



National Audit Office

Report

by the Comptroller
and Auditor General

UK competition authorities

The UK competition regime

Key facts

£66m

Estimated annual direct spending on UK competition regime in 2014-15

£745m

Competition & Market Authority's estimate of average annual direct consumer benefit created by its work

£65m

competition enforcement fines imposed by Office of Fair Trading and CMA between 2012 and 2014, in 2015 prices

- 8** competition regulators in the UK share concurrent competition powers with the Competition & Markets Authority (CMA)
- £19.1 million** increased funding in 2014-15 for competition work carried out by the CMA and regulators with new competition powers
- 23%** of businesses in 2014 felt that they knew competition law well
- 5** concluded non-criminal competition enforcement cases in UK in 2014
- 0** successful contested criminal prosecutions since the CMA was established. One company director pleaded guilty to cartel conduct in advance of trial
- 100%** of mergers assessed by the CMA within the 40 working day statutory limit
- 15 (out of 19)** civil cases that have come before the courts where the CMA has been successful

Summary

1 Effective competition between businesses can bring benefits to consumers including greater choice, improved product quality, innovation, and lower prices. Competition is central to the government's ambitions to improve growth and productivity. Research by the Organisation for Economic Cooperation and Development (OECD) has found that industries where there is more competition experience faster productivity growth, with knock-on benefits for the rest of the economy. Where markets fail to operate effectively, consumers and taxpayers can suffer. For example, fuel surcharges on a typical Virgin Atlantic or British Airways long-haul return flight rose from £5 to £60 per ticket over the two-year period in which the two airlines illegally coordinated their surcharge pricing.

2 The UK competition regime is the result of the Competition Act 1998, the Enterprise Act 2002, the Enterprise and Regulatory Reform Act 2013, the Consumer Rights Act 2015 and sector-specific competition legislation. This national legislation is underpinned by a European framework, with competition authorities across the EU having similar laws and requirements. The legal framework aims to ensure that markets work well, encouraging businesses to compete with each other and protecting consumers from anti-competitive practices such as bid-rigging, price-fixing and abuse of market power.

3 The Competition & Markets Authority (CMA) is the main UK competition authority. It is a non-ministerial department funded by HM Treasury. Its duties include: advocating and enforcing competition law; identifying and remedying competition problems; and investigating mergers which could restrict competition. Additionally, eight sector-specific regulators, such as Ofgem in the energy sector, share competition powers with the CMA. The Department for Business, Innovation & Skills (BIS) sets the overall policy and legal framework for competition issues in the UK as well as the CMA's performance framework. The European Commission is responsible for enforcing competition rules at the European level. It takes on many multinational cases that affect the UK, and is outside the scope of this report.

4 We reported in 2010 on the effectiveness of the operation and oversight of the UK competition regime. We concluded that, while the regime was well regarded internationally, it needed to make more flexible and efficient use of resources, strengthen the development of case law, and encourage sector regulators to refer markets for review. The government subsequently announced far-reaching changes to the competition regime, including new legislation and merging the Office of Fair Trading and the Competition Commission into a new organisation – the CMA. The objectives of the reforms were to:

- Improve the robustness of decisions and strengthen the regime.
- Support the competition authorities in taking forward the right cases.
- Improve speed and predictability of decision-making for business.

Scope of the report

5 In this report, we assess the performance of the UK competition regime in tackling the problems identified in our 2010 review, and in meeting government’s objectives. We use the term competition regime to cover those bodies that have competition powers in the UK, and focus on the CMA as the principal national competition regulator. The CMA began operating fully in April 2014, and there can be long lead times between beginning competition work and achieving improvements. We therefore consider early evidence on the performance of the regime, and risks to achieving value for money. We intend to analyse the overall effectiveness of the regime in future work.

6 We assess:

- The cost of the regime and how well it coordinates its activities (Part One).
- How successfully the regime uses its competition powers (Part Two).
- How the regime measures its impact on competition, productivity and growth, and how it uses this information to inform its work (Part Three).

7 Many other interventions by public bodies can influence the level of competition, including patent and tax law, regulation and consumer protection. These are outside the scope of this report, but we treat them as important contextual factors.

Key findings

Cost and coordination

8 Effective competition is a key priority for the government in its drive to improve growth and productivity, and it has significantly increased funding for the regime. OECD research suggests that competition has been an important factor in UK productivity growth. However, productivity in the UK is still lower than in other major developed nations. There is no measure of the competition regime's impact on growth or productivity, but the CMA estimates that itself and its predecessors' work produced annual average direct consumer benefits of £745 million over the period 2012-13 to 2014-15. The government has committed increased resources to the competition regime. In 2014-15, the three bodies with new competition powers spent £7.1 million on competition work and the CMA was granted an additional £12 million to expand its competition work. The total direct cost of competition work was £66 million in 2014-15, with around 810 full-time equivalent competition staff. The government does not calculate the cost of the regime as a whole (paragraphs 1.1, 1.3, 1.19 and 3.5).

9 The creation of the CMA did not significantly disrupt competition work, but it required additional funding to recruit and retain staff for its staffing model.

The CMA took over operations from its predecessor bodies as planned in April 2014. Its leadership ensured that front-line competition work continued uninterrupted; external stakeholders told us that they saw few transitional problems. There were, however, several teething issues internally, with IT problems and high staff turnover during the early phase of the transition (5.4% permanent staff turnover in the third quarter of 2014). To promote retention and recruitment, particularly for qualified competition specialists, the CMA used approximately £2.2 million of its increased funding of £12 million in 2014-15 to increase pay and recruit specialists in competition grades. Staff morale has improved substantially in the last year and permanent staff turnover fell to 3.1% in the third quarter of 2015, although the CMA continues to use temporary staff in some key back-office positions (paragraphs 1.15 to 1.17).

10 The coordination of the regime has improved, but there are inherent structural problems that may work against cohesion. The newly-established UK Competition Network, with the CMA at its centre, provides a forum for cooperation between regulators, particularly in using competition powers more consistently and sharing best practice. The CMA gives more support to smaller regulators than did its predecessor bodies, the regime now reports to Parliament annually, and the CMA is currently investigating markets in two regulated sectors. But the different regulators are overseen by different policy departments, have different legislative frameworks, and are funded in a variety of ways. Substantial salary differences between competition bodies have resulted in unplanned staff movements and retention difficulties in lower-paying organisations. Sector regulators can still find it easier and more effective, at least in the short term, to use their regulatory powers rather than their competition powers (paragraphs 1.23 to 1.26).

11 The independence of the competition regime is central to its credibility and impact. The importance of competition work means that it can come under significant external pressure. For instance, industry and consumer representatives have made many public comments about the CMA's provisional findings in its current investigations into the energy and retail banking markets. The CMA's role is founded in UK statute, and it has established robust processes to maintain its independence, including publication of evidence submissions and of correspondence with ministers (paragraph 1.21).

Promoting competitive markets

12 Business awareness of the competition authorities and of competition law is low, potentially harming compliance. In a CMA survey of UK industry conducted in late 2014, only 23% of businesses felt they knew competition law well, compared to 45% who had never heard of competition law or did not know it at all well. As a new organisation, awareness of the CMA was also low; in 2014, the year when the CMA began operating fully, more than twice as many businesses believed the defunct Office of Fair Trading to be responsible for enforcing competition law than the CMA (75% versus 32%). The CMA is taking steps to improve awareness through, for example, advocacy work with both public and private sector bodies following enforcement cases (paragraphs 2.2 to 2.4).

13 Competition authorities have increased their efforts to detect anti-competitive behaviour, particularly in financial services, where long-standing problems have only recently been identified. Like other jurisdictions, the UK competition regime failed to identify major and persistent breaches of competition law in the financial sector. Following applications for leniency, in 2013, the European Commission fined financial institutions €1.71 billion for participating in cartels in interest rate derivatives. The European Commission is now investigating alleged cartel activity in foreign exchange markets. The new competition powers for the Financial Conduct Authority and the Payment Systems Regulator should provide a stronger basis for action in future. More broadly, the CMA is investing in gathering information from a wide variety of sources to identify anti-competitive behaviour, including consumer organisations and whistleblowers (paragraphs 2.5 to 2.6).

14 The CMA has strengthened processes with the aim of increasing the robustness of its work to legal challenge. Following two high-profile failures in the Office of Fair Trading's competition enforcement work in 2010 and 2011, the CMA has set up independent decision-making panels and enhanced internal oversight. The CMA has been successful in 15 of the last 19 civil cases across its competition work that have come before the courts. Despite the acquittals in its first criminal cartel prosecution, the judge noted the procedural thoroughness of the CMA's case. The overall success of the CMA's changes is likely to be tested further by possible appeals on high-profile market investigations or enforcement cases (paragraphs 2.9 to 2.10).

15 The regime faces big challenges in increasing the low number of enforcement decisions to date. Successful high-profile enforcement action builds the credibility of a competition authority, clarifies the law and deters anti-competitive behaviour. The low caseload we identified in 2010 has continued, with the Office of Fair Trading and the CMA making 24 decisions and the regulators just eight since 2010. The UK competition authorities issued only £65 million of competition enforcement fines between 2012 and 2014 (in 2015 prices), compared to almost £1.4 billion of fines imposed by their German counterparts. The CMA faces significant barriers in increasing its flow of competition cases, although recent activity means it now has 12 ongoing cases. Its enforcement work is not mandatory, does not have statutory deadlines, and faces a stringent regime of judicial oversight. The CMA prosecuted its first criminal cartel case in 2015; one company director pleaded guilty to price fixing in advance of trial, while two others were acquitted (paragraphs 2.7, 2.8, 2.11 to 2.13 and 2.16).

16 The CMA has taken an innovative approach to merger control, potentially improving its effectiveness in promoting well-functioning markets. It has made all of its initial merger decisions within its statutory deadline of 40 working days. Stakeholders were positive about the quality and continuity of the CMA's merger teams, and told us that they valued having early discussions with decision-makers. The CMA is expanding the practice of clearing cases with remedies in phase 1 without the need to go for a more detailed and resource-intensive phase 2 review, and is making efficiency gains from using some of the same people on both phase 1 and phase 2 investigations. It has also developed case law, in particular winning three significant recent legal challenges in this area (paragraphs 2.19 to 2.22).

17 The competition regime is placing a marked emphasis on market investigations, with implications for the regime as a whole. The CMA's ability to investigate an entire market can have big effects; for instance, a 2009 market investigation by the Competition Commission resulted in BAA selling Edinburgh, Stansted and Gatwick airports. The CMA is currently investing 16% of its front-line competition resources in two high-profile market investigations into energy and retail banking, and businesses are also incurring substantial unmeasured costs. There is major public and parliamentary interest, with a parliamentary hearing already dedicated to the retail banking inquiry. The ability of the CMA to present a credible market analysis and formulate effective remedies if appropriate will have a significant effect on its reputation (paragraphs 2.24 to 2.29).

Evaluation of impacts and outcomes

18 The CMA has made good progress in evaluating the impact of its legacy remedies and open cases. The CMA inherited many remedies and undertakings from past merger cases. It has so far reviewed 76 cases to assess their impact and continued significance, and has released companies from their undertakings in 51 of them. The CMA also evaluated its inherited cases against its strategic priorities. Its case decision groups assess open projects at key points to decide whether they should be continued (paragraphs 3.2 to 3.3).

19 The CMA is meeting the measures agreed in its business plan, but these output-based measures do not fully capture the impact of its work. The CMA has improved its reporting systems and is able to track progress, resourcing and spending on all of its projects. In line with its statutory duty to seek to promote competition for the benefit of consumers, it aims to produce benefits for consumers of at least ten times the cost of running the organisation, which it has so far exceeded. This target measures only direct impacts rather than wider deterrence effects and has mainly been achieved through market investigation work. The Office of Fair Trading left a legacy of research into the wider impacts of competition work, which is yet to be fully developed by the CMA and BIS. There is a strong theoretical and empirical link between competition and productivity, and evidence that competition enforcement can have a positive impact on growth. However, there is less evidence on the links between specific competition interventions and growth, or on how competition is evolving in different UK industries (paragraphs 3.5 and 3.7 to 3.11).

20 The competition regime faces significant constraints in prioritising its work to meet its objectives. The CMA and sector regulators have well-established prioritisation criteria, based on factors such as impact and strategic significance, and use them to determine which work to pursue. However, it is difficult to make fully robust prioritisation decisions on its use of different tools, such as market investigations and enforcement actions, because there is limited evidence on their relative effectiveness. The CMA has to meet different legal criteria to apply the different tools, and a substantial proportion of its work is mandatory, further limiting its choice of which tools to use and its flexibility to respond to changing circumstances (paragraphs 1.23 and 3.10).

Conclusion on value for money

21 The newly-created CMA has taken significant steps to tackle the failings identified in our previous reports, and is still relatively early in its development. For example, it has taken an innovative approach to merger control, has strengthened processes to improve the robustness of its work, and has encouraged greater coordination across regulators. The CMA and the regulators are acting to improve the detection of anti-competitive behaviour and to build a pipeline of cases, but the system has so far failed to produce a substantial flow of enforcement decisions. Awareness of competition law and the competition authorities is low, and there is limited evidence on the full impacts of competition work. While the changes made look likely to improve value for money, the regime has further to go to ensure that it achieves it.

Diagnosis and recommendations

22 The creation of the CMA has enabled it to build on a strong legacy of merger and market analysis in its predecessor bodies, and has given it a wider remit to follow through on competition issues. But the CMA also inherited significant challenges in competition enforcement, including a difficult legal environment, low business awareness of competition law, and reputational damage resulting from high-profile lost cases. At the regime level, legislative and personnel changes have encouraged a greater commitment to competition work by sector regulators. Our recommendations aim to help embed the improvements we have identified, and to tackle some of the remaining problems.

23 The government should:

- a Report regularly the full cost of the regime on a consistent basis, including all direct and overhead costs, and keep its cost-effectiveness under review.** This could be achieved by, for example, BIS and HM Treasury working with the UK Competition Network to report costs in the CMA's annual report on concurrency. This would increase transparency and help the government to judge whether it is achieving value for money.
- b Encourage greater flexibility of resourcing and a more coherent approach across the regime.** The UK Competition Network now provides a forum for greater coordination. Further developments could include BIS working with other departments to ensure that sector regulators receive consistent messages about the role of competition. More radically, the government could consider greater pooling of competition enforcement resources across the concurrent regulators.

24 BIS, working with the CMA, should:

- c Develop indicators of the competitive health of UK markets, such as their profitability and the level of entry and exit.** This would help in assessing the success of the competition regime, and could also provide warning signs of emerging competition problems. BIS should work with the CMA and the Office for National Statistics to pursue this agenda.

25 If the CMA's work to increase the number of enforcement decisions fails to increase caseload significantly, BIS, working with the CMA, should:

- d Assess the fundamental reasons for low enforcement caseload, and consider the case for removing any legislative or institutional barriers.** This should include analysis of lessons to be learned from competition enforcement in other developed economies, and the experience of other UK bodies with enforcement powers, such as Trading Standards and HM Revenue & Customs.

26 The CMA should:

- e **Build on its current strategy of raising awareness of competition law, drawing on the work of other leading enforcement agencies.** Awareness-raising is an important tool in encouraging voluntary compliance and reporting of breaches in competition law. Wherever possible, the CMA should publish details of the results of its cases, including, to the extent permitted by law, those that were closed without action.
- f **Take further action to step up the flow of successful enforcement cases.** Caseload has been low for a long time and it is important to convert the pipeline and ongoing cases into results. This could include ensuring dedicated, tightly-focused, expert teams for the most high-impact cases, led by decision-makers with strong internal and external reputations. The CMA should continue to develop its understanding of how leading European counterparts manage their enforcement casework, and review its own approach in light of lessons learned.
- g **Commission an external review of the costs (including those of business), processes and their anticipated outcomes of its two major market investigations.** This should determine whether their resourcing and processes were efficient and appropriate, including whether it could achieve greater value for money by using smaller expert teams. This should help it to determine whether large, high-profile market investigations are an effective way of achieving its objectives.

27 The CMA and regulators should:

- h **Develop further their understanding of consumer behaviour to inform proposed remedies.** This should include greater testing of remedies before implementation, and could include the establishment of a dedicated centre of excellence within the UK Competition Network, to enable others to learn from the approach of more experienced and better-resourced UK regulators.