

Concurrency between OFT and Regulators*

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Abstract

This article assesses the benefits and possible pitfalls resulting from the concurrency of powers between the OFT and industry regulators under the Competition Act 1998. One of the main advantages is the extension of competition enforcement powers to sectoral regulators who have detailed knowledge and experience of their respective industries. Achieving a broadening of the regulators' powers within the wider competition policy regime also yields benefits of consistency and transparency. However, some attention may need to be paid to the implementation of the regime, such as the allocation of the investigating role in particular cases and ensuring the acquisition by sectoral regulators of the necessary competition policy tools. Moreover, it is unclear whether the approaches and objectives of industry regulators and competition authorities are entirely aligned, and how this will impact upon the exercise of Competition Act powers.

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The Competition Act 1998, which came into force on 1 March 2000, brought in a major reform of UK competition law, aligning it closely with Articles 81 and 82 of the EC Treaty. In the main the powers established under the Act are exercised by the Office of Fair Trading (OFT).¹ However, under schedule 10 of the Act, in relation to the regulated (broadly-speaking, utility) industries these powers are exercised concurrently with the relevant sectoral regulator: Oftel/Ofcom,² Ofgem, Ofwat, ORR, CAA and Ofreg. The various regulatory statutes are also amended to provide that a regulator's duty to take licence enforcement action does not apply where the regulator is satisfied that, in a particular case, it is more appropriate to proceed under the Competition Act. The detailed framework for coordinating the exercise of the concurrent powers, and the procedures to be followed, are set out in

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¹ The Enterprise Act 2002 transfers to the OFT the powers previously vested in the Director General of Fair Trading and abolishes that statutory position. The OFT is now headed by a board consisting of a Chairman and a minimum of four other members.

² On 29 December 2003 the newly-established regulator for the communications industries, Ofcom, takes over from five pre-existing bodies: Oftel, the Independent Television Commission (ITC), the Radio Authority, the Radiocommunications Agency and the Broadcasting Standards Commission (BSC). The concurrent powers held by Oftel are transferred to Ofcom from that date.

the Competition Act 1998 (Concurrency) Regulations 2000. The general principle governing the allocation of cases between the industry regulator and the OFT is that a case will be dealt with by whichever is better, or best, placed to deal with it. Bi-monthly meetings of the Concurrency Working Party, bringing together the various regulators and the OFT, are held to prepare guidelines and to ensure smooth operation of the concurrent powers.

From the perspective of the sectoral regulators, Competition Act powers represent a significant addition to the portfolio of competition enforcement measures that might be taken, where similar powers did not already exist under the regulatory statutes and licences. Although from 1996 BT's licence contained a Fair Trading Condition modelled on Articles 81 and 82, this was not widely replicated across the regulated sectors.³ With concurrency, the Act's powers are granted explicitly to all the sectoral regulators, and apply to all of the regulated companies regardless of individual licence conditions. Moreover, achieving this broadening of powers within the wider competition policy regime, and drawing on existing casework from the UK and EU, yields benefits of consistency and transparency to the companies concerned. Thus, to the extent that a number of potential competition concerns are not fully captured under the regulatory statutes and licences, concurrency helpfully fills this gap in the sectoral regulators' powers.

Of course, competition law already applied to the utility industries, with competition authorities being empowered to carry out investigations in these sectors as in other industries. For example, British Gas was referred to the Monopolies and Mergers Commission (now Competition Commission, or CC) under the Fair Trading Act 1973 in 1987 and 1992 (in the latter case jointly with a reference under the Gas Act 1986, which had a more limited scope). However, prior to the Competition Act, competition enforcement was generally conducted by the competition authorities rather than sectoral regulators. One of the main advantages of concurrency comes from utilising the large body of sector-specific knowledge and experience built up by the regulators. In addition, there may be benefits from allowing the body with on-going oversight of those sectors to play a more important role in enforcing competition rules. For example, information that is gathered for regulatory purposes may also play a role in the detection of competition problems. In these ways, concurrency strengthens the competition policy regime itself, as well as extending the powers of the sectoral regulators.

In cases where the OFT or CC carries out an investigation in a regulated sector the industry regulator may adopt an unofficial stance as a quasi-prosecutor, with the competition authority then adjudicating between the regulator's position and that of the company (or companies) under investigation. It might be argued that placing Competition Act powers in the sole hands of the OFT would permit a separation between the roles of judge and prosecutor, resulting in a more robust judicial system. However, there would appear little reason for such a structure to apply to the regulated sectors alone: if the OFT's role were to be one of an adjudicator, rather than investigator and judge, there would presumably be a need for an equivalent prosecuting body in cases involving other sectors of the economy. Since such an approach has not been adopted more widely, it would appear unnecessary in the regulated industries. Moreover, the Competition Appeals Tribunal (CAT) has been put in place precisely to deal with cases where the party under investigation feels that it has been treated less than fairly by the investigating body. This should be sufficient to safeguard against the possibility of a one-sided investigation, both in the regulated sectors and elsewhere.

³ Non-discrimination clauses existed in the licences of many of the privatised utilities, such as those of the successor companies in the electricity supply industry. In 2000 Ofgem proposed a Market Abuse Licence Condition for the larger electricity generators, but this was rejected by the Competition Commission and, in any case, bore little resemblance to Article 82.

From this discussion it might be concluded that given the significant benefits to be gained from the establishment of concurrent powers, with little to be lost by placing the industry regulator in the investigating role, the allocation of concurrent powers is straightforward. However, without in any way undermining these benefits, there are a few potential pitfalls that should not be overlooked. Although these concerns should not be overstated, and certainly not to the extent of weakening the case for concurrency in itself, some attention may need to be paid to these issues in the operation of the regime.

First, in determining the appropriate authority to enforce the Competition Act in a particular case, the respective competencies of the sectoral regulator and the OFT should be borne in mind, along with the nature of the issue under consideration. The regulators bring with them an in-depth knowledge of the sector with which they are concerned, including industry costs, technologies and business models. This expertise can be just as valuable in the exercise of Competition Act powers as in the setting of price controls, and it is unlikely that such knowledge can readily be matched within the competition authorities. Indeed, this was a key consideration underlying the establishment of concurrent powers, as was discussed during the passage of the Act through Parliament.

Meanwhile, the OFT has its own areas of expertise. Specifically, it is practiced in using the competition toolkit of market definition techniques, making competition assessments, evaluating the pro- and anti-competitive effects of various business practices, and so on. A broader approach to market analysis might also be expected. It is unclear as yet whether all of the sectoral regulators are as adept in employing these tools. Thus, the decision as to which authority should exercise Competition Act powers in a particular case might be taken in part with a view to the relative importance of their respective competencies for the issues at hand. No doubt over time the experience of implementing the concurrent powers will itself stimulate the development of competition policy expertise among regulators. Moreover, the existence of a regulatory labour market, in which personnel move between agencies having acquired the relevant skills and knowledge, can be expected to hasten this process. Just as there are utility panels on the Competition Commission, for example, sectoral regulators might be expected to build up (formal or informal) competition enforcement teams to foster the development of the relevant expertise within their organisation.

A second aspect of a Competition Act case in a regulated sector that might affect the choice between the OFT and regulator is the likely form of any remedies that might be imposed (to the extent that this can be foreseen at the start of the inquiry). If behavioural, as opposed to purely structural, remedies are required, oversight and enforcement of these undertakings is very likely to involve the sectoral regulator. Thus if such an outcome is likely, involvement of the sectoral regulator during as well as after the inquiry may be advisable, indeed inevitable. However, the distinction between structural and behavioural remedies is not always so clear-cut in practice since behavioural measures may also be needed to achieve and sustain a structural remedy.

Moving beyond the question of allocating Competition Act powers in a particular case, it might be considered more generally whether the approaches of the sectoral regulators and competition authorities are entirely aligned. Traditional utility regulation has focused on *ex ante* measures such as the setting of price controls for natural monopoly elements and segments where the incumbent has substantial market power. Competition law, by contrast, does not tackle dominance *per se* but rather operates to counter specific forms of behaviour that constitute an abuse of this position, taking enforcement measures only after such actions have been observed. Furthermore, sectoral regulators have tended to scrutinise the cost efficiency, investment plans and quality of service of regulated operators, and to use such information in the setting of price controls. The traditional regulatory

mindset deems it necessary to control, or at least to oversee, these aspects of an incumbent's behaviour. This is in contrast with the approach of competition authorities, which generally regard such matters as beyond their jurisdiction except insofar as they impinge on competition concerns.

Since the 1990s, however, many of the regulated industries have experienced substantial liberalisation and waves of entry into segments where this was previously seen as infeasible or undesirable. The success of this process is in large part due to the actions of the regulators, who have acted to guarantee access and fair interconnection terms, and fostered the development of competition using, in some cases, competition policy-like powers such as those set out in the Fair Trading Condition in BT's licence. Following the establishment of competition there has been considerable rolling back of price caps at the retail level, most notably in electricity and gas supply and also in parts of the telecoms industry, though regulation remains at the wholesale level to ensure network access and prevent excessive pricing by the remaining monopoly businesses. Moreover, in the telecoms sector the new European regulatory framework for electronic communications networks and services requires the designation of Significant Market Power (SMP), equivalent to the competition policy concept of dominance, before *ex ante* regulation can be imposed on an operator.

By facilitating competition where feasible and then removing price controls, the business of regulation is becoming closer to that of competition policy. However, many important aspects of *ex ante* regulation remain, particularly in relation to network elements, and in these areas the regulator's bread and butter business of setting price controls continues. Given this, there is some danger that the traditional regulatory mindset might impinge on the exercise of Competition Act powers. For example, competition policy has not traditionally focused on a firm's profitability as something requiring attention in itself – although this might form part of the assessment as to whether there is a competition problem requiring remedial measures – whereas debates over appropriate rates of return feature prominently in regulatory price reviews. In dynamic markets where the risk of failure is high, there is the danger that an undue focus on the profitability of a successful enterprise might undermine the incentive to invest in the first place. Inappropriate regulation may be more likely in situations with vertical integration, or where SMP is transitory due to market liberalisation, or where the market definition (including aspects such as location and timing) is complex.

The Competition Act 1998 amends the various regulatory statutes to allow the regulators to use the Act's powers instead of licence enforcement action when this is seen to be more appropriate. It might then be asked which approach is likely to be more suitable, and whether the two are always entirely consistent. Competition Act powers are likely to be used when there is no appropriate power available under the existing regulatory regime, or when competition law offers a superior route to tackle the issue under consideration. For example, the Gas and Electricity Market Authority, which governs Ofgem, recently investigated whether London Electricity's "win back" offering – a financial inducement for returning customers – was an infringement of the Chapter II prohibition. This approach was adopted because, in the Authority's view, the price discrimination conditions in supply licences are insufficiently broad to cover such behaviour.⁴ Oftel went further than this and explicitly stated its objective of using the Competition Act in preference to sectoral powers wherever possible, citing superior powers of investigation and enforcement.⁵ Oftel has followed this approach in numerous investigations: for example in 2003, following a complaint by Freeserve, Oftel investigated

⁴ For details see the Gas and Electricity Market Authority's Decision of 12 September 2003 at http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/4525_ca98_ni_decision_120903.pdf.

⁵ See *Oftel's Competition Act Strategy*, 1 July 2002, available at http://www.ofcom.org.uk/static/archive/oftel/publications/about_oftel/2002/cact0602.htm

BT's conduct in relation to the marketing and billing of BT Broadband under the Competition Act.⁶ Thus, to the extent that some competition concerns could not be effectively addressed under the regulatory statutes and licences, or superior enforcement can be achieved using the Competition Act, concurrency plays a useful role in strengthening the regulator's armoury of competition powers.

Under regulatory statutes the regulators are required to carry out a number of additional, non-competition related duties. These include the promotion of service provision and security of supply; protection of consumers, especially vulnerable groups; distributional concerns, which may be enshrined in universal service obligations; environmental protection; informed citizenship; and so on. The duty to promote competition is frequently circumscribed in some way. For example, Ofcom's mission statement is "to further the interests of citizen-consumers through a regulatory regime which, *where appropriate*, encourages competition" (emphasis added).⁷ Ofwat similarly cites among its roles to "work to encourage competition where appropriate."⁸ In the railway industry, when the regulator exercises powers under the Railways Act 1993 it has to balance the various duties listed under section 4, only one of which is the promotion of competition. The requirement to promote competition might be qualified if, for example, the loss of synergies from unbundling to facilitate competition would outweigh the benefits of competition. Thus, the promotion of competition *per se* is not necessarily the regulator's priority.

It is conceivable that Competition Act enforcement might occasionally give rise to a conflict with one or more of the other regulatory objectives. Should primacy in such cases be given to competition concerns? A distinction might be drawn between segments where competition is successfully developing and those where the development of direct, service-based competition is slow to non-existent (and may not make economic sense). In the gas and electricity sectors, the development of competition led to the removal of retail price controls in the domestic markets in 2001 and 2002 respectively. In telecoms, liberalisation has been followed by some drawing back of price controls, though access regulation remains important. By contrast, in the railway industry the initial proposal to develop head-to-head competition between train operators on the same routes has not been pursued, in part due to capacity constraints, although competition exists in places between train services using the same or alternative routes, or with alternative modes of transport. Similarly, competition in the water industry, through so-called inset appointments, is limited to a handful of large customers. The types of competition issues that arise, and the regulator's approach to competition policy enforcement, might be expected to differ between these areas.

In those segments where competition is now well developed it might be queried whether sector-specific regulation is required at all. Sectoral regulation might be viewed as a necessary tool to open up markets, especially where interconnection to a monopoly network is essential for operation. But once competition is up and running it may be possible to rely on competition policy enforcement alone. On the other hand, licence conditions might nonetheless remain useful to ensure the timely provision of detailed information needed for market surveillance, rather than relying on *ex post* requests for information once there are sufficient grounds for suspicion. The longer-term boundaries between regulation and competition policy, and the future role for sector-specific regulation, are assessed in detail by David Newbery in this volume and will not be discussed further here.⁹

⁶ See <http://www.ofcom.org.uk/static/archive/oftel/publications/broadband/other/free0703.htm>.

⁷ See http://www.ofcom.org.uk/about_ofcom/how_we_work/mission?a=87101.

⁸ See <http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/Content/customerinterestprotect2001>.

⁹ David M. Newbery, "Regulation and competition policy: longer-term boundaries," *Utilities Policy*, this issue.

By contrast, non-competition considerations may weigh more heavily in other areas, and could at times provide a reason for holding back the full force of competition. For instance, universal service obligations tend to carry embedded cross-subsidies, since customers with very different costs are served at similar prices. Such cross-subsidies are difficult to maintain following the introduction of competition, yet their elimination raises distributional concerns. In sectors such as telecoms historic pricing patterns are being unravelled, but this is far less prevalent in the water industry for example. It would seem that in certain utility areas, and in some industries more than others, the exercise of competition powers may need to be balanced against, and perhaps qualified by, the other regulatory duties. It is even possible that something closer to the public interest test of the Fair Trading Act 1973 might be more appropriate in those sectors where direct competition between service providers is not being actively promoted.

Notwithstanding these reservations, the importance of the Competition Act powers and the desirability of their being available to the sectoral regulators as well as to the OFT should not be understated. The combination of the competition-focused regime of the Act with the detailed sectoral knowledge and continuing oversight of the industry regulators is a powerful one indeed. In addition, Competition Act powers provide a ready-made backstop of *ex post* competition rules available to a regulator if and when competition develops in a sector and formal, *ex ante* regulation is withdrawn.