

Director of Legal Services :
David Tatlow

BRIEFING

THE COMPETITION ACT 1998

Introduction

1. The Competition Act 1998 (“**the 1998 Act**”) introduces two new prohibitions:-
 - ◆ The Chapter I Prohibition (Anti-competitive agreements) – This deals with agreements (whether written or not) which prevent, restrict or distort competition and which may affect trade within the United Kingdom; and
 - ◆ The Chapter II Prohibition (Abuse of a dominant position) – This deals with conduct by undertakings which amount to an abuse of a dominant position in a market and which may affect trade within the United Kingdom.
2. The two prohibitions came into force on **1 March 2000**.
3. The Council needs to ensure that it does not engage in conduct (e.g. as a purchaser of services or as a party in a consortium) that infringes the Act. Equally it needs to be alert to conduct by others (e.g. its suppliers or contractors) that may contravene the 1998 Act.
4. This briefing is based largely on a range of guidance documents which have been issued in the last year by the Office of Fair Trading. The Director General of Fair Trading

(“**DGFT**”) will apply and enforce the 1998 Act. As the 1998 Act focuses on commerce and how businesses operate, it is not straightforward to apply in the public sector context.

5. The concepts in the 1998 Act are different from those of anti-competitive behaviour that the Council was used to considering in its implementation of Compulsory Competitive Tendering under the Local Government, Planning and Land Act 1980 and the Local Government Act 1988.
6. Achieving effective competition is now a very relevant issue as the Council seeks to make arrangements under Section 3 of the Local Government Act 1999 to secure continuous improvement in the way its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

Undertakings

7. Both the Chapter I and Chapter II Prohibitions address conduct by “**undertakings**”. The interpretation of this term as with other terms in the 1998 Act has to be undertaken in accordance with the law of the European Community. The Office of Fair Trading in October 1999 stated:-

*“It extends to any natural or legal person carrying on commercial or economic activities, whatever its legal status, and regardless of the way in which it is financed (cf, for example, **Hofner & Elser –v- Macrotron** [1983] 4CMLR 306). The term has therefore been held to include a company, partnership, sole trader and trade association. Undertakings engaged in the supply of services have been held to be “undertakings” as well as undertakings engaged in the supply of goods.*

*The position of local authorities is less clear-cut. For example, the membership of the ANSEU Association fined for a breach of Article 85(1) appears to have included certain local water authorities ([1982] 2CMLR 193). Concession contracts between French communes acting in their capacity as public authorities and undertakings entrusted with the operation of a public service were, however, found not to constitute agreements between undertakings in the case of **Bodson –v- Pompes Funebres** [1989] 4CMLR 984.”*

8. The term undertaking is likely to be interpreted broadly by the DGFT to include any natural or legal persons capable of carrying on commercial or economic activities relating to goods or services.

THE CHAPTER I PROHIBITION (ANTI-COMPETITIVE AGREEMENTS)

9. Section 2 of the 1998 Act prohibits agreements between undertakings, decisions by associations of undertakings or concerted practices which may affect trade within the United Kingdom and have as their object or effect the prevention, restriction or distortion of

competition within the United Kingdom.

10. The Act sets out examples of agreements which are caught by this prohibition namely, those agreements, decisions or practices which:-

“(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.”

This is not an exhaustive list. All such agreements are void.

Appreciable Effect

11. An agreement will infringe the Chapter I Prohibition only if it has as its object or effect an appreciable prevention, restriction or distortion of competition in the United Kingdom. This notion of appreciable effect does not appear from the 1998 Act but is a principle which applies from European Court case law.
12. DGFT takes the view that an agreement would generally **not have an appreciable effect on**

competition if the parties' combined shared of the relevant market does not exceed 25% although there would be circumstances in which this is not the case.

13. DGFT will in addition generally regard any agreement between undertakings which:-

- ◆ directly or indirectly fixed prices or shares market; or
- ◆ imposes minimum resale prices; or
- ◆ is one of a network of similar agreements which have a cumulative effect on the market in question;

as being capable of having appreciable effect even when the combined market share falls below the 25% threshold.

14. The Chapter I Prohibition does not apply to agreements where there is only one undertaking; that is between undertakings which form a single economic unit e.g. a parent and its subsidiary company.

15. Examples of Anti-Competitive Agreements are listed in Appendix 1.

Action by Council

16. The Council should review the following types of agreement to which it is a party: consortium agreements with other local authorities, long term agreements which grant exclusive rights. A consortium agreement could constitute no more than an informal arrangement. Similarly the Council needs to be alert to conduct by tenderers which may be in breach of the Part I Prohibition. It may however, be unable to formulate

conclusions on tendering practices by others without sharing information with other employers.

Exemptions

17. Individual Exemption – an individual exemption may be applied for and may be granted for individual agreements which satisfy the statutory exemption criteria. An individual exemption may be granted subject to conditions or obligations and/or for a specified period.

18. Block Exemption – DGFT may by order make domestic block exemptions which exempt particular categories of agreement which he considers are likely to satisfy the statutory exemption criteria.

19. Section 9 of the 1998 Act sets out the criteria which must be met if an exemption is to be granted, that is any agreement which:-

“(a) *contributes to –*

- (i) *Improving production or distribution, or*
- (ii) *Promoting technical or economic progress,*

while allowing consumers a fair share of the resulting benefit; but

(b) *does not –*

- (i) *impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives; or*
- (ii) *afford the undertakings concerned the possibility of eliminating competition in respect of a substantial*

part of the products in question.”

20. DGFT has indicated that an exemption will be unlikely if the parties cannot show that there will continue to be effective competition in the market for goods or services concerned.

Exclusions

21. Schedules 1 to 4 contain a wide range of exclusions, including the following which may be relevant for the Council:-

- ◆ An agreement which is required in order to comply with, and to the extent which it is, a planning obligation.
- ◆ An agreement which constitutes a designated professional rule, imposes obligations arising from such a rule, or constitutes an agreement to act in accordance with such rules.
- ◆ An agreement/conduct to the extent to which it is made/engaged in to comply with a legal requirement imposed by an enactment of the EC Treaty.
- ◆ An agreement made or conducted engaged in by an undertaking entrusted with the operation of services of general economic interest or of a revenue producing monopoly, insofar as the prohibition would obstruct the performance of those tasks.

22. The 1998 Act gives the Secretary of State power by Order to exclude vertical agreements. The draft Order provides that a vertical agreement is an agreement:-

“(a) between two or more undertakings, each operating at a different stage of the economic process for the purposes of that agreement, and

(b) in respect of the supply or purchase, or both, of goods for resale or processing or in respect of the marketing of services.”

23. The 1998 Act also gives the Secretary of State power by Order to exclude land agreements. The draft Order provides that this is:-

“an agreement between undertakings which creates, alters, transfers or terminates an interest in land, or an agreement to enter into such an agreement, together with any obligation or restriction which in accordance with Article 3 is to be treated as part of the agreement.”

Notification to DGFT

24. There is no statutory requirement to notify agreements or conduct to DGFT. It is for parties to an agreement or conduct themselves to take on the responsibility of ensuring that their agreements and conduct are lawful and to decide whether notification is appropriate in any particular case.

25. Notification provides the parties with provisional immunity from financial penalties in respect of an agreement from the time a valid notification is received by the DGFT.

26. Guidance given by the DGFT may indicate whether or not the agreement or conduct would be likely to infringe the relevant prohibition.

27. The decision may be that the agreement or conduct is outside the

relevant prohibition, or that it is prohibited, or in the case of agreements only that it is exempt.

28. If after preliminary investigation the DGFT considers it is likely that an agreement will infringe the Chapter I Prohibition and that it would not be appropriate to grant an individual exemption he may make a provisional decision notifying the parties of his preliminary conclusions. The decision means the provisional immunity from financial penalties which arose as a consequence of that notification will be treated as never having been applied in respect of that agreement.

THE CHAPTER II PROHIBITION – ABUSE OF A DOMINANT POSITION

29. Any conduct on the part of one or more undertakings which amounts to abuse of a dominant position in the market is prohibited if it may affect trade within the United Kingdom.
30. This is a two-stage process to determine:-
- ◆ whether an undertaking is dominant in the relevant market; and
 - ◆ if so whether it is abusing its dominant position.
31. This may be relevant in the context of the Council's practice in procuring a wide range of contracts.

Abuse

32. Section 18(2) of the 1998 Act states that conduct may in particular constitute an abuse if it consists in:-

“(a) directly or indirectly imposing unfair purchase or selling prices

or other unfair trading conditions;

- (b) Limiting production, markets or technical development to the prejudice of consumers;*
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;*
- (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts.”*

33. The way in which the Council awards contracts is strictly controlled by the rules it specifies in invitations to tender, Standing Orders relating to contracts, and the European Procurement Rules (where they apply). However, the Council is under increasing pressure to achieve value for money by conducting post tender negotiations or seeking revised tenders, and therefore needs to be careful that such conduct does not amount to an abuse.

34. The Council may need to justify that the terms of its contracts are commercially acceptable. In any event, unreasonable terms will not assist the discharge of the Council's best value duty.

Exclusions

35. There are specific exclusions for a wide range of conduct including the following which may be relevant for the Council:-

- ◆ Conduct which is carried out by an undertaking entrusted with

the operation of services of general economic interest or having the character of a revenue producing monopoly, insofar as the prohibition would obstruct the performance of those tasks;

- ◆ To the extent to which it is engaged in an order to comply with a specified legal requirement imposed by an enactment or the EC Treaty;
- ◆ Where there are exceptional compelling reasons of public policy and it is also the subject of an order made by the Secretary of State.

Exemptions

36. The DGFT has no power to grant an exemption from the Chapter II Prohibition.

Dominance

37. Before assessing whether an undertaking is dominant the relevant market must be determined. The relevant market will have two dimensions:-

- ◆ The relevant goods or services (the product market); and
- ◆ The geographic extent of the market (the geographic market).

The Product Market

38. The boundaries of the market are determined by taking a product or services relevant to the investigation and looking at the closest substitute products, those products which consumers would switch to if the price of the relevant products or services rose. These substitute products are included in the market

if substitution by consumers would prevent the prices of the products relevant to the investigation from rising above competitive prices. The alternative products do not need to be perfect substitutes, but alternatives which would fill a similar role to the goods or services in question, and to which consumers will be prepared to switch in the event of a price increase. If such similar goods or services will prevent price-setting above competitive levels, they should be included in the definition of the relevant product market. This is again difficult to apply to the Council as it is its conduct as “consumer” not “provider” of services/goods that could be in question.

The Geographic Market

39. Similar methods are used to define the geographic boundaries of the market. The geographic market will sometimes be the area supplied by the complainant, or the party or parties to the conduct concerned, but DGFT also considers whether customers could easily obtain similar products and supplies in other areas on reasonable terms. If so, those other areas may form part of the geographic market. The size of the Council can mean that the geographic market could in some cases be no larger than the Council's area.

Assessing Dominance

40. Economic analysis skills will be necessary to reach an authoritative opinion as to the relevant market and dominance. Equally under Best Value the assessment of the market will be a necessary feature of effective consultation.
41. An undertaking may be dominant if it possesses a substantial level of market power. The essence of

dominance is the power to behave independently of competitive pressures. This can allow dominant undertakings to charge higher prices profitably (or, if it is a dominant buyer, to extract lower prices) than if it faced effective competition. It can also use its market power to engage in anti-competitive conduct and exclude all its other competitors from the market.

42. The European Court has defined a dominant market position as:-

“A position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and/or ultimately of consumers.” (United Brands –v- EC Commission [1978] ECR207)

43. In assessing whether there is dominance DGFT considers whether and to what extent an undertaking will face constraints on its ability to behave independently. Those constraints might be:-

- ◆ Existing competitors, according to their strength in the market: this may be shown by market shares;
- ◆ Potential competitors: this may be shown by lack of significant entry barriers and the existence of other undertakings which might easily enter the market; and
- ◆ Other constraints such as strong buyer power from the undertaking’s customers (which may include distributors, processors and commercial users).

Market Share

44. The Act does not set any market share thresholds for defining dominance. Market share is an important factor but does not on its own determine whether an undertaking is dominant. An undertaking is more likely to be dominant if its competitors enjoy relatively weak positions or if it has endured both a high, and relatively stable, market share. **The European Court has stated that dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50%. (AKZO Chemie BV –v- Commission [1993] 5CMLR 215).**
45. **DGFT considers it unlikely that an undertaking will be individually dominant if its market share is below 40%**, although dominance could be established below that figure if other relevant figures (such as the weak position of competitors in that market) provided strong evidence of dominance.
46. The Act lists broad categories of business behaviour within which particular examples of abusive conduct are most likely to be found rather than specified prohibited business practices. Conduct may be abusive when, through the competitive process, it adversely affects consumers directly (through the prices charged for example) or indirectly (for example conduct which raises or enhances entry barriers or increases competitor’s costs).
47. Conduct for which there is an objective justification is not regarded as an abuse even if it does restrict competition. For example, a refusal to supply might be justified by the poor credit worthiness of the customer. It will still be necessary to

show that the behaviour is proportionate to the justification. Barriers preventing persons from for instance being accepted onto an approved list need to be carefully considered. Conduct which stems from the superior efficiency of an undertaking is not an abuse – the purpose of competition policy is to encourage, not to penalise efficiency.

48. The exclusive rights provided by an intellectual property right (“IPR”) do not necessarily give rise to a dominant position. In addition, even where an undertaking is dominant, the legitimate exercise of an IPR is not an abuse. However, it is possible that the way in which an IPR is exercised may give rise to concern if it goes beyond the legitimate exploitation of the IPR.

49. Abusive conduct generally falls within one of the following categories:-

Conduct which exploits customers or suppliers through, for example:-

- ◆ excessively high prices; or
- ◆ discriminatory prices, or other terms or conditions;

or conduct which is anti-competitive (sometimes called “exclusionary behaviour”), because it removes or limits competition from existing competitors or because it excludes new undertakings from entering the market, for example:-

- ◆ Predatory behaviour;
- ◆ Vertical Restraint; or
- ◆ Refusing to supply existing or potential customers.

50. Examples of abuses of a dominant position are listed in Appendix 2.

INVESTIGATION AND ENFORCEMENT

51. The 1998 Act gives DGFT powers of investigation to determine whether there has been an infringement of the Chapter I or Chapter II Prohibition in the Act.

52. The DGFT may:-

- ◆ Require the production of specified documents or specified information;
- ◆ Enter premises without a warrant; and
- ◆ Enter and search premises with a warrant.

53. The 1998 Act sets out a number of criminal offences which may be committed where a person fails to co-operate when the investigation powers set out in the Act are exercised.

54. DGFT may give such directions as he considers appropriate to bring an infringement to an end where he has made a decision that the Chapter I or Chapter II Prohibition has been infringed.

55. DGFT may impose financial penalties of up to 10% of turnover in the UK on an undertaking which has infringed the Chapter I or Chapter II Prohibition. DGFT can impose penalties for infringements which have already stopped as well as for ongoing infringements. Before exercising the power to impose a penalty, DGFT must be satisfied that the infringement has been committed intentionally or negligently.

56. The decision to impose a penalty and the decision as to the amount of that penalty can be appealed to an

appeal tribunal of the Competition Commission.

57. Third parties who consider that they have suffered loss as a result of any unlawful agreement or conduct have a claim for damages in the courts.

**For advice on the Competition Act 1998
contact Rob Barker on:-**

Tel: 0121 303 3870

Fax: 0121 303 4936

E-mail: rob_barker@birmingham.gov.uk

APENDIX 1

EXAMPLES OF ANTI-COMPETITIVE AGREEMENTS

1. **Directly or indirectly fixing purchasing or selling prices**

Agreements which explicitly and directly fix prices, or the resale prices of any product or service are likely to infringe the prohibition.
2. **Agreement to fix trading conditions**

Undertakings may agree to regulate the terms and conditions in which goods or services are to be supplied, in addition to the prices. Associations may be involved in the formulation of standard terms and conditions to be applied by members. This may be no more than a useful simplification of what otherwise might be complex and, to the customer potentially confusing conditions. If an association imposes on its members an obligation to use common terms and conditions of sale or purchase, this will inevitably restrict competition to some degree. Standard conditions, however, are less likely to have an appreciable effect on competition where members feel free to adopt different conditions if they so wish.
3. **Agreements to share markets**

Undertakings may agree to share markets, whether by territory, type or size of customer or in some other way. This may be as well as, or instead of the price to be charged, especially where the product is reasonably standardised. Such an agreement is likely to have an appreciable effect on competition.
4. **Agreements to limit or control production or investment**

Such an agreement may relate to prices/product levels or quotas.
5. **Collusive tendering**

Tendering procedures are designed to provide competition in areas where it might otherwise be absent. An essential feature of the system is that prospective suppliers prepare and submit tenders or bids independently. Any tenders submitted as a result of joint activities are likely to have an appreciable effect on competition.
6. **Joint buying/selling**

An agreement between buyers to fix (directly or indirectly) the price they are prepared to pay, or to purchase only through agreed arrangements, limits competition between them.
7. **Information-sharing agreements**

As a general principle the more information made publicly available to market participants the more effective competition is likely to be. The extent of information may, however, have an effect on competition where it serves to remove any uncertainties in the market and therefore eliminate any competition between undertakings.
8. **Exchange of price information**

The extent of information on prices may lead to co-ordination and therefore eliminate any competition which would otherwise be present between undertakings.
9. **Exchange of Non-price information**

The exchange of information other than price may have an appreciable effect on competition depending on the type of information exchanged and the market to which it relates.

10. **Advertising**

Restrictions on advertising, whether relating to the amount, nature or form or advertising restrict competition to some degree. Whether the effect is appreciable depends on the purpose and nature of the restriction, and on the market to which it is to apply.

11. **Standardisation agreements**

An agreement on technical or design standards may lead to an improvement in production by reducing costs and raising quality, or it may promote technical or economic progress by reducing waste and consumers' search costs. The agreement may, however, have an appreciable effect on competition if it includes restrictions on what the parties may produce or is in effect a means of limiting competition from other sources, for example by raising entry barriers.

APPENDIX 2

EXAMPLES OF ABUSE OF A DOMINANT POSITION

1. Excessively high prices

This is where a dominant undertaking charges prices higher than it would if it faced effective competition.

“Charging a price which is excessive because it has no reasonable relation to the economic value of the product supplied ... is an abuse” (United Brands –v- Commission [1978] ECR 207)

2. Price discrimination

This can be either:-

- The charging of different prices to different customers, or categories of customers, for the same product – whether differences in price do not reflect the quantity, quality or any other characteristics of the items supplied.
- The charging of the same price to different customers, or categories of customers, even though the cost of supplying the product was very different.

3. Discounts

Whilst offering of discounts to customers is encouraged, it can be an abuse if they are conditional on customers buying all or large proportion of their purchases from a dominant undertaking, or where they are conditional on purchase of tied products.

4. Predation

Predatory behaviour constitutes a class of anti-competitive behaviour where prices are set so low as to eliminate some undertakings and threaten the competitive process itself. The European Court has stated where the prices are below the average variable cost for production, predation should be presumed.

5. Vertical restraints

Vertical restraints are arrangements between suppliers and purchasers which restrict the commercial freedom of one or more parties. They are agreements between undertakings at different stages in the economic process e.g. the manufacturer and the retailer. Any assessment of the effects of vertical restraint needs to take account of both its potential anti-competitive effects and of any countervailing benefits.

6. Refusal to supply

The European Court established in **Commercial Solvents –v- Commission** [1974] ECR223 that refusal to supply an existing customer by a dominant undertaking can be an abuse if no objective justification for the behaviour can be provided.