



National Audit Office

THE OFFICE OF FAIR TRADING

Enforcing competition in markets

LONDON: The Stationery Office
£10.75

Ordered by the
House of Commons
to be printed on 14 November 2005

EXECUTIVE SUMMARY



1 In 2001, an England replica football shirt cost £40 in most high street stores. In August 2003, following an Office of Fair Trading (OFT) investigation, the same shirt could be bought for as little as £25, a saving of £15. The case led to the OFT imposing fines of over £18 million against ten businesses for fixing the prices of football kit.

2 This was one of the first high profile displays of the OFT's new competition powers. Since 2000, the OFT has opened 5,900 complaint cases. It has carried out over 170 formal investigations into allegations of anti-competitive activity, covering industries as diverse as toy retailing, horse racing, construction, newspaper distribution, insurance, crematoria, private schools, bus transportation and healthcare. Since 2003-04, five to ten OFT investigations have reached a formal decision each year whilst others are resolved informally.¹

3 Anti-competitive behaviour by companies is detrimental to consumers. It leads to increased prices, and reduced choice and quality. UK economic policy is focused on supporting competition in markets. The Competition Act 1998 transformed the competition laws

in the UK and brought them in line with those of the European Union. The Act gave the OFT statutory powers to investigate, enforce and punish anti-competitive behaviour.² The OFT's new powers were enhanced by the Enterprise Act 2002, which introduced criminal penalties for the worst cartels.

4 The OFT lies at the heart of the UK's modernised competition regime and is integral to the Government's commitment to competitive markets. Using its enhanced powers, the OFT plays a leading role in protecting consumer interests throughout the UK whilst ensuring that business practices are fair and competitive. Its over-arching goal is to make markets work well for consumers and fair-dealing businesses. This benefits the economy as a whole.

5 In recognition of its new responsibilities, the resources allocated to the OFT increased significantly. In 2005-06 the OFT's estimated annual expenditure is £56.8 million, an increase of over 70 per cent since 2000-01. The increase was spread across the consumer and competition functions of the OFT, with some £17 million of the total OFT budget dedicated to competition enforcement work in 2005-06.

¹ The OFT can reach a decision as to whether competition law has or has not been breached. If it finds that the law has been breached (infringement decision), the OFT generally fines the companies responsible. Since 2003-04 the OFT Annual Plan, Objective 3 has included a deliverable target to make between 5 and 10 reasoned, published infringement decisions each year.

² The Competition Act 1998, Chapter 3, Section 25 gives the Director (of the OFT) the power to conduct an investigation if there are reasonable grounds for suspecting anti-competitive agreements or conduct.

6 This increase in powers and resources has, in turn, raised the expectations of Government and other stakeholders. The Government set out clearly what is expected of the OFT. Its White Paper in 2001 states that competition decisions should be taken by strong, pro-active and independent competition authorities.³ The National Audit Office therefore examined the extent to which the OFT is operating as an effective competition enforcement authority. We considered the way the OFT:

- determines its approach to competition enforcement (Part 2);
- carries out its competition casework (Part 3); and
- measures and reports the results of its competition work (Part 4).

Our methodology is summarised in detail in Appendix 1.

Main conclusions

7 The UK's competition regime is still relatively young compared to those of many other major economies around the world. This presents a challenging context for the OFT, as highlighted by the Chair of the Competition Appeal Tribunal: *"In a system so young and so complicated there are bound to be problems and tensions."*⁴ Despite this, the OFT has established a growing reputation internationally⁵ since its powers were strengthened in 2000 and is recognised for leading the intellectual debate on substantive issues in competition analysis. There is, however, scope for the OFT to raise its effectiveness at an operational level. The OFT itself has identified many of these weaknesses in its approach, and is taking steps to address them. We believe that the OFT could translate its intellectual leadership into greater practical results by focusing on three areas:

- **making best use of its resources:** by addressing a perceived 'experience gap' in its staff; and developing further the expertise of staff to handle the rigours and pressures of investigations;
- **improving the management of investigations:** the OFT could improve the transparency of competition investigations by communicating more with the external parties involved, setting expected timescales and using them to drive the management of cases and help to maintain their momentum, where possible. The OFT also could build on its work to improve internal guidance and quality review to ensure consistency of casework; and

- **improving the measurement of its achievements and the communication of its work:** by developing a series of performance indicators which would help demonstrate more clearly the effectiveness of its competition enforcement work, including the benefits to consumers; and by improving accessibility to information on its enforcement work for external audiences.

Our findings in more detail

OFT's approach to competition enforcement (Part 2)

8 The OFT has identified its priorities for enforcement but faces a number of challenges in implementing them.

Although the OFT has developed plans to respond to its enhanced powers and increase in resources, in 2005-06 the OFT Board identified a need to refine this response in order to focus its resources more effectively. The OFT selected five priority sectors in which to channel its efforts: credit; construction and housing; healthcare; the public sector's interaction with markets, and mass-marketed scams. The OFT has not, however, been able to fully reflect these priorities in its day-to-day competition work, principally because the source of investigations is drawn largely from the complaints received, and on-going investigations and appeals consume significant resources. The OFT has exploited some areas of discretion but should continue to explore these options, such as the balance of resources allocated to hard enforcement activity and softer compliance mechanisms.

9 OFT faces an on-going challenge in recruiting and retaining suitably-qualified staff.

The OFT witnessed a peak in competition staff turnover of nearly 20 per cent in 2004-05. Losing experienced staff combined with the difficulties faced by the OFT in recruiting more senior case officers contribute to an experience gap. The current inflexibility in pay and grading is unhelpful in recruiting and retaining suitably experienced staff. The OFT could address this experience gap by strengthening the mentoring of junior staff and enhancing their training and personal development. The OFT has also identified a fundamental weakness in the investigation guidance available to staff. Although a new manual is being developed, with a staged introduction from mid 2005, staff continue to operate without full up-to-date guidance.

3 Department of Trade and Industry White Paper, *"Productivity and Enterprise: A World Class Competition Regime"*, July 2001.

4 Sir Christopher Bellamy, Chairman of the Competition Appeal Tribunal, Beesley Lectures, 28 October 2004.

5 The peer review commissioned by the Department of Trade and Industry in 2004 places the UK competition regime, including the OFT, as the third best-regarded competition authority in the world.

OFT's case management (Part 3)

10 Investigations are time consuming. In 2004-05 the OFT completed 36 investigations and reached formal decisions on nine cases (the remainder were closed or resolved informally).⁶ Most full investigations take between one year and three years for the OFT to reach a decision. As at April 2005, six of the 37 on-going investigations had exceeded three years, including one very complex case which had been investigated for five years. Although other competition authorities also face difficulties with the timescales of cases, we believe there is a need for the OFT to strengthen its case management and set deadlines for resolving cases by helping staff to develop project management skills. The OFT has recognised these weaknesses and begun to address them.

11 Practitioners⁷ are concerned about a lack of transparency in competition investigations and the costs incurred by parties. There is a level of uncertainty that is unavoidable for businesses that are subject to an OFT investigation. Some practitioners, however, observed that the OFT approach can increase this burden if the case team does not engage constructively or regularly with the parties involved. Increasing the transparency of investigations, where appropriate, would help reduce some of the direct and indirect costs incurred by businesses (for example: legal fees; reputation costs; and management opportunity costs). There is also a responsibility on the parties involved in investigations themselves: they frequently miss deadlines for providing information. The OFT has criminal powers to enforce timely and accurate provision of information but finding the right balance between the proportionate and effective use of such powers is not straightforward, as bringing criminal charges against individuals may be disproportionate in many cases.

12 Quality controls have been introduced but need strengthening in some areas. Competition investigations are highly complex, requiring robust quality control measures throughout. In recognition of this, the OFT has introduced systematic case review meetings before its case findings are published. The OFT could enhance its internal quality control of cases by strengthening the internal challenge on each case before the decision is taken to proceed to full investigation and by developing the routine use of ex-post evaluation of its interventions.

Measurement and communication of the OFT's achievements (Part 4)

13 The OFT monitors its competition activity but does not quantify the benefits it achieves for consumers.

Measuring and quantifying the influence that competition authorities have on the economy is difficult, with some outcomes, such as deterrence effects, virtually impossible to measure. The OFT monitors its high-level activities but this is not part of a well-defined performance management system. Some other competition authorities measure the benefits they achieve for consumers, and the OFT is now beginning to do so.

14 The OFT is developing more targeted communication on competition issues. One of the most important roles of a competition authority is to educate business and consumers about the benefits of competition. The OFT's business surveys indicate that general awareness is growing in the UK, but there is still a significant lack of understanding about competition law. The OFT faces a challenge in educating business, particularly in assisting small business to complain when they are a victim of anti-competitive activity. The OFT undertakes a range of promotional and educational work on competition and in May 2005 embarked upon a campaign to help smaller businesses avoid anti-competitive practices.

15 OFT could improve the availability of case information. The OFT is one of the few competition authorities to publish its reasons for closing some cases. These summaries help indicate how the OFT might approach similar cases in future. The OFT does not, however, publish all case information and statistics on its website or in its annual report. Where information is provided, it can be hard to find or is provided in a format that is not readily of use to the public.

⁶ The OFT made eight decisions under the Competition Act in 2003-04, and 13 decisions in 2002-03. Appendix 2 lists the OFT's decisions in the three years to 2004-05.

⁷ 'Practitioners' include lawyers and economic consultants who act for companies involved in OFT investigations.



RECOMMENDATIONS

16 The OFT has made progress since the Competition Act came into force in March 2000, and is developing plans to raise standards across the board by making changes to improve its effectiveness and professionalism. There is scope for the OFT to build on its achievements and refine further its approach to competition enforcement. The following recommendations are designed to assist the OFT in this aim.

On the use of resources

- a** The OFT should address the experience gap amongst some of its competition staff by increasing the input of senior case officers to investigations and helping more junior staff develop the necessary expertise to manage cases.
- b** The OFT needs to deliver on its commitment to producing a complete set of guidance for staff.

On case management

- c** The OFT should publish expected timescales for its investigations, which are realistic but challenging, and use these to drive case management.
- d** The OFT should explore options for making business and practitioners observe deadlines for providing information requested in the course of investigations.
- e** The OFT should engage more openly with parties to the investigation, both in terms of indicating its concerns and keeping them updated on progress. This would help reduce the uncertainty for parties.
- f** The OFT should encourage internal economic and legal challenge of potential cases as they progress to formal investigation, as well as ensure constructive senior input at an earlier stage. This will ensure that resources are only committed to cases that continue to merit investigation. The OFT should also review how cases were selected and commission an analysis of the effects of its intervention.



On measuring and communicating achievements

- g** The OFT should develop a group of indicators to help it monitor and review the results of its activities. With the recent creation of an evaluation unit, the OFT should follow the lead of some competition authorities who have attempted to quantify the benefits they achieve for consumers.
- h** The OFT should evaluate the success of education campaigns to ensure the resources in this area are being effectively targeted, in particular on its priority sectors and on its target audiences (smaller businesses and government). For example, the OFT could carry out further research to ascertain the reasons why nearly a quarter of small and medium sized firms believe they are harmed by unfair practices but only a minority would report this to the OFT.
- i** The OFT needs to develop a more comprehensive database of information on cases and improve the accessibility of this information to external users who have an interest in competition enforcement matters. The OFT should consider surveying website users to gain a better understanding of their needs.