



National Audit Office

Report

by the Comptroller
and Auditor General

UK competition authorities

The UK competition regime

Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Sir Amyas Morse KCB, is an Officer of the House of Commons and leads the NAO, which employs some 810 people. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of £1.15 billion in 2014.



National Audit Office

UK competition authorities

The UK competition regime

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 4 February 2016

This report has been prepared under Section 6 of the
National Audit Act 1983 for presentation to the House of
Commons in accordance with Section 9 of the Act

Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

3 February 2016

This report examines the UK competition regime since our report in 2010 and in the light of the government's reforms to the regime in 2013.

© National Audit Office 2016

The material featured in this document is subject to National Audit Office (NAO) copyright. The material may be copied or reproduced for non-commercial purposes only, namely reproduction for research, private study or for limited internal circulation within an organisation for the purpose of review.

Copying for non-commercial purposes is subject to the material being accompanied by a sufficient acknowledgement, reproduced accurately, and not being used in a misleading context. To reproduce NAO copyright material for any other use, you must contact copyright@nao.gsi.gov.uk. Please tell us who you are, the organisation you represent (if any) and how and why you wish to use our material. Please include your full contact details: name, address, telephone number and email.

Please note that the material featured in this document may not be reproduced for commercial gain without the NAO's express and direct permission and that the NAO reserves its right to pursue copyright infringement proceedings against individuals or companies who reproduce material for commercial gain without our permission.

Links to external websites were valid at the time of publication of this report. The National Audit Office is not responsible for the future validity of the links.

Contents

Key facts 4

Summary 5

Part One

Costs and coordination 13

Part Two

Use of competition powers 27

Part Three

Evaluating outcomes 42

Appendix One

Our audit approach 46

Appendix Two

Our evidence base 48

Appendix Three

Sector regulators and
their responsibilities 50

The National Audit Office study team consisted of:
James Bartlett, Peter Langham,
Charles Nancarrow,
Oliver Simms, Alice Sturgess and
Anna Sydorak-Tomczyk under the
direction of Joe Perkins.

This report can be found on the
National Audit Office website at
www.nao.org.uk

For further information about the
National Audit Office please contact:

National Audit Office
Press Office
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Enquiries: www.nao.org.uk/contact-us

Website: www.nao.org.uk

Twitter: @NAOorguk

Key facts

£66m

Estimated annual direct spending on UK competition regime in 2014-15

£745m

Competition & Market Authority's estimate of average annual direct consumer benefit created by its work

£65m

competition enforcement fines imposed by Office of Fair Trading and CMA between 2012 and 2014, in 2015 prices

- 8** competition regulators in the UK share concurrent competition powers with the Competition & Markets Authority (CMA)
- £19.1 million** increased funding in 2014-15 for competition work carried out by the CMA and regulators with new competition powers
- 23%** of businesses in 2014 felt that they knew competition law well
- 5** concluded non-criminal competition enforcement cases in UK in 2014
- 0** successful contested criminal prosecutions since the CMA was established. One company director pleaded guilty to cartel conduct in advance of trial
- 100%** of mergers assessed by the CMA within the 40 working day statutory limit
- 15 (out of 19)** civil cases that have come before the courts where the CMA has been successful

Summary

1 Effective competition between businesses can bring benefits to consumers including greater choice, improved product quality, innovation, and lower prices. Competition is central to the government's ambitions to improve growth and productivity. Research by the Organisation for Economic Cooperation and Development (OECD) has found that industries where there is more competition experience faster productivity growth, with knock-on benefits for the rest of the economy. Where markets fail to operate effectively, consumers and taxpayers can suffer. For example, fuel surcharges on a typical Virgin Atlantic or British Airways long-haul return flight rose from £5 to £60 per ticket over the two-year period in which the two airlines illegally coordinated their surcharge pricing.

2 The UK competition regime is the result of the Competition Act 1998, the Enterprise Act 2002, the Enterprise and Regulatory Reform Act 2013, the Consumer Rights Act 2015 and sector-specific competition legislation. This national legislation is underpinned by a European framework, with competition authorities across the EU having similar laws and requirements. The legal framework aims to ensure that markets work well, encouraging businesses to compete with each other and protecting consumers from anti-competitive practices such as bid-rigging, price-fixing and abuse of market power.

3 The Competition & Markets Authority (CMA) is the main UK competition authority. It is a non-ministerial department funded by HM Treasury. Its duties include: advocating and enforcing competition law; identifying and remedying competition problems; and investigating mergers which could restrict competition. Additionally, eight sector-specific regulators, such as Ofgem in the energy sector, share competition powers with the CMA. The Department for Business, Innovation & Skills (BIS) sets the overall policy and legal framework for competition issues in the UK as well as the CMA's performance framework. The European Commission is responsible for enforcing competition rules at the European level. It takes on many multinational cases that affect the UK, and is outside the scope of this report.

4 We reported in 2010 on the effectiveness of the operation and oversight of the UK competition regime. We concluded that, while the regime was well regarded internationally, it needed to make more flexible and efficient use of resources, strengthen the development of case law, and encourage sector regulators to refer markets for review. The government subsequently announced far-reaching changes to the competition regime, including new legislation and merging the Office of Fair Trading and the Competition Commission into a new organisation – the CMA. The objectives of the reforms were to:

- Improve the robustness of decisions and strengthen the regime.
- Support the competition authorities in taking forward the right cases.
- Improve speed and predictability of decision-making for business.

Scope of the report

5 In this report, we assess the performance of the UK competition regime in tackling the problems identified in our 2010 review, and in meeting government’s objectives. We use the term competition regime to cover those bodies that have competition powers in the UK, and focus on the CMA as the principal national competition regulator. The CMA began operating fully in April 2014, and there can be long lead times between beginning competition work and achieving improvements. We therefore consider early evidence on the performance of the regime, and risks to achieving value for money. We intend to analyse the overall effectiveness of the regime in future work.

6 We assess:

- The cost of the regime and how well it coordinates its activities (Part One).
- How successfully the regime uses its competition powers (Part Two).
- How the regime measures its impact on competition, productivity and growth, and how it uses this information to inform its work (Part Three).

7 Many other interventions by public bodies can influence the level of competition, including patent and tax law, regulation and consumer protection. These are outside the scope of this report, but we treat them as important contextual factors.

Key findings

Cost and coordination

8 Effective competition is a key priority for the government in its drive to improve growth and productivity, and it has significantly increased funding for the regime. OECD research suggests that competition has been an important factor in UK productivity growth. However, productivity in the UK is still lower than in other major developed nations. There is no measure of the competition regime's impact on growth or productivity, but the CMA estimates that itself and its predecessors' work produced annual average direct consumer benefits of £745 million over the period 2012-13 to 2014-15. The government has committed increased resources to the competition regime. In 2014-15, the three bodies with new competition powers spent £7.1 million on competition work and the CMA was granted an additional £12 million to expand its competition work. The total direct cost of competition work was £66 million in 2014-15, with around 810 full-time equivalent competition staff. The government does not calculate the cost of the regime as a whole (paragraphs 1.1, 1.3, 1.19 and 3.5).

9 The creation of the CMA did not significantly disrupt competition work, but it required additional funding to recruit and retain staff for its staffing model.

The CMA took over operations from its predecessor bodies as planned in April 2014. Its leadership ensured that front-line competition work continued uninterrupted; external stakeholders told us that they saw few transitional problems. There were, however, several teething issues internally, with IT problems and high staff turnover during the early phase of the transition (5.4% permanent staff turnover in the third quarter of 2014). To promote retention and recruitment, particularly for qualified competition specialists, the CMA used approximately £2.2 million of its increased funding of £12 million in 2014-15 to increase pay and recruit specialists in competition grades. Staff morale has improved substantially in the last year and permanent staff turnover fell to 3.1% in the third quarter of 2015, although the CMA continues to use temporary staff in some key back-office positions (paragraphs 1.15 to 1.17).

10 The coordination of the regime has improved, but there are inherent structural problems that may work against cohesion. The newly-established UK Competition Network, with the CMA at its centre, provides a forum for cooperation between regulators, particularly in using competition powers more consistently and sharing best practice. The CMA gives more support to smaller regulators than did its predecessor bodies, the regime now reports to Parliament annually, and the CMA is currently investigating markets in two regulated sectors. But the different regulators are overseen by different policy departments, have different legislative frameworks, and are funded in a variety of ways. Substantial salary differences between competition bodies have resulted in unplanned staff movements and retention difficulties in lower-paying organisations. Sector regulators can still find it easier and more effective, at least in the short term, to use their regulatory powers rather than their competition powers (paragraphs 1.23 to 1.26).

11 The independence of the competition regime is central to its credibility and impact. The importance of competition work means that it can come under significant external pressure. For instance, industry and consumer representatives have made many public comments about the CMA's provisional findings in its current investigations into the energy and retail banking markets. The CMA's role is founded in UK statute, and it has established robust processes to maintain its independence, including publication of evidence submissions and of correspondence with ministers (paragraph 1.21).

Promoting competitive markets

12 Business awareness of the competition authorities and of competition law is low, potentially harming compliance. In a CMA survey of UK industry conducted in late 2014, only 23% of businesses felt they knew competition law well, compared to 45% who had never heard of competition law or did not know it at all well. As a new organisation, awareness of the CMA was also low; in 2014, the year when the CMA began operating fully, more than twice as many businesses believed the defunct Office of Fair Trading to be responsible for enforcing competition law than the CMA (75% versus 32%). The CMA is taking steps to improve awareness through, for example, advocacy work with both public and private sector bodies following enforcement cases (paragraphs 2.2 to 2.4).

13 Competition authorities have increased their efforts to detect anti-competitive behaviour, particularly in financial services, where long-standing problems have only recently been identified. Like other jurisdictions, the UK competition regime failed to identify major and persistent breaches of competition law in the financial sector. Following applications for leniency, in 2013, the European Commission fined financial institutions €1.71 billion for participating in cartels in interest rate derivatives. The European Commission is now investigating alleged cartel activity in foreign exchange markets. The new competition powers for the Financial Conduct Authority and the Payment Systems Regulator should provide a stronger basis for action in future. More broadly, the CMA is investing in gathering information from a wide variety of sources to identify anti-competitive behaviour, including consumer organisations and whistleblowers (paragraphs 2.5 to 2.6).

14 The CMA has strengthened processes with the aim of increasing the robustness of its work to legal challenge. Following two high-profile failures in the Office of Fair Trading's competition enforcement work in 2010 and 2011, the CMA has set up independent decision-making panels and enhanced internal oversight. The CMA has been successful in 15 of the last 19 civil cases across its competition work that have come before the courts. Despite the acquittals in its first criminal cartel prosecution, the judge noted the procedural thoroughness of the CMA's case. The overall success of the CMA's changes is likely to be tested further by possible appeals on high-profile market investigations or enforcement cases (paragraphs 2.9 to 2.10).

15 The regime faces big challenges in increasing the low number of enforcement decisions to date. Successful high-profile enforcement action builds the credibility of a competition authority, clarifies the law and deters anti-competitive behaviour. The low caseload we identified in 2010 has continued, with the Office of Fair Trading and the CMA making 24 decisions and the regulators just eight since 2010. The UK competition authorities issued only £65 million of competition enforcement fines between 2012 and 2014 (in 2015 prices), compared to almost £1.4 billion of fines imposed by their German counterparts. The CMA faces significant barriers in increasing its flow of competition cases, although recent activity means it now has 12 ongoing cases. Its enforcement work is not mandatory, does not have statutory deadlines, and faces a stringent regime of judicial oversight. The CMA prosecuted its first criminal cartel case in 2015; one company director pleaded guilty to price fixing in advance of trial, while two others were acquitted (paragraphs 2.7, 2.8, 2.11 to 2.13 and 2.16).

16 The CMA has taken an innovative approach to merger control, potentially improving its effectiveness in promoting well-functioning markets. It has made all of its initial merger decisions within its statutory deadline of 40 working days. Stakeholders were positive about the quality and continuity of the CMA's merger teams, and told us that they valued having early discussions with decision-makers. The CMA is expanding the practice of clearing cases with remedies in phase 1 without the need to go for a more detailed and resource-intensive phase 2 review, and is making efficiency gains from using some of the same people on both phase 1 and phase 2 investigations. It has also developed case law, in particular winning three significant recent legal challenges in this area (paragraphs 2.19 to 2.22).

17 The competition regime is placing a marked emphasis on market investigations, with implications for the regime as a whole. The CMA's ability to investigate an entire market can have big effects; for instance, a 2009 market investigation by the Competition Commission resulted in BAA selling Edinburgh, Stansted and Gatwick airports. The CMA is currently investing 16% of its front-line competition resources in two high-profile market investigations into energy and retail banking, and businesses are also incurring substantial unmeasured costs. There is major public and parliamentary interest, with a parliamentary hearing already dedicated to the retail banking inquiry. The ability of the CMA to present a credible market analysis and formulate effective remedies if appropriate will have a significant effect on its reputation (paragraphs 2.24 to 2.29).

Evaluation of impacts and outcomes

18 The CMA has made good progress in evaluating the impact of its legacy remedies and open cases. The CMA inherited many remedies and undertakings from past merger cases. It has so far reviewed 76 cases to assess their impact and continued significance, and has released companies from their undertakings in 51 of them. The CMA also evaluated its inherited cases against its strategic priorities. Its case decision groups assess open projects at key points to decide whether they should be continued (paragraphs 3.2 to 3.3).

19 The CMA is meeting the measures agreed in its business plan, but these output-based measures do not fully capture the impact of its work. The CMA has improved its reporting systems and is able to track progress, resourcing and spending on all of its projects. In line with its statutory duty to seek to promote competition for the benefit of consumers, it aims to produce benefits for consumers of at least ten times the cost of running the organisation, which it has so far exceeded. This target measures only direct impacts rather than wider deterrence effects and has mainly been achieved through market investigation work. The Office of Fair Trading left a legacy of research into the wider impacts of competition work, which is yet to be fully developed by the CMA and BIS. There is a strong theoretical and empirical link between competition and productivity, and evidence that competition enforcement can have a positive impact on growth. However, there is less evidence on the links between specific competition interventions and growth, or on how competition is evolving in different UK industries (paragraphs 3.5 and 3.7 to 3.11).

20 The competition regime faces significant constraints in prioritising its work to meet its objectives. The CMA and sector regulators have well-established prioritisation criteria, based on factors such as impact and strategic significance, and use them to determine which work to pursue. However, it is difficult to make fully robust prioritisation decisions on its use of different tools, such as market investigations and enforcement actions, because there is limited evidence on their relative effectiveness. The CMA has to meet different legal criteria to apply the different tools, and a substantial proportion of its work is mandatory, further limiting its choice of which tools to use and its flexibility to respond to changing circumstances (paragraphs 1.23 and 3.10).

Conclusion on value for money

21 The newly-created CMA has taken significant steps to tackle the failings identified in our previous reports, and is still relatively early in its development. For example, it has taken an innovative approach to merger control, has strengthened processes to improve the robustness of its work, and has encouraged greater coordination across regulators. The CMA and the regulators are acting to improve the detection of anti-competitive behaviour and to build a pipeline of cases, but the system has so far failed to produce a substantial flow of enforcement decisions. Awareness of competition law and the competition authorities is low, and there is limited evidence on the full impacts of competition work. While the changes made look likely to improve value for money, the regime has further to go to ensure that it achieves it.

Diagnosis and recommendations

22 The creation of the CMA has enabled it to build on a strong legacy of merger and market analysis in its predecessor bodies, and has given it a wider remit to follow through on competition issues. But the CMA also inherited significant challenges in competition enforcement, including a difficult legal environment, low business awareness of competition law, and reputational damage resulting from high-profile lost cases. At the regime level, legislative and personnel changes have encouraged a greater commitment to competition work by sector regulators. Our recommendations aim to help embed the improvements we have identified, and to tackle some of the remaining problems.

23 The government should:

- a Report regularly the full cost of the regime on a consistent basis, including all direct and overhead costs, and keep its cost-effectiveness under review.** This could be achieved by, for example, BIS and HM Treasury working with the UK Competition Network to report costs in the CMA's annual report on concurrency. This would increase transparency and help the government to judge whether it is achieving value for money.
- b Encourage greater flexibility of resourcing and a more coherent approach across the regime.** The UK Competition Network now provides a forum for greater coordination. Further developments could include BIS working with other departments to ensure that sector regulators receive consistent messages about the role of competition. More radically, the government could consider greater pooling of competition enforcement resources across the concurrent regulators.

24 BIS, working with the CMA, should:

- c Develop indicators of the competitive health of UK markets, such as their profitability and the level of entry and exit.** This would help in assessing the success of the competition regime, and could also provide warning signs of emerging competition problems. BIS should work with the CMA and the Office for National Statistics to pursue this agenda.

25 If the CMA's work to increase the number of enforcement decisions fails to increase caseload significantly, BIS, working with the CMA, should:

- d Assess the fundamental reasons for low enforcement caseload, and consider the case for removing any legislative or institutional barriers.** This should include analysis of lessons to be learned from competition enforcement in other developed economies, and the experience of other UK bodies with enforcement powers, such as Trading Standards and HM Revenue & Customs.

26 The CMA should:

- e **Build on its current strategy of raising awareness of competition law, drawing on the work of other leading enforcement agencies.** Awareness-raising is an important tool in encouraging voluntary compliance and reporting of breaches in competition law. Wherever possible, the CMA should publish details of the results of its cases, including, to the extent permitted by law, those that were closed without action.
- f **Take further action to step up the flow of successful enforcement cases.** Caseload has been low for a long time and it is important to convert the pipeline and ongoing cases into results. This could include ensuring dedicated, tightly-focused, expert teams for the most high-impact cases, led by decision-makers with strong internal and external reputations. The CMA should continue to develop its understanding of how leading European counterparts manage their enforcement casework, and review its own approach in light of lessons learned.
- g **Commission an external review of the costs (including those of business), processes and their anticipated outcomes of its two major market investigations.** This should determine whether their resourcing and processes were efficient and appropriate, including whether it could achieve greater value for money by using smaller expert teams. This should help it to determine whether large, high-profile market investigations are an effective way of achieving its objectives.

27 The CMA and regulators should:

- h **Develop further their understanding of consumer behaviour to inform proposed remedies.** This should include greater testing of remedies before implementation, and could include the establishment of a dedicated centre of excellence within the UK Competition Network, to enable others to learn from the approach of more experienced and better-resourced UK regulators.

Part One

Costs and coordination

1.1 Effective competition between businesses can bring benefits to consumers including greater choice, improved product quality, innovation and lower prices. Competition is central to the government's ambitions to improve growth and productivity. The Organisation for Economic Cooperation and Development (OECD) has found that industries where there is more competition experience faster productivity growth, with knock-on benefits for the rest of the economy.¹ Where markets fail to operate effectively, consumers and taxpayers can suffer. For example, fuel surcharges on a typical Virgin Atlantic and British Airways long-haul return flight rose from £5 to £60 per ticket over the two year period in which the two airlines illegally coordinated their surcharge pricing.

1.2 In this part, we describe how the competition regime operates, including the recent reforms, and assess the regime's costs and arrangements for coordination.

Competition as a government priority

1.3 Effective competition is a key priority for the government in its drive to improve growth and productivity. The government issued two policy papers to Parliament in 2015, setting out its ambitions for creating and maintaining well-functioning markets in the UK economy. It views these as 'essential to the UK's long-term economic success', growth and productivity.² OECD research finds that competition has been an important factor in UK productivity growth. Productivity in the UK is currently lower than in other major developed nations (**Figure 1** overleaf), and OECD analysis suggests that higher productivity is associated with higher wages (**Figure 2** on page 15).

The competition regime

1.4 The UK's competition regime consists of the Competition and Markets Authority (CMA) and eight sector regulators (which we refer to in this report as the regulators).³ The Competition Appeal Tribunal acts as the initial appeal body for competition cases.

¹ OECD, *Factsheet on how competition policy affects macro-economic outcomes*; October 2014, p. 2.

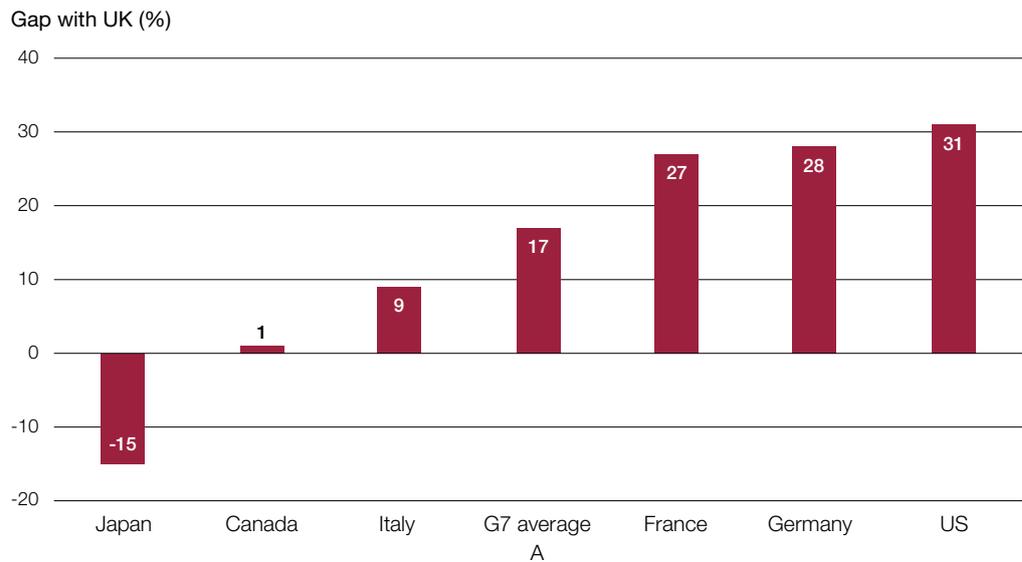
² HM Treasury, *Fixing the foundations: Creating a more prosperous nation*; July 2015 and HM Treasury, *A better deal: boosting competition to bring down bills for families and firms*; November 2015.

³ In addition, the Northern Ireland Utility Regulator has competition powers in Northern Ireland. It is outside the scope of this report.

Figure 1

The productivity gap: comparisons between the UK and G7

Productivity in the UK is lower than in other major developed nations



■ Difference to UK GDP per hour worked

Note

1 A: G7 average excluding the UK.

Source: Office for National Statistics International Comparisons of Productivity – Final Estimates, 2013 quoted in HM Treasury *Fixing the foundations: Creating a more prosperous nation*, July 2015

1.5 The CMA is the primary competition body within the UK. It is a non-ministerial government department funded by HM Treasury. Its main statutory duty is to ‘promote competition, both within and outside the United Kingdom, for the benefit of consumers’.⁴ Its competition-related responsibilities are to:

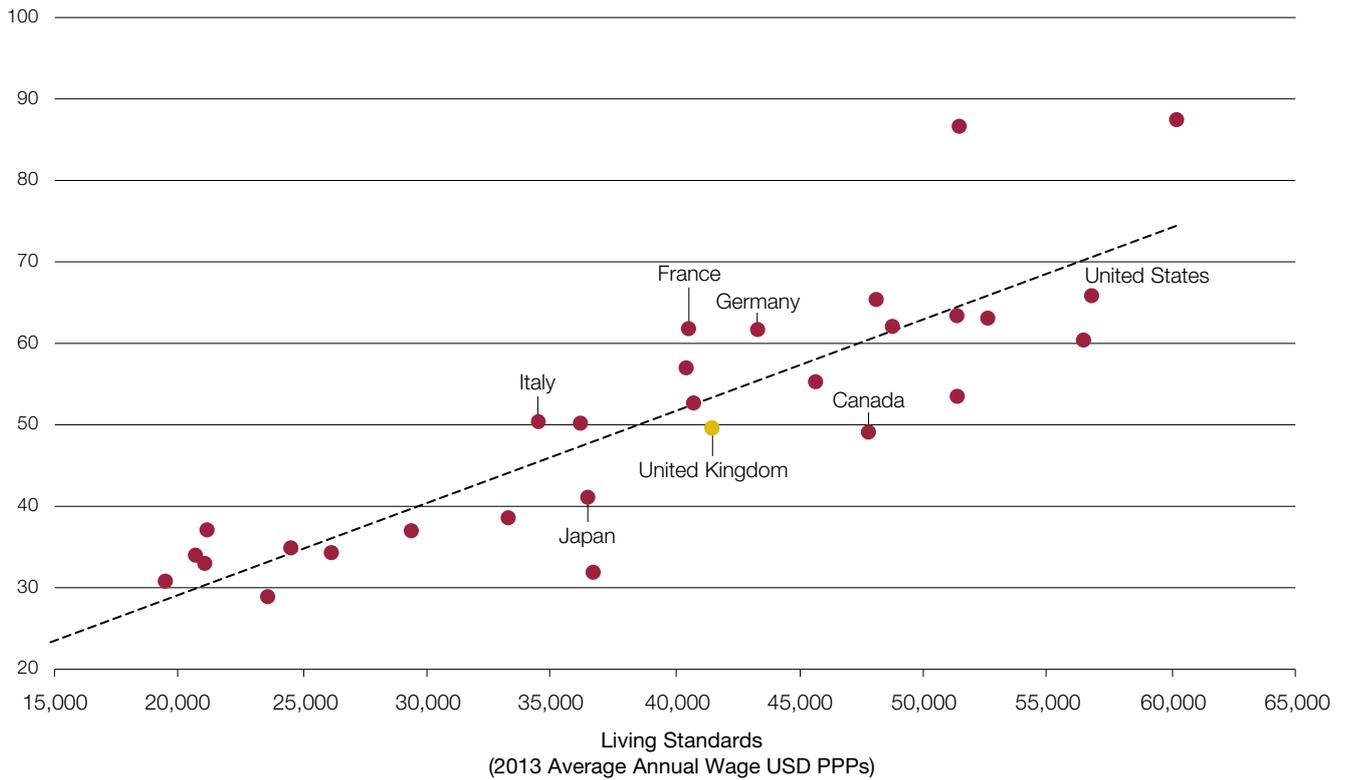
- Investigate mergers.
- Conduct studies and investigations to explore any concerns with competition in particular markets.
- Investigate anti-competitive agreements such as price fixing or abuses of dominant positions.
- Bring criminal proceedings against individuals who are members of cartels.
- Work with sector regulators to enforce competition law in regulated sectors, and to promote competition.

4 The Enterprise and Regulatory Reform Act 2013.

Figure 2
Productivity and living standards

Productivity is a key determinant of average wages

Productivity (2013 GDP per hour worked USD PPPs)



● Productivity
-- Average annual wage

Note

- 1 OECD Dataset: Average annual wages; OECD Dataset: Level of GDP per capita and productivity.
- 2 USD PPPs = US Dollar Purchasing Power Parity

Source: Organisation for Economic Co-operation and Development data quoted in HM Treasury, *Fixing the foundations: Creating a more prosperous nation*, July 2015

1.6 The CMA also considers regulatory references and appeals, and is one of the bodies that enforces consumer protection law. These are outside the scope of this report.

1.7 The regulators are established by statutes which set out their duties and powers (both regulatory and competition-related) in their respective sectors (see Appendix Three). There are currently eight:

- The Civil Aviation Authority (CAA), covering air traffic services and airport operation services.
- Monitor, covering healthcare services in England.
- The Office of Rail and Road (ORR), covering railway services in Great Britain.⁵
- The Office of Communications (Ofcom), covering electronic communications, broadcasting and postal services in the UK.
- The Gas and Electricity Markets Authority (Ofgem), covering gas and electricity in Great Britain.
- The Water Services Regulation Authority (Ofwat), covering water and sewerage in England and Wales.
- The Financial Conduct Authority (FCA), covering financial services in the UK.
- The Payment Systems Regulator (PSR), covering payment systems in the UK.

1.8 The regulators have concurrent competition powers with the CMA, meaning that, in the sectors they regulate, both they and the CMA can enforce aspects of competition law. Under the Enterprise and Regulatory Reform Act 2013, the regulators are required to consider whether it is more appropriate for them to use their competition law powers before taking action under their licencing regulatory powers.⁶ The Secretary of State for Business, Innovation & Skills may remove a sector regulator's competition powers following consultation, for instance if he believes that the regulator is failing to use its powers effectively.

1.9 The Department for Business, Innovation & Skills (BIS) has overall policy responsibility for competition in the UK, and sets the CMA's performance framework. It considers that a "strong competition policy and its effective enforcement have a strong impact on productivity and growth".⁷ The regulators are sponsored by several different government departments.

⁵ The Office of Rail and Road also monitors the performance and efficiency of Highways England but does not have competition powers in this regard.

⁶ Monitor is not subject to this obligation.

⁷ Department for Business, Innovation & Skills, *A Competition Regime for Growth: Government Response to Consultation*, March 2012, p. 5.

1.10 The UK is part of the wider EU competition regime, which is outside the scope of this report. The Treaty on the Functioning of the European Union sets common rules on competition that apply across the EU. In practice, the European Commission investigates the largest EU-wide mergers and competition enforcement issues, such as its ongoing investigation of Google’s alleged abuse of a dominant position. This means that the UK competition authorities do not in general deal with the most high-profile cases, though they may assist the European Commission and other national authorities when their investigations are relevant to the UK.

Scope of the report

1.11 In this report, we assess the performance of the UK competition regime in addressing the problems identified in our 2010 review, and in meeting government’s objectives. We use the term ‘competition regime’ to cover all those bodies that have competition powers in the UK, and focus in particular on the CMA as the principal national competition regulator. The CMA began operating fully in April 2014, and there can be long lead times between beginning competition work and achieving improvements. We therefore consider early evidence on the performance of the regime, and risks to achieving value for money. We intend to analyse the overall effectiveness of the regime in future work.

1.12 Many other interventions by public bodies can influence the level of competition, including patent and tax law, regulation and consumer protection. These are outside the scope of this report, but we treat them as important contextual factors. In addition, we do not evaluate government’s efforts to increase private enforcement of competition law, including through the Consumer Rights Act 2015.

Reforms

1.13 We reported in 2010 on the effectiveness of operation and oversight of the UK competition regime.⁸ We concluded that, while the regime was well-regarded internationally, it needed to make more flexible and efficient use of resources, strengthen the development of case law, and encourage sector regulators to refer markets for review. The government subsequently announced far-reaching changes to the competition regime, including new legislation in the Enterprise and Regulatory Reform Act 2013. This merged the Office of Fair Trading and the Competition Commission into a new organisation, the CMA, which became fully operational on 1 April 2014.

The creation of the CMA

1.14 BIS’s 2012 consultation on the competition regime expected the creation of the CMA to lead to “benefits for consumers and long run improvements to UK productivity and growth” (**Figure 3** overleaf).

⁸ National Audit Office, *Review of the UK’s Competition Landscape*, March 2010.

Figure 3**Anticipated benefits from creating the CMA**

- Greater coherence in competition practice and a more streamlined approach in decision-making.
- More flexibility in resource utilisation to address the most important competition problems of the day and better incentives for sector regulators to use antitrust and markets tools.
- Faster, less burdensome processes for business.
- A single strong centre of competition expertise, which can provide leadership for the sector regulators on competition enforcement and a single authoritative voice for the UK internationally.
- Increased accountability and transparency in public bodies and lead to savings in corporate governance and back-office costs.

Source: Department for Business, Innovation & Skills, *Growth, competition and the competition regime: Government response to consultation*, March 2012

1.15 External stakeholders we interviewed felt that the CMA had a strong leadership team and that there had been little disruption to the CMA's casework during the transition. In its first year in operation, the CMA reported that it had exceeded BIS's performance target to achieve at least £10 of direct benefits for consumers for every pound spent.⁹

1.16 The new organisation did, however, experience several internal teething problems, including IT system issues and loss of staff. Between 2013-14 and 2014-15, the Office of Fair Trading, the Competition Commission and the CMA lost 38 staff to the regulators (**Figure 4**); less than a third of this number moved in the opposite direction. The turnover rate for permanent staff peaked at 5.4% in the third quarter of 2014, but had fallen to 3.1% in the third quarter of 2015. The CMA has relied heavily on temporary staff, particularly in key back-office positions. In 2014-15, 133 of 653 staff (20%) were temporary, representing 17% of total staff cost (£7.4 million of £43.8 million). The CMA's 2015 staff survey shows that morale has risen since the transition, with its engagement index rising to 61% from 58% in 2014, compared to a civil service benchmark of 59%. In 2015, it received a bronze medal from Investors in People.

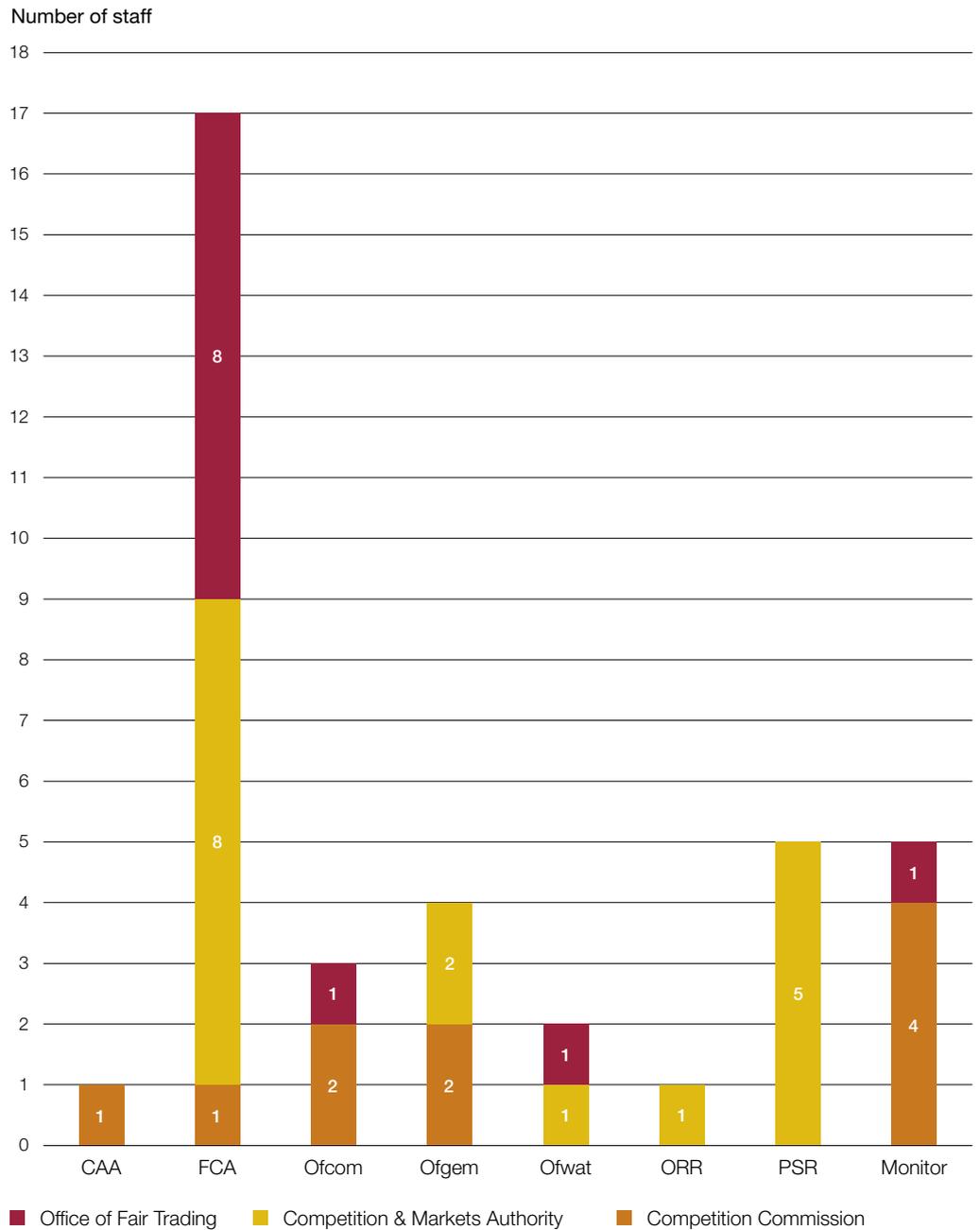
1.17 The CMA identified its target operating model very early in its development. However, it was unable to attract sufficient staff of the right calibre with its initial pay and funding structure. At that time, some equivalent competition posts at sector regulators attracted a salary 50% higher. To promote retention and recruitment, particularly for qualified competition specialists, the CMA used, from its increased funding of £12 million in 2014-15, just over £1.3 million to increase pay in key competition grades, and approximately £0.9 million to recruit experienced competition specialists. The new CMA average salaries exceeded the equivalent average salaries paid by the Office of Fair Trading and Competition Commission in key competition grades by 1% to 24%. The CMA considers this is helping it to reduce significantly its use of higher-cost temporary competition staff and to improve staff retention.

9 The Competition & Markets Authority, *CMA impact assessment 2014-15*, July 2015.

Figure 4

Staff joining regulators from the CMA or its predecessor bodies between 2013-14 and 2014-15

Nearly 40 staff left to join regulators in the transition period



Note

1 At a similar time to the transition from the Office of Fair Trading and the Competition Commission to the CMA, the FCA and the PSR were in formation and recruiting staff for their competition work.

Source: National Audit Office analysis of authority returns

The overall regime

1.18 Since 2010, three regulators have received new competition powers – the Financial Conduct Authority and the Payment Systems Regulator (from April 2015) and Monitor (from April 2013). **Figure 5** sets out the competition regime at the time of our 2010 report and following the reforms.

1.19 The government does not collect aggregate data on the cost or size of the regime. In 2010, we estimated that direct costs of staff and litigation related to Competition Act and Enterprise Act work were around £30 million annually (in 2015 prices). This does not include overheads such as property and IT because organisations account for these differently. In 2014-15, the three regulators with new competition powers (the FCA, the PSR and Monitor) spent £7.1 million on competition work. In addition, the CMA was granted £12 million in extra funding for competition staff recruitment and retention, and to improve the CMA's support to the regulators and its enforcement work. **Figure 6** on page 22 shows the direct costs of competition work in all the bodies in the regime. It covers sector-specific competition legislation as well as Competition Act and Enterprise Act work.

1.20 While the regime as a whole has expanded, the CMA has captured efficiencies from the merger of the Office of Fair Trading and the Competition Commission, for example by reducing technology and property costs per head. It estimates that these savings contributed to actual spend falling below budget by 6% in 2014-15.

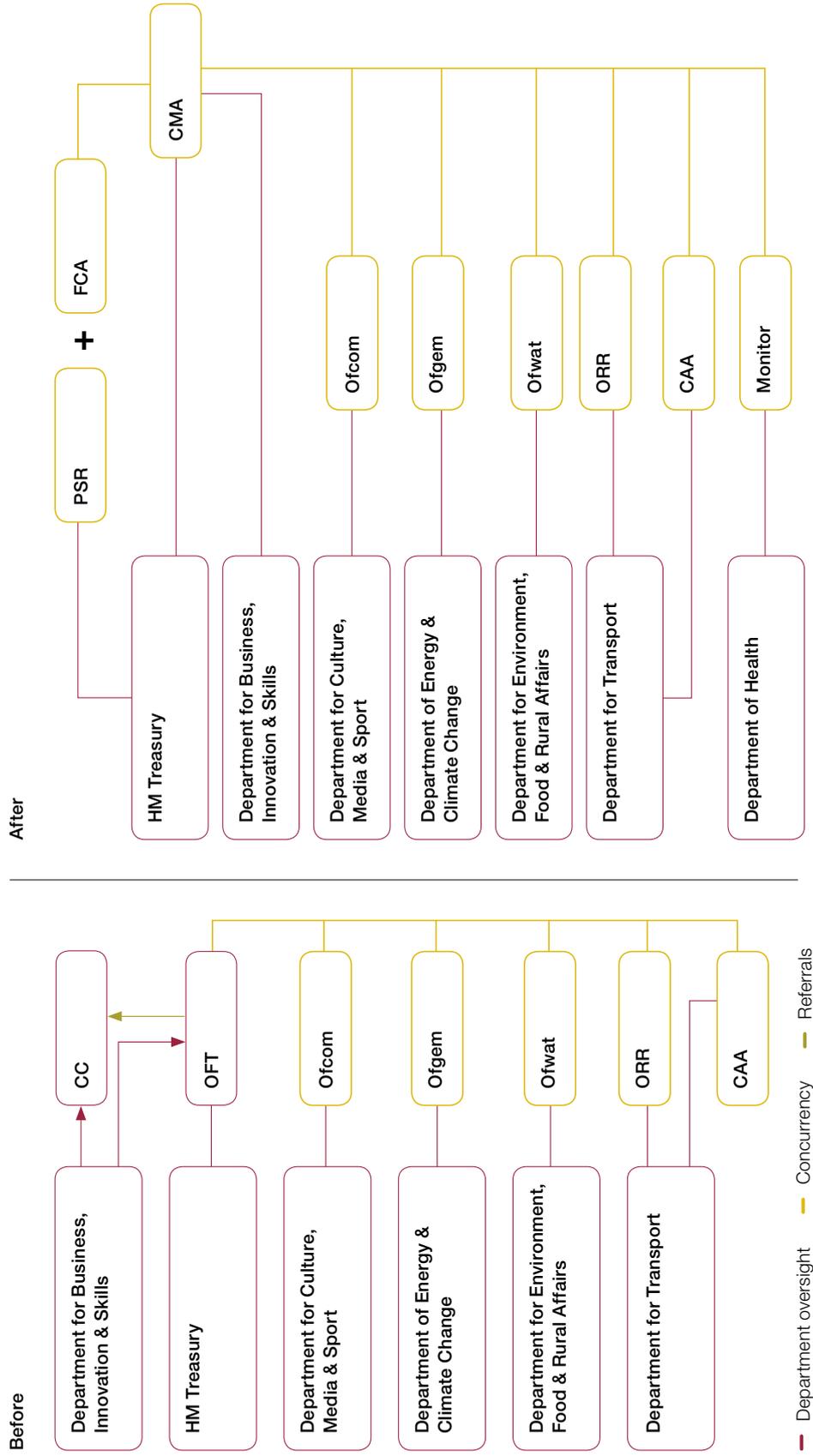
Independence

1.21 The regime's ability to make independent decisions is central to its credibility and impact. The importance of competition work means that it can come under significant external pressure. For instance, industry and consumer representatives have made many public comments about the CMA's provisional findings in its current investigations into the energy and retail banking markets. In September 2015, several business leaders wrote an open letter calling for a CMA investigation into communications infrastructure in the UK.¹⁰ The CMA's role is founded in UK statute, and it has established robust processes to maintain its independence, including publication of evidence submissions and of correspondence with ministers.

¹⁰ 'Reform market to deliver fast broadband in the UK', letter to the Financial Times, 20 September 2015.

Figure 5
The competition regime before and after the reforms

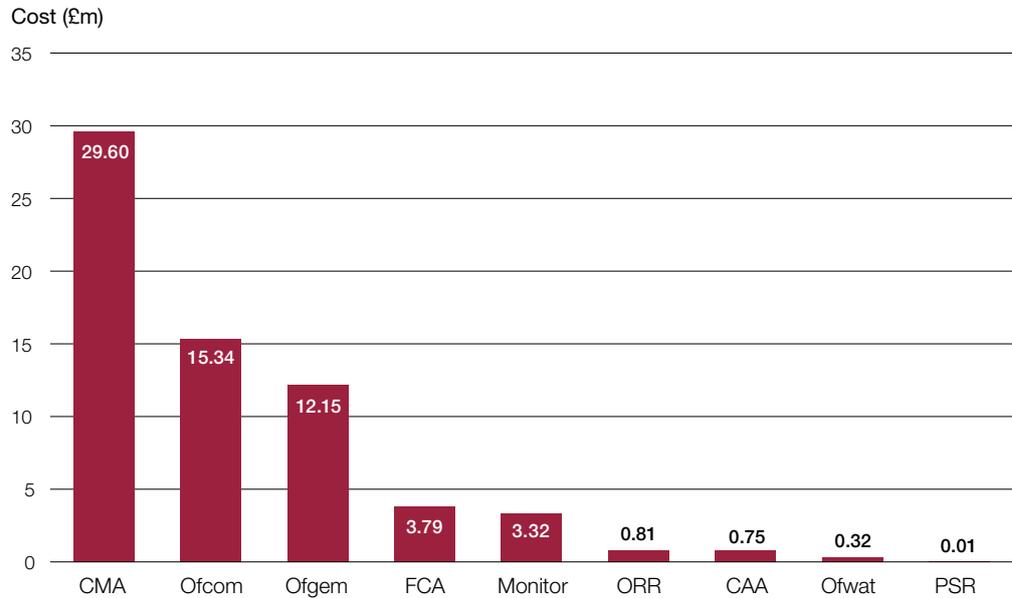
The number of sector regulators with competition powers has increased



Notes

- 1 See Appendix Three for further information.
- 2 CC = The Competition Commission; OFT = The Office of Fair Trading; Ofcom = The Office of Communications; Ofgem = The Gas and Electricity Markets Authority; Ofwat = The Water Services Regulation Authority; ORR = The Office of Rail and Road; CAA = The Civil Aviation Authority; PSR = The Payment Systems Regulator; FCA = The Financial Conduct Authority; CMA = The Competition & Markets Authority.

Figure 6
Competition regime estimated cost in 2014-15



Notes

- 1 We asked bodies to report the direct costs of Competition Act 1998 and Enterprise Act 2002 competition work, as well as their broader competition responsibilities, which can cover more general market monitoring and competition-oriented regulatory policy-making. There is no current single definition within the competition regime of these broader activities.
- 2 The competition teams at the FCA and the PSR were still expanding at the time of our analysis, so their costs are likely to increase. Ofgem's figures include staff working on projects which contribute to competition in the energy market. Monitor has reported the costs of staff carrying out its commissioning, patient choice and competition-related activities.
- 3 The total estimated cost of the UK competition regime in 2014-15 was £66 million.

Source: National Audit Office analysis of authorities' data.

Coordination of the regime

1.22 Our 2010 report identified serious failings in the coordination of the regime, reducing its effectiveness. The CMA and regulators subsequently established the UK Competition Network, aiming to strengthen cooperation between them and to promote competition and competitive outcomes across regulated sectors.

1.23 The network has improved coordination in several ways, including through:

- Clarifying further the existing principles for prioritising work, covering factors such as the impact and strategic significance of projects. The principles provide a basis for choosing interventions to maximise effectiveness, such as which markets to investigate or which competition cases to continue. The CMA has more ability to prioritise its work than its predecessor bodies, although approximately 40% of its front-line work is still mandatory.¹¹
- Better allocation of competition work around the system. Ofgem referred the energy market for a full competition investigation by the CMA in June 2014, something that commentators told us was difficult to imagine happening before the reforms.
- More sharing of expertise and support in enforcement cases. For instance, Monitor has provided expert advice to the CMA when assessing NHS hospital mergers, and the CMA has supported Ofgem, the Office of Rail and Road, and the Civil Aviation Authority in competition enforcement.

1.24 Under the Enterprise and Regulatory Reform Act 2013, the CMA is held accountable for the success of the concurrency arrangements, and reports publicly each year on how they have operated. Its report for 2014-15 stated, for example, that:

- The Financial Conduct Authority carried out, or had ongoing, several market studies using its powers under the Financial Services and Markets Act.
- Ofgem launched a review of the electricity connections market in June 2014. The findings were published in January 2015, and as a result of evidence received during the review, Ofgem opened an investigation under the Competition Act 1998.

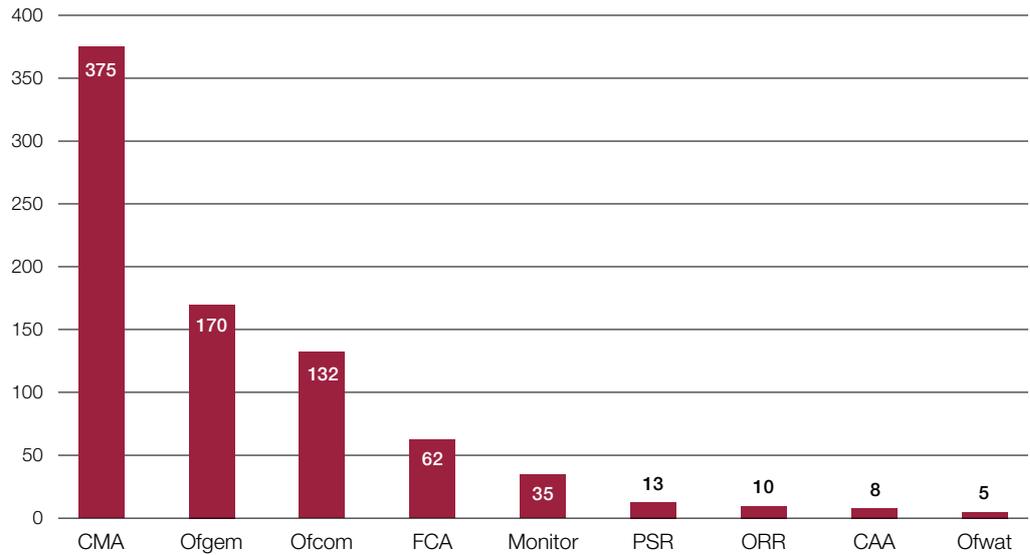
1.25 In 2013, the government agreed to provide the CMA with an extra £4 million of funding in 2014-15 to support work in regulated sectors. It has used this to share knowledge and to support individual cases, particularly in the smaller regulators. Competition capacity varies greatly among the regulators, and some may be unable to handle complex cases (**Figure 7** overleaf).

¹¹ 'Mandatory' refers to merger control, litigation, remedies, super complaints, investigations referred by regulators and regulatory appeals. It excludes other core CMA activities such as enforcement work.

Figure 7
Size of competition teams

Competition capacity varies greatly

Number of competition staff



Notes

- 1 Staff numbers as a full-time equivalent (FTE).
- 2 The total number of competition staff in the regime is 810 FTE.
- 3 We asked bodies to report the number of staff engaged in Competition Act 1998 and Enterprise Act 2002 competition work, as well as their broader competition responsibilities. There is no current single definition within the competition regime of these broader activities.
- 4 The competition teams at the FCA and the PSR were still expanding at the time of our analysis, so their costs are likely to increase. Ofgem's figures include staff working on projects which contribute to competition in the energy market. Monitor has reported the costs of staff carrying out its commissioning, patient choice and competition-related activities.

Source: National Audit Office analysis of data returns

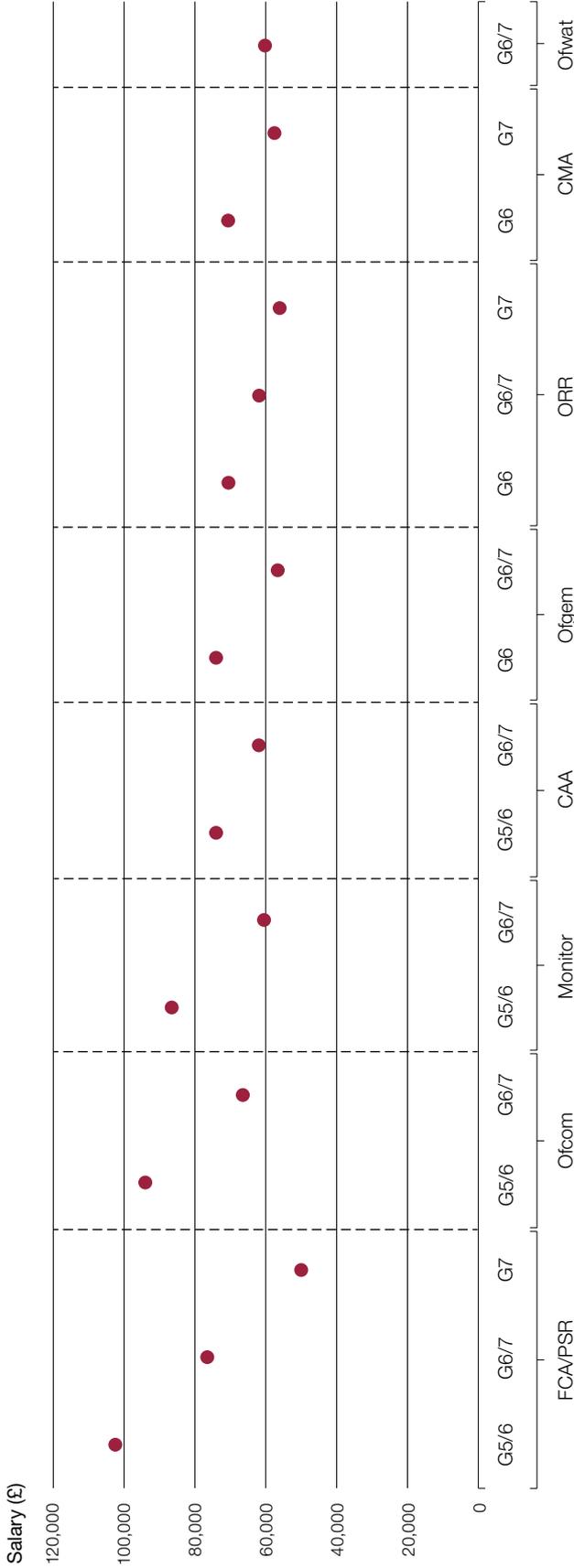
1.26 There are still several areas where coordination could be improved to ensure a more effective use of competition resources:

- Recruitment and remuneration of competition experts reflects the varied funding and governance arrangements of competition bodies and market conditions in different sectors, rather than an overall assessment of competition priorities. **Figure 8** overleaf illustrates salary differences across the regime.
- There have been relatively few secondments, with only nine occurring between competition bodies in the last three years.
- Regulators may still find it easier and more effective, at least in the short term, to use their regulatory powers instead of their competition powers, and some regulators are required to consider the use of other methods before promoting competition. Several external commentators told us that they felt that Ofgem had not sufficiently prioritised competition in the past; the CMA is considering this in its energy market investigation.
- Some regulators told us that, while the UK Competition Network is valuable, there is further to go to develop the network as a genuinely collaborative enterprise. They felt that, at present, the CMA typically leads on most issues.

1.27 As well as national coordination, coordination between the UK authorities and the European Commission is also required for an effective competition regime. External stakeholders generally viewed the relationship as positive, with sensible and quick settlements of any jurisdictional issues. Some were, however, concerned by apparent confusion over online bookings cases, which have been pursued by several national authorities, including the CMA. Gaps can also arise because of legislative differences; unlike the CMA, the European Commission cannot block companies from purchasing minority interests in other firms. In the case of Ryanair's purchase of a minority interest in Aer Lingus in 2006, this was an important factor in the case taking nine years to be resolved, despite the competition authorities having their judgement that this would be anti-competitive upheld at every stage in the litigation.

Figure 8
Salary midpoints by grade and body

Base salaries of competition specialists vary substantially across regulators



Notes

- 1 The CMA's civil service grades (G7, G6 and G5) do not exist in most regulators, so we asked regulators to approximate their own grades to the equivalent CMA grade as far as possible.
- 2 The CMA's salary bands for competition specialists are slightly higher than the organisation-wide bands for Grade 6 and Grade 7.
- 3 The chart shows midpoint salaries for each of the grades (designated by a dot).
- 4 The chart is based on base salaries only. It excludes factors such as differing pension and bonus arrangements.
- 5 The FCA, PSR and Ofcom noted that their salary ranges are wide, and the upper parts of the ranges are less utilised than the lower ones. As a result, the actual average salaries are lower than the midpoints indicated in the figure above.
- 6 FCA = The Financial Conduct Authority; CAA = The Civil Aviation Authority; PSR = The Payment Systems Regulator; Ofgem = The Gas and Electricity Markets Authority; Ofcom = The Office of Communications; ORR = The Office of Rail and Road; CMA = The Competition & Markets Authority.

Source: National Audit Office analysis of data returns

Part Two

Use of competition powers

2.1 There is a broad consensus across regulatory and enforcement agencies about what constitutes good practice in promoting compliance with regulations or statute. For example, the International Organisation of Securities Commissions, an international standard-setter in financial securities markets, lists the necessary factors as including: public understanding of a regulator's role; legal clarity of the regime; bold and resolute enforcement; and strong punishment.¹² This part examines:

- business awareness and understanding of competition law;
- identification of competition problems; and
- use of powers to enforce competition law and promote effective markets.

Awareness of competition authorities and laws

2.2 Business awareness of competition law is important in encouraging compliance, but it is currently low. The Competition & Markets Authority's (CMA's) 2014 survey of UK industry found that only 23% of businesses felt they knew competition law well, while 45% either had never heard of competition law or did not know it at all well (**Figure 9** overleaf). Forty per cent of businesses thought that they could agree not to sell to the same customers as each other, while 55% of businesses knew that price fixing is unlawful. A 2014 survey of public attitudes found that 53% of UK respondents knew that price-fixing was illegal, compared with 75% in Germany, 53% in Italy, and 41% in the USA. More than half of UK respondents thought that price-fixing was about as serious as fraud, while just over 40% thought that it was less serious.¹³

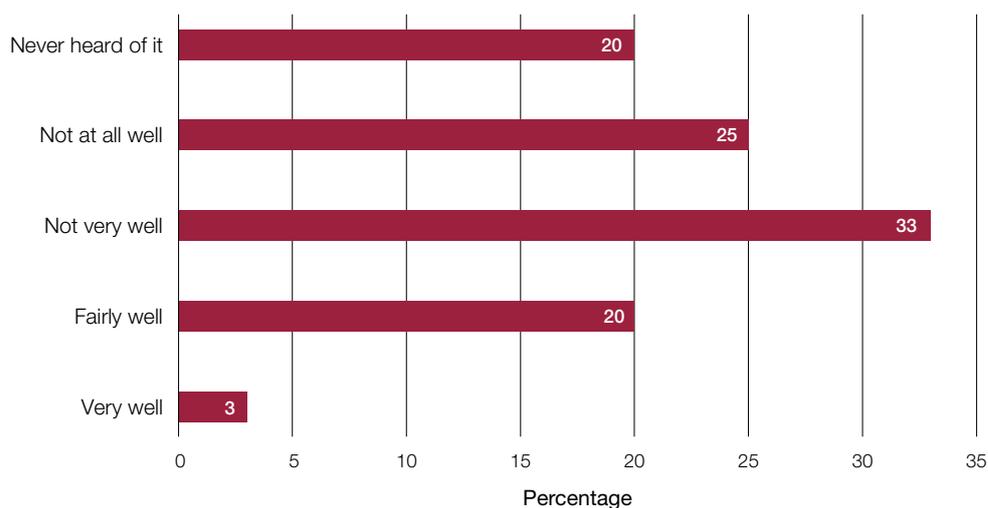
2.3 Early awareness of the newly-created CMA is low. The CMA's 2014 survey, taken as a baseline shortly after its formation, found that less than 2% of businesses knew the CMA 'very well' or 'fairly well' at that point. More than twice as many businesses believed the defunct Office of Fair Trading to be responsible for enforcing competition law than the CMA (75% versus 32%). In a 2014 survey of leaders of large companies, 27% knew the CMA 'very well' or 'a fair amount' compared with 60% giving the same answers for the Office of Fair Trading, and 68% for the Financial Conduct Authority, which began operating in 2013 (**Figure 10** on page 29).

¹² IOSCO, *Credible Deterrence In the Enforcement of Securities Regulation*, June 2015, pp. 6, 7, and 41.

¹³ Andreas Stephan, *Survey of Public Attitudes to Price Fixing in the UK, Germany, Italy and the USA*, CCP Working Paper 15-8, July 2015.

Figure 9 Awareness of competition law

Only 23% of businesses felt they knew competition law well



Notes

- 1 IFF Research 2015: telephone-based survey of 1,201 private sector businesses in the UK drawn from all sectors of the economy, different sizes of businesses, and across all UK regions. The survey was conducted in November and December 2014.
- 2 Figures may not round to 100%.

Source: IFF Research, 'UK businesses' understanding of competition law', prepared for Competition & Markets Authority, 2015

2.4 The CMA aims to raise business and public awareness of competition requirements, for instance by publishing materials targeted at smaller businesses, by disseminating the results of significant cases such as its recent enforcement action against estate agents, and carrying out other activities described in **Case study 1**. The CMA also works with partners such as trade associations to provide information about competition issues. However, these efforts have been limited by a lack of enforcement decisions. The CMA does not routinely publish the results of its casework where cases are closed due to administrative priorities or where it finds no grounds for action.

Case study 1 Three Counties Estate Agents

In March 2015, the CMA issued a decision which found that a trade association, three estate agents and a newspaper publisher had breached competition law by agreeing to prevent estate and letting agents from advertising fees or discounts in the local newspaper. During the investigation, they admitted breaching competition law and agreed to pay penalties totalling over £775,000.

The CMA followed up the case by working with the key trade association and other relevant bodies to distribute compliance material. It published open letters on the illegality of such practices and sent warning letters to a significant number of other estate and lettings agents, which it suspected had been involved in similar practices. The CMA estimates that its materials were distributed to 95% of UK estate agents and 75% of lettings agents. The CMA has subsequently received complaints and intelligence about similar practices elsewhere, resulting in it opening a further enforcement case.

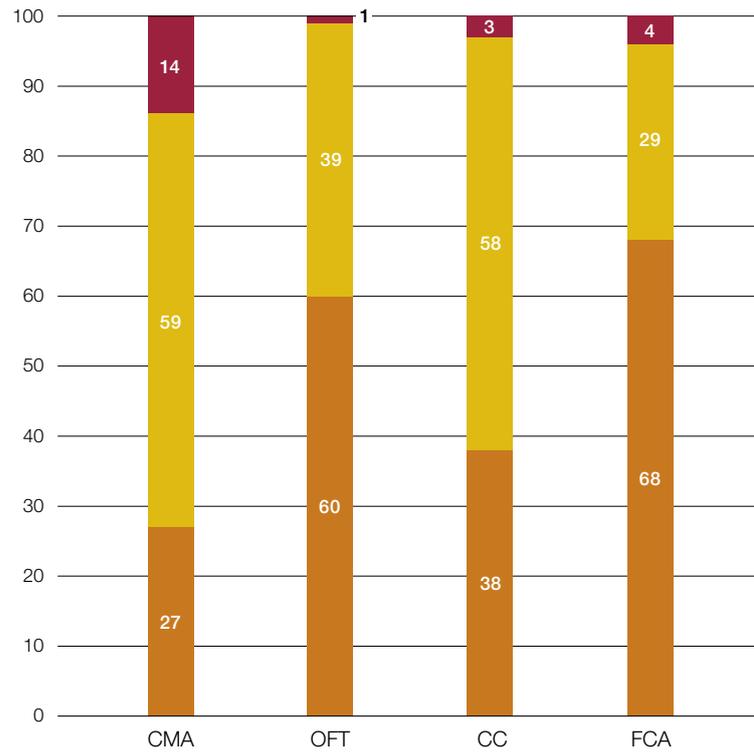
Source: National Audit Office

Figure 10

Awareness of the CMA and other competition bodies

The CMA is less well-known than comparable organisations

Percentage of respondents aware of the CMA and other competition bodies



- Never heard of
- Heard of only/know just a little
- Know very well/know a fair amount

Notes

- 1 Based on 108 interviews with directors and chairmen of top 500 industrial and top 100 financial companies, September to December 2014.
- 2 Figures may not round to 100%.

Source: Ipsos MORI, 'Survey of Britain's Captains of Industry 2014 Competition & Markets Authority'

Identification of competition problems

2.5 Historically, the UK competition regime has struggled to identify anti-competitive behaviour, notably in financial services. The Office for Fair Trading and the CMA found only three breaches in financial services between 2001 and 2015, despite serious and long-running problems. Following applications for leniency, in 2013 the European Commission fined financial institutions €1.71 billion for participating in cartels in interest rate derivatives, particularly in London markets. The European Commission is now investigating alleged cartel activity in foreign exchange markets. The CMA told us that it has been cooperating with partner agencies in their investigations, including the European Commission and the US Department of Justice. The new competition powers for the Financial Conduct Authority and the Payment Systems Regulator (gained in April 2015) should provide a stronger basis for future action, but their powers are relatively untested.

2.6 To improve its detection of anti-competitive behaviour, the CMA collects data and intelligence from a wide variety of sources, including its own merger unit, the regulators, consumer organisations such as Citizens Advice, law enforcement agencies and whistleblowers. Nearly half of the cartel investigations opened by the Office of Fair Trading and the CMA since 2010 have been intelligence-led, rather than relying on leniency applications. The CMA is also developing specialist expertise in digital forensics to help uncover cartels. These actions have yet to result in a substantial increase in the flow of competition cases, however.

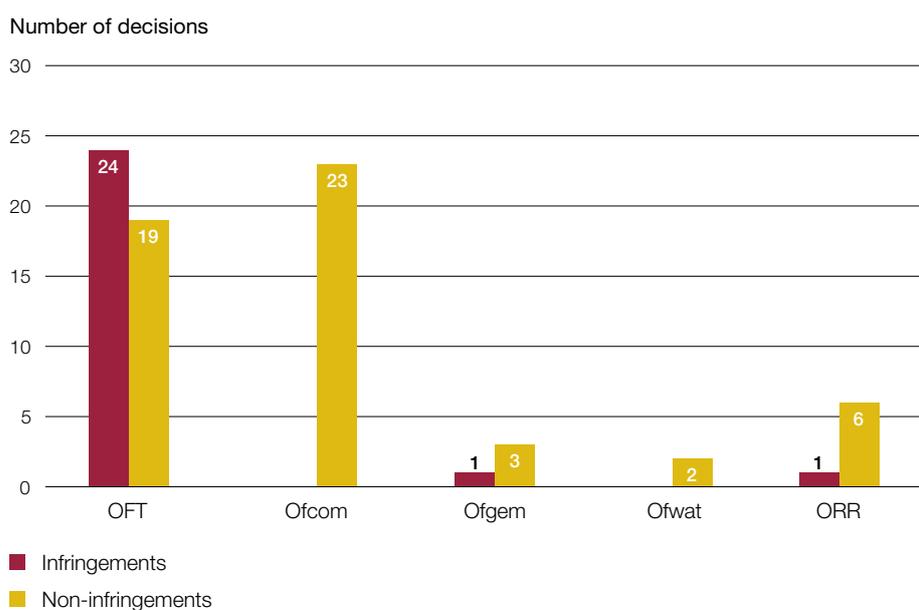
Enforcement of competition law

2.7 To enforce competition law successfully, the regime needs to build up a steady flow of successful high-profile cases, decisions and fines that withstand appeal. A decision that finds an infringement of competition law can provide a deterrent effect, clarify the law and result in financial penalties. Lower profile and local, targeted cases can also play an important role in promoting deterrence, particularly among small and medium-sized enterprises. A non-infringement decision is unlikely to provide as much deterrence, but can help to clarify the law and set a precedent.

2.8 Our 2010 report found that the competition authorities had used their competition powers sparingly, with few decisions since the law was implemented in 2000 (**Figure 11**). The Office of Fair Trading made 43 decisions (about four per year), of which just over half found infringements of the law. Over the same period, the regulators made just two infringement decisions.

Figure 11

Infringement and non-infringement decisions (2000-01 to 2009-10)

There were few enforcement decisions between 2000 and 2010**Notes**

- 1 The FCA, PSR, and Monitor did not exist in this period so do not appear in this Figure.
- 2 During this period the CAA's concurrent powers were restricted to air traffic services only.

Source: National Audit Office report *Review of the UK's competition Landscape*, 22 March 2010

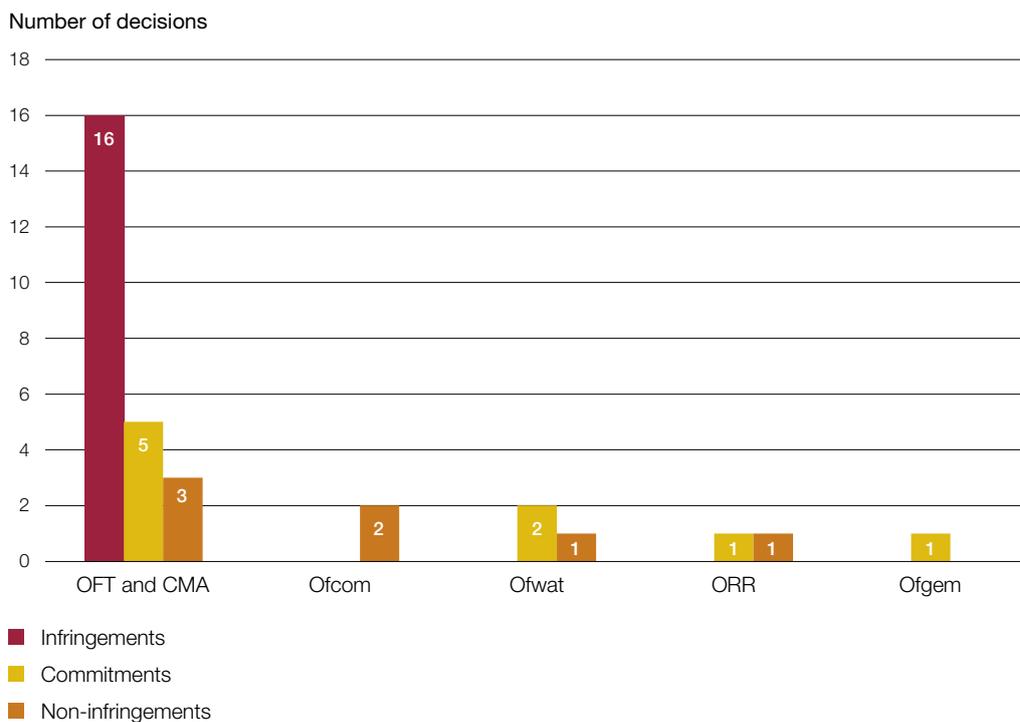
2.9 Subsequent to our 2010 report, the Office of Fair Trading suffered two high-profile case failures. In May 2010, a criminal cartel case against executives and former executives of British Airways collapsed on the grounds of procedural failings by the Office of Fair Trading. In December 2011, the Competition Appeal Tribunal annulled infringement decisions by the Office of Fair Trading in its tobacco pricing case, including on grounds of lack of evidential rigour. The government's subsequent consultation on regime reform identified problems with the timeliness of competition cases and the quality and robustness of decision-making.

2.10 In response, the CMA has set up independent decision-making panels, and enhanced the role of the senior procedural officer. So far, the CMA has concluded cases promptly, reaching early settlement decisions with parties on two enforcement cases in 2015 (in 13 and 17 months respectively), and has improved robustness. Its procedural thoroughness was noted by the judge in the CMA's recent criminal cartel case. Furthermore, in 15 out of its last 19 civil cases brought before the courts, the CMA has successfully defended its actions. These include appeals across the CMA's work, including appeals against phase 1 merger decisions and appeals by third parties.

2.11 The flow rate of cases has not increased since our 2010 report, remaining at around four per year at the primary competition authority, with no infringement decisions by the regulators (**Figure 12**). In 2014, the German competition authorities concluded nearly six times as many cases than their UK counterparts, and the French competition authorities four times as many (**Figure 13**), despite similar levels of resourcing for enforcement work and similar-size economies. The level of fines imposed for competition breaches is also low – £65 million (at 2015 prices) between 2012 and 2014 (**Figure 14** on page 34). International comparisons between competition authorities need to be treated with some caution because economic factors and legal characteristics of jurisdictions can vary.

Figure 12
Enforcement cases completed during the period 2010-11 to 2015

There continues to be a low number of enforcement decisions



Notes

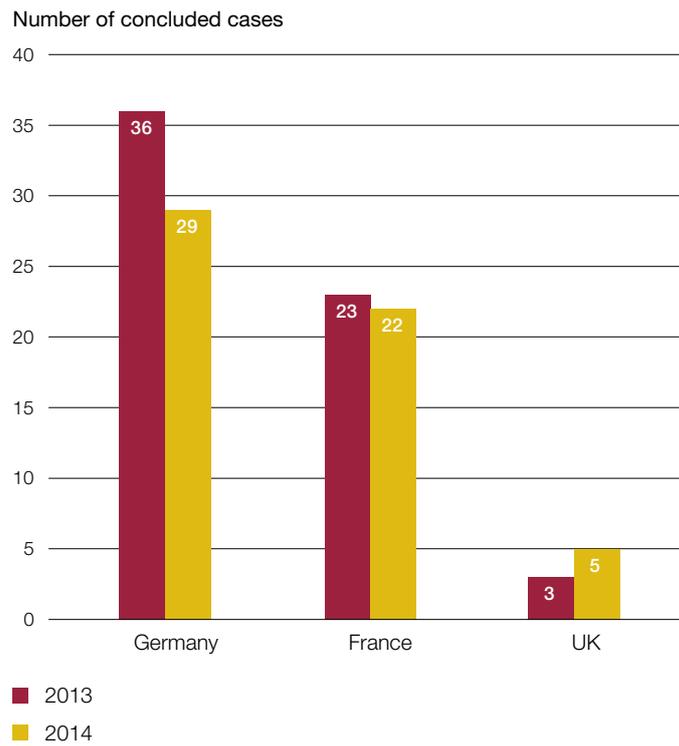
- 1 Out of 14 OFT infringement cases, there were 5 separate decisions on Mercedes Benz.
- 2 Non-infringement decisions include 'no grounds for actions' decisions.

Source: National Audit Office analysis of data returns

Figure 13

Total number of concluded cases by competition authorities in Germany, France and the UK

The number of enforcement decisions in the UK is much lower



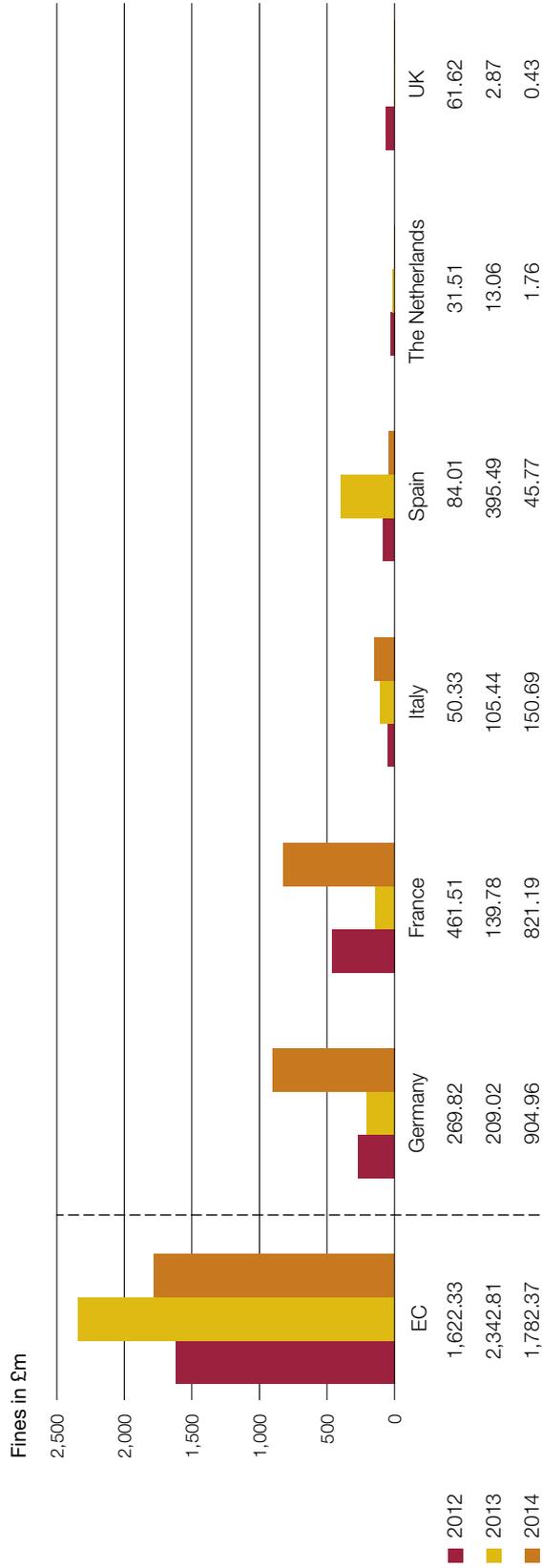
Note

1 Decisions for 2014 in France include 2 interim measures, which are decisions in emergency situations.

Source: National Audit Office analysis of competition authorities' annual reports

Figure 14 Fines imposed by selected national European competition authorities and the European Commission from 2012 to 2014

Other leading European competition authorities imposed higher fines than the UK authorities



Notes

- 1 Fines for Spain in 2013 cover the period from 1 September 2012 to 30 September 2013.
- 2 All fines, other than for the UK, have been changed from euros to sterling using an average exchange rate for each year and are adjusted to 2015 prices.
- 3 The UK fines are adjusted to 2015 prices.
- 4 In addition, the UK imposed £1.1 million of fines (after settlement¹) in 2015, meaning that total fines were £66 million between 2012 and 2015.

Source: National Audit Office analysis of competition authorities' annual reports

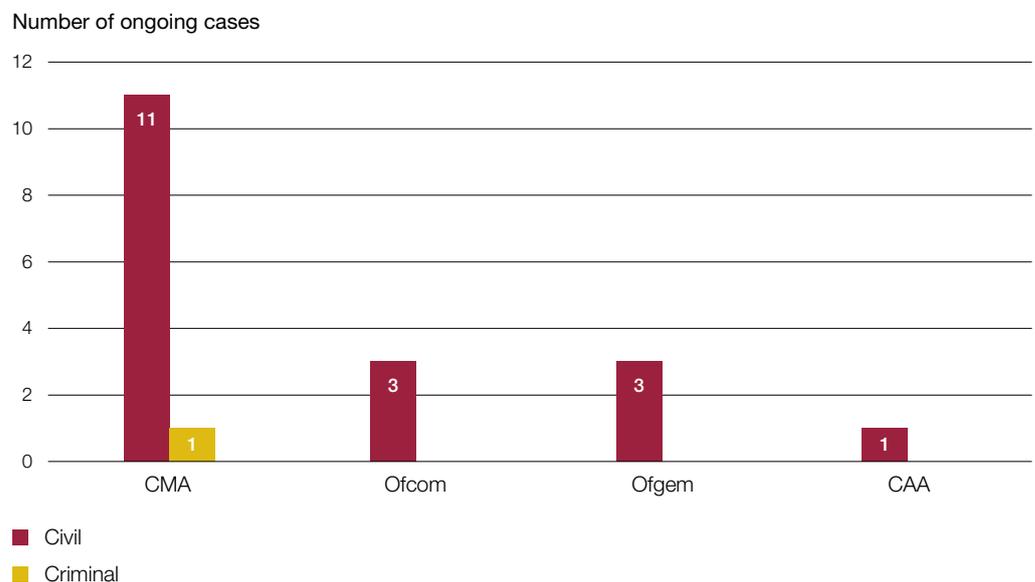
2.12 Our interviewees considered the low number of decisions a key failing of the UK competition regime so far, as this does not help to raise awareness or promote compliance. There has, however, been some increase in the number of decisions by the OFT and the CMA that have found infringements, from 2.6 to 3.6 per year.

2.13 To help build a flow of cases, the CMA has a pipeline function alongside its intelligence-gathering capability. Together with the enhanced concurrency arrangements, this has led to a total of 19 ongoing cases across the regime in December 2015 (**Figure 15**).

2.14 A principal source of intelligence is 'leniency', where a business applies for leniency from potential fines in return for information that leads to enforcement action. For instance, in 2007, Virgin Atlantic applied for leniency from fines for agreements that it had with British Airways to coordinate their surcharge prices on certain of their long-haul flight routes. The CMA receives a comparable number of applications to its European peers, but few leniency applications have been converted into successful cases (**Figure 16** overleaf). The reasons for this are not currently well understood.

Figure 15
Live cases

There are 19 ongoing cases in the competition regime



Note

1 Several of the CMA's criminal cases were closed following the outcome of the galvanised steel tanks case in June 2015.

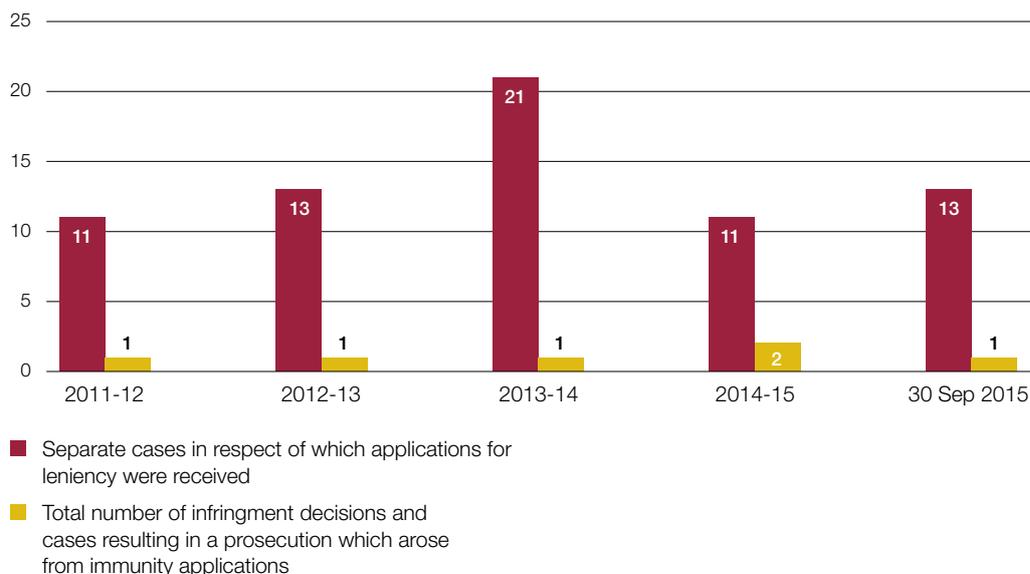
Source: National Audit Office analysis of data returns

Figure 16

Actions arising from leniency applications

Few leniency applications were converted into successful cases

Number of actions arising from leniency applications

**Note**

1 There was only one prosecution that arose from immunity applications.

Source: Competition & Markets Authority's analysis

2.15 Furthermore, many stakeholders and legal practitioners we spoke to think there are strong incentives for businesses to litigate if they lose a case, which can lead to risk aversion in the competition authorities. One stakeholder told us that the UK was the best jurisdiction in the world to defend a competition case; this was consistent with the views of several other interviewees. Competition Act enforcement cases, unlike mergers or market investigations, do not have any statutory deadlines and are at risk of being squeezed by activities that do. Several interviewees told us that, in their view, the CMA's competition enforcement work has a lower profile with their competition staff than, for example, the two current large market investigations.

2.16 The CMA and, previously, the Office of Fair Trading, have found criminal enforcement against individuals for cartel offences particularly challenging, since criminal cases need to be proved beyond a reasonable doubt. Moreover, for alleged crimes committed before April 2014, the competition authorities had to prove that agreements were entered into dishonestly. The CMA has prosecuted one criminal case so far (**Case study 2**), under the pre-2014 legislation. Although one of the three defendants pleaded guilty, the other two defended the case on the basis that they had not acted dishonestly and were acquitted at trial. Following this case, the CMA dropped two of its three remaining cases under the previous legislation. The CMA used £3.5 million of additional funding in 2014-15 to enhance its criminal enforcement capability and to establish a digital forensics and intelligence team.

Case study 2

Criminal prosecution – galvanised steel tanks

Galvanised steel tanks are used in buildings to store water used in the event of fire. The UK industry is characterised by several medium-sized firms. In 2012, a manufacturer reported being part of a cartel and sought immunity from fines and immunity from prosecution for its cooperating employees under the leniency programme. In January 2014, a director of one company pleaded guilty to price-fixing and other cartel activity between 2004 and 2012.

In 2014, the CMA brought similar criminal charges against two other directors. However, these two directors were acquitted after a trial in which the CMA was unable to persuade the jury they had acted dishonestly. The defendant who pleaded guilty was given a suspended sentence in recognition of his guilty plea and cooperation with the CMA. In summing up, the judge made clear that the economic damage done by cartels is such that those who involve themselves in them must expect prison sentences to mark the seriousness of these offences and to act as a deterrent to others. The CMA is now pursuing its civil investigation.

Source: National Audit Office

Mergers

2.17 Merging businesses can bring benefits to the economy, for example through achieving economies of scale, or bringing together complementary skills and operations. However, some mergers can lead to worse outcomes for consumers by increasing prices, reducing choice and harming innovation. The CMA has the power to block a merger if it believes it will substantially lessen competition, or grant it in return for suitable remedies. The European Commission also examines some large and international mergers.

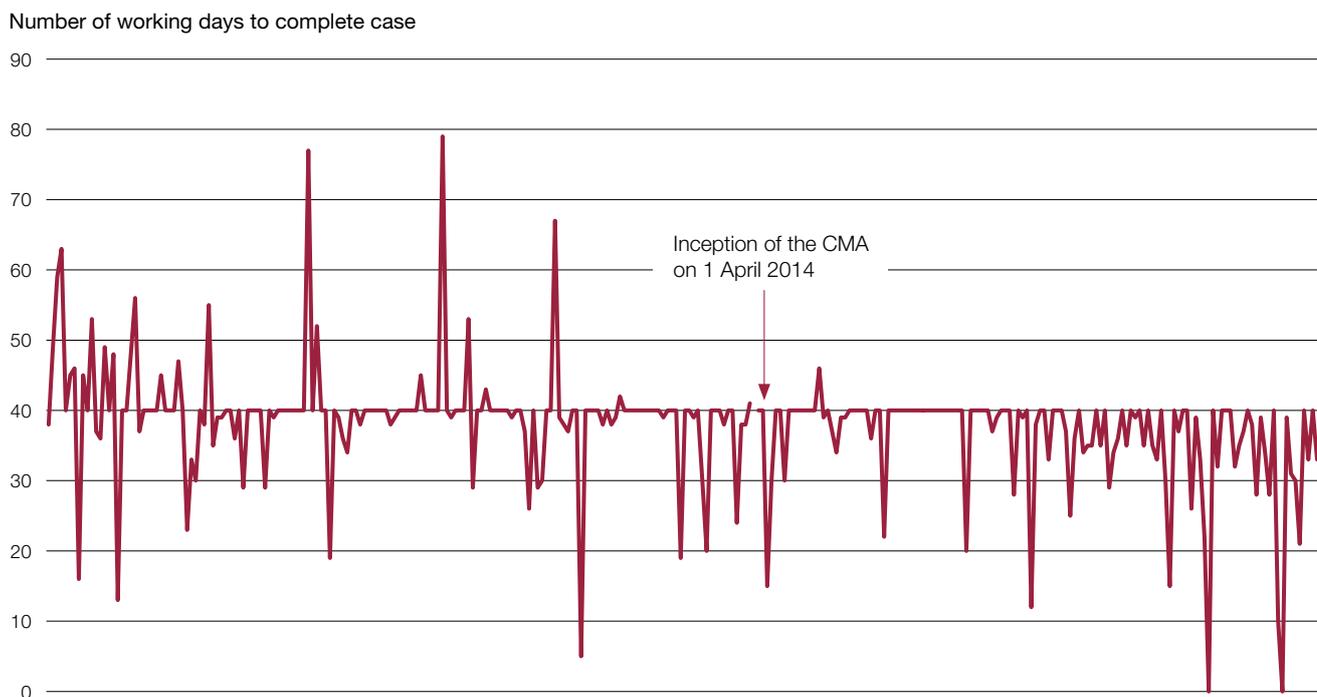
2.18 The UK's merger regime has two phases. Phase 1 is an initial assessment of whether a notified merger has the potential to reduce competition substantially. If not, the merger is cleared to proceed or cleared with remedies. If so, there is a more costly in-depth assessment, lasting up to 24 weeks, (phase 2), which leads to clearance, a block, or clearance with remedies (for example sale of part of the merged business). Before the CMA was established, the Office of Fair Trading carried out phase 1, and the Competition Commission undertook phase 2.

2.19 The Enterprise and Regulatory Reform Act 2013 aimed to make the process more efficient. It merged responsibility for phases 1 and 2 into the CMA, and introduced a statutory deadline of 40 working days for phase 1 (it did not change the deadline of 24 weeks for phase 2). In response, the CMA has changed the merger process, particularly by seeking to resolve more mergers at phase 1, reducing the need for a costly and lengthy phase 2 (where businesses can also face significant costs). It is using more senior decision-makers at phase 1 and is encouraging early consideration of possible remedies that would allow clearance. Furthermore, the CMA has developed case law, in particular winning three significant recent legal challenges in this area.

2.20 The CMA has met the new 40 working day statutory deadline for phase 1 on all merger cases (**Figure 17**). The average cost for phase 1 merger cases has increased by £9,600 from £23,900 in the Office of Fair Trading’s final two years (2012-13 and 2013-14) to around £33,500 in 2014-15. This is partly due to increased senior oversight and a greater focus on resolving cases at phase 1 rather than phase 2 (7% of cases were referred to phase 2 in 2014-15, lower than in any of the previous four years). It also reflects the CMA’s more targeted approach in identifying mergers that require a formal investigation, resulting in fewer decisions having to be taken.

Figure 17
Working days to complete phase 1: pre- and post-statutory deadline of 40 days over the period April 2012 to December 2015

The CMA has met its statutory deadline in all phase 1 mergers



Note

1 The only case that exceeded the 40 working days limit after 1 April 2014 was the Pure Gym/The Gym case that was inherited from OFT and therefore not subject to a statutory deadline.

2.21 Most stakeholders we spoke to welcomed the CMA's changes in approach, particularly the ability to have an early meaningful discussion about key issues and the potential for merging parties to offer remedies at phase 1. **Case study 3** gives an example of remedies at phase 1 that avoided the need for a phase 2 referral. However, some companies and legal practitioners told us that the CMA's phase 1 information requests imposed substantial burdens on businesses.

Case study 3

Phase 1 merger remedies

The CMA announced in March 2015 its provisional decision to refer to phase 2 the proposed acquisition by Greene King plc of the Spirit Pub Company. This was because its initial work indicated that around 1,000 Spirit pubs overlapped with a Greene King pub in their local areas. The merging parties worked with the CMA to try to find a remedy at phase 1. The phase 1 CMA case team made extensive use of resources previously available only at phase 2, such as the remedies, business and financial analysis, and statistics teams. This ability to draw on wide-ranging expertise at phase 1 enabled the CMA team to carry out sophisticated analysis. As a result, the CMA found that the merger gave rise to a realistic prospect of substantially reducing competition in only 16 local areas. The merging parties offered to sell their pubs in these areas, avoiding the need for a referral to phase 2.

Source: National Audit Office

2.22 The CMA has also changed its phase 2 process, using phase 1 staff on phase 2 assessments where appropriate so that they can transfer knowledge. We examined the five most recent phase 2 merger cases as at the end of October 2015. In three of these, between 29% and 44% of staff involved in the phase 1 investigation were also involved in the phase 2 investigation.¹⁴ To reduce the risk of confirmation bias and maintain independence, the key decision-makers, inquiry chairs and panel members at phase 2 are always different. At phase 2, the new process appears more efficient; the CMA estimates that, on average, phase 2 CMA mergers have cost £275,000, compared with £358,000 at the Competition Commission.¹⁵

Market investigations

2.23 Under the Enterprise Act 2002, the CMA and the regulators can carry out market studies – initial high-level reviews of the state of competition in a particular market. If there is evidence of any market feature that may prevent, restrict or distort competition they may refer the market to the CMA for a full market investigation reference (MIR) – an independent detailed examination. Since April 2010, the Office of Fair Trading and subsequently the CMA have undertaken a total of 15 market studies, and a total of ten MIRs in the same period.

¹⁴ In the other two cases, a small proportion of staff were involved in both phases.

¹⁵ The CMA told us that the Competition Commission made greater use of contractors in the run-up to transition than the CMA does, but indicated that these figures should be treated with caution given differences between the two organisations in how costs have been calculated.

2.24 The CMA can impose far-reaching remedies to strengthen competition. These can be either structural (such as selling assets) or behavioural (such as giving consumers better comparative information on pricing). For example, a 2009 market investigation by the Competition Commission resulted in BAA selling Edinburgh, Stansted and Gatwick airports.

2.25 Our 2010 report noted that an internal joint evaluation by the Office of Fair Trading and the Competition Commission in 2008 had found that the MIR system was not operating as intended. It found that all but one of the MIRs had taken longer than the 11-14 months expected in the Competition Commission's original planning assumptions, with only one of the six completed MIRs, at the time of the review, reporting appreciably before the 24-month statutory deadline. Our 2010 report also found there were strong disincentives to regulators referring their own markets for review. The 2013 Enterprise and Regulatory Reform Act reduced the statutory deadline for MIRs to 18 months (with a 6-month extension in certain circumstances) to reduce costs and minimise uncertainty. It also introduced a six-month time limit for the CMA to implement remedies.¹⁶

2.26 Within eight months of its inception in April 2014, the CMA launched two of the largest and most high-profile market investigations undertaken in the UK. In June 2014, it began an investigation into the energy market, following a referral from Ofgem (**Case study 4**). In November 2014, it began investigating the retail banking market. These two investigations both involved large and highly-skilled project teams (typically taken together 50 to 60 people, representing 16% of the CMA's front-line staff). The CMA estimates the lifetime costs for these investigations at £5.2 million (energy) and £4.5 million (banking), with the possibility of increased costs if they are appealed. In addition, the CMA inherited three MIRs from the Competition Commission, into private healthcare, payday lending and private motor insurance.

Case study 4

Energy market investigation

The energy market represents 6% of UK GDP. The six largest suppliers supply 95% of domestic retail energy demand, and own 70% of generating capacity.

In November 2013, Ofgem agreed to work with the Office of Fair Trading and the CMA to conduct an assessment of competition in the energy markets in Great Britain. It referred the market to the CMA for a market investigation in June 2014 because it identified obstacles to new firms entering the market, limited competition between major suppliers and low consumer trust. The CMA assigned a large project team to the MIR, typically between 25 and 30 full-time equivalent staff, of whom six had previously worked on the market study.

The CMA's provisional findings (published in July 2015) stated that competition in the wholesale market was working relatively well, but that there were several issues, including on the consumer side where it found relatively high levels of consumer inertia in switching between suppliers and a lack of transparency and consumer engagement. The report set out 18 possible remedies for consultation.

In September 2015, the CMA announced that it needed to extend the deadline for its investigation from 18 months to 24 months. It expects to publish its final report by the end of April 2016.

Source: National Audit Office

¹⁶ The six-month time limit for remedy implementation can be extended by four months.

2.27 The CMA has made some efficiencies in its markets work by transferring people who worked on the initial market studies to the market investigation. It has also tried to develop remedies throughout the investigations rather than waiting until they are completed. Because of the complexity of its energy market investigation, it has extended its timetable by six months, with a new deadline of June 2016.

2.28 External interviewees told us that they thought there was more staff continuity and better consideration of remedies during the MIR process than was the case with the Competition Commission. However, some raised concerns about the large data burden of investigations, and felt the CMA needed to clarify the criteria it uses to determine whether a market is 'well-functioning' in each sector.

2.29 There is a high degree of public interest in the CMA's market investigations, with an entire parliamentary hearing already dedicated to the retail banking inquiry. Members of the Treasury Select Committee expressed reservations about whether the proposed remedies would go far enough to address identified market failures. There is always a possibility that the CMA's decisions and remedies will be appealed by affected parties, potentially extending timescales and costs. This can be seen with the CMA's private healthcare market investigation, originally opened in April 2012. The CMA is currently reconsidering some of its decisions after one of the affected parties identified errors in its analysis. The CMA's ability to present a credible analysis of the markets and propose effective and robust remedies (where appropriate) that withstand appeal in its high-profile investigations will have a significant effect on the reputation of the market investigations tool in the UK.

Part Three

Evaluating outcomes

3.1 In this part, we examine the competition authorities' and regulators' methods for evaluating performance against intended outcomes at the project, organisational and system level, and against the government's high-level policy objectives.

Evaluating project outcomes

3.2 The CMA inherited a large number of remedies and undertakings from past merger and markets work undertaken by the Office of Fair Trading and the Competition Commission. There were also several open enforcement cases, including on multilateral interchange fees and on sports bras.

3.3 Shortly after being established, the CMA set up a rolling programme of assessment. It has now examined 76 structural merger undertakings given by companies before 1 January 2005. By December 2015, its independent panel had provisionally decided to release companies from merger undertakings in 51 cases as these were no longer relevant, and in two further cases market remedies were removed after review. The CMA has also closed all inherited cases that did not meet its new priorities. It now assesses all its 'live' projects at key points to decide whether they should continue. The CMA is also considering putting 'sunset' clauses into future remedies, meaning that they would automatically expire after a specified date. These actions should enable the regime to reduce the burdens it imposes on businesses.

3.4 Each year, the CMA evaluates two former outputs (including one market study or investigation). It told us that its two evaluations thus far had informed its approach to working with the government and to monitoring pharmaceutical markets. The CMA has established a rolling programme of research into past remedies to help it to develop its policy and practice. In April 2015, it published its latest research into 13 merger remedies from cases between 2000 and 2011.¹⁷ Learning points included how best to identify and keep separate certain business functions in a merger while it is under review, and how to choose and design final remedies. The CMA has also improved its reporting systems and is able to track progress, resourcing and spending on all of its projects.

¹⁷ Competition and Markets Authority, *Understanding past merger remedies: Report on case study research*, July 2015.

Evaluating entity and regime performance

3.5 The government agreed a performance management framework for the CMA in January 2014. This includes a target of achieving direct financial benefits to consumers of at least ten times the CMA's cost, based on a three-year rolling average. The methodology was developed by the Office of Fair Trading and each year's analysis is validated by independent academic reviewers. In 2014-15, the CMA impact assessment estimated that its work produced on average £745 million of direct consumer benefits each year between 2012 and 2015, just over 11 times its costs of £66.5 million.¹⁸ Seventy-seven per cent of the benefits achieved came from the CMA's markets work (**Figure 18**). While useful, this measure does not include potential deterrence effects, and therefore does not measure the CMA's total impact. Some stakeholders felt that this could lead the CMA to prioritise market investigations over enforcement actions that could have wider deterrence benefits.

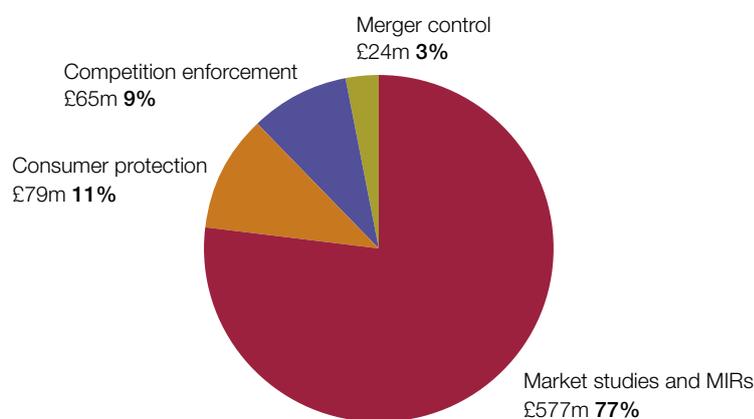
3.6 The CMA's performance management framework also requires it to report each year against its five strategic goals:

- deliver effective enforcement;
- extend competition frontiers;
- refocus consumer protection;
- achieve professional excellence; and
- develop integrated performance.

Figure 18

Estimated average annual consumer benefits between 2012 and 2015

The CMA's performance against the target of achieving financial benefits is heavily skewed towards its markets work



Note

1 MIRs stand for market investigation references.

Source: National Audit Office analysis of Competition and Markets Authority data

¹⁸ Competition and Markets Authority, *CMA impact assessment 2014-15*, July 2015. The CMA cost figure is a three-year rolling average.

3.7 Some regulators, particularly those that have recently gained competition powers, do not yet have an evaluation framework for their competition enforcement work. At the system level, however, the CMA does report annually on how competition law is being enforced across regulated sectors. Its report for 2014-15 highlighted several promising developments, including: an increase in the number of enforcement cases opened by the regulators; agreement of memoranda of understanding; and productive cooperation between the CMA and regulators. This is helpful, but the indicators thus far are largely based on outputs achieved, such as the number of cases opened or closed, rather than outcomes for consumers.

Evaluating outcomes of competition work

3.8 Aside from the CMA's evaluations of individual competition interventions, the regime does not report its wider impacts on competition (such as through deterrence) or on productivity and growth, and these effects can be difficult to quantify. In 2007, the Office of Fair Trading was one of the first competition authorities internationally to define and quantify the deterrence effect of its work. Its research indicated that its decisions had a substantial impact on deterrence. For example, its surveys of lawyers and businesses found that between five and 16 potentially anti-competitive agreements had been abandoned or significantly modified for each enforcement decision.¹⁹ The Office of Fair Trading's research also found a significant deterrence effect of sanctions against individuals (especially imprisonment) as well as fines and reputational damage.

3.9 The CMA has been working with the European Commission and the Dutch competition authority to estimate the total benefits (including both direct and indirect effects) of their work, and to improve understanding of the deterrence effect. In September 2015, the three authorities organised a conference to examine practical approaches to estimating deterrence effects and the broader macroeconomic impact on productivity and growth, concluding that further research was needed.²⁰ To improve understanding of the wider impact of its interventions, the CMA is currently undertaking research into the deterrence effect of competition authorities' work.

3.10 In September 2015, the CMA published a summary of existing evidence on the relationship between competition and productivity.²¹ It found a strong theoretical and empirical link between competition and productivity and evidence that competition enforcement can have a positive impact on growth. However, there is less evidence on the links between specific competition interventions and growth, or on how competition is evolving in different UK industries both of which are very difficult to measure in practice. There is also limited evidence either in the UK or internationally, on the relative effectiveness of different tools in promoting growth and productivity (such as a market investigation versus an enforcement action). A substantial proportion of the CMA's work is mandatory, limiting its choice of which tools to use or its flexibility to choose its targets or respond to changing circumstances.

¹⁹ Deloitte and Touche, *The Deterrent Effect of Competition Enforcement by the OFT*, OFT Report 962, 2007.

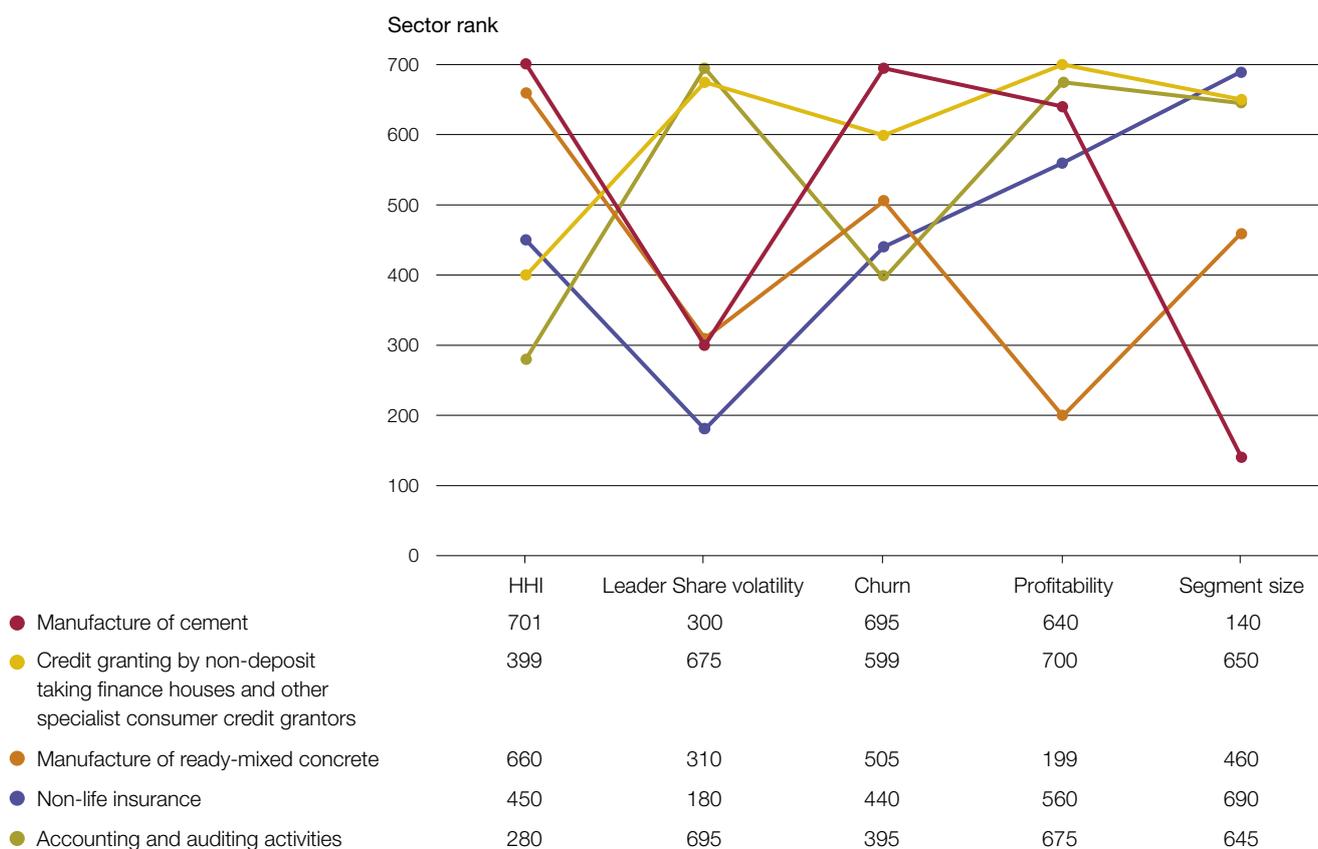
²⁰ European Commission, *Deterrence and macroeconomic impact of the work of competition authorities*, available at: <http://ec.europa.eu/competition/information/macroeconomy/index.html>

²¹ Competition and Markets Authority, *Productivity and competition: A summary of the evidence*, CMA 45, July 2015.

3.11 The CMA has explored indicators to help identify the level of competition in different sectors and potentially guide its work effort. For instance, this could help it to assess whether a sector warrants a detailed market study. Potential indicators, which could be used alongside other intelligence, include the market shares and profitability of leading suppliers, volatility of the leader's market share, and rates of market entry and exit. However, the limited data available at present only allow a crude assessment of competitiveness, and access to the data is heavily restricted and time consuming. **Figure 19** is intended to be illustrative of the sort of analysis conducted by the CMA. It shows the CMA's application of potential indicators to five sectors of the economy in which relatively recent market studies have been undertaken. The CMA's analysis ranks the sectors from best to worst according to each indicator, with the higher the line generally suggesting more grounds for investigation.

Figure 19
CMA's illustrative analysis of five past market studies

The graph shows the CMA's application of competition indicators to five sectors of the economy



Notes

- 1 Each sector shows its relative ranking against various measures of competition.
- 2 HHI stands for Herfindahl-Hirschman Index, a measure of market concentration.
- 3 This work contains statistical data from ONS which is Crown Copyright. The use of the ONS statistical data in this work does not imply the endorsement of the ONS in relation to the interpretation or analysis of the statistical data. This work uses research datasets which may not exactly reproduce National Statistics aggregates.

Appendix One

Our audit approach

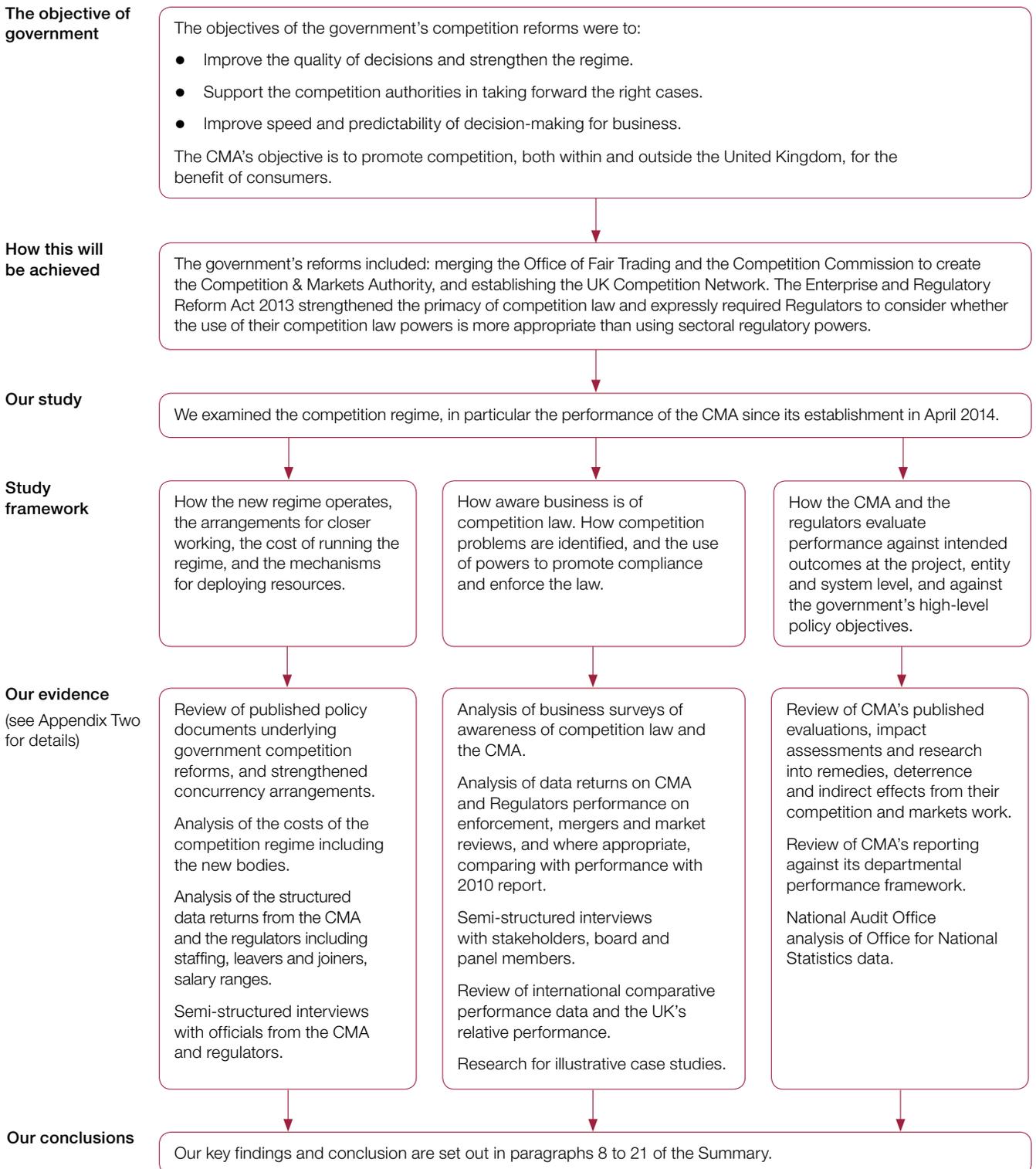
1 This study examined the UK competition regime since our report in 2010 and in the light of the government's reforms to the regime in 2013. We assessed:

- whether the Competition and Markets Authority (CMA) and regulators prioritise their work appropriately to enhance competition and productivity;
- whether the reformed competition regime is using its powers effectively; and
- whether there is an effective system for measuring and evaluating costs and competitive outcomes.

2 **Figure 20** summarises our audit approach. Our evidence base is described in Appendix Two.

Figure 20

Our audit approach



Appendix Two

Our evidence base

Evidence

- 1 We reached independent conclusions for the UK competition reforms after having analysed evidence from our fieldwork carried out between June and September 2015. Our audit approach is described in Appendix One.
- 2 We used several study methods to reach our conclusion on value for money. We analysed data returns provided by the Competition and Markets Authority (CMA) and sector regulators at our request, which corresponded closely with data we required from the competition regime members at the time of our 2010 report *'Review of the UK's Competition Landscape'*. Our study methods are described below.
- 3 We conducted semi-structured interviews with CMA's senior management and with officials at various levels of the organisation, as well as CMA board members (a former Director General for Competition at the European Commission, and a former Chair of the US Federal Trade Commission). We interviewed two CMA panel members (inquiry chairs working on merger and market inquiries across a range of the CMA's competition work).
- 4 We also talked to competition officials from the following regulators:
 - The Civil Aviation Authority;
 - The Financial Conduct Authority;
 - The Payment Systems Regulator;
 - Monitor;
 - The Office of Communications;
 - The Gas and Electricity Markets Authority;
 - The Office of Rail and Road; and
 - The Water Services Regulation Authority.
- 5 We interviewed officials at the Department for Business, Innovation & Skills (BIS), which is responsible for competition policy. We also interviewed officials from HM Treasury, which funds the CMA.

6 We interviewed stakeholders in the competition regime, including:

- businesses;
- business associations (the Federation of Small Businesses and the Confederation of British Industry);
- law firms;
- economic consultancies; and
- consumer representatives such as Which? and the Citizens Advice Bureau.

7 We interviewed officials from the European Commission and the German competition authority (the Bundeskartellamt).

8 We examined the competition regime resources and competition work using the CMA and regulators' data returns which included information about:

- costs of competition work;
- competition staffing;
- competition enforcement cases;
- markets and mergers work;
- appeals; and
- evaluation and prioritisation.

We analysed the data returns and compared them with data in our 2010 report.

9 We observed meetings of the UK Competition Network to understand the mechanism of network collaboration.

10 We reviewed policy documents describing competition reforms and concurrency arrangements, including BIS's impact assessments, and the CMA's evaluations of research into remedies, deterrence and indirect effects.

11 We analysed annual reports of leading European competition authorities, and professional journals such as the Global Competition Review, to provide international comparisons for the UK regime.

12 We conducted desk research to provide evidence for case studies of the CMA's competition work.

13 We reviewed the CMA's reporting against performance framework set by BIS.

14 We used data from the Office for National Statistics to assess the possibility of developing indicators of competition developments.

Appendix Three

Sector regulators and their responsibilities

Figure 21

Sector regulators and their responsibilities

Regulator	Responsibilities	Department(s) overseeing it
The Gas and Electricity Markets Authority (Ofgem)	Regulates the gas and electricity markets. It aims to protect the interests of gas and electricity consumers by monitoring markets to ensure they are working for consumers and regulating network monopoly companies. It also has responsibility for administering the government's social and environmental schemes in energy.	Department of Energy & Climate Change
The Office of Communications (Ofcom)	Regulates a wide range of electronic communications services including TV and radio sectors, fixed-line telecoms, mobile and postal services, as well as the airwaves over which wireless devices operate.	Department for Culture, Media & Sport
The Water Services Regulation Authority (Ofwat)	The economic regulator of the water and sewerage sector in England and Wales.	Department for Environment, Food & Rural Affairs
The Civil Aviation Authority (CAA)	Oversees and regulates all aspects of civil aviation in the UK.	Department for Transport
The Office of Rail and Road (ORR)	The independent safety and economic regulator for Britain's railways and monitor of Highways England.	Department for Transport
Monitor	Assesses NHS trusts for foundation trust status, and licenses foundation trusts and other eligible providers of NHS healthcare services.	Department of Health
The Financial Conduct Authority (FCA)	Responsible for protecting consumers, promoting competition and enhancing confidence in financial services and markets.	HM Treasury
The Payment Systems Regulator (PSR)	Responsible for regulating payment systems; its statutory objectives are promoting competition, innovation and the interests of service-users	HM Treasury

Note

1 The Financial Conduct Authority and the Payment Systems Regulator took on concurrent competition powers on 1 April 2015.

Source: National Audit Office's compilation of data from sector regulators' annual reports and accounts 2014-15 and data return

Total expenditure 2014-15 (£m)	Cost of competition work in 2014-15 (£m)	Total headcount (full-time equivalent)	Competition staffing (full-time equivalent)
87.3	12.1	1,032	170
116.5	15.3	787	132
29.1	0.3	136	5
138.3	0.7	966	8
29.3	0.8	277	10
72.3	3.3	532	35
476.1 (does not include PSR)	3.8	3,000	62
11.5	0.01	48	13

This report has been printed on Evolution Digital Satin and contains material sourced from responsibly managed and sustainable forests certified in accordance with the FSC (Forest Stewardship Council).

The wood pulp is totally recyclable and acid-free. Our printers also have full ISO 14001 environmental accreditation, which ensures that they have effective procedures in place to manage waste and practices that may affect the environment.



National Audit Office

Design and Production by NAO Communications
DP Ref: 10908-001

£10.00

ISBN 978-1-78604-025-1



9 781786 040251
