

Trade and Industry Committee: inquiry into the work of the OFT

Evidence submitted by the Office of Fair Trading

27 April 2007

OFT's role, objectives and organisational development

1. The OFT's mission is to make markets work well for consumers and we have a diverse set of tools available to help us achieve this. The bulk of our work consists of analysing and studying markets, enforcing competition and consumer protection law, undertaking advocacy, and working with partners to raise standards and to deliver relevant education programmes to businesses and consumers. We aim not to impose unnecessary burdens or costs on business: such costs could only detract from benefits to consumers and the economy.
2. Competition stimulates businesses to offer the most attractive array of price and quality options possible. Consumers and the economy are best served by vibrant competition in open and well functioning markets, which are in turn driven by empowered and confident consumers. Competition drives productivity, innovation and growth in the economy at large.¹
3. The Government's vision for the UK competition regime was set out in its White Paper of July 2001 *Productivity and Enterprise: A World Class Competition Regime* (the 2001 White Paper),² with a broader consumer perspective in the 1999 White Paper *Modern Markets; Confident Consumers*. The OFT is committed to these aims while being totally independent in all the decisions we take and in advocacy advice we offer to Government. It does

¹ For recent OFT thinking in the link between competition and productivity see www.offt.gov.uk/shared_offt/economic_research/oft887.pdf

² www.archive.official-documents.co.uk/document/cm52/5233/523301.htm

not have an overarching statutory remit, rather it has powers and duties under a number of statutes. We operate within a clear understanding of the Government's vision and have adopted the above mission statement and a set of objectives to give coherence and direction to our work.

4. The OFT has developed considerably since those white papers and the legislative reforms that went with them. For the first few years of the new regime the OFT was subject to a target-driven set of service delivery agreements with HMT and was operating on a structure based on legislative tools. This was recognised by the OFT, HMT and the NAO in its 2005 report, as not being an ideal situation and one which was giving incorrect incentives for OFT action. In the 2005 report the NAO recommended that the OFT develop a series of performance indicators which would better demonstrate the effectiveness of its work along with further recommendations which are covered later in this paper.
5. We now have a series of targets and objectives organised within four broad themes: delivering high-impact outcomes, being a centre of excellence and intelligence, working in partnership, and building our internal capability. In the past year we have made radical changes to our internal structure to be better able to meet the challenges we face and ensure that we are more strategic, focused and coherent as an organisation. A key aspect of the new structure is that it puts together project and enforcement work in three sector-focused market groupings covering goods, services, and infrastructure & knowledge economies; supported by dedicated merger, cartel and scambuster teams.
6. Our aim under this new structure is to take a fully market-informed approach to our work: making use of intelligence, evaluation and analysis in order to prioritise our action and resources, and taking a robust risk-based approach to current and future problems. All of this is set out in depth in our Annual Plan 2007/08³ on which we recently consulted. This consultation on our Annual Plan forms a strategic tier to our engagement with stakeholders, crucial at working level to much that we do. The Annual Plan/ Annual Report process is part of an accountability regime which relies also on Parliamentary scrutiny such as the present inquiry and on judicial oversight mentioned below.

³ http://www.oft.gov.uk/shared_oft/about_oft/349517/oft881p.pdf

7. For 2007/08, the last year of the CSR 2004, we will be reporting against both the old output-based KPIs and the new outcome-based objectives as agreed with HM Treasury for CSR 2007. We expect that this will mean, as in 2006/07 that we will fail to hit a number of old targets, but in fact provide a better series of outcomes for consumers and the economy.

Powers and performance in main areas of activity

8. **Enforcement of prohibitions on anti-competitive behaviour.** These apply across the economy and are designed to ensure that the process of competition is protected against misuses of market power. The two prohibitions are those of anti-competitive agreements and of abuse of a dominant market position, contained in the Competition Act 1998 (in force since 2000, with additional criminal powers since 2003) and in Articles 81 and 82 of the EC treaty (which OFT has had powers to enforce fully since 2004). The Competition Act also created a specialist independent appeals body (the Competition Appeal Tribunal (CAT)) with a full merits review jurisdiction over OFT decisions on infringement; the CAT's powers have since been further strengthened to allow it to hear appeals on merger and market decisions. This legislation provides strong enforcement powers which had been lacking before, together with a high degree of judicial oversight. The challenge for us now is to make best possible use of these powers.
9. In the first five years since implementation of the Competition Act 1998, the OFT made a number of high profile prohibition decisions (for example, in the markets for toys and games, newspapers, and replica football kit), and imposed fines originally totalling £60 million (consumer benefit set out in paragraph 20). This effective enforcement activity has been built on over the past year in the form of decisive action against unlawful exchange of future fee information by fifty independent schools, and the imposition of multi-million pound fines in the markets for flat roofing, car park resurfacing, window spacer bars and stock check pads.

10. The National Audit Office (NAO) report on the OFT's competition enforcement work (*Enforcing competition in markets*, published in November 2005)⁴ has made a valuable contribution to appraising and refocusing our work after several years of experience of the new legislation. The report recognised the OFT's achievements during a period of dramatic change in the legal environment. It also made a number of recommendations on prioritisation and resourcing of OFT's casework; case management in terms of timescales, cost and quality control; and measurement and communication of the OFT's achievements. The OFT accepted all of the NAO's recommendations,⁵ and has been working over the past year to implement them, in conjunction with the internal change programme that has taken place over the same period, and directed at the same aim of improving the overall focus and impact of the OFT's work. In October 2006, for example, in line with the NAO's recommendation that the OFT provide more information on how it selects competition cases for investigation, we published refocused criteria explaining how it assesses which cases should be pursued, and whether existing investigations should be continued.⁶ The shift towards refocusing of our resources on fewer, high priority competition cases has meant that some 15 investigations have been closed; as noted in paragraph 7 this has also resulted in fewer decisions than originally anticipated. We would have liked to have opened further significant competition enforcement cases last year: we did not for positive reasons (applying NAO recommendations to the whole range of OFT activity as part of the restructuring; fuller consideration of alternative tools, particularly through market studies) but we are looking hard at our planning process in order to achieve more significant new cases.
11. **Merger control.** The OFT investigates completed and anticipated mergers above a certain size to assess their competitive effects. Mergers are referred to the Competition Commission, or the OFT accepts undertakings instead of a reference, where it is believed that they might substantially lessen competition. Since 2003 the OFT has operated under the more competition-focused regime in the Enterprise Act, which took Ministers out of the

⁴ www.nao.org.uk/publications/nao_reports/05-06/0506593.pdf.

⁵ See OFT evidence before Public Accounts Committee in *Enforcing competition in markets* (42nd Report of 2005-06):

www.publications.parliament.uk/pa/cm200506/cmselect/cmpubacc/841/841.pdf

⁶ www.of.gov.uk/shared_of/press_release_attachments/compcriteria.pdf

decision-making process for most mergers. This greatly enhanced the independence of the competition authorities in this area (OFT and the Competition Commission – to whom problematic mergers are referred). And it removed the public interest test from merger cases.⁷

12. The 2005 Global Competition Review Rating Enforcement Survey noted that the OFT was still doing good work in mergers despite the increasing need for in-depth investigations in the first stage. Users praised the decision not to refer the Boots/Alliance Unichem merger as an 'exceptional example of a robust stance on a controversial merger' The OFT is currently reviewing and revising its procedural guidance to ensure that best practice continues to be used by the UK's merger regime.
13. **Market investigation references to the Competition Commission.** This is a mechanism (unique to the UK) where markets in which features adversely affect competition (but which cannot be tackled by the prohibitions on anti-competitive agreements) can be investigated and legally enforceable remedies imposed. As with merger control, since 2003 OFT and the CC have been applying a more competition-focused regime, with the former public interest test removed and no role for Ministers in most cases. For market investigations, as for referred mergers, OFT is the initiator with the CC as second-phase reference body: making the system work well requires close co-operation and co-ordination between us.
14. It is early days to say how well the new regime is working. Eight market investigation references have been made (store cards, LPG, home credit, classified directory advertising, NI banking, groceries, PPI, airports): of these, only four have reached the stage of implementation of remedies. Three of these references (home credit, NI banking, PPI) have followed from super-complaints: this is very much in line with Ministers' intentions to empower consumer organisations to bring forward such matters and require OFT to consider what action, if any, it should take.⁸ We recognise that there is an onus on OFT (by the references we make) and the CC (by the remedies that

⁷ Barring exceptional cases where Ministers are involved and take responsibility for considering public interest issues.

⁸ For list and details of individual super-complaints:
www.ofc.gov.uk/advice_and_resources/resource_base/super-complaints/

come out of them) to demonstrate that the market investigation mechanism (which the UK retained when it caught up with other countries on enforceable prohibitions on business behaviour) is working well and adding value in driving competition in markets.

15. **Enforcement of consumer protection rules.** Consumer protection legislation, like competition law, has been strengthened considerably in recent years, notably since the *Modern Markets; Confident Consumers* white paper. Ensuing changes to the consumer protection landscape include: introduction of controls on distance selling, rationalisation of civil consumer enforcement and strengthening of self-regulation by the Enterprise Act, establishment of Consumer Direct (now part of OFT) providing national consumer advice, and the Unfair Commercial Practices Directive. The OFT enforces some consumer protection rules itself but also has a role to provide strategic leadership for and to champion Local Authority Trading Standards Services (LATSS) to ensure they take a risk-based, proportionate and coordinated approach to their work, including enforcement. Since the Hampton Report⁹ much work has been done on getting a proportionate approach to enforcement and one of the real benefits of the OFT/LATSS collaboration is the ability to use intelligence to prioritise the allocation of resources to deal with the worst aspects of consumer detriment. While protecting individual consumers from exploitative practices is important in itself, we believe it also helps strengthen competition in markets: most consumer protection measures will have a competitive effect through increasing consumer information, empowerment and confidence, but individual measures can have more specific effects eg in enabling distance selling channels to compete more strongly with physical retailing. We would like to highlight this interaction and to emphasise the value we believe comes from OFT being both a consumer and competition authority.
16. **Market studies, advocacy, communications.** The OFT has always had the ability to study markets, highlight issues and make recommendations, but those recommendations often had little force. What made it worthwhile for OFT to undertake market studies of the scope and scale it now does was the Government's invitation in the 2001 white paper to competition authorities to advise it on the impact of laws and regulations on competition, and its

⁹ www.hm-treasury.gov.uk./media/A63/EF/bud05hamptonv1.pdf

commitment to respond publicly within 90 days. That provided the assurance that recommendations to Government within a market study report could not simply be ignored. Since then OFT has undertaken some 30 market studies:¹⁰ while there have been other successful outcomes (eg market investigation references to the CC; threat of enforcement action changing behaviour - and recently announced market studies on retail banking and on medicines distribution have aimed at setting possible enforcement action with in a context of better understanding of the market and consideration of alternative options), the majority have resulted in advocacy recommendations to Government. The studies on Public Subsidies and European State Aid Control focused on competition distortion and productivity incentives; the study on Commercial Use of Public information found that more competition in public sector information could benefit the UK economy by around £1 billion a year and made recommendations on guidance, regulatory framework and securing compliance; the Pharmaceutical Price Regulation Scheme has been the subject of a major study which recommended reforms aimed both at releasing resources and producing better focused incentives on research and investment. These are examples of where OFT can undertake work that is significant for productivity and economic performance without necessarily going to the CC with a market investigation reference.

17. The OFT regards this sort of advocacy as very important. We believe that the shape of Government regulation can be more significant for the working of some markets than the behaviour of companies and thus have higher impact. Market studies are not our only means of advocacy. We frequently have direct dialogue with Government departments on the development of new legislation (sometimes as part of our role to advise on competition assessments within the regulatory impact assessment (RIA) process). We also undertake free-standing pieces of work and pursue lines that arise in connection with enforcement or other activity including earlier market studies. Published examples of recent OFT advocacy work are the guide (with the Office of Government Commerce) to public procurers of construction services,¹¹ a

¹⁰ For list and details of individual studies:

www.of.gov.uk/advice_and_resources/resource_base/market-studies/

¹¹ www.of.gov.uk/shared_of/reports/comp_policy/of892.pdf

review on schools' uniforms policies,¹² and a recent collaboration with CAA to produce a report for DG Tren on the impact of liberalising airport slot trading.¹³

18. Our advocacy work links across to wider communications. Government will be more inclined to shape regulation to support competition if there is broad public understanding of the value to them of competition in markets. Publicity for OFT successes is important in developing such understanding, as is communication with business. We aim to ensure that effective communications are embedded into all aspects of the OFT's work. In September 2006, a new Business Communications team was established: its aim is to educate and support businesses and to work with them rather than simply telling them about their obligations. It takes forward OFT's drive to promote the benefits of competition to businesses, encouraging compliance and high standards of service to consumers.

Value for money

19. The OFT's budget for the past year was £55m (plus £19m for Consumer Direct). We have achieved efficiency savings of 3 per cent and 5 per cent in the past two years; the saving of £2.5m last year was a considerable achievement. On funding, we believe strongly that our independence is best preserved through continued funding direct from HM Treasury, rather than through the DTI, as has been mooted in the past.
20. A very conservative analysis of the impact of our competition enforcement work suggested it saved consumers at least £750m over the years 2000-2005 compared to a cost to OFT/CC of £98m over the same period. The positive impact is likely to be much larger than this, as indicated by preliminary results of our research into the deterrence effect of the UK competition regime. An example of competition case which led to considerable consumer savings was the Replica Football Kit price-fixing case, where our intervention reduced prices significantly and resulted in savings of £15 for an adult shirt.

¹² www.of.gov.uk/news/press/2006/135-06

¹³ www.of.gov.uk/shared_of/reports/of_response_to_consultations/of832.pdf

21. There is evidence of value for money in a number of other areas of our work. The evaluation of the OFT market study into new car warranties showed that the study saved consumers around £150m, compared to a cost of £300k. An independent evaluation of the OFT training provided to LATSS in the use of the Enterprise Act 2002 found that the training saved local government £5m per year through increased efficiency even though the total cost of the support is £150k per year. A recent evaluation of the OFT Consumer Code Approval Scheme suggests that the scheme delivers consumer benefits with minimal extra burdens for members.
22. With CSR 2007, we have agreed to deliver measurable benefits to UK consumers of five times our annual budget for all activities excluding Consumer Direct (and 3.5 times budget for Consumer Direct). We are devoting increasing effort to measure the impact of our work through independent evaluations and internal monitoring; evaluation feeds back to better prioritisation and improved outcomes. We have started embedding anticipation of evaluation into our market studies and merger work.

Partnership

23. OFT is at the centre of consumer protection and competition enforcement in the UK but that is a very wide canvas; successful partnerships are crucial to the overall aim of making markets work well for consumers and doing so in ways that are joined up, reduce burdens on business and look for market-driven solutions involving industry where possible. In particular:
 - **LATSS.** As noted in para 15, a new relationship and major new championing role for OFT
 - **Consumer organisations.** Shared overall aim of benefiting consumers; key working relationships in areas such as advocacy and super-complaints
 - **Business organisations and self-regulatory bodies.** Shared aim of raising standards, driving out rogue traders and ensuring markets work well, while avoiding unnecessary burdens and costs. Examples are the Consumer Codes Approval Scheme and the Payment Systems Task Force
 - **Competition Commission.** As noted in paras 11 and 13, key complementary roles on mergers and market investigations

- **Sector regulators.** Vital enforcement partnerships, both with those regulators who have concurrent competition powers¹⁴ and those who don't (see below)
- **EU and international.** Partnerships with Commission and member states on enforcement, advocacy relationships, mutual support and learning across international community
- **Government departments.** Often shared aims in relation to consumers; advocacy as a means for Government to achieve policy aims by best use of markets.

24. Among sector regulators without concurrent competition powers, OFT has greatest dealings with the FSA. That is because, as well as the interaction between OFT's competition powers and FSA's sectoral powers, there is a great deal of interaction on the consumer protection side, arising in part from our joint powers under the Unfair Terms in Consumer Contracts Regulations as well as OFT's role in consumer credit licensing. Both the OFT and FSA are committed to working closely together where our interests overlap, as demonstrated though the OFT/FSA Joint Action Plan published in April and updated in November 2006.¹⁵ Payment protection insurance (PPI) provides a good example of how well the OFT and FSA can work together to tackle key consumer problems. The National Audit Office (NAO) has conducted a review of the FSA, including the way the FSA works with other bodies such as the OFT. The OFT has contributed to this review, which we understand is likely to be published shortly and may provide a useful source of information on co-operation between OFT and FSA.

¹⁴ More information on relationships with concurrent powers regulators, and on international relationships, can be found in an extended version of this evidence submitted to the HoL Committee on Regulators in February:
http://www.offt.gov.uk/shared_offt/reports/oft_response_to_consultations/oft907.pdf

¹⁵ These are available at www.offt.gov.uk/shared_offt/about_offt/oft838.pdf and www.offt.gov.uk/shared_offt/about_offt/oft879.pdf