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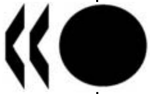

Organisation de Coopération et de Développement Économiques
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**English text only**

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS**
**COMPETITION COMMITTEE**

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**COMPETITION AND FINANCIAL MARKETS**

**Roundtable 2 on Crisis: The Role of Competition Policy in Financial Sector Rescue and Restructuring**

**-- Note by the United Kingdom --**

*This note is submitted by the United Kingdom to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 16-18 February 2009.*

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## 1. Executive Summary

### *1.1 Section One: Application of the failing firm defence during periods of financial distress or economic retrenchment*

#### *1.1.1 The UK competition authorities' approach to analysing 'failing firm' claims*

1. 'Failing firm' claims are ones where merging parties argue that the target business will exit the market without the merger; any harm to competition should therefore not be attributed to the merger.

#### *1.1.2 Criteria to assess absence of causal link between the merger and any competitive harm*

2. As is appropriate for a phase I body, the UK Office of Fair Trading (OFT) has explicitly adopted a stringent approach in such cases out of recognition that counterfactuals are easily the subject of self serving speculation – relatively easily alleged but difficult, given information asymmetries, to verify independently.

3. The OFT will only clear a transaction based on 'failing firm' claims where it has sufficient compelling evidence that all of the following conditions are met:

- **Inevitable exit of the target business absent the merger:** often because the business in question is in a parlous financial situation. Having demonstrably explored such options, there is no serious prospect of the target business being reorganised.

- **No realistic substantially less anti-competitive alternative:** there are no other realistic purchasers whose acquisition of the target business would produce a substantially better outcome for competition. Alternatively, in some cases it may be better for competition that the target business fails and the remaining players compete for its market share and assets rather than these being transferred wholesale to a single purchaser.

4. At Phase II the CC similarly considers whether or not the firm is failing as part of its assessment of the counterfactual. The considerations are similar to those of the OFT though the Competition Commission's (CC) decision as to the appropriate counterfactual is based upon its expectation of the most likely outcome in the market.

5. The above criteria demonstrate that it is important for the OFT in its merger assessment not merely that the target business would have exited the market, but also that the merger in question does not raise competition concerns compared to other realistic scenarios following exit of the target business.

#### *1.1.3 Application of the 'failing firm' criteria in the prevailing economic and market conditions*

6. The UK competition authorities will take account of the prevailing economic and market conditions when assessing evidence put forward by merging parties. A contextual evaluation of evidence will be important in relation to, for example:

- the inevitability of the target business exiting the market because of, for example, cash flow difficulties or an inability to raise capital; and

- the realistic availability of alternative purchasers for the target business as a result, for example, of difficulties in raising investment finance.

7. Therefore, while the prevailing economic and market conditions will be relevant to the UK competition authorities' consideration, they neither alter the analytical framework nor relax the thresholds that apply to the authorities' decision making. In particular, even if the authorities are satisfied that the firm is a failing firm, they will consider whether there was a less anti-competitive merger.

8. In its recent restatement of the 'failing firm' criteria, the OFT said:-

- There is no good reason why owners of a struggling business should be permitted to sell to another close competitor in the market simply because it is prepared to pay the highest price for the target business.

- Mere assertion that there is only one purchaser for a failing business will not suffice; compelling evidence must be provided.

### *1.1.4 Case study: Lloyds TSB and Halifax-Bank of Scotland*

9. Merger principles, including the 'failing firm' test, are applied no differently to mergers within the financial sector than to any other industry.

10. In its report regarding the merger of two of the largest retail banks in the UK, Lloyds TSB and Halifax-Bank of Scotland (Lloyds/HBOS), the OFT considered that the application of the failing firm defence was not appropriate given that it was not realistic to consider that HBOS would have been allowed to fail. Instead the OFT considered a range of possible counterfactuals besides a failing firm, concluding that the two most realistic scenarios, which would be expected to occur sequentially, were:

- Government would not have allowed HBOS to fail, and rather would have intervened in the short term with some form of rescue package. In these circumstances, the OFT believed it realistic to consider that HBOS would still be able to exert some competitive pressure in the market.

- In the medium to longer-term, Government would have withdrawn its support, leaving either a fully independent HBOS once more, or an HBOS in the hands of a 'no overlap' purchaser. In these circumstances, HBOS would constitute a significant player in the market place in the medium term.

11. In his subsequent decision of 31 October 2008, the Secretary of State decided not to refer the merger to the CC. This decision was not taken on protectionist grounds, e.g. the creation of a "national champion", but rather on the basis that the public interest. In this case, the risk to financial stability outweighs any potential competition concerns. The UK's merger regime explicitly provides for Government to intervene on public interest grounds. Lloyds/HBOS was the first case—in light of the exceptional economic and financial conditions—where the Government intervened and subsequently cleared a merger that raised competition concerns using an expedited (i.e. without reference to the CC) and explicit process on public interest grounds.

## ***1.2 Section Two: minimising market distortions in the market place***

### *1.2.1 Types of remedies*

12. The UK competition authorities have a number of tools for addressing competition issues in the economy, including in the financial services sector. These can be split into ex ante tools and ex post tools. The principal ex ante tool is merger control ('first phase' by the OFT and 'second phase' by the CC under the Enterprise Act 2002). The principal ex post tools are market studies and antitrust investigations (both

tools can be applied by the OFT—the former under the Enterprise Act, the latter under the Competition Act 1998), and market investigations (which are undertaken by the CC under the Enterprise Act).

13. The UK competition authorities have a preference for structural remedies, where these are available, over behavioural remedies in relation to merger control, since they tend to be more clear-cut in addressing concerns and to be more easily administered than behavioural remedies. These benefits of structural remedies also apply in relation to market studies and market investigations.

14. The application of remedies to alleviate competition concerns in a time of financial instability is more challenging as there is greater uncertainty and greater potential for unintended consequences. Further, remedies which address competition concerns need to take into account other polices designed to address the instability itself. In the case of ex ante remedies, a climate of economic instability may mean structural remedies become harder to apply. In the case of ex post remedies designed to address competition concerns that have already arisen, the challenge to competition authorities during a period of financial instability is to make appropriate remedies that account for both static and dynamic concerns and to consider trade-offs, while being sensitive to the prevailing economic climate.

15. However, in doing so the UK authorities also need to be mindful of whether the competition concern being remedied is independent of the financial instability, or is a consequence of it. If it is the former, then competition remedies should be taken forward. If it is the latter, then it may be better addressed by wider policy measures combating the instability as opposed to the use of specific competition policy tools.

16. On the basis of the above, behavioural remedies that address competition concerns might, at the margin, be more appropriate in some cases during a period of financial instability since they can be reviewed and revised as the market evolves. However, this should not mean that competition authorities should not consider structural remedies for competition concerns in a time of financial instability. If they can be devised in a manner appropriate for the case at hand and demonstrate an awareness of market conditions, then they can be equally effective to create conditions for effective competition.

*1.2.2 The impact of state intervention*

17. One of the consequences in the UK of the ongoing financial crisis has been an increase in instances of direct state intervention in the financial services sector, mainly banking. The main interventions have been the taking into public ownership of certain banks, or components of banks, injections of capital into banks (in exchange for shareholdings) and guarantee/insurance schemes to stimulate lending.

18. State ownership does not necessarily equate to State management, however, although it may be the case that banks with significant State shareholding are perceived by the market or consumers as having some form of unfair competitive advantage. If this is the case, then certain behavioural and structural remedies or monitoring may be appropriate to ensure that the banks do not exploit State ownership for anti-competitive purposes.

19. State interventions through guarantee/insurance schemes are more complex. If these schemes are offered to the whole market, then there should not be any competitive concerns, though there may be a risk that these guarantees protect inefficient firms from leaving the market. However, if interventions are selective, then there is the potential for anti-competitive effects and for potential conflicts with EC rules on State aid.

20. Intervention to rescue the financial system from systematic collapse in exceptional circumstances can be crucial, but should not be seen as a reason to suspend the importance of competition in other sectors, either via State aid, anti-competitive mergers or cartels.

## 2. Section One: application of the failing firm defence during periods of financial distress or economic retrenchment

### *2.1 Introduction*

21. This section first describes the OFT's position regarding its approach to cases where merging parties seek to persuade it that a merger raising competition concerns should be cleared on 'failing firm' grounds, or because the assets are inevitably exiting the market.

22. Although the OFT believes that its approach to 'failing firm' claims is capable of being applied whatever the market conditions, the financial sector may be uniquely prone to the adverse effects of systemic risk and loss of consumer confidence in periods of economic retrenchment.

23. Consequently, this section then describes how, in some circumstances, the UK Government may intervene in mergers to take public interest grounds into account, as well as competition considerations. Ensuring financial stability was recently included as one of three circumstances when Government may intervene on public interest grounds (the others being ensuring national security and ensuring plurality of the media).

24. This section lastly includes a case study on the recent merger of two of the UK's largest retail banks, Lloyds and HBOS, which illustrates the intersection in the financial sector of the OFT's application of its approach to 'failing firm' claims and the UK Government's approach to the new financial stability public interest consideration.

25. In reading this section, it is important to note that it applies to the position of the OFT to 'failing firm' claims and not that of the CC. This is because in the one application by the Government of the financial stability public interest consideration, the Secretary of State did not refer the Lloyds/HBOS merger to the CC, so there is no intersection between its application and the CC's position on 'failing firm' claims.

### *2.2 OFT's approach to analysing 'failing firm' claims*

26. The following is a summary of the OFT’s recent publication restating its position on 'failing firm' claims as set out in its existing guidance and decisional practice.[1] That restatement did not constitute new guidance that departs from or relaxes the OFT's basic approach, because the OFT considered that the applicable principles are capable of being applied whatever the economic and market conditions.The OFT published that restatement for two reasons. First, because it considered that consistent and transparent application of the criteria it uses to approach such cases is the best means of ensuring that businesses can continue to assess regulatory risk whatever the economic and market conditions. And second, in the light of the current financial climate, to highlight its willingness to give informal advice to merging parties on its application of those criteria.'Failing firm' claims are, in essence, ones that the target business[2] will exit the

[1] OFT Restatement of OFT's position regarding acquisitions of 'failing firms', December 2008 (OFT1047).

[2] 'Failing firm' arguments may alternatively apply to the acquiring business. Whether referring to the target or the acquiring business, the OFT has taken the view in its decisional practice that 'failing firm' arguments may apply to an entire business or to divisions or stand-alone business units (for example, individual retail stores). The term 'target business' is used as shorthand in this context.

market without the merger; any harm to competition should therefore not be attributed to the merger. As the UK's substantial lessening of competition ('SLC') test requires that the merger be the cause of competitive harm, the OFT has always believed that meritorious 'failing firm' cases should be allowed to proceed relatively swiftly through clearance by the OFT, even where for example the target business was not yet in liquidation or administration, notwithstanding that there have been few such cases to date.[3]

### *2.3 Criteria to assess absence of causal link between the merger and any SLC*

27. The OFT's duty under the Enterprise Act 2002 (the Act) to refer a merger to the CC for further investigation arises where the merger creates only a realistic prospect of an SLC, not just where the merger does so on the balance of probabilities.[4] Where merging parties argue that prevailing conditions of competition are not the appropriate benchmark to assess merger effects because the target business would have exited the market absent the merger in any event, the OFT has explicitly adopted a stringent approach in such cases out of recognition that such non-standard counterfactuals are easily the subject of self-serving speculation.

28. The hurdle set by the OFT's 'realistic prospect of an SLC' test therefore requires it to take a cautious approach, requiring compelling evidence where merging parties present 'failing firm' claims. In particular, the OFT will only clear a transaction based on 'failing firm' claims where the following two conditions are both met:

- **Inevitable exit of the target business absent the merger**

  There are two limbs to this condition. First, that the business in question would have inevitably exited the market in the near future. This will often be because the business is in a parlous financial situation, even if not yet in liquidation, but may be for some other reason such as a change in the seller's corporate strategy. Second, that having demonstrably explored such options, there is no serious prospect of the target business being reorganised. This takes account of the reality that even businesses in receivership often survive and recover.

- **No realistic and substantially less anti-competitive alternative**

  There are no other realistic purchasers whose acquisition of the target business would produce a substantially better outcome for competition. Even if such a purchaser may not pay the seller as high a purchase price or otherwise benefit the target business, the OFT will take into account any realistic prospect of alternative offers above liquidation value.Alternatively, in some cases it may also be better for competition that the target business fails and that the remaining players compete for its market share and assets rather than that these be transferred wholesale to a single purchaser.

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3 The OFT has applied the 'failing firm' defence four times under the Enterprise Act 2002: (i) *Anticipated acquisition by First West Yorkshire Limited of Black Prince Buses Limited* 26 May 2005 (failing firm defence met in respect of a bus business as a whole); (ii) *Anticipated acquisition by Tesco Stores Limited of five former Kwik Save stores (Handforth, Coventry,* Liverpool, Barrow-in-Furness and Nelson) 11 December 2007 (failing firm defence met in respect of individual local grocery stores); (iii) Completed acquisition by the CdMG group of companies of Ferryways NV and Searoad Stevedores NV 24 January 2008 (failing firm defence met in respect of target business); and (iv) Completed acquisition by Home Retail Group plc of 27 leasehold properties from Focus (DIY) Ltd 15 April 2008 (failing firm defence met in respect of an individual DIY store).

4 As clarified in *IBA Health Ltd v OFT* [2004] EWCA Civ 142.

### *2.4 Application of the 'failing firm' criteria in prevailing economic and market conditions*

29. The OFT will take account of prevailing economic and market conditions when assessing evidence put forward by merging parties. However, as a legal and policy matter, the OFT will not, regardless of prevailing economic and market conditions, relax the 'sufficient compelling evidence' standard required to demonstrate that a merger between close competitors is not itself the cause of any SLC for three reasons:

- Although merging parties may find their businesses under financial pressure as a result of changing conditions, their customers may well be in a similar position. Weakening evidentiary standards to allow anti-competitive mergers is likely to bolster operators with market power at one level of the supply chain, only to increase pressure downstream as a result of anti-competitive price increases, or other anti-competitive conduct, resulting from the merger. The creation of, or increase in, market power in UK markets, where this is far from inevitable, will also fail to serve productivity of the UK economy well in the longer term.

- There is no good reason why owners of struggling businesses should be permitted to sell to another close competitor in the market simply because it is prepared to pay the highest price for the target business. Businesses wishing to exit the market must be aware of the implications of choosing to try to sell to a close competitor. To advance a 'failing firm' argument, they will need to adduce evidence to demonstrate the absence of any realistic and substantially less anti-competitive alternative purchaser. In terms of execution risk for a deal, the quickest and least risky sale is to a purchaser that raises no competition issues, if such a purchaser exists, even if the price which that purchaser offers is lower than that which was offered by a close competitor.

- In situations where the target business is failing and there is genuinely only one purchaser for the business in question, merging parties must be aware that they will need to provide compelling evidence of this to the OFT if they are to avoid a reference to the CC. Mere assertion that this is the case will not suffice.

30. The OFT's 'realistic prospect' threshold is intentionally a lower and more cautious threshold for an SLC finding than that applied by the CC after more extensive investigation. While applying a similar analytical approach, the difference in the test has implications for the two authorities' approach to the counterfactual. In particular, the prevailing conditions of competition will generally be the relevant starting point for the OFT when making the counterfactual assessment. The CC will consider what it thinks is the most likely outcome in the market under investigation and will define the counterfactual based upon its expectation. Hence from an evidentiary perspective it may be relatively more difficult to establish a failing firm counterfactual at the OFT stage than at the CC stage.

### *2.5 UK public interest considerations in mergers*

31. As explained above, the Act allows for an assessment to be made of qualifying mergers on competition grounds by the OFT and, if referred, the CC. However, the Act also allows for the possibility of Government intervention in the normal process on certain specified public interest grounds.[5]

32. Under the Act, the Secretary of State has the ability to issue a public interest intervention notice (PIIN) in the case of mergers that meet the jurisdictional thresholds, which have public interest implications and which the OFT has not referred to the CC. At the time of the announcement of the

[5] See chapter 8 of the OFT's Mergers – Procedural Guidance (OFT 526) for a full description of the procedure in public interest cases. What follows here is a summary only.

Lloyds/HBOS merger on 18 September 2008 (discussed below), public interest considerations were limited to national security (including public security), and plurality and other considerations relating to newspapers and other media.

33. The Secretary of State therefore issued a PIIN on the merger on 18 September that specified 'the stability of the UK financial system' as a public interest consideration under the Act. This new public interest consideration was subsequently laid before Parliament on 7 October for its approval. It was then approved by the House of Lords on 16 October and by the House of Commons on 22 October, and came into force on 24 October 2008, the date the OFT submitted its report on the merger to the Secretary of State as requested by him.

34. When a PIIN is issued by the Secretary of State, the OFT publishes an invitation to comment seeking third party views on both any competition and public interest issues. Following its own internal review, the OFT then provides binding advice to the Secretary of State on a date specified by him on jurisdictional and competition issues. The OFT may also advise on the public interest considerations that are relevant to the Secretary of State's decision on reference, and must, other than in media cases, pass to the Secretary of State a summary of any representations it has received that relate to these public interest matters.[6] The OFT also informs the Secretary of State as to whether it would be appropriate to deal with competition concerns by way of undertakings in lieu of reference. The Secretary of State then subsequently makes a judgment on the outcome of the case in the light of the OFT's advice.

35. In doing so, the Secretary of State may make a reference to the CC, if he believes:

- that the merger gives rise to a realistic prospect of an SLC and, combined with the relevant public interest consideration(s), operates against the public interest; or
- while there is no SLC arising from the merger, that the public interest considerations are such that the merger operates against the public interest.[7]

36. Conversely, the Secretary of State may decide not to make a reference to the CC, if he believes that the OFT's findings on SLC are outweighed by one or more public interest considerations.

37. In either event, the Secretary of State is bound by the OFT's competition findings.

### *2.6 Case study: Lloyds-TSB and Halifax-Bank of Scotland*

38. On 18 September 2008, Lloyds announced its intention to acquire HBOS. The parties were two of the largest banks in the UK, whose activities covered retail, commercial and corporate banking. However, the parties overlapped most closely in the supply of personal current accounts (PCAs), banking services to small and medium-sized enterprises (SMEs), and mortgages—in each of which they were two of the largest five banks in the UK.

39. In its report to the Secretary of State on 24 October 2008, the OFT concluded that the merger gave rise to a realistic prospect of an SLC in the supply of PCAs, banking services to SMEs and mortgages. In doing so, the OFT considered that merger principles, including the 'failing firm' criteria, are applied no differently to mergers within the financial sector as they would to any other industry.In

[6] In cases raising media public interest issues, Ofcom (the UK's communications regulator) will provide a separate report on issues of media plurality and diversity.

[7] If a reference is made on public interest grounds (with or without competition grounds) the Secretary of State will also make the final decision on the merger following the CC's report.

particular, the OFT considered that the application of the failing firm defence was not appropriate given that it was not realistic to consider that HBOS would have been allowed to fail by the UK Government (or that its assets would have been allowed to exit the market). Accordingly, the OFT did not consider it realistic to consider that the failure/exit of HBOS (or its assets) would inevitably have occurred, and therefore ruled out failure/exit as a possible substitute counterfactual. Instead the OFT considered a range of possible counterfactuals besides a failing firm, concluding that the two most realistic, which would be expected to occur sequentially, were:

- Government would not have allowed HBOS to fail, and rather would have intervened in the short term with some form of rescue package. In these circumstances, the OFT believed it realistic to consider that HBOS would still be able to exert *some* competitive pressure in the market (although it recognised the possibility that HBOS might, at least in the short term, be a weaker force when compared to the HBOS prior to the current financial crisis).

- In the medium to longer-term, Government would have withdrawn its support, leaving either a fully independent HBOS once more, or an HBOS in the hands of a 'no overlap' purchaser. In these circumstances, HBOS would constitute a significant player in the market place in the medium term.

40. In his subsequent decision of 31 October 2008, the Secretary of State decided not to refer the merger to the CC. This decision was not taken on protectionist grounds, e.g. the creation of a "national champion", but rather (due to the risk to financial stability) because the merger did not operate against the public interest. In particular, the Secretary of State took into account the views of the Tripartite Authorities (the Bank of England, the Treasury and the Financial Services Authority—the UK financial services regulator) that the merger also provided an effective, market based means of restoring the stability of HBOS and helped to secure the stability of the UK financial system as a whole. On balance, therefore, the Secretary of State concluded that ensuring the stability of the UK financial system outweighed the competition concerns identified by the OFT and that the public interest was best served by clearing the merger.

41. This interaction of the OFT's treatment of 'failing firm' claims in this case and of the Secretary of State's treatment of the financial stability public interest consideration suggests that the OFT's approach to 'failing firm' claims is capable of being applied whatever the market conditions, even in the financial sector where consumer confidence and systemic risk may be particularly important. In the case of Lloyds/HBOS, the OFT found that the application of the failing firm defence was not appropriate (based on the finding that HBOS would not have been allowed to fail). Instead, the risk to financial stability was addressed using a pre-existing mechanism under the UK's merger regime for dealing with public interest considerations, and changes to that mechanism are subject to the normal democratic parliamentary process for changing laws.

42. Further, in periods of financial distress, widespread adverse effects of the loss of consumer confidence and of systemic risk in the financial sector can occur very quickly. This perhaps contrasts to other sectors where loss of consumer confidence and, in particular, systemic risk are likely to have less serious consequences. The European Commission has reacted to these risks by granting derogations from the suspensory effect of its merger regulation in a number of cases (although it has still gone on to review these cases under its normal review periods and against its normal competition test). The position in the UK is different in two material ways.

43. First, the UK's merger regime is voluntary which means that parties are able to complete their merger at any time (and therefore potentially mitigate against loss of consumer confidence/systemic risk).

44. Second, and arguably more important, the regime explicitly provides for cases raising financial stability issues via an expedited merger control procedure (i.e. the Secretary of State can—in exceptional circumstances—clear a deal without an in-depth CC inquiry), as in Lloyds/HBOS. Such an expedited, explicit procedure arguably can restore confidence and mitigate systemic risk while providing the Secretary of State with proper consideration of the competitive effects of the merger.

## 3. Section Two: minimising distortions to competition in the financial sector

### *3.1 Introduction*

45. This section briefly describes the principal types of remedies to competition problems in the financial sector that are available to the UK competition authorities, the OFT and the CC. This section then discusses the use of state intervention in the financial sector, which has increased in the UK as a result of financial instability. In doing so, this section emphasises trade offs in using both so as to minimise distortions to competition.

### *3.2 Types of remedies*

46. The UK competition authorities have a number of tools for addressing competition issues in the economy, including in the financial services sector. These can be split into ex ante tools and ex post tools. The principal ex ante tool is merger control ('first phase' by the OFT and 'second phase' by the CC under the Enterprise Act 2002).[8] The principal ex post tools are market studies and antitrust investigations (both tools can be applied by the OFT—the former under the Enterprise Act, the latter under the Competition Act 1998), and market investigations (which are undertaken by the CC under the Enterprise Act).[9]

47. A number of remedies, which can be behavioural or structural, can result from these tools. A behavioural remedy is normally an ongoing measure that regulates behaviour by a firm or firms, such as price caps and supply commitments. A structural remedy is typically a one-off measure, such as divestment of shares or assets[10]. The two types of remedy can be combined, for example where a behavioural remedy is necessary in order to support a structural remedy.

48. The remedies that result from these tools differ between the two UK competition authorities.

- An adverse finding by the OFT under the Competition Act means that the conduct is unlawful. The OFT can therefore impose legally-enforceable directions to stop the unlawful conduct. The OFT can also impose fines of up to 10 per cent of annual worldwide turnover.[11]

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8 Other ex ante tools include the recognition of trading exchanges, and the review of practices and regulations under the Financial Services and Markets Act 2000.

9 Other ex post tools include the Consumer Credit Act 2006 and other parts of the Financial Services and Markets Act 2000.

10 The focus of this discussion is on remedies. This is distinct from fines or penalties. A remedy is typically more a directional action to prevent an infringement occurring, whereas a fine/penalty acts more as a deterrent or is a punishment when competition law is violated.

11 There are other consequences of breaching UK competition law that are not directly imposed by the OFT. It is a criminal offence for individuals to engage dishonestly in cartels. Individuals found guilty by a court can be imprisoned for up to five years and face an unlimited fine. Company directors whose companies breach competition law may be subject to competition disqualification orders imposed by the OFT, which will prevent them from being involved in the management of a company for up to 15 years. Damages

- The OFT may accept (but not impose) behavioural or structural undertakings in lieu of reference to the CC under the Enterprise Act: where a merger raises the realistic prospect of a substantial lessening of competition (SLC); and where the OFT has reasonable grounds for suspecting that any feature, or combination of features, of a market is preventing, restricting, or distorting competition.

- By contrast, the CC may impose behavioural or structural remedies in two situations under the Enterprise Act: where a merger gives rise to an SLC; and where any feature, or combination of features, of a market prevents, restricts or distorts competition.

49. The UK competition authorities, in common with many others, have a preference for structural remedies, where these are available, over behavioural remedies in relation to merger control, for two reasons. Firstly, they tend to be more clear-cut in addressing concerns. Structural remedies can directly address any market power arising from the merger by restoring the pre-merger market structure. Secondly, structural remedies also tend to be more easily administered than behavioural remedies. These benefits of structural remedies also apply In relation to market studies and market investigations. However, depending on the nature of the competition concern identified, an appropriate structural remedy may not exist, so measures to address supplier or consumer behaviour may be appropriate.

### *3.3 Remedies in periods of financial instability*

50. Competition concerns can still arise in periods of financial instability. Indeed, they may be more pronounced or have the potential to be longer lasting. The application of remedies to alleviate competition concerns in a time of financial instability is more challenging as there is greater uncertainty and potential for unintended consequences. Further, remedies which address competition concerns need to be aware of other policies designed to address the instability itself. There may be trade offs and tensions between the two.

51. In the case of ex ante remedies to address competition concerns a climate of economic instability may mean structural remedies become harder to apply. Companies may find it harder to dispose of assets as part of a structural remedy, or to do so within the timescales that would usually be considered appropriate, because they cannot find a buyer. It may also be harder to devise remedies when the market itself is being realigned and a remedy that does not acknowledge this may lead to a sub-optimal equilibrium in the new state of the world. When devising ex ante remedies there is a need to be sensitive to the prevailing economic climate, although the general policy preference for structural measures should remain.

52. Turning to ex post remedies designed to address competition concerns that have already arisen, under a period of financial instability the challenge to competition authorities is to make appropriate remedies that account for both static and dynamic concerns and consider trade-offs. Again, when devising ex post remedies, there is a need to be sensitive to the prevailing economic climate.

53. However, in doing so the UK authorities will also need to be mindful of whether the competition concern being remedied is independent of the financial instability, or is a consequence of it.

54. If it is the former, then competition remedies should be taken forward. For example, in the PPI market investigation, whilst no party suggested that its overall financial stability would be jeopardized by remedies (though several said they would consider exiting the market for PPI if the proposed remedy

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claims can also be brought by third parties and by consumer groups on behalf of named consumers against businesses that breach competition law.

package was implemented), several parties to the investigation said that the CC should take a cautious approach to remedies in light of the prevailing economic circumstances. In that case the CC concluded that, if anything, in an economic downturn the case for intervention to address a competition problem in PPI could be seen to be more pressing, since the current high prices discourage PPI uptake and could result in consumers being uncovered at a time of increased risk.[12]

55. If it is the latter, then it may be better addressed by wider policy measures combating the instability as opposed to specific competition policy tools.

56. On the basis of the above, behavioural remedies to address competition concerns might, at the margin, be more appropriate in some cases, in a time of financial instability. Applying behavioural remedies have the advantage of not being static; they can be reviewed and revised as the market evolves.

57. However, this should not mean that competition authorities should not consider structural remedies for competition concerns in a time of financial instability. If they can be devised in a manner appropriate for the case at hand and demonstrate an awareness of market conditions, then they can be equally effective. In the PPI market investigation the CC's package of remedies includes structural elements – such as prohibitions on selling policies where the premium is paid in one lump sum at the beginning of the policy, and on selling PPI bundled with merchandise protection insurance unless PPI is also sold on its own. The CC concluded that, despite the current financial instability, these remedies were needed to create conditions for effective competition between providers.

### *3.4 State intervention in periods of financial instability*

58. One of the consequences in the UK of the ongoing financial crisis has been an increase in instances of direct state intervention in the financial services sector, mainly banking. The main interventions have been the taking into temporary public ownership of certain banks, or components of banks, injections of capital in banks (in exchange for shareholdings) and guarantee/insurance schemes to stimulate lending.

59. In the absence of explicit reasons to expect a linkage in a firm's competitive strategy between the identity of its owner(s) and the nature of their control over its competitive actions (for example, where a competing firm's owners have material influence over its pricing decisions), the identity of a firm's owner(s) is not normally relevant to competition policy. This is the case with banks which are owned by the State or have a significant State shareholding. In the UK, the recent capital injections have led to the State having shareholdings in the banks, but day-to-day management and strategy is not carried out by Government.[13] That is, State ownership should not necessarily equate to State management.

60. However, it may be the case that banks that have a significant State shareholding are perceived by the market and consumers as having features that allow them to gain some form of unfair competitive advantage. If this is the case, then certain behavioural and structural remedies or monitoring may be appropriate to ensure that the banks do not exploit State ownership for anti-competitive purposes.

61. State interventions through guarantee/insurance schemes are more complex. If these schemes are offered to the whole market, then there should not be any competitive concerns, though there may be a risk that these guarantees protect inefficient firms from leaving the market. However, if this intervention is

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[12] Market investigation into payment protection insurance, paragraph 10.20. http://www.competition-commission.org.uk/rep_pub/reports/2009/fulltext/542.pdf.

[13] http://www.hm-treasury.gov.uk/press_105_08.htm.

selective, then there is the potential for anti-competitive effects and potentially conflicts with EC rules on State aid.

### *3.5 State intervention vis-à-vis anti-competitive restrictions*

62. In a recent speech on 'Competition policy in troubled times', OFT Chief Executive John Fingleton discussed state intervention vis- à -vis anti-competitive restrictions, such as anti-competitive mergers and cartels.[14]

63. In doing so, he commented that 'intervention to rescue the financial system from systemic collapse in exceptional circumstances can be crucial, but should not be seen as a reason to suspend the importance of competition in other sectors, either via State aid, anti-competitive mergers or cartels. Subsidies are rarely ideal: they are costly for the taxpayer, can prop-up less efficient firms, create dependency, and ultimately damage competitive incentives. Restrictions on competition are worse. In addition to higher consumer prices and the inefficiency, they are less transparent and can result in permanent changes to market structure. Ad hoc changes to the competition rules can also remove consistency and predictability for business, with additional harm to efficiency. Naturally, incumbent business will rarely object to subsidies or restrictions on competition.'

[14] http://www.oft.gov.uk/shared_oft/speeches/2009/spe0109.pdf.