument than relying on the system of prohibitions (see paragraph 17). Prohibitions on using market power to exploit customers or exclude rivals, or on coordinating with the few rivals that remain, may not be sufficient to address issues in a market whose characteristics and structure limit the ability or incentive of firms to compete effectively. There are markets, for example, in which the root cause of a problem lies within the regulatory framework; or it may lie within the way the market operates, with weak competition resulting, for example, from network effects,¹⁴ customer inertia or imperfect information flows between market participants.

Public interest issues

25. Although market investigation references are generally only concerned with competition issues, in the first four months after a reference has been made, the Act allows ministers to ask the CC to consider the implications of its competition analysis for any public interest consideration Parliament may identify in the case. Correspondingly, in those four months, the CC is under a duty to bring to the attention of the Secretary of State any case that it believes raises a public interest consideration specified in the Act.¹⁵ (But it has not done so in any case before the issue of these Guidelines.) Substantial changes to the framework for the consideration of public interest issues are included in the Enterprise and Regulatory Bill currently (March 2013) before Parliament (see paragraph 6).

Terms of reference and the statutory questions

26. In its terms of reference (ToR) for the CC investigation, the referring body describes the goods or services in the UK that the CC is to investigate. The ToR will indicate

¹³ For further details see OFT511, www.of.gov.uk/shared_of/business_leaflets/enterprise_act/oft511.pdf.

¹⁴ See paragraph 179.

¹⁵ Section 152(2).

the sources (the feature or features, see paragraph 28) the referring body suspects are giving rise to an AEC (see paragraphs 19 and 29). When making the reference, the referring body may also require the CC to confine its investigation to either the supply or the acquisition of the goods or services described in the ToR, in particular by reference to the place where the goods and services are supplied or acquired or the persons by or to whom they are supplied or acquired or by or from whom they are acquired.¹⁶ The ‘relevant market’ is defined in the Act to mean the market for the goods or services described in the ToR given to the CC for investigation.¹⁷ The market definition(s) used by the CC (see paragraphs 130 to 153) need not always correspond with the ‘relevant market(s)’ as used in the Act.¹⁸ It will also be for the CC to reach its own conclusions on whether or not there is any AEC.

27. The Act enables the ToR to be varied, either at the instigation of the referring body, after consultation with the CC, or at the request of the CC. In principle this could be to widen or narrow the scope of the investigation while it is in progress,¹⁹ although it would be likely to raise procedural and timing issues. A variation would not affect the statutory timetable.

An AEC

28. The CC is required to decide ‘whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of goods or services in the United Kingdom or a part of the United Kingdom’.²⁰
29. If that proves to be the case, under the Act this constitutes an AEC (see paragraphs 19 and 26).²¹ The CC interprets the phrase ‘prevents, restricts or distorts’ in the Act broadly to cover any adverse effect on competition, whether actual or potential. It will therefore consider features that affect potential competition in a market (for example, by preventing entry and expansion) as well as those that affect the existing market situation.
30. The Act does not specify a theoretical benchmark against which to measure an AEC. In its market investigation reports the CC uses the term ‘a well-functioning market’ in the sense, generally, of a market without the features causing the AEC, rather than to denote an idealized, perfectly competitive market. The criteria the CC applies in coming to a view on the existence of an AEC are discussed in paragraphs 319 and 320, below.

Features

31. The Act states that the following may be taken to be a ‘feature’ of a market:²²
- (a) the structure of the market concerned or any aspect of that structure;

¹⁶ Section 133.

¹⁷ Section 134(3). An alternative description could be ‘reference market’.

¹⁸ In these Guidelines, ‘relevant market’ is used in two contexts: first, when referring to the statutory test, it has the meaning as defined in section 134(3) (see footnote 17); secondly, when referring to market definition, the relevant market is the market defined by the CC (an alternative description of which could be ‘economic market’).

¹⁹ The ToR in March 2004 for the investigation of (a) store card credit and related services to retailers, and (b) consumer credit through store cards were, for example, varied in March the following year to include insurance services, related to store cards, for retailers, and insurance for consumer credit associated with store cards (see *Store cards market investigation*, 7 March 2006).

²⁰ Section 134(1).

²¹ Section 134(2).

²² Section 131(2).

- (b) any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or
 - (c) any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.
32. How the CC identifies features that prevent, restrict or distort competition is described in paragraphs 155 to 162.

Remedial action

33. Where the CC decides that there is an AEC, it is required to decide additional questions relating to remedial action, which are set out in paragraph 325.

Part 2: The conduct of a market investigation

34. This part of the Guidelines begins by outlining the ways the CC gathers evidence and the range and depth of the analysis it conducts (paragraphs 35 to 41). A second section outlines the processes and procedures typically followed in the conduct of market investigations and in the implementation of remedies (paragraphs 42 to 93); the latter section discusses: (A) statutory obligations and rules for Inquiry Groups; (B) the appointment of Inquiry Groups and staff; (C) overarching procedural issues; and (D) the main stages of an investigation.

1. The gathering and analysis of evidence

35. In collecting and analysing evidence on the way the market under investigation operates, the CC will particularly try to assemble evidence on the impact possible features have on the market's operation.

Range of analysis

36. The CC only carries out analysis that it considers necessary so as to reach a decision on the statutory questions. As the CC scrutinizes evidence, it will prioritize the uses of its resources to undertake as wide and as deep analyses as appropriate.²³
37. The CC's analysis covers all relevant aspects of competition. It often assesses the ability or incentives firms have to offer better prices or terms to customers and to strive for efficiency, better ways of operating and improved products.
38. Whatever forms competition takes, the CC considers its effects and expected development over time. Although there may be circumstances in which analysis can be conducted only on the basis of the current state of the market, the CC always considers how a market may evolve. The prospect of gaining a lasting advantage over rivals can be a spur to competition, and the CC may in some circumstances

²³ The need for the CC to focus on the bigger issues in reaching a decision on the statutory questions has been underlined in Competition Appeal Tribunal (CAT) judgments: in *Barclays Bank plc v Competition Commission* (2009), CAT 27 (paragraph 21); citing *Tesco v Competition Commission* (2009), CAT 6 (paragraph 139), the CAT wrote: 'the depth and sophistication called for in relation to any particular relevant aspect of the inquiry needs to be tailored to the importance or gravity of the issue within the general context of the Commission's task.' This proposition was labelled 'double proportionality' in the CAT judgments.

consider assessing the effectiveness of competition for the market as well as, or rather than, within the market (see paragraph 11).

Qualitative and quantitative analysis

39. The CC applies a range of analytical techniques, both qualitative and quantitative, so as to understand the nature of competition in the market under investigation as well as the impact of any features. The CC will seek data and information about a range of factors, including the pricing and quality of goods and services supplied in the market under investigation. It often commissions surveys, normally on customer behaviour and attitudes, at an early stage of an investigation (see paragraph 67). It will use various other means of collecting evidence, including questionnaires to parties, requests for internal company documents (including management information), and discussions with customers, investors and other market participants. (See paragraphs 63 to 69 on the procedures for information-gathering).
40. Parties may also choose to provide the CC with any information they consider relevant to the investigation. When making submissions involving technical economic analysis, parties should adhere to the principles set out in the CC's publication *Suggested best practice for submissions of technical economic analysis from parties to the Competition Commission*.²⁴ A joint CC/OFT good practice guide for parties wishing to submit evidence based on consumer surveys in merger inquiries²⁵ is also relevant to market investigations.
41. The extent to which the CC will seek to quantify particular effects (eg on the adverse effects on competition or the effects of remedies)—and the degree of precision with which this is attempted—is likely to vary from case to case. Relevant considerations in determining the extent and nature of quantification that the CC will carry out in a particular case may include:
- (a) The scale of any particular effect: if it is clear from an initial assessment that a particular effect is unlikely to be material, it may not be necessary to quantify its magnitude with great precision to reach a view about the scale of any harm to competition. Similarly, when it considers that the harm is material, the CC may decide that quantification would not add value to its assessment.
 - (b) The practicality of conducting quantitative analysis: whether reliable data is available and the extent to which it is possible to quantify a particular effect with any degree of accuracy. (In general, it is likely to be more straightforward to estimate the effects on prices in the shorter term than to quantify the longer-term effects on dynamic and non-price competition.)
 - (c) The resource implications: the costs in terms of time and resources to acquire and process the data, to apply a suitable methodology and to test the robustness of the results would not be justified if the outcome would not significantly help the CC to reach a decision on the statutory questions.

2. Processes and procedures

42. The procedures the CC follows in market investigations have been developed to fulfil and balance different demands. It is imperative that investigations are concluded

²⁴ Suggested best practice for submissions of technical economic analysis from parties to the CC, www.competition-commission.org.uk/rep_pub/corporate_documents/corporate_policies/best_practice.pdf.

²⁵ www.competition-commission.org.uk/assets/competitioncommission/docs/2011/consultations/good_practice_guide.pdf.

within the statutory time limit, and the time and resources of both the CC and the parties must consequently be used efficiently. At the same time, the CC recognizes that market investigations can result in significant interventions in markets and that its investigations must not only be thorough and disciplined but also fair. The requirement for fairness includes giving the parties opportunities to understand the CC's analysis affecting them; the CC accordingly aims to be open and transparent in its work.²⁶

43. The following sections:
- A. outline the statutory obligations and rules with which Inquiry Groups must comply (paragraphs 44 and 45);
 - B. explain how Inquiry Groups and staff teams are appointed (paragraphs 46 to 49);
 - C. discuss some of the overarching procedural issues in conducting a market investigation (paragraphs 50 to 61); and
 - D. provide a guide to the main stages in a typical investigation (paragraphs 62 to 93).

A. Statutory obligations and rules for Inquiry Groups

44. The CC has a statutory duty to consult on its proposed decisions on the AEC test and the remedy questions when it considers a decision likely to have a substantial impact on any parties' interests.²⁷ The Chairman of the CC is also required to issue Rules of Procedure for market reference Inquiry Groups. The current Rules of Procedure²⁸ are published on the CC website and may be revised from time to time. The Rules include requiring Inquiry Groups to:
- (a) draw up and notify the parties of the administrative timetable for each investigation (and to prepare a revised timetable if required);
 - (b) decide the forms of hearings (public or private, joint or individual) and who should attend them;
 - (c) notify the main parties of their provisional findings on the statutory questions (on the AEC issue) and allow them at least 21 days to comment on the provisional findings; and
 - (d) notify main parties of actions which may be taken to remedy the AEC and give the parties the chance to make representations about the Inquiry Group's proposed actions.

²⁶ As explained in *CC7 (Revised), Chairman's Guidance on Disclosure of Information in Merger Inquiries, Market Investigations and Reviews of Undertakings and Orders accepted or made under the Enterprise Act 2002 and Fair Trading Act 1973* (April 2013), an important aim of transparency is to ensure that 'by having a better understanding of the CC's analysis affecting them, the main parties in inquiries are treated fairly' (paragraph 2.2(a)).

²⁷ Section 169 of the Act.

²⁸ *CC1, Competition Commission Rules of Procedure*, 2006:
www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/rules_and_guide/pdf/cc1.pdf.

45. Subject to complying with the Rules of Procedure, and having regard to any guidance issued by the CC Chairman, Inquiry Groups are free to decide how they conduct a market investigation.²⁹

B. Appointment of Inquiry Groups and staff

46. Market investigations are performed by Inquiry Groups of independent CC members³⁰ (commonly between four and six), normally chaired by the Chairman of the CC or by one of the Deputy Chairmen.³¹ An Inquiry Group conducting an investigation provides its strategic direction, weighs the evidence and considers the arguments from parties, both received in writing and given orally, and directs and assesses the analysis produced by the staff team. It makes the final decisions on whether or not there are features of a market that give rise to an AEC and if so on the remedies to be applied.

Appointment of Inquiry Groups

47. As soon as practical after receiving the reference, the CC Chairman identifies and appoints an Inquiry Group. The composition of the Inquiry Group and biographical details of its members are sent to parties and published on the CC inquiry webpage. The appointment of the Inquiry Group is made for the duration of the investigation, up to the point at which the reference is 'finally determined.'³²
48. Before deciding to appoint a member to a particular Inquiry Group, the CC will consider whether there might be a risk that a member's outside interests could affect, or could be perceived as affecting, the impartiality of the CC.³³ In some cases the CC may inform parties of specific interests and give them the opportunity to comment before deciding whether to make a proposed appointment. Relevant outside interests of appointed members are disclosed on the CC website. In addition, the CC may take action to deal with any relevant and significant changes in members' interests that may arise during the course of the investigation.³⁴

Staff team

49. Each Inquiry Group is supported by a staff team. The team is led by an Inquiry Director and includes both inquiry management and specialist staff. The inquiry management team is responsible for the day-to-day running of the investigation; the key point of contact at the CC for the parties is likely to be the Inquiry Manager. The specialist staff provide advice to the Inquiry Group in their areas of expertise

²⁹ CA98, Schedule 7, paragraph 19 (see paragraph 17 above).

³⁰ A pool of members—currently (March 2013) around 40—is appointed by the Department for Business, Innovation and Skills (BIS) for eight years, following open competition. Members are selected for their experience, ability and diversity of skills in competition economics, law, finance and industry. All except the CC Chairman and Deputy Chairmen work part-time for the CC.

³¹ Occasionally, a member who is neither the Chairman nor one of the Deputy Chairmen will be asked to chair an Inquiry Group conducting a market investigation.

³² Generally a reference is finally determined, as defined in [section 183\(3\)-\(6\)](#) of the Act, when the final report is published or, if remedial action is to be taken by the CC, when the remedies are implemented (ie either by the making of an Order or acceptance of Final Undertakings). Paragraph 17 of Schedule 7 to CA98 provides that the CC Chairman may appoint replacements to the Inquiry Group if necessary. Members may be reappointed to deal with matters arising from the reference following final determination, for example to consider any ongoing remedy implementation or post-litigation issues (see paragraph 91).

³³ See guidance on outside interests on the CC website: www.competition-commission.org.uk/our_peop/members/conflicts_interest/110407_Conflicts_guidance_for_publication.pdf. The guidance categorizes the most common interests that could put the CC's impartiality at risk as: financial interests, organizational relationships, personal relationships and prejudgement.

³⁴ If at any time during an investigation it appears to the Chairman that, because of a particular interest of a member, it is inappropriate for him or her to remain in the Inquiry Group, the Chairman may appoint a replacement. CA98, Schedule 7, paragraph 17(1)(c).

(including economics, law, business and finance). They conduct the analysis on the substantive issues that arise during the investigation and develop remedies where needed. The staff team may sometimes be supplemented by academic specialists or other advisers.

C. Overarching procedural issues

50. The following paragraphs provide an overview of the procedures for a market investigation. In practice some detailed aspects of the procedures used in a particular case may vary from those set out below. This is inevitable because no two market investigations are alike in all respects. The sectors under investigation can range in size from small, highly specialized industries to large-scale multi-faceted markets. Some references can encompass both upstream and downstream markets.³⁵ Moreover, the numbers of parties with an interest in the investigation may vary from a few to several hundred.

Managing investigations with a large number of parties

51. All providers of the goods or services in a market under investigation are potentially main parties to an investigation. However, the degree of each party's engagement with the CC may vary, particularly where there are substantial numbers of main parties. The CC may need more information and evidence from some than from others. Some firms may choose to engage more with the CC than others. Differences in communication by the CC with different main parties may consequently reflect the different levels of party engagement.
52. In addition, there will be parties which are not providers of the goods or services in the market but which may be materially affected by the investigation (including super-complainants,³⁶ customers and consumer groups, upstream suppliers, and trade and professional bodies). Levels of engagement with these parties will also vary. For example, the CC may seek information from some of them, while others may volunteer information and views to the CC.
53. The CC makes extensive use in market investigations of its website to communicate or to make disclosures, enabling any number of parties to follow the progress of an investigation (as far as possible the CC alerts parties when relevant material is posted). While the detail of its processes might vary, the CC will ensure that its procedures are fair and give parties the opportunity to participate appropriately in an investigation.

Timescales

54. The Act requires the CC to publish its report on a market investigation within two years of the reference.³⁷ However, while its largest and most complex investigations will take two years, the CC aims to complete a 'standard' investigation within 18 months.
55. The timescales for the different stages of a market investigation cannot be exactly prescribed. The following timetable illustrates the progressive stages of procedures for an 18-month investigation. But in practice, some of the stages may overlap and

³⁵ An upstream firm provides raw materials or manufactures inputs for processing and/or distribution by a downstream firm.

³⁶ See paragraph 23.

³⁷ The timings envisaged for investigations by the CMA (see paragraphs 5 and 6) will be shortened to 18 months (with a possible six-month extension in special circumstances).

on occasions developments in the investigation, for example a revision of the provisional findings and a consequent need for additional consultations, will require adjustments to the timings and procedures.

Stage of process	18-month process
Reference	Pre-reference sharing of appropriate information with the CC by the referring body
'First day letter'/initial information requests Publication of initial issues statement (setting out theories of harm) Initial submissions from main and third parties	Months 1–2
Site visits	Month 3
Publication of relevant working papers Publication of annotated issues statement Hearings with parties Final deadline for all parties' responses before provisional findings	Months 5–9
Publication of provisional findings Publication of remedies notice (if relevant)	Months 11–12
Consideration of responses to provisional findings and consultation on remedies (if needed). Response hearings with parties	Months 13–15
Publication of provisional decision on remedies (if needed) Final deadline for all parties' responses before final report	Month 16
Publication of final report	Month 18

56. The CC draws up and publishes an administrative timetable at an early stage in the investigation. A draft is first sent to main parties for comment.³⁸ The administrative timetable is updated as necessary during the investigation.

Information provision and disclosure

57. While the time taken to conclude a market investigation depends on several factors, including the complexity of the investigation and the number of parties involved, a key factor is timely provision of information. The CC aims to be fair and reasonable in its requests for information and the deadlines it sets for parties to respond to such requests. It expects parties to meet the timescales set. The CC is empowered to require information and the attendance of witnesses.³⁹ It will use its mandatory powers if necessary to ensure that its information requests are answered completely and in a timely fashion. The provision of false or misleading information to the CC is

³⁸ Rule 6.4 provides that the administrative timetable should be produced having regard to the views of the main parties (CC1).

³⁹ Section 109 of the Act, which applies to market investigations by virtue of section 176 of the Act. For further details see CC5, *Statement of Policy on Penalties, June 2003*.

a criminal offence, regardless of whether that information has been provided voluntarily or in response to a statutory notice.⁴⁰

58. In pursuing its aim to conduct investigations in a fair and transparent manner, the CC discloses its key documents, mainly by publishing them (in particular an issues statement, an annotated issues statement, provisional findings, Notice of possible remedies—if needed, provisional decision on remedies—if needed, and final report). Typically, it also publishes a large amount of other documentation, for example non-confidential versions of key submissions from parties, including their submissions on the issues statement and responses to other publications, key submissions of third parties, hearing summaries, survey reports and some working papers.
59. The Act provides for the protection of confidential information relating to individuals and businesses.⁴¹ But the CC may disclose information under certain circumstances and having taken into account the considerations specified in the Act.⁴²
60. Where issues arise as to the confidentiality of some information in the CC's possession that underlies a decision or a piece of analysis, but the CC nevertheless considers that disclosure of some sort is necessary to allow a party to comment on it, the CC may decide on some form of limited disclosure.⁴³
61. For further details on the statutory provisions relating to the information obtained during the course of an investigation and to its disclosure, see the Chairman's guidance to Groups and Chairman's guidance on disclosure.⁴⁴

D. The main stages of an investigation

62. The following paragraphs describe the main stages of a market investigation and outline the key interactions which the CC has with parties and their advisers in the course of a typical investigation.⁴⁵ This procedural guidance is not intended to be binding and may be adapted to take account of the particular circumstances of an investigation, in which case parties will be notified of the reasons for departures from usual procedures.

Information-gathering

63. The CC begins preparatory work on an investigation on a contingency basis shortly before the formal reference arrives. It identifies any relevant information that is publicly available and makes use of any market or company information that can be shared by the referring body⁴⁶ so as to avoid duplication of effort by the parties or the authorities between the first phase (typically a market study by the OFT or other

⁴⁰ Section 180 of the Act deals with the provision of false or misleading information and the commission of offences by bodies corporate. Section 125 states that offences of bodies corporate may be an offence of the secretary, director or other officer of the body corporate.

⁴¹ Part 9 of the Act, in particular section 245, provides that a person commits an offence if he or she discloses or uses specified information unless in the circumstances permitted by the Act or the information is already in the public domain in the circumstances described by section 237(3).

⁴² Section 244.

⁴³ For example, to enable disclosure of some data used in its analysis, the CC might set up a data room in which the parties' economic advisers can review it. Rules relating to access, use and non-disclosure are applied and participants are required to sign undertakings that they will comply with the restrictions.

⁴⁴ CC7 (Revised) and CC6, *Chairman's Guidance to Groups*, March 2006, paragraphs 19–26.

⁴⁵ On possible variations in the timing and content of procedures see paragraph 55.

⁴⁶ Section 170 of the Act stipulates that the referring body provide the CC with: (a) such information in its possession as the CC might reasonably require; (b) any other assistance which the CC may reasonably require to carry out its investigation and which the body has the power to give, and; (c) information in its possession which, although not requested by the CC, is appropriate for the referring body to give the CC to assist it in carrying out its functions.

referring body⁴⁷) and the second-phase market investigation. (But, as noted in paragraph 22, the CC's decisions are reached wholly independently of the referring body.)

64. Once the reference has been received, the CC formally launches its investigation with a 'first day letter' from the CC Chairman to key main parties. The letter includes information on the terms of the reference, the statutory deadline for the CC's report, relevant guidance material, the key CC staff working on the investigation, and the next steps to be taken. (Subsequently the CC, having consulted the key main parties, prepares the administrative timetable, see paragraph 56). The first day letter also takes forward the information-gathering process by requesting specified initial factual and financial information.
65. At an early stage, informal meetings are held between the staff team and selected main parties (and, where relevant, with other parties such as the super-complainant).⁴⁸ Such meetings usually cover the procedures to be adopted for the conduct of the investigation, and often seek information and views on the market. In addition, the CC holds 'data meetings' with appropriate main parties to discuss the organization and availability of technical data. (There may be subsequent staff meetings as the investigation progresses—see, for example, paragraph 73.)
66. A detailed market and financial questionnaire is next sent to the main parties; and, in many cases, other information is collected from a wider range of parties. The information-gathering will be informed by the developing 'theories of harm' (see paragraph 163). When practicable, parties are consulted on questionnaires to facilitate efficient collection of useful and consistent information, whilst as far as possible minimizing the burden to business.
67. The CC may decide to conduct one or more surveys as part of the information-gathering process (see also paragraph 39).⁴⁹ If the decision is taken to conduct a survey, relevant parties are consulted on the draft survey design and content. In some cases, so as to construct the sample for questioning, parties may be required to provide contact details for some or all of their customers or suppliers.
68. In many cases, the CC organizes early site visits to several parties. These are designed to be helpful to both the CC and the parties involved. A site visit offers a chance for the Inquiry Group members and staff to gain a greater understanding of the party's business by visiting key facilities and meeting key operational staff. A party receiving a site visit is encouraged to organize a short presentation, and take some questions, on its business so as to explain its nature and the market context in which it is operating.

Issues statement

69. An issues statement is released by the CC at an early stage in the investigation process. This generally discusses the theories of harm framing the analysis the CC intends to pursue (see paragraph 163). Parties are invited to provide submissions commenting on the issues set out in the statement.

⁴⁷ See paragraph 23.

⁴⁸ See paragraphs 23 & 52.

⁴⁹ The survey results will usually be disclosed through publication (accompanied by an explanation of the methodology) but there may be instances when it is inappropriate to publish the whole report. The Inquiry Group will consider whether other information relating to the survey should be disclosed, for example cross-tabulations of the survey results.

Assessment

70. Using the information gathered and the theories of harm postulated the competition assessment gets under way. The issues addressed will be diverse, covering the many aspects raised by the investigation: for example, background on the market, the operation of the market or the performance of parties, market definition and assessments of the relevant competition issues set out in the issues statement.
71. The staff and the Inquiry Group work together on these issues, and many internal working papers are typically prepared on the various aspects of the investigation. Generally, internal communications are not disclosable.
72. The Inquiry Group's developed analysis is included in the provisional findings (see paragraph 81). However, the Inquiry Group will disclose its developing approach and analysis before publication of provisional findings:
- (a) Ahead of the main party hearings (see paragraph 77), it will disclose (normally by publishing) an annotated issues statement. This gives an overview of the Inquiry Group's current thinking with reference to the theories of harm and its analysis to date. (In this way, the theories of harm the CC may then be considering (paragraph 168) will be communicated to the parties.)
 - (b) An additional means of conveying the Inquiry Group's developing approach and analysis is to disclose some of the working papers, or parts of working papers (see paragraph 71), often through publication.⁵⁰
73. On occasions, specific pieces of technical analysis merit discussion between a party and the CC on the methodology used and, possibly, the results found. The CC arranges meetings with one or more parties for this purpose. These are generally attended by CC staff (together, on occasion, with members of the Inquiry Group), the party and its technical advisers.
74. The administrative timetable will include a deadline for the receipt of all parties' responses and submissions for consideration by the Inquiry Group in forming its provisional findings.

Put-back

75. The CC may also send ('put back') text to parties for the purpose of enabling them to:
- (a) verify the factual correctness of certain content (usually information supplied by them); and
 - (b) identify any confidential material, prior to publication; parties are asked to provide reasons for any requests for excisions of the material from published documents.
76. The put-back process is separate from disclosure of the CC's developing thinking (see paragraphs 72 and 73).

⁵⁰ See [CC7 \(Revised\)](#), paragraphs 7.1–7.3. Disclosed working papers provide a snapshot of the issues, analysis and views that are relevant at the time of disclosure and may change.

Hearings

77. The Inquiry Group holds a round of formal private hearings with parties (or a selection of them) ahead of the publication of its provisional findings. The primary purpose of these hearings is to enable the CC to test the evidence and explore key issues with the parties. They also provide an opportunity for the parties to explain their views in person directly to the decision-makers as their thinking is developing. The CC aims to ensure that hearings are held with as wide a range of parties as possible. However, decisions on which main and third parties to invite to hearings, and the sequencing of any hearings, rest with the CC.
78. Parties are given an opportunity to make brief opening and/or closing statements, and should expect to respond to the CC's questions. A transcript of the hearing will be taken and will be sent to the relevant party for checking (the transcript will not be published). Additionally, staff-led hearings (sometimes via teleconferencing) are conducted with some parties not attending hearings with the Inquiry Group, including some main parties when there are large numbers of them. Some members of the Inquiry Group may also participate. Transcripts or written notes are taken and sent to the relevant party for checking.
79. A summary of the key points raised at a hearing is normally prepared by the CC, and the party is given the opportunity to comment on both content and confidentiality before the summary is published. The party is also invited to follow up in correspondence any issue raised during the hearing.

Provisional findings and the Notice of possible remedies

80. CC staff will start to gather information on possible remedies and identify relevant remedy options after the basis of a possible AEC has been identified. However, the investigation of possible remedies will remain hypothetical until a decision regarding a provisional AEC finding has been made, at which point the Inquiry Group will consider possible remedy options.
81. When the Inquiry Group has provisionally formed a view on whether or not there are features of the market(s) that give rise to an AEC, its provisional findings will be published and a public consultation on them will be held. The Rules (paragraphs 44 to 45) state that the time allowed for the consultation will be no less than 21 days and the CC applies some flexibility in setting reasonable deadlines case by case in light of the relevant circumstances.
82. If an AEC has provisionally been found, the CC will publish, in addition to its provisional findings, a Notice of possible remedies (the Notice). The Notice will contain details of remedies the CC has identified as possibly addressing the AEC effectively, and will provide a starting point for a discussion of remedies with the relevant parties to the investigation, including main parties, customers, competitors, any sectoral regulator and the OFT. The Notice may also outline details of remedies the CC considers unlikely to be effective and the reasons why it has reached this provisional view, as well as inviting parties to put forward any other remedy options that they wish the CC to consider. Normally, the CC will publish the Notice on the same date as its provisional findings and will set a deadline of no less than 21 days for responses, which may coincide with the deadline for responses to the provisional findings.

Response hearings and the provisional decision on remedies

83. Where the CC provisionally finds that there is an AEC, response hearings will take place with main parties and potentially with key third parties. At a response hearing, parties will be given the opportunity to comment orally on the provisional findings and the CC may seek clarification of particular points made in written submissions or at the hearing. However, much of the discussion will focus on possible remedies and/or relevant customer benefits (RCBs) (see paragraphs 355 to 357). Transcripts, or alternatively Notes, of response hearings will be taken and, in most cases, summaries prepared and both will be processed in a similar way to those relating to hearings held earlier in the investigation (see paragraphs 77 to 79).
84. Having considered the responses from parties, the CC will notify its provisional decision on remedies, normally through publication on its website, for comment before reaching its final decision. The CC will normally allow a period of at least 21 days for parties to respond to its provisional decision on remedies.
85. Separately, a deadline will have been set in the administrative timetable for the receipt of all parties' responses and submissions for consideration by the Inquiry Group ahead of reaching its final decision.

Final report

86. The CC will publish its final decision on the competition question and (if necessary) remedies together with supporting reasons and information in a final report.⁵¹ The report will, if it confirms the finding of an AEC, contain sufficient detail on the nature and scope of remedies to provide a firm basis for subsequent implementation of remedies by the CC.
87. Parties may, during the two months following the release of the CC's findings, lodge an appeal with the CAT against the decisions. If a judgment of the CAT upholds an aspect of an appeal, this could lead to the investigation or a part of it being remitted to the CC for reconsideration.⁵² (Appeals against CAT judgments can, if allowed, go forward to the Court of Appeal or, in Scotland, the Court of Session and, ultimately, to the Supreme Court.)

Implementation of remedies

88. Following publication of the final report, if the CC has determined to take action itself, the CC has the choice of implementing remedies by accepting undertakings from the relevant parties and/or by making an order (see paragraphs 92 and 93 for a discussion of the considerations relevant to this choice).
89. The CC will publish an administrative timetable for the implementation of those remedies where it has decided to take action itself. For straightforward remedies, the CC expects to make an order or accept undertakings within around six months of publication of its final report. The implementation of more complex remedies may take longer, though the CC expects to make an order or accept undertakings within ten

⁵¹ [Section 136](#).

⁵² Following appeals against CC decisions, the CAT ordered the CC to reconsider parts of the remedies packages in the final reports on [Groceries](#) (April 2008) and [Payment Protection Insurance \(PPI\)](#) (January 2009). These aspects were, respectively, the competition test applied to grocery retail planning applications and the inclusion of a prohibition of the issuing of PPI at the point of sale.

months from publication of its final report, other than in exceptional circumstances.⁵³ The CC consults all parties affected by the remedies in determining the required undertakings or order. This includes a period of formal public consultation.⁵⁴

90. The action the CC takes in implementing remedies must be consistent with the decisions in the final report unless there has been a material change of circumstances since the preparation of the report or the CC has a special reason for acting differently.⁵⁵
91. An Inquiry Group will normally be disbanded following its acceptance of Final Undertakings or the imposition of an order to implement remedies. Responsibility for overseeing any further implementation activity that falls to the CC, such as the implementation of any divestiture remedy, falls to either the CC's Remedies Standing Group or to a specifically-appointed Group. A Group specifically appointed to oversee further implementation activity may include some or all members of the original Inquiry Group (see footnote 32). The identity of the Group charged with this activity is determined in light of factors such as the availability and expertise of members, the type of remedy to be implemented and the extent to which implementation is expected to be resource- and/or time-intensive. If all remedies are being implemented by means of recommendations to other bodies, the Inquiry Group originally appointed is normally disbanded following publication of the final report. The OFT is normally responsible for monitoring and enforcement of behavioural remedies⁵⁶ following acceptance of undertakings or the imposition of an order by the CC. Compliance with undertakings or an order is enforceable in the courts.⁵⁷

Undertakings and Orders

92. The CC's decision whether to implement remedies by means of accepting undertakings or making an order is determined case by case, primarily by practical issues including the number of parties concerned, and their willingness to negotiate and agree undertakings. Another consideration is the scope of the CC's order-making powers and whether the remedy it is considering falls within those powers.
93. The content of any orders made by the CC is limited by the Act.⁵⁸ In contrast, the subject matter of an undertaking is not similarly limited.⁵⁹ This, and the process involved in agreeing undertakings, can help the CC and the parties, in terms of flexibility and suitability, in implementing remedies. However, because market investigations are likely to be market-wide rather than focused on the conduct of one firm, it may be more practical to implement remedies by order rather than through undertakings, so as to avoid the likely delay and complexity of negotiating

⁵³ The period envisaged for the implementation of remedies by the CMA (see paragraph 5) is limited to six months, with the possibility of a four-month extension.

⁵⁴ As specified in [Schedule 10](#) to the Act.

⁵⁵ [Section 138](#). For example, following the Court of Appeal's judgment on 13 October 2010 to reinstate the CC's findings on the [BAA airports](#) investigation (March 2009), the CC invited representations from all interested parties as to whether there had been any developments since the publication of the CC's report which constituted a material change of circumstances or a special reason within the scope of [section 138\(3\)](#) of the Act, to the extent that it should amend the remedy package set out in the report, for example the timing of proposed airport divestitures. In its decision of July 2011, the CC found that while the change in government policy on building new runway capacity in south-east England represented a significant change of circumstances, it did not remove the scope for, and the need for, competition between airports in south-east England as claimed by BAA. Consequently, the CC did not change its decision on the appropriate remedy.

⁵⁶ [Section 162](#).

⁵⁷ If a person fails to comply with any undertakings that it has given or any order imposed on it by the CC, compliance may be enforced by means of civil proceedings brought by the OFT or the CC ([section 167](#)). In addition to enforcement by the OFT or the CC, any person affected by the contravention of undertakings or an order who has sustained resulting loss or damage may also bring an action against the relevant party.

⁵⁸ [Schedule 8](#) sets out the types of provisions that could be included in an order and Part 1 of [Schedule 9](#) enables the CC to modify, by order, licence conditions in various regulated markets.

⁵⁹ [Section 164\(1\)](#).

undertakings with several parties.⁶⁰ In regulated sectors, if the CC decides to modify licence conditions to give effect to, or take account of, any provision of a proposed remedy, it will make an order.⁶¹

Part 3: The AEC test

94. In assessing whether or not an AEC has arisen the CC looks at three basic issues:
- (a) the main characteristics of the market and the outcomes of the competitive process;
 - (b) the composition of the relevant market⁶² within which competition may be harmed (market definition); and
 - (c) the features, if any, which are harming competition in the relevant market (the competitive assessment—which the CC frames using ‘theories of harm’), considering also possible countervailing factors, such as efficiencies, which may remove or mitigate the competitive harm of the features.
95. Analyses of these issues are not conducted as distinct chronological stages of the investigation but as overlapping and continuous pieces of work, which often feed into each other. For example, the CC may take an initial view about the scope of the relevant market but the competitive assessment may suggest that this initial view of the market was either too broad or too narrow. Evaluation of outcomes continues throughout the investigation.
96. Part 3, Sections 1 to 3, below, deal with each of these issues in turn, and are followed by a short section on the conclusion of the AEC test.

Part 3: Section 1—Market characteristics and outcomes

97. To develop robust findings on whether or not features in a market are harming competition, the CC needs to understand how a market operates and reach a view about its performance. A part of its investigation is therefore the collection and analysis of information about the main characteristics of the market referred and the outcomes of the competitive process within that market. The CC’s evaluation of characteristics and outcomes goes on throughout an investigation and continuously informs its assessment of what might be causing any adverse effects in the market.

Market characteristics

98. Reviewing evidence and observations on the main characteristics of the markets that it investigates helps the CC to frame the analysis of market definition and competitive effects, as well as to assess the practicability of remedy options, should an AEC be found.

⁶⁰ For example, in *Home Credit* and *PPI*, the remedies applied to a large number of parties and this was a reason for implementing these measures by means of an order. By contrast, in *Classified Directories*, the remedies applied to only one party and undertakings were preferred. In other cases (eg *Groceries*, *Rolling Stock Leasing market (ROSCOs)*), some measures were implemented by means of an order, while others were implemented through undertakings.

⁶¹ The CC has the power to make such changes by Order through the amendments made to sector specific legislation by Part 1 of [Schedule 9](#) to the Act.

⁶² The term ‘relevant market’ is used throughout these Guidelines in two contexts, see paragraph 26.

99. Any assessment of the working of competition usually begins with an overview of market structure and the possible implications of this structure for the conduct of the firms within the market. The CC studies the profiles and performances of the suppliers (or, where relevant, acquirers) of the goods or services referred for investigation.

Market share data

100. The CC calculates the market shares of the suppliers of the reference products (and sometimes other measures of market concentration), if possible over several years, using the methodologies set out in Annex A (The measurement of: market shares and concentration; profitability).
101. The calculation of market concentration measures can provide background data for the assessment of the levels of firms' market power (see paragraphs 9, 14 and 186 to 195)⁶³ and may be relevant for the assessment of other sources of potential competitive harm, for example coordinated conduct. In many cases, the weight the CC places in its competitive assessment on market concentration measures will be influenced by its ability to define with confidence the boundaries of that market (see paragraph 195) so as to ensure that these are neither too narrow nor too wide (paragraph 137). However, there are some measures of market concentration, such as the Logit Competition Index (LOCI), which can be used, if relevant information is available, without relying on establishing market boundaries (see Annex A, paragraph 8).

Other background market characteristics

102. The other market characteristics most relevant to the CC's investigation will vary from case to case. However, the CC normally looks at the following:
- (a) The nature and characteristics of the products or services included in the terms of reference and of any potential substitutes for these products.
 - (b) The nature of the customer base—for example, whether customers are businesses or final consumers, the extent of customer segmentation in a market, the demographic profile of the customer base or, where relevant, the extent to which they are informed about the products in the market subject to investigation.
 - (c) The legal and regulatory framework that applies to the reference market. Laws and regulations can determine the nature of competition within a market and may also be relevant to the CC's consideration of remedies.
 - (d) Industry practices, for example the way in which products are sold and how prices are set and communicated to customers.
 - (e) The history of the market, including recent competitive developments such as any recent examples of entry, expansion or exit and any significant changes that are anticipated in the market in the foreseeable future.

⁶³ Examples of investigations in which the CC found that high concentration was a feature of the market that prevented, limited or distorted competition are given in paragraph 157.

Market outcomes

103. Outcomes of the competitive process in their different forms in a market—eg prices and profitability, levels of innovation, product range and quality—can also provide evidence about its functioning. Evaluating these outcomes helps the CC determine whether there is an AEC and, if so, the extent to which customers may be harmed by it, ie the degree and nature of ‘customer detriment’. This can be an important factor in any later consideration of possible remedies.
104. Prices and costs are among the more observable and measurable outcomes and an analysis of these may be useful in quantifying the extent and nature of competition and can be helpful in measuring customer detriment. However, the other, less-quantifiable factors, such as quality and innovation, are no less important to customers.
105. Although the outcomes of the competitive process may differ in character, there may be linkages between them, and the CC does not therefore consider each in isolation. The extent to which prices respond to changes in costs and the question of whether those costs are at an efficient level, for example, may have implications for a firm’s profitability, and the level of investment may have implications for efficiency and product or service quality.
106. The following paragraphs in this section deal in turn with:
 - A. Prices and profitability.
 - B. Quality, innovation and other non-price indicators.

A. Prices and profitability

107. The types of analysis the CC may undertake on prices and profitability depend on the nature of the markets and the theories of harm the CC has postulated (see paragraphs 163 to 169). Four possible types of analysis are considered below: pricing patterns; price cost margins; price comparisons; and profitability.

Price patterns

108. In markets subject to effective competition prices are likely to respond to changing supply and demand conditions and firms will seek to win business by improving their prices and other aspects of their offer. The pattern of prices over time can therefore indicate the nature of competition (see, for example, paragraph 246). However, the CC recognizes that there may be several factors affecting prices and will take this into account when considering inferences from this type of analysis. Taken in conjunction with other evidence and in the absence of other explanatory factors, such as cost increases:
 - (a) static or continually rising prices may indicate a lack of competition; and
 - (b) parallel pricing—ie the practice by a seller of varying prices in a similar way and at about the same time as competitors—may be a symptom of coordinated effects (see paragraphs 249 and 189).
109. The pricing strategies adopted by firms in the market can also be indicative of competitive conditions. For example:

- (a) introductory discounts followed by price increases might indicate high switching costs or customer inertia (see section on weak customer response, paragraphs 295 to 318); and
 - (b) a wide range of prices for similar goods or services might indicate the presence of search costs (see section on weak customer response, paragraphs 295 to 318).
110. Another type of analysis in this category, price concentration studies, looks at the extent to which prices may vary with market concentration. This is relevant to the assessment of unilateral market power (paragraphs 186 to 195). For example, if there were several local geographic markets, higher prices being charged in more concentrated areas may indicate limitations in the competitive process in those areas.⁶⁴ This type of analysis may also examine the relationship between prices, margins and concentration over time.

Price-cost margins

111. The analysis of prices will in many cases be complemented by an analysis of costs, because these may explain price changes over time or differentials between areas. Therefore when analysing patterns of prices over time or geography, the CC may consider price-cost margins. Typically a price-cost margin is calculated by subtracting some measure of marginal cost from revenue and expressing the difference as a percentage of revenue.⁶⁵
112. Price-cost margins can also provide useful information about the effectiveness of competition in the short run (ie for a current range of products), including about the willingness and ability of customers to switch between alternatives. Vigorous competition may be expected to lead firms to price towards marginal cost. The CC may therefore consider the pattern of price-cost margins across geographic markets or customer segments or over time. A pattern of sustained high price-cost margins may, for example, indicate an unwillingness or inability to switch because of, for example, switching costs, search costs, limited customer information or significant product differentiation (see section on 'weak customer response', paragraphs 295 to 318). But the CC interprets price-cost margins with caution: margins may be a misleading indicator in some industries⁶⁶ and in many circumstances a gap between price and marginal cost can be consistent with robust competition.⁶⁷ A fuller analysis of profitability may be required to establish whether prices are on average above the competitive level, as described below.

Price comparisons

113. Comparisons of prices with those of other markets, such as markets for similar products in other countries or in markets for comparable products in the UK, are sometimes made in CC market investigations. Such comparisons can be relevant where market conditions are similar. In the Home Credit investigation (November

⁶⁴ The suitability of this technique will vary on a case by case basis. For examples of where the CC has applied the technique see [The supply of groceries in the UK market investigation](#), 30 April 2008 (paragraphs 4.106–4.113) and [Local bus services market investigation](#), 20 December 2011 (paragraph 7.37). In the latter investigation, an analogous performance concentration study was also undertaken (paragraphs 7.35 & 7.36 and Appendix 7.1).

⁶⁵ Typically, this analysis is feasible only if it is possible accurately to measure price and some version of marginal cost, usually average incremental cost.

⁶⁶ Those in which marginal cost is below average cost and capacity constraints are not binding.

⁶⁷ For example, where there are no entry barriers, fixed costs are present and products are differentiated. Customers might be unwilling to switch between highly differentiated products, but nonetheless competition on the basis of development efforts to introduce new products could be robust.

2006), for example, the CC found that prices in that market were high in comparison with the prices of other credit products and were higher than prices in the Republic of Ireland, where similar products were offered to customers.

Profitability

114. One approach to the question of whether prices are above competitive levels is to consider the profitability of the business activity being investigated. In many cases, the CC's focus will be on the largest incumbent firms in the market or market sector. However, the CC may also consider the profitability of less well established firms with smaller market shares, eg for comparative purposes. Where the business activity being investigated is only one part of the firms' activities, it will be necessary to take this into account.
115. In its analysis the CC is concerned with economic profits and these can differ in important respects from accounting profits. The CC will generally derive the profitability of the relevant business activity by identifying the relevant revenues and costs for that business activity, including an appropriate value for capital employed and an allowance for the cost of capital. More information about the CC's approach to the calculation of profitability is in Annex A (The measurement of profitability).
116. Firms in a competitive market would generally earn no more than a 'normal' rate of profit—the minimum level of profits required to keep the factors of production in their current use in the long run, ie the rate of return on capital employed for a particular business activity would be equal to the opportunity cost of capital for that activity. The profitability of firms representing a substantial part of the market can therefore be a useful indicator of competitive conditions in a market (see paragraphs 118 and 119).
117. In practice, a competitive market would be expected to generate significant variations in profit levels between firms and over time as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of the firms involved. At particular points in time the profitability of some firms may exceed what might be termed the 'normal' level. There could be several reasons, including cyclical factors, transitory price or other marketing initiatives, and some firms earning higher profits as a result of past innovation, or superior efficiency.
118. However, a situation where profitability of firms representing a substantial part of the market has exceeded the cost of capital over a sustained period could be an indication of limitations in the competitive process.
119. The ability to earn profits persistently above the competitive level could indicate the presence of entry barriers (see paragraph 231). A situation where a firm with a large market share has earned profits that have been persistently above the competitive level may indicate significant market power (see paragraph 180). A situation where levels of profitability have remained persistently high and stable over time across several incumbent firms may indicate coordinated conduct (see paragraph 247).
120. The extent to which the results of profitability analysis indicate limitations in the competitive process may depend on both the size of the gap between the level of profitability and the cost of capital and the length of the period over which the gap persists.
121. The appropriate time period over which to examine the persistence of the gap between profitability and the cost of capital may therefore vary according to the specific market. The pattern of investment and the nature of sources of competitive advantage (advertising, research and development (R&D), more efficient production)

may affect the CC's view of the relevant timescales over which it would expect to see competition playing out in the market. Where large and risky investments have been made, the CC would expect to see a normal level of profitability restored over a relatively long timescale.

122. In cases where a persistent gap is not unequivocally substantial, it is particularly important for the CC to consider the analysis in conjunction with other information about the operation and nature of the market concerned.
123. Moreover, as with other forms of analysis, the CC's interpretation of profitability analysis may be affected by the quality of the data available (see section on the gathering and analysis of evidence, paragraphs 35 to 41).
124. The trend in profits will be an important consideration and the CC will seek to understand the reasons for the observed trend. Where the size of the gap between the level of profitability and the cost of capital has grown over a period the competitive situation may have worsened. Where that gap has narrowed competitive conditions may have improved. Where that gap has fluctuated the CC may consider whether, on average for firms representing a substantial part of the market, profits have exceeded the cost of capital.
125. A CC finding of low profitability would not necessarily signify that competition is working well. Low profitability may be concealing ineffective competition. Reasons for this may include:
 - (a) A period of low profitability may occur during the course of a downturn in trading conditions, regardless of the state of competition in the affected market.
 - (b) Weak competition as a result of customers not responding effectively to competing offers may sometimes result in an inefficient market structure in which operators have higher costs and set higher prices than would be the case in a competitive market⁶⁸ (see section on weak customer response, paragraphs 295 to 318).
 - (c) Incumbent firms, despite being protected from new entry, are not earning high profits because they are inefficient and operate with higher costs than would be sustainable with stronger competition in the market (see section on barriers to entry, paragraphs 205 to 236).

In some cases, the CC may be able to compare actual costs with efficient costs when looking at the level of profitability achieved by firms but this may not always be practical.

Indicators—not features

126. In summary, the CC will consider prices and profitability in the context of its overall assessment of the market. While useful, findings that price-cost margins are wide or profitability is high in a market do not on their own provide conclusive evidence that the market could be more competitive. Such findings are not in themselves causes of competitive harm—they are not features of the market for the purpose of the AEC test.

⁶⁸ Hotels near airports, for example, may exhibit a form of monopolistic competition characterized by low entry barriers, in which customers do not compare offers effectively, and hence there are more operators, with excess capacity, charging higher prices than would otherwise be the case. Individual operators may be observed to have normal profitability in this example.

B. Quality, innovation and other non-price indicators

127. As indicated above, prices and costs are not the sole indicators of the level of competition in a market. Poor quality, lack of innovation, or limited product ranges are prominent among other indicators of weak competition in a market. Evidence about this kind of indicator tends to be qualitative, coming particularly from surveys, questionnaires or discussions with customers, investors, or other market observers. In several past market investigations, such analysis has spotlighted various negative non-price factors as important indicators of weak competition.
128. In the investigation into Northern Irish personal banking, the CC chose a range of indicators on which information was readily obtainable and readily comparable and, analysing responses to questionnaires, made a comparison between banks within Northern Ireland and some of the large banks based in Great Britain. This evidence indicated several non-price indicators of a lack of competition between Northern Irish banks in relation to branch opening hours, functionality of Internet banking and product innovation.⁶⁹ In its investigation into PPI, the CC considered evidence it had obtained so as 'to identify: any new PPI policies which had been introduced, whether there had been any innovations within existing policies, the rationale for product change or innovation, and whether, and if so how, distributors advertised and marketed their policies'. The CC concluded that there was less choice (and possibly less innovation), as well as higher prices, 'than would be expected in a well-functioning market'.⁷⁰
129. In its investigation into BAA airports, the CC compared Aberdeen Airport with other regional airports and found slower development of routes; lack of ambition in development; underinvestment and poor facilities. In relation to the South-East of England airports the CC found a lack of responsiveness to the interests of airlines and passengers that would not be expected in a well-functioning market;⁷¹ weaknesses in the approach to planning and consulting on capital expenditure; and deficiencies in the level and quality of service.⁷²

Part 3: Section 2—Market definition

130. A market is a collection of goods and services provided in particular geographic areas (or in some cases to particular groups of customers or at particular times), connected by a process of competition. The process is one in which firms seek to win customers' business over time by improving their portfolios of products and the terms on which these are offered, so as to increase demand for the products (see paragraph 10). The willingness of customers to switch to other products is a driving force of competition. In forming its views on market definition, the CC will therefore consider the degree of demand substitutability. In some markets, supply-side constraints will also be important (see paragraph 134).
131. In considering the substitutability of goods or services or areas of supply set out in the ToR, the CC may (as stated above, paragraph 26) conclude that the market definition goes wider or narrower than those goods and services.

⁶⁹ *Northern Irish personal banking*, 15 May 2007, paragraphs 4.193–4.206.

⁷⁰ *PPI market investigation*, 29 January 2009, paragraphs 4.12 & 9.4. For the concept of a 'well-functioning' market, see paragraph 30 and paragraphs 319 & 320.

⁷¹ See paragraph 30.

⁷² *BAA airports market investigation*, 19 March 2009.

The role and determinants of market definition

132. In defining the relevant market (see paragraph 26), the CC identifies the participating firms and customers and the traded products in the market(s) that are the subject of the reference. This enables the CC to focus on the sources of any market power⁷³ and provides a framework for its assessment of the effects on competition of features of a market (see paragraph 31).⁷⁴
133. Market definition is thus a useful tool, but not an end in itself, and identifying the relevant market involves an element of judgement. The boundaries of the market do not determine the outcome of the CC's competitive assessment of a market in any mechanistic way. The competitive assessment will take into account any relevant constraints from outside the market, segmentation within it, or other ways in which some constraints are more important than others.
134. While the composition of a relevant market is usually determined by the degree of demand substitutability (see paragraph 130), the CC will where relevant include supply-side factors in defining the market. There might, for example, be a possibility that firms supplying non-substitute products have the capabilities and assets to redirect production to goods and services that would be substitutes for those in the market.⁷⁵ (For further detail on substitutability, see paragraphs 198 to 204.) Alternatively, the same firms might compete to supply the non-substitute products under similar conditions of competition; in that case aggregating the supply of these products and analysing it as one market does not affect the competitive assessment (for example, in markets characterized by bidding and tendering processes⁷⁶).
135. The nature of competition in a particular market (and the theories of harm⁷⁷ under consideration) may require that the CC identify more than one market for the same product so as to understand different aspects of competition. For example, in some industries certain aspects of competition are determined at a national level, while others occur at a local level. Looking at how competition operates at both levels, and at how the levels interact, could produce important insights.⁷⁸
136. Substitutability in the short run may, moreover, be different in the longer term. In the short run firms compete on the basis of the products in their existing portfolios and the current geographical footprint of their distribution systems. In assessing short-run competition the CC will therefore usually define markets on the basis of substitutability between existing products and areas. However, in the longer term

⁷³ See paragraph 9.

⁷⁴ Market definition in a market investigation flows from the statutory questions the investigation is required to address (see paragraphs 26–28. Markets defined in answering other statutory questions under other regimes may not necessarily be comparable.

⁷⁵ Manufacturers of fast-moving consumer goods may use their expertise in marketing and product development to compete by expanding their portfolios of products. The CC may therefore identify such a supply-side market when, for example: (a) at least some suppliers supply a range of different products in the same broad category, using the same set of assets and capabilities; or (b) these suppliers regularly introduce new products or reposition existing ones within the category.

⁷⁶ In markets characterized by bidding and tendering processes firms bid on the basis of the service they can offer to supply customers with bespoke products. The competitive constraint on firms in these markets comes from a customer's willingness to award a contract to a rival rather than to switch to a different bespoke product. Aggregating a range of contracts where the same set of firms would have been credible bidders can provide more useful information about the competitive constraints on each firm than is available from focusing on just one bespoke product.

⁷⁷ See paragraph 164.

⁷⁸ See, for example, *Local bus services market investigation*, 7 January 2010, Summary, paragraph 23:

We found that local markets will generally be at the level of particular flows. However, competition between bus operators may occur on a number of different geographic levels including at the level of specific flows, routes or across a wider local area. The appropriate geographic area for the assessment of competition depends on the nature of the constraints faced by local bus operators. Regardless of the precise geographic boundaries of the market, we therefore assessed competition between bus operators at a number of geographic levels, including at the route and depot level. We also used Urban Areas to measure concentration and to consider the constraints of supply-side substitution from different operators.

firms may compete by improving their product portfolios, or extending the geographical scope of their operations. The CC's assessment of this sort of competition may be concerned with identifying groups of firms that have the capability to introduce new or improved substitute products, or open new outlets in a more broadly defined product category or areas.

Assessing substitutability

137. In defining a market it is important to ensure that the pool of products identified as effective substitutes for the relevant product(s) is not unrealistically small. If the market is drawn too narrowly there is a risk that a party is incorrectly viewed as holding significant market power,⁷⁹ whereas in reality that position is undermined by constraints from alternative suppliers that should be included in the market. (Conversely, defining a market too widely carries the risk that market participants, in seeming to be in weaker positions, are inferred to have less market power than they actually enjoy.)
138. The hypothetical monopolist test (HMT) is a tool which can be used to identify effective substitutes and to check that the market is not defined too narrowly. The principle behind it rests on defining a market as a product, or collection of products, a sole supplier of which could hypothetically impose a small but significant non-transitory increase in price (sometimes referred to as the SSNIP test). The test can help to identify the constraints that would prevent a hypothetical monopolist from exercising market power. In practice it may often be used, not quantitatively, but as a conceptual framework.⁸⁰
139. There are some practical difficulties in using the HMT in market investigations. If significant market power is already being exercised, using prevailing prices can lead to defining markets too broadly and possibly to an incorrect inference that significant market power does not exist.⁸¹ In theory, the HMT could be implemented in the presence of significant market power using notional competitive prices, but in many cases it is difficult to assess what those prices would be. There is also a risk that using a notional benchmark in effect assumes the existence of significant market power as part of the framework within which the competitive assessment is being undertaken.⁸²
140. The CC will consider the pros and cons of using the HMT depending on the particular facts and circumstances of the case, including whether the practical difficulties mentioned above can be avoided and how informative its use would be.
141. In practice, the HMT is more likely to be used to check that the market has not been defined too narrowly in cases where the CC's findings include a finding that high concentration is a feature harming competition (see paragraph 195).

Dimensions of the market

142. The different dimensions of the market are discussed in the following sections. These are (as indicated in paragraph 130): the product dimension, the geographic

⁷⁹ Unilateral market power is discussed in paragraphs 178–184.

⁸⁰ In these Guidelines, references to the 'use' of the HMT applies to its use both quantitatively and as a conceptual framework.

⁸¹ This problem is known as the 'Cellophane Fallacy' because it arose in a US Supreme Court case involving cellophane, in which the issue was whether the relevant market was cellophane or all flexible packaging materials.

⁸² Competitive price levels that are clearly below current levels will usually be an indicator of an AEC. Alternatively, the competitive assessment may provide some insight into an appropriate competitive benchmark to feed into the HMT.

dimension, and markets defined with reference to customer group or temporal factors.

Product market

143. The CC may consider the following types of information, where available, when assessing whether products are substitutes:
- (a) Product characteristics, such as physical properties and intended use that can indicate similarities (from the purchaser's perspective) between different products.
 - (b) Relative price levels and the extent to which prices of products within the possible relevant market are correlated with each other, as compared with the prices of products outside that market.
 - (c) Prices and sales volumes over time or across areas that permit analysis of the way that customers respond to changes in prices or to firms entering or leaving the market.
 - (d) Responses from customers, competitors and interested and informed third parties to questions—sometimes posed in surveys—about customer behaviour.
 - (e) Firms' view of the products, drawing on internal documents such as marketing studies, consumer surveys prepared in the normal course of business, market analyses prepared for investors, and internal business analyses (eg board papers, business plans and strategy documents).
144. The existence of a market for secondary products has sometimes to be considered in fixing the dimensions of a market. Secondary (or aftermarket) products are those that are purchased only as a result of the customer having purchased a primary product. An example is the market for printer cartridges, a secondary market linked to the primary market for printers. The CC may sometimes consider primary and secondary products to be in separate markets. However, it may consider the products to be in the same market where customers take into account the cost of the secondary product when purchasing the primary product (see also paragraphs 291 to 293). Whichever of the two definitions is chosen will not determine the outcome of the CC's competitive assessment, since the competitive constraint from other suppliers will be taken into account in either case.⁸³

Geographic market

145. Geographic markets may be based on the location of either suppliers or customers. In the case of the former, the geographic market is an area covering a set of firms or outlets which compete closely because enough customers consider them to be substitutes (as in the case of retail markets and some industrial markets). In the latter case, a geographic market is an aggregation of customers paying individually negotiated prices but enjoying sufficiently similar purchasing options (ie in effect many customers in industrial markets).
146. The geographic market: may be local, regional, national or wider. Imports may be taken into account as well as UK products. Depending on the circumstances of the

⁸³ Other types of markets are described in paragraphs 179 & 193.

case and the theory of harm posited, the CC may examine geographic markets at more than one level in the same investigation, eg at both national and local levels.

147. The key to defining both supplier-based and customer-based geographic markets, as to defining the product market, is the degree of substitutability, ie the extent to which suppliers can switch their areas of supply and the extent to which customers in one area may be served in another area.
148. In the case of supplier-based markets the geographic scope may be described as a set of competing outlets. In identifying these sets the CC may consider the following information on:
- (a) the catchment areas from which the bulk of an outlet's customers is drawn;
 - (b) differences in pricing, sales, advertising and marketing strategies by area;
 - (c) which outlets customers consider to be substitutes for each other; and
 - (d) natural experiments which show the effect on one outlet's sales arising from entry, exit or expansion by other outlets nearby.
149. The CC may consider the following when identifying the boundaries of customer-based markets:
- (a) product characteristics such as perishability;
 - (b) differences in pricing, sales, advertising and marketing strategies by area;
 - (c) information enabling the estimation of switching costs (which can include additional delivery costs) that customers might incur in changing to products currently supplied in other geographic areas, relative to the value of the products and the length of time taken to make the switch; and
 - (d) the flows of goods between regions or into the UK and any barriers to entry, whether legislative, natural or strategically created.

Other issues

Customer groups

150. Many markets serve a diverse customer base, for example suppliers may have both business and personal customers. One set of customers may be more affected than others by any particular feature. Where such diversity exists, and where suppliers can charge different prices to different groups (ie price discriminate), the CC will recognize these differences. In terms of market definition, depending on the market and the evidence presented, the CC may choose either to treat these different groups as separate markets, or as segments within one market, noting the scope for price discrimination between different groups within the market (see also the discussion of the hypothetical monopolist test at paragraph 139).

Temporal dimensions

151. When customers are not able to substitute products between periods, there may be a temporal dimension to the market, for example seasonality, peak and off-peak services. A typical example concerns commuters and leisure travellers on trains.

Commuters constrained by their hours of work have little choice but to travel at ‘peak’ times, during which the train companies charge more than at other times. On the other hand, leisure travellers may be less concerned about the time of travel and more willing to travel at off-peak times and are charged less. In such instances, depending on the circumstances of the case, the CC may decide to define two or more markets, or it may decide to define only one market and note the scope for price discrimination within the market, for instance identifying a market for rail travel with different prices charged to peak and off-peak travellers.

Grouping markets together

152. In some cases, the CC may treat a group of product, geographic or other types of markets together for the purposes of assessing competitive effects. This can be the case where a feature manifests itself in a similar way across several different markets (for example, the need for an operating licence may be an aspect of many local markets) and the CC is able to reach a view about the effects of the feature on competition across the group of markets as a whole. In the investigation into home credit,⁸⁴ for example, the CC was satisfied that the conditions of competition were sufficiently similar to justify a conclusion that applied throughout the reference area, without looking at every geographic area in detail.

Effects outside the relevant market

153. The CC may also consider effects in neighbouring markets, including those which are upstream or downstream of the relevant market (see paragraph 26). For example, one firm’s advantage as a buyer in an input market may protect it from competitive pressures when supplying a downstream market for manufactured goods relying on that input. If the input market has been referred to it, the CC may consider effects in the downstream output market.

Part 3: Section 3—The competitive assessment

154. In deciding whether or not there is an AEC, the CC’s core task—given the statutory questions (paragraphs 28 and 29)—is to assess the effects of possible features on competition. In conducting this assessment, the CC will seek to establish whether or not any of the possible features, or any combination of them, can be expected to harm competition when measured against a theoretical benchmark (see paragraphs 30, 319 and 320). The emphasis on assessing the competitive effects of features means that any AEC finding will be grounded in a clear understanding of why competition in a market may be harmed.

Identifying features that harm competition

155. As noted in paragraph 31, a market feature may be intrinsic to the structure of the market or may arise from the conduct of any market participant (whether supplier, acquirer or customer and whether or not in the reference goods or services market). The Act does not require the CC to state whether particular features of a market are to be considered structural features or an aspect of conduct. Provided the relevant feature falls within at least one of these categories, the categorization is of little practical importance. Since the concept of a feature is broad, the CC has the

⁸⁴ [Home credit market investigation](#), 28 April 2006.

flexibility to investigate a wide range of possible market features, each of which may have effects on the different aspects of competition (see paragraphs 13 to 15). Moreover, how far any feature identified by the CC is along a causal chain resulting in harm to competition may vary (ie some may be directly causing harm and others may be doing so indirectly).

156. It has been emphasized (see paragraph 22) that the CC, on receiving a market investigation, makes no presumption that there are market features that harm competition. A CC investigation may find that there are no such features giving rise to an AEC in the relevant market (as was the case in the investigation into Movies on Pay TV⁸⁵).

Structural features

157. Structural features may include high levels of market concentration, high entry barriers, common ownership of competing facilities and buyer power.⁸⁶ For example, market concentration was identified as a feature harming competition, in the market investigations into classified advertising services⁸⁷ and the supply of groceries by retailers;⁸⁸ high barriers to entry in the cases of the supply of groceries and domestic bulk liquefied petroleum gas (LPG)⁸⁹ and the ROSCOs⁹⁰ investigation; common ownership in the case of BAA airports;⁹¹ and buyer power in the case of the supply of groceries investigation.
158. Specific structural features identified in past investigations to be harming competition include aspects of the planning system, government policy and the regulatory system (in the BAA airports investigation and, with regard to the planning regime, in the grocery retailing market); the criteria applied for the award of franchises (in the ROSCOs market investigation); information asymmetries between incumbents and entrants (in the home credit market investigation);⁹² and a point-of-sale advantage for credit providers selling PPI (in the PPI market investigation).⁹³

Conduct features

159. 'Conduct' of a market participant includes any failure to act, whether intentional or not, and any other unintentional conduct.⁹⁴
160. Conduct features by sellers identified in past investigations as harming competition include: a failure of Northern Irish banks sufficiently to explain their charging structures and practices for personal current accounts;⁹⁵ and the failure of distributors and intermediaries in the market for PPI to try to win customers by setting competitive price or quality levels for their policies.⁹⁶ 'Exclusionary behaviour'—for example, by bus companies deliberately obstructing the services of competitors⁹⁷—also falls within the category of a conduct feature. The conduct of firms which supply

⁸⁵ *Movies on pay TV market investigation*, 2 August 2012.

⁸⁶ Buyer power is the ability of a firm to secure from its supplier(s) prices or other terms in its favour.

⁸⁷ *Classified Directory Advertising Services market investigation*, 21 December 2006.

⁸⁸ *The supply of groceries in the UK market investigation*, 30 April 2008.

⁸⁹ *Market investigation into supply of bulk liquefied petroleum gas for domestic use*, 29 June 2006.

⁹⁰ *ROSCOs market investigation*, 7 April 2009.

⁹¹ *BAA airports market investigation*, 19 March 2009.

⁹² *Home credit market investigation*, 28 April 2006.

⁹³ *PPI market investigation*, 29 January 2009.

⁹⁴ Section 131(2).

⁹⁵ *Northern Irish personal banking*, 15 May 2007.

⁹⁶ *PPI market investigation*, 29 January 2009.

⁹⁷ *Local bus services market investigation*, 7 January 2010, paragraphs 8.263–8.277.

the market when acting in other markets can be a feature of the market. For example, if the market investigation concerned competition to supply a particular manufactured good, the conduct of vertically integrated suppliers in the market for the input might be a conduct feature.

161. The behaviour of customers can also sometimes be a feature limiting competition between firms. (As noted in paragraph 19, market investigations allow the competition authorities to look at customer behaviour and customer vulnerability in relation to their implications for competition, instead of just looking at them as consumer protection issues; see also paragraphs 295 to 318). The insensitivity of customers to measures of price other than the level of weekly repayment was found to be a feature detrimental to competition in the home credit market.⁹⁸ Similarly, the low sensitivities of customers to store card APRs⁹⁹ and late payment charges were identified as features harming competition between store card credit services.¹⁰⁰ A customer behaviour feature—failure to investigate alternative accounts or banks—was also found in the market for personal current accounts in Northern Ireland.¹⁰¹

A combination of features

162. In some circumstances, several features may in combination harm competition. In the PPI investigation,¹⁰² for example, competition was found to be adversely affected by several interconnected features, including barriers to searching and switching, which hindered customers' ability to compare PPI policies or to switch to alternatives, as well as the point-of-sale advantage credit providers enjoyed. Barriers to searching included product complexity, the perception that taking PPI would increase a customer's chances of being given credit, the bundling of PPI with credit and the limited scale of stand-alone provision. Barriers to switching included contract terms which made switching expensive or which risked leaving customers uninsured.

Theories of harm

163. To provide focus and structure to its assessment of the way competition is working in a market the CC sets out one or more 'theories of harm'. A theory of harm is a hypothesis of how harmful competitive effects might arise in a market and adversely affect customers. The use of the term does not imply any prejudgement of an AEC in a given market.
164. Focusing the competitive assessment on the testing of theories of harm helps the CC to understand the market and to evaluate evidence so as to be able to decide the statutory question of whether or not there is a prevention, restriction or distortion of competition and, if so, identify what features are causing it. The use of theories of harm also helps the parties by identifying the issues that will be addressed and indicating the information that will be gathered.

Formulating and reviewing theories of harm

165. The starting point for formulating theories of harm in market investigations is the work already done by the referring body, particularly the terms of reference (paragraph 26)

⁹⁸ [Home credit market investigation](#), 28 April 2006.

⁹⁹ Annual Percentage Rate of the Total Charge for Credit.

¹⁰⁰ [Store cards market investigation](#), 7 March 2006.

¹⁰¹ [Northern Irish personal banking](#), 15 May 2007.

¹⁰² [PPI market investigation](#), 29 January 2009.

and decision documents.¹⁰³ These will not only include observations on the structure of the market but will also have described the products the referring body considers are affected and the features it has grounds for suspecting may be the cause of harm to competition. At this stage, the CC supplements the analysis carried out by the referring body with its own initial consideration and may formulate theories of harm involving other possible aspects of the market on the basis of its own analysis (see paragraphs 98 to 105 on market characteristics and outcomes).

166. The initial theories are set out in the issues statement published at an early stage in an investigation (see paragraph 68). In the market investigation into local bus services, for example, the CC noted in the issues statement (4 February 2010): ‘It appears from the OFT investigation that in many (local bus) markets there is limited head-to-head competition. The OFT’s report also suggests that concentration is high.’ It went on to list hypotheses as to why this might be so, including theories derived from barriers to entry, supplier behaviour and aspects of the tendering and bidding systems.
167. Although the CC aims to focus on those aspects of the market that appear most likely to influence competition directly, these are not always clear at the outset of an investigation. At this early stage, one or more theories may often therefore be set out in broad, generic terms.
168. As the CC investigates the interlinked issues of market characteristics and outcomes, market definition and the operation of competition within that market, it reviews its theories. The theories often become increasingly specific to the investigation. Some may be dropped and others put forward (see paragraph 72 for information on how substantial changes in theories of harm are communicated to the parties).
169. Several different hypotheses may be put forward for investigation. They need not be mutually exclusive. One or more theories may be linked to different outcomes, may in combination produce a single outcome, or may relate to different markets. On the other hand, several competing theories may sometimes be advanced linking features with observed market outcomes, and in that case the CC has to consider which theory, if any, best explains the outcome.

Potential sources of competitive harm

170. Individual theories of harm are numerous and specific to different market investigations. However, most draw on a limited number of common potential sources of competitive harm. These reflect the nature of competition as set out in Part 1 (paragraphs 10 to 15), which explained that the constraints helping to ensure that competition is effective mainly come: first, from other firms already in the market; secondly, from firms that could readily enter it; and, thirdly, from their customers; conversely, competitive harm can flow from five main sources:
 - (a) unilateral market power (including market concentration);
 - (b) barriers to entry and expansion;
 - (c) coordinated conduct;
 - (d) vertical relationships; and

¹⁰³ But, as noted in paragraph 22, the CC proceeds wholly independently of the referring body.

(e) weak customer response.

171. The list is not exhaustive. While the majority of theories of harm flow from these five sources, other theories may be identified that do not do so.
172. Moreover, the five sources are not mutually exclusive. Individual features identified in a market investigation have been associated with more than one of them. Some may have mutually reinforcing effects. Barriers to entry and expansion, in particular, have been found to be features, sometimes in combination with other features, in many investigations.

Countervailing factors

173. In assessing the potential sources of harm, the CC considers aspects of the competitive situation that may, on the other hand, benefit competition and operate to the benefit of customers.
174. In some circumstances, for example, the positive effects of *efficiencies* on competition associated with a particular market feature may outweigh the harmful effects of that feature, which would otherwise cause an AEC. Efficiencies can enhance rivalry when they induce one or more firms to follow a course of action of benefit to customers (eg lowering prices or increasing innovation) in response to actual or expected actions by rivals. Examples of such rivalry-enhancing efficiencies are given within each of the following sections on the potential sources of competitive harm. Should the CC decide that, despite the existence of some efficiencies that benefit customers, there is still an AEC in the market, these efficiencies may be taken into account as RCBs when the CC considers possible remedies (see paragraphs 355 to 366).
175. The prospect of *entry or expansion* (see paragraphs 205 to 236)—and therefore of stronger competition in the longer term—may also sometimes offset competitive harm that may otherwise arise, if there are no significant barriers to entry or expansion and the CC judges that:
- (a) actual entry or expansion is likely, of sufficient scale and swift enough to constrain incumbent firms in the near future; or
 - (b) the threat of potential entry or expansion is sufficient to exercise a constraint even though no actual entry of sufficient scale has been observed in the recent past (small-scale past entry does not demonstrate the absence of entry barriers see paragraph 234); such a constraint could arise when entry would be swift and low-cost so as to exploit any commercial opportunity in the market.
176. Countervailing buyer power may also be taken into account in the CC's competitive assessment. In some markets prices are in effect determined by the relative bargaining power of sellers and buyers. The exercise of buyer power can sometimes be a feature harming competition (see paragraph 157 and footnote 86). However, in other circumstances 'countervailing buyer power' can have the positive effect of preventing the exercise of a supplier's market power in the bargaining process. The presence of large buyers relative to the size of the suppliers does not necessarily guarantee that the buyers can exert countervailing buyer power. The relative importance to each buyer and supplier of its business with the other party¹⁰⁴ is a key

¹⁰⁴ In retailing, for example, a supplier may be more dependent on its sales to a large retailer than is the retailer on its purchases from that supplier. (This may be the case even if the supplier has a larger share of its market than the retailer has of the retail market.)

factor, and the strength of the buyers' 'outside options', ie their alternative strategies in relation to the relevant product, is often the crucial determinant of countervailing buyer power. Whether or not suppliers have the ability to offer different prices that discriminate between customers and customer groups, and thereby reduce any potential impact of buyer power, can sometimes be an important issue in the CC's assessment. The CC will also assess the extent to which the benefits of any countervailing buyer power are passed on to customers in lower prices.

The five potential sources of competitive harm

177. The following subsections deal with each of the five sources of potential competitive harm identified above (see paragraph 170) by considering first the nature of the mechanism involved, and secondly its potential impact on the market, including any positive effects, and the CC's approach to testing this impact.

1. Unilateral market power

178. As explained in Part 1 of these Guidelines (see paragraph 14), competition within a market may be weak when one or more market participants¹⁰⁵ enjoys significant market power,¹⁰⁶ and is therefore able to influence market outcomes and other important aspects of competition. The features that give rise to significant market power may cause an AEC to arise. When exerted by a single firm, or by several firms acting independently in a market, such power is termed 'unilateral market power', distinguishing it from the market power that arises as a result of coordinated conduct.

179. A single firm's level of market power will be related to the elasticity of demand for its product and its rivals' elasticity of supply for that product. The market power of a firm will be strong if the level of demand for its product is insensitive to an increase in price of that product and if its rivals are unlikely to step up their supplies in response to a price rise. Significant market power may also be conferred on one or more firms operating in markets with particular characteristics. Such cases include:

(a) monopolies, where a single firm or group supplies all or nearly all of a market for a product or service;

(b) oligopolies, where a concentrated market or industry is dominated by a small number of sellers (see paragraph 189);

(c) network or two-sided markets providing services over a network or through a platform;¹⁰⁷ and

(d) secondary or after-markets (where the products are purchased only as a result of the customer having purchased another (primary) product; see paragraph 144 and paragraphs 291 to 293).

¹⁰⁵ See paragraph 9.

¹⁰⁶ See paragraphs 9 & 14.

¹⁰⁷ Customers value the network or platform more highly when it is used by a greater number of other customers; for example, in newspaper (and other media) markets both readers (or viewers, or listeners) and advertisers are served and the value of the product (eg an advertisement) to one group of customers (advertisers) is affected by the number of customers served in the other group (the number of readers of a newspaper, listeners to a radio station or viewers of a television channel).

Indicators of unilateral market power

180. The CC may sometimes observe indicators of unilateral market power, such as high profits (see paragraphs 114 to 126), high price-cost margins (see paragraph 112), low single-firm demand elasticities (see paragraph 179) or other evidence of adverse effects in the form of high prices, low quality and limited choice (see paragraphs 127 to 129).
181. The way a firm behaves—for example, in relation to its customers or competitors—may also give an indication of the market power it may enjoy. However, actions apparently indicating the exercise of unilateral market power may be benign or even beneficial practices. For example, a supplier pitching prices below cost may be predatory action, but may alternatively be part of an introductory offer which will expand future demand for the product and therefore increase competition in the longer term.

Innovation and new product development

182. One important outcome of unilateral market power can be to stifle incentives on firms to innovate or invest in product development and thereby prevent the gains in productive efficiency and customer benefits that innovation or new products bring over time. When firms face competition—whether from other incumbents or from the threat of entry—the possibility of generating high profits encourages them to discover new products and processes. In contrast, firms that do not face competitive pressures may choose not to invest significantly in R&D (see paragraph 121).
183. However, the relationship between market power and innovation is not always clear cut. Large incumbent firms may benefit from significant economies of scale in the innovative process.¹⁰⁸ On the other hand, an incumbent firm with unilateral market power may have a lower incentive to innovate than a smaller competitor or new entrant because it has less to gain.¹⁰⁹ In some markets innovators may expect to benefit only to a small extent but, even in such markets innovation incentives may be strong if rivalry is intense.
184. In assessing market power in high-technology industries, the CC will pay particular attention to the number of products and/or technologies that are being developed. Another useful indicator in high-technology industries is R&D spending relative to sales. High R&D spending to sales ratios provide a clear indication that competition takes place through innovation. Where R&D investment is high, market power may be vulnerable to future innovations by rivals or new entrants. Substantial shifts in market share over time are also positive signs of a high level of rivalry in innovative or high-technology industries.

Assessing sources of unilateral market power

185. Generally, the most common reasons for one or more firms to possess unilateral market power are:

¹⁰⁸ Large-scale firms that undertake large amounts of R&D may be able to employ more specialized resources; they will face smaller average total costs because they can average the fixed costs of their innovative effort over a greater level of output; and they may be able to support a larger portfolio of R&D efforts, increasing the likelihood that this will develop an improved product or process likely to be applicable to at least one of its businesses.

¹⁰⁹ A strong incumbent company might be deterred from investing because it could not be confident that it would increase its sales or its already large share of the market. In contrast, a new entrant or small incumbent supplier might have a strong incentive to invest because, having only a small or no presence in the market, its investment would have greater potential to gain business there.

- (a) high concentration (see paragraphs 186 to 195);
- (b) capacity constraints (see paragraphs 196 and 197);
- (c) lack of substitutability (see paragraphs 198 and 199); and
- (d) absence of supply-side constraints (see paragraphs 200 to 204).

(a) High concentration

186. An examination of market structure, including the initial calculation of market shares and sometimes other concentration measures (as discussed above, paragraph 101 and in Annex A), often provides a starting point for the assessment of firms' market power.
187. In general, a highly concentrated market—as indicated by, for example, persistently high market shares held by one or more firms—might be an indicator that one or more firms hold unilateral market power. If a firm has a high market share it might have less incentive to compete vigorously with its rivals (particularly if there are barriers to entry). For example, if a price reduction aimed at new customers would also apply to existing customers, a firm with a large market share may be more reluctant to implement a price reduction than might one with a small share. The firm with a large market share may feel little pressure to reduce price even if a smaller rival does so.
188. A large market share could also confer advantages in bargaining with suppliers upstream, or buyers downstream (see paragraph 50), and a firm may be able to control prices in its favour or impose conditions in the negotiation process that restrict competition in one or more markets.
189. As explained in paragraph 179, market concentration and the exercise of market power are not necessarily linked to the position of a single firm. A market with a small number of suppliers which are protected by barriers to entry (an oligopoly), for example, may be characterized by significant market power. One mechanism by which this market power can manifest itself is through coordinated conduct (see paragraphs 237 to 294). However, unilateral market power can be enjoyed by a number of firms even where they act independently, albeit aware of each other's presence—so-called 'non-coordinated oligopolies'.¹¹⁰ In such situations, each firm knows that it can affect market prices and hence its rivals' profits. This awareness conditions the way in which competition occurs, although the precise way it does so will depend on the specific characteristics of the market in question.
190. A large market share does not always indicate that competition within the market is weak. It may simply indicate that the firm(s) possessing it is capable and relatively efficient, having low costs, an attractive product, or both. Moreover, a firm with a large market share could be vulnerable to entry and expansion which might constrain its market power (see paragraphs 175), or face countervailing buyer power (see paragraph 176).
191. Conversely, since a firm's level of market power will be related to the elasticity of demand for its product, and to its rivals' elasticity of supply for that product (see

¹¹⁰ It may on occasions be difficult to assess whether a particular market outcome has been driven by coordinated conduct or is the result of a non-coordinated oligopoly.

paragraph 179), even a firm with a low share of sales of a product may have significant market power if both measures of elasticity are low.

192. Observed changes in market share over time (see paragraph 101) may help interpret the implication of high concentration in a market. For example, when market shares have been stable over time, especially in the face of historical changes in prices or costs, high concentration may indicate that competition within the market is weak. However, a highly concentrated market may be competitive if market shares fluctuate over short periods in response to changes in competitive offers; such volatility may indicate the existence of effective competitive constraints, such as successful entry and innovative developments.
193. In markets characterized by bidding and tendering processes (see paragraph 134 and footnote 76), market shares may fluctuate only when tenders occur and a firm may have a high market share at any given point, as a result of winning several recent tenders, without necessarily possessing significant market power.
194. In some cases, recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm's expected competitive significance in the near future. Predictable effects of such changes—for example, the spreading of new technologies, the longevity of patents and the prospective development of new products—may be taken into account when calculating and interpreting market share data.
195. In some circumstances, the CC will find that high concentration is a feature causing harm to competition. It has been so identified in several market investigations (see paragraph 157). As explained in paragraphs 101 and 137, the CC will consider how confident it is that it has defined the market neither too widely nor too narrowly before identifying market concentration as a feature harming competition. The CC would generally expect to find this in conjunction with other features, such as barriers to entry.

(b) Capacity constraints

196. In markets involving relatively undifferentiated products, one or more market participants may find it profitable unilaterally to reduce output and increase the market price (eg by leaving capacity idle or diverting production to another market). Such a strategy is more likely to be profitable when any rival is limited by capacity constraints or a relatively low elasticity of demand in the market (see paragraph 179). In some markets, therefore, share of capacity may be more important than share of supply.
197. In assessing the power of a firm to suppress output unilaterally in this way the CC focuses on the degree of spare capacity other firms in the market may possess, the ease with which these firms could expand existing capacity, and their commercial incentive to counteract any overall output shortfall.

(c) Lack of substitutability of products

198. A firm may also enjoy unilateral market power because it controls a group of close substitute products, for which its customers have limited alternatives. In differentiated product markets, while some products can be close substitutes and compete strongly with each other, others are more distant substitutes and compete less strongly. Branding, quality, product characteristics or geographical location will have effects on the extent to which a product competes with another; one high-end product, for

example, may compete more directly with another high-end product than with a low-end product.

199. Assessing the extent of direct competition between close and distant substitute products may involve calculations of diversion ratios and of cross-price elasticities of demand.¹¹¹ The higher the cross-price elasticity of demand between two products the closer substitutes they are in the eyes of customers.

(d) Weak supply-side constraints

200. Unilateral market power can only be sustained if potential market participants will not respond to a price rise by expanding their production facilities to produce the goods and services concerned,¹¹² ie 'supply-side substitutes' do not come into the market.
201. Two products are considered to be supply-side substitutes if the supplier of one of the products already owns the key assets needed to produce and market the other, without incurring additional sunk (ie non-recoverable) costs.¹¹³ An incumbent firm may be able to do so, and sometimes new entrant firms may exert a competitive constraint if they can easily and rapidly begin selling in the market without incurring significant sunk costs. This may be the case when, for example, a firm has idle capacity or when it produces the relevant product but sells it in a neighbouring geographic market—or to customers in another market. Similarly some firms, even producing relatively distant substitutes, may have access to the know-how, and may have assets (physical and human) that can be easily and rapidly adjusted to produce and distribute close substitute goods.
202. So as to assess the extent to which suppliers of potential supply-side substitutes enhance competition in the market (or whether the absence of supply-side constraints restricts competition), the CC considers whether:
- there are economic incentives to engage in production of the relevant goods/services;
 - the suppliers are able to divert production to the relevant goods or services, or conversely are contractually tied to continue production of existing products; and
 - the suppliers possess unused plant capacity that can be brought into production at a reasonable cost.¹¹⁴
203. The CC will also consider whether the existence of supply-side substitutes influences the market behaviour of incumbent firms which otherwise would enjoy significant market power (seeking evidence, for example from internal documents, past episodes of successful rapid entry and exit, and from customers about the credibility of rapid entrants¹¹⁵).

¹¹¹ A *diversion ratio* between Product A and Product B represents the proportion of sales that would divert to Product B (as opposed to Products C, D, E etc) as customers' second choice in the event of a price increase for Product A. The *cross-price elasticity of demand* of Product A to Product B is a measure of the percentage change in the quantity of Product A sold when the price of Product B rises by 1 per cent.

¹¹² As noted in paragraph 179.

¹¹³ See also paragraph 211.

¹¹⁴ The extent of intra-market rivalry may depend on whether firms' cost structures are similar, and how low-cost firms utilize this advantage.

¹¹⁵ Situations in which firms compete with products that are currently available may be distinguished from situations where firms compete by producing to order or on the basis of blueprints or where firms define their businesses in terms of the skills of their employees. In the latter situations the extent to which substitution exists is likely to be particularly important.

204. In assessing the prospects of expansion, repositioning, and mobility, the CC will consider in particular, the timing of the likely supply response, possible legal restrictions, access to distribution channels, and commercial risks and incentives on account of such factors as customer loyalty, brand reputation or managerial expertise.

2. Barriers to entry and expansion

205. Entry or expansion by firms will often stimulate competition and, as noted in paragraph 175, the prospect of entry and expansion within a short time can sometimes countervail against a prospective AEC decision. The possibilities of entry by outside firms or the expansion of incumbent firms have featured in most findings on whether or not there is an AEC in a market.

206. Firms can enter a market or expand within it in several ways. Firms coming into a market may build new capacity or take over existing capacity to use it in new or more productive ways. Incumbent firms may expand by building new plants or capacity, developing new products or expanding into neighbouring markets. Incumbent firms may invest in upstream or downstream companies to supply materials and process their output, respectively (see paragraph 50). Entry or expansion, or just the threat of it, can:

- upset established patterns of market conduct, particularly by making it difficult for an incumbent firm to continue wielding significant market power;
- promote efficient firms at the expense of inefficient ones;
- introduce new technology and fresh approaches to product design, marketing and delivery; the impact of entry and expansion on innovation within an industry has been observed above (see paragraph 182); and
- lead to more competitive prices as well as greater choice and quality to the benefit of customers.

207. A major source of competitive discipline is therefore generally eliminated or reduced if there is any barrier to market entry and expansion, whether an absolute barrier¹¹⁶ or some other form of restriction such as aspects of the market that deter entry.¹¹⁷ Barriers to entry and expansion give at least some incumbent firms an advantage over efficient potential firms or rival incumbent firms, either by reducing the expected profits, or increasing the expected costs, of entry or expansion. They may therefore constitute a feature, often in combination with other features, that harm competition.

208. The main focus of the CC's assessment of the conditions for entry and expansion in a market is generally on the ability and incentive of new or relatively small incumbent firms to enter into or expand in a market. However, the prospects for larger incumbent firms, which can also in some cases be an important driver of competition, will also be evaluated.

¹¹⁶ Absolute barriers to entry may include, for example, the constraints on entering a network market (paragraph 216).

¹¹⁷ Factors that delay entry may include licensing, certification, or product registration requirements that involve little or no costs but take significant amounts of time to satisfy. Other examples include the time required to obtain contracts (ie where the market's products are sold via long-term contracts) or to gain a market share large enough to influence the behaviour of incumbents significantly. Sometimes these market aspects can apply for such a long period as to be tantamount to an absolute barrier.

209. A barrier to entry, as well as denoting different levels of restrictions (paragraph 207), takes various forms. The following sections of these Guidelines, first, outline the different types of barriers to entry and, secondly, describe the CC's approach to assessing the impact of these barriers. The barriers surveyed are mostly entry barriers but some are barriers to expansion; the same analytical principles apply in assessing both sorts of barrier.

Types of entry barriers

210. There are three broad categories of barriers to entry: natural or intrinsic barriers; strategic and other 'first mover' advantages (including the endogenous costs of investing in market entry¹¹⁸); and regulatory barriers. Other factors will also help determine an entrant's decision to move into a market, for example, the possession of the necessary production facilities, and the economic prospects for the market. Barriers to exit—the cost of exit from the market if the business venture fails—have also to be considered. Barriers to entry or exit can interact with and magnify each other's effects.¹¹⁹

Natural or intrinsic barriers to entry

211. Firms entering a market unavoidably incur costs. These costs can sometimes in effect be 'natural' or 'intrinsic' barriers to entry, and may include the cost of putting the production process in place, gaining access to essential facilities or inputs and the acquisition of any necessary intellectual property rights (IPRs). Important considerations in evaluating the effects of such costs on the ability of firms to enter the market are the nature of the costs and the extent to which the costs are 'sunk', ie investments that cannot be recovered upon exit and hence would serve to commit a firm or firms to staying in the market. Sunk costs may include, for example, some specific asset investments, advertising, R&D and, in some markets, the costs of acquiring a reputation (eg for producing quality products).¹²⁰ (Non-sunk costs, in contrast, are recoverable if production ceases, and do not therefore pose the same risk.)
212. Economies of scale, in combination with sunk investment costs, can constitute a barrier in cases where these relate to the cost of getting into or expanding in the market.
213. In industries where economies of scale are significant, entry on a small scale may not be profitable unless the firm is aiming at a 'niche' in the market or can develop a new production strategy which offsets the disadvantages of small-scale production. Entry on a large scale will often entail a high risk (that sunk investment costs may not be recovered) because it will generally be successful only if the firm can expand the total market significantly, or substantially replace one or more existing firms.¹²¹

¹¹⁸ Endogenous costs are those located within a firm's organization—human capital, innovation, knowledge and so forth.

¹¹⁹ Economists distinguish between 'stand-alone' and 'ancillary' barriers. The former is a cost that constitutes a barrier to entry by itself. An 'ancillary' barrier to entry is a cost that does not constitute a barrier by itself but reinforces other barriers that may be present. A group of small stand-alone barriers may constitute a significant barrier but a group of small ancillary barriers cannot do so.

¹²⁰ Three important aspects of sunk costs may influence entry and exit decisions. First, sunk costs increase the risk of entering an industry because they cannot be recouped on exiting. Secondly, sunk costs create a cost asymmetry between entrants and incumbents. Once costs are sunk they are no longer a portion of the opportunity costs of production, and hence an incumbent will require a lower return on costs so as to stay in an industry than will be required to enter. Thirdly, sunk costs can serve as a commitment by incumbent firms not to exit the industry.

¹²¹ Economies of scale may constitute a particular barrier to entry if the size of the market is small relative to the minimum efficient scale.

214. Entrant firms may also face disadvantages relative to incumbents where production costs decrease as the cumulative quantity produced increases (ie through ‘learning by doing’). Similar considerations apply to economies of scope, which arise where producing two (or more) products is less costly for a single firm than for two (or more) firms each to produce the products separately. Where economies of scope are significant, an entrant, if it is to be successful, might have to produce a range of products from the outset, adding to the costs of entry.
215. Other disadvantages to entrants, imposed by natural or intrinsic barriers to entry, may arise simply because incumbents are already in the market. Switching costs for customers may be such an intrinsic barrier, as well as other demand-side factors (see also strategic and ‘first-mover’ advantages, paragraphs 217 to 222).
216. Network effects—where other customers committing to a particular product or service makes it more attractive to new customers (see paragraph 179)—may constitute a barrier to entry.¹²² This is because incumbents with an existing customer base have an automatic advantage over entrants. However, when demand is growing fast, or innovation is rapid, the barrier might not be as high as when demand or technological change is more static.

Strategic advantages of incumbents

217. Some forms of investments by incumbents, although they may often be pro-competitive and/or benefit customers, may sometimes have the effect of deterring market entry by increasing the sunk costs of entry. Such barriers are termed strategic and can have the effects of:
- (a) lowering the incumbents’ costs relative to those of potential entrants (for example, by increasing capacity);
 - (b) altering the cost structure of rivals (for example, by vertical arrangements); and
 - (c) altering demand conditions in their favour (for example, by brand and product proliferation).
218. Such strategic entry barriers may increase the risks faced by new entrants. For example, vertical arrangements may in some cases make it difficult for an entrant to gain sufficient distribution outlets, because existing sellers are largely tied up with existing suppliers, or to gain access to vital components (see also paragraph 269).
219. The risks will be proportionately higher if the sunk costs of entry are high and the difference between the incumbent’s profitability and the rival’s post-entry profitability is substantial. In general, the greater the financial investment needed by a potential entrant the greater becomes the risk associated with entry.
220. The existence of significant switching costs for customers may act as a barrier to entry. These may be intrinsic to the market (see paragraph 215), but firms may also act strategically to increase them, for example by offering fidelity discounts or agreeing long-term contracts with customers, accompanied by penalties for early termination. Moreover, incumbent firms producing complementary goods may tie or

¹²² On telephone networks, for example, customers pay less to call other people on the network than they pay to contact those on other networks. If most existing customers (and therefore likely recipients of calls from new customers) are on the same network, it is harder for a rival to attract new customers.

bundle them together, potentially raising the costs for an entrant producing only one of the complementary goods (see paragraphs 286 to 290).

221. The incumbent firms may also be able to deter entry by signalling that they would respond aggressively to entry, including by over-investing in spare capacity, or seek to target entrants specifically to discourage them from entering the market.

'First mover' advantages

222. Other entry barriers may result simply from the established position of the incumbent firms in the market. Such so-called 'first-mover' advantages may make it difficult for other firms to enter a particular industry because experience or an established reputation is necessary to compete effectively. Relevant factors in this context include customer loyalty to a particular brand, the closeness of the relationships between suppliers and customers, and the role of promotion or advertising in the particular industry.

Regulatory barriers to entry

223. The ability of firms to enter a market can be affected by the market's regulatory framework, broadly defined as including any applicable legislation (for example, intellectual property law and planning law), voluntary or compulsory standards and codes of practice, and other applicable sectoral regulations.
224. Regulations may be beneficial for a variety of reasons ranging from ensuring the stability of the financial system to protecting the environment, but they may inhibit the extent to which competition can flourish in certain circumstances. Some types of regulations may concern the production process and the characteristics of the finished product, for instance health and safety standards. Others may limit the number of competitors in the market directly, for example by requiring that only firms with a licence or permit may operate within it.¹²³
225. With regard to their effect on competition, a distinction can be drawn between regulations that impose costs proportionately on all firms and those that hit new entrants harder than incumbent firms. Subsidies, tax reliefs and preferential purchasing may raise barriers to entry in a market if potential entrants are not equally eligible for them. Barriers that raise fixed costs can more easily be absorbed by an incumbent firm than by an entrant (because of the former's larger sales in the market); however, barriers that raise variable costs would fall more evenly on both firms. Planning policies and regulations can also constitute a barrier to potential entrants into a market to the advantage of incumbent firms. IPRs such as patents, trademarks and copyrights give the owners of such rights exclusive use of them and the ability to control their use by others, though the period of such exclusivity or control varies according to the nature of the property right. IPRs can act as barriers to entry when access to the rights owned by an incumbent may be vital for entry.¹²⁴
226. Quality, environmental, and health and safety standards that apply to all the firms in a market may on occasions adversely affect entry despite making no formal distinction between incumbents and new entrants. For example, they might favour the technology the incumbent owns and therefore raise the costs of a new entrant. Some

¹²³ Although sometimes in a competitive market licences and permits can be traded and a potential entrant is able to enter the market by buying a licence, depending on how frequently such opportunities arise.

¹²⁴ In some such cases it might be appropriate to assess the impact of IPRs on competition for the market rather than within it.

regulations may give advantage to incumbents by not requiring them to comply with the same standards as new entrants.¹²⁵

Assessing the impact of entry barriers

227. To test a theory of harm based on the effects on competition of any barriers to entry, the CC has to assess the impact that the entry barriers identified have had, are having or may have in the future.

Current competitive climate

228. The CC considers how the competitive climate within a market affects the decisions of individual firms to enter or invest in that market, taking into account the advantages of established sellers. This entails examining the factors influencing entry decisions, while recognizing that these will be accorded different weights by different firms.
229. The post-entry profitability that a firm can expect—and therefore the degree of attractiveness to that firm of entering a market—is affected, not only by the extent to which entry costs are sunk (see paragraph 211) but also by its assessment of the likely intensity of competition post-entry. The expectation of a tough competitive regime post-entry leads entrants to anticipate lower prices, reducing the profitability of entry and making it less attractive. If, on the other hand, growth in demand is likely to be large and rapid, barriers to entry are less likely to have a lasting effect. Similarly, in markets characterized by innovation, product cycles are likely to be shorter and barriers less likely to have a lasting effect. Entry decisions are often influenced by a range of other factors, including payback periods, the effect on other business segments (eg possible cannibalization, ie creation of competition to a firm's existing business), and the risk of the project. The risk will in turn be affected by various factors influencing the certainty or otherwise of forecast future cash flows: for example, the management team's level of experience, the predictability of demand, and likely competitor reactions.
230. In assessing the factors influencing entry decisions, the CC therefore may consider:
- the costs involved in entry and in operating at the minimum efficient scale necessary to achieve a reasonably competitive level of costs;
 - the likelihood of entry within a timescale that would bear on the incentives and decisions of the existing firms in the market;
 - the cost of exiting the market; and
 - the likely response to entry by incumbent firms.

Past and prospective entry

231. Evidence of persistent profits above the competitive level within the industry or among large incumbents could suggest there may be entry barriers in the market. But such evidence is neither necessary nor sufficient. Conversely, data showing that incumbents consistently fail to earn high profits may be consistent with low entry

¹²⁵ For example, existing high pollution factories often have 'grandfather' rights to pollute, which are not enjoyed by entrants, because the factory existed before the relevant regulation came into force.

barriers, but it does not prove that barriers are low and that competition is working dynamically (see paragraph 125).

232. The CC will examine the history of entry and evidence of planned entry. This assessment will include the extent to which past entrants and smaller firms have successfully gained market share (see paragraphs 100 and 101) and, more generally, the cost of gaining a significant share of the market.
233. In considering historical evidence, the CC may consider: survival rates, ie how long any entrants traded in the market; the effects that entry or expansion had on competition in the market, in particular whether past entry or expansion modified the pattern of behaviour and competition; and if so, whether this would be relevant for the present analysis. The CC may also consider the price effects, if any, from past episodes of entry, the viability of the entrant and its experience in trying to gain market share.
234. Although evidence of past entry (or the lack of it) can be helpful in assessing the significance of entry barriers in a market, previous episodes of entry do not necessarily prove that it was easy, that it was competitively significant, that it is likely to take place again, or that the possibility of entry is imposing a competitive constraint (see also paragraph 175). Moreover, current potential entrants may not face the same market conditions that previous entrants faced. Similarly, although an absence of actual or meaningful entry in the past may indicate the presence of entry barriers, it does not necessarily prove that significant entry is unlikely in the future.

The positive effects of a barrier

235. In some circumstances barriers to entry may have a positive impact:
- Entry barriers may sometimes increase incentives to innovate. While new entrants can often lead to innovative competition, the effect of entry barriers, or the prospect of creating them, may also increase the incentives for incumbents to create new products and services. IPRs, for example, provide an incentive to innovate because they prevent rivals ‘free-riding’¹²⁶ on other firms’ innovations. Given these conflicting factors, the CC will assess the incentives of incumbents relative to those of potential entrants to engage in innovative activities in the presence of entry barriers. The CC will also sometimes assess whether or not potential technological change and innovation could affect the nature and effectiveness of current barriers to entry.
 - Some regulations which restrict entry may achieve important social goals outside the scope of competition policy (see paragraphs 224 and 226). Safety regulations, for example, may make it more difficult to switch suppliers of domestic liquified gas in the UK, but the CC recognized in its investigation of the LPG market that regulation in that industry was necessary.¹²⁷
236. Such positive impacts could be taken into account at different stages of an investigation. First, they may be considered as part of the competitive assessment, for example, a restriction on short-run competition might be tolerated so as to preserve incentives to compete in longer-term ways. Secondly, they may be considered during the remedies process as RCBs (see paragraphs 355 to 366).

¹²⁶ See paragraph 261 and footnote 142.

¹²⁷ [Market investigation into supply of bulk liquified petroleum gas for domestic use](#), 29 June 2006.

3. Coordinated conduct by firms

237. The successful adoption by rival firms of a coordinated course of action is a third way in which competition in a market may be harmed to the detriment of customers.

Forms of coordination

238. Coordination typically involves repeated interaction, aimed at increasing or protecting profits, between firms in the market. But coordination can take different forms across a wide spectrum of behaviour.
239. At one end of the spectrum, direct and unambiguous communication among competitors can lead to explicit agreements to fix prices, share markets or allocate customers. At the other end of the spectrum, when a market is sufficiently stable and rival firms interact repeatedly they may be able to anticipate each other's future actions, enabling them tacitly to establish a coordinated course of action without communicating directly or sharing information. Coordination does not have to be 'perfect' at all times to affect a market. For example, it may be intermittent; ie periods of coordination may be interspersed with periods of greater competition when not all competitors see it in their interest to cooperate.
240. The sole focus of any market investigation is upon the effects on competition of possible features of the market (whether through coordinated conduct or otherwise) and it is not the CC's role to ascertain whether one or more parties have been acting unlawfully. While enforcement action on some cases of coordinated behaviour may fall within Article 101 of the TFEU or Chapter 1 of CA98,¹²⁸ the CC may investigate all forms of coordination. Any form of coordination has the potential to reduce strategic uncertainty among competitors to the detriment of their customers and, depending on the degree, may thereby result in an AEC.

Impact of coordinated conduct

241. Coordination may have an impact on any dimension of competition, including price and output levels, the scope of firms' geographic operations, investment or innovation.
242. Not all cooperation will be harmful. It may sometimes also bring about pro-competitive effects, which benefit customers. For example:
- In some financial markets, credit providers and insurers routinely share certain data (eg about customers' repayment or claim history) that facilitates the efficient operation of those markets. The CC found that the absence of such data sharing was a feature harming competition in the market for home credit and required lenders above a certain size to provide credit reference agencies with full data on the payment records of customers.¹²⁹
 - In its investigation into local bus markets, the CC found that effective multi-operator ticketing schemes could reduce barriers to entry and expansion associated with network effects and made various recommendations to facilitate the development of such schemes.¹³⁰

¹²⁸ See footnotes 3, 4 and 5.

¹²⁹ *Home credit market investigation*, 28 April 2006, paragraphs 26, 9.36–9.40, and Appendix 2.1.

¹³⁰ *Local bus services market investigation*, 20 December 2011, paragraph 15.11 and Appendix 9.2.

243. However, in many cases coordination between rivals has harmful effects on both competition and customers. Prices may be higher than they would have been if firms had taken unilateral decisions. In other cases, coordination may involve limiting production or innovation. Firms may divide up the market between them, for example by geographic area or customer characteristics, or by allocating contracts between themselves. Joint action may be taken to foreclose access to markets, inputs or customers. In these ways, coordination between rivals can worsen the terms on which products are offered to customers, reduce customer choice and hold back efficiency and innovation.

Assessing potential concerns about coordination

244. In assessing whether coordination gives rise to an AEC, the CC will examine the evidence of the behaviour of firms in the market, structural characteristics of the market and market outcomes. In doing so, the CC considers whether market conditions are conducive to coordination, seeks to understand the way in which the firms in the market operate and comes to a view on whether the observed outcomes are best explained by coordinated or non-coordinated behaviour.¹³¹

Observed market outcomes

245. The CC will consider whether observed market outcomes may suggest coordinated behaviour. A range of market outcomes may be relevant to this assessment. Some examples are given below (paragraphs 246 to 248).
246. Certain forms of pricing behaviour can be possible outcomes of coordination. For example, information on demand elasticities (see paragraph 179) and variable profit margins (sales revenue minus costs of sales) may suggest that prices are higher than would be expected if firms were acting unilaterally since each firm would stand to profit by undercutting the current market price.
247. It has also been noted (see paragraph 119) that a situation where levels of profitability have remained high and stable over time across several incumbent firms could indicate coordinated behaviour.
248. The absence of a provider serving an area where there are potential customers that it would be economic to supply may also be an indication of coordination by firms over the scope of geographic operations.
249. The CC will generally look at a range of market outcomes in combination. A single outcome looked at in isolation may often be consistent with both coordinated and non-coordinated behaviour. For example, whilst coordination may result in price parallelism (see paragraph 108(b)), intense price competition often also does so. Non-coordinated behaviour may be the more likely explanation if parallel pricing is explained by common movements in costs, and the CC will therefore consider information about changes in variable costs alongside price movements.

Market conditions and characteristics

250. Three conditions are necessary for coordination to be sustainable in a market:

¹³¹ 'Non-coordinated behaviour' in this context refers to the interaction of firms acting unilaterally.

- (a) Firms need to be able to reach an understanding and monitor the terms of coordination. Where there is no explicit agreement, firms need to have sufficient awareness of each other and be able to anticipate each other's reactions so as to identify a mutually beneficial outcome.
 - (b) Coordination needs to be internally sustainable among the coordinating group—ie firms have to find it in their individual interests to adhere to the coordinated outcome; the firms must lack an incentive, or have a positive disincentive, to compete because they appreciate how each other will react. However, coordination does not need to be perfect or continuous to fulfil this criterion (see paragraph 239).
 - (c) Coordination also needs to be externally sustainable, in that coordination is unlikely to be undermined by competition from outside the coordinating group or from the reactions of customers.
251. An important part of the CC's investigation is therefore to establish whether or not the specific characteristics of the market—structural characteristics and the way firms behave—create the conditions in which coordination can arise and be sustained.¹³² These characteristics are described below. Which of them the CC will consider as potentially facilitating coordination will depend on the facts of the individual case.
- (A) *Structural characteristics of the market*
252. Structural characteristics that may help firms reach an understanding and monitor terms of coordination, include:
- (a) *A non-complex and stable economic environment* can help firms to reach an understanding on the terms of coordination. For example: where markets are concentrated, firms are more likely to be aware of the behaviour of individual competitors; it is often easier to coordinate on a price when demand and supply conditions are relatively stable than when they are continually changing.
 - (b) *Simple and relatively undifferentiated products* are more easily subject to the coordinated setting of prices than situations in which each firm's offering is different from the offerings of its rivals.¹³³
 - (c) *Customers with easily identifiable characteristics* help firms coordinate by way of market segmentation (based on geography or customer type or simply on customers who typically buy from one supplier).
 - (d) Firms that are relatively *symmetric*, for example in terms of cost structures, market shares or spare capacity levels, may more easily respond to incentives to reach an understanding with each other.¹³⁴

¹³² For an example of the CC's approach see, for example, the [Local bus services market investigation](#), 20 December 2011 (paragraphs 8.239–8.243 and 8.261). The CC had identified as a conduct feature of some bus markets that 'operators avoid competing with other operators in "Core Territories" (certain parts of an operator's network which it regards as its "own" territory) leading to geographic market segregation' (final report, paragraph 5). The CC found evidence of contacts between operators and actions which had the effect of segregating areas of operation. These behaviours reduced or eliminated head-to-head competition and diminished the constraint from potential competition. Finding conditions facilitating coordination caused the CC to be concerned that geographic market segregation might be a more widespread feature than was identified.

¹³³ Coordination can become more complex—and may be more difficult to sustain—if important characteristics of the product are changed over time or if new products are introduced. However, coordination through, for example, simple pricing rules may overcome problems stemming from complex economic environments. One example of such a rule is the setting of only a small number of pricing points. The more complex the market environment the more transparency or communication is needed to reach an understanding of coordination arrangements.

¹³⁴ Coordination is also possible where markets display elements of asymmetry: for example, one participant (say, the largest) may act as a market leader.

- (e) Firms with cross-shareholdings, participating in joint ventures with each other or in reciprocal supplier/buyer relationships may also find it easier to reach an understanding.
253. Other structural characteristics that may help firms reach an understanding and monitor terms include the need for firms to make a long-term market commitment, and the existence of institutions (eg trade associations) or regulations that may facilitate the sharing of information.
254. The following market characteristics can help increase the *internal sustainability* of coordination:
- (a) A *concentrated market* is the foremost factor in helping to sustain coordination internally. It allows deviations to be spotted quickly. (In a less concentrated market with many companies coordinating, deviation may be more likely because a larger market share can be gained through undercutting.)
- (b) *Market transparency* also allows coordinating firms to monitor whether one or more of them are deviating from a coordinated outcome. The way transactions are conducted will often determine the degree of transparency in a market; price transparency will, for example, be higher on a public exchange, than when transactions are negotiated confidentially and bilaterally. Nonetheless, even where price transparency is limited, other aspects of transparency (eg of sales or production volumes or customer relationships) may help increase internal sustainability.
- (c) *Transparency* in the market also affects the speed, and hence effectiveness, of any deterrent mechanism used against a deviating firm or strengthens firms' ability to anticipate each other's conduct.
- (d) *Factors that make it easier to respond quickly to deviation from a coordinated outcome* may make coordination easier to sustain. For example, firms could use excess capacity as a credible threat against deviation. Likewise a response to a perceived deviation from a coordinated outcome need not necessarily take place in the same market as the deviation; if coordinating firms have commercial interactions in several markets, these may offer various ways of responding to deviations, such as cancellation of joint ventures or selling shares in jointly-owned companies.
255. The *external sustainability* of coordination may be affected by the following characteristics:
- (a) *Barriers to entry or expansion* facilitate coordination. If barriers to entry or expansion are low, the threat of entry or expansion by non-coordinating competitors will tend to undermine coordination.
- (b) *The number and size* of the non-coordinating (or fringe¹³⁵) rivals, their *cost* and *profit margins* and, critically, their scope to *expand output* in relation to their current levels and to the output of the coordinating firms will determine the extent to which non-coordinating firms act as a competitive constraint.
- (c) If a firm has the capacity to take significant share from any group of firms that tried to coordinate without its participation but also has substantially different

¹³⁵ The term 'competitive fringe' is often used by economists to describe a group of relatively small firms in a market containing larger firms.

incentives from those of the coordinating group, it can undermine a coordination strategy. (Such a firm is sometimes referred to as ‘a maverick’.)¹³⁶

- (d) *Countervailing buyer power* of customers (see paragraph 176) can similarly undermine the stability of coordination. For example, a large buyer may do so by concentrating its purchases on one supplier or by offering long-term contracts and tempting one of the coordinating firms to break ranks to gain substantial new business.

(B) *Practices of firms operating in the market*

256. In addition to investigating structural characteristics of the market that may be conducive to coordination and considering evidence of outcomes that might be indicative of coordinated conduct, the CC will look at whether would-be competitors have taken any actions¹³⁷ to reach, sustain or enhance coordination. Such actions may involve exchanges of information or specific types of arrangements.
- *Availability of information*
257. The ease with which firms can obtain information about their competitors tends to facilitate coordination. Readily available information or exchanges of information increase transparency between firms and help firms interpret the choices their competitors have made. Information availability can facilitate coordination by:
- (a) generating mutually consistent expectations among rival firms regarding their conduct and beliefs, making it easier for firms to reach an *understanding on the terms of coordination* (paragraph 250(a));
 - (b) giving an indication of rivals’ past and present conduct and enabling rival firms to monitor deviations and, potentially, to retaliate, thereby increasing *internal sustainability* of coordination (paragraph 250(b)); and
 - (c) increasing transparency making it easier for coordinating companies to monitor where and when other companies are trying to enter the market, allowing the coordinating companies to target the new entrant. This can increase the *external sustainability* of coordination (paragraph 250(c)).
258. The means by which companies may obtain or exchange information, other than by the many forms of direct communication, include most-favoured customer clauses (MFCs, see paragraphs 261 and 272), voluntary publication of information, price announcements, or information shared—even anonymously—through trade associations. Cross-directorships, joint ventures, supplier/buyer relationships and similar arrangements may also make monitoring and retaliation easier.
259. Less obvious means and practices may also increase the transparency or predictability of the environment in which firms operate. These may include the adoption of rules of conduct, ethics codes, product standardization, regulatory disclosures, joint marketing or buying agreements, price computation manuals and R&D joint ventures. Such practices may sometimes be justifiable on efficiency or customer-benefit grounds, but they could also create market conditions favourable for coordination.

¹³⁶ For example, a firm might value having a reputation for offering the lowest price in the market, and might consider itself likely to sacrifice profits in the long term if it were to lose that reputation by coordination.

¹³⁷ Equivalent, in economic parlance, to ‘facilitating practices’.

260. These Guidelines cannot be prescriptive about the type of information that may be associated with coordinated conduct. The likely effects of the availability of particular items of information on competition are analysed by the CC on a case-by-case basis. The assessment compares the likely effect of the information flow with the competitive situation that would prevail in its absence.

- *Specific arrangements made by firms*

261. The specific types of arrangements firms make, which, although sometimes benign from a competition viewpoint, can sometimes facilitate coordination, include:

- *Best price policies (or low-price guarantee)*;¹³⁸ they can increase transparency, facilitating consensus and the detection and punishment of cheating.
- *Most favoured customer (MFC) clauses*;¹³⁹ although generally benign, these provisions can in some circumstances deter competitive price cutting, reduce the incentive to deviate from established terms of coordination, and deter a firm from offering discounts to its smaller customers.
- *Minimum advertised price agreements*¹⁴⁰ can be conducive to coordination at both retail and manufacturing levels since they can control the pricing strategies of several competing retailers and are visible to competing manufacturers.
- *Resale price maintenance (RPM)*¹⁴¹ can be used to facilitate coordination between suppliers and retailers, making it easier to detect whether a supplier deviates from a coordinated price; strong or well-organized distributors may be able to use RPM to influence one or more suppliers to fix their resale price above the competitive price. Instances of RPM may sometimes fall to CA98 and TFEU investigation (see paragraph 17). However, depending on the circumstances, manufacturers can use RPM to promote effective competition by preventing ‘free-riding’¹⁴² at the distribution level.

4. Vertical relationships

262. Market outcomes may sometimes be the result of vertical integration or other vertical arrangements within the market (collectively known as ‘vertical relationships’).

- ‘Vertical integration’ means that activities at upstream and downstream levels of the supply chain have been brought under common ownership and control (see paragraph 50).
- ‘Vertical arrangements’ fall short of vertical integration and may involve agreed pricing schemes or other contractual provisions between companies at different levels of the supply chain.

¹³⁸ Best price policy is a commitment made by a firm (frequently a retailer) either to match or beat the lower price charged by other firms—a price-matching guarantee (PMG) and price-beating guarantee (PBG)—or by the same firm to other current or future customers—MFC clause. Such policies may be adopted unilaterally or through agreement or they may simply become accepted practice.

¹³⁹ An MFC clause is a provision in a sales contract, under which the seller agrees to give the buyer the benefit of any more favourable contract terms it may later negotiate with some other purchaser.

¹⁴⁰ Under minimum advertised price agreements, the manufacturers set the price of a product and the distributor enforces it; retailers may spend cooperative advertising allowances they receive from the product manufacturers.

¹⁴¹ RPM is the practice whereby a manufacturer and its distributors agree that the latter will sell the former’s product at certain prices.

¹⁴² ‘Free-riding’ is where other parties benefit from the provision of a good or service without paying for its provision.

263. Vertical relationships will often have been established when upstream and downstream firms in a trading relationship (see paragraph 50) consider that it is more efficient and economical for transactions to be organized within firms.¹⁴³ Arm's length supply contracts between such firms may be imprecise, incomplete and/or difficult to enforce and in practice may give one of the contracting firms leverage over the other. To avoid this risk one or other of the firms may decide to bring the transaction 'in house', either through internal growth or external acquisition.
264. Alternatively, firms may make vertical arrangements with each other, either via legally enforceable contracts or commitments by each firm not to behave opportunistically against the interests of the other. By restricting each other's actions, vertical arrangements may give both parties a mutual incentive to invest in their relationship. A wide variety of vertical arrangements are employed by firms. Among the most prominent are exclusive purchasing, tying and bundling, franchising, selective distribution systems and pricing arrangements. Some examples of vertical arrangements, and the CC's approach to assessing their effects, are discussed in paragraphs 271 to 294.

Impacts of vertical relationships

265. Vertical relationships often have beneficial effects. They can improve the coordination of activities at different stages of the supply chain and deliver savings in transaction and inventory costs.¹⁴⁴ With vertical integration, the benefits are achieved by bringing 'in-house' activities which would otherwise be carried out in separately-owned businesses.¹⁴⁵ The benefits of other vertical arrangements flow from a closer alignment of the incentives of firms within a supply chain (eg the supplier and its distributor), towards the achievement of complementary objectives. Vertical relationships may also help to resolve the 'free-rider' problem¹⁴⁶ in markets where suppliers require their distributors to incur certain costs if advice and other pre-sale services are to be provided in a sustained way.
266. Since vertical relationships involve complementary products, services or activities, each firm would like the other to lower the price of its product. Such a relationship can therefore have the effect of lowering prices that would be charged to customers if the firms acted independently and in this way can sometimes benefit customers.
267. However, despite their potential to enhance efficiency and consumer welfare, vertical relationships can also sometimes lead to an AEC in a market, particularly by allowing the firms to:
- (a) foreclose rivals' access to inputs and customers; and/or
 - (b) otherwise have a dampening effect on competition.

¹⁴³ In economists' parlance, the relationships often result from attempts to resolve a market failure.

¹⁴⁴ For example, by helping guarantee stability of supplies, improve coordination on product design, production process and the way in which the products are sold).

¹⁴⁵ In the absence of vertical coordination, if both producers and distributors add mark-ups over their costs, the resulting 'double' mark-up—or 'double marginalization'—may lead to inefficiently high prices. This is because each partner, when setting its price (the wholesale price for the producer and the retail price for the distributor) takes no account of the effect of this price on the other's profit. By aligning incentives, vertical relationships may lead to a coordinated reduction of the mark-ups at different levels in the supply chain, both increasing firms' profits and benefiting consumers.

¹⁴⁶ See paragraph 261 and footnote 142.

(a) Foreclosure

268. For a vertically related firm, foreclosure may be achieved by practices that restrict access to essential inputs or raise rivals' costs, or limit rivals' ability to acquire sufficient customers to benefit from economies of scale, learning effects¹⁴⁷ and/or network effects.
269. Foreclosure can be total (where rivals are forced to exit from the market or are prevented from entering) or partial (where rivals or potential entrants—are materially disadvantaged and consequently compete less effectively).
270. Foreclosure of access to key inputs ('input foreclosure') may lead to a reduced competitive constraint on a vertically related firm. When deciding whether to supply its competitors downstream with key inputs, a vertically integrated firm may take into account how these sales would affect the profits of its own downstream division. If it has significant market power in the upstream market, the firm may have an incentive to refuse access to the input or to raise its price, and consequently increase the costs of competing downstream firms. By being subjected to higher input prices—of which an extreme form is a 'margin squeeze'¹⁴⁸—downstream competitors may be unable to compete effectively. As a result of such foreclosure effects a vertically integrated firm may be able to maintain high prices and/or increase the prices charged to customers relative to the prices obtained in the absence of vertical integration.

(b) Dampened competition

271. Since the rationale for vertical relationships is often unconnected to competition issues (see paragraph 263), a widespread network of overlapping vertical relationships may develop within an industry. While such arrangements may address market failures, they can have far-reaching effects on the operational structure of the upstream and downstream markets, reducing the incentives on firms to compete vigorously against each other and possibly leading to an increased likelihood of coordinated conduct by firms at the same level of the supply chain and to a greater incidence of entry barriers.
272. Pricing relationships especially, notably MFC and RPM arrangements (see section on coordinated conduct, paragraph 261) may sometimes harm competition in some industries because a commitment to apparently less vigorous conduct may lead rivals to see that their best interest lies in allowing prices to rise. Such practices have greatest impact when the arrangements have been adopted by most or all of the firms in an industry.

Assessment of vertical relationships

273. In reaching a judgement on whether a particular vertical relationship has an adverse effect on competition, the CC will evaluate its overall impact on competition, taking into account rivalry-enhancing, as well as adverse, effects. This will normally require

¹⁴⁷ 'Learning effects' relate to firms becoming more efficient as they gain experience of providing a good or service (average cost falls over time spent in the market); see paragraph 214.

¹⁴⁸ A margin squeeze occurs when downstream competitors are charged such a high price for the upstream input of the upstream firm that they cannot compete downstream since their operating costs plus the wholesale prices exceed retail prices.

an assessment of the impact of the vertical relationship on rivalry at different stages of the supply chain.¹⁴⁹

274. For vertical relationships to result in foreclosure of rivals, the firms involved must have significant market power in one or more markets along the supply chain. They will also need to have both the ability and an incentive to seek to foreclose rivals (this will not necessarily be the case, even if the firms enjoy significant market power¹⁵⁰).
275. In conducting its assessment of the overall impact of vertical relationships on competition, the CC will look at a variety of evidence. Economic modelling may be used to test whether or not different vertical relationships have a harmful effect on the evolution of competition in a market. The CC will also assess the conduct and strategic interactions of relevant market participants. This may involve comparing relevant industry characteristics and firm behaviour over time or across geographical locations, making comparisons with other similar sectors or examining and drawing inferences from any observed natural experiment, where available.
276. Analysis of profitability and financial data can help provide an insight into whether foreclosure would be a profitable strategy.
277. The profitability of input foreclosure will depend on:
- (a) the integrated firm's ability to refuse to supply or to increase the price of an essential input, or limit access to an asset, facility or platform;
 - (b) the competitiveness of upstream and downstream markets (lower competition leads to higher profitability);
 - (c) the size of any cost asymmetry¹⁵¹ it can create on the downstream market (higher cost asymmetries lead to higher profitability); and
 - (d) counter-measures by rivals such as vertical integration, or other factors (such as switching costs) which could reduce the profitability of foreclosure.
278. The following paragraphs survey some of the more prominent among the wide range of vertical arrangements and discuss how the CC approaches an assessment of their effects on competition. Some arrangements, such as exclusive purchasing arrangements, tying and bundling and RPM can sometimes come within the jurisdiction of the TFEU and CA98 (see paragraph 17).

Exclusive purchasing obligations

279. Exclusive purchasing obligations may effectively require the customer to purchase all or a significant part of its requirements from a particular upstream supplier.¹⁵² If the customers make up a large part of the market, this has the effect of foreclosing the

¹⁴⁹ Vertical arrangements normally relate to competition between brands (inter-brand competition) but some arrangements can affect competition between the same brands sold in different outlets (intra-brand competition). While the latter could potentially lead to an AEC, the CC is more likely to identify an AEC if vertical relationships result in a reduction in inter-brand competition.

¹⁵⁰ For instance, an upstream monopolist may have limited incentive to leverage its upstream power to monopolize the downstream market since monopoly profits can be taken only once along a vertically linked chain; moreover, suppliers often have an incentive to expand their distribution networks and to expand sales.

¹⁵¹ ie the difference between the costs of an affiliated downstream firm and those of its downstream rivals. If the costs of an affiliated downstream firm are lower than those of its downstream rivals it makes commercial sense for the upstream firm to supply its downstream affiliate since it increases the profitability of the overall relationship. If, on the other hand, the costs of downstream rival firms are significantly lower than those of the affiliate, this will reduce the profitability of the relationship.

¹⁵² Obligations, such as stocking requirements that appear to fall short of requiring exclusive purchasing, may in practice lead to exclusivity.

upstream supplier's competitors from the market. Similar foreclosure effects may derive from conditional rebates and other inducements that levy switching costs on any buyer seeking to switch from an incumbent. Exclusive purchasing may thus be used in some situations as a substitute for vertical integration and have similar effects as a refusal to deal.

280. Foreclosure may lead to an AEC where, without the exclusive purchasing obligations, an important competitive constraint could be exercised by competitors that either were not present in the market at the time the obligations were concluded, or that were not in a position to compete for the full supply of the customers.
281. In general, the longer the duration of the obligation, the stronger the likely foreclosure effect, in particular if new entrants are affected. Foreclosure of this type will be more likely if the exclusive purchasing obligation has been tied selectively to buyers of particular relevance to new entrants. In such cases an anticompetitive foreclosure effect may result even though the market share involved is modest.
282. The existence of exclusive purchasing arrangements in a market does not necessarily suggest that competition is harmed. For example, when an upstream supplier faces significant inter-brand competition,¹⁵³ it may need to compensate buyers, in whole or in part, for the loss in choice resulting from the possible foreclosure. Such compensation could, for instance, take the form of lower prices or other benefits.
283. Moreover, competitors may have counter-strategies at their disposal allowing them to protect themselves against exclusive purchasing strategies and to prevent any harm to competition. Such counter-strategies could, for instance, include: (a) concentrating their sales on certain customers; (b) building up stronger 'ex-ante' competition for the customers, as foreclosure is less likely if customers, before entering into exclusive purchasing obligations, have had access to several alternative competitive offers; and (c) ensuring new entry in the downstream market, either by sponsoring entry or by integrating vertically.

Exclusive supply obligations

284. Exclusive supply obligations—by which a supplier is obliged to sell exclusively or to a large extent to an incumbent downstream firm—may also be used to try to foreclose the downstream market to new entry if an incumbent downstream firm has sufficient market power to induce all input suppliers to make such arrangements. Exclusive supply obligations may be found to lead to an AEC if they have tied most of the efficient input suppliers and rival buyers have been unable to find alternative sources of input supply. The foreclosure effects would be likely to be stronger if there were significant scale economies or network effects in the downstream market (see paragraph 179) or if there were significant entry barriers for input suppliers.
285. Exclusive supply incentives may have similar effects to exclusive supply obligations. Under such arrangements, for example, an incumbent firm with significant buyer power offers to pay a higher price if the supplier sells it a higher percentage of its output, or the supplier may be required to pay a lump sum so as to get its goods on to the shelves of the incumbent buyer.

¹⁵³ See paragraph 273 and footnote 149.

Tying and bundling

286. Tying and bundling are common commercial practices, frequently having no anticompetitive consequences but with the potential sometimes to foreclose markets and harm customers.
287. Tying occurs when the supplier makes the sale of one product (the tying product) conditional upon the purchase of another distinct product (the tied product) from the supplier or a firm designated by that supplier. Bundling relates to situations where a package of two or more goods is offered in fixed proportions.¹⁵⁴ Tying and bundling may also be achieved in indirect ways, eg by offering discounts or rebates to customers using both products or limiting guarantees to customers using only one of the products.
288. Tying and bundling can benefit customers by enabling firms to provide better products or offerings in cost-effective ways. They can lead to significant savings in production, distribution and transaction costs.
289. However, a firm with significant market power in the tying market can harm customers through tying by foreclosing the tied market and, indirectly, the tying market. In the case of the tied market, competition may be harmed if the tying has led to less competition for customers buying the tied good but not the tying good; if there are not enough of these customers to sustain competitors of the tying firm in the tied market, these customers may face higher prices. In the tying market such foreclosure may constrain market entry by rivals, which would have been likely in the absence of the tie. Similar effects may arise from pure and mixed bundling. (Paragraph 220 discusses tying and bundling as a potential barrier to entry and expansion.)
290. The factors the CC considers in assessing the extent of the foreclosure effect of tying and bundling in a market, include: the nature of the restriction applied, eg whether tying or bundling, and its effects on the choices of customers and the commercial strategies of firms; the tied percentage of total sales on the tied market; the overall strength of the tying firm on both the tying and the tied markets; the identity of the tied customers; the level of sales of the tied product to customers not buying the tying product and, in the case of bundling, the extent to which a firm is bundling goods, and whether the items within the bundle may also be purchased separately. In considering whether foreclosure of the tying market had deterred market entry, the CC may examine previous attempts to enter it.

Aftermarket arrangements

291. In those aftermarkets where secondary products can be used with one brand of primary product but not easily with another brand (although the primary products may be substitutable), the supplier of the primary product may reserve the secondary product for itself by excluding competitors, for example through tying or a refusal to deal (eg to supply necessary information, licences, IPRs or spare parts). In other cases, the supplier of the primary product may have a point-of-sale advantage in

¹⁵⁴ With 'pure bundling' only the bundle, and not the components, is made available. 'Mixed bundling' allows both the sale of the bundle and at least some of the separate components. 'Technical bundling' is where the tied product is physically integrated in the tying product.

relation to the secondary product that restricts the ability of other potential suppliers of the secondary product to serve its customers.¹⁵⁵

292. In assessing the effects of aftermarket arrangements, the CC will typically first consider the nature of the relationship between the primary and secondary markets. This may constrain the extent of, or in some cases remove, any market power enjoyed in the secondary market by the supplier of the primary product. In particular, if the primary market is competitive and if customers anticipate the likely cost of secondary products when making decisions about which primary product to buy, competition in the primary market may constrain suppliers' ability to raise prices of the secondary product. Competition in the primary market may in this way ensure that the overall price of the 'bundle' of goods and services comprising the primary product and the secondary product(s) is set at a competitive level.
293. The extent to which competition in the primary market may constrain market power in the secondary market is determined by:
- (a) The amount of information available to customers, together with the use customers make of this information when buying a primary product. These are important factors in assessing the extent to which customers calculate the overall cost of the bundle over the expected life cycle of the primary product. For this competitive constraint from the primary market to function effectively, a sufficient number of customers must engage in life-cycle cost calculations, and the supplier(s) concerned must not be able to discriminate between customers that make such calculations and those that do not.
 - (b) Whether the suppliers, even if customers have not based their choice on accurate life-cycle calculations, make their own assessment of the profitability of a customer relationship over the life cycle of a product and compete vigorously in the primary market so as to enjoy profits on subsequent aftermarket sales.¹⁵⁶ The CC may consider the extent to which customers benefit from lower prices of the primary product as part of its assessment of RCBs (see paragraphs 355 to 366).¹⁵⁷

Wider competition-dampening effects

294. As explained (see paragraphs 271 and 272) in some circumstances vertical relationships can have far-reaching effects on the operational structure of a market. These potential effects, for example the possibilities of coordination or entry barriers arising from competition-dampening relationships are assessed in the ways described in the relevant sections on coordinated conduct and entry barriers.

5. Weak customer response

295. Competition (as emphasized in Part 1, paragraph 15) may be threatened if customers respond weakly to competitive offers. A weakness of customer response may be variously caused by customers' behaviour, actions by suppliers or a structural feature of the market (for example, affecting the availability of information). A market investigation is well placed among competition policy instruments to

¹⁵⁵ For example, in its investigation into PPI, the CC found that suppliers of credit (the primary product) enjoyed a point-of-sale advantage in relation to the supply of PPI (the secondary product) to their own credit customers and that, in combination with other features, this feature of PPI markets harmed competition.

¹⁵⁶ This pattern of low pricing for primary products and high pricing for secondary products is sometimes referred to as a 'waterbed effect'.

¹⁵⁷ This was the approach adopted in the *PPI* market investigation (29 January 2009).

analyse and remedy undesirable patterns of customer responses which result in a lack of competition.¹⁵⁸

Impacts and assessment of weak customer response

296. To drive effective competition customers need to be both willing and able to: access information about the various offers available in the market; assess these offers to identify the good or service that provides the best value for them; and act on this assessment by switching to purchasing the good or service from their preferred supplier.
297. Theories of harm that competition is adversely affected by weak customer response are therefore generally examined in relation to these three issues so as to establish what may be restricting customers from exercising effective choice. The following sections of the Guidelines examine barriers to:
- (a) accessing information;
 - (b) identifying best value offers; and
 - (c) switching suppliers.

(a) Barriers to accessing information

298. When customers face significant impediments or costs in their search for—and comparison of—alternatives, sellers may be able to set prices with only limited regard to competition.
299. Firms can enjoy some market power (see paragraph 9) if customers cannot easily or effectively compare their products with others on offer, because of the difficulty or cost (including the opportunity cost of customers' time) of finding better deals.¹⁵⁹
300. Where it is difficult to obtain information, or where the cost of obtaining information is high, customers may not search the market but simply choose a firm randomly; firms may respond by charging a high price to these customers. Search costs are likely to be substantial in cases where the information that could possibly affect purchasing decisions is relatively complex, or difficult to obtain or process.
301. Firms may be able to charge high prices even where some customers search for information but a significant number of less well-informed customers remain; a seller's profit foregone by losing informed customers who buy elsewhere may be more than offset by the higher profits accruing from less well-informed customers who do not shop around.¹⁶⁰ An increase in the proportion of informed customers will generally increase the level of effective competition in a market.
302. Prices in the market tend to increase with the cost of acquiring information (although there is no general formulation for the relationship between prices and customers' search costs). This is because the higher the search costs, the lower the net gain for

¹⁵⁸ While strengthened competition plays an important role in solving some customer-related problems, others can only be tackled by means of consumer protection policies.

¹⁵⁹ If, for example, one store raises its price for a commonly-available good above the level of other stores, and all customers know this and switch to rivals, that store would lose all its business. In contrast, if some or all customers do not know that other stores charge lower prices and hence do not switch, the store may be able to raise its price without losing all its sales, ie the store has some degree of market power.

¹⁶⁰ For example, markets serving both tourists (with high search costs) and local residents (with low search costs).

- customers from searching for a lower price and the higher the degree of market power that firms can exploit.
303. Firms may sometimes engage in practices that increase search costs so as to obtain market power (or fail to engage in practices that would reduce search costs). They may do so, for example, by:
- (a) charging different prices for the same good at various locations or under different brand names, making it difficult to find the low-priced brand;
 - (b) not clearly displaying prices or referring to some prices (eg special offers) which are not necessarily available to all customers; and
 - (c) failing to make available all the product information needed by customers to make an informed choice, in particular of one-off purchases.¹⁶¹
304. Other reasons buyers—in particular end-consumers—may have difficulty acquiring knowledge of substitutes or of the quality and prices of goods on offer might include:
- (a) information may vary in availability or may become dated;
 - (b) customers' knowledge about their requirements may be imprecise;
 - (c) customers may have limited capabilities to search for products and compare alternatives, for example they can remember and readily recall only a limited amount of information; and
 - (d) customers may be sensitive or embarrassed about the product for which they are searching.
305. Advertising and other freely available information on products (eg online price comparison sites or organizations conducting product reviews) might be expected to reduce search costs. However, their influence may be limited in this respect, for example because:
- (a) Advertising, while a 'free' resource reducing buyers' search costs to some degree, may not tell customers everything that they want or need to know about a product.
 - (b) Third party providers of information may have a legitimate commercial interest in protecting the IPRs (see paragraph 211) to the information they collect and distribute—for example, to prevent its use to publicize only the 'bottom' line (eg which brand is most or least reliable overall), or to benefit those who have not produced or paid for information.¹⁶²
 - (c) The large fixed costs typically associated with the creation of information, and the small marginal costs of distributing it, may prevent fully efficient pricing and may give sellers an incentive to limit the information they provide.

¹⁶¹ For example, in the case with many financial products, extended warranties on electrical products, certain professional services and some consumer durables.

¹⁶² The 'positive externalities' associated with the provision of information in consumer markets affect both buyers and sellers: buyers because, for example, search by some individuals tends to improve the market for all customers; and sellers because, for example, advertised information that applies to more than a single brand may help sellers of competing brands or other competing products.

(b) Barriers to identifying best value offers

306. Even if customers are able to access several offers, their assessment of those offers may be handicapped by two main factors:
- (a) the susceptibility of some customers to behavioural biases and the potential for exploitation of these biases by providers (see paragraphs 307 to 310); and
 - (b) the potential for asymmetries of information to exist between suppliers and their customers (see paragraphs 311 to 315).

Behavioural bias

307. There are many explanations of the biases customers apply when making purchasing decisions. The main biases identified in the literature on the subject¹⁶³ are:
- (a) Processing power biases including: choice overload (faced with too many choices, customers have difficulties making a purchasing decision); representational biases (customers use visible value as a reliable indicator of hidden value); and rules of thumb (for example, customers imitate what other customers do rather than make their own decisions).
 - (b) Framing biases including: relative utility (a customer's choice is affected by reference points such as past actions); default biases (customers adopt the default option); and placement biases (customers' choices depend on where goods are placed on a list—for example, they may tend to choose the first).
 - (c) Time inconsistency biases including: projection bias (customers expect that they will feel the same tomorrow as they do today); overoptimism (customers overestimate how much they will use a good, or underestimate how much it will cost them); and hyperbolic discount biases (customers value a reward today disproportionately more than one tomorrow).
 - (d) Loss aversion biases including endowment biases (customers value something more once they have owned it than before they own it).
308. In practice it can be difficult to predict how a customer will react in a particular situation. Empirical evidence is normally required to identify behavioural biases and any possible impact on competition in particular markets. The persistence of a bias is also hard to predict. Customers can learn from their biases and become more sophisticated, for example in markets where they make frequent purchases (or can benefit from the learning of others via word of mouth).¹⁶⁴ Advisers, intermediaries, consumer organizations and the media can also act as catalysts in improving customer decision-making, where there are customer biases.¹⁶⁵

¹⁶³ There is a wide economic literature on the influence of bias—cognitive, emotional or reflexive—on economic decision-making. See, for example, Steffen Huck, Jidong Zhou and London Economics (Charlotte Duke), *Consumer Behavioural Bias in Competition: a Survey* (OFT1324), OFT, 2011.

¹⁶⁴ When purchases are infrequent or large value (for example, when entering into a sale and rent back arrangement), learning may not provide the constraint required. There will also be circumstances where biases are hardwired (for example, limits to computation capabilities cannot be overcome) or where customers cannot learn from others.

¹⁶⁵ The reach and effectiveness of intermediaries have been greatly extended with the advent of the Internet and price-comparison websites and the consequent ability to compare prices and terms across different sellers. However, there may be cases when incentives of the intermediaries are not always aligned with customers. For example, when firms pay intermediaries for their advice to customers their impartiality may be questioned.

309. As well as influencing their purchasing decisions, the behavioural biases of customers can have a bearing on suppliers' behaviour. Where such biases exist, firms can act to exploit them at every stage in the decision-making process. They can potentially increase their profits by playing to these biases in certain ways, for example, unilaterally or jointly restricting the information provided to customers or by failing to highlight the add-on costs of a service.
310. In some markets there will be a proportion of 'active' customers who recognize their biases and correct for them and a proportion of more 'passive' customers who do not do so. Competition in these markets will work most effectively where there is a high proportion of 'active' customers and it is difficult for suppliers to discriminate between 'active' and 'passive' customers.

Information asymmetries

311. Information asymmetries between suppliers and customers might have adverse effects on competition, particularly in markets for goods or services where customers are not able to gauge the quality of a service when acquiring it.
312. Buyers may not know, for example, how quality varies across brands. Markets where customers may be unsure about quality include those for professional services, used goods and complex mechanical or electronic products. When, as a result of information asymmetries, customers are unable to form an accurate assessment of product quality (eg if they consistently underestimate the probability of product failure), a market may operate inefficiently. Imperfect information about quality can be a particularly severe problem for infrequently purchased goods or goods the quality of which cannot be verified even after purchase—so-called 'credence' goods.
- *Potential adverse effects on competition*
313. In extreme cases, asymmetric information about quality may lead to only the lowest quality product being offered, effectively meaning that a true market may not exist. This could arise where sellers of low-quality products are able to make their products appear indistinguishable from higher-quality products, and consequently sellers of the higher-quality products are unable to convince customers of their products' worth. In this situation, customers are only willing to pay the price of the average quality product, which is not enough to cover the cost of the higher quality products, leading to these products not being supplied. Even if information asymmetries do not lead to all higher-quality products being forced out of the market, quality levels are lower than they would be in the absence of any asymmetry.
314. A related issue (the so called '*principal-agent*' problem) arises where a provider (the agent) acts on behalf of another party (the principal), thereby providing a service to it. If the agent has better information than the principal about how well it is providing the service, the principal may be prevented from exercising effective choice. Moreover, where the two parties' interests are not aligned, the agent may act against the interests of the principal if information asymmetries allow it to do so undetected by the principal.¹⁶⁶
315. These effects of asymmetric information are generally commensurate with the degree of asymmetry: the greater the asymmetry of information, the greater the

¹⁶⁶ Similarly, where a service (eg liability insurance) is provided to one party, while another party is liable to pay for it, a service provider may not have an incentive to compete as fiercely on price, or quality, as where the party receiving the service also pays for it.

effect. However, the potential effects of asymmetric information may be mitigated in various ways:

- (a) The Government, consumer groups, industry groups or others may provide information in the form of standards (defining a metric, or scale, for evaluating a particular product) and certification (that a particular product has been found to meet a standard)—for example, relating to the licensing of new drugs, car safety regulations and rules for financial fund managers.
- (b) Liability laws may serve the same function as explicit warranties, forcing the manufacturer to make good any defective products.
- (c) Professional and other bodies can regulate entry into, and ongoing participation in, the profession and require that practitioners obtain certain qualifications, thus guaranteeing quality of service to some degree (see also discussion of entry barriers, paragraphs 223 and 224).
- (d) A disinterested expert may be able to provide customers with reliable information, for example, a mechanic in the case of a used car.
- (e) Warranties or guarantees may eliminate problems due to limited information or act as a signal of the item's quality at the time of purchase, for example 'satisfaction guarantees' might be offered by holiday providers.

(c) Barriers to switching suppliers

- 316. Switching from one supplier or provider to another, so as to respond to attractive offers, may be made difficult for customers by the costs of doing so.
- 317. In investigating switching costs, the CC recognizes that they can sometimes have both detrimental and beneficial effects on different groups of customers.
 - (a) On the one hand, switching costs allow firms potentially to charge high prices to 'captive' customers. Even if the firm is unable to discriminate between 'captive' and new customers, switching costs may enable it to charge higher prices in what would in other respects be a competitive market.
 - (b) On the other hand, the presence of switching costs may benefit some customers by intensifying the competition for new customers, particularly if there is scope to charge different prices to new as opposed to existing customers. In other situations, some limited constraint on switching (eg for a fixed period after signing a contract) may enable providers to recoup upfront costs of supplying a customer and may in that way facilitate customer-specific investments (eg in the equipment needed to receive a particular product).
- 318. Among the causes of high switching costs the CC may consider are:
 - (a) Lack of information on the part of the customer about alternative products; in some markets the customer may be unaware of the existence of competing products, possibly because of a lack of access to information or high search

costs (see paragraph 300 above). The latter in particular magnify switching costs.¹⁶⁷

- (b) Inconvenience and administrative obstacles: the CC's report on banking services to small and medium-sized enterprises¹⁶⁸ identified the 'hassle in moving direct debits, standing orders etc and a fear that crucial payments could be missed whilst a switch was in progress' as a factor discouraging switching between banks.
- (c) The presence of network effects (see paragraph 179 and footnote 107), which gives rise to collective switching costs, locking customers into existing standards and the firms that control them.
- (d) If customers have made a large investment in a piece of equipment or in product-specific skills they may be deterred from switching if it involves a further substantial investment;¹⁶⁹ the CC found that such high switching costs were features harming competition in the markets for domestic LPG.¹⁷⁰
- (e) Contractual terms (eg low early settlement rebates¹⁷¹) or marketing devices, such as loyalty cards, and negative advertising can have the effect of increasing switching costs or influencing switching decisions.

Part 3: Section 4—Concluding the AEC test

319. Having considered evidence of all kinds, the CC comes to a rounded judgement on what may be causing any adverse effects on competition. This judgement entails the CC reaching a finding on whether there is a feature, or combination of features, of a relevant market that prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or part of the UK. If so, it will find that there is an AEC. In forming its judgement the CC will apply a 'balance of probabilities' threshold to its analysis, ie it addresses the question: is it more likely than not that features or a combination of features lead to an AEC?
320. In identifying some features or combination of features of the market that may give rise to an AEC, the CC has to find a benchmark against which to determine how the market may be judged to be performing. In the absence of a statutory benchmark, the CC defines such a benchmark as 'a well-functioning market' (see paragraph 30)—ie one that displays the beneficial aspects of competition as set out in paragraphs 10 to 12 but not an idealized perfectly competitive market.¹⁷² The benchmark will generally be the market envisioned without the features. But there may some-

¹⁶⁷ In purchasing durable goods, for example, the customer needs information on the availability and costs of spare parts, other aftermarket services and maintenance. A competition problem can arise where customers are unable to factor into their purchase decisions all the aftermarkets costs of the product or where the aftermarket is not competitive.

¹⁶⁸ *The supply of banking services by clearing banks to small and medium-sized enterprises*, CC, 2002 under the Fair Trading Act 1973.

¹⁶⁹ However, such a cost may not reduce competition if customers are able to make a fully informed choice about the lifetime costs of all the alternatives at the time of the initial investment.

¹⁷⁰ *Market investigation into supply of bulk liquefied petroleum gas for domestic use*, 29 June 2006 (see, for example, paragraphs 4.47–4.52.)

¹⁷¹ For example, *PPI market investigation*, paragraph 53: 'The final barrier to switching we identified was the rebate policy on single-premium policies. Rebates are not given on a pro-rata basis ... if a consumer cancels a PPI policy, the rebate given is not enough to take out an identical policy ...'

¹⁷² See, for example, the CC report on the *PPI* market investigation. Referring to this in its judgment in *Barclays Bank v CC* (October 2009) the CAT wrote (paragraph 104): 'On a fair reading, the Commission concluded that a well-functioning market for PPI (ie a market without the AEC) was consistent with the continuation of some incumbency or POSA being enjoyed by distributors and intermediaries. There is, in our view, a clear distinction between a properly functioning market unaffected by an AEC and an ideal market, in which every potential supplier of the relevant product competes on a precisely level playing field.'

times be reasons to depart from that general concept, for example, if features are intrinsic to the market but nevertheless have anticompetitive effects (as in the case of a natural monopoly) or if the nature of competition in the market is defined by arrangements put in place by Government, eg as in rolling stock leasing.¹⁷³

321. If the CC decides that there are features in the market leading to an AEC, it moves on to consider appropriate remedies.

Part 4: Remedial action

322. When identifying and implementing a remedy to an AEC the CC may have to intervene directly in the structure of established markets and/or address the conduct of firms and their customers. Consideration of whether remedies are necessary and identification of the right remedy are highly dependent on the facts and context of the investigation and require the exercise of judgement by the Inquiry Group conducting the reference.¹⁷⁴ The starting point for the CC's remedies assessment is its finding of features that give rise to an AEC and the related findings of fact. More broadly, the CC will have developed, through the course of its investigation, a detailed understanding of the market and an appreciation of the way in which it is capable of working.
323. In choosing a remedy the CC will normally have to consider the interaction of a range of legal, factual and economic considerations.
324. This part of the Guidelines first sets out the framework for consideration of remedies (paragraphs 325 to 369). It then provides an overview of the different types of remedy and their characteristics (paragraphs 371 to 380) before setting out some of the main considerations that go into the selection of remedies from the options available (paragraphs 381 to 393). A more detailed discussion of particular types of remedy is included in Annex B.

Framework for consideration of remedies

The remedy questions

325. Where the CC decides that there is an AEC, it is required to decide the following additional questions:¹⁷⁵
- (a) whether action should be taken by [the CC] ... for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition;
 - (b) whether it should recommend the taking of action by others for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition; and

¹⁷³ [ROSCOs market investigation](#), 7 April 2009.

¹⁷⁴ See paragraph 46 for information on Inquiry Groups.

¹⁷⁵ [Section 134\(4\)](#).

(c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

326. A detrimental effect on customers is defined as one taking the form of:¹⁷⁶
- (a) higher prices, lower quality or less choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or
 - (b) less innovation in relation to such goods or services.
327. Whether action should be taken therefore involves consideration of both the action the CC can take and the action the CC can recommend others to take. The CC may act itself through exercising its order-making powers or through accepting undertakings from parties (see paragraphs 92 and 93). Alternatively or in addition, the CC may recommend that remedial action should be taken by others, such as government, regulators and public authorities. Such recommendations do not bind the person to whom they are addressed, although the UK Government has committed to respond to any recommendation made to it within 90 days of publication of the CC's final report.¹⁷⁷ When deciding on certain remedial actions in regulated sectors the CC has to have regard to the relevant statutory functions of the sectoral regulator concerned.¹⁷⁸ In all cases, the CC will state the action that should be taken and what it is designed to address.
328. In practice, the CC may decide to take several actions itself and/or make several recommendations. This combination of actions and/or recommendations is sometimes referred to as a 'package' of measures. Unless otherwise specified, reference to a remedy or a remedy option in this section encompasses the package of measures the CC is taking and/or recommending.
329. The Act requires the CC, in considering these questions, 'in particular to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effects on customers so far as resulting from the adverse effect on competition'.¹⁷⁹ To fulfil this requirement, the CC will consider how comprehensively possible remedy options address the AEC and/or its detrimental effects and whether they are effective and proportionate. The CC may also have regard, in accordance with the Act, to any RCBs of the market feature(s) giving rise to the AEC¹⁸⁰ (see paragraph 83). Paragraphs 330 to 333 provide greater detail about these factors and their interaction, the ways in which the CC seeks to assess the impact of remedies and the possible outcomes that may arise from balancing these factors.

A comprehensive solution to the AEC and/or detrimental effects

330. Remedies can remedy, mitigate or prevent the AEC or its detrimental effects on customers. The clear preference of the CC is to deal comprehensively with the cause or causes of AECs wherever possible, and by this means significantly increase competitive pressures in a market within a reasonable period of time.

¹⁷⁶ Section 134(5). The reference to customers includes future customers.

¹⁷⁷ The Enterprise White Paper, *A World Class Competition Regime*, Department of Trade and Industry, July 2001 Cm 5233, p12.

¹⁷⁸ Section 168.

¹⁷⁹ Section 134(6).

¹⁸⁰ Section 134(7).

331. AECs are likely to result in costs to the UK economy in general and to customers in particular. Remedies that are effective in generating competition are likely to deliver substantial benefits, by driving down prices and costs and increasing innovation and productivity, thereby facilitating economic growth and increasing the choice available to customers.
332. In deciding what action to take, the CC will typically consider whether tackling some or all of the features it has identified (see paragraphs 154 to 162) will remedy, mitigate or prevent the AEC. In some situations, for example where an AEC arises from a combination of features, it may be necessary to devise a package of remedies to address the AEC, generally by addressing its causes. However, the remedy that is ultimately selected need not directly address every feature identified, if for example, tackling a subset of features directly would be sufficient to generate effective competition and thereby remedy the AEC.
333. While generally preferring to address the causes of the AEC, the CC will consider introducing measures which mitigate the harm to customers created by competition problems, for example if other measures are not available, or as an interim solution while other measures take effect.¹⁸¹ Such measures to control outcomes may be able to reduce the harm to customers associated with high prices, for example, but are unlikely to generate the dynamic benefits, such as innovation, that are normally associated with competitive markets. These measures are therefore likely to represent a less comprehensive remedy to the AEC and any detrimental effects.

Effectiveness

334. The CC will assess the extent to which different remedy options are likely to be effective in achieving their aims, including their practicability.
335. The effect of any remedy is always uncertain to some degree. In evaluating the effectiveness of potential remedies, the CC will consider the risks associated with different remedy options and will tend to favour remedies that have a higher likelihood of achieving their intended effect. Assessing the effectiveness and practicability of a remedy may involve consideration of several dimensions discussed further below.
336. First, a remedy should be capable of effective implementation, monitoring and enforcement. To facilitate this, the operation and implications of the remedy need to be clear to the persons to whom it is directed and also to other interested persons. Other interested persons may include customers, other businesses that may be affected by the remedy, sectoral regulators, and the OFT (and/or any other body) which has responsibility for monitoring compliance. The effectiveness of any remedy may be reduced if elaborate monitoring and compliance programmes are required.¹⁸² Remedies regulating behaviour generally have the disadvantage of requiring ongoing monitoring of compliance and may also constrain beneficial aspects of competitive rivalry.
337. Secondly, the timescale over which a remedy is likely to have effect will be considered. The CC will generally look for remedies that prevent an AEC by extinguishing its causes, or that can otherwise be sustained for as long as the AEC is expected to endure. The CC will also tend to favour remedies that can be expected to show

¹⁸¹ Section 138(6). However, the CC is prevented from taking action to address future detrimental effects on customers if no detrimental effects on customers currently exist and the CC is not remedying the AEC (that is, the source of the problem).

¹⁸² The CC will also consider the costs of compliance as part of its assessment of the impact of remedies and their proportionality (see paragraph 352).

- results within a relatively short time. Some remedy options may have an almost immediate impact, while the effects of others will be delayed. In such instances the CC may select a remedy package combining both types of measure taking into account both when each measure would take effect and how long it would endure.
338. Where an AEC is expected to be short-lived (for example, because a specific future event is expected to bring it to an end) and the timescale for implementation of a remedy option would extend significantly into this period, the CC will consider whether an alternative measure would more be appropriate.
339. The CC may also consider whether to specify a limited duration—for example, by means of a long-stop date in a ‘sunset clause’—for individual measures, where these are designed to have a transitional effect.¹⁸³ This might occur if the CC expects an AEC to be time-limited, or if a particular element of a remedy package is intended to be a temporary arrangement to deliver improvements in the short term, while other longer-term measures take effect. However, the period used for any long-stop or review date will depend on the circumstances of the case. The duration of an AEC, in the absence of an intervention by the CC, cannot normally be predicted during the course of an investigation and there will normally be some uncertainty about the precise timescale over which remedies will take effect. For these reasons, the CC will generally rely on parties applying for variation or cancellation of remedies on the basis of a change of circumstances.¹⁸⁴ In some cases, the CC may also recommend that the OFT reviews (or considers reviewing) the continued need for particular measures at some future date and/or specify the types of future circumstances which might be expected to trigger such a review (eg significant new entry).¹⁸⁵ Alternatively, the OFT might identify a change of circumstances following a review conducted on its own initiative.
340. Thirdly, remedies may need to take account of existing laws or regulations either currently applicable or expected to come into force in the near future. Such other legislation may include both UK and EU legislation and directives and could cover any aspect, for example competition law, health and safety, or data protection). Where there is a tension between existing laws or regulations and the actions that the CC considers necessary to achieve an effective remedy, the CC may make recommendations to the body responsible for the laws or regulations in question. Remedies will also need to take into account the extent to which the prohibitions on anticompetitive agreements and abuses of market power are applicable to the market concerned and impact, if any, these have on the need and ability to impose remedies (see paragraph 17).

¹⁸³ For example, in the report on *Veterinary Medicines* (April 2003) under the Fair Trading Act 1973, the package of remedies included an obligation on veterinary surgeons not to charge for writing prescriptions for a period of three years.

¹⁸⁴ For example, in 2012, the CC decided to remove the Domestic Electrical Goods Order (the DEGs Order) (and certain associated undertakings). The DEGs Order, which was introduced in 1998, prevented suppliers of goods such as televisions and washing machines from recommending resale prices or making agreements that restricted the resale prices of wholesalers and retailers, and from restricting or withholding supply from particular retailers. In deciding to lift the DEGs Order, the CC found that a number of changes since the Order was introduced had significantly increased competition in the market and removed the need for the safeguards provided by the Order. The CC also considered that the enactment of CA98 provided an effective mechanism to address attempts to fix prices or restrict supply unfairly. A memorandum of understanding setting out how the OFT and CC approach their respective roles on reviews of undertakings and orders may be found at www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/our_role/ms_and_fm/pdf/mou_between_of_t_and_cc.pdf.

¹⁸⁵ For example, in the 2002 report on *The supply of banking services by clearing banks to small and medium-sized enterprises* under the Fair Trading Act 1973, the CC recommended that, three years after implementation of the remedies, the OFT should review whether further measures were needed or, on the other hand, in the light of market developments, whether any or all of the measures in the CC’s package of remedies could be modified or discontinued. Following a review by the OFT, the CC decided in 2007 to release the UK’s four largest clearing banks from most of the Transitional Undertakings given by them in 2002.

341. Fourthly, where more than one measure is being introduced as part of a remedy package, the CC will consider the way in which the measures are expected to interact with each other. As a general rule, measures which have a shared aim of introducing, or strengthening competition within a market will tend to be mutually reinforcing. For example, where market-opening measures are being introduced that increase customer choice by facilitating entry or removing barriers to switching, these may be accompanied by information remedies that help customers choose the best product available to them.¹⁸⁶

Reasonableness and proportionality

342. In considering the reasonableness of different remedy options the CC will have regard to their proportionality.
343. The CC's assessment of proportionality will depend on the particular facts and circumstances of the case. It often depends on what other remedy options are also being considered and on judgements about the respective merits of each option, including whether or not a remedy option is likely to be effective in practice.
344. In making an assessment of proportionality, the CC is guided by the following principles. A proportionate remedy is one that:
- (a) is effective in achieving its legitimate aim;
 - (b) is no more onerous than needed to achieve its aim;
 - (c) is the least onerous if there is a choice between several effective measures; and
 - (d) does not produce disadvantages which are disproportionate to the aim.¹⁸⁷
345. Applying these principles to the circumstances of particular cases usually involves consideration of remedy options both relative to other effective measures as well as relative to taking no action
346. The CC will apply these principles to the evaluation of individual measures within a package of remedies as well as to the package taken as a whole (see paragraph 332).
347. Where the CC is considering whether to modify licence conditions in a regulated sector would be proportionate it will have regard to the relevant statutory functions of the regulator concerned.¹⁸⁸

¹⁸⁶ For example, the packages of remedies in the market investigations into *Home Credit* (November 2006), *LPG* (June 2006) and *PPI* (January 2009) each included a combination of market-opening measures and information remedies.

¹⁸⁷ These principles have been referred to by the CAT in various judgments including *Tesco v CC* (4 March 2009), the PPI appeal (*Barclays and others v CC*, 16 October 2009) and *BAA v CC* (21 December 2009 and 1 February 2012). See *Tesco* judgment, paragraph 137:

A useful summary of the proportionality principles is contained in the following passage from the judgment of the ECJ in Case C-331/88 R v Ministry of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte Fedesa [1990] ECR I-4023, paragraph [13], to which we were referred by the Commission: 'By virtue of that principle, the lawfulness of the prohibition of an economic activity is subject to the condition that the prohibitory measures are appropriate and necessary in order to achieve the objectives legitimately pursued by the legislation in question; when there is a choice between several appropriate measures recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued'.

¹⁸⁸ Section 168.

Assessing the impact of remedies

348. In reaching a judgement about whether to proceed with a particular remedy, the CC will consider its potential effects—both positive and negative—on those persons most likely to be affected by it. The CC will pay particular regard to the impact of remedies on customers. The CC will also have regard to the impact of remedies on those businesses subject to them and on other affected parties, such as other businesses (eg potential entrants, or firms active in upstream or downstream markets¹⁸⁹), government and regulatory bodies, the OFT and other monitoring agencies.
349. The CC will explain what effects it expects to result from a remedy option and will form a view of their significance. As in its assessment of competition in a market (see paragraphs 35 to 41), the CC may take into account a variety of evidence and use a variety of techniques—both qualitative and, where appropriate, quantitative—to analyse effects of remedy options. Similarly to its prioritization of resources in conducting the AEC test (see paragraph 36), the level of detail in which the CC investigates particular effects of a remedy will be influenced by their importance to the CC's overall assessment. For example, if it is clear that the costs of a particular remedy are likely to be very small—both in absolute terms and relative to its likely benefits—the CC may not seek to establish these costs with greater precision.¹⁹⁰
350. The extent to which the CC will seek to quantify particular effects of remedies, and the degree of precision with which such quantification is attempted, are likely to vary from case to case. The CC will not carry out quantitative analysis that it considers unnecessary or otherwise not justified by the need to identify a remedy that meets the statutory tests. The general principles the CC follows in its use of evidence are set out in paragraphs 35 to 41.
351. The CC will assess the potential beneficial effects of its interventions. In considering how markets may develop with remedies in place, the CC will consider both benefits that are relatively easy to quantify (such as lower prices) and benefits that are more difficult to quantify (for example, the dynamic benefits of increased rivalry on productivity and innovation). Both are important. The more an AEC reflects longer-term and structural problems within a market, the greater the significance the CC is likely to accord to the long-term development of competition in the market and to the less quantifiable consequences of an improvement in the competitive pressures in the market.¹⁹¹ Conversely, if addressing the AEC requires a remedy focused on achieving relatively predictable changes to outcomes in the shorter term, quantification of these changes is more likely to be a material aspect of the CC's assessment of the beneficial effects of the remedy.
352. Similarly, the CC will consider the potential negative effects of a remedy including the costs to business. Such negative effects may arise in various forms, for example:

¹⁸⁹ See paragraph 50.

¹⁹⁰ For further discussion of this principle, see the judgment of the CAT in *Tesco v Competition Commission* (2009), CAT 6, (paragraph 139): 'it may well be sensible for the Commission to apply a 'double proportionality' approach: for example, the more important a particular factor seems to be in the overall proportionality assessment, or the more intrusive, uncertain in its effect, or wide-reaching a proposed remedy is likely to prove, the more detailed or deeper the investigation of the factor in question may need to be'; see also the CAT judgment in *Barclays Bank plc v Competition Commission* (2009), CAT 27 (paragraph 21), and footnote 23, above.

¹⁹¹ For example, in the *BAA airports* market investigation (March 2009), the CC concluded that the main benefits from the divestitures of Gatwick and Stansted airports would result from the dynamic aspects of competition, for example in relation to the delivery and allocation of airport capacity. While it was not possible to quantify the benefits of divesting these airports, given among other factors the interaction with the regulatory regime, the CC was confident that the expected benefits would outweigh the costs of divestiture.

- (a) A remedy may result in unintended distortions to market outcomes. This is more likely to be the case where behavioural remedies are used which intervene directly in market outcomes, especially over a long period. Such distortions may reduce economic efficiency (including dynamic incentives to invest and innovate) and adversely affect the economic interests of customers over the longer term.
 - (b) A remedy may result in implementation costs (for example, modifying a distribution system), ongoing compliance costs (for example, providing the OFT with periodic information on prices or reporting to the OFT on other aspects of compliance), and monitoring costs (for example, the costs of the OFT or other agencies in monitoring compliance). The CC will normally collect information from parties about the potential cost of implementing and complying with its remedies. In evaluating such information, the CC will bear in mind that it has less information than the parties have about how such potential costs have been estimated and that there might be incentives for parties to overstate the cost of those remedies that they do not support. The CC is likely to place most weight on estimates of implementation and compliance costs where parties have provided a clear explanation of how the estimate was reached, together with supporting evidence as to the assumptions used to derive those estimates.
 - (c) If remedies extinguish RCBs, the amount of RCBs foregone may be considered to be a relevant cost of the remedy (see discussion of RCBs, paragraphs 355 to 366).
353. To avoid imposing unnecessary burdens on business, the CC will seek (as stated in paragraph 344) to ensure that its remedies are no more onerous than is necessary to remedy the AEC it has identified. In selecting and designing remedies, the CC will also have regard to the potential for more competitive markets to create profitable opportunities for new and innovative competitors as well as the cost of remedial measures on established businesses. However, where businesses have been found to be earning profits persistently in excess of their cost of capital as a direct result of a feature of the market (see paragraphs 114 to 126), and are likely to continue to do so in the absence of intervention, the CC will not usually give any significant weight to the anticipated reduction of such profits as a negative effect of a remedy.

Possible remedy outcomes

354. In reaching a decision on what remedial action to take, the CC will seek a comprehensive solution to the AEC and resulting customer detriment. In so doing, it will have regard to the need for the solution to be both reasonable and practicable. A consequence of balancing these considerations is that there may be circumstances where the CC judges, for example on the basis of considerations of proportionality, that it should not pursue an effective remedy option that is potentially available to it. There may also be rare cases where, having found an AEC, the CC chooses not to take any remedial action, for example:
- (a) Where there are no practicable remedy options available to the CC, including any possible recommendations to others.
 - (b) Where the cost of each practicable remedy option is disproportionate compared with the extent that the remedy option resolves the AEC. This might be the case, for example, if the market in which the AEC was found was small in relation to the costs of each practicable remedy option and/or if it was only practicable to mitigate some of the negative consequences of an AEC and the costs of doing so were prohibitively high.

- (c) Where RCBs accruing from the market features are both large in relation to the AEC and would be lost as a consequence of any practicable remedy (see paragraphs 355 to 359).

Relevant customer benefits

355. The CC, in deciding the question of remedies, may in particular ‘have regard to the effect of any action on any relevant customer benefits of the feature or features of the market concerned’.^{192, 193}
356. RCBs are limited to benefits to relevant customers in the form of:¹⁹⁴
- (a) lower prices, higher quality or greater choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or
 - (b) greater innovation in relation to such goods or services.
357. The Act provides that a benefit is only an RCB if the CC believes that:
- (a) the benefit has accrued as a result (whether wholly or partly) of the feature or features concerned or may be expected to accrue within a reasonable period of time as a result (whether wholly or partly) of that feature or those features; and
 - (b) the benefit was, or is, unlikely to accrue without the feature or features concerned.¹⁹⁵
358. In considering potential RCBs, the CC will therefore need to ascertain that the market feature(s) with which it has been concerned results, or is likely to result, in lower prices, higher quality, wider choice or greater innovation, and that such benefits are unlikely to arise in the absence of the market feature(s) concerned. RCBs may include benefits to customers in the market in which the CC has found an AEC and to customers in other markets within the UK,¹⁹⁶ provided these benefits meet the criteria set out in paragraphs 356 and 357.
359. In general, the CC would expect parties to put forward for the CC’s consideration any RCBs they think relevant. Parties doing so will be expected to provide convincing evidence regarding the nature and scale of any RCB that they claim to result from the market feature(s) concerned and to demonstrate that these fall within the Act’s definition of such benefits.

Possible relevant customer benefits

360. Whether a particular claimed benefit to customers is found to be an RCB will depend on the facts of the case and the characteristics of a particular market.
361. It would normally be expected that market features that have been found to adversely affect competition—after consideration of any potential rivalry-enhancing efficiencies

¹⁹² Section 134(7).

¹⁹³ As noted in paragraph 173, in reaching a judgement about a particular theory of harm, the CC will evaluate its overall impact on rivalry, taking into account rivalry-enhancing as well as adverse effects.

¹⁹⁴ Section 134(8)(a).

¹⁹⁵ Section 134(8)(b).

¹⁹⁶ For example, in the *PPI* market investigation (January 2009), the CC found that credit prices, and credit cut-off scores, were lower than they otherwise would be because of PPI income generated at the credit point of sale and that this was an RCB.

(see paragraph 174)—would also have detrimental effects on customers. For example, one usual consequence of a failure of competition is that prices will be higher than they would otherwise be. Nevertheless, it is possible that features that adversely affect competition could result in beneficial effects on customers, either in the market in which competition is adversely affected, or in other related markets. The potential loss of such beneficial effects on customers may therefore be taken into account by the CC in its consideration of remedies. In the following paragraphs, examples of possible RCBs are given. In all instances the CC will need to consider whether the criteria set out in paragraphs 356 and 357 are met.

362. Aspects of market structure that could adversely affect competition, such as a high level of concentration, might enable economies of scale and/or scope to be obtained that would not be available if there were a larger number of firms in the market. Whether scale or scope economies would constitute an RCB in a particular case would depend partly on the extent to which, in practice, any cost economies were being passed on to customers as lower prices, improved quality, greater innovation or more choice.
363. Similarly, on the demand side, network effects and the operation of multi-sided markets or platforms (see paragraph 179) may lead to barriers to entry and sustained market concentration, but may also bring benefits to customers of being able to participate in a larger and/or better integrated network or platform.¹⁹⁷ In determining whether a particular form of network effects constitutes an RCB, the CC will consider whether customers benefit in practice from such effects and whether such benefits are unlikely to arise in the absence of the AEC resulting from the network effects.¹⁹⁸
364. Generally, customers are unlikely to enjoy any benefits as a direct result of entry barriers. However, some entry barriers may indirectly secure other kinds of benefit (see paragraph 235). For example, regulations that limit entry to persons of proven competence or with adequate capital resources may lead to an improvement in product or service quality. Likewise regulations that protect IPRs (see paragraph 211), while potentially restricting access to markets, may lead to improvements in innovation by enabling innovative companies to benefit from the new ideas that they generate. The CC will generally have regard to the wider purpose of such regulations in considering their effects on customers. In the absence of clear, countervailing customer benefits from barriers to entry, the CC would normally expect customers to benefit from any reduction of entry barriers as this would be expected to facilitate dynamic competition and better market outcomes (see paragraphs 205 and 206).
365. As set out in paragraphs 265 and 266, vertical relationships can often have beneficial effects, for example through better coordination of activities at different stages in the supply chain, resolving ‘free-rider’ problems between producers and distributors and creating incentives to reduce the price of complementary products. Where an AEC has nonetheless arisen from vertical relationships within a market (see paragraph 267), the CC will consider whether these relationships have resulted in RCBs.
366. The CC will similarly consider, when AECs have arisen from the many forms of business conduct that can also have either positive or negative effects, depending on the context, whether these conducts have resulted in RCBs. Tie-in sales or product bundling (see paragraphs 286 to 290), for example, may sometimes be convenient to customers, reduce transaction costs or provide quality assurance.

¹⁹⁷ For example, in the [Stagecoach/Preston Bus](#) merger inquiry the CC took into account an RCB associated with integrated ticketing brought about by the merger.

¹⁹⁸ For example, it may be possible for network benefits to be preserved through requiring interoperability between competing networks.

Relevant customer benefits and remedies

367. If the CC is satisfied that there are RCBs deriving from a market feature that has resulted in an AEC, the CC will consider whether to modify the remedy that it might otherwise have imposed or recommended. The CC will consider several factors including the size and nature of the expected RCB, what proportion of the benefit will be preserved through the modification, and how long the RCB may be sustained. The CC will also consider the different impacts of the features on different customers or groups of customers.
368. It is possible that the RCBs are of such significance compared with the effects of the market feature(s) on competition that the CC will decide that no remedy is called for (see paragraph 354). This might occur if no remedies can be identified that are able to preserve the RCBs whilst also remedying or mitigating the AEC and/or the resulting customer detriment. This situation has not arisen on a market investigation to date.
369. Alternatively, the CC, as a result of identifying RCBs, may choose a different remedy, for example a behavioural remedy rather than a structural remedy (see paragraph 371 for an explanation of this distinction). In this case, the CC will have to weigh the disadvantage of a less comprehensive solution to the competition problem against the preservation of the RCBs that result from the feature concerned.¹⁹⁹

Choice of remedy

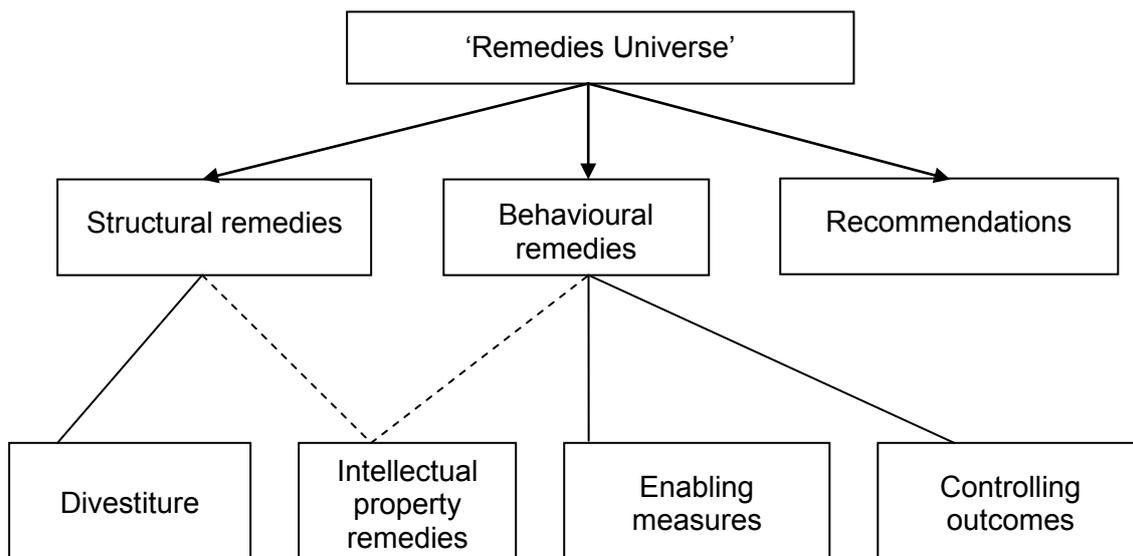
370. Paragraphs 371 to 380 provide an overview of the various types of remedy and their characteristics. Paragraphs 381 to 393 consider the selection from these types of remedy by applying the decision framework outlined in paragraph 384.

Remedies universe

371. A diagrammatic representation of the universe of possible remedies is shown in Figure 1. Remedies are conventionally classified as either structural or behavioural. Structural remedies are generally one-off measures that seek, in market investigations, to increase competition by altering the competitive structure of the market. Behavioural remedies are generally ongoing measures that are designed to regulate or constrain the behaviour of parties in a market and/or empower customers to make effective choices. Some remedies, such as those relating to access to IPRs, may have characteristics of structural or behavioural remedies depending on their particular formulation. Likewise, recommendations to others may be either structural or behavioural in nature, depending on their content. Further discussion of the different categories of remedy may be found in Annex B.

¹⁹⁹ For example, in the *Macquarie UK Broadcast Ventures/National Grid Wireless Group* merger inquiry (March 2008), the CC required the merged company to agree a package of measures with the CC, including price reductions for customers on new and existing contracts and the appointment of an adjudicator to resolve disputes. The CC decided that these measures would be effective in addressing the adverse effects of the acquisition, whilst preserving the RCBs that could arise from the acquisition, including reducing the risks associated with the digital switchover process and passing back cost savings to customers.

FIGURE 1

Overview of the universe of possible remedies

Source: CC.

Divestiture

372. The aim of divestiture in market investigations will generally be to address competition problems resulting from structural features of a market.²⁰⁰ This may be done by either creating a new source of competition through disposal of a business or assets to a new market participant, or by strengthening an existing source of competition through disposal of a business or assets to an existing market participant that is independent of the divesting party (or parties).
373. A successful divestiture will address at source the lack of rivalry resulting from structural features of a market. Divestiture remedies will generally not require detailed ongoing monitoring beyond the completion of the disposal of the business or assets in question, although, in some cases, an effective divestiture may require supplementary behavioural measures for an interim period (eg to secure supplies of an essential input or service from the divesting party to the divested business). The requirements for design and implementation of divestiture remedies are considered in detail in Annex B, paragraphs 3 to 30.

Intellectual property remedies

374. A remedy that provides access to intellectual property (IP) by licensing or assignment of those rights may be viewed as a specialized form of divestiture remedy.²⁰¹ The aim of such a remedy is that the party or parties acquiring the IPRs should thereby be able to compete effectively with other companies in the market. Where the terms of an IP remedy result in a material ongoing link between the original owner of the IP and the parties gaining the IP (eg providing access to new releases or upgrades of

²⁰⁰ For example, in the *BAA airports* market investigation (March 2009), the CC required the divestiture of Gatwick and Stansted airports and a Scottish airport as part of its package of remedies.

²⁰¹ At the time of publication of these Guidelines, the CC had not used an IP remedy in any market investigation. The package of remedies applied in the *Nufarm/AH Marks* merger inquiry (February 2009) had some characteristics of an IP remedy.

technology) an IP remedy may take on some of the characteristics of a behavioural commitment, which may require ongoing monitoring and enforcement. As with other types of remedies, the CC will assess the extent to which specific interventions in relation to IPRs may risk creating distortions, for example by reducing incentives to innovate (see paragraphs 225 and 235). Considerations regarding the design and implementation of IP remedies are outlined in Annex B, paragraphs 31 to 36.

Enabling measures

375. Certain forms of behavioural remedy operate principally to enable competition by removing obstacles to competition or stimulating actual or potential competition.
376. Within the category of enabling measures, there are further distinctions between:
- (a) market-opening measures, which are intended to open up a market to new sources of competition by removing or reducing barriers to entry, expansion or switching. Such measures may, for instance, limit parties' ability to require their customers to enter into long-term or exclusive contracts or to otherwise create switching costs for customers (see Annex B, paragraphs 46 to 60);²⁰²
 - (b) informational remedies, which are aimed at giving customers information to help them make choices and thereby increase competitive pressure on firms in the market (see Annex B, paragraphs 61 to 71).²⁰³ Where an AEC results from coordinated effects (see paragraphs 241 to 243) the CC may consider remedies that prevent the sharing of information between firms, if sharing such information has been found to facilitate coordination; and
 - (c) remedies that restrict the adverse effects of vertical relationships (see paragraphs 267 to 272). Such measures may include restriction of access to confidential information ('firewall provisions'), or obligations to provide access to facilities on fair, reasonable and non-discriminatory (FRND) terms (see Annex B, paragraphs 72 to 85).²⁰⁴
377. Enabling measures are generally likely to require ongoing intervention and monitoring. In some instances this may involve complex issues, for instance the pricing of access to facilities that are subject to rapid technological change. Further considerations regarding the design and implementation of enabling measures are outlined in Annex B, paragraphs 46 to 85.

Controlling outcomes

378. Certain forms of behavioural remedy seek to prevent the exercise of significant market power and thereby control the detrimental effects arising from an AEC. For example, price caps, supply commitments and service level undertakings all control the way a business can operate to limit any possible detrimental effects on a

²⁰² For example, the remedies introduced following the *LPG* market investigation (June 2006) included measures designed to facilitate the transfer of tank ownership when a customer wishes to switch supplier and other measures to make the switching process easier.

²⁰³ For example, the remedies introduced following the *Home Credit* market investigation (November 2006) included an obligation to publish price and other information on a comparative website www.lenderscompared.org.uk.

²⁰⁴ In the *Local bus services* market investigation, the CC decided to introduce by means of an Order a requirement for bus operators to provide access on FRND terms to privately-owned and operated bus stations. This type of remedy is also sometimes used in merger cases. For example, the *Centrica/Dynegy Storage* merger inquiry (2003) was a case in which firewall provisions and an access remedy were introduced to restrict the adverse effects of vertical relationships following a merger.

customer.²⁰⁵ Such measures are often used in regulated sectors, where it may not be feasible to introduce effective competition. However, this type of behavioural remedy can be complex to implement and monitor, given informational asymmetries between the parties and the authorities and the associated risk of circumvention. There is also a risk that such controls create market distortions, particularly if they are kept in place over a long period. Ensuring that measures to control outcomes remain fit for purpose in the light of market developments may involve costs for monitoring and enforcement agencies as well as for the parties subject to them. Further considerations regarding this type of remedy are outlined in Annex B, paragraphs 86 to 93.

Recommendations

379. The CC can decide to make recommendations to other bodies, rather than taking action itself. Such recommendations can be thought of as falling into one of two categories:
- (a) In some cases, the legal framework, regulations or conduct applicable to a market may be a structural feature giving rise to an AEC; for example, planning or certification requirements may inhibit entry or restrict market outcomes (see paragraphs 223 to 226). In such cases the CC may recommend modifications of these requirements to the Government or other controlling body to help address the AEC or control its detrimental effects. For example, the CC may recommend the removal or reform of regulatory requirements that have been found to constitute a barrier to entry.
 - (b) The CC may also make recommendations in situations where it is more practicable, or otherwise preferable, to implement a remedy by means of a recommendation.²⁰⁶
380. It will, of course, be for the Government or other person to whom a recommendation is addressed to decide whether to act on the recommendation and the CC will consult with the relevant body prior to making the recommendation. Further considerations regarding this type of remedy are outlined in Annex B, paragraphs 94 to 102.

Selection of remedies

381. As set out in paragraphs 88 to 93, the identification of the Group's preferred remedy is an iterative process in which a potentially wide range of remedy options are progressively narrowed down until a solution has been found that enables the CC to meet its statutory duties. This process involves public consultation on those remedy options that appear to the Inquiry Group to have the best chance of being both effective and proportionate. Some of the key considerations that affect the selection of remedies are set out in the remainder of these Guidelines.

²⁰⁵ In the *Classified Directories* market investigation, the CC found that prices of Yell, the largest provider, had been largely constrained by an existing price cap rather than competition. Were it not for the price cap, customers of Yell would be paying more for advertisements in Yellow Pages than they would if the market was functioning well. However, the CC expected that growing competition would increasingly constrain Yell's prices and that Yell would feel more pressure due to the Internet. The CC's remedies included a revised price control to prevent Yell from exploiting its market power and other measures designed to preserve developing competition from actions that could be targeted at competitors.

²⁰⁶ For example, in the *Local bus services* market investigation the CC decided to make a series of recommendations (eg in relation to multi-operator ticketing schemes) which would enable the implementation of these measures to take account of specific local conditions.

382. As set out in paragraph 330, in deciding what remedial action should be taken, the CC will first look for a remedy that would effectively address the causes of the AEC directly and thereby deal with any detrimental effects on customers of the AEC.
383. The type of action that will be effective in increasing competition will depend on the nature of the AEC concerned. The range of potential competition problems that may be identified as giving rise to an AEC is wide, as is the range of potential remedies. The relative merits of different remedy options will be determined by the facts of the case and, in particular, the nature of the underlying competition problem that gives rise to the need for remedial action.
384. Table 1 illustrates some possible approaches to remedying some of the different types of competition problem that may give rise to an AEC.

TABLE 1 Illustration of possible remedy approaches to different types of competition problem

<i>Example of problem arising</i>	<i>Possible remedy approaches</i>
<p>Restrictions on competitive entry or expansion reduce dynamic competition and slow technological progress and introduction of new products.</p>	<ul style="list-style-type: none"> • Market-opening measures to reduce barriers to entry and promote dynamic competition. • Recommendations to Government or regulatory bodies to address any barriers to entry which are caused or created by government laws or regulatory actions (eg planning rules).
<p>Concentrated market structure means that the market is dominated by one player, or a small number of players, whose position is protected by high barriers to entry and/or expansion.</p>	<ul style="list-style-type: none"> • Structural measures (eg divestiture, IP licensing) to create directly a less concentrated market structure. • Market-opening measures (eg reduction of entry barriers) to increase the competitive constraint from entry, addressing market structure indirectly and thereby increase competitive threat to incumbents. • Recommendations to Government or regulatory bodies to address regulatory barriers to entry or expansion. • Measures to control outcomes (eg price caps) possibly on an interim basis to mitigate the harm to customers until market-opening measures become effective. Measures to control outcomes might also be used if market concentration is very difficult or very costly to alter in practice (eg in a natural monopoly) and/or if concentration gives rise to very substantial RCBs (eg network effects) that would be lost in a more fragmented market structure and market-opening measures are unlikely to be successful.
<p>Coordination between rivals means that competition is restricted and customers are made worse off.</p>	<ul style="list-style-type: none"> • Structural measures (eg divestiture, IP licensing) to make it harder to achieve, monitor and sustain a coordinated outcome, by increasing the number of significant market participants. • Market-opening measures (eg reduction of entry barriers) to increase the competitive constraint from entry and thereby increasing competitive threat to incumbents. • Restrictions on supplier conduct or other market features that have the effect of facilitating coordination—for example, remedies might be aimed at limiting the availability of information held by suppliers about their rivals. • Recommendations to Government or regulatory bodies to ensure that government laws or regulatory actions do not facilitate coordination or cause unnecessary barriers to entry or expansion.
<p>Vertical effects. Competition problems can arise where a single firm operates at a number of levels of the supply chain or where there are other vertical arrangements between firms active at different levels of a supply chain.</p>	<ul style="list-style-type: none"> • Structural measures—for example, to separate ‘natural monopoly’ activities from potentially competitive activities, or to reduce market power at one or other stage of the supply chain. • Remedies to restrict the effects of vertical relationships to ensure access to key services, products or facilities; prevent discrimination; or prohibit vertical arrangements that restrict competition. • Measures to control outcomes—for example, to mitigate the detrimental effects in ‘natural monopoly’ activities and/or if vertical relationships give rise to substantial RCBs (eg network effects) that would be lost with other measures.
<p>Information shortfalls and behavioural biases. Competition can be weak, when customers find it hard to identify good value products in a market or switch between providers, or are subject to behavioural biases.</p>	<ul style="list-style-type: none"> • Market-opening measures to address the source of switching costs and/or encourage entry and expansion by firms with incentives to reduce search costs (eg by advertising). • Informational remedies to make it easier for customers to find out about products in the market and to facilitate comparisons; to address ‘customer’ barriers to switching (eg inertia, or lack of familiarity with the switching process) and/or to encourage whole-life costing (eg upfront disclosure of ‘hidden’ charges). Such measures might involve an element of product regulation to simplify the choices facing customers and/or to protect customer interests, where customer search for information on a particular aspect is unlikely to occur.

Source: CC.

385. As Table 1 shows, structural remedies such as divestiture are a potential solution where horizontal market concentration, coordinated effects or vertical integration are among the principal market features that give rise to an AEC (see Annex B, paragraphs 3 to 30). Likewise, IP licensing may be used to remedy AECs that result from highly concentrated markets, if, by virtue of an IP remedy, new or expanding suppliers would be able to provide an effective competitive constraint on powerful incumbents (see Annex B, paragraphs 31 to 36).
386. Enabling measures may also remedy structural problems. Market-opening measures, for example, may remove or reduce barriers to entry (see Annex B, paragraphs 47 to 60) or measures may be introduced to restrict the adverse effects of vertical relationships (see Annex B, paragraphs 72 to 85).
387. In choosing between structural remedies and enabling measures that impact on market structure indirectly, the CC will consider whether the market response to either type of remedy will be timely and of sufficient scale to represent a comprehensive solution to the AEC. In remedying competition problems arising from high concentration structural remedies have some important advantages over other measures. Once implemented, structural remedies may be expected to increase competitive constraints on the behaviour of firms in the market within a short timescale and without requiring ongoing detailed monitoring by the OFT and/or any other body such as the relevant sector regulator. The underlying cause of high concentration may also be relevant. For example, if certain features of a market (eg network advantages or other barriers to entry and expansion) result in a tendency towards high levels of concentration, enabling measures that address the underlying causes of high concentration (eg by lowering barriers to entry or expansion) might be preferred. The costs of different remedy approaches, including the extent to which any RCBs are retained (see paragraphs 355 to 366) may also be relevant to this choice.
388. In other circumstances, structural remedies may not address the features giving rise to the AEC and behavioural remedies are likely to be preferred. An important difference between remedies in merger and market investigations is that structural remedies, even if they are feasible in a market investigation, may not be an appropriate solution to a particular AEC because of the wide range of features, including non-structural features, that can give rise to an AEC. For example, enabling measures are more likely to be chosen where:
- (a) the conduct of firms has given rise to an AEC—for example, by raising barriers to entry or facilitating coordination. In such situations the CC may consider restrictions on firms' behaviour that constrain firms' future ability to engage in such conduct (see Annex B, paragraphs 49 to 53);
 - (b) switching costs or barriers to entry or expansion are among the features that give rise to an AEC. Here, the CC may consider market-opening measures that address the main barriers to switching, entry or expansion that it has identified (see Annex B, paragraphs 54 to 60); or
 - (c) search costs and other information shortfalls are among the features giving rise to an AEC. In such situations, informational remedies that make it easier for customers to search and switch may be an appropriate response (see Annex B, paragraphs 61 to 71).
389. Remedial action may also be required to address customer detriment directly, for example where effective remedies aimed at introducing competition by addressing the AEC are unavailable or will not bear fruit in the short term (see Annex B, para-

graphs 86 to 93). Price controls are the most obvious example. However, such measures to control outcomes are not likely, by their nature, to provide a solution to the underlying problem and may also give rise to distortion risks, if retained over a long period. For these reasons (as stated in paragraph 330), remedial action to control outcomes will not generally be preferred as a long-term solution.

390. As stated in paragraph 379, recommendations may be considered where an aspect of regulation or government behaviour is itself giving rise to an AEC or where it would be more practicable (or otherwise preferable) for the CC to implement a remedy by means of a recommendation rather than taking action itself. This may include situations in which other bodies have powers that are unavailable to the CC²⁰⁷ or where a recommendation enables a remedy to be better integrated with existing interventions in a sector.²⁰⁸ It may also include cases where a remedy to increase competition in a market has the potential to come into conflict with other important public policy objectives and it is more appropriate for Government, rather than the CC, to balance these conflicting objectives.²⁰⁹
391. In deciding whether to make a recommendation rather than take action itself, the CC will form a view as to the likelihood that the recommendation will be acted upon and, if so, over what time period. In reaching this view, the CC will have regard both to the stated policy of the body to which the recommendation is to be directed and to the possibility that that stated policy may change, either in light of the CC's recommendation or subsequent events (see Annex B, paragraphs 94 to 102). The likelihood of a recommendation being implemented is therefore relevant to the timeliness and effectiveness of such a recommendation. However, the CC may sometimes make recommendations that may not be implemented immediately, where it judges that these are nonetheless likely to be more effective than other possible remedies.
392. In looking for remedies that would be likely to increase competition in the relevant market(s), the CC will give attention to the time period within which the remedy can be expected to show results. If a remedy is not likely to have rapid results, the CC may choose an alternative remedy or implement additional remedies such as measures to address the detrimental effects on customers during the interim period. Otherwise, not only might there be uncertainty as to whether the beneficial effects of the remedy would materialize, but, in the meantime, customers would continue to suffer from the consequences of the AEC.
393. The CC's experience to date suggests that remedies in market investigations may take the form of a 'package' of measures, rather than the implementation of a single measure (see paragraph 332). This may be because there are several features giving rise to an AEC, and consequently an individual measure may be incapable of addressing the AEC in its entirety. For example, to deal with problems associated with a lack of customer switching it may be necessary both to remove contractual barriers to switching and also to put in place informational remedies that raise customer awareness of the potential benefits of switching. Where more than one measure is being introduced, the CC will consider the way in which the measures are expected to interact with each other. As a general rule (as stated in paragraph 341),

²⁰⁷ For example, in the [Local bus services](#) market investigation the CC made several recommendations to the OFT about the operation of existing competition law mechanisms that are the responsibility of the OFT rather than the CC.

²⁰⁸ For example, in the [PPI](#) market investigation, the CC made a recommendation to the Consumer Financial Education Body—now known as the Money Advice Service—to publish information on its existing price comparisons website, rather than requiring the creation of a new price comparison site.

²⁰⁹ For example, in the [ROSCOs](#) market investigation, the CC made recommendations in relation to the operation of the rail franchising system to increase competition in the supply of rolling stock. In making these recommendations, the CC was mindful of the Government's wider public policy objectives in relation to rail franchising.

measures which share the aim of introducing competition into a market will tend to be mutually reinforcing.

Annex A: Market characteristics and outcomes

1. Measuring market shares and concentration

Market shares

1. Subject to the availability of data, the CC normally calculates market shares for all firms currently producing products in the relevant market or in any market the CC considers relevant to its investigation. It does so on the basis of the available indicators of firms' future competitive significance in the market. These may depend upon the nature of competition in the market as well as on the availability of data. In many cases, the CC will calculate market shares on the basis of several indicative measures (see paragraph 2) so as to understand fully how a market is operating. The CC may use information from a variety of sources including established sellers, potential entrants, customers, buyers, suppliers, trade associations and market research reports.
2. Market shares can be measured in terms of revenues, volumes, production capacities or inputs:
 - *Revenues.* In most contexts, the CC uses actual or projected revenues in the market as the bases for measurement. They are the best 'real world' measure and are particularly pertinent when products differ in quality. But in some cases, unit sales (eg when a new, less expensive product has entered the market) or revenues earned just from recently acquired customers (when long-term contracts or high switching costs are involved) may be better measures of competitive significance than total revenues.
 - *Capacities.* In markets for homogeneous products, the level of readily available capacity or reserves to serve the market can be an appropriate measure if that capacity is efficient enough to make expansion profitable in response to a price rise or to reduced output by competitors. If this measure is used, market participants that are not current producers may sometimes be assigned positive market shares to reflect their impact on competition.
3. Typically, annual data is used, but where individual transactions are large and infrequent, annual data may be unrepresentative, and in these cases the CC may measure market shares over a longer period of time.

Concentration measures

4. The degree of concentration in a market may be measured in different ways, depending on the nature of competition and availability of data. A numerical count of the firms in a market is the basic measure. It does not take into account differences in market shares and the size distribution of firms, but can be useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure revenues in the market. The CC attaches particular weight to a numerical count of firms when considering coordinated conduct.
5. Two other commonly used measures are the concentration ratio and the Herfindahl-Hirschman Index (HHI).
6. The concentration ratio measures the combined market share of the largest firms in a market. For example, the 'five firm' concentration ratio is simply the sum of the mar-

ket shares of the five largest firms in the market. It does not provide any information on the relative size of the firms nor on the number, or size, of the smaller firms.

7. The HHI potentially reflects both the number of firms in the industry and their relative size. It is defined as the sum of the squares of all the market shares in the market, and thus gives proportionately greater weight to the larger market shares. The CC is likely to regard any market with an HHI in excess of 2,000 as highly concentrated, and any market with an HHI in excess of 1,000 as concentrated. However, the CC will have regard to these threshold levels—if considered relevant—only as one factor in its wider assessment of competition.
8. The calculations of market shares, numbers of firms, concentration ratios and the HHI generally depend on being able to identify the boundaries of the market concerned. However, one technique, which is closely related to other traditional concentration measures, but does not rely on pre-defined boundaries, is the Logit Competition Index, sometimes referred to as LOCI. LOCI can be computed as (one minus) a firm's weighted average market share across the submarkets within which it operates. The weights are calculated according to the importance to the firm of each submarket, and the definition of a submarket depends on the particular application. In practical terms, LOCI requires that a much greater amount of information be available than is required for computing the traditional concentration measures described in paragraphs 4 to 7 above.

2. Measuring profitability

9. In measuring profitability the CC's approach will often be to start with accounting profit produced in line with UK Generally Accepted Accounting Principles (GAAP) and then to make adjustments to arrive at an economically meaningful measure of profitability, usually in terms of rates of return on capital.¹ The CC will often inform its judgement on what is an 'economically meaningful measure of profitability' by examining the management accounting records of the firms in question. The manner by which industry participants, including firms, analysts, and investors, assess profitability for the purposes of monitoring and reporting performance may well inform our view as to what is an appropriate measure for the industry in question.² For example, in the financial sector the CC has previously considered return on equity over a five-year period as its primary measure of profitability. In other industries the CC has considered return on capital employed over a similar period.³
10. The appropriateness of a given measure will also depend on the nature of the industry and the pattern of investment. Where investment is characterized by large one-off expenditure, or the industry has experienced a period of growth, it may be desirable to consider profitability over a relatively long period of time or on a project appraisal basis. For example, it may be appropriate to use a cash-flow-based model to compute a measure of the internal rate of return (IRR) where reliable data is available on this basis.⁴
11. An important factor to consider when selecting an appropriate model will be data availability. Where possible, the CC will base its calculations on financial data that can be reconciled to audited financial statements, albeit with appropriate adjust-

¹ Where the capital base is valued appropriately. See, for example, the reports on *Store Cards* (March 2006), *Home Credit* (November 2006) and *PPI* (January 2009).

² See, for example, *PPI*.

³ See *BAA Airports*.

⁴ In *Movies on Pay TV* the CC used a cash-flow-based truncated IRR in conjunction with a return on capital employed (ROCE) approach.

ments. For example, where the market of interest is a division or segment of a company it may not be possible to obtain reliable cash flow data at this level and the CC may therefore adopt a return on capital approach for this reason.

12. Whatever measure of profitability is used, the calculation of profitability for the purposes of competition analysis is often not straightforward because of the need to obtain an appropriate value for capital employed, as described below. In industries with a relatively low level of tangible assets, such as service and knowledge-based industries, the book value of capital employed may bear little relationship to the economic value because of the presence of significant intangibles. In some cases, the replacement cost of assets may be different from historical costs due to the length of time elapsed and changes in asset prices and efficient technologies over time.
13. Obtaining a value for capital employed can present difficulties irrespective of the choice of model. For example, the use of a truncated IRR requires the assets to be valued appropriately at the beginning and end of the period selected. Similarly, a return on capital approach, whether return on equity or return on capital employed (ROCE), requires an economically meaningful value for the capital base which may not accord with the value ascribed in the financial records.
14. Hence, it may be necessary to make adjustments to accounting data produced in line with UK GAAP. In particular, the following adjustments may be considered:
 - Under current accounting standards, most assets are held at historical cost and this may differ substantially from the ‘replacement cost’ or ‘Modern Equivalent Asset value’,⁵ which the CC considers to be the economically meaningful measure for its purposes in most cases. In these circumstances, and where this would be likely to have a material effect on its calculations, the CC will consider whether replacement cost values can be derived reliably.
 - Secondly, the CC may consider the inclusion of certain intangible assets where the following criteria⁶ are met:
 - it must comprise a cost that has been incurred primarily to obtain earnings in the future;
 - this cost must be additional to costs necessarily incurred at the time in running the business; and
 - it must be identifiable as creating such an asset separate from any arising from the general running of the business.

In establishing a value for intangible assets meeting the above criteria, the CC will have regard to similar principles as for other types of assets.
 - Other adjustments may be considered on a case-specific basis.

⁵ These terms are used interchangeably to mean the current cost of acquiring assets which yield equivalent services to those currently used by the firm, based on the most efficient technology and optimal configuration.

⁶ These criteria were originally set down in the CC report, *The supply of banking services by clearing banks to small and medium-sized enterprises* (March 2002).

15. In situations where capital employed cannot be reliably valued the CC may consider alternative measures, such as the return on sales or other relevant financial ratios. For instance, comparisons with businesses operating in different but similar markets may on occasions be helpful.
16. In assessing levels of profitability the CC will have regard to its view of firms' cost of capital. The CC will generally look to the capital asset pricing model (CAPM) when considering the cost of capital, since this is a widely understood technique with strong theoretical foundations. However, the CC will have regard to alternative models where appropriate.

Annex B: Remedial action

Types of remedy

1. This annex summarizes some of the key considerations relevant to the evaluation, design and implementation of different classes of remedies. It is structured as follows:
 - (a) [Section 1](#) discusses divestiture and IP remedies.
 - (b) [Section 2](#) discusses behavioural remedies.
 - (c) [Section 3](#) discusses recommendations.

Section 1: Divestiture and intellectual property remedies

2. This section deals with issues relating to divestiture and IP remedies. These types of remedy are sometimes referred to as ‘structural remedies’, though as set out in paragraph 31, IP remedies can have both structural and behavioural aspects. Divestiture remedies are discussed in paragraphs 3 to 30 and IP remedies in paragraphs 31 to 36.

Divestiture remedies

Introduction

3. In essence, a divestiture seeks to remedy an AEC by either creating a new source of competition through disposal of a business or set of assets to a new market participant or strengthening an existing source of competition through disposal to an existing market participant independent of the divesting party (or parties).
4. The CC has required divestiture in one market investigation to report to date (BAA Airports). This guidance reflects the CC’s experience in that case and also, where relevant, the experience of designing and implementing divestiture remedies in merger inquiries, where divestiture is the most frequently used remedy option.¹
5. The design of a divestiture remedy will seek to address the underlying cause of an AEC and will take account of any risks of not addressing the AEC and any RCBs that may be affected by the form of divestiture.

Divestiture risks

6. Divestitures may be subject to a variety of risks that may limit their effectiveness in addressing an AEC. It is helpful to distinguish between three broad categories of risks that may impair the effectiveness of divestiture remedies as follows:
 - (a) *Composition risks*—these are risks that the scope of the divestiture package may be too constrained or not appropriately configured to attract suitable purchasers or may not allow a purchaser to operate as an effective competitor in the market.

¹ As a consequence, many of the examples cited in this section relate to divestitures in merger inquiries, where these examples illustrate a point that is also relevant to market investigations.

- (b) *Purchaser risks*—these are risks that a suitable purchaser is not available or that the divesting party (or parties) will dispose to a weak or otherwise inappropriate purchaser.
- (c) *Asset risks*—these are risks that the competitive capability of a divestiture package will deteriorate before completion of divestiture, for example through loss of customers or key members of staff.
7. The incentives of divesting parties may serve to increase the risks of divestiture. Although divesting parties will normally have an incentive to maximize the disposal proceeds of a divestiture they will also have incentives to limit the future competitive impact of a divestiture on themselves. Parties may therefore have, on balance, an incentive to make divestitures to weaker competitors of less competitive assets or businesses and may also allow the competitiveness of divestiture packages to decline during the divestiture process.²
8. Divestiture risks can be overcome, at least in part, through the design of the divestiture and by adopting protective measures such as appointment of monitoring and divestiture trustees and alternative divestiture packages as shown later in this section. To be effective in increasing rivalry—and managing divestiture risks—a divestiture remedy should involve the sale of an appropriate divestiture package to a suitable purchaser through an effective divestiture process. These critical elements of the design of a divestiture remedy are discussed in detail in the following sections.

Scope of divestiture packages

Package definition

9. In defining the scope of a divestiture package that will satisfactorily address an AEC, the CC will normally seek to identify a divestiture package that comprises a viable, stand-alone business that can compete successfully on an ongoing basis and is of sufficient scale and scope to enable its acquirer to become an effective competitor. This may comprise a division or the whole of an operating company functioning in the market affected by the AEC. Depending on the nature of the AEC, it may be necessary to identify more than one divestiture package to achieve a comprehensive solution—for example, if several distinct businesses under common ownership need to be divested to remedy the AEC.³
10. In order to achieve a proportionate solution, the CC will seek to identify the smallest such package (or packages) that is likely to be a viable competitor and satisfactorily addresses the AEC. Following discussion with parties, the CC may modify the scope of the proposed divestiture package (or packages) provided that the parties can demonstrate, to the CC's satisfaction, that the modified package (or packages) addresses the AEC and the modification does not create significant additional new costs or composition, purchaser or asset risks after taking account of protective measures.
11. The scope of a divestiture package will be outlined, with reasons, in the CC's report. The package will generally be specified in greater detail in the undertakings accepted or orders made by the CC when implementing the remedy. The divesting parties may

² See, for example, the *SCR Sibelco/Fife Silica Sands* inquiry (2001) as discussed in the CC's report *Understanding past merger remedies; report on case study research* (2010). See also the Federal Trade Commission's *A Study of the Commission's Divestiture Process* (1999) and DG COMP's *Merger Remedies Study* (2005) (for example, paragraph 44 of Summary and Conclusions).

³ As was the case in the *BAA Airports* market investigation.

also add further assets to the specified package at their request with the approval of the CC, or may be required to do so by the CC, to secure divestment to a suitable purchaser. The divesting parties will generally be prohibited from subsequently purchasing assets or shareholdings sold as part of a divestiture package or acquiring material influence over them. The CC will normally limit this prohibition to a sunset clause period of ten years.

Divestiture of an existing business or package of assets

12. The CC will generally prefer divestiture of an existing business that can compete effectively on a stand-alone basis independently of the divesting party (or parties), to divestiture of part of a business or a collection of assets. This is because divestiture of a complete business is less likely to be subject to purchaser and composition risk and can generally be achieved more quickly.
13. Where a proposed divestiture comprises part of a business or specified assets, such as IPRs, the capabilities and resources of prospective buyers are likely to be more critical to a successful outcome than for a stand-alone business. A package of assets proposed for divestiture may, for example, lack an established infrastructure and its viability may therefore be more dependent on an appropriate match with the capabilities of the purchaser. A package of assets may also be far more difficult to define or 'carve out' from an underlying business⁴ and the CC may have less assurance that the purchaser will be supplied with all it requires to operate competitively. In such circumstances, the CC is likely to require additional protective measures such as identification of an alternative divestiture package (see paragraphs 15 and 16) to mitigate increased purchaser and composition risk. Where a package of assets is proposed for divestiture, the CC will require the divesting parties to specify the composition and operation of the package in detail.
14. In particular circumstances, parties may propose a 'virtual divestiture' consisting of divestiture of production capacity⁵ for a specified period rather than conventional disposal of a business or package of assets. Such a proposal may have higher risks and costs than a conventional divestiture, and require continuing monitoring and compliance activity. The CC would need to satisfy itself that there was good reason to justify such a proposal in preference to a conventional divestiture and that the risks of the proposal could be appropriately contained.

Alternative divestiture packages

15. In some circumstances, it may be appropriate to define a more extensive and/or more marketable divestiture package ('alternative divestiture package'⁶) which the CC would require the parties to sell if the initially proposed divestiture package were not sold within a specified period. Alternative divestiture packages may be appropriate if there is doubt as to the marketability of the initially proposed divestiture package or where a business is subject to major asset risks and speed of divestiture is likely to be a critical requirement.⁷ In such circumstances, prior identification of a

⁴ DG COMP's *Merger Remedies Study* (2005) found that carve-out problems were a common cause of serious design and implementation issues in a significant proportion of divestiture remedies within its purview—see section 6 of Summary and Conclusions (pp152–155, public version).

⁵ So-called 'virtual power plant' remedies are examples of this type of remedy. See, for example, the Nuon/Reliant Energy case in the Netherlands, outlined in Appendix J of the ICN's Merger Remedies Review Project.

⁶ Such packages are sometimes referred to as 'Crown Jewel' packages; however, in view of the wide variety of usage of this term, the CC uses the more closely defined terminology of 'alternative divestiture packages'.

⁷ Other measures are also available to the CC to manage the risk that a divestiture is not implemented to the timescales set out by the CC in its final report. These include the ability to appoint a monitoring or divestiture trustees (see paragraphs 26 & 29). The specification of an alternative divestiture package may be used in conjunction with such measures.

more extensive, more marketable package may be the most effective means of facilitating rapid disposal if the initial package cannot be sold to a suitable purchaser within a specified period.⁸ In specifying an alternative divestiture package the CC would wish to satisfy itself that divestiture of such a package would be effective and (in the event that the proposed divestiture package had not been disposed to a suitable purchaser) proportionate.

16. The alternative divestiture package will include all the core assets necessary to remedy the AEC. The CC will wish to satisfy itself that the purchaser of such a package is committed to operate the core assets so as to compete effectively in the market(s) affected by the AEC and not primarily attracted by the additional assets. The CC will identify the alternative package in its report but the precise nature, and in some cases the existence, of an alternative package may be excised from the published version of the report to prevent the existence of the alternative package undermining divestiture of the initial package.

Suitable purchasers

Criteria

17. The identity and capability of a purchaser will be of major importance in ensuring the success of a divestiture remedy. The divesting party (or parties) will therefore need to obtain the CC's approval of the prospective purchaser(s). The CC will wish to satisfy itself that a prospective purchaser is independent of the divesting parties, has the necessary capability to compete, is committed to competing in the relevant market(s) and that divestiture to the purchaser will not create further competition concerns. The relative importance that the CC attributes to each of these criteria will depend on the circumstances of the inquiry. These criteria are considered in more detail below:

- (a) *Independence*. The purchaser should have no significant connection to the divesting parties that may compromise the purchaser's incentives to compete with them or, where relevant, with other major suppliers in the relevant market(s). Significant connections may include, for example, an equity interest, shared directors, reciprocal trading relationships or continuing financial assistance. The CC will seek to understand the significance of such connections in the context of the overall relationship between the parties concerned, in order to form a view of their cumulative effect on incentives to compete.
- (b) *Capability*. The purchaser must have access to appropriate financial resources, expertise and assets to enable the divested business to be an effective competitor in the market. This access should be sufficient to enable the divestiture package to continue to develop as an effective competitor. For example, a highly leveraged acquisition of the divestiture package that left little scope for competitive levels of capital expenditure or product development is unlikely to satisfy this criterion. Where the purchaser takes the form of a consortium, the CC will wish to satisfy itself that the structure and governance arrangements of the consortium will permit appropriate access to expertise and finance.⁹

⁸ The *EWS Railway Holdings/Marcroft Engineering* (2006), *Stericycle International LLC/Sterile Technologies Group Limited* (2006) and *Capita/IBS* (2009) merger inquiries provide examples of the use of alternative divestiture packages.

⁹ The CC reviewed consortium arrangements in the divestiture of Gatwick Airport (*BAA Airports*).

- (c) *Commitment to relevant market.* The CC will wish to satisfy itself that the purchaser has an appropriate business plan and objectives for competing in the relevant market(s).¹⁰
- (d) *Absence of competitive or regulatory concerns.* Divestiture to the purchaser should not create a realistic prospect of further competition or regulatory concerns. Moreover, the CC's approval of a purchaser may be subject to clearance by the OFT or other regulatory authority.
18. Except in circumstances, as specified below, where a divestiture trustee is in place, the divesting parties are responsible for securing a prospective buyer which is able to demonstrate that it satisfies the CC's criteria for a suitable purchaser. However, the CC will keep the progress of the divestiture under close scrutiny.
19. Where divesting parties receive interest from more than one prospective buyer, the CC will generally wish to evaluate whether purchasers fulfil the criteria before any purchaser is granted exclusivity to undertake detailed due diligence. This is to avoid situations where a prospective purchaser undertakes lengthy due diligence on an exclusive basis but is then found not to satisfy the CC's criteria.
20. In certain cases, for example where the effectiveness of a divestiture remedy is particularly dependent on the long-term development of the divested entity, the CC may require a purchaser to provide it with undertakings that it will not sell on the divested entity within a limited period other than with the CC's approval that the new purchaser satisfies the same purchaser criteria as applied in the initial divestiture. Whether such a restriction is necessary and the time period over which any such restriction will apply will be determined by the facts of the case.¹¹

Continuing links and purchaser protection

21. A purchaser should not have continuing links with the divesting party (or parties) after divestiture that may compromise the purchaser's incentives to compete with these parties, for example financial, ownership or management links. However, purchasers may require access to key inputs or services at appropriate terms from the divesting party (or parties), on an interim basis, in order to enable the divestiture to operate effectively. Such transitional service arrangements may be permitted by the CC for a limited period. The timescale over which transitional service arrangements will be permitted is likely to vary from case to case, depending on the time that it may reasonably be expected to take potential purchasers to develop their own independent access to the inputs or services in question.
22. The CC may also permit or require non-solicitation clauses or other measures to protect the purchaser from the divesting party (or parties) for a limited period to enable the purchaser to become established as an effective competitor in the relevant market(s). In order to ensure a timely remedy, the CC will seek to ensure that any period of purchaser protection is no longer than necessary and can be justified by reference to the steps necessary for the purchaser to become established as an effective competitor. In any event, given the desirability of achieving a timely remedy, the CC would not normally expect to permit or require such measures for more than two years.

¹⁰ This approach was upheld by the CAT in the *Somerfield v Competition Commission* case [2006] where the CC excluded limited assortment discount retailers from acquiring Somerfield stores on the basis that these were insufficiently close competitors to conventional supermarkets, paragraph 183.

¹¹ This restriction was required in the BAA divestitures, for which a period of five years was specified. This is the only instance to date in which the CC has specified a restricted period of this type in either a merger inquiry or a market investigation.

Effective divestiture process

Objective of process

23. An effective divestiture process will protect the competitive potential of the divestiture package before disposal and will enable a suitable purchaser to be secured in an acceptable timescale. The process should also allow prospective purchasers to make an appropriately informed acquisition decision.

Protecting the divestiture package

24. Divesting parties may have significant incentives to run down or neglect the business or assets of a divestment package, and/or continue to extract know-how and other commercially sensitive information from the divestment package. Such incentives, if acted upon, are likely to reduce the future competitive impact of the divestment package. The resulting asset risk may also be influenced by such factors as the length and complexity of the divestiture process and the pace at which customer goodwill and employee relations may erode.
25. To protect against these forms of asset risk, the CC will generally seek undertakings from the relevant parties which impose a general duty to maintain the divestiture package in good order and not to undermine the competitive position of the package. The CC may also require 'hold-separate' undertakings to mitigate asset risk. These will require the divestiture package to be held and managed separately from the retained business. Protection measures specified in final undertakings may sometimes continue existing measures specified in any interim undertakings that have been accepted by the CC (although interim undertakings can only be accepted in market investigations following publication of the final report). The appointment of a hold-separate manager or management team may also be required to manage the assets/business to be divested so as to maintain their competitiveness and establish separation from the retained assets.¹² Establishing separation may be a more complex issue than in merger inquiries.

Use of monitoring trustees

26. Where divestiture undertakings are in place, the CC will normally require the appointment of an independent monitoring trustee to oversee the parties' compliance with the undertakings and, if applicable, the performance of the hold-separate manager. The trustee will have an overall duty to perform in accordance with his or her agreed mandate and the directions of the CC. The trustee will monitor the ongoing management of the divestiture package and the conduct of the divestiture process. The CC will have the right to propose and direct measures necessary to ensure compliance with the undertakings. The trustee will report to the CC at regular intervals.

The divestiture period

27. The CC will state in its report the period in which the parties should achieve effective disposal of a divestiture package to a suitable purchaser (ie the 'initial divestiture period'). However, this period will normally be excised from the report if it is considered that disclosure to third parties may undermine the divestiture process. The

¹² The appointment of a hold-separate manager is particularly likely where strong incentives exist for the current senior management of the divestiture package to operate the divestiture package on behalf of the divesting party and/or if there is a high risk of deterioration of the business, for example through loss of key customers or members of staff.

length of this period will depend on the circumstances of the case but will normally have a maximum duration of six months in relatively straightforward divestiture cases. The CC, when determining the initial divestiture period, will seek to balance factors which favour a shorter duration, such as minimizing asset risk and giving rapid effect to the remedy, with factors that favour a longer duration such as canvassing a sufficient selection of potential suitable purchasers to facilitate effective disposal and adequate due diligence. In general, the CC would expect that the period permitted for divestiture in market investigations would be sufficient for the divesting company to realize an approximation-to-fair market value for the divestiture package. The initial divestiture period may be extended by the CC where this is necessary to achieve an effective disposal.

28. While the divesting parties are responsible for securing a suitable purchaser in the initial divestiture period, the CC will keep the progress of the divestiture process under close review through regular reporting and, where applicable, the scrutiny of a monitoring trustee.

Use of divestiture trustees

29. If the divesting parties cannot procure divestiture to a suitable purchaser within the initial divestiture period, then, unless this period is extended by the CC, an independent divestiture trustee may be mandated to dispose of the package within a specified period (the trustee's divestiture period) at the best available price in the circumstances, subject to prior approval by the CC of the purchaser and the divestiture arrangements. If the CC has reason to expect that parties will not procure divestiture to a suitable purchaser within the initial divestiture period, the CC may require that a divestiture trustee is appointed before the end of the initial divestiture period, or in unusual cases, at the outset of the divestiture process.¹³ The role of a divestiture trustee is distinct from that of a monitoring trustee, but the two roles may be performed by the same person subject to consideration of any potential conflict of interest. The CC may require a divestiture trustee to be selected and made ready prior to the end of a divestiture period in order to prevent any delay in appointment following the end of the divestiture period.

Review of divestiture documentation

30. The CC will wish to ensure, before providing its final approval of the divestiture at the end of the divestiture process, that the divestiture agreement and relevant supporting documentation convey all assets required to be divested, and contain no provisions that are inconsistent with the remedial objectives of the divestiture. For example, continuing links between the purchaser and the parties, as outlined in paragraph 21, may undermine competitive incentives.

Intellectual property remedies

Introduction

31. The licensing or assignment of IP, including patents, licences and brands, may be viewed generally as a specialized form of asset divestiture. However, in certain cases, the terms of a licence may contain ongoing behavioural elements such that the remedy is a structural/behavioural hybrid. The key element is the extent to which

¹³ The [Tesco/Co-op](#) store acquisition inquiry (2008) is an instance where the CC has required the appointment of a divestiture trustee from the outset of the divestiture period.

any material link between licensor and licensee will exist following award of the licence. A remedy that requires an assignment or licence of an IP right that is exclusive, irrevocable and non-terminable with no performance-related royalties will effectively be treated by the CC as structural in form and subject to similar consideration and evaluation as an asset divestiture. A licence that requires a licensee to rely on the licensor for updates of the technology or continuing access to specialist inputs or know-how will be regarded as a behavioural commitment and is generally subject to greater risks of not being an effective remedy.

32. For licensing of IP alone to be effective as a remedy, it must be sufficient to enhance significantly the acquirer's ability to compete with other parties in the market and thus address the AEC.¹⁴ Such a remedy may not be effective if the IP needs to be accompanied by other resources (for example, technical expertise and sales networks) to enable effective competition if these are unlikely to be available in potential acquirers of the IP.
33. In view of the possible risks to effectiveness, as outlined in paragraph 32, that may result from using IP remedies, the CC will generally prefer to divest a business including IPRs, where this is feasible, rather than rely on licensing narrowly defined IP alone. This is because divestiture of a business including IPRs is more likely to include all that the acquirer needs to compete effectively with other parties in the market.

Design factors

34. The appropriate design of an IP remedy may be influenced by several case-specific factors such as:
- (a) *The form and jurisdiction of the relevant IP (eg patent, exclusive licence, trade mark etc).* The CC will wish to ensure that the IP to be divested is sufficient to enable a purchaser to compete effectively. This may sometimes include less easily transferable forms of IP (eg 'know-how').¹⁵ Where there is uncertainty regarding the scope of a licence or its terms and conditions, the parties may be required to divest the underlying right and accept a licence back.
 - (b) *The relative specialization of the IP.* Highly specialized IP may impose particular constraints on selecting a suitable acquirer as there may be few parties competent to use the IP.¹⁶
 - (c) *The rate of innovation expected in the relevant market.* A high rate of innovation may imply a shorter required duration for a licensing remedy than in a more stable market.
 - (d) *Forms of payment for IP.* The form of payment (eg one-off payment, royalties or profit shares) may have an effect on competitive incentives.
35. IPRs generally enable the remuneration of investment in innovation by granting time-limited exclusivity. In considering the design and scope of IP remedies, the CC will

¹⁴ In the *Thermo Electron Manufacturing/GV Instruments* merger inquiry (2007) the CC rejected a licensing remedy proposed by the parties on the basis that it would not adequately restore competition lost by the merger.

¹⁵ See, for example, the *Shell/BASF* case in which the EC found that difficulties in transferring 'know-how' and other types of IP could have significantly reduced the scope and effectiveness of a licensing commitment (as outlined in Appendix D of the ICN's Merger Remedies Review Project).

¹⁶ The *Nufarm/AH Marks* merger inquiry is an example of an IP-style remedy where the field of suitable acquirers was particularly constrained.

recognize the need for preserving incentives for innovation while addressing competitive concerns.

36. Remedies relating to the transfer of IPRs may have international repercussions due, for instance, to international filing and licensing of patent rights. International co-operation with other competition authorities is therefore often particularly necessary in these cases.

Section 2: Behavioural remedies

Introduction

37. Behavioural remedies are designed to regulate the ongoing conduct of parties so as to address an AEC and/or its adverse effects. In market investigations the CC may use behavioural measures as a main remedy or as an adjunct to other measures (eg structural measures or recommendations).
38. The variety of market features and possible behavioural measures that may be encountered on individual investigations is extensive. This guidance therefore seeks to outline the CC's general approach to behavioural remedies, making reference to the types of measure that have been implemented in investigations to date, rather than dealing with all possibilities.
39. In the rest of this section some general issues are first considered relating to the design, monitoring and enforcement of behavioural remedies and their duration (paragraphs 40 to 45). The two main categories of behavioural remedies are then considered, namely enabling measures (paragraphs 46 to 85) and measures to control outcomes (paragraphs 86 to 93). The former address an AEC by seeking to remove obstacles to competition or otherwise stimulating competition within a market, whereas the latter seek to prevent the exercise of significant market power and thereby control the detrimental effects arising from an AEC rather than remedy the AEC itself. A comprehensive and timely solution to an AEC may require both categories of remedy.

General issues

Design, monitoring and enforcement

40. Behavioural remedies seek to change aspects of business conduct from what may be expected based on businesses' incentives and resources. The design of behavioural remedies should seek to avoid four particular forms of risk to enable these measures to be as effective as possible:
 - (a) *Specification risks*—These risks arise if the form of conduct required to address the AEC or its detrimental effects cannot be specified with sufficient clarity to provide an effective basis for monitoring and compliance. The intended operation of the measure needs to be clear to the persons to whom it is directed and other relevant parties, so that it is apparent what conduct constitutes compliance and what does not. For example, a commitment to permit access on FRND terms, without further clarification of what this means in practice, may create significant specification risk as the provision may be insufficiently specific to allow effective enforcement. Markets that are subject to frequent change in products or supply arrangements may be particularly prone to specification risk if the definition of required conduct is vulnerable to such changes.

- (b) *Circumvention risks*—It is possible that other adverse forms of behaviour may arise if particular forms of behaviour are restricted.¹⁷ For example, if prices are controlled a firm may reduce product quality. To avoid or reduce these risks, behavioural measures will generally need to deal with all the likely substantial forms in which enhanced market power may be applied. In some cases this may not be feasible or may make the behavioural measures too complex to monitor and/or enforce.
- (c) *Distortion risks*—These are risks that behavioural remedies may create market distortions that reduce the effectiveness of these measures and/or increase their effective costs. Distortion risks may result from remedies overriding market signals or encouraging circumvention behaviour. For example, prohibiting the use of long-term contracts may result in a lack of incentives to compete for new business.
- (d) *Monitoring and enforcement risks*—Even clearly specified remedies may be subject to significant risks of ineffective monitoring and enforcement. This may be due to a variety of causes such as the volume and complexity of information required to monitor compliance, limitations in monitoring resources, asymmetry of information between the monitoring agency and the business concerned and the long timescale of enforcement relative to a rapidly moving market.
41. For behavioural remedies to have the desired impact it is important that there are effective and adequately resourced arrangements in place for monitoring and enforcement so that there is a powerful threat that non-compliance will be detected and that action will be taken to enforce compliance where this is necessary.
42. The OFT, or the relevant sectoral regulator where appropriate, is responsible for monitoring and enforcing compliance of remedies under the Act.¹⁸ Customers and competitors of the firms subject to behavioural remedies may be in a strong position to report to the OFT, or the relevant sectoral regulator, on instances of non-compliance where they have appropriate resources and incentives to do so. However, such persons may be inhibited from fulfilling this reporting role by lack of resources and verifiable information, lack of understanding of the measures, fear of reprisals and other disincentives.
43. In view of constraints on the OFT's resources and the possible limitations in the reliance that can be placed on the reporting role of customers and competitors, it may be necessary for the CC to seek undertakings from the relevant parties to appoint and remunerate a third party monitor to enable the OFT, or the relevant sectoral regulator, to fulfil its monitoring responsibilities effectively.¹⁹ Alternatively monitoring may be facilitated by the CC making an order requiring the relevant parties to publish certain information²⁰ or to produce compliance reports that have been verified by an independent third party.²¹ The likelihood of effective monitoring will be significantly increased if it is possible to involve a sectoral regulator in the monitoring regime.

¹⁷ This general phenomenon may be sometimes referred to as a 'waterbed effect'.

¹⁸ Section 162.

¹⁹ For example, in *Northern Irish personal banking* the Lending Standards Board (LSB) played an important role in monitoring compliance with the CC's remedies. The duties of a third party monitor might include arbitrating disputes and advising the CC and/or OFT of relevant market developments as well as monitoring compliance.

²⁰ The *Home Credit* market investigation provides an example where parties were required to publish product and pricing information on a website.

²¹ The *PPI* market investigation provides an example where the largest providers were required to produce compliance reports and to have these verified by an independent third party.

44. A behavioural remedy may seek to prevent certain conduct that may be prohibited under the CA98's Chapter II Prohibition or under Article 102 TFEU. Similarly, a behavioural remedy may seek to prevent the making of agreements that may be prohibited under the CA98's Chapter I Prohibition or Article 101 TFEU. The CC recognizes the importance of ex post competition enforcement. However, the CC has an obligation to achieve as comprehensive a solution to the AEC and its detrimental effects as is reasonable and practicable. The CC will therefore normally prefer to specify its own remedial measures rather than rely on the general provisions of competition law, as this has the advantages that the CC measures can be designed to take account of the circumstances of the case and the provisions for monitoring and enforcement can be fully defined.

Duration

45. As behavioural remedies are designed to have ongoing effects on business conduct throughout the period they are in force, the duration of these measures is a material consideration. The CC may specify a limited duration if measures are designed to have a transitional effect. Where measures need to apply as long as an AEC persists and as this period can rarely be predicted during the course of an inquiry, the CC will generally rely on the relevant parties applying for variation or cancellation of the measures on the basis of a change of circumstances²² or possibly recommend that the OFT reviews the need for the measures after a given period. However, the CC may, in addition, specify a long-stop date in a 'sunset clause' beyond which the measures will definitely not apply. The period used for the long-stop date will depend on the circumstances of the case.

Enabling measures

46. Enabling measures aim to remedy an AEC by removing obstacles to competition or otherwise stimulating competition. Most enabling measures that have been introduced by the CC to date may be classified as:²³
- (a) market-opening measures;
 - (b) informational remedies; or
 - (c) measures to restrain the impact of vertical relationships.

Market-opening measures

47. Market-opening measures are aimed at removing impediments to effective competition, such as barriers to entry, expansion and/or switching. Such impediments may result from structural features of the market (eg barriers to entry) or from the behaviour of individual firms in that market (eg exclusionary conduct).
48. This is a diverse category of remedies. The specific aim of any market-opening measure and the particular mechanism that is used in any case, will depend on the market features that have been identified as preventing, restricting or distorting

²² Section 162. For example, in 2007, acting on the basis of advice from the OFT, the CC decided to release the UK's four largest clearing banks from most of the Transitional Undertakings given by them in 2002 following the investigation into *The supply of banking services by clearing banks to small and medium-sized enterprises* under the Fair Trading Act 1973.

²³ This is not an exhaustive classification. For example, in a situation where the CC found an AEC resulting from tacit coordination, remedy options might include enabling measures designed to prevent or restrict the flow of information between market participants, alongside other measures (eg structural remedies or measures to facilitate new entry).

competition and the practical opportunities available for addressing those features. Market-opening measures can be further subdivided into the following two categories:

- (a) Firm-specific measures to restrain horizontal market power.
- (b) Market-wide measures to reduce barriers to entry, expansion and switching.

Firm-specific measures to restrain horizontal market power

49. Where a firm enjoys significant market power it may be able to use the strength of this position in a number of ways to limit or restrain competition. These may include:
- (a) requiring customers to enter into long-term and/or exclusive contracts;
 - (b) creating switching costs for customers through, for example, volume discounts or contractual penalties;
 - (c) bundling or tying the sale of particular products; and
 - (d) selective discounting or exclusionary conduct.
50. Remedies may be introduced that prohibit, restrict or discourage types of behaviour, such as those listed above, where these have been found to prevent, restrict or distort competition. The selection and design of these measures will depend critically on the circumstances revealed by the inquiry and the need to manage specification, circumvention, monitoring and enforcement risks. Where circumstances point to the use of these measures, the CC will follow the general approach of considering the anticompetitive conduct that has been identified as having an AEC. It will then consider the measures that may be taken to prevent or limit this conduct and the effectiveness and costs of these measures.
51. As an example of the types of consideration relevant to this approach, the use of long-term and/or exclusive contracts by a firm with significant market power may create a barrier to entry or expansion. However, if, in the relevant market, firms need to invest heavily to acquire new customers (for example, by investing in new facilities or systems) requiring a firm with significant market power to have contracts that are short term in nature may generate distortion risks as this could reduce incentives to compete for new contracts if firms do not have sufficient opportunity to recoup their initial investment. In implementing a constraint on the use of long-term contracts, the CC will therefore seek an appropriate balance between facilitating switching and permitting sufficient incentives to compete for new contracts.
52. Likewise, selective discounting or price discrimination by a firm with market power can also have the effect of creating barriers to entry or expansion when used systematically to reduce prices to particular customers that are more likely to switch to other suppliers.²⁴ Measures to restrict selective discounting or price discrimination may therefore sometimes be necessary to address an AEC. However, measures restricting selective discounting or price discrimination may themselves generate significant distortion risk by adversely affecting the competitive dynamics of a market if maintained in the long term. They may therefore be most appropriate as a transitional measure until other sources of competition develop.

²⁴ The CC considered introducing measures designed to reduce the scope for selective discounting in the *LPG* market investigation.

53. The CC will have particular regard to avoiding circumvention risk in implementing measures limiting the behaviour of firms with significant market power that has been found to prevent, distort or restrict competition. This is because firms with significant market power may readily evolve new forms of behaviour to replace prohibited or restricted conduct.

Market-wide measures to reduce barriers to entry, expansion and switching

54. Market-opening measures may also be applied where incumbency advantages and other barriers to entry or switching have been found to prevent, restrict or distort competition. In this type of situation, market-opening measures to address these features may be applied to a market as a whole or, if this is not necessary and/or practicable, to the largest suppliers within the market.
55. The selection and design of these measures will depend critically on the specific features that have been identified as preventing, restricting or distorting competition. The types of measures that might be considered by the CC include:
- (a) measures to address barriers to switching; and
 - (b) measures to reduce incumbency advantages and other barriers to entry and expansion.
56. In some markets, customers may be put off switching suppliers by a perception that switching is costly, complex, time consuming and/or risky. This perception may be grounded in customers' own experience. Where barriers to switching have been identified as causing competition problems, measures may be introduced to make it easier for customers to switch.²⁵ For example, the CC may introduce obligations on a customer's existing supplier to cooperate with the proposed new supplier to ensure that costs and disruption to customers are minimized. Generally a new supplier will have significant incentives to make the switching process as easy as possible for the customer and will not normally require corresponding obligations.
57. Another factor that can deter customers from switching is if an important attribute of their current service is not transferable (or 'portable') from one provider to another and this leads them to remain loyal to their current supplier. For example, customers may wish to retain their existing telephone number if they change suppliers and may be deterred from doing so if this were not possible. Interventions to increase the portability of product attributes are most likely to be beneficial when the attribute that customers value is easily identifiable and the ownership rights of the attribute are easily transferable to rival firms or customers. In assessing remedies of this type, the CC is likely to evaluate the extent of any material benefits to customers associated with non-portability such as, for example, being able to identify the network to which a call is being made.
58. Remedies may also be introduced to address competition problems in markets where some existing providers have significant incumbency advantages over other providers (eg potential entrants), which are found to act as a barrier to entry and/or expansion. In some cases, 'incumbency advantages' may result from good com-

²⁵ For example, in the *LPG* market investigation, the CC found that a major barrier to switching was the requirement to replace a customer's existing tank with one owned and operated by the new supplier. This was costly and disruptive to customers. To overcome this barrier to switching the CC developed and implemented a 'tank transfer' remedy requiring suppliers to transfer the ownership of the LPG tank from one supplier to another when a customer switched. The tank transfer remedy was accompanied by other measures aimed at preventing contract terms that acted as a barrier to switching and informational remedies to raise customers' awareness of the options available to them.

mercial decisions made in the past (eg to invest in and patent a successful new technology) and interventions to overcome these sources of competitive advantage may risk undermining dynamic incentives to invest and innovate. In other situations the source of incumbency advantages may result from firms having preferential access to key resources, information or customers and it may be possible to intervene to promote competition without adversely affecting dynamic incentives.²⁶

59. A further potential source of incumbency advantage, which may sometimes require intervention, is the ‘point-of-sale advantage’. This occurs when a particular supplier has systematically better access to customers than potential rivals. A range of possible approaches might be taken to remedying competition problems resulting from a point-of-sale advantage. For example:
- customers may be encouraged to search for alternatives (eg through informational remedies) before they reach a particular point of sale;
 - providers who enjoy a point-of-sale advantage may be prohibited from completing a sale until a customer has an opportunity to shop around;²⁷ or
 - providers who enjoy a point-of-sale advantage may be required to offer customers a choice of products at the point of sale.²⁸
60. In considering such alternatives, the CC will consider the effectiveness and proportionality of different approaches, for example their impact on the behaviour of customers and suppliers as well as whether there are benefits to customers associated with purchasing a product at a particular point of sale.²⁹

Information remedies

61. Informational remedies can be used to address competition problems that are caused by shortfalls in the information that customers have to enable them to make informed purchasing or switching decisions. Informational remedies can lead to changes in customer behaviour, for example by reducing search costs, increasing customers’ awareness of alternatives and making it easier for customers to make comparisons between products when making an initial purchase or when switching suppliers. Informational remedies can also lead to changes in suppliers’ behaviour—for example, suppliers may improve their offering, in order that their products appear attractive in terms of the information that customers receive. Information remedies may also facilitate new entry, if a lack of awareness by customers of alternatives was a factor that was restricting entry.³⁰
62. The CC has introduced informational remedies in six market investigations completed to date (April 2013) under the Act,³¹ as well as in complex monopoly

²⁶ For example, in the *Home Credit* market investigation, the CC found that an existing home credit lender had a critical incumbency advantage in lending to its existing customer base over all other potential lenders. This was its knowledge of its customers’ repayment history in relation to loans taken out with it. This acted as a barrier to customer switching and as a barrier to entry and expansion. It also served to restrict competition from mainstream lenders. As part of a package of measures, the CC required the largest home credit lenders to share their repayment data with other lenders by entering into agreements with at least two credit reference agencies.

²⁷ For example, the point-of-sale prohibition in the *PPI* market investigation.

²⁸ For example, the so-called ‘guest beer’ provision in the ‘Beer Orders’.

²⁹ For example, in the *PPI* market investigation and the subsequent remittal, the CC considered the implications of any loss of convenience for the assessment of the proportionality of including the point-of-sale prohibition in the remedy package.

³⁰ A survey of the economic literature on different types of informational remedies may be found in Garrod et al, *Assessing the effectiveness of potential remedies in consumer markets*, OFT research paper 994, April 2008.

³¹ *Store Cards*, *LPG*, *Home Credit*, *Northern Irish personal banking*, *PPI*, *ROSCOs*.

investigations under the Fair Trading Act 1973, such as *Extended Warranties*.³² Informational remedies put in place by the CC include:

- (a) obliging firms to submit information about their products for publication on price comparisons sites (eg *Home Credit*, *PPI*);
 - (b) standardization of pricing structures³³ (eg *PPI* single-premium prohibition);
 - (c) mandatory disclosure of price and other key messages at the point of sale and in marketing materials (eg *Extended Warranties*, *Northern Irish personal banking*);
 - (d) requirement to offer written quotations that remain valid for a fixed period (eg *Extended Warranties*, *PPI*);
 - (e) requirement to provide information to existing customers in regular statements (eg *Store Cards*, *Northern Irish personal banking*, *PPI*);
 - (f) requirements to provide information to customers about their rights to switch and the switching process (*LPG*, *Northern Irish personal banking*, *PPI*);
 - (g) requirements to provide or extend ‘cooling-off’ periods (eg *Extended Warranties*); and
 - (h) requirements to provide financial information underpinning the pricing of products and services to potential franchise operators (eg *ROSCOs*).
63. The CC’s starting point for the selection of appropriate informational remedies will generally be the identification of the particular barrier to search or other information shortfall which is causing the AEC. This will help identify the information or message that needs to be communicated to customers: for example, if switching is suppressed because many customers have a mistaken belief that they are unable to switch suppliers, then an informational remedy could focus on correcting this misperception.
64. The CC will also consider how information may best be communicated to customers (eg via a website, through companies’ marketing material, or by periodic statements to customers). The choice between these options may depend on a number of factors, including:
- (a) *The ways in which customers currently obtain information about the product.* It may be more practicable to introduce informational remedies that build on existing sources of information used by customers.³⁴
 - (b) *Customers’ ability to access particular information channels.* For example, the level of Internet access among a customer base is likely to be relevant to consideration of whether to require firms to disclose prices on a price-comparison website.
 - (c) *The nature of the information to be provided to customers.* For example, the CC will generally consider whether information needs to be tailored to individual

³² *Extended warranties on domestic electrical goods* (2003).

³³ This type of remedy is more prescriptive than most informational remedies as it can constrain the type of product that can be offered. It therefore has some characteristics of a measure that controls outcomes.

³⁴ For example, in the *Home Credit* market investigation, some of the informational remedies required information to be included on customers’ payment books as this was a document that customers were likely to retain and look at regularly.

customers (eg via a customer statement) or whether a common message needs to be communicated to all customers (eg in marketing materials).³⁵

65. Any obligation to provide information to customers will usually fall on the providers of the product under investigation.³⁶ If information is to be provided using a medium over which providers have control, the CC may find it necessary to specify in some detail what information is to be provided and how. This is particularly likely to be the case if:
- (a) the disclosure is intended to help customers make comparisons between providers and a standard format for disclosure will help achieve this objective;³⁷ or
 - (b) providers have incentives to conceal or marginalize information that presents them in an unfavourable light or which encourages their customers to switch or shop around.
66. The CC will also have regard to the potential benefits of taking a less prescriptive approach. The cost to firms of complying with informational remedies will generally be lower if they have some flexibility as to how they meet their requirements. It may also be necessary to allow some flexibility, in order to ‘future proof’ the remedy, so that it is still effective in relation to new or unusual situations or products.
67. In considering the design of informational remedies, the CC will generally be mindful of how the remedy is likely to interact with existing obligations on firms relating to information provision. For example, the content of advertisements may already be regulated (as was the case in *Home Credit*) or firms may already be required to give various disclosures to customers at the point of sale (as was the case in *PPI*). The CC will look, where possible, to exploit positive synergies between existing regulations and CC proposed remedies.³⁸ It may sometimes be possible to implement informational remedies by building on existing mechanisms for communication with customers. Where this is the case, this may be a lower cost option than requiring the establishment of a new form of communication.³⁹
68. In specifying information remedies, the CC will look to ensure that information is provided at a time that the recipient can make use of it. For example, informational remedies that are intended to help customers search the market and compare products will tend to be most effective when customers see this information *before* they have made their main purchase decision. So, for example, providing price and product information in writing after a sale has been concluded—while sometimes

³⁵ For example, in *Store Cards*, information on the option to pay by direct debit and any APR that was over 25 per cent was provided to customers on statements; and in *Northern Irish personal banking*, information on charges relating to overdrafts was required to be communicated in marketing materials. Similarly, in *PPI* the CC is requiring PPI providers to provide existing customers with a personalized annual review and to include a small number of ‘key messages’ (which are not customer-specific) in their marketing material.

³⁶ In some circumstances (eg an obligation to publish information on an existing website) a third party may control the final presentation of information to customers. In such cases the CC would need to be satisfied that the way in which information was provided by a third party would be effective in addressing the competition problem identified. This may give rise to a recommendation to the third party concerned.

³⁷ See, for example, *Consumers and mortgage disclosure documentation*, September 2006, FSA, p9 and *Insight Research PPI forms consumer testing*, April 2009, CC, p4.

³⁸ For example, the recent review on the Northern Ireland Personal Current Account Banking Order took into account the information obligations banks face under two European Directives (the Payment Services Directive and the Consumer Credit Directive) and under other UK regulations (eg the FSA’s Banking Conduct of Business Sourcebook).

³⁹ For example, in *PPI*, the CC is obliging firms to provide information to the Money Advice Service for publication in its comparative tables, rather than developing a new site.

required for consumer protection—may only have a limited impact on search behaviour.⁴⁰

69. Informational remedies that are intended to facilitate switching will tend to be most effective if they are targeted at those customers who are able to switch, at a time when they are likely to be interested in switching (eg on invoices or statements setting out how much they have paid over a period).⁴¹
70. The CC may consider whether introducing an information remedy might have the unintended consequence of facilitating coordination between suppliers. As not all markets are conducive to coordination and as suppliers will generally have better information than customers about the prices charged by their competitors, this is most likely to be a material risk if the conditions for coordination are met and if prices are opaque to competitors in the absence of the remedy (eg because prices are subject to individually negotiated discounts).⁴²
71. The CC will consider carrying out specific customer research into informational remedies (or ‘road-testing’) before they are put in place.⁴³ Road-testing may be carried out during a market investigation to inform choices between alternative remedy options and the design of individual options. The CC has also carried out road-testing after publication of the CC’s final report, to fine-tune the detail of particular remedies prior to final implementation.⁴⁴

Restraining the impact of vertical relationships

72. Competition problems can sometimes arise where individual firms are active at different levels of the supply chain of particular goods or services (vertical integration). Similar problems can arise from contractual arrangements between firms active at different levels of the supply chain (vertical arrangements). Where a party has significant market power at one or more levels of the supply chain, vertical integration and/or vertical arrangements (collectively, vertical relationships) may contribute to an AEC, typically through the firm’s incentive and ability to disadvantage competitors by foreclosing access to key inputs, facilities or customers and/or exploiting access to confidential information.
73. For example, if, as illustrated below, the manufacturer (Compco) of most of a key industry component also owned a major user of this component (Prodco1) then the ability of other users (Prodco2 and Prodco3) to compete could be disadvantaged by the combined entity through restricting supply of this component to Prodco2 and Prodco3 or making use of information concerning component orders by Prodco2 and Prodco3.

⁴⁰ There is evidence from the academic literature that consumers can display a ‘status quo’ bias, which makes them more reluctant to change decisions that they have already made than to consider alternatives when making an initial choice. See, for example, FSA, *Financial Capability: A Behavioural Economics Perspective*, July 2008.

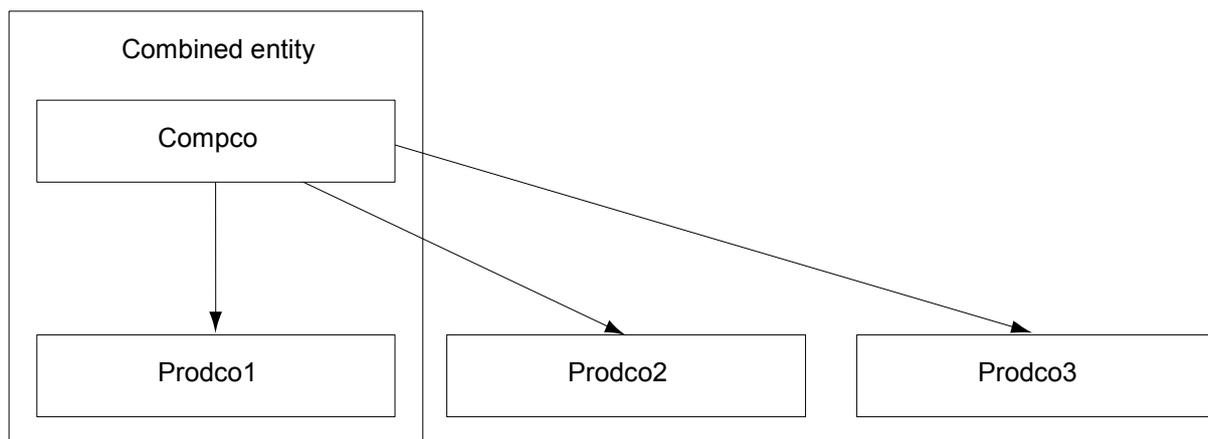
⁴¹ For example, in *Northern Irish personal banking*, a switching leaflet was required to be provided alongside customers’ annual summaries.

⁴² For an example of how such a risk might materialize, see ‘Government-Assisted Oligopoly Coordination? A Concrete Case’, S Albæk, P Møllgaard and PB Overgaard, 1997, *Journal of Industrial Economics*, 45(4), pp429–443. The CC considered the possibility that informational remedies could facilitate coordination in the *LPG* and *Home Credit* market investigations.

⁴³ See *Road Testing of Consumer Remedies*, London Economics, July 2009.

⁴⁴ For example, in *PPI*, the CC appointed market researchers after the final report to conduct focus groups with PPI customers, to see how customers reacted to different specifications of personal PPI quote and annual review forms. The findings of this research informed the development of the two forms, which were used as the basis for schedules to the resulting Order.

FIGURE 1

Illustration of vertical configuration

Source: CC.

74. An AEC resulting from vertical relationships might be remedied by structural measures. Such measures might involve vertical separation (eg requiring divestiture of ProdCo1),⁴⁵ but could also involve reducing the significant market power that the combined entity has at the critical stage of the supply chain (eg partial divestiture of Compco).
75. If vertical relationships produce substantial RCBs that would be largely reduced by structural measures, or if divestiture is otherwise not appropriate or feasible, then behavioural measures may be selected by the CC that enable continued access to necessary products or facilities on appropriate terms and/or measures that prevent the combined entity exploiting privileged access to information.

Access remedies

76. Access remedies seek to address competition problems resulting from vertical relationships by enabling competitors to have access on appropriate terms to the products and facilities of a combined entity that they require to be an effective competitor.
77. An access remedy will normally need to specify an access commitment by the firm concerned to third parties in sufficient detail so that third parties and monitoring agencies can enforce the commitment effectively. This will include details of the product or facility to be provided, including quality and technical parameters, and the terms of supply of the product or facility, including service levels and the basis of pricing. The latter may be particularly complex and may be subject to some of the same issues that are encountered with price caps, as discussed in paragraphs 90 to 93. If the access commitment is not specified or monitored in sufficient detail then the measure may be vulnerable to specification risk and the combined entity may be able to avoid its obligations readily. In such circumstances the CC may need to consider alternative forms of remedy (eg divestiture) that are likely to be more effective.
78. To overcome specification risk, the CC will also generally require that an access remedy should make explicit provision for accommodating future changes, for

⁴⁵ Or in the case of vertical arrangements, prohibiting the commercial arrangements between Compco and Prodco1.

example, in product specifications or supply arrangements. Where a market is likely to be subject to frequent technological change or other wide-ranging market developments, there is likely to be a significant risk that an access remedy will become ineffective if the terms of the access commitment do not accommodate these changes. However, significant technological change might also reduce the market power that results in the AEC (eg if—see Figure 1—effective substitutes are developed for the component supplied by Compco).

79. In some supply arrangements, certain factors that are not easily specified may be particularly important for competitive access, for example quality of product support, priority for system upgrades, and quality of management assigned to a customer's account. Such factors may result in 'soft biases' in access to supply that may generate significant circumvention risk and may significantly undermine the purpose and suitability of an access remedy.⁴⁶
80. In certain circumstances it may be possible to simplify the specification of an access remedy by obliging the combined entity to supply a particular product on FRND terms where supplies to external customers are provided on the same or similar terms as apply to its own businesses (see paragraph 40). For this to be effective, the nature of FRND terms must deal adequately with the circumstances of external customers and must be transparent to customers and monitoring agencies in sufficient detail to enable effective enforcement.
81. The use of FRND terms may still leave competitors vulnerable to a margin squeeze by the combined entity as it may have an incentive to charge all downstream businesses, including its own, a uniformly high price since reduced profitability in its downstream business can be offset by higher profitability in its upstream business. The CC may therefore require that use of FRND terms is accompanied by provisions to protect against a margin squeeze (eg submission of regular reports demonstrating full cost recovery in the downstream business).
82. Where it is necessary to preserve access to a key facility owned or controlled by a vertically integrated company and the usage and capacity of the facility is readily assessed, the CC may determine that the most practical and effective means of providing access to competitors is to cap usage of the facility by the combined entity and require it to auction remaining capacity to third parties.⁴⁷ This would be effectively a form of 'virtual divestiture' as considered in paragraph 14.

'Firewall' measures

83. 'Firewall' measures⁴⁸ seek to prevent a vertically integrated company from accessing and using privileged information generated by competitors' use of the company's facilities or products. For example, in Figure 1, in the absence of firewall provisions, Prodco1 may be able to exploit privileged information regarding the orders and deliveries of key components from Compco to Prodco2 and Prodco3.
84. Firewall measures prevent access to privileged information by effectively insulating the firm or division generating the information from other group companies. This is generally achieved by restricting information flows and use of shared services,

⁴⁶ In the *London Stock Exchange plc* merger inquiry (2005), the CC rejected a solely behavioural access commitment to clearing and settlement services due, in part, to the likely difficulty of 'soft biases'.

⁴⁷ In the *Centrica/Dynegy Storage* merger inquiry (2003), the CC required Centrica to restrict its usage of the Rough Gas Storage Facility to a percentage of total capacity to prevent foreclosure of access.

⁴⁸ These may be referred to alternatively as 'Chinese wall' measures.

physically separating premises and staff, and regulating transfers of management and any permitted interactions between relevant staff.⁴⁹

85. To ensure effective compliance with firewall provisions, the relevant firm will normally need to commit significant resources to educating staff about the requirements of the measures and supporting the measures with disciplinary procedures and independent monitoring.

Controlling outcomes

86. Remedies that control or restrict the outcomes of business processes, such as price caps, supply commitments and service level agreements, seek to prevent firms from exercising market power. As such, these remedies seek to restrict the customer detriment arising from an AEC, rather than addressing its cause.
87. In order to overcome specification risk, remedies that control outcomes normally need to specify in significant detail the products or services that are subject to control and the basis of the control, for example, the application of price indices to a price cap. The remedy will generally also need to specify how the control will deal with changes, such as the introduction of new products.
88. Measures to control outcomes are often used in regulated sectors, where it may not be feasible to introduce effective competition. The introduction of such measures is also a potential outcome of market investigations, particularly where it is not possible to identify effective ways of addressing the causes of the AEC or where competition-enhancing measures are likely to take a long time to remove the customer detriment that results from the AEC. However, such measures are vulnerable to the main risks associated with behavioural remedies (see paragraph 40) and this can have a negative impact on their effectiveness and cost. Specifically:
- (a) Defining appropriate parameters for the control measure—for example, the level of a price cap—may be complex and, in some cases impractical, and the measure may therefore be vulnerable to specification risks. This is especially likely where any of the following conditions apply:
- (i) Pricing in the relevant market is naturally volatile, for example because of variability in input costs.
 - (ii) Products or services are differentiated rather than homogeneous; this may increase the complexity of any control in order to capture adequately the diversity of products offer.
 - (iii) Prices are individually negotiated, which may also increase the complexity of any control measure.
 - (iv) Supply arrangements and products are subject to significant ongoing change, which require the control measure to change to reflect new developments.
- (b) This class of remedy directly overrides market signals with the result that it may generate distortion risks over time that increase the effective cost of the remedy or reduce its effectiveness. For example, a supply commitment for a particular product may discourage product innovation. While it may sometimes be possible

⁴⁹ The [Centrica/Dynegy Storage](#) merger inquiry provides an example of the measures that may be required by the CC to make firewalls effective.

to design measures to minimize distortion risk (sometimes referred to as ‘incentive regulation’) this may be at the expense of increasing the complexity of the control.

- (c) The control may be vulnerable to circumvention risks. For example, a price cap may be circumvented by a firm reducing the quality of controlled products or restricting the supply of controlled products. It may be sometimes possible to add preventative provisions to reduce the risk of circumvention, though this may be at the expense of increasing the complexity of the control.
 - (d) Monitoring and enforcement may be costly and intrusive and, in the absence of an industry-specific adjudicator or regulator,⁵⁰ may lack effectiveness, especially where the form of remedy is complex.
89. In view of these risks the CC will not generally use remedies that control outcomes unless other, more effective, remedies are not feasible or appropriate.⁵¹ In addition, where this class of remedy is employed, it is most likely to be used on a temporary basis unless there is no alternative to a continuing regulatory solution.

Price caps

90. Price caps are likely to be the most common form of measure for controlling outcomes and illustrate many of the issues outlined above.
91. Different approaches may be adopted to defining the products and prices to be controlled depending on the circumstances of the case:
- (a) Prices of all affected products may be individually capped. This may be impractical where a large number of products are involved and may be inflexible in dealing with product changes.⁵²
 - (b) The average price of a basket of products may be capped. This allows greater flexibility in taking account of shifts in demand between products but the weighting of the constituents of the basket may be problematic and subject to distortion, for example, if revenue-weighting is used and the firm introduces a number of low-cost product variants.⁵³
 - (c) The price cap may apply to key benchmark products. This approach could greatly simplify monitoring and compliance but is only likely to be effective if a few key products are likely to continue to account for a large proportion of sales and the

⁵⁰ Monitoring and enforcement of measures to control outcomes may be facilitated by the existence or appointment of a sufficiently resourced monitoring or adjudication body and/or a specialist industry regulator. For example, in the [Macquarie UK Broadcast Ventures/National Grid Wireless Group](#) merger inquiry, an independent adjudicator was appointed to resolve disputes arising in relation to the commitments that formed the package of behavioural remedies in this case. The adjudicator is paid for by the parties but is accountable to the OFT and under the guidance of Ofcom. In reaching its decision in this case, the CC had regard to the fact that Ofcom already had regulatory responsibilities for the relevant market.

⁵¹ Measures to control outcomes have been considered but rejected in a number of market investigations to report to date, including, for example, [ROSCOs](#) and [Store Cards](#).

⁵² For example, in the [Classified Directories](#) market investigation, consideration was given to how new local and re-scoped directories should be taken into account in order to avoid circumvention of the price control. The final remedies package included a provision within the price cap which set maximum prices that Yell could charge in new directories created as a result of re-scoping.

⁵³ For example, in the [Classified Directories](#) market investigation it was noted that although a basket may be preferable for regulated monopolies, its use on an incumbent facing emerging competition may not be beneficial. In this instance it was considered that the greater flexibility that a basket mechanism would give to Yell would enable it to target price-sensitive customers of its competitors and so undermine emerging competition. It would also enable it to target less price-sensitive Yell customers with price increases. Finally, it was also noted that a basket control introduced greater complexity, making it more difficult for customers and the OFT to monitor compliance.

pricing of other products is expected to remain closely related to the benchmark products.

- (d) The price cap may be to particular product terms (eg ‘hidden charges’). Again, this approach could simplify monitoring and compliance and may increase the overall level of price transparency for customers, though it may result in a ‘waterbed effect’ whereby other charges increase.⁵⁴

92. The CC will seek a basis for the price cap which will restrict the extent to which a firm’s market power is reflected in prices. The basis of a price cap may take a variety of forms:

- (a) Prices may be benchmarked to the prices of products in analogous markets that are determined by competition. In practice, this may only be feasible in limited circumstances due to the lack of an analogous market.
- (b) Prices may be determined on the basis of input cost data and an approved return on capital. This resembles the approach adopted by many sectoral regulators but generally requires a highly resource-intensive regulatory process backed by extensive information-gathering and enforcement powers to be effective.
- (c) A hybrid approach may be taken whereby an initial price reduction is determined on the basis of input cost data and an approved return on capital, with subsequent changes to the level of the price cap being updated by reference to an index that is representative of input cost changes after incorporating current productivity gains.⁵⁵ The CC will wish to use an index which has robust data sources which cannot be influenced by the parties subject to the price control. Use of such an index may provide a broad approximation to a competitive price outcome in the short term but is at risk of departing significantly from such an outcome in the medium to long term.

93. The CC will generally require that price caps are accompanied by measures to prevent circumvention risk that may arise, for example, through the merged entity restricting the supply or service levels of price-controlled products or reducing product quality.

Section 3: Recommendations

94. The CC can decide to make recommendations to others, either on their own or in combination with other measures as part of a solution to an AEC. The most common instances where the CC is likely to use recommendations are where it does not have jurisdiction to implement undertakings or orders directly, for instance where the area concerned is governed by a regulator or government department. Recommendations may also be included as a ‘fallback’ remedy, if it is uncertain whether the CC will be able to achieve its preferred remedy itself—for example, if this depends on parties being prepared to offer satisfactory undertakings.⁵⁶

⁵⁴ For example, in the *Home Credit* market investigation, the CC increased the value of the rebates paid to customers when they settled a loan early.

⁵⁵ For example, variation to the original FirstBus/SBH Undertakings was made to allow revenue to rise by a hybrid index calculated using costs from the Confederation of Passenger Transport UK (CPT) Scotland index, rather than the original 1997 fare cap which was based on increases to RPI. This was because there was concern that the previous method was distorting competition by restricting fare increases below increases in bus industry costs.

⁵⁶ For example, in *Groceries*, a recommendation was made to BIS that if the CC did not receive satisfactory undertakings from the parties in relation to the establishment of an Ombudsman then BIS should take action to establish the Ombudsman.

95. Recommendations will be directed to the party that is best able to implement the necessary action. It will, of course, be for the person to whom a recommendation is addressed to decide whether to act on the recommendation. The Government has made a commitment to give a public response to any recommendation made to it within 90 days of the publication of a CC report. In its response, the Government will set out where it does or does not propose to make changes in light of the report, or where it proposes to consult on options. The Government will take into account all public policy and welfare considerations, including considerations of Better Regulation, in making its assessment.
96. The CC has made recommendations in five market investigations to report to date (April 2013)—*Home Credit*, *ROSCOs*, *PPI*, *Groceries*, *BAA Airports*. Recommendations have been used to address a diverse range of market features and have had structural and behavioural elements, for example:
- (a) Improvements to the information provided to customers. For example, in *Home Credit*, the CC made a recommendation to BIS to require additional information on the Annual Statement that already had to be produced by lenders subject to the Consumer Credit Act.
 - (b) Changes to the policy and regulatory framework applying to a market. In *BAA Airports*, the CC made recommendations to the Department for Transport (DfT) and CAA about future airport regulation and airports policy.
 - (c) Changes to the operation of rail franchising. In *ROSCOs*, the CC made recommendations to the DfT and to Transport Scotland about the operation of the rail franchise system, for example the introduction of longer rail franchise periods.
 - (d) Changes to the operation of the planning regime. In *Groceries*, one element of the remedies package was a recommendation to the Department for Communities and Local Government (CLG) that a competition test for grocery store developments should be introduced into the planning system.
97. The fact that recommendations are not binding on the party to which they are addressed represents an intrinsic risk to their effectiveness as a remedy. A recommendation may not be accepted, may not be implemented in a way that is consistent with the CC's intentions, or may become redundant following a change of policy. There may be a risk to the effectiveness of a wider package of remedies, if the success of other measures in the package is dependent on a recommendation being followed.
98. In evaluating the effectiveness of a recommendation as a potential remedy, the CC will form a view on the likelihood that the recommendation will be acted on and the timescale over which this might be expected to occur. In reaching this view, the CC will have regard both to the stated policy of the body to which the recommendation is to be directed and to the possibility that that stated policy may change, either in light of the CC's recommendation or subsequent events.
99. Before making a recommendation, the CC will consult with the body to which the recommendation may be directed as well as parties likely to be affected by it. This will enable the CC to understand the benefits and risks of implementing the recommendation, to inform decisions about the specification of any recommendation, as well as informing the CC's judgement about the likelihood of the recommendation being accepted.

100. When considering the specification of a recommendation, the CC will normally consider a range of factors including:
- (a) what change is required to remove or reduce the obstacle to competition that has been identified;
 - (b) who is best placed to take the action necessary to effect the necessary change;
 - (c) how that change might be best achieved by the party to which the recommendation is addressed; and
 - (d) the likelihood of a recommendation being implemented, the timescale within this would happen under different assumptions and the likelihood that change, if implemented, would be sustained.
101. In relation to these factors, the CC will have regard to the degree of complexity and the number of institutions involved in making the change. Recommendations that are relatively straightforward to specify and to introduce are generally more likely to be implemented than recommendations which are more complex or which require closely coordinated action by a large number of bodies.
102. There may sometimes be a trade-off between these factors. For example, the ideal outcome from a competition perspective might be very difficult to achieve in a reasonable timescale, whereas it may be possible to achieve a material improvement in competition by means of a recommendation that can be implemented more quickly. In such circumstances, the CC will weigh up the relative merits of increased certainty of implementation against the possibility of achieving a better outcome, but with less certainty or over a longer timescale.



