

Approach to calculating direct benefits to consumers

Consultation

September 2007

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Responding to this consultation

Consultees responding to this consultation are asked to supply a brief summary of the interests or organisations they represent, where appropriate. We ask that any suggested changes or comments on the documents be submitted in writing (by email, or alternatively by letter or fax) to:

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The consultation period

The consultation period will run until 18 December 2007. This period of 12 weeks is in accordance with the criteria set out in the Cabinet Office's Code of Practice.

Next steps

We will collate responses to the consultation and publish a formal summary of these, along with a final version of the Approach to Calculating Benefits to Consumers, by March 2008, taking into consideration comments made in response to the consultation.

Data use statement for responses

Please note that we may choose to refer to comments received in response to this consultation in future publications. In deciding whether to do so, we will have regard to the need for excluding from publication, as far as that is practicable, any information relating to the private affairs of an individual or any commercial information relating to a business which, if published, would or might, in our opinion, significantly harm the individual's interests, or, as the case may be, the legitimate business interests of that business ('confidential information'). If you consider that your response contains such information, that information should be marked 'confidential information' and an explanation given as to why you consider it is confidential. All information received is subject to Part 9 of the Enterprise Act 2002.

If you are replying by email, these provisions override any standard confidentiality disclaimer that is generated by your organisation's IT system.

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1 INTRODUCTION

1.1 The OFT is responsible for making markets work well for consumers. We achieve this by promoting and protecting consumer interests throughout the UK, while ensuring that businesses are fair and competitive.

1.2 As part of the Comprehensive Spending Review settlement 2007 (CSR07), the OFT has proposed the following two high-level targets:

- **Target A:** In each annual report provide quantitative evidence of how the OFT delivers **direct financial benefits** to consumers of at least five times that of its cost to the taxpayer across the spending review period. ('5 to 1' hereafter)
- **Target B:** In each annual report estimate the **additional wider benefits** of OFT's work, for example increasing consumer and business confidence in markets and deterring future anti-competitive behaviour.

1.3 The OFT evaluation team will conduct a wide-ranging programme to measure these targets. It includes in-depth ex-post evaluations of OFT projects, research into the wider benefits of OFT work, and procedural support in helping to estimate the impact of our work at the moment that we do it.

1.4 Impact assessment and evaluation are relatively new to competition authorities. To date there are only a handful of OECD countries' competition authorities that measure their impact and even then this is usually restricted to mergers and/or competition enforcement¹.

¹ See for example NMa's Annual Report 2004 at http://www.dte.nl/images/Annual%20Report%202004%20NMa%20and%20DTe_tcm7-55865.pdf and Competition Commission's Annual Report and Accounts 2005-6 at http://www.competition-commission.org.uk/rep_pub/annual_rev_archive/pdf/cc2006.pdf

- 1.5 This document consults on the OFT approach to measuring performance against the target A above: direct benefits of our work to consumers.²
- 1.6 The first section outlines the high level framework and assumptions. The second section describes the process of embedding the measurement of the target across the Office. The third section briefly summarises the methods the OFT has used so far to estimate the impact of its work. These methods are explained in greater detail in Positive Impact 06/07 (OFT 928) and Consumer Savings from Merger Control (OFT917), which are available at www.offt.gov.uk/about/benefits/evaluation/publications along with other publications about the OFT evaluation regime.
- 1.7 We would welcome your comments on our approach to calculating direct financial benefits to consumers. Your responses will help us defining how best to measure and account on the achievement of target A. Please send comments in writing by no later than 18 December 2007 to: Neil Smart, Room 3E/011, Office of Fair Trading, Fleetbank House, 2-6 Salisbury Square, London EC4Y 8JX, Fax: 020 7211 8114, Email: neil.smart@oft.gsi.gov.uk

² This target refers to all OFT activities except for Consumer Direct, for which there is a commitment to deliver 3.5 to 1 benefits. The target also excludes consumer credit and anti-money laundering as these activities will be self-funded and therefore not a cost to the taxpayer. On consumer credit and anti-money laundering the OFT will be subject to statutory requirements and have no ability to reallocate resources.

2 HIGH LEVEL FRAMEWORK

Meeting the target

2.1 We will consider the target **fully met** if:

- by April 2011, the OFT has provided evidence that on an annual average basis during 2008-2011 it has delivered **direct financial benefits to consumers** that are at least five times its cost to the Exchequer.

2.2 HM Treasury recognizes that meeting the above target fully may be difficult as, whilst the OFT costs are known, many benefits cannot be measured yet. As such, it considers that reporting also on the benefits and costs of those projects whose benefits we can estimate is essential. We will, therefore, consider the target **partly met** if:

- the projects aimed at delivering **direct financial benefits**³ are shown to provide consumer benefits of at least five times the cost of these projects to the taxpayer (per year averaged across the spending review period); **and**
- success indicators for those projects that are not primarily aimed at delivering direct financial benefits to consumers move in a **favourable direction**, indicating that consumer/business changes of behaviour following OFT work is taking place, as a result of which consumer benefits are likely to be achieved.

2.3 It is important to reiterate that **this target (partly or fully met) does not reflect the full impact of the OFT's value-for-money work**. The target represents only a partial measure of the OFT impact. The OFT would

³ For example CA98 enforcement, market studies, mergers and scams. Scams are, usually, discrete operations by organisations wilfully breaking the law and that have a defined way of operating and a relatively limited life before the scam becomes no longer possible. This limited scope and time horizon, combined with a clear counterfactual due to the organisations wilfully breaking the law, tends to make impact estimation simpler compared to other consumer law enforcement work with a wider objective.

expect to achieve wider benefits such as deterrence effects (high level target B), beyond the direct financial impact on consumers. This document does not discuss those commitments and how they are going to be measured.

Question:

Do you think that there is a danger of measuring too precisely comparatively less important things (direct financial benefit vs cost to Exchequer) leading to insufficient emphasis on comparatively more important things (productivity and deterrence vs total economic cost) which are difficult to estimate and are delivered later?

Definition of 'direct financial benefits'

- 2.4 The OFT's goal is to 'make markets work well for consumers'. For this reason, and in line with other competition authorities around the world, the OFT's impact target focuses solely on the benefit to consumers of OFT actions, or action by others (eg. Courts, government, Competition Commission) pursuant to an OFT intervention.
- 2.5 Consumer benefit does not arise solely from actions that remedy price raising anticompetitive activity. Direct consumer benefits may also arise from a market study that facilitates switching, enforcement of consumer law or education activities that lead consumers to make improved choices.
- 2.6 Financial benefits to consumers include: decrease in price, monetized improvements in quality, monetized time savings, and the benefits that consumers gain from making better informed choices about what goods to purchase.

- 2.7 The benefits of our deterrent effect,⁴ and the improvements in consumer and business confidence in markets induced by OFT actions are included in target B and as such are not included in the measurement towards target A which is focused on the **direct** financial impact on consumers of our work.
- 2.8 Where the problem is in an upstream market and benefit arises in the first instance to business customers, we assume full pass-through of benefits to final consumers, unless strong evidence shows otherwise, as in the vast majority of cases it is disproportionately time consuming to determine the level of this pass-through. Thus, for example, an increase in manufacturer competition that results in lower wholesale prices which in turn result in lower retail prices is treated as a direct benefit. Similarly, a benefit to final consumers could also arise from addressing an anti-competitive situation between a supplier and a business customer.

Definition of costs

- 2.9 In the '5 to 1', benefits are compared to (gross) costs to the Exchequer. In 2006/07 the OFT cost, excluding Consumer Direct, was £57.3m.⁵ To avoid any chance of prejudicing our fine setting process, we do not offset fines against our costs or include them as part of our benefits. We will record fines recovered separately.
- 2.10 Total costs to the Exchequer will be used as denominator in calculating the value for money ratio in the fully met target. For the partially met target we will use just the cost of the activities whose benefits can be estimated.

⁴ On deterrence of anti-competitive mergers, anti-competitive agreements, and abuse of dominance, the OFT has commissioned research from Deloitte & Touche, forthcoming on the OFT website.

⁵ Please note that over the CSR07 period the OFT costs to be used for the value for money ratio will exclude not only Consumer Direct but also the cost of administering consumer credit and anti-money laundering activities, as these will be self-funded from 2008.

2.11 While our principle target is to help markets work well for consumers, we are mindful of our better regulation commitments and make every effort to keep administrative burdens on businesses to a minimum.⁶

Question:

How should we treat revenues from fines? Should they be subtracted from our costs to the Exchequer? Should they be taken as a proxy for compensation to consumers and thus added to the benefits, even if they do not directly go to consumers?

Conservatism of benefits estimates included in the 5 to 1

2.12 OFT strives to get best estimates of its impact. However, in aggregate OFT estimates of impact will be conservative because:

- **Not all projects are included.** For some projects it will not be possible to estimate financial benefits (for example the support we provide to Local Authority Trading Standards Services (TSS) across the country⁷). However a number of reports have been published in the financial years 2005/2007 that evaluate the impact of some of these activities,⁸ and
- **many of the beneficial outcomes of the OFT's work are not easily quantifiable** (eg reducing psychological distress). We also do not quantify the dynamic effects of increased competition on efficiency,

⁶ Explicit consideration of the costs to business is embedded in our new project management framework, rolled out in August 2007.

⁷ Empowering partner organisations, such as TSS, so that they in turn can deliver more positive outcomes for consumers, is a key OFT impact. However, measuring the impact of it depends to a great extent on the ability of partner organisations to measure the benefits they in turn deliver to consumers. If third parties do not measure impact, OFT cannot measure the effect of its partners' empowerment initiatives in consumer benefit terms.

⁸ These include evaluations of: the Consumer Codes Approval Scheme (OFT 870); the Car Warranties market study (OFT 852); support for Trading Standards in using Part 8 of the Enterprise Act (OFT 549); and the use of the Consumer Direct database by Trading Standards services (OFT 871).

innovation, and productivity. We assume, however, that immediate harm suffered from a frustration of competition is a good proxy for the extent to which innovation and efficiency incentives are diminished, **and**

- where evidence is weak, our **assumptions** to estimate direct financial benefits are **conservative**.

Baseline approach

2.13 A common approach underpins all OFT impact estimates:⁹

- Unless there is evidence otherwise, we take as given that all decisions or interventions not overturned on appeal are correct.¹⁰ We assume that the institutional structure, and the right of parties to appeal OFT decisions, are sufficient to ensure that poor decisions, or planned decisions, are identified and corrected.
- Where possible, we base our estimate on information obtained during our investigations/projects. This information has already gone through a rigorous process of internal peer-review, and at times also external review by the Competition Appeals Tribunal. Where the relevant information is not available from internal project documents, assumptions are based on international best practice, academic research, and case officers' expertise.
- We are embedding impact estimation, monitoring and evaluation in our project work. Our measures of financial benefits will increasingly be based on data from monitoring and actual evaluations rather than parameters estimated elsewhere.

⁹ See Positive Impact 06/7, Positive Impact 05/06 and OFT's Economic Discussion Paper 4.

¹⁰ This does not mean that we will not claim a benefit until all appeal opportunities have been exhausted, but, rather, that we will claim a benefit until and unless an appeal overturns an intervention.

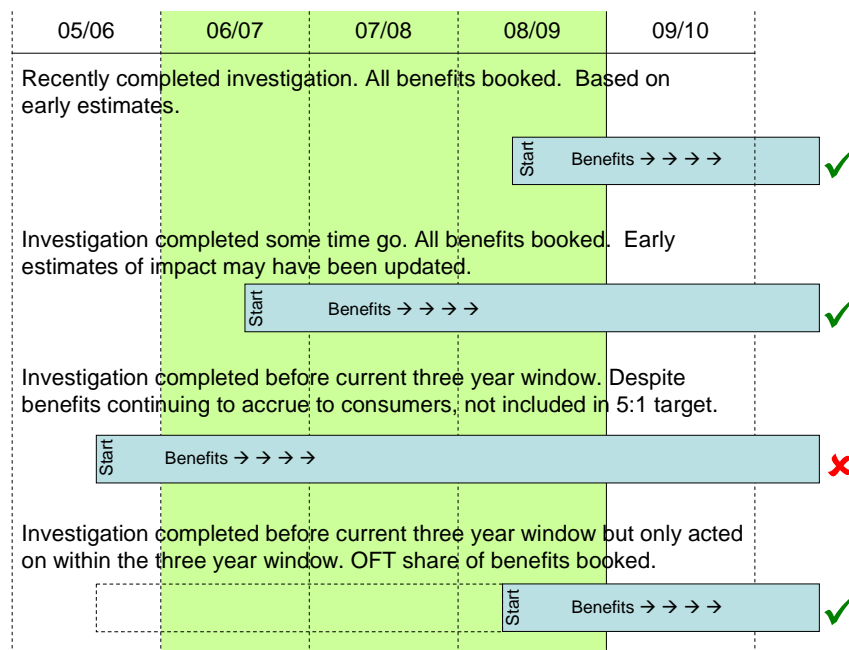
- Our in-depth ex-post evaluations can usually only be carried out three or so years after project completion when the full effects of an interventions have, or should have, taken place. As such, the value for money ratio for CSR cannot rely only on project evidence from ex-post evaluations, but also involves impact estimation and monitoring of market developments.

Presentation of results

- 2.14 In each annual report we will present, as an annual average, our assessment of impact for selected work completed over the previous three financial years. This is consistent with our three-year CSR target and provides a clearer snapshot of our impact, which can fluctuate greatly from year to year due to the lumpiness of our work.
- 2.15 For discrete, time-limited projects we will first include an estimate of their impact in the annual report for the year in which the project is completed. For market studies, or other work that recommends action by other agencies, we will publish estimates of impact in the annual report for the year that the recommendations are implemented.
- 2.16 For continuous programmes, such as scams and mergers, we will include in each annual report an estimate of the impact of the programme over the past year. Each year we present a rolling average of annual impact over three years.
- 2.17 Where we have only recently completed some work we will include an **estimate** of its impact. We will monitor markets in which we have made interventions, and we will amend our estimate of impact based on the evidence we obtain.
- 2.18 Where we believe our work will benefit consumers for a number of years we will include in our estimate of impact the discounted stream of predicted future benefits that are foreseen (for example, this period is usually two years for mergers).
- 2.19 We will also commission in-depth analysis of some of our projects. These evaluations are independent of those involved in the casework,

are carried out by outside consultants and often have external representation. These ex-post evaluations of impact will probably be conducted more than three years after project completion, and so they are unlikely to feature in our estimates of impact for the purpose of the '5 to 1' target. However they will serve as a test of our initial estimates of impact, and the lessons learned from them will be applied to our ongoing impact estimation techniques. For example, if ex-post evaluations provide evidence of whether we generally overestimate or underestimate impact, that will feed into new project impact estimates.

2.20 The following diagram illustrates the above.



Questions:

Do you have any comments on the adoption of a three year rolling average? Would a longer or shorter period be appropriate?

Do you have any comments on the approaches taken to include estimates in the annual report for discrete projects and for continuous programmes?

Each year the OFT will report on fines recovered, on the results of its actions and of other agencies who respond to OFT recommendations, and on results from ex-post evaluations. Do you have views on which of these should contribute to direct financial benefits to consumers, and which to the wider benefits of the OFT?

In meeting the target, should we only include expected benefits for completed projects? Or should we also include benefits from ex-post evaluations, when these benefits become apparent more than three years after projects have been completed? Should we include unanticipated benefits realised after an intervention and never included in estimates of impact?

When other government departments (OGDs) act in response to our recommendations, and thus lead to benefits to consumers, how much of these benefits should we apportion to the OFT? Should we agree attribution of impact with OGDs on an ad-hoc basis?

3 PROCESS OF EMBEDDING IMPACT ESTIMATION

Towards the '5 to 1' measurement: measurement of impact in 2006/7.

3.1 Monetary estimates of impact in 2006/7 (three year average) were based on direct measurable benefits that could be attributed to OFT work in the following activities: CA98 investigations (including cartels), mergers and scams. These are shown in the table below.

| OFT Activity | | | Annual estimated benefit [A] See notes | Annual estimated cost [B] See notes | Benefit/ Cost ratio [C] [A]/[B] |
|--------------|-------|--|--|---|--|
| Scams | [1] | See Notes | £10m | £1m | 10 |
| Mergers | [2] | See Notes | £52m | £4m | 13 |
| CA98 | [3] | See Notes | £64m | £23m | 3 |
| Total | [4] | [1] + [2] + [3] | £126m | £28m | 5 |
| Other | [5] | See notes | n/a | £29m | |
| Total | [6] | { 4 } + [5] | £126m | £57m | 2 |
| Notes | [A]: | Scams, Mergers and CA98 estimates from Positive Impact 06/07 (OFT 928) | | | |
| | [B]: | Total annual OFT cost (excl. Consumer Direct) for 2006/07 | | | |

3.2 Overall, we estimated that the consumer savings, in monetary terms, generated by the OFT in 2006/7 were likely to be about **£126m**. This,

compared to annual OFT costs of about **£57m** (excluding Consumer Direct),¹¹ equates to a value for money ratio of about **2:1**.

- 3.3 However, in 2006/7 we were on track to meet the target partially, as for mergers, CA98 and scams, value for money was estimated at approximately **5:1**.
- 3.4 It is important to note that the benefits flowing from the blocking of, or accepting undertakings in lieu of a Competition Commission reference for, mergers which significantly lessen competition are indicative of the value of our work, and are not a 'performance indicator' in its strictest sense. This is because the OFT has no control on the number and types of mergers proposed and notified each year. In addition, the decision made by the OFT for each proposed merger (either to take undertakings in lieu, refer a merger to the Competition Commission, or clear it) should be unrelated to, and uninfluenced by, the 5 to 1 target.
- 3.5 In 2006/7 we also completed our first ex-post evaluation of a market study, which showed that we achieved £120m-£170m benefits to consumer against a cost to the Exchequer of about £300,000.¹² We are committed to commission an independent evaluation of the impact of at least one market study per year.

Towards the 5 to 1 measurement: Embedding impact estimation

- 3.6 Estimates of direct financial benefits in 2006/7:
- do not include all OFT projects that deliver direct financial benefits, and

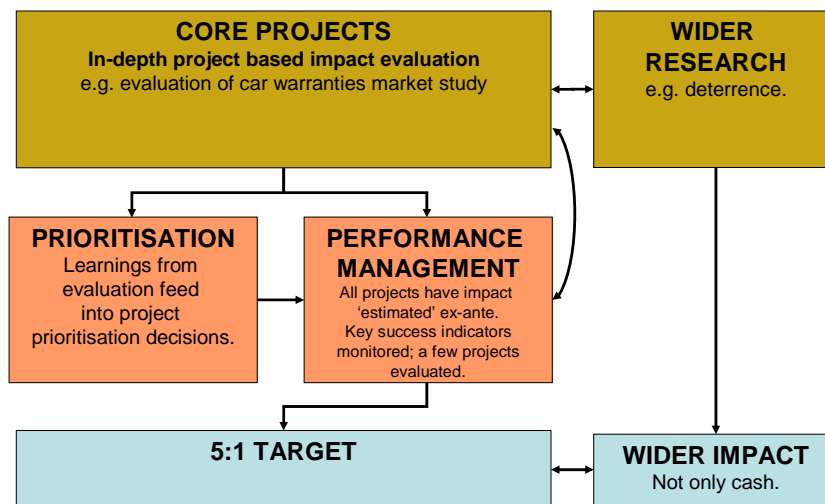
¹¹ Please see footnote 5.

¹² Car warranties (OFT852).

- are based on methodologies that can be improved over time by further research and better data recording at the time of the case/project.
- 3.7 To address this, the OFT is embedding impact estimation at project level, so that, from April 2008, we will have a wider range of projects for which we have estimates of impact. Initially, some of these estimates may be based on assumptions and expert knowledge. However, over time, because of the embedding process, estimates of impact of OFT projects will be based increasingly on publicly available monitored data and evidence from ex-post evaluations.
- 3.8 A major step the Office is taking to embed outcome focused performance monitoring is by encouraging all projects to develop **Impact Estimation Plans** that clearly state what outcomes the project is designed to achieve, an estimate of their scale of impact, and a description of how to monitor it.
- 3.9 At the time of project completion, teams can use their plans to provide an estimate of project impact. This estimate will be reported in the annual report, and will contribute towards the '5 to 1' target.
- 3.10 After project completion, the Office will monitor some key indicators of project success, and adjust the initial estimate of impact if necessary. These adjusted estimates will be reported in future annual reports.
- 3.11 Some projects will be subject to ex-post evaluation which, in addition to providing general learning points in the conduct of our work, will also provide an evidence base to enable improved impact estimates for future projects.
- 3.12 Evidence from ex-post evaluation also informs OFT allocation of resources, as it provides new project proposals with information on the likely direct effect on consumer welfare in the market or sector where

the intervention would take place. Impact is one of the key principles¹³ on the basis of which the OFT prioritises its work.

3.13 The following diagram shows how the '5 to 1' target is measured and how it fits with the wider context of performance management and some of the other impact targets (wider benefits) agreed with HM Treasury.



Principles of outcome-focussed performance monitoring

3.14 A few key principles underlie our impact estimation, monitoring and evaluation programme:

¹³ For more detail on this please see Consultation on OFT Prioritisation Principles, published on 25 September 2007. For any comments on it, please contact Naja Felter, Office of Fair Trading, Fleetbank House, 2-6 Salisbury Square, London EC4Y 8JX, or e-mail Naja.Felter@oft.gsi.gov.uk

- **Proportionality:** direct resources towards seeking to monitor/measure the most important outcomes. Spend less time monitoring / measuring less important outcomes and smaller projects.
- **Transparency:** There is a great deal of uncertainty surrounding outcomes but transparent assumptions and methods can be challenged and improved.
- **Comprehensive Coverage of projects:** Cover more OFT projects through embedding impact estimation.
- **Comprehensive coverage of outcomes:** While every project should contribute towards increasing consumer welfare, in some cases it may not be possible to measure impact in monetary terms.

3.15 The last principle is especially important. Impact other than consumer savings contributes to the achievement of our other CSR07 targets, for example target (B) in the introduction. A project may lead to a number of outcomes that are not directly financial, for example psychological detriment, deterrence, or productivity (ease of entry, efficiency gains, scope for R&D and innovation). These may be aggravated or mitigated by case specific circumstances, such as the financial vulnerability of those affected.

3.16 All of these need to be recognised as successes/failures of a project even though they may not be quantified in monetary terms. Where quantitative monetary estimates are not possible, the OFT will need to rely on qualitative considerations (for example through bespoke surveys) and non-monetary indicators of performance (eg compliance, complaints, new entry etc).

Question:

Do you have any comments on our general framework to measuring direct financial benefits?

4 MEASUREMENT OF IMPACT SO FAR

What do we report each year? Estimates of impact in Annual Reports

- 4.1 The OFT has published estimates of impact for specific areas of its work in its Annual Report 2006/7 (please see www.offt.gov.uk/shared_offt/annual_report/438243/hc532.pdf). The methodology behind the estimates is detailed in Positive Impact 06/07 (OFT 928) (please see www.offt.gov.uk/about/benefits/evaluation/publications).
- 4.2 Areas of OFT work where monetary benefits could be estimated were limited to four. In future annual reports the OFT aims at increasing the number of areas for which monetary estimates of impact will be available.

Methods of estimating direct financial benefits

- 4.3 The following outlines the methods the OFT has used so far for the areas for which we have been able to estimate direct financial benefits to consumers.

Merger control

- 4.4 As a matter of procedure, we have agreed with the Competition Commission (CC) that the OFT is responsible for estimating consumer savings from undertakings in lieu of a CC reference (UILs), and that the CC estimates the consumer savings from referred mergers which they subsequently block or amend.¹⁴ This way the body closest to the final decision is responsible for estimating the decision's impact.
- 4.5 Where necessary, and as a matter of presentation, we have agreed to apportion consumer savings from mergers referred to the CC by the OFT roughly in proportion to the past cost of running the merger regime

¹⁴ The Competition Commission started publishing estimates of consumer savings from the mergers it blocks or amends in its Annual Report 2005/6.

between the OFT and the CC. As such, we allocate to the OFT 20 per cent of consumer savings resulting from CC remedies, and 100 percent of the consumer savings from any UILs.¹⁵

- 4.6 We use merger simulation to estimate the impact of each of the OFT's UIL decisions made in a given year. This allows us to present conservative point-estimates of impact, rather than the lower-bound estimates we used in the past. While developing our methodology we conducted a statistical sensitivity analysis which suggested that, when aggregated across mergers, the level of uncertainty surrounding our estimates are fit for purpose. For a detailed explanation of the impact estimation methodology for mergers please see www.of.gov.uk/shared_of/reports/401801/oft917.pdf.

Question:

Do you have any comments on the methodological approach to estimating impact in mergers?

CA98 enforcement

- 4.7 We use a combination of established rules of thumb and case officer expertise to determine the likely price increases that would have taken place had the OFT not intervened.¹⁶ Estimates of the likely duration of a cartel in the absence of OFT intervention are based on a hazard models.¹⁷ This takes advantage of the fact that knowing how long a

¹⁵ It is hard to apportion benefits of a joined regime and as such any attempt to do so is subject to some degree of arbitrariness. We will continue to discuss with the CC best ways to apportion benefits from our joined work (mergers and market studies/investigations).

¹⁶ We use rules of thumb as our starting assumptions. For example, we assume that as cartels tend to raise prices by at least 10 per cent, competition enforcement that stops the cartel operating will reduce prices by the same extent. The aim of the monitoring and evaluation process described above is to verify whether these assumptions are valid, not only by monitoring prices but also other market developments that might affect them other than the OFT intervention.

¹⁷ A hazard model is a model used to predict the risk (hazard) of experiencing an event at a given point of time.

cartel has already existed provides some information on how long it is likely to exist in the future. We combine these to estimate the impact of CA98 decisions made during the financial year. For detail of this please see www.oft.gov.uk/shared_oft/reports/evaluation/oft928.pdf. We also seek ex-post evidence of price decreases through monitoring and case studies (see for example www.dti.gov.uk/files/file13299.pdf).

Question:

Do you have any comments on the methodological approach to estimating the impact of cartels?

Scams

- 4.8 The consumer losses from a scam are divided by the duration of the scam to obtain a 'flow' of detriment. We then estimate how long the scam would have continued (expected duration). This is based on the scam's duration and other available information. Consumer savings are then calculated as: flow of detriment x expected duration. For detail of this please see www.oft.gov.uk/shared_oft/reports/evaluation/oft928.pdf.

Question:

Do you have any comments on the approach used to estimate the impact of scams?

Market studies

- 4.9 Estimates of value for money for each market study in each financial year are based on the embedding approach illustrated above. They also draw on information from ex-post evaluations carried out by independent parties. So far we have carried out two ex-post evaluations. Methods used in ex-post evaluations depend on the market study in question. In the evaluation of taxi market study, the contractor calculated their estimates of impact through a Difference-in-Difference study of waiting times and taxi utilisation in a number of Local Authorities (LAs), combined with a LAs survey. In the evaluation of the car warranties

market study, the contractor based its estimated benefits on increased ability to 'shop around' for the best price following the removal of warranty restrictions. This was assessed using a survey of consumers coupled with in-depth interviews, against a counterfactual which accounted for external influences (such as EC regulation) in the market.

- 4.10 For the evaluation of the Car Warranties market study, please see www.offt.gov.uk/shared_offt/about_offt/oft852.pdf, and the forthcoming evaluation of Taxis market study for more detail.