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**CONCURRENT COMPETITION
POWERS IN SECTORAL
REGULATION**

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CONCURRENT COMPETITION POWERS IN SECTORAL REGULATION

Executive Summary

1. The aim of the project was to understand:
 - how the interface between the Office of Fair Trading (OFT) and the sectoral regulators operates when dealing with competition cases;
 - how the regulators balance their concurrent competition powers against their sector-specific regulatory powers; and
 - how regulators that have concurrent competition powers use these powers.
2. The project attempts to explore the reasons for the decisions made, and to consider any differences between the regulators. Ultimately we were interested in what might be the consequences for the regulated industries, and whether anything could be done to improve or enhance the current arrangements.
3. We have consulted a number of stakeholders, including the regulators that possess concurrent powers (Ofgem, Ofcom, ORR, CAA and Ofwat) and one that does not (Postcomm), as well as colleagues from the OFT, the Competition Appeal Tribunal (CAT) and two companies in the energy industry.
4. We have considered **economic regulation** only (as opposed to environmental regulation, social regulation and so on), and focused on three broad sets of issues – the arrangements for exercising concurrent powers; the interaction between concurrent powers and wider sector-specific powers; and the way in which competition law is used by the sectoral regulators.

The Arrangements for Exercising Concurrent Powers

5. The process for deciding who deals with a particular complaint appears to work well, with the OFT generally passing cases over to a regulator if the complaint involves a regulated sector. Co-operation between the OFT and the regulators is facilitated by the existence of the Concurrency Working Party (CWP), a forum in which views on current practice are exchanged, although the group does not purport to reach any binding decisions.
6. We believe that it may be beneficial to enhance the existing cooperation between the OFT and the sectoral regulators. The CWP should coordinate all concurrent functions of the regulators and the OFT, including market investigations, with a view to ensuring that the application of all of these

functions is consistent and reflects best practice. In particular, the CWP could carry out a more detailed analysis of how the approaches of the regulators and the OFT differ from one another. There could be some scope for the OFT and the regulators to share best practice and expertise. The OFT should further be encouraged to take an overall view about whether competition law is being applied consistently and proactively across all sectors of the economy and to report to the Joint Regulators Group.

Striking the Balance Between Sectoral Powers and Competition Law

7. A distinctive feature of the concurrency regime is that it allows the regulators to use both sector-specific regulatory powers and general competition powers to regulate markets. Indeed, sectoral regulation has played a key role in opening up markets and stimulating market development, removing barriers to entry, regulating dominant players and in ensuring fair, transparent pricing. It will continue to be essential (for the foreseeable future) in those segments of the utility industries where competition is neither possible nor desirable (natural monopoly), in sectors where competition is still developing and as a way of addressing a wide range of other issues (safety, environment, universal service provision, equity) that general competition law does not address.
8. The interaction between sector-specific powers and competition powers raises a number of important policy questions. First, where regulators have a choice, how do they decide whether to use competition powers or regulatory powers? Some of the regulators see advantages in using sectoral regulation where there is a choice, because it is seen to be better targeted at the particular regulated activity concerned; enforcement involves a less burdensome appeals process¹; is less resource-intensive; and is more easily implemented. In contrast, Ofcom stated that they would normally favour investigating a case under the Competition Act 1998 (Competition Act) if at all possible, as a matter of policy and (in some instances) law. Ofgem also stated that relying on competition law is more appropriate as markets become competitive.
9. It is for regulators to judge when it is best to use particular powers but where they have a choice, regulators should carefully consider the grounds for their selection of particular powers and give clear explanations for their decisions.
10. A second important policy question is whether, once effective competition has become fully established in a market (either by entry or the threat of new entry or innovative provision), there will be a point when regulators should cease to rely on their sector-specific powers. In principle, withdrawing from *ex ante* regulation could reduce the regulatory burden on firms. However, this needs to be set against the benefits of using regulatory powers to open up markets and encourage effective competition. We would welcome the

¹ A notable exception to this is that many of Ofcom's decisions using sectoral powers are subject to the same appeal process to the Competition Appeal Tribunal under the Competition Act 1998.

regulators' views on what conditions would need to be met for it to be appropriate to remove sectoral regulation and instead rely on competitive forces and competition law to ensure the attainment of desired market outcomes, and we welcome sectoral regulators keeping licence conditions under review.

Use of Competition Law

11. In dealing with competition complaints, we found that the regulators were able to use their sectoral knowledge to good effect – a major benefit of the concurrency arrangements. However, we note that since the beginning of 2001, investigations by the regulators under the Competition Act have not led to infringement decisions. This does not necessarily mean that the regime is not working; there may be a number of possible reasons for a lack of infringement decisions, including the structure of the markets, high levels of compliance within regulated markets, a lack of information or evidence or the company changing its behaviour in response to the investigation.
12. We did observe that non-infringement decisions have sometimes been made by the sectoral regulators and the OFT on the basis that the company in question has changed its behaviour after a complaint has been made or once the investigation has been opened under the Competition Act. Whilst there may be good reasons why such decisions were made in specific cases², if there is a presumption that breaches of competition law will not lead to infringement decisions, companies will not be deterred from future violations of the Competition Act and if there are no infringement decisions then third parties who have been disadvantaged by anti-competitive behaviour may find it harder to be compensated. When considering how to proceed with Competition Act investigations, the regulators should carefully consider the incentives that all companies will face in the future.
13. One of the aims of the Enterprise Act was to empower the competition authorities and regulators to proactively promote effective competition in markets that were not working effectively. We would encourage the regulators to think about whether they can be more proactive in using competition law, including the use of market investigation references.
14. We recommend that the regulators should publish a response to this report, including a plan for taking forward the recommendations, within 6 months of the publication of this report.

² The OFT has published guidelines on when it may be appropriate to accept commitments in lieu of reaching an infringement decision.

CONCURRENT COMPETITION POWERS IN SECTORAL REGULATION

I. Introduction

- 1.1 This project has been carried out jointly by the Economic Regulation team in DTI and the Competition and Economic Regulation team in HM Treasury. The aim of the project was to understand:
 - how the interface between the Office of Fair Trading (OFT) and the sectoral regulators operates when dealing with concurrent competition cases;
 - how the regulators balance their concurrent competition powers against their sector-specific regulatory powers; and
 - how the regulators that have concurrent competition powers use these powers.
- 1.2 The project attempts to explore the reasons for the decisions made, and to consider any differences between regulators. Ultimately we were interested in what might be the consequences for the regulated industries, and whether anything could be done to improve or enhance the current arrangements.
- 1.3 The scope of the report covers economic regulation (i.e. any regulation which has as its objective the promotion of fair and effective competition) and does not cover the social, environmental or other duties and powers of the regulators. In this report, sectoral regulation refers to **economic regulation only**.
- 1.4 The original principle at the time of privatisation of many of the utilities was that sectoral regulation would be withdrawn over time as effective competition was introduced into the market. According to the Littlechild Report on Regulation of BT (1983)³, “profit regulation is merely a ‘stop-gap’ until sufficient competition develops”. Competition would replace the role of price control regulation and would be in the best interest of consumers. There might still remain a role for the regulators to regulate the irreducible core natural monopoly elements of the market, but competition should replace regulation wherever this was feasible.
- 1.5 The utility regulators were therefore given a duty to promote effective competition, as well as ensuring the sufficient provision of the regulated service and protecting the interests of consumers. The regulators were assigned competition powers concurrent with the OFT. This was intended to make use of the regulators’ considerable specialist knowledge of their

³ ‘Regulation of British Telecommunications’ Profitability’ by Stephen Littlechild, Report to Secretary of State for Industry, February 1983.

particular sectors and assist in co-ordinating their use of sector-specific regulation with the exercise of general competition law functions.

- 1.6 An agreement or practice may therefore take place within a regulated sector which falls within the scope of the regulator's sector-specific powers, as well as their powers under general competition law. In this case, the regulator must decide which powers it is most appropriate to use. A regulator is not required to fulfil its duty to take licence enforcement action if it decides that it is more effective to use its competition powers⁴.
- 1.7 However, while sectoral regulators have a clear mandate to apply competition law alongside the OFT, the criteria under which a regulator decides whether to exercise these powers are less clear. Regulators have a degree of discretion over whether to tackle potential competition concerns through their concurrent powers or through other means, such as licence changes, and in practice appear to have differing views about when each should be used.
- 1.8 In the past it has been argued that regulators have incentives to exercise their sectoral regulatory powers in preference to concurrent competition powers, where they have a choice. For example, the 2001 Better Regulation Taskforce (BRTF) report⁵ on the economic regulators stated: "It is still too early to judge the impact of concurrency, but our stakeholders in industry and think-tanks felt that competition law would remain under-used by the sectoral regulators without further measures to encourage this." This was still the view of some of the parties we consulted in the process of producing the report.
- 1.9 The rest of the report is split into five sections:
 - II. a description of the concurrent powers and their application;
 - III. an analysis of the current framework for exercising concurrent powers;
 - IV. an analysis of the balance being struck between sectoral regulation and competition law;
 - V. an analysis of the regulators' use of competition powers; and
 - VI. conclusions and recommendations.
- 1.10 This report has been compiled through a mixture of desk-based research and stakeholder interviews. DTI and HM Treasury are very grateful to all those who contributed their time and experience to this project.

⁴ Ofcom is required to resolve disputes referred to it under section 185 of the Communications Act.

⁵ Better Regulation Task Force (July 2001), "Economic Regulators", see <http://www.brtf.gov.uk/docs/pdf/econreg.pdf>.

II. The Concurrency Powers and their Current Application

Key Features of the Concurrency Regime

2.1 The term ‘concurrent powers’ in this paper refers to the powers to apply competition law in particular sectors, exercisable by either the relevant sectoral regulator or the Office of Fair Trading (OFT). The sectoral regulators which have concurrent powers with the OFT are the Office of Communications (Ofcom), the Office of Gas and Electricity Markets (Ofgem), the Northern Ireland Authority for Energy Regulation (NIAER), the Director General of Water Services (Ofwat), the Office of Rail Regulation (ORR) and the Civil Aviation Authority (CAA).

2.2 The concurrent powers are as follows:

- Powers to make market investigation references under section 131 of the Enterprise Act 2002 where sectoral markets appear to be displaying anti-competitive features. These powers are contained in the relevant sectoral legislation. Prior to the enactment of the Enterprise Act, sectoral legislation had given sectoral regulators similar powers to make monopoly references to the Competition Commission (CC) in respect of their particular regulated sector under the Fair Trading Act 1973. Section 168(9) and Part 2 of schedule 9 of the Enterprise Act amended this legislation to give the relevant sectoral regulators concurrent powers to make market investigation references to the CC. Certain regulators established since then have also been given such powers (Ofcom⁶ and the Water Services Regulation Authority). To the time of writing, none of the regulators have made references under these powers, although Ofcom have accepted undertakings from BT in lieu of making a reference to the CC.
- Powers to investigate infringements of the prohibitions in Chapter 1 and 2 of the Competition Act and Articles 81(1) and 82 of the EC Treaty in the UK. Chapter 1 and Article 81(1) prohibit certain anti-competitive agreements between undertakings. Chapter 2 and Article 82 prohibit abuse of a dominant position in a market by undertakings. Section 54 and schedule 10 of the Competition Act⁷ give sectoral regulators the same powers in relation to breaches of these provisions in individual cases by undertakings trading in the sectors they regulate as the OFT have in all cases. Regulators are empowered to investigate breaches by undertakings who they suspect to have breached these prohibitions⁸. They also permit them to accept commitments from such undertakings⁹, impose interim remedies¹⁰, take decisions as to whether the prohibitions

⁶ By section 370 of the Communications Act 2003.

⁷ In the case of Ofcom Section 371 of the Communications Act

⁸ Section 25 Competition Act 1998.

⁹ Section 31A Competition Act 1998.

¹⁰ Section 35 Competition Act 1998.

have been breached¹¹, require infringements to be brought to an end¹² and to impose financial penalties in relation to infringements¹³ where appropriate. Their ability to apply and enforce Articles 81 and 82 arises pursuant to Article 5 of the EC Modernisation Regulation¹⁴ which requires Member States to designate national competition authorities (NCAs) and such NCAs and the courts of the Member States to apply and enforce Article 81 and Article 82. The regulators have been designated as NCAs in their own sectors¹⁵.

- Powers to carry out market studies. The OFT have general powers to carry out such studies in relation to any market, and the sectoral regulators in effect have similar powers in the sectors they regulate as part of their general regulatory powers¹⁶.

2.3 Thus sectoral regulators have all the powers of the OFT to deal with individual cases under the Competition Act¹⁷; but not certain general powers to issue general guidance on the application of the prohibitions and on penalties and to make and amend the Procedural Rules that set out the procedures to be followed when implementing the provisions of the Competition Act. The OFT alone has these powers, although it is required to consult with the sectoral regulators when undertaking these duties.

2.4 Concurrency working arrangements in relation to the enforcement of the prohibitions in the Competition Act and Articles 81 and 82 (as between the OFT and the sectoral regulators) are set out in a statutory instrument which specifies how the system of concurrency should apply – the Competition Act 1998 (Concurrency) Regulations (SI 2004/1077)¹⁸. The OFT has also issued guidance on the arrangements for concurrency pursuant to section 52 of the Competition Act¹⁹.

2.5 Once it has been decided which UK authority will exercise prescribed functions in relation to a case, the Concurrency Regulations prevent another authority from exercising prescribed functions unless the case is formally transferred under the Concurrency Regulations. Prescribed functions are defined in Regulation 2 of the Concurrency Regulations.

¹¹ Section 31 Competition Act 1998.

¹² Sections 32 and 33 Competition Act 1998.

¹³ Section 36 Competition Act 1998. Fines may not exceed 10% of the worldwide turnover of an undertaking (see the Competition Act 1998 (Determination of Turnover for Penalties) Order SI 2000/309 as amended by SI 2004/1259).

¹⁴ Council Regulation (EC) No 1/2003.

¹⁵ By Article 3 of the Competition Act and Other Enactments (Amendment) Regulations 2004 (2004/1261).

¹⁶ Ofcom not only have powers, but also a duty, to regularly review certain markets.

¹⁷ Only the OFT have the power to investigate a cartel under the Enterprise Act. The CWP have agreed that any investigation which may have criminal penalties should be investigated by the OFT.

¹⁸ See <http://www.legislation.hmsso.gov.uk/si/si2004/20041077.htm#note3>.

¹⁹ “Concurrent application to regulated industries”. OFT Guidance note 405, December 2004.

- 2.6 In relation to the application and enforcement of Articles 81 and 82, a “European Competition Network” (ECN) of competent authorities designated under regulation 1/2003 has been set up to deal with the potentially overlapping jurisdictions of the European Commission and national competent authorities (NCAs). The OFT and the sectoral regulators with concurrent powers participate in the ECN as NCAs²⁰.
- 2.7 The concurrency arrangements do not extend to merger regulation. Responsibility for assessing mergers lies with the OFT and the CC, subject to any intervention by the Secretary of State on public interest grounds²¹. However, the regulators are typically consulted by the OFT and the CC on merger cases relating to their sector. There are special arrangements in relation to mergers of water and sewerage undertakings, where mergers of enterprises with significant turnover are automatically referred to the CC and have to be assessed in particular by reference to their anticipated effect upon the ability of Ofwat to carry out its functions to make comparisons between different water enterprises²².
- 2.8 The regulator for postal services, Postcomm²³, does not have concurrent powers. Their primary duty is to secure the provision of a universal postal service²⁴. However, they have a secondary duty to further the interests of postal users, wherever appropriate by promoting effective competition between postal operators. In practice, they have exercised their regulatory powers to require the dominant undertaking in the postal sector, Royal Mail, to act in a manner that is consistent with competition law, through the imposition of licence terms to that effect²⁵. Postcomm feel that, even if they *did* possess concurrent powers, much the same groundwork would need to be followed and it is likely that there would be relatively few differences in terms of the decision as to how individual cases would be pursued²⁶.
- 2.9 There are also other regulated sectors where the regulator does not have concurrent functions: for example, the financial services sector, where the Financial Services Authority has a subsidiary duty to promote effective competition, but no concurrent competition powers.

²⁰ Where the European Commission investigate an infringement the NCAs cannot do so save to assist the Commission.

²¹ Currently, national security and media plurality. In the case of mergers of newspaper publishers or certain media mergers if the Secretary of State intervenes, OFCOM have a role in advising the Secretary of State on the media plurality implications.

²² There is also a particular provision in section 66 of the Railways Act 1993 which extends the definition of a qualifying merger situation to include situations involving the award of various rail franchises.

²³ The Postal Services Commission.

²⁴ Section 3(1) of the Postal Services Act 2000. This implements the EU obligations in Articles 3, 5 and 22 of the Postal Services Directive 97/67/EC; Article 22 permits Member States to allow the sectoral regulator to exercise concurrent competition powers in the postal sector, but the UK has not exercised this option.

²⁵ See condition 11 of their current licence.

²⁶ See the Memorandum of Understanding between Postcomm and the OFT dated June 2003.

2.10 In the broadcasting area, where Ofcom have the power to include licence conditions for ensuring fair and effective competition²⁷, Ofcom must consider whether a more appropriate way of proceeding in relation to a matter would be under the Competition Act and where they decide it would, they cannot exercise their regulatory powers²⁸.

Market studies and investigations

2.11 The OFT have general powers to carry out market studies²⁹ and the sectoral regulators broad powers to examine markets in the sectors they regulate. The OFT and sectoral regulators also have specific powers to investigate markets where they suspect there is some element of market failure – either regarding competition or consumer detriment – with a view to deciding whether or not to make a market investigation reference to the CC under section 131 of the Enterprise Act, or to accept undertakings in lieu of doing so³⁰.

2.12 In addition, all the regulators are under a duty to respond to “supercomplaints” i.e. complaints that features of a UK market appear to be significantly harming the interest of consumers, made by designated consumer bodies³¹. Where a supercomplaint is made by one of these designated bodies³², the OFT or the relevant regulator to whom the supercomplaint is made must respond within 90 days. Such responses can include a decision to exercise sectoral regulatory powers, competition powers (whether under the Enterprise Act or Competition Act) or consumer protection powers.

2.13 The OFT’s role in market studies provides a useful comparison with the regulators’ activities in monitoring markets. In broad terms, the difference is that, because regulators cover a single sector, they constantly monitor activity in their area, whereas the OFT has to focus on particular areas of potential concern. Ofcom have a duty to keep certain markets under review in order to decide whether sectoral regulation continues to remain appropriate.

2.14 There are a number of options available to the OFT or a regulator once the preliminary investigation is complete. If no serious problem is identified they may choose to take no further action. If they suspect a breach of the

²⁷ Under section 316 Communications Act 2003.

²⁸ Section 317(2) of the Communications Act 2003.

²⁹ Pursuant to sections 5 and 7 of the Enterprise Act 2002.

³⁰ See section 154 Enterprise Act 2002.

³¹ Defined in section 11 Enterprise Act 2002. Such complaints can be made to sectoral regulators by virtue of section 205 Enterprise Act 2002, the Enterprise Act 2002 (Super-complaints to regulators) Order 2003 (SI 2003/1368) and the Enterprise Act 2002 (Bodies Designated to make Super-complaints) (Amendment) Order 2005 (SI 2005/2468).

³² Which? (formerly the Consumers’ Association), the National Consumer Council, Citizens Advice Bureau, energywatch, the Consumer Council for Water, Postwatch, General Consumer Council for Northern Ireland and the Campaign for Real Ale (CAMRA) have been designated as potential supercomplainants under the Enterprise Act.

Competition Act, they may take enforcement action. Where there is no such suspicion, but they have reasonable suspicion that a feature or features of the market are distorting competition, they may make a market reference to the CC, or accept undertakings in lieu of such a reference where they believe they will remedy problems in the market concerned.

- 2.15 The usual outcome of a market study is a report and series of recommendations. These may propose regulatory change or other action by Government, other public bodies (including devolved administrations and local councils), companies or other organisations. Such actions may, for instance, include the development of a code of practice. Alternatively, the OFT or a regulator may choose to mount an information campaign.
- 2.16 In the event of a market reference, the CC will perform a market investigation. This will produce a set of conclusions as to whether a market has anti-competitive features and if so, whether action should be taken. The Commission has significantly wider powers to take remedial action than the OFT or sectoral regulators and in many cases will be able to impose remedies directly. It may also make recommendations to any organisation (which it is likely to do where changes to the regulatory framework are required). Where recommendations are made to Government, Government will respond within 90 days, as with market studies.

Why do the Regulators have Concurrent Competition Powers?

- 2.17 Sectoral regulation prescribes in detail the framework within which the market participants may operate, and creates standards and processes that define the behaviour of companies. The emphasis is therefore on the prevention of market abuse *before* it happens. The prohibitions in the Competition Act and Article 81 and 82 are also in a sense *ex ante* in that they seek to deter breaches of the prohibitions; the existence of general competition law principles provides a framework that can and should be used by companies to guide their compliance even in the absence of clearly defined case law. However, they operate *ex post* in that they are only enforceable *ex post* in particular areas.
- 2.18 Concurrence is desirable for several reasons – first, the regulator has detailed knowledge of the sector, and may be best placed to understand complaints being made under competition legislation and to come up with appropriate remedies. Second, sectoral regulators are also better placed to spot competition problems in the markets they regulate, even in the absence of specific complaints. Third, and perhaps most importantly, having concurrent powers means that the regulator is able to judge whether conduct will be more appropriately regulated by sector-specific regulation or the use of general competition powers. Regulators can co-ordinate their use of sector-specific regulation and expertise with the exercise of general competition law.

The Role of Sectoral Regulation

- 2.19 Any assessment of current practice needs to be placed in the context of the strategic objectives for sectoral regulation and the operation and enforcement of competition law in the economy generally. Sectoral regulation is to some extent required to ensure that objectives other than those related to the efficient functioning of the market (e.g. safety standards) are secured. With respect to market behaviour, application of general competition law is the norm, and that is reflected in the absence of any provisions to exempt markets that are subject to specific sectoral regulation from the operation of general competition law.
- 2.20 Specific sectoral regulatory regimes in relation to competition primarily reflect the need to actively inject and promote effective competition into the sector, and to address the risk that businesses in these sectors have inherited, or by virtue of the nature of the characteristics of the markets involved, possess either alone or in conjunction with others, “market power” in the markets in which they operate i.e. the ability to exercise control over the price and/or output in a particular market, and (if not placed under additional controls to other undertakings) the opportunity to use it to prevent the development of effective competition in the market.
- 2.21 Objectives for sectoral regulation are, of course, set out in legislation, and the details of these objectives vary from sector to sector, as does the extent to which they are constrained or required by EC law³³.
- 2.22 In many cases a key role of sectoral regulation is to act as a surrogate for competition. This explains the focus of economic regulation on monopoly elements in the market, be they inherently a natural monopoly or in transition to full competition. Sectoral regulation attempts to give benefits similar to a competitive market by setting (and raising) quality standards for services, removing barriers to entry and by ensuring efficient pricing.
- 2.23 As well as sectoral powers derived directly from sectoral legislation, the regulators also monitor, enforce, and develop the licensing³⁴ regime for companies operating in regulated markets³⁵. The licence conditions impose obligations on licensees that cover relations between the licensee and other licensees, and between licensees and consumers. Taken together, the licences map out the operation of the market through specific performance requirements. In many cases, the detail of market operation is contained in

³³ In the postal sector, for example, the licensing regime gives effect to the Postal Services Directive, which requires member states to appoint a regulatory authority whose primary role is to secure the delivery of universal service obligations.

³⁴ In the case of telecommunications the regulatory regime no longer involves licences but special conditions apply to undertakings that have market power in particular markets, pursuant to an EC law based regulatory regime implemented through the Communications Act 2003.

³⁵ In the water sector, licences are known as appointments.

multilateral agreements or codes of practice to which individual licensees are compelled by licence condition to subscribe.

- 2.24 These regulatory functions flow from the practical implementation of the statutory objectives and duties placed on regulators, which usually have as a primary focus some customer-facing objective. In some instances, such as electricity, gas and water, the regulator has a primary objective “to protect the interests of consumers...wherever appropriate by promoting effective competition”. Other regulators have duties to secure the ongoing provision of the service to consumers or the orderly conduct of the market (for example), which are also customer-facing objectives.
- 2.25 The functions and objectives do not, in themselves, provide a compelling case for specific sectoral regulation, even where competition has not yet fully developed. General competition law could – and does – deal with markets which have dominant players; where competition is not self-sustaining; and where industry agreements and codes need to underpin the functioning of the market.
- 2.26 Rather, sector-specific regulation reflects the fact that there is a role for the sectoral regulator as the facilitator of market reform, seeking to promote competitive markets wherever appropriate and acting as the catalyst to produce self-sustaining, effective, competition³⁶. The emphasis here is on ensuring the appropriate market conditions are present to encourage effective competition, as opposed to the emphasis of general competition law which is to prevent anti-competitive conduct. It is for this reason that the government has implemented sector-specific regimes in sectors whilst competition was developing.
- 2.27 Most of the major utilities have now been in the private sector and subject to regulation by independent bodies with sectoral and concurrent competition powers for fifteen years or more. Clearly effective competition has been much more firmly established in some markets than in others, but where it is established it is worthwhile re-visiting the extent to which the sectoral regimes have been instrumental in moving market supervision in the relevant sectors away from sectoral regulation and towards the application of general competition law. Essentially, the question is one of how sectoral regulation has enabled the markets to mature to the point where the need for sector-specific regulation can be fully or partially withdrawn in respect of a market, or part of a market.

When Might There Be a Choice Between Sectoral Regulation and Competition Powers?

- 2.28 The choice about whether to investigate a case under the Competition Act will depend on the regulators’ consideration of section 25 of the

³⁶ In certain cases, there is a legal obligation to maintain sectoral regulation.

Competition Act. Section 25 provides that a case may be investigated under the Competition Act if there are reasonable grounds for suspecting that there is an agreement which affects trade within the UK or between Member States, or which has as its object or effect the prevention, restriction or distortion of competition within the United Kingdom or the European Community. A case may also be conducted where there are reasonable grounds for suspecting that the Chapter II prohibition or the prohibition in Article 82 of the EC Treaty has been infringed.

- 2.29 The Competition Act also gives powers to the designated NCAs to conduct investigations where the above conduct has occurred in the past, immaterial of whether the agreement in question remains in existence or conduct is continuing.
- 2.30 Thus if the regulator believes that there are reasonable grounds for suspecting an infringement, the regulator may launch an investigation under the Competition Act. If not, the regulator may also be able to apply existing licence conditions or conditions of authorisation where these exist, or use its sectoral powers to either expand the scope of the existing licence conditions or introduce new ones. EC Regulation 1/2003 (the Modernisation Regulation) requires the NCAs of the Member States (which includes the regulators) to give primacy to and enforce Article 81 and Article 82 of the EC Treaty where the behaviour under investigation is believed to affect trade between the Member States.
- 2.31 This decision will be complicated where a complaint is received under the Competition Act about a company that has a licence that contains a significant market power condition, such as a requirement to provide access. The way in which regulators decide in such circumstances is covered in more detail in the next chapter.
- 2.32 The consequences of any such decision could be far-reaching, particularly if a regulator does not simply react to a single complaint, but decides to make long-term amendments to the existing regulatory framework. Over the longer-term, the regulator may either remove licence conditions where they overlap with the Competition Act provisions, thereby relying on general competition law to handle any similar cases that may arise in the future, or it may choose to introduce new licence conditions and hence pre-empt future violations.
- 2.33 There may also be cases where the regulators do not have a choice of power to use; for example, it is an inherent requirement of the EU telecoms/spectrum regime that the national regulator take action against any breaches of the sectoral rules that come to its attention using sectoral regulation. This means that in the UK, Ofcom will not necessarily have a

choice between using the specific sectoral competition rules and general competition law³⁷.

2.34 In the Postal Sector the licence conditions³⁸ have been formulated in such a way that they reflect the Competition Act. Postcomm believe that it is feasible to imagine that if they were given concurrent powers, both the regulator's competition powers and sectoral powers could be appropriate to use with regard to a particular case. This opinion was not shared by other regulators we consulted; in their experience, there has generally been little ambiguity about which powers should be exercised in any one case. However, several cases before the Competition Appeal Tribunal have involved debates over which set of powers were applicable in the circumstances.

³⁷ Ofcom's discretion whether or not to take action for breaches of the EU electronic communications regime varies depending on the condition being breached and Ofcom's obligations under the Directives.

³⁸ Condition 11 of the current licence of Royal Mail.

III. The Current Framework for Exercising Concurrent Powers

The Arrangements for Determining the Jurisdiction

3.1 When a case is brought under the Competition Act which relates to a regulated sector, the OFT will take into account the following criteria (as set out in the Competition Law Terms of Reference for the Concurrency Working Party (CWP)³⁹) when deciding whether the case should be undertaken by the OFT or the sectoral regulator:

- the sectoral knowledge of a regulator;
- whether the case affects more than one regulated sector;
- any previous contact between the parties or complainants and a regulator or with the OFT; and
- any recent experience in dealing with any of the undertakings or similar issues that may be involved in the proceedings.

3.2 These arrangements appear to work well in practice. However, the system has arguably not been tested for a particularly difficult case where the jurisdiction is less clear-cut. This does not, in itself, mean that the current arrangements are not appropriate. As the number of investigations under the Competition Act increases over time, this should bring to light any potential issues with the current system, and will provide the OFT and the regulators with greater experience over a wider range of cases. The CWP provides a useful forum for such issues to be discussed, and to agree any changes to the current practice to take account of issues over jurisdiction, if required⁴⁰.

3.3 The OFT is responsible for publishing guidance on the scope and use of concurrent competition powers by the regulators⁴¹, which it produces after consultation with the regulators concerned. This is updated as required and used by the sectoral regulators to produce sector-specific guidance more directly related to each regulated sector. Overall, the regulators find the guidance to be clear and that it reflects the practical arrangements well. There is also a degree of discretion built into the guidance, and this flexibility is welcomed.

³⁹ See Annex B of the OFT's guidance "Concurrent application to regulated industries", December 2004, available at <http://www.of.gov.uk/nr/rdonlyres/819e0492-cb75-4e48-8afc-c2df5890881c/0/of405.pdf>.

⁴⁰ In practice, if a dispute were to arise it would be dealt with at a more senior level.

⁴¹ OFT, December 2004, "Concurrent Application to Regulated Industries", see <http://www.of.gov.uk/nr/rdonlyres/819e0492-cb75-4e48-8afc-c2df5890881c/0/of405.pdf>.

The Concurrency Working Party

- 3.4 The Concurrency Working Party consists of the OFT and the regulators that hold concurrent competition powers, although other regulators without these powers may also sit in as observers. The CWP is chaired by a representative of the OFT. The group was set up in 1997 to facilitate a consistent approach by the regulators and the OFT in the exercise of their functions and powers under the Competition Act; to consider the practical working arrangements between them; to provide a vehicle for the discussion of matters of common interest and the sharing of information where appropriate and where legally permitted; and to co-ordinate the provision of advice and information on the application of Article 81, Article 82 and on the Competition Act to the public.
- 3.5 However, and perhaps due to the differences in the regulated markets, the approaches taken by regulators differ. As far as possible, it is desirable for the decisions and approaches of the regulators to be consistent. Where there are differences in approaches these should be clearly explained. We would encourage the OFT to take an overall view of whether competition law is being applied consistently and proactively across all sectors of the economy and report to the Joint Regulators Group. Further, steps could be taken to share expertise and promote best practice between the regulators and the OFT. Among the issues for consideration are:
- (a) should the sectoral regulators and the OFT together provide senior strategic direction for the work of the CWP on concurrency issues through their regular meetings?
 - (b) should there be established sub-groups of the CWP to deal with legal and economic issues in more detail and in confidence, with a view to sharing best practice and establishing a consistent approach between regulators?
 - (c) should the CWP adopt a more focused forward work plan to identify and address the issues involved in any move towards greater reliance on general competition law by sectoral regulators?
 - (d) is there scope for more systematic sharing of expertise between staff at the OFT and the regulators?
- 3.6 With the implementation of the Enterprise Act the CWP was given the additional responsibility to coordinate action on super- complaints. However, the remit of the CWP does not cover market investigation references. The CWP should be given the remit of coordinating all concurrent functions of the regulators and the OFT with a view to ensuring that the application of all of these functions is consistent and reflects best practice.

IV. Striking the Balance Between Sectoral Regulation and Competition Powers

The Current Approaches of the Regulators

- 4.1 The number of cases investigated under the Competition Act for some regulated sectors is relatively few – of the 38 decisions published by the regulators under the Act between 2001 and September 2005, 23 were brought by Oftel/Ofcom, 6 by Ofgem⁴², 4 by Ofwat, 3 by ORR and 2 by the Office for the Regulation of Electricity and Gas (now the Northern Ireland Authority for Energy Regulation)⁴³. The CAA has not exercised its concurrency powers by the time of writing.
- 4.2 Sectoral regulation will continue to be essential (for the foreseeable future) in those segments of the utility industries where competition is neither possible nor desirable (natural monopoly) and where competition is still developing⁴⁴, although competition powers can still play an important role in these sectors.
- 4.3 The expectation that regulators would start to use competition law more frequently as competition develops, while simultaneously withdrawing from sectoral regulation, does not appear to have materialised to any great extent in practice. However, there is evidence that the sectoral regulators are making more decisions under the Competition Act. In the 12 months to December 2005, 7 of the 13 published decisions under the Act have been issued by the sectoral regulators.
- 4.4 EC law and administrative law limits the choice between sectoral regulation and competition powers. However, there have been, and there will continue to be, many areas in which the regulator has to decide whether to use sectoral regulation or competition powers and whether and how to withdraw sectoral regulation.
- 4.5 Where a regulated company is in breach of one of its existing licence conditions, the regulator will enforce the condition or consider whether it should be revoked – competition powers are generally only used where there are gaps in existing sectoral powers (such as an absence of relevant licence conditions). Given the extent of sectoral powers, this approach may just leave competition powers as a “backstop”. Whilst the extent of competition in the regulated markets may necessitate retaining sectoral powers, there is a risk that this approach ignores the potential for removing particular licence conditions and instead relying increasingly on competition

⁴² As this report goes to publication, Ofgem have just issued a Statement of Objections against National Grid as part of a Competition Act investigation into the provision of domestic-sized gas meters.

⁴³ See the OFT Competition Act public registry, available at <http://www.of.gov.uk/Business/Competition+Act/default.htm>.

⁴⁴ This is not to say that competition law has not had and cannot have an important role to play in opening up markets to competition and from preventing the abuse of dominance in natural monopolies.

powers in markets, even where competition is not fully developed. A similar general approach was to consider first whether there are existing licence conditions which need to be enforced. If there are, sectoral powers are used, as above. However, if not, new conditions are defined, and Competition Act powers are only then used if enforcing the new licence (or other) conditions would fail to address the perceived problem.

- 4.6 Ofcom stated a preference for the use of its powers under the Competition Act if a case arose which could be resolved using either their Competition Act or their sector-specific regulatory powers. Ofcom also have a statutory responsibility in relation to their broadcasting powers, as laid out in the Communications Act 2003⁴⁵, to consider whether a case can be dealt with using their powers under the Competition Act before considering whether to use their sectoral powers.
- 4.7 There is a potential concern that, where there has been little use of competition powers, the regulators have not had the opportunity to build up experience of cases brought under the Competition Act which can be a problem given the very extensive and detailed analysis that any investigation under the Act requires. There is in practice a degree of expertise and resource sharing between the OFT and the regulators, although access to the OFT's legal resources was noted by some regulators as an area where greater access would be welcomed.
- 4.8 There may be scope for greater sharing of expertise between the regulators and the OFT to ensure that best practice is followed in all sectors. As more cases are brought under the Competition Act and the regulators gain experience in this area, this problem should diminish. However, some commentators have further argued that regulators may deliberately attempt to avoid exercising the Competition Act so as to reduce the potential for conflict with the industries they regulate.

The Potential Benefits of Withdrawing from Sectoral Regulation

- 4.9 Sectoral powers are a flexible tool specifically designed for particular markets that allow the regulator a degree of influence over a final outcome in a market; it is a policy approach that is both practical and relatively easy to implement and which has contributed a great deal to protecting consumers and facilitating competition in the regulated markets.
- 4.10 Sectoral regulation has played a very important role in the initial stages of market development. It has enabled markets to be opened by the regulator and has helped to establish competition; for instance, incumbent energy suppliers were subject to price controls until only a few years ago when the

⁴⁵ See Communications Act 2003 s.317. This refers to the exercise of Ofcom's Broadcasting Act powers "for a competition purpose".

controls were lifted as competition was felt to have developed sufficiently within the market under the sectoral controls for these to be removed.

4.11 However, a greater reliance on competition powers and a withdrawal from sectoral regulation may have a number of possible benefits, including:

- the presence of sectoral regulation introduces the possibility of unanticipated distortions in the market arising due to new restrictions or licence conditions being imposed by the regulator;
- perhaps as a consequence, the existence of sectoral regulation which requires firms to act in particular ways can reduce the scope for competitive pressures to work on firms in regulated markets, resulting in a sub-optimal outcome for the market as a whole (particularly if regulation protects competitors, rather than protecting the competitive process);
- relying to a greater extent on general competition law and the subsequent absence of specific constraints allows firms greater flexibility and provides stronger incentives to innovate in ways which may be beneficial to consumers and which may improve sector productivity;
- competition law sets a higher hurdle for intervention which can help avoid undue regulatory intervention in a market that is broadly competitive;
- the Competition Act allows greater third party scrutiny of regulatory decisions;
- competition law principles provide a framework that can and should be used by companies to guide their compliance and provides companies with incentives to ensure that they do not act anti-competitively even in the absence of clearly defined *ex ante* rules; and
- withdrawing from sectoral regulation means that firms are only subject to one set of regulations.

Reasons for the Continued Use of Sectoral Powers

4.12 The continued use of sectoral regulation may be justified by the particular circumstances of the regulated sectors, and the continuing need to put market structures in place that encourage the development of effective competition. However, given some of the possible advantages, there may also be cases where it would be possible to withdraw the sectoral regulation and rely more heavily on general competition law.

4.13 The regulators interviewed gave various reasons for why the Competition Act is not used to a greater extent, including: the extent of competition within the market, the fitness of general competition policy for the required

purpose, the speed of decisions and the appeals process and the greater regulatory certainty that sectoral regulation was perceived to offer. We discuss each of these in more detail below.

The Extent of Competition in the Regulated Market

4.14 One regulator explained, “sectoral powers are to be preferred where the objective is to open markets to competition, and general competition law is preferred where competition has been established”. Indeed, Ofgem went further and stated that:

“we do believe that once competition is established in a market, competition law is the right approach and sets the appropriate regulatory hurdle for regulatory action in terms of the effect on competition”

4.15 The regulators generally hold that sectoral powers are more appropriate for changing the structure of the market, reducing barriers to entry and opening the market up to effective competition. Powers under the Competition Act are seen as being more appropriate for affecting conduct and maintaining competition once it has already become established.

4.16 If this view is to be accorded some weight (and it was expressed by a number of parties), it fits with the general development of the use of competition powers. Where effective competition has been established in the market for a significant amount of time, competition powers can play a much greater role, as has been demonstrated by Ofcom (and previously Oftel).

4.17 The fact that we have sector-specific regulation reflects the fact that there is a role for the sectoral regulator as the facilitator of market reform, where appropriate. Because of this we would expect that once competition had become established in a market, specific sectoral regulation could start to be withdrawn, and licence conditions removed from companies that now operate in a competitive market. In practice, this appears to be happening more quickly in certain sectors than others. In some sectors, licence conditions continue to be imposed on companies operating in competitive downstream areas of a market, where one might expect that the application of competition law could be sufficient.

4.18 It may therefore be reasonable to ask whether certain regulators could do more to remove particular licence conditions from firms once it can be ascertained that effective competition to the regulated firm exists. This would further reduce any perceptions by the firm of over-regulation.

4.19 However, it can also be argued that sectoral regulation is not the only way in which markets can be opened up to competition. For example, regulators have the authority to invoke the Enterprise Act 2002 and refer a

case to the CC or accept undertakings in lieu of doing so⁴⁶. The CC then has the power to impose a wide range of remedies, including price controls, divestment, and in certain cases, the break-up of a monopoly company. Indeed, it was the reference to the CC by Ofgas that helped to create an industry structure conducive to competition in the gas industry. Competition law can be used not only to maintain competition where it already exists, but also to encourage effective competition where it is still relatively undeveloped.

4.20 The argument that competition law sets a high hurdle for intervention is not a convincing argument for using sector-specific regulation as an alternative. If regulators believe that they cannot use their competition powers to remedy perceived problems within a *competitive* market, then it is questionable whether it is appropriate to use sector-specific regulatory instruments in that market instead.

Fitness for Purpose

4.21 Some regulators stated a preference for the use of sectoral powers as they are specifically tailored to the regulated sector, and are therefore more clearly applicable and can make it easier for companies to comply. Regulators felt that some case law from cases pursued under the Competition Act and Articles 81 and 82 was too general to apply easily to the regulated industries.

4.22 An example of this can be seen in a case where Ofgem had concerns that, based on the existing case law at that time, the Competition Act would not be sufficient to remedy anti-competitive behaviour in the electricity market. Ofgem therefore attempted to introduce a 'market abuse licence condition' (the MALC) into the licences of certain generators. Two of the generators refused to accept the modification and the case was referred to the CC. The CC concluded that the two companies involved were not in a position to manipulate the market as Ofgem had suggested, and therefore that the licence modification was not required. The licence condition was therefore removed from the licences of all of the companies in the market. Should problems arise again, Ofgem have stated that they would seek to take action under competition law in the wholesale electricity market given the developments in case law that have occurred since this time, whilst retaining the right to use sectoral powers should competition law prove insufficient.

4.23 The lack of specific *ex-ante* guidelines for companies has been, and can be, addressed through the accumulation of new case law as a greater number of cases in these sectors are brought under general competition law, rather than by relying on existing, or introducing new, sector-specific measures. Case law and legal precedent will, of course, never provide firms with

⁴⁶ See, for example, Ofcom's recent decision to accept undertakings offered by British Telecom in lieu of a reference to the CC.

certainty in all cases. However, although sectoral regulation may provide clear guidelines, it will never cover all possible anti-competitive practices. So the fact that new sectoral regulation may need to be introduced to prohibit certain behaviour will also create uncertainty for firms. If cases are not brought before the Competition Appeal Tribunal there will not be an opportunity to test the detailed circumstance of a particular case and establish precedent.

- 4.24 In any event, it is debatable whether the peculiarities that characterise some of the regulated utilities are so unique as to be incompatible with the existing – albeit not always very specific – provisions of the Competition Act. Indeed, it could be argued that every industry possesses certain characteristics that set it apart from other industries, and yet they are all subject to the same general competition law. The generality of competition law has also been argued to be an advantage, as, unlike sectoral regulation, the general principles of competition law guide and incentivise company behaviour even in the absence of clearly defined *ex ante* rules.

The Speed of the Process

- 4.25 The use of sectoral powers is generally held to lead to a more timely resolution of the problem, whereas a case taken forward using powers under the Competition Act can take much longer to come to completion, and can result in considerable uncertainty for the company under investigation as well as potential competitors in the meantime. For example, in the telecommunications sector, the statutory timescales laid down in the Communications Act are generally shorter than the time taken for typical cases under the Competition Act, and issues which typically take some time to determine, such as the definition of the relevant market and dominance, will already have been determined when the relevant significant market power condition had been imposed.
- 4.26 Unlike the use of sectoral powers which will only be referred to the CC in the event of a licensee refusing to accept a modification to the licence condition, the Competition Act contains an extra safeguard which allows a third party (in many cases a new entrant) to appeal a decision not to take action to the Competition Appeal Tribunal. However, the regulators felt that there was significant resource cost in dealing with such an appeal (in terms of time and money) for all the parties involved and that it can be difficult to close what might be considered non-meritorious cases.
- 4.27 The average length of appeals to the CAT to September 2005 (from the registering of the appeal to the stage at which the cases were substantively determined) was 7.8 months. If cases that were withdrawn at an early stage are excluded (even though in some of these cases the withdrawal involved the CAT in issuing judgements or rulings) then the average length of time

was 9.4 months⁴⁷. For the cases which have reached a full hearing, the average time taken from registration to the hearing of the substantive issue is about 5.8 months. Where a matter is really very urgent, a determination can be obtained from the Tribunal in a timescale that makes sense in the context. The CAT is currently looking at ways to reduce the time taken to complete an appeal, and this is expected to result in a more timely resolution to cases brought to the Tribunal.

4.28 However, although this is quite a lengthy process, it needs to be seen in the context of the length of time that regulators take to reach their own decisions. In addition, it is unlikely that a market investigation carried out by the CC would be completed, with remedies imposed, in significantly less than two years.

Greater Perceived Regulatory Certainty

4.29 Specific rules are thought to be easier to impose under sectoral powers, especially as companies appear to prefer a rules-based form of regulation. The regulators generally felt that there is less ambiguity with licence conditions, and the industry is currently more used to this form of regulation.

4.30 However, the advantages of a gradual withdrawal of rules-based *ex ante* regulation, which we have previously discussed, must be borne in mind. Such an approach should not compromise regulatory certainty. On the contrary, a greater reliance on general competition law will bring the competitive parts of the regulated utilities more closely in line with other sectors, and as the body of case law increases, so will the level of familiarity and certainty. Indeed, it was acknowledged that regulatory certainty would increase as more Competition Act investigations are carried out.

The Future Approach to Using Competition Law

4.31 The combination of comparative speed and certainty (or the perception of same) in the use of sectoral powers over general competition powers must be an important consideration for any regulator, particularly in a dynamic market where early resolution can make a difference in terms of avoiding or minimising consumer detriment or curtailing anti-competitive behaviour. A long resolution time might dissuade potential competitors from entering the market as potential new entrants decide to wait until important cases are resolved before deciding whether to enter the market.

4.32 However, the Competition Act contains a statutory ability to take interim measures decisions to preserve the status quo pending the completion of an investigation and, if appropriate, during an appeal to the Competition Appeal Tribunal. To date no interim measures decisions have been taken

⁴⁷ Source: The Competition Appeal Tribunal.

by sectoral regulators and, if the speed of the process is deterring new entrants, this may be an area for consideration.

- 4.33 In any case, as one regulator pointed out, there is a need for sectoral regulators to use general competition law more regularly in order to build up a body of case law and precedent to clarify the scope and effect of general competition law for the regulated sectors.
- 4.34 This is important for two reasons. First, it permits the regulators to ‘test the envelope’ for their competition powers. Cases taken to the Competition Appeal Tribunal in particular will provide valuable and instructive lessons, to the benefit of regulators generally and to regulated companies, irrespective of the outcome. The limits of the competition powers cannot be fully tested if regulators pursue a strongly risk-averse strategy. Regulators need to acknowledge that cases that they take to the Competition Appeal Tribunal and lose will nevertheless be valuable.
- 4.35 Second, the use of general competition law is valuable simply because it is not unique to any one sector or market: decisions and precedents established under general competition law can be relevant across all markets. It is only by making aggressive use of general competition law that the sectoral regimes can be rolled back effectively.
- 4.36 Taken together with the belief that sectoral regulation was best for opening markets and general competition law for markets where competition had been established, it is apparent that the approach of the regulators has differed. Of course, this is to be expected given that the markets are very different, with degrees of competition, dominance, and a range of regulatory issues. But the regulatory regimes do have a common framework and – with the exception of postal services – long-established concurrency powers. It is important that, where there are differences in approach, they are clearly explained.

Withdrawing from Sectoral Regulation

- 4.37 After some fifteen to twenty years of sectoral regulation in many of the key markets, some thought needs to be given to how the sectoral regimes will wither, and the regulated sectors will be treated as far as possible as other sectors are treated by the OFT under general competition law, especially where competition is more developed. We found the regulators generally to be supportive of the idea of regulatory withdrawal where effective competition exists, although an across-the-board withdrawal of the *ex ante* approach was felt to be undesirable and unrealistic due to the existence of natural monopolies in the regulated markets.
- 4.38 An instructive example of regulatory withdrawal is set by Ofgem. Having successfully completed the final roll-out of competition in gas and electricity supply in 1998/99, Ofgem considered that by 2002 the supply markets for

the two fuels were sufficiently competitive that the supply price controls could be abandoned, and duly brought these controls to an end in April 2002. Ofgem reviewed the non-domestic market in 2003, and found that it was broadly competitive, and a comprehensive review of domestic supply competition in April 2004 concluded that competition continued to be effective in protecting the interests of customers. Similarly, Ofcom have reduced the regulatory burden in a number of markets including mobile access and origination, unmetered narrowband access, inter-tandem conveyance and transit and international services.

- 4.39 Currently the regulators are withdrawing from sectoral regulation in several areas. From January 2006, the ORR removed competition based licence conditions from operator licences that predated the Competition Act and the Enterprise Act, on the basis that concurrent competition powers now serve these functions. Ofgem is also currently carrying out a major review of supply licences to ensure that they remain fit for purpose in a competitive market. The overall objective of the review is to “provide a flexible framework within which the competitive markets can evolve without the need for unnecessary sector-specific regulation of the domestic and non-domestic gas and electricity retail markets”.
- 4.40 Much will depend on how the review is taken forward, and on the end results. But in principle, this is a clear opportunity to roll back sectoral regulation where appropriate, and to make a landmark contribution towards bringing the treatment of these markets into line with other markets which do not face specific sectoral regulation. It will be interesting to see how radical the regulator (and other stakeholders) can be.
- 4.41 Another challenge for regulators will be to examine how far they have been able to encourage competition in the operation of the natural monopoly elements of their markets over the last fifteen to twenty years, and how much of an opportunity there is to apply general competition law alongside ongoing sectoral regulation.

V. An Analysis of the Current Application of Competition Powers

The Use of Competition Powers

- 5.1 Between January 2001 and September 2005, 38 cases have been investigated by the sectoral regulators using their concurrent competition powers. Of these, none have resulted in infringement decisions^{48, 49}.
- 5.2 Why have investigations by the sectoral regulators not resulted in infringement decisions? An analysis of the reasons given for the decisions suggests that some of the reasons are:
- (a) there is insufficient information to proceed;
 - (b) there is sufficient information, but insufficient evidence to reach an infringement decision (possibly because the firm in question has not acted anti-competitively); or
 - (c) changes in behaviour by the company during the course of the investigation mean that the problem no longer exists, or the problem can be dealt with by the use of sectoral powers and the case is taken forward under that approach.
- 5.3 These broad categories pose questions which merit further consideration. First, if there is insufficient information available to the sectoral regulator in order to proceed with the case, is there a generic problem with information provision? Are the information gathering powers sufficient for the regulators to conduct their investigations and discharge their duties?⁵⁰
- 5.4 Second, where insufficient evidence is found to reach an infringement decision, this may simply reflect the absence of behaviour to cause an infringement actually occurring in practice. This may in part be due to the structure of the regulated industries, the nature of the companies investigated and the type of cases brought (for example, regulators are far less likely to investigate cartels) and greater knowledge of competition law and greater compliance on the part of large regulated companies. Indeed, the fact that no infringements have been made may be an indication that the system is working well and that companies are not acting anti-competitively. However, it would also be worthwhile to ask whether there is anything that can be done to share best practice and to improve the powers of the regulators to conduct their inquiries; the resources which the

⁴⁸ Ofcom has issued two statements of objections (the procedural step immediately before an infringement decision) against BT in relation to its residential broadband pricing.

⁴⁹ There have been several cases in which the Competition Appeal Tribunal has ruled that the regulator's action did in fact constitute a non-infringement decision and furthermore there was a competition issue that required further investigation.

⁵⁰ It should be noted that the regulators themselves did not feel that their information gathering powers were insufficient. Indeed, the regulators have extensive powers of compulsion to gather information, for example under the Regulation of Investigatory Powers Act 2000.

regulators are able to deploy; or the process for choosing which complaints to investigate.

- 5.5 The third category is perhaps the most interesting from the concurrency perspective. In some cases, there may be evidence that an infringement has occurred, but steps are taken by the party under investigation – before the inquiry is concluded – to ameliorate the practice or behaviour which led to the inquiry.
- 5.6 There are also cases where companies change their behaviour after a complaint has been made but before a Competition Act investigation is begun. In this generic case, the regulator decides not to proceed under competition law in the light of the detriment having been removed. Alternatively, the regulator decides to take the case forward under existing sectoral powers or licence conditions or by considering amending the licences or other sectoral requirements in order to provide a specific and targeted remedy that is applicable across the sector and to prevent similar cases occurring in the future.
- 5.7 Since the 1st of May 2004, following the entry into force of the EC Modernisation Regulation, it has become possible for NCAs to accept binding commitments to address any competition concerns in lieu of reaching an infringement decision. The procedure for accepting commitments is now formalised within the Competition Act⁵¹.
- 5.8 In many cases it may be appropriate to seek an agreement with the firms involved rather than to proceed to an infringement decision for reasons of proportionality; and sensible prioritising of public resources on the part of the regulator. However, the existence of a presumption that an infringement may be mitigated by subsequent action by a company may be an unhelpful precedent to establish, if the extent of that presumption generally results in a non-infringement decision. Indeed, the OFT guidelines on commitments make clear that they should not be used in more serious cases. In the operation of the *ex post* element of competition law, it is the event or behaviour constituting the infringement at a time or over a period that is at issue, and not any subsequent corrective action taken by the relevant party.
- 5.9 Moreover, a consequence of any non-infringement decision in some cases will be that damaged parties will find it harder to obtain compensation as they will not be able to rely on the decision to obtain financial compensation under the Competition Act. (The exception to this is in the telecoms sector, where the sectoral rules now incorporate a penalty/compensation regime.) One of the key messages in the

⁵¹ The OFT has taken commitments in two cases to date. Ofgem have also accepted commitments after investigating allegations that the electricity company SP Manweb was providing a better service to its affiliate connections business, Core, than to independent connection providers. Ofgem accepted commitments from the company that it would provide its connections in a non-discriminatory manner in the future.

Government's 2001 White Paper, *Productivity and Enterprise: a world class competition regime*, was that the competition regime should provide real redress for third parties disadvantaged by anti-competitive behaviour.

- 5.10 Just as importantly, a reluctance to penalise clear violations of the Competition Act – if they are mitigated by a change of behaviour – may mean that future incidents of anti-competitive behaviour are not effectively discouraged. When considering how to proceed with Competition Act investigations, the regulators should carefully consider the incentives that all companies will face in the future.

A Proactive Approach

- 5.11 In its 2001 White Paper *Productivity and Enterprise: a world-class competition regime*, the Government stated its view that competition authorities should be proactive in promoting competition in the economy.
- 5.12 The market investigation reference powers of the regulators under section 131 of the Enterprise Act are one important tool for pursuing a proactive approach. To date, the economic regulators have not made any references to the CC, although Ofcom have accepted undertakings from BT in lieu of a market investigation reference. As with other competition powers, the benefits of making a market investigation reference need to be considered carefully alongside other powers available to the regulator. As the regime develops we expect the economic regulators to actively consider market investigation references as a possible alternative to direct regulatory intervention in tackling potential competition problems.
- 5.13 The idea of pursuing a proactive approach can also be taken more widely to encompass other areas of the regulators' competition work, beyond market investigation references. For example, the OFT conducts market studies, which allow it to monitor competition in markets and come up with recommendations to address competition concerns without recourse to a full CC market investigation. We see the regulators' market monitoring activities as fulfilling a similar function. Similarly, in prioritising competition enforcement action under the Competition Act, there is some scope for the regulators (as with the OFT) to behave strategically and focus on key competition concerns. We would encourage the regulators to think about whether they can be more proactive in using competition law to secure their goals.

VI. Conclusions and Recommendations

- 6.1 This report has looked at the concurrent powers of the regulators – how these have been used in practice; the interface with the OFT; and the process by which the regulators select the appropriate powers to use in different situations.
- 6.2 The analysis can be split into three main areas of investigation – the process involved between the regulators and the OFT to investigate a case in one of the regulated sectors; the selection of appropriate powers; and the way in which general competition law is used.

Process

- 6.3 The liaison process between the OFT and the regulators currently appears to work well, although there may be a greater role for direct senior engagement on the issue by the Joint Regulators Group, and the provision of strategic direction by that Group to the Concurrency Working Party.

Recommendation 1: Under the direction of the Joint Regulators Group, the Concurrency Working Party should:

- (a) undertake a programme of work to determine the precise differences in the practical approaches taken by sectoral regulators and the OFT in competition investigations; and
- (b) set out the steps necessary to ensure that best practice and expertise is shared between regulators and the OFT and that a consistent approach is followed.

Recommendation 2: The regulators are currently working well together in allocating responsibility for dealing with particular complaints. The CWP should, however, coordinate all concurrent functions of the regulators and the OFT with a view to ensuring that the application of all of these functions is consistent and reflects best practice.

Recommendation 3: The OFT should take an overall view about whether competition law is being applied consistently and proactively across all sectors of the economy and report to the Joint Regulators Group.

Choosing Between Sectoral Regulation and Competition Powers

- 6.4 Sectoral regulation has played a key role in opening up markets and stimulating market development, removing barriers to entry and in ensuring fair, transparent pricing. However, greater use of competition law has potentially significant benefits. It appears that, where the regulators have a choice, they usually choose to use their regulatory powers and do not use their concurrent competition powers.

Recommendation 4: While in many cases it may be appropriate to exercise sectoral powers, regulators should carefully consider the grounds for deciding on the use of either competition or regulatory powers in economic regulation and give clear explanations for their decisions.

Recommendation 5: Sectoral regulators should consider the ways in which they are preparing to withdraw from economic sectoral regulation wherever practicable and permissible in legislation and especially in sectors where competition has developed, and should include an assessment of progress in their annual report, as, for example, Ofcom does.

Recommendation 6: Sectoral regulators should consider reviewing their licence conditions, with a particular focus on proving the necessity of retaining any specific licence condition in the context of the application of general competition law.

Recommendation 7: Sectoral regulators and the OFT should consider whether inquiries undertaken under general competition law would be best conducted by a joint team drawn from both the sectoral regulator and the OFT in relevant cases. Decisions on which body would lead the case would, of course, need to be taken on a case-by-case basis.

The Use of Competition Powers

- 6.5 It is perhaps surprising that the regulators have never made an infringement decision on a case brought under the Competition Act since it came into force on 1 March 2000. Why is this? It could be that there has never been an infringement of Chapter I or Chapter II of the Competition Act by a company within a regulated sector. It could also be because existing licence conditions within the regulated sectors address competition concerns sufficiently. However, in certain cases, it is due to subsequent changes in behaviour by the firm under investigation, or because action is taken forward under sectoral legislation, rather than progressing the investigation to a stage where the regulator reaches an infringement decision.
- 6.6 Where there is evidence of infringement, there may be valid reasons for not reaching an infringement decision. However, the benefits of resolving a complaint informally need to be balanced against the incentives that companies will face in the future and the need to provide real redress to third parties disadvantaged by anti-competitive behaviour.
- 6.7 If the regulators took more decisions under the Competition Act or Enterprise Act, it would test the process a bit further and ensure that the regulators' expertise continues to develop.

Recommendation 8: We would encourage the regulators to think about whether they can be more proactive in using competition law, including the use of market investigation references.

6.8 We recommend that the sectoral regulators and the OFT should publish a response to this report, including a plan for taking forward the recommendations, within 6 months of publication.

End