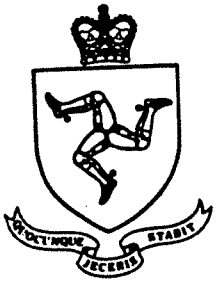
MONOPOLIES AND MERGERS



A REPORT BY THE COUNCIL OF MINISTERS

October, 1996

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MONOPOLIES AND MERGERS

On the 11 January 1996, Council appointed a sub-committee "to review the case for Isle of Man legislation relating to monopolies and mergers and to report by 30 September 1996 to the Council of Ministers on whether such legislation is desirable and practical".

The sub-committee comprised -

Hon T R A Groves, MHK (Chairman)
Hon R K Corkill, MHK
Mr P W Kermode, MHK
Mr J H Webster
Mrs J Karran

supported by :-

Mr J F Kissack (Chief Secretary)
Mr K A Kinrade (Chief Trading Standards Inspector)
Mr S Carse (Economic Adviser)

The sub-committee has reported to the Council of Ministers and has concluded that the introduction of monopolies and mergers legislation is neither desirable nor practical.

Instead, the sub-committee recommends extensions and amendments to the Fair Trading Act so that :

- where public sector bodies are supplying, on a direct user charge basis, such supplies are covered by any new legislation that might arise in response to this report;
- cartels and other collusive arrangements between independent suppliers are open to investigation and subsequent action;
- procedures, as currently established, are retained and adopted for the Act's extended areas of application, but with clear direction to be given to ensure that the investigatory authorities act only upon cases which are significant both in terms of their potential impact on a given party or interest group and in respect of the overall impact on the general economic interest.

The sub-committee has highlighted a number of outstanding issues and has recognised that its recommendations for strengthening existing competition policy will require further detailed examination. Accordingly, they have recommended that their recommendations be the subject of further developmental work with the object of introducing the necessary additional legislation.

The Council of Ministers has agreed -

1. to accept the recommendations of the sub-committee;
2. to publish the sub-committee's report for public information and discussion; and
3. To recommend to the next administration that the further development work recommended by the sub-committee be undertaken.

A copy of the sub-committee's report is attached.

14 October 1996

Miles R Walker
Chief Minister

REPORT OF THE MONOPOLIES AND MERGERS SUB-COMMITTEE OF THE COUNCIL OF MINISTERS

EXECUTIVE SUMMARY

The Council of Ministers agreed to establish the Monopolies and Mergers Sub-Committee on the 11th January 1996. Under the Chairmanship of The Hon. T.R.A. Groves, M.H.K. the sub-committee was requested to consider the supply of goods and services to the local market and:

"To review the case for Isle of Man legislation relating to monopolies and mergers and to report by the 30th September 1996 to the Council of Ministers on whether such legislation is desirable and practical".

Monopolies and mergers legislation would be seeking to define and determine monopoly market positions and then to control likely or actual abuses of such positions.

The sub-committee's investigatory work was supplemented by submissions received from individuals and organisations.

A monopoly is said to exist where a supply is dominated by a single company. In an Isle of Man context there is likely to be a greater incidence of markets dominated by a single company and where the low level of demand discourages the entry of alternative suppliers. The limited market size is particularly likely to deter new competition where a new entrant would be involved in high initial capital costs. However, whilst the existence and maintenance of monopoly positions might be a consequence of natural factors, barriers to entry can also be erected with the express objective of stifling competition.

Essentially the arguments for controlling monopoly situations relate to the benefits that competitive supply can bring in the form of improved product and service quality, lower prices, and wider consumer choice. However, particularly in the Isle of Man situation, there are significant counter arguments, pointing to the benefits that companies in monopoly positions can bring through the achievement of economies of scale and reduced wastage caused by duplication and spare capacity.

Basically, the anti-monopoly case rests on a belief in competitive forces producing low prices and high quality. The pro-monopoly case points to the same outcome, but as a consequence of greater cost-effectiveness in turn driven by the prospect of monopoly profits. On the basis of its own deliberations the sub-committee concludes that whilst competition is inherently preferable, monopoly situations are not necessarily against consumer interests. The objective of any legislation ought therefore to be to identify and remove market abuses and so protect the consumer, but without the establishment of an overpowering bureaucracy and the imposition of punitive compliance costs.

Monopoly legislation is common in most major western countries but the form of the legislation is variable in terms of its rigour and severity. The strongest controls are those which prohibit forms of anti-competitive behaviour and practices and even dominant market shares. In other instances, as in the United Kingdom, the preference is for a more pragmatic approach where, conscious of the arguments for and against monopoly positions, the approach is to assess situations on a case-by-case basis. In smaller jurisdictions, the statutory control of restrictive practices and market abuse is relatively rare.

The Island's Government has the monopoly on the supply of a wide range of key services, through the operation of its central Departments and through the statutory boards i.e. the M.E.A., the Post Office Authority and the Water Authority. Beyond the public sector, the Council of Ministers and Tynwald have the ability to initiate investigations by a number of means including by Select Committee and by reference to the Board of Consumer Affairs. The legislature also of course has the ultimate power to affect corporate behaviour through statute. The recently introduced Fair Trading Act constitutes the most obvious use to date of such powers, and provides for the investigation of, and action against, anti-competitive practices of individual businesses. Government has also entered into a small number of licensing arrangements wherein a degree of market power is conferred on a supplier in exchange for the fulfilment of conditions and standards relating to their service supply.

In view of the natural tendency towards concentration of supply in many sectors of the economy the sub-committee considered the adoption of a prohibition approach to be totally inappropriate. In then assessing the case for monopoly and mergers legislation it identified particular significant difficulties in:

- defining the "market" for investigative purposes
- defining a monopoly
- setting the criteria for establishing the public interest
- establishing a well-resourced, expert, investigative authority and attendant procedures whilst not over-burdening either existing or prospective new commercial operations
- determining the case for exemptions from any legislative provisions.

The sub-committee concludes that the introduction of monopolies and mergers legislation is neither desirable nor practical.

Instead, and in recognition of the fact that concerns over monopoly structures primarily relate to the increased potential for anti-competitive practices and behaviour rather than to the existence of monopoly itself, the sub-committee recommends extensions and amendments to the Fair Trading Act so that:

- **where public sector bodies are supplying on a direct user charge basis such supplies are covered by any new legislation that might arise in response to this report**
- **cartels and other collusive arrangements between independent suppliers are open to investigation and subsequent action**
- **procedures as currently established are retained and adopted for the Act's extended areas of application, but with clear direction to be given to ensure that the investigatory authorities act only upon cases which are significant both in terms of their potential impact on a given party or interest group and in respect of the overall impact on the general economic interest.**

The sub-committee has highlighted a number of outstanding issues and recognises that its recommendations for strengthening existing competition policy will require further detailed examination. Accordingly, the final proposal is that the recommendations of the sub-committee, which discharge the sub-committee's remit, be the subject of further developmental work with the object of introducing the necessary additional legislation.

REPORT OF THE MONOPOLIES AND MERGERS SUB-COMMITTEE OF THE COUNCIL OF MINISTERS

1. BACKGROUND

The issue of monopolies and mergers has been the subject of intermittent consideration by Government over the last ten years.

Following the issue of a consultative document in 1987, the Board of Consumer Affairs produced a report to Executive Council in 1990 on proposals to control and regulate anti-competitive and restrictive trade practices, monopolies and mergers. A sub-committee of Executive Council was formed to consider this report. Meetings between the sub-committee and the Board of Consumer Affairs failed to produce a detailed agreed basis for legislating on monopolies and mergers. However, it was decided that legislation based on the United Kingdom Fair Trading Act should be prepared.

A Fair Trading Bill 1993 was drafted which included provisions on monopolies and mergers based upon the United Kingdom legislation.

The Central Economic Strategy Unit was established in January 1993 and was convened to provide advice and recommendations to the Chief Minister and the Council of Ministers on matters of economic strategy. The Unit's Report, "Prosperity through Growth", contained a section on competition and market regulation and the Unit took into account the provisions of the draft Fair Trading Bill as part of its deliberations.

The Unit believed that the realistic threat of competition could impose a performance and behaviour discipline upon monopolies without the need for formal regulation. So long as a market was, to use the technical phrase, "contestable", then the behaviour of the incumbent monopolist would tend to approximate that of a competing company. Monopolies were not, therefore, unambiguously `a bad thing'. The issue of market regulation was one of determining whether markets were contestable.

To ensure that market regulation, where necessary, would enhance economic development, the Unit made the following recommendations:-

(a) Government should formalise its approach to competition and market regulation, beginning with an examination of the existence of monopolies and the viability of competition.

(b) A report should be commissioned to see if regulation is necessary and recommend how market regulation might best be formalised.

(c) Competition policy should form part of the responsibilities of the Department of Trade and Industry.

(d) The matter of competition and regulation should be thoroughly examined before the Government progresses the Fair Trading Bill.

The Fair Trading Act 1996, prepared by the Department of Local Government and the Environment and the Board of Consumer Affairs, has recently completed its passage through the House of Keys and Legislative Council. As originally drafted, the Act included clauses on monopolies and mergers. Specifically these clauses addressed the meaning of monopoly and the determination of a merger and gave powers to investigate

and take action against these if found to be against the public interest. The proposals largely followed UK law and defined that a monopoly situation was taken to exist if one quarter (25%) of goods and services of any description were supplied by one person, a body corporate or a collusive group.

In order not to delay the implementation of the other desirable provisions in the Fair Trading Bill the Board decided to delete the clauses dealing with monopolies and mergers from the Bill. The Council of Ministers authorised the introduction of the Bill having taken into account the recommendations of the Central Economic Strategy Unit.

The issue of monopoly regulation is important for the Isle of Man. Depending on the definition of monopoly, many important goods and services provided might be said to be the subject of monopoly supply. Previous attempts to address monopolies, culminating in the provision included in the original draft of the Fair Trading Bill, have shown that the issue is by no means straightforward.

2. REMIT

On the 11th January 1996, the Council of Ministers agreed to establish a sub-committee to investigate the issue of monopolies and mergers and the appropriateness of introducing associated legislation in the Isle of Man.

The sub-committee's remit was agreed as follows:-

> "To review the case for Isle of Man legislation relating to monopolies and mergers and to report by 30th September 1996 to the Council of Ministers on whether such legislation is desirable and practical".

3. MEMBERSHIP OF THE SUB-COMMITTEE

The following were appointed to serve on the sub-committee :-

Hon. T.R.A. Groves, MHK (Chairman)
Hon. R.K. Corkill, MHK
Mr. P.W. Kermode, MHK
Mr. J.H. Webster
Mrs. J. Karran

supported by
Mr. J.F. Kissack, Chief Secretary
Mr. K.A. Kinrade, Chief Trading Standards Inspector
Mr. S. Carse, Economic Adviser

4. MODUS OPERANDI

A Public Notice was placed in the local newspapers inviting the public to put forward their views (see Appendix 1). In addition there was radio coverage of the establishment of the sub-committee and its remit. Specific letters of invitation to submit views were sent to:-

All Members of Tynwald
Isle of Man Chamber of Commerce
Isle of Man Trades Council
Isle of Man Law Society

Views were sought by 11 April 1996 in order to allow the sub-committee to invite interested individuals and organisations to appear before the sub-committee to expand upon their written submissions. It had been anticipated that a great deal of public interest would be shown in the whole issue of monopolies and mergers and the sub-committee was disappointed at the limited response. Further publicity was given, and the deadline for submissions was extended until the end of April. This produced only a slight improvement to the number of submissions received. A list of those who have made submissions appears at Appendix 2.

The Public Notice made it clear that the sub-committee would not be addressing any aspects of monopolies and mergers relating to international business and would concentrate only on the supply of goods and services to the local market. It was also emphasised that, as the Fair Trading Bill 1996 legislates for anti-competitive practices and pricing, the sub-committee did not wish to duplicate consideration of these issues.

In particular, the sub-committee sought evidence on:-

(a) what was seen as constituting a monopoly in an Isle of Man context;

(b) whether monopolies were detrimental to the interests of local consumers;

(c) any concerns about monopolistic activity and any examples of clear abuse of market position; and

(d) what machinery and powers, if any, might be put in place to regulate the activities of monopolies.

A number of individuals and representatives from various organisations were invited to appear before the sub-committee in order to expand upon their written submissions.

Research was also undertaken into the situation in other jurisdictions concerning monopoly legislation.

The sub-committee wishes to record its thanks to those who did make written submissions and to those who appeared before it.

5. MONOPOLY AND COMPETITION - THE PRINCIPAL ISSUES

The structure of a market or industry can be defined with reference to:

(i) the number of suppliers (or buyers)

(ii) the relative size of the largest of the suppliers

(iii) the substitutability between the choices open to the consumer i.e. the degree to which each supplier's good or service differs from any one elses, and

(iv) the existence and significance of barriers to entry, deterrents to new entrants and potential providers of competition.

Basically a monopoly is said to exist where a supply is dominated by a single company, although there is no rule from any economic theory that neatly delineates on the basis of market share, or anything else, the existence of a monopoly.

In an Isle of Man context there is likely to be a greater incidence of markets where the supply of goods or services is dominated by a single company and where the low level of demand discourages entry. The limited market size is particularly likely to deter new competition where, in order to establish a competing supply, the new entrant would be involved in high, front-end capital costs.

Whilst the existence and maintenance of monopoly positions might be a consequence of natural factors deriving from the limited market size, artificial barriers to entry can be erected with the express objective of stifling competition. Most obviously such barriers might exist in the shape of tied supply, other restrictive trade agreements, and in licensing arrangements. Less obviously however barriers can be created through other means including cross-subsidisation, price discrimination, temporary price cutting, advertising and the deployment of advanced technology. These and other practices might of course emanate from suppliers located outside the Island's jurisdiction.

In general, there is a presumption in favour of competition in the supply of goods and services. The arguments supporting this predisposition are essentially those which underpin the belief in the efficacy of free market forces in:

- Determining an allocation of productive resources that best matches consumer demands
- Enforcing efficiency by ensuring production is at lowest possible costs
- Keeping prices close to unit costs, so removing the likelihood of excessive profits to suppliers
- Preventing any single supplier, acting independently, from driving up prices simply by restricting supply
- Ensuring supplies are responsive to changing consumer demands
- Enhancing choice for the consumer
- Providing the spur for companies to undertake investment in product and systems development
- Ensuring high standards of service and product quality, since failure to do so will lead to a loss of customers to rival suppliers and would ultimately undermine the commercial viability of the enterprise

However, the case in favour of competition is far from indisputable. Some of the points that follow refer to the benefits of large size as opposed to those of monopoly power per se. But in an Isle of Man context relatively small companies can hold monopoly positions because of the small size of the local market.

- Perhaps the principal argument in favour of large size is the potential that size gives for reaping the benefits of economies of scale in production or supply. Supply on a larger scale can produce cost savings and efficiencies which in turn can lead to greater profitability, lower prices, and greater reinvestment.

- Although the possibility of monopoly profits can be seen as a reason for a preference for competition, it must also be said that the incentive such profits provide can encourage greater efficiency. They can also be an incentive to product development. In essence what is being said here is that the knowledge that any profits to be made can be sustained and not extracted by competitors is in itself a spur to better all-round performance.

- Although competition provides the consumer with choice, the monopoly supplier is in a position to create a more efficiently serviced market, by ensuring that there is less or no duplication of services or products. As a consequence there may be less waste in the form of spare capacity.

- The absence of competition can allow a monopoly supplier to meet the full spectrum of requirements when otherwise, where there is competition, suppliers would all concentrate on serving the higher volume segments of the market, to the detriment of minority tastes and demands. In this instance monopoly means more, not less, consumer choice. It might also allow the monopolists to supply on a less commercial basis to meet minority demand.

Of course it can be argued that the structure of the market and whether one supplier is dominant is not the only relevant issue affecting the potential abuse of market power. Whilst actual competition is preferable, a secondary relevant factor might be whether the sector is "contestable" - whether there exists the real possibility of new suppliers entering the market place and hence providing future competition. If there is, then it is likely that the potential for abuse is much reduced. In this reckoning we are again back to the issues of entry barriers and the significance of costs of entry and exit.

6. APPROACHES ELSEWHERE

Competition policy is a feature of most industrial economies but the approaches adopted vary greatly in terms of the coverage of the legislation, the rigour of the investigative procedure and the severity of actions taken.

The United Kingdom approach can be said to be pragmatic rather than, with the exception of resale price maintenance and cartel practices, prohibitive. Matters are considered on a case-by-case basis with the criteria for acceptance being that of 'the public interest', a wide ranging concept to do not just with the promotion of competition and consumer interests but with wider economic considerations including product development, employment and export performance.

United Kingdom law comprises four principal Acts:

i) The Fair Trading Act 1973

ii) The Competition Act 1980

iii) The Restrictive Trade Practices Act 1976

iv) The Resale Prices Act 1976.

The *Fair Trading Act* deals with mergers and monopolies. It is not concerned with individual anti-competitive practices but with the operation of a market in which supply is concentrated in one or a small number of hands. The Act limits consideration of monopoly market situations to where a single company, or group of companies acting

concertedly (with or without formal agreement), supplies one quarter or more of all goods or services, either nationally or in a defined area. A merger becomes liable to investigation should it create a monopoly as defined, or if the merged entity has gross assets of over £30 million.

The *Competition Act* deals with anti-competitive practices and was originally intended as an extension of the Fair Trading Act. The Act does not specify what anti-competitive practices are but defines such as actions that may restrict, distort or prevent competition. It is not the nature of the practice itself which the Act is concerned with but how it affects market competition. The Act does not apply to companies with a turnover of less than £5 million p.a.

The UK nationalised industries are subject to both these Acts. Under the Competition Act the Secretary of State may refer to the Monopolies and Mergers Commission any question relating to the efficiency and costs in, or possible abuse of market power by, nationalised industries. These enquiries can effectively constitute efficiency audits.

The *Restrictive Trade Practices Act* is concerned with agreements between companies that limit their freedom to operate independently. It requires, with certain exceptions, restrictive trading agreements (formal or informal) including a wide range of anti-competitive practices such as cartel pricing and market sharing arrangements, to be registered with the Director General of Fair Trading and thus open to investigation and the possibility of opposing action within the Restrictive Practices Court.

The *Resale Prices Act*, again with certain exceptions, prohibits attempts to impose minimum prices at which goods can be resold.

These statutes broadly divide into two legislative categories. In the case of the Restrictive Practices Act and the Resale Prices Act action is taken in the courts while the Fair Trading Act and the Competition Act are wholly administrative and require the examination of any practice by the Director General of Fair Trading, the Monopolies and Mergers Commission and the Secretary of State for Trade and Industry. Under the Restrictive Trade Practices Act and the Resale Prices Act the Commission has no role and that of the Secretary of State is limited.

In the European Union, competition policy is governed by Articles 85 (on restrictive agreements) and 86 (on monopoly abuse) of the Treaty of Rome. These Articles apply only where an agreement or practice has an effect on inter-State trade. The scope of the Community competition rules was extended in December 1989 by the adoption of a merger control regulation. Essentially European law begins with the prohibition of practices and then provides a system for exceptions on grounds of economic benefit.

The United Kingdom has been reviewing its approach to competition policy. Valuable insight into the history, the workings, and the proposals for the future of United Kingdom competition legislation was provided by Mr. A. Pryor of the United Kingdom Department of Trade and Industry who had accepted an invitation to discussions with the Committee.

A March 1996 consultative document details an intention to replace the Restrictive Trade Practices Act and the Resale Prices Act with new legislation, under the Office of Fair Trading, introducing prohibition of agreements which prevent, restrict or distort competition. The new law would follow the EU Article 85 approach of prohibition with applications for exemptions judged on an economic benefit criteria. Proposals to amend abuse of market power legislation are concerned principally with strengthening the Office of Fair Trading's powers of investigation and enforcement. The

Government has, at this time, decided against the prohibition approach in this area on the grounds of the difficulties in making definitive judgements, and the potentially burdensome nature of any regulatory regime that would need to be introduced.

It has to be said that statutory control of restrictive agreements and market abuse is rare in small jurisdictions with, as in the case of Jersey for example, the difficulties and drawbacks generally being perceived as outweighing any potential benefits. Where controls do exist elsewhere they are more likely to be in the form of price controls over specified areas of the economy. As an example, Bermuda's Price Commission Act 1974 established a Commission to regulate price increases by the privately owned monopolies in the fields of electricity and telecommunications.

7. CONTROLS ALREADY IN PLACE

Whether in the light of the arguments for or against monopoly market structure it is determined that the Isle of Man needs to develop further its competition policy will to a degree depend on an assessment of measures and powers already in place which seek to control the behaviour and practices of monopoly suppliers.

The Council of Ministers and Tynwald have the ability to initiate investigations by a number of means including by Select Committee and by reference to the Board of Consumer Affairs. The House of Keys and Legislative Council also of course have the ultimate legislative power to affect corporate behaviour.

Such controls as do currently exist in relation to monopolistic and other businesses take the form of:-

(i) the Fair Trading Act, which provides for investigation of and correcting action against anti-competitive practices, practices which typically are only possible where a supplier or buyer has a degree of monopoly power. Also, the Board of Consumer Affairs can be asked by the Council of Ministers to investigate any price "of major public concern"

(ii) the accountability of the non-revenue funded statutory boards (the MEA, the Post Office Authority and the Water Authority) to Government

(iii) Government licensing agreements

There is no legislation which seeks to address the matter of mergers.

The Board of Consumer Affairs is a statutory board charged with safeguarding consumer interests. Under the *Fair Trading Act* the Board of Consumer Affairs is given powers to deal with the anti-competitive practices of individual businesses. The Act does not prohibit arrangements or practices outright. Rather it seeks to address situations and assess how arrangements are affecting competition in practice. An anti-competitive practice is one which has or is intended to have or is likely to have the effect of restricting, distorting or preventing competition. Examples of conduct which may in certain circumstances have anti-competitive effects include exclusive supply dealing arrangements wherein a supplier agrees to supply only one customer, the customer in turn agreeing not to stock or handle products of competitors of his supplier and perhaps not to compete with other customers of his supplier in their exclusive territories, and tie-ins, wherein the supplier of one product or service insists that the customer must buy all or part of his requirements of some other product or service from the supplier or someone nominated by him.

Such practices may prevent or restrict competition but competition may be said to be distorted if firms are not able to compete in a certain market on the same basis for reasons other than differences in their relative efficiency. Discriminatory treatment of customers may distort competition between those customers and so it becomes important to look at the overall effect of any practice on a market rather than on the practice itself.

Part 2 of the Fair Trading Act deals with the investigation of anti-competitive practices and prices but the procedures provided by the Act for these two areas are quite different.

If it appears to the Council of Ministers that a person has been or is pursuing a course of conduct which may amount to an anti-competitive practice they may request the Board of Consumer Affairs to investigate the matter and report back to them. The Board and any subsequent "commission" can require attendance of persons to give evidence, and call for the production of documents or other information such as estimates and returns. Where it appears to the Board of Consumer Affairs that there are reasonable grounds for believing that a person (individual or corporate) has or is pursuing a course of conduct which is anti-competitive they can (at any time before the Council of Ministers refers the matter to a commission) accept an undertaking from that person that he will cease such practices. If the undertaking is accepted the Board is then required to review its operation and decide whether the person can be released from the undertaking or whether it should be revised. If an undertaking is not sought or obtained from the person under investigation then the Board makes its report to the Council of Ministers who then decide if the matter should be referred to a "commission". A commission can be any Department, Statutory Board or such other person or persons as are appropriate and they enjoy the powers previously mentioned. Appendix 3 provides a schematic illustration of procedures under the Act.

The remit of the commission is to ascertain if the person has engaged in anti-competitive practices and whether the practice operated or might be expected to operate against the public interest. When the commission has completed its investigation it has to report back to the Council of Ministers with comments on what action needs to be taken to remedy or prevent the effects of any anti-competitive practices found. Where anti-competitive practices are reported and they operate against the public interest the Council of Ministers can request the Board of Consumer Affairs to seek an undertaking from the person concerned which will prevent or remedy the adverse effects of the anti-competitive practice. Where an undertaking is not obtained or is refused or subsequently breached, the Council of Ministers may make an Order (subject to Tynwald approval) within the limits specified in Schedule 2 of the Act. Such an Order can include price regulation. The reports issued by either the Board or the commission following their investigation are required to be laid before Tynwald and published.

In the case of a price investigation the Board may carry out an investigation into any price with a view to providing the Council of Ministers with information relating to that price, if it is satisfied that the price is one of major public concern. The powers of investigation are the same as they are for anti-competitive practices but there is no follow up action such as referring the matter to a commission or seeking undertakings or making an Order of Tynwald. The report is submitted to the Council of Ministers and is laid before Tynwald and published but no further action can be taken under the Fair Trading Act. Again, however, it should be noted that the legislature can take legislative action on issues of this nature.

The Board is also given the additional duties of keeping under review the carrying on of commercial activities in the Island with a view to ascertaining the circumstances relating to practices which may adversely affect the interests of consumers in the Island. It is also required to give information and assistance to the Council of Ministers in respect of these additional duties together with recommendations for any action thought appropriate by the Board. The Act does not provide powers to assist with these additional duties and any information will have to be gathered from sources available to the general public.

The statutory boards with monopolies in the supply of water, electricity and postal services all have chairmen and other members appointed by the Council of Ministers and approved by Tynwald. Whilst in the case of the MEA and the Post Office the respective statutes include general economic objectives within their duties, no authority is bounded by specific reference in statute over charges. However the Department of Trade and Industry can give directions to all three boards regarding any of their functions including, presumably, pricing policy. In practice too, the Council of Ministers and Tynwald can exert control over increases to charges. Other aspects of the financing of all three services, including allocations to reserves and borrowings, are controlled in statute under Treasury directions. Of course, any controls over these services are applicable only for so long as they are supplied by public sector bodies.

Appendix 4 details the sections of the Acts governing the statutory boards which pertain to controls over the behaviour of the monopolised utilities.

Licensing is designed to regulate aspects of service provision such as quantity, coverage, quality, after sales support, and pricing. Such arrangements may provide a degree of market power to a supplier in exchange for the fulfilment of conditions and standards relating to that supply. Ultimately, licensing conditions and their enforcement are dictated by the regulatory authorities. The framework for licensing is in some instances provided by statute, as with the arrangements with Manx Telecom in the telecommunications field and with the Stakis Group in respect of the operation of the Casino. In other cases it arises from the existence of a freely negotiated commercial agreement between a Government body and an operator, as with the Isle of Man Steam Packet Company's Linkspan User Agreement. It is perhaps worth noting that the latter represents the first overt measure imposing constraints on the pricing of goods or services on the Island by a privately owned enterprise.

8. PROBLEMS WITH MONOPOLIES LEGISLATION

Unlike the United Kingdom Act bearing the same name, the Island's Fair Trading Act is concerned with individual practices and not market situations. It also differs in emphasising the consumer perspective. The Island's Act covers practices which although available to all sizes of companies typically are only feasible, certainly over a significant period of time, for companies in a dominant market position. Accordingly, monopolistic practices will fall under the provisions of a Fair Trading Act. What monopolies legislation would seek to do is enable the investigation of markets that could be deemed to be monopolistic i.e. sectors in which one supplier (or maybe a group of suppliers acting together) has an overwhelming proportion of market share or other measure. The purpose of investigation would be to assess whether the situation operates for or against the public interest.

In developing monopoly legislation on the Island the reality of the economic structure with its tendency towards market concentration in many sectors would preclude the adoption of a prohibition approach wherein monopoly positions are defined and then

made illegal with companies attaining such dominance being required to divest their interests or otherwise curtail activity. Accordingly the pragmatic, case-by-case approach would be the only feasible way forward.

In addressing the matter of monopoly legislation consideration would need to be given to the:

- defining of the "market" for investigative purposes
- criteria for defining a monopoly
- institutional requirements
- investigative procedure and investigative powers
- criteria for establishing 'the public interest'
- decision-making procedure
- sanctions and penalties
- case for exemptions
- need for complementary legislation

The matter of how one *defines an industry or market* for the purpose of calculating market share is critical in determining the extent of the coverage of any legislation in practice. Essentially the issue is how narrowly or how widely a boundary is to be drawn around 'the market' and on what basis. It is a truism to say that wherever each supplier is supplying a differentiated product or service (however slight the difference) then each supplier has a monopoly in the supply of that particular good or service. Whilst it would clearly be a nonsense to work on this basis the issue is continually at the fore in each potential case. So, for example, there is only one electricity supplier on the Island but in many areas that company is competing with suppliers of alternative forms of energy.

Defining a monopoly for the purpose of investigating potential abuse of market power is far from straightforward in all except instances of pure monopoly i.e. literally just one supplier. The issues and questions which arise include:

(i) which measure of size, and hence which basis for assessing market concentration, should be used? Any one or combination of measures may be employed including sales volume, sales turnover, capital assets and labour. Each measure will invariably produce a different result when applied to a given sector. Typically however where monopoly legislation is in existence turnover is the chosen criterion so that measurement is essentially of the concentration of market share. But this can be unsatisfactory where competitors in the defined market are nevertheless supplying different products or services. For example, if considering the market for on/off Island travel should Manx Airlines and Steam Packet Company shares be measured on a basis of turnover from ticket sales or by passenger volumes?

(ii) should a market share criterion be applied to 'define' a monopoly situation? If so what should this threshold be? In an Isle of Man context this would need to be relatively high if it was thought desirable to limit the application of the

legislation. There is nothing in economic theory that provides a neat cut-off point beyond which it can be said that a monopoly exists or the threat of market abuse significantly increases. Indeed the whole question of market power is related to a range of factors unconnected with a company's market share e.g. its underlying financial strength, the relative size of the other companies in the industry, the existence of inter-company interests between suppliers, and the existence of countervailing power amongst purchasers. And, of course, there is the contestability of the market through prospective entrants or the expansion of existing competitors. Even pure monopolies, companies supplying 100% of market output, can be affected simply by the threat of entry.

As noted earlier, *the institutional set-up* for investigating monopoly markets in the United Kingdom involves the Director General of Fair Trading monitoring specific industries, and examining the activities of large companies and receiving allegations of abuse. Preliminary investigations might lead to no action, to him seeking assurances from companies to change their practices, or to a referral to the Monopolies and Mergers Commission. In the latter instance, referral is of the market as a whole and whether the monopolist is abusing his position. The Commission's report or recommendations to the Secretary of State for Trade and Industry may or may not be accepted and acted upon. If action is determined, the responsibility for enforcement is with the Director General. In the case of mergers, once aware of a merger (planned or actual) the Director General undertakes a brief inquiry related to competition effects and the public interest and can then ask the Secretary of State to refer the merger to the Commission. The Commission will then make recommendations back to the Secretary of State for his final decision. Again, enforcement responsibilities lie with the Director General.

With anything other than a prohibition approach to competition policy there will invariably be a political input. Political forces will shape the legislation itself and the assessment criteria within in it, whilst typically final decisions on actions to be taken rest at Ministerial level. Experiences elsewhere suggest that political considerations tend to produce inconsistencies in Ministerial decision-making.

Irrespective of what the labels attached to the various bodies involved might be, it is clear that with monopoly legislation a bureaucracy is created with corresponding costs to both Government (for administration) and private enterprise (in compliance). In the United Kingdom there have been 27 reports by the Monopolies Commission in the last 5 years into possible abuses of market power. This reflects, amongst other things, the depth and difficulty of investigations. Clearly the total number of companies touched so heavily by the United Kingdom procedure is very small. If only because of the relatively small numbers of Island trading companies in existence the likelihood of any one company coming under investigation under Island legislation would inevitably be mathematically greater. Being typically relatively small concerns, companies coming under investigation would face proportionately higher compliance costs. Accordingly, consideration might need to be given to some kind of recompense for companies ultimately found not guilty of abuse. In turn it focuses on the need for thorough and competent initial monitoring and preliminary investigation by the established body.

It is unlikely that the requisite administrative and investigatory expertise will be generally available on the Island. It is impossible, without a better feel for the necessary procedural detail, for the coverage of the final legislation, or for the volume of work likely to come the way of any such authority, to put a potential cost on the institutional operation under any legislation. But it would not be inconsequential, particularly where a pragmatic approach was adopted and cases looked at individually, an approach which, the Committee would argue, would have to be adopted here in view

of the prevalence of monopolised markets on the Island.

Powers of investigation and powers to impose *penalties and sanctions* are at the heart of any worthwhile competition legislation. The United Kingdom system has for many years been regarded as weak and the authorities as toothless. The Island's Fair Trading Act might be regarded similarly since initial action would tend to be in the form of requests for undertakings before an order is made. The United Kingdom intends to strengthen its policy in this regard giving its Office of Fair Trading stronger investigative powers (including right of entry) and power to impose interim orders against a practice pending full investigation.

The Isle of Man is a very open economy and heavily dependent upon inward investment for its further development. It certainly could not afford for the structure of its competition legislation to be so embracing and heavy-handed as to deter either new or existing direct investment. By its very nature, monopoly legislation will create uncertainty and involve compliance costs. It would be critical from both of these perspectives that the practical coverage of the legislation be minimised. If not, the effect of the legislation might well be to reduce competition by reducing the number of suppliers.

To weigh matters on the basis of "*the public interest*" has a strong and logical appeal to it but it carries practical difficulties. Nothing can be ruled out in making such a judgement although particular emphasis can be given in statute. But without a hierarchy of public interest matters it can be very difficult to make an overall judgement on the net benefits and disadvantages of any particular market situation or practice. Even with a clear statement of the public interest, the quantification of costs and benefits will require knowledge not just of the impact of a practice but also of the affected interest groups within the economy and the importance of the distribution of the costs and benefits between these groups. Again, the Island perspective is important here. Whereas, for example, the United Kingdom criteria for the public interest pays particular attention to competition and consumer interests (and by implication, cost efficiency and prices), in view of its dependence on relatively small numbers of suppliers in many key areas of the economy, the Island's view of its own "public interest" might need to pay more attention to dimensions such as the stability and security of supply.

Even before the public interest is assessed there is the matter of recognising the abuse. For example, are high profits in themselves evidence of market abuse? Profits are, after all, essential to the workings of the free market mechanism in providing entrepreneurial incentives to risk-taking, cost efficiency, and technical and product development, and so redirecting economic resources. Perhaps then a long period of high profits might be viewed as evidence of abuse. But for how long do profits need to be maintained before being deemed evidence of abuse? Similarly, if high prices are to be seen as indicating abuse what, especially in the context of a small insular economy, is to be used as a benchmark for determining what constitutes "high"? Clearly, the use of the theoretical measure of excessive pricing involving the comparison of price against marginal cost of supply is not practical.

Exemptions are a feature of competition legislation everywhere. Exemption in respect of market share is of course a frequent feature. Sometimes exemption can remove whole sectors from falling under the legislation. The United Kingdom for example excludes aviation and shipping from its monopoly legislation. It might be argued that, in the event of there being deemed to be existing adequate alternative controlling mechanisms, any Island legislation should exclude public sector bodies. Exemption might be with reference to de minimis rules on turnover or company assets. The

Island's Fair Trading Act allows for orders to be made limiting applicability on this basis but does not specify any size thresholds. Other grounds for exemption might warrant consideration: for example, where a monopoly arises because of default, that is to say, not through gradual expansion or merger but by competitors leaving the industry. A time factor might also be used as grounds for exemption, to exclude from investigative action what might be transient monopoly situations. Whenever these or any other types of exemption are introduced however, the potential for abuse would need to be recognised.

Although, as noted previously, there are just four pieces of competition legislation in the United Kingdom, there are references to the functions and powers of the Director General for Fair Trading in some twenty acts in total. There could be likewise *changes required to existing Manx legislation* should monopoly and mergers legislation be introduced. Most obviously this would be in the legislation governing the statutory boards (should the competition legislation also embrace the public sector) and licence agreements (a potentially very sensitive and difficult area where companies might have committed long term investment on the basis of existing licensing arrangements and now find themselves faced with 'a change in the rules'). Depending on the powers given to any established authority there might also be a need for new primary legislation to facilitate the work of the authority. For example, any criteria which included market share as grounds for investigation would presume the existence of publicly available information on company turnover, in fairness both to consumers and to the suppliers themselves who would clearly need to monitor how close they were to any established share criteria. In these circumstances Government might need to avail itself of statutory powers for the continuous collection of statistical detail relating to company performance.

9. CONCLUSIONS AND RECOMMENDATIONS

Primarily this sub-committee was established to investigate the need for the introduction of monopolies and mergers legislation, to supplement the provisions recently introduced in the Fair Trading Act. In relation to competition matters the Fair Trading Act seeks to control individual anti-competitive practices by individual companies whereas monopolies legislation would be seeking to control the potential abuse of market power in sectors where such power was seen to exist in the hands of one or a small number of companies. Similarly, the control of mergers would be intended to consider the impact of a merger on the structure of a market and the potential for resultant market power to be abused.

In considering the case for monopolies and mergers legislation the sub-committee has no doubts concerning the extent to which supply on the Island tends towards monopoly structures. The small size of the local market for goods and services inevitably creates conditions in which the limited potential for profit and efficient supply means natural monopolies will tend to develop. But equally, the sub-committee, on the basis of prima facie argument, experiences elsewhere, and on consideration of monopoly situations on the Island, recognises that, whilst in an ideal world competition is preferable to limited consumer choice between suppliers, in reality there is often a fine judgement to be made between the relative merits of competition and monopolised supply.

In general the sub-committee's feeling is that monopolies on the Island (however the word monopoly is defined) are inevitable. In many cases they will be in the best interests of the consumer. Indeed in some instances they will be the only realistic option for the supply of a particular good or service. In addition, the sub-committee has set out above some of the particular problems of monopoly legislation in an Isle of

Man context. In particular it highlights the insuperable difficulties in defining markets and distinguishing monopoly situations within them, and the potential costs of a monopoly-controlling bureaucracy to the taxpayer and trading companies, important considerations in the light of a governing ethos which values the minimisation of intervention and other strictures unless there is clear evidence of significant additional benefits for government, business, or the public at large from further imposition.

Thus, a legislative approach which begins from an assumption that action should be taken to prevent monopolies and mergers is unrealistic, impractical and would be contrary to the public interest.

Whilst monopolies, in themselves, should not be a cause of concern, what needs to be safeguarded is that a monopoly (again, however defined) should not engage in trading practices which are detrimental to the interests of the consumer.

The sub-committee in considering all the evidence and arguments concludes against the introduction of legislation related specifically to monopolies and mergers.

The essence of the approach the sub-committee recommends is that consideration should instead focus on trading practices. The sub-committee recommends extensions and amendments to the Fair Trading Act:

- to allow for the investigation of certain public sector suppliers. A number of essential services on the Island are supplied by Government Statutory Boards. The Committee sees no reason why the provisions of a Fair Trading Act should exempt from investigation possible anti-competitive practices or exploitative behaviour by such bodies, where these bodies levy a direct charge for their supplies and therefore are supplying to the customer on a similar basis as would a private concern

- to allow for the investigation of cartels and other collusive arrangements between independent suppliers

- to sharpen the focus of the investigative procedure. One appropriate procedural system would oblige the Board of Consumer Affairs, or other appropriately resourced authority, to undertake limited preliminary investigation in a case and report to the Council of Ministers who in turn would decide whether there was need for further investigation and the appointment of a body appropriate in expertise and independence. This body would in turn report back with recommendations to the Council who would then have the final decision on appropriate action. This is essentially the procedure envisaged in the Fair Trading Act. But to minimise the number of references for full investigation and to obviate the need for a permanent standing investigatory body the directions and principles to be passed on to the investigatory authorities should emphasise the requirement for references to concentrate on practices and behaviour which are significant both in terms of their potential impact on a given party or interest group and in terms of the overall impact on the general economic interest. If, on advice from the Attorney General's Chambers, it is considered that any such directions are not lawful under the present legislation, additional or amended legislation should be considered.

The sub-committee has fulfilled its remit and decided to recommend against monopoly and mergers legislation. It has gone a stage further and made a number of other recommendations as to what might be undertaken to strengthen competition policy in the absence of such legislation. The sub-committee recognises that such

recommendations require detailed examination and refinement. Accordingly, the sub-committee's final proposal is for the work it has commenced to be continued and its recommendations to be further considered.

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Chairman

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27th September 1996

PUBLIC NOTICE

MONOPOLIES AND MERGERS SUB-COMMITTEE OF THE COUNCIL OF MINISTERS

A Sub-Committee of the Council of Ministers has been established to investigate the issues of monopolies and mergers and the appropriateness of introducing associated legislation in the Isle of Man. The Sub-Committee is seeking evidence from the public in the discharge of its remit which is as follows :-

> "To review the case for Isle of Man legislation relating to monopolies and mergers and to report by 30 September 1996 to the Council of Ministers on whether such legislation is desirable and practical".

The Sub-Committee will not be addressing any aspects of monopolies and mergers relating to international business and will concentrate only on the supply of goods and services to the local market. The Fair Trading Bill 1996, which will shortly be considered by the Legislative Council, will legislate for anti-competitive practices and prices and the Sub-Committee does not wish to duplicate consideration of these issues.

The Sub-Committee will, in particular, be seeking evidence on :-

(a) what is seen as constituting a monopoly in an Isle of Man context;

(b) whether monopolies are detrimental to the interests of local consumers;

(c) any concerns about monopolistic activity and any examples of clear abuse of market position; and

(d) what machinery and powers, if any, might be put in place to regulate the activities of monopolies.

Any person wishing to put forward their views in relation to the Sub-Committee's remit should address their comments, by 11 April 1996, to:-

Mrs C A Moreton
Secretary
Monopolies and Mergers Sub-Committee
Chief Secretary's Office
Government Office
Bucks Road
DOUGLAS
IM1 3PN

During the summer months, interested organisations and individuals may be invited to appear before the Sub-Committee to expand upon their written views.

WRITTEN SUBMISSIONS

Hon J C Cain FCA SHK	*
Mr J E Colledge	*
Mr R C Rawcliffe	
Mr B Shannon	
Manx Telecom	*
Manx Airlines	*
G H Waft Esq MLC	
Institute of Directors	
Ellan Vannin Farms	*
Isle of Man Steam Packet Co	*
Communications Commission	*
Mr H Johnson	
Mr G Braund	
Dr E J Mann MLC	*
W A Gilbey Esq MHK	
Isle of Man Chamber of Commerce	

Those marked * also gave oral evidence

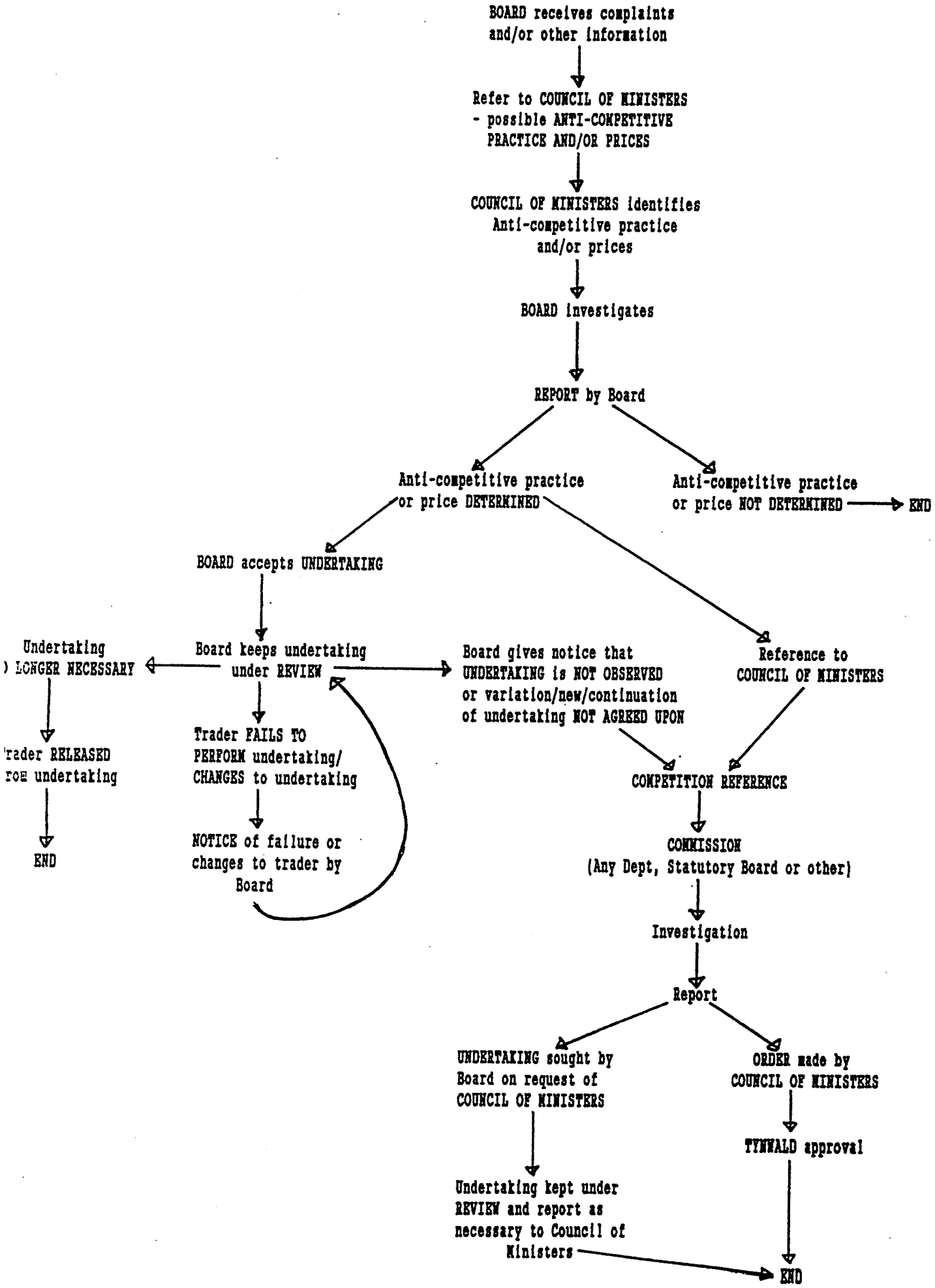
Submissions have not been attached as some contributors have requested confidentiality.

The following gave oral evidence only:-

Mr A Pryor, Department of Trade and Industry (United Kingdom)

Mr L K Stewart, Department of Trade and Industry (Isle of Man)

FAIR TRADING ACT 1996 - PROCEDURES



AREAS OF CONTROL THROUGH STATUTE

	Appointments	Economic Objectives	Prices/ Charges	Quality/ Standard of Service	Expenditure	Other Financial Matters	General Directions
MEA[1]	Sch. 1	2	-	2(9)	4	3, 5	2(8)
PO[2]	1(2)	2(2)	-	3(2)	8	5, 6, 7, 9	3(1)
WA[3]	1(2)	-	-	2(7), 12, 13 19, 22 23(2), 23(3)	34	33, 35	2(6)

Notes 1. Sections refer to Electricity Act 1996
2. Sections refer to Post Office Act 1993
3. Sections refer to Water Act 1991