Briefing

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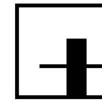

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Maximising Economic Recovery of the UK Continental Shelf (MER UK): Competition Law Update

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MER UK Strategy - The story so far

In response to a downturn in the Oil and Gas sector, in June 2013 the Secretary of State for Energy and Climate Change, asked Sir Ian Wood to conduct an independently led review of UK Continental Shelf (UKCS) to explore ways to maximise economic recovery. The Government accepted all of the Wood Review's recommendations. On 1 April 2015, the Oil and Gas Authority (OGA) was established as an Executive Agency. Through the Energy Act, the OGA will be given the *"necessary levers to help revitalise exploration by driving greater collaboration and productivity in the industry"*. As required under the amendments introduced by Infrastructure Act 2015, the first MER UK Strategy came into force on 18 March 2016[1] (which we have written on in our article *Building a new regulatory regime for the North Sea: the MER UK Strategy*, available here). And finally, the Government committed to provide financial support to the industry through a new City Deal for Aberdeen and additional tax breaks and support to investment announced in the 2016 Budget by the Chancellor of the Exchequer.

Against this backdrop of Government policies geared towards supporting the sector, the industry is also looking into ways of maximising efficiencies to meet global competition, by way of collaboration to achieve efficiencies and exploring ways to merge substantial parts of their operations. This is also supported by the OGA, as one of its identified roles is *"to influence and encourage a culture of greater cooperation and collaboration on the UKCS, improved commercial behaviours, and the creation of a lower cost, more efficient industry"*.

However, the industry's drive towards greater collaboration and, in particular, the additional powers included in the Energy Act attracted the attention of the UK Competition and Markets Authority (CMA). In a letter to the Energy Secretary, Amber Rudd, in response to the provisions on greater collaboration in the Energy Act, the CMA noted its work on the Wood Review and reiterated the importance of adhering to the *"boundaries competition law places on collaboration among industry participants"*.[2] The OGA responded by including in its corporate plan for 2016-2021 an objective to *"improve understanding of actual versus imagined constraints of competition law"*.

In this article we review competition law implications and parameters for compliant industry collaboration in an environment that is both conducive for collaboration and is under a spotlight of competition and regulatory authorities.

Competition v industry cooperation, collaboration and coordination – where is the legal line?

Competition authorities in the EU and the UK recognise the benefits of industry-wide cooperation, and at the same time they express caution when cooperation leads to collaboration, and even more so, when competition is replaced by coordination. The drive towards greater collaboration is particularly common in the industries

[1]Maximising economic recovery of UK petroleum: the draft MER UK strategy
[2]CMA letter to the Rt Hon Amber Rudd MP – Energy Bill Competition issues

facing an economic downturn and it is important that the industry does not stray into the anti-competitive realm of coordination, by replacing it for competition.

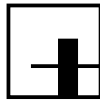
The CMA advised on *"the boundaries competition law places on collaboration among industry participants and on the continued potential for competition as well as collaboration in achieving your objectives."* The CMA has also raised concerns in relation to these competition risks with the government officials who worked on the Energy Bill, and the OGA. Whilst the industry is leaning towards collaboration in the face of adversity, the CMA was keen to reiterate that competition laws apply to sectors in economic difficulty without any exceptions. The endorsement received from the OGA for the industry-wide efficiency drive by way of cooperation is not a 'get-out-of-jail-free' card. In other words, a regulatory approval or encouragement for any industry-wide scheme is not a certification of competition law compliance, and the CMA was keen to point this out in its letter - *"the fact that an agreement is sanctioned by the OGA does not necessarily prevent it from falling foul of national or European competition law."* It is also noteworthy in this regard that under the Infrastructure Act 2015 and the Energy Act 2016, the OGA does not have a statutory duty to have regard to competition law. In the same vein, it does not have any powers to enforce competition law, which is reserved to the CMA and other sector regulators have concurrent competition powers and are members of the UK Competition Network (UKCN), including, amongst others, Ofgem, Ofcom and recently the FCA.

Given the degree of spotlight on the oil and gas sector, it is paramount that the industry participants have competition compliance at the forefront of their recovery and efficiency strategies, in particular if those strategies involve cooperation or collaboration with other industry participants. The issues are complex, and the line between pro-competitive cooperation, and anti-competitive coordination, or collusion is sometimes very thin indeed. For the industry players, it may be timely to review internal competition training, compliance and dawn raid procedures.

In this context, the relevant competition rules are set out in Chapter I of the Competition Act 1998 (Chapter I Prohibition) and Article 101 of the Treaty on the Functioning of the EU (Article 101 TFEU). Broadly, these provisions prohibit agreements and concerted practices that may affect trade (UK / EU respectively) and which have as their object or effect restriction of competition and do not satisfy the conditions for an exemption. The essential aspect of these provisions is that they apply where there is coordination between two or more independent undertakings. However it is noteworthy that the exchange of information is interpreted broadly and in certain cases, even a unilateral one-way disclosure of commercially sensitive information, can amount to a serious infringement of the competition rules.

The key areas of concern stemming out of industry-wide cooperation may be summarised as follows:

- Agreements (defined broadly to include gentlemen's agreements, concerted practices and vertical arrangements) that restrict competition by object are prohibited. Even if the object of the agreement is not to infringe competition, it is necessary to assess its effects on competition.
- The EU Commission recognises in its Guidelines on horizontal agreements that cooperation agreements between companies active in the same market *"can lead to substantial economic benefits, in particular if they combine complementary activities, skills or assets. Horizontal cooperation can be a means to share risk, save costs, increase investments, pool know-how, enhance product quality and variety, and launch innovation faster."* On the other side of the coin, such agreements may also lead to competition problems. For example, where parties agree to fix prices or output or to share markets, or where cooperation allows parties to increase market power with resulting negative effects on prices, output, product quality, product variety or innovation.
- Pro-competitive cooperation may cover a wide range of areas, such as research and development, production (including subcontracting and specialisation), purchasing or joint procurement, commercialisation, standardisation (including standard contracts), and information exchange, such as benchmarking. In the oil and gas industry, it is common to see joint operating and unit operating agreements, joint procurement and sales agreements that are often concluded between companies who are actual or potential competitors.
- The competition analysis of any cooperation agreements concluded between competing entities is carried out by assessing wider economic context, taking into account market power of the parties and other factors relating to the market structure. However, the fact that industry is facing a downturn is not considered an exceptional circumstance that allows for disapplication of competition law.
- Information exchange between competitors is often associated with industry cooperation and is a particularly sensitive area. Any information exchange mechanisms designed as industry-wide best practices or benchmarks must be structured in accordance with guidance and legal precedent. Even where the parties do not reach a common understanding, information sharing poses significant risks and must be done



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only in a compliant manner. In its letter to the Energy Secretary, the CMA sets out the basic principles, which serve as a helpful pointer. For example, sharing or exchanging commercially sensitive information is at the higher end of the risk spectrum. On the other hand, producing industry-wide best practices based on aggregated, anonymized and not commercially sensitive data compiled by an independent third party poses lower risks.

In terms of competition law procedure, the CMA does not issue clearance as to whether individual behaviour is compliant with competition rules. As such, individual companies are required to self-assess and failure to do so may render agreements void and may attract fines of up to 10% of worldwide turnover. Increasingly, anti-competitive infringements are followed up with third party actions for damages by victims of such anti-competitive conduct and notably legal framework at the UK and the EU level has changed to facilitate such actions before the national courts. In addition, employees or directors may also be exposed to individual liability for anti-competitive conduct, which is largely reserved to infringements of the most serious type such as price fixing or bid-rigging.

Examples of the CMA enforcement in relation to information exchange

In this context, it is useful to consider examples of CMA enforcement in the area of information exchange.

On 13 April 2016, the CMA published final Cement Market Data Order and undertakings following an investigation that spanned over a four year period into information exchange conduct.[3] The order restricts the disclosure and publication of production and sales volume data by cement producers in Great Britain. The investigation found that both structural and conduct features of the market allowed for anti-competitive coordination by the largest cement producers. The imposed undertaking addressed structural defects in the market by way of a divestiture order and specific measures were imposed to reduce transparency in the market. The latter included, (i) a prohibition on suppliers of cement and cement products from sending their customers generic price announcement letters; and (ii) restrictions on the disclosure and publication of cement production and sales volume data. This case serves as an example of how CMA may deal with a market segment that displays structural as well as conduct related transparency competition concerns.

Another recent example of CMA enforcement action in relation to information exchange concerns investigation into the exchange of broker pricing information between insurers in the private motor sector via a third party, Experian[4]. The investigation that lasted nearly two years identified an increased risk of price coordination among motor insurers using a specialist market analysis tool provided by Experian. The investigation found that the tool provided by Experian to the industry in fact served as an information exchange mechanism that raised competition law concerns because the parties were able to access information about their competitors' future pricing intentions that may potentially be used to coordinate prices. The CMA and the parties involved have concluded a commitments decision by which the firms accepted the principles under which they would operate, the parties are required to exchange information only if it is less than six months old, is anonymised, aggregated across at least five insurers and already 'live' in broker-sold policies. This case serves as a good guiding precedent of what a compliant information exchange mechanism may look like.

Joint ventures and merger regime

It is common to seek efficiencies by merging (or otherwise sharing) substantial business assets or operations, such as R&D, procurement, logistics or distribution and it is common to do so by setting up a joint venture. In most instances such joint venture agreements are assessed under the antitrust provisions, Chapter I and Article 101 TFEU, and this has indeed been the case for a number of joint ventures concluded in the past by the operators in the North Sea.

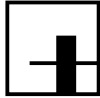
However, a creation of a joint venture may also engage UK or EU merger regimes. In the UK, creation of a new joint venture, or change of control over the existing joint venture, may trigger the relevant merger situation, provided that the share of supply test or the turnover test is met.[5] Cooperation by way of a joint venture falls within the merger regime, where the activities of a joint venture constitute an 'enterprise' under the UK rules, or a 'full-function' joint venture under the EU rules. The 'enterprise' is defined broadly and covers the activities of a business. The principle elements of a full-function joint venture include: joint control, functional autonomy of the venture and an operation on a lasting basis (duration).

The UK operates a voluntary merger notification regime. However, merger situations that meet the notification criteria are usually notified as parties seek legal certainty. Notification to the EU Commission is mandatory if the EU thresholds are met, and follows strict procedures and deadlines.

[3]https://www.gov.uk/cma-cases/aggregates-cement-and-ready-mix-concrete-market-investigation

[4]https://www.gov.uk/cma-cases/private-motor-insurance-exchange-of-data

[5]Share of supply test is satisfied if merger creates or enhances a 25% share of supply or purchases of any goods in the UK (or substantial part of it); turnover test is met if the UK turnover of the acquired enterprise exceeds £70 million (in a case of joint venture, the turnover of the highest value).



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One benefit of falling within the merger regime may be achieving a degree of legal certainty through the notification to the competition authorities that may be required to review the merger. Joint venture agreements that fall outside the merger regime require self-assessment by the participants under the competition rules.

Concluding remarks

It is expected that the OGA will invest significant resources to aid the industry. One of its key roles is set to "encourage a culture of greater cooperation and collaboration on the UKCS, improved commercial behaviours, and the creation of a lower cost, more efficient industry". Industry players will no doubt benefit from such focus on collaboration and commercial efficiencies, but should do so with competition law in mind, and should seek legal advice in situations where the line between competition and collaboration may appear blurry.

For further information or advice on any of the issues discussed in this briefing note, please get in touch with your usual Shepherd and Wedderburn contact.

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