

# **OFT response to points raised during the consultation on its approach to calculating benefits**

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OFT955a

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# CONTENTS

<i>Chapter/Annexe</i>	<i>Page</i>
1 Introduction	4
2 Main findings and OFT response	5
3 Access to responses	12
Annex	
A Full list of respondees	13

# 1 INTRODUCTION

1.1 The consultation on the Office of Fair Trading's (OFT) approach to calculating benefits to consumers was published in September 2007 to obtain the views of businesses, business representatives, consumer groups and other stakeholders on the proposals contained within the consultation document. This paper sets out the main issues raised and the OFT's responses.

1.2 The OFT received a total of eight responses from business associations, consumer groups, sectoral regulators and law firms. The breakdown of these respondents is as follows.

- One consumer body
- Two Local Authority Trading Standards Services representative bodies
- One business association
- One sectoral regulator
- One bank
- One law firm
- One national environment agency

## 2 KEY POINTS RAISED AND OFT RESPONSES

2.1 Overall the draft approach to calculating benefits received positive and constructive feedback from respondents. All respondents have welcomed the opportunity to comment. The OFT would like to thank all respondents for the considered and helpful points they have raised. Our paper on calculating the benefits has been changed in a number of places to reflect these comments. Our specific responses are set out here.

### General comments

2.2 A few respondents to the consultation have expressed concern that the Comprehensive Spending Review (CSR) 5:1 target could lead to perverse incentives towards cases which will contribute to meeting the target, rather than facilitating effective competition (for example favouring Undertakings in Lieu (UILs) to merger references to the Competition Commission, favouring market studies over Market Investigation References (MIRs), or moving resources away from areas where the direct value for money (VFM) ratio is lower without considering other benefits such as deterrence). These stakeholders commented that there should not be a link between the CSR target and prioritisation because the OFT's enforcement policy may be distorted by target setting.

### OFT response

The OFT Prioritisation Principles show that direct impact is only one of the factors taken into account when deciding whether to undertake a project. There are also some mechanisms in place (e.g. the possibility to appeal to the Competition Appeal Tribunal; the 80:20 rule of apportionment with the Competition Commission etc) that discourage the OFT from taking unreasonable enforcement actions. It should also be noted that the 5:1 target is one of twenty targets set out in the OFT-HM Treasury performance framework agreement (which includes estimating the wider benefits of OFT's work, including the wider deterrent effect of competition enforcement).

- 2.3 Some respondents to the consultation commented that in balancing consumer benefits against the cost of OFT actions, the OFT should bear in mind the costs to business. They also highlighted that the OFT does not have a remit to ask for extra data solely for measuring benefits purposes and not as part of the core investigation.

#### OFT response

To a large extent, data needed for impact estimation purposes are already collected as evidence for OFT investigations. Even where data may not be strictly necessary to prove infringement of competition law, it may be required for calculation of penalties (for example, relevant affected turnover of parties in a price-fixing case). In addition, our use of these data in evaluation helps the OFT lower the burden to business in the future by helping us to direct resources where they can have most effect. Asking for data at the time of the investigation, rather than once this is concluded, is more cost-efficient both for the OFT and the parties involved.

The burden to business has been highlighted also by the Hampton Review. On the other hand Hampton is also about proportionality. We do not consider that our actions impose disproportionate burdens on business. We also believe that the effort involved in measuring costs would go against the principle of proportionality.

However, we have started to do further work in this area. Ongoing ex-post evaluations are looking at whether there are substantial costs to business in implementing recommendations that result from our work. We plan to continue to do so in the future. The purpose of this exercise is not to come to an accurate measure of the extent of the burden on business, but, rather, to develop ways to minimise unnecessary burden to business whilst still achieving our objectives. It should also be noted that we also do not count the deterrence benefits when calculating our 5:1 target.

- 2.4 The table at 3.1 of the approach consultation document shows that the VFM of competition enforcement appears to be lower than for scams.

One respondent to the consultation expressed concerns that, because of the relative VFM ratios, resources would be moved away from competition enforcement. In addition, the ratios achieved in any given time period may be misleading. We are currently taking fewer but higher impact Competition Act cases and we expect the impact ratios to be higher for these.

#### OFT response

This ignores the considerable deterrent effect of competition enforcement<sup>1</sup>. OFT prioritises its resources taking into account several factors, and not only the direct financial benefit of its projects.

- 2.5 A few respondents to the consultation expressed concern that estimating impact is costly and diverts scarce OFT resources away from enforcement, which is what the OFT should be concentrating on.

#### OFT response

The cost of measuring performance towards the target itself is kept to a minimum by estimating impact of projects only when the effort involved is proportionate to the cost/likely impact of the project, and by focussing on medium to large projects/projects closer to delivery. This work is relatively low cost, minimal in fact compared to the cost of competition enforcement. The impact estimation work in turn feeds into the wider OFT evaluation programme, which includes monitoring success indicators (such as compliance, prices, shopping behaviour, new entry etc.) and commissioning ex-post evaluations. The costs involved in this programme are higher, but the programme has several additional benefits beyond measuring direct financial benefits, in terms of learning from our experiences and enhancing our impact.

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<sup>1</sup> Please see recent research by Deloitte on the deterrent effect of competition enforcement. The report can be downloaded at [http://www.of.gov.uk/advice\\_and\\_resources/resource\\_base/evaluation/publications](http://www.of.gov.uk/advice_and_resources/resource_base/evaluation/publications)

Where interventions lead to benefits due to the joined action of the OFT and other agencies, we need to apportion the benefits. Where possible we agree automatic rules (e.g. with the Competition Commission). Again, one key reason for this is to minimise the costs involved in assessing our impact. In those cases where some ad-hoc negotiation with other departments is necessary, it will be kept to a minimum.

- 2.6 Some stakeholders have asked whether the practices used to estimate impact stand up to scrutiny and have warned that the OFT needs to be conservative in its impact estimates given the potential for litigants to rely on OFT estimates in the context of private enforcement.

#### OFT response

The OFT provides detail of its methodologies and assumptions in its annual Positive Impact note and where possible uses ranges to reflect uncertainty of the estimates. It cannot, however, provide project-specific estimates, assumptions and level of accuracy, because it has to protect confidential information from disclosure. In general, the more uncertain the assumptions, the more conservative they are. We also calculate our impact estimates on a forward looking basis in terms of assessing damage to consumers, with past damages to customers not included within our assessment.

Some elements of our methodology are also reviewed by academic experts and feedback on impact estimation methods is actively sought by presenting at conferences in the UK and abroad.

Most ex-post evaluations are carried out by independent external consultants. This in turn ensures objectivity over the effects of an intervention. Evaluation research is regularly published on the OFT website and disseminated through seminars. One of the aims of commissioning independent ex-post evaluations is to have informal audits of our ex-ante impact estimates and thus inform and improve our impact estimation methods.

We will continue to seek appropriate ways to get external oversight of our impact estimation and ex-post evaluation work.

- 2.7 Some stakeholders have expressed concerns that merger modelling is too complex and resource intensive.

OFT response

The cost of merger simulation is kept to a minimum, however, by complementing standard models and data available in phase I with case officers' judgement, and also by modelling only a few major UILs each year. This takes about one man/day work per simulated merger. Average low-range estimates from those few simulated mergers are then applied to the other, smaller mergers for which simulation is not carried out.

- 2.8 One respondent to the consultation observed that it is important to include in any measure of consumer benefits not only the benefits of direct intervention by the OFT through formal commitments or requirements to change conduct, but also the benefits created where a business under investigation changes its conduct voluntarily in order to settle or close the investigation.

OFT response

We do include those benefits where easy to observe. An example of this can be seen in the evaluation of the car warranties market study, where car manufacturers amended their code of practice and dropped the specific restrictions which tied the car warranty to servicing at a franchised garage without need for referral of the market to the CC. The independent consultants who carried out the evaluation took this into account when estimating the consumer savings that resulted from the study.

- 2.9 Many respondents have commented that we must record and publish fines separately rather than record them as a benefit to consumers.

OFT response

To avoid any chance of prejudicing our fine setting process, and also as the consumers receive no direct benefits from the fines, we do not

offset fines against our costs or include them as part of our benefits. We will record fines recovered separately.

- 2.10 One respondent stated that instead of a three year rolling average the OFT should consider a larger time period, such as five years in order that a more statistically calculated average can be more meaningful. Others commented that we review this time scale after the first three years to ensure it is appropriate.

#### OFT response

OFT considers that a three year period is probably appropriate given the CSR period. Anything longer than three years is likely to result in a less clear measure of performance. The adoption of a three-year rolling average will soften any spikes in data. We will review at the end of the CSR period whether this time scale is appropriate.

- 2.11 One respondent expressed concern that quantitative measures are not always an appropriate reflection of OFT's outcomes. There may therefore be a need for qualitative evaluations. Use of complaints should be used carefully though as improved consumer awareness leads to an increase in consumer complaints.

#### OFT response

OFT complements the monitoring of quantitative indicators with qualitative research, such as focus groups and in-depth interviews with stakeholders, to pick up outcomes that cannot be monetised or quantified.

A project may lead to a number of outcomes that are not directly financial, for example psychological detriment, deterrence, or productivity. These may be aggravated or mitigated by case specific circumstances, such as the financial vulnerability of those affected. We recognise these as successes/failures of a project even though they may not be quantified in monetary terms.

- 2.12 Respondents commented that estimates should be transparent and adjustments would need to be made retrospectively to take account of unintended consequences if they develop at a later date.

#### OFT response

OFT's yearly impact estimates are based on the best evidence available at the time of estimation and some detail on how they are derived is provided in its annual Positive Impact note. The OFT may, however, revise the benefit cost ratio for each reporting period as new information becomes available. In this case we will make downwards as well as upwards adjustments to impact estimates of the project the new evidence (for example from ex-post evaluations) refers to. For other projects that have used similar impact assessment methodologies, and thus may be affected by the new evidence, we will not make adjustments but take account of the new evidence in future projects' assessments.

Ex-post evaluations 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, this will feed into new project impact estimates. Similarly, if intelligence from ex-post evaluations outside the rolling assessment period suggests benefits could have been more accurately measured, this will inform future assessments.

### **3 ACCESS TO RESPONSES**

- 3.1 The OFT was not asked to treat any responses to the consultation in confidence.
- 3.2 Copies of all the responses will therefore be available from the 1 April 2008 for public viewing on the OFT website: [www.offt.gov.uk](http://www.offt.gov.uk) or in hard copy at

Office of Fair Trading  
Fleetbank House,  
2-6 Salisbury Square,  
London  
EC4Y 8JX.

## **A FULL LIST OF RESPONDEES**

- A.1 Royal Bank of Scotland
- A.2 The Wales Heads of Trading Standards
- A.3 Confederation of British Industry
- A.4 Ashurst
- A.5 Trading Standards North West
- A.6 Scottish Environment Protection Agency
- A.7 The Consumer Council
- A.8 The Office of Water Services