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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

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ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN THE UNITED KINGDOM

-- From 2005 through June 30, 2006 --

This report is submitted by the Delegation of the United Kingdom to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 18-19 October 2006.

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Executive Summary

1. In the past year, both the Office of Fair Trading (OFT) and the Competition Commission (CC) built on the experience gained operating with their relatively new functions (for example, under the Enterprise Act 2002), and successfully defended challenges of their respective decisions (for example, Genzyme and Somerfield). In addition to case work, both have continued to keep under review their processes and guidance and participated in a number of cross-jurisdictional initiatives.

2. The past year has been one of considerable progress for the OFT. The OFT built on its previous achievements to improve outcomes across the broad spectrum of its activities. The OFT prepared for further change, which included the UK Government's decision to strengthen its consumer role called for by the Hampton Report. This decision to entrust the OFT with new roles in relation to consumer law and trading standards, initially proposed by the Hampton report for a separate entity, ensures the continued integration of consumer and competition policy and enforcement.

3. The UK National Audit Office (NAO) conducted an inquiry into the OFT's competition enforcement work following several years of experience of new legislation. The NAO, which reported its findings in November 2005, recognised the OFT's intellectual leadership and intellectual reputation and the measures the OFT had already taken, or would be taking, in the three areas identified by the NAO: prioritisation and resourcing of case work; transparency and speed of case management; and measurement and communication of achievement.

4. Among the measures already introduced in 2005/06 were:

- the creation of a new Preliminary Investigation Unit to screen and prioritise incoming complaints based on clear, published criteria:
- the appointment of a Senior Director of Case Scrutiny and Policy to ensure that case teams receive first-class legal and economic advice, and to head case review meetings to test the robustness of the OFT's decision-making, and
- a more flexible approach to case management, allowing experienced staff from across the division to be deployed in investigations, while retaining a core of sector specialists.

5. In identifying its priority areas, the OFT takes into account size and importance of markets, size and evidence of consumer detriment, potential impact on markets and where the OFT can provide the most benefit. The OFT's five priority areas for 2005/06 cover:

- credit markets;
- construction and housing markets, including estate agency services;
- healthcare markets:
- interaction between government and markets, for example, through public procurement, regulation and public sector bodies competing with the private sector, and
- mass-marketed scams.

6. The OFT's competition work showed that the UK regime, though relatively young by international standards, was coming of age in terms of its economic impact. Key highlights during 2005/06 include:

- discovery of further evidence of bid-rigging in the construction industry
- action against 50 independent schools whose information-sharing agreement on proposed fee increases involved a distortion of competition
- a Decision that a collective agreement to fix the domestic interchange fee for MasterCard credit and charge card transactions infringed UK and EC competition law and led to higher prices for shoppers
- liaison with professional bodies to end a number of regulations and practices which were incompatible with competition law, and
- consideration of 248 mergers and merger proposals.

7. The OFT also successfully defended an appeal to the Competition Appeal Tribunal (CAT) by pharmaceuticals company Genzyme, and its approach to setting penalties against appeals to the replica football kit decision was largely upheld.

8. Market studies carried out by the OFT highlighted the need for a one-stop-shop for information on care home provision and for reform of the property search market, as well as fulfilling a commitment to look again at the UK grocery market, which was referred to the Competition Commission (CC) for a market investigation.

9. The early achievements of the OFT-led Payment Systems Task Force showed how stakeholder liaison could be as effective as enforcement action in combating consumer detriment. The historic agreement reached with major banks on faster clearing times for internet and telephone payments may, according to independent estimates, benefit the economy to the tune of between £750m and £1,340m over a 10-year period from late 2007.

10. This period was also very busy for the CC in terms of the number of merger investigations referred by the OFT. During 2005/06, the CC received 17 merger inquiries and published 11 reports of its merger investigations. It also successfully contested its first review process on a merger decision before the CAT.

11. The CC completed its first market investigations referred under the Enterprise Act 2002: these were into the market for store cards and into the supply of liquid petroleum gas for domestic use. Provisional findings were published for the Home Credit inquiry and the OFT referred two new market investigations to the CC during the reporting period.

12. The CC continued to review the quality of its merger investigations. It commissioned NERA Economic Consulting to undertake the first in what will be a series of 'analytical procedures reviews' looking at past CC cases to determine whether the analysis could have been improved. The CC also commissioned an analytical procedures review of quantitative techniques used in inquiries and looked at possibilities for streamlining its merger procedures, particularly for less complex cases.

13. The OFT continued to play a leading role in European Community competition and consumer work, and in organisations such as the OECD, UNCTAD and the International Competition Network, where the CC plays a significant role. The OFT and CC continued to play a leading role in European Community competition and consumer work, and in organisations such as the OECD, ICN and UNCTAD, to develop best practice approaches to competition and consumer regulation enforcement and to provide a UK perspective in policy discussions.

14. In September 2005, the OFT organised the first joint European Competition and Consumer Day, as part of the UK's Presidency of the European Union. The event, which was attended by around 350 delegates from 34 countries, emphasised the value of competition and consumer policies working well together to promote choice for consumers and businesses in markets. This theme was explored through sessions on retail financial services and private healthcare markets and the future of competition and consumer policy. The OFT also hosted the annual meeting of the European Competition Authorities in April 2005.

15. As part of our membership of the ICN, the OFT co-chaired (with the Irish Competition Authority) a subgroup developing an analytical framework for the competition assessment of mergers. A preliminary draft of a mergers 'workbook' – providing authorities with step-by-step guidance on determining issues such as market definition and unilateral and coordinated effects – was presented to the ICN's annual conference in Bonn in June 2005. The document was subsequently finalised and presented to the 2006 ICN gathering in South Africa.

16. The CC presented a remedies study to the ICN annual conference in Bonn in June 2005. The CC also contributed to the paper on waivers of confidentiality in merger cases. The study was undertaken jointly with the Irish Competition Authority and provides a practical guide outlining the key principles and range of tools for use in merger remedies.

17. On September 2005, Sir John Vickers stepped down as the OFT's Chairman and Chief Executive after completing his term of appointment. As required by the Enterprise Act 2002, the roles of Chairman and Chief Executive were then split. Philip Collins took over as the OFT Chairman for a four-year term and John Fingleton became Chief Executive for a five-year period.

18. In December 2005, Peter Freeman was appointed Chairman of the Competition Commission. Peter Davis was appointed Deputy Chairman in June 2006 and joined the CC in September 2006.

1. Changes to competition laws and policies, proposed or adopted

1.1 Summary of new legal provisions of competition law and related legislation

19. Although the UK Government made no proposal for new legislation or regulations, it introduced an amendment to Part 9 of the Enterprise Act 2002 in November 2005, which relates to the disclosure of information on specific consumer and competition matters. The amendment will allow information to be more easily released for civil proceedings so as to improve consumer redress and help companies protect their intellectual rights. The changes should be in place by April 2007.

20. The OFT continues to respond to consultations by other government departments as well as providing a wide range of policy advice to individual government departments on competition matters, to ensure that competition and consumer protection issues are properly considered in government policy-making. Examples include the OFT's response to the DTI's Hampton Report consultation; and work with the Office of Government Commerce to examine how public procurement can affect competition and capacity in the municipal waste management sector.

1.2 *Other relevant measures, including new guidelines*

21. To help ensure that the leniency programme functions effectively, the OFT held a conference for competition lawyers in June 2005 to seek their views on its policies. The OFT's leniency programme is essential to detecting cartel activity. Following the conference, the OFT published an interim policy note setting out in some detail how it will deal with applications for leniency and 'no-action' letters, going forward. The guidance covers both the OFT's corporate leniency policy under the Competition Act 1998 (CA98) and criminal immunity policy under the Enterprise Act¹. The OFT will monitor the effectiveness of these procedures before publishing a final note later this year.

22. During the year the OFT consulted on a guideline explaining how it will involve complainants and third parties in CA98 investigations. The final guidance was published in April 2006 and will deliver greater transparency and better information gathering for OFT cases².

23. In November 2005 the OFT announced that, until further notice, confidential guidance on prospective mergers which are not in the public domain would no longer be provided, and that informal advice would be given only in exceptional cases. This OFT Notice on the provision of informal advice and confidential guidance was updated in April 2006. The new guidance will be published, at the latest, by March 2007 following consultation. The consultation is part of a wider revision of the OFT's merger enforcement procedures after three years' experience under the Enterprise Act regime.

24. During the period, the OFT consulted on changes to its published guidance, which clarified the OFT's approach to making market investigation references concerning the effects of government regulation on competition. Revised guidance was published in February 2006³.

25. The OFT provides advice and guidance on the potential competition impacts of proposed legislation as part of its Regulatory Impact Assessment (RIA) work. During 2005-06, the OFT provided advice on 81 RIAs, of which two cases resulted in a change to the proposal or RIA. The OFT also delivered eight educational seminars to regulatory departments. Following an OFT review, work began on changing the 'competition filter' and revising guidance on competition assessments. This work helped raise the quality of competition assessments in RIAs.

2. **Enforcement of competition laws and policies**

2.1 *Action against anticompetitive practices, including agreements and abuses of dominant positions*

2.1.1 *Summary of activities*

26. In 2005-06, using powers under the CA98 and/or powers under Articles 81 and 82 of the EC Treaty, the OFT opened 1,195 cases, of which 23 involved possible cartel activity. Formal investigations were launched into 18 cases where the OFT had reasonable grounds to suspect an infringement had occurred; seven of these were potential cartel cases. The OFT issued six formal decisions during the reporting period and one interim measures direction.

¹ Leniency and no-action: OFT's interim note on the handling of applications: <http://www.offt.gov.uk/NR/rdonlyres/FE4F98BF-D8C5-48FB-9F7E-D6133F907538/0/oft803.pdf>

² Guidance on Involving third parties in Competition Act investigations: <http://www.offt.gov.uk/NR/rdonlyres/DB4B3133-72A5-4158-84E0-A5899704A9F2/0/oft451.pdf>

³ Guidance on Market Investigation References: <http://www.offt.gov.uk/NR/rdonlyres/57C2BA34-81E8-4560-93CC-4BC4BBFC6DAF/0/oft511.pdf>

27. The OFT conducted 92 on-site inspections in seven cases. Of these, 34 were under section 27 of the CA98 (under which the OFT has the power to enter premises without a warrant and require the production of documents) and 58 were under section 28 (under which the OFT has the power to enter and search business premises under a warrant from the High Court or the Court of Session in Scotland).

28. Under the OFT's leniency programme, fines can be reduced for businesses which 'blow the whistle' on cartels, and, if certain conditions are satisfied, give total immunity to the first to come forward. In 2005-06, the OFT entered into conditional leniency agreements with 22 undertakings in nine cases, and imposed fines totalling £4,696,305, reduced to £1,864,305 after leniency. The OFT closed two cases after securing changes in behaviour from the businesses involved, and published summaries of these cases on the OFT website.

2.1.2 Summary of Key Cases

Mastercard

29. On 6 September 2005, the OFT issued an infringement Decision under Article 81 of the EC Treaty and the Chapter I prohibition of the CA98 against the rule of MasterCard UK Members Forum Limited (MMF) which set the 'multilateral interchange fee' (MIF) paid on purchases in the UK made using UK-issued MasterCard consumer credit and charge cards between 1 March 2000 and 18 November 2004. The MMF rule was rescinded on 18 November 2004 and new arrangements for setting UK domestic MIFs were put in place by MasterCard.

30. On 19 October 2005, the OFT issued a Statement of Objections against Visa, proposing to find that Visa interchange fee arrangements between members infringed the prohibition in Article 81, EC and the Chapter 1 prohibition. This followed the same principles as those set out in the MasterCard Decision.

31. Appeals against the OFT's Decision were lodged with the CAT by MMF, MasterCard International/MasterCard Europe and the Royal Bank of Scotland Group. Visa and the British Retail Consortium were given the right to intervene in the appeal proceedings. The OFT's Defence was filed on 28 February 2006.

32. In February 2006, the OFT launched an investigation into MasterCard's new arrangements for setting the MIFs that apply to UK domestic transactions made using UK-issued MasterCard consumer and commercial credit and charge cards, introduced by MasterCard on 18 November 2004.

33. The MasterCard decision was set aside by the CAT on 19 June 2006 and the appeal proceedings came to a close. The Visa Statement of Objections was also withdrawn on 19 June 2006. The OFT concluded that it was far better to look at MasterCard's and Visa's arrangements at the same time, and in the wider context of UK interchange fees on payment cards as a whole. The OFT is currently carrying out simultaneous investigations with a view to issuing Statements of Objections (if appropriate) in respect of MasterCard's and Visa's current arrangements.

Construction cartels

34. Bid-rigging in the construction sector – one of the OFT's priority areas – continued to be the focus of the OFT's cartel investigations work. During 2005, the OFT unearthed evidence of anti-competitive practices in over 1,000 contracts with a combined value of £500m.

35. In July 2005, the OFT found that six roofing contractors had engaged in collusive tendering to fix the prices of roofing services in western and central Scotland, in breach of the Chapter I prohibition of the CA98. The parties were fined almost £260,000 in total, reduced to around £138,000 by leniency.

36. In February 2006, the OFT imposed fines on 13 roofing contractors who had been involved in a series of separate price-fixing arrangements in tendering for contracts in London and the south east, the Midlands, Doncaster, Edinburgh and Glasgow between 2000 and 2002. One of the firms paid compensation to rival contractors of between £15,000 and £50,000 for backing off a contract or providing a cover bid which they knew would be higher than its own tender. Most of the rigged contracts involved the installation of mastic asphalt for flat roofs or car parks. The contractors were fined a total of around £2.3 million, reduced to around £1.6 million by leniency.

From the five separate investigations into bid-rigging in the construction industry between March 2002 and February 2006, and assuming a 10 per cent price increase (consistent with a conservative analysis of known side-payments) and a five-year future duration, the OFT estimates that its timely action averted at least £20 million of consumer detriment. The total turnover of the infringing firms in the relevant market was £45 million.

Stock check pads

37. The OFT imposed financial penalties on a number of companies that had agreed to fix the prices of, and share the market for, the supply of stock check pads in the UK. Stock check pads are paper notepads with tear-off sheets that are used by staff in restaurants and similar establishments to record customers' orders.

38. The OFT found that Bemrose Group Ltd and BemroseBooth Ltd and Achilles Paper Group Ltd had agreed the prices at which they would sell check pads to their customers and also agreed not to try and win business from each other's customers.

39. Bemrose Group Ltd and BemroseBooth Ltd were together fined £1,888,600 (reduced to £nil by leniency), Achilles Paper Group Ltd was fined £255,697.50 (reduced to £127,848.75 by leniency), and 4imprint Group PLC (which owned the Bemrose business for a short period at the beginning of the infringement) was fined £40,470.

Independent Schools

40. Following one of the largest inquiries ever conducted, the OFT provisionally concluded in November 2005 that an agreement between 50 fee-paying independent schools to exchange detailed information about the fees they intended to charge was in breach of competition law.

41. During the 2001–02, 2002–03 and 2003–04 academic years, the schools, all of which are registered charities, exchanged information on intended fee increases and fee levels for boarding and day pupils through a survey known as the 'Sevenoaks Survey'. This information was updated and circulated between four and six times a year as schools developed their fee increase proposals as part of their annual budgetary processes.

42. In order to arrive at an effective conclusion of the case, the OFT worked with a steering group of the Independent Schools Council (which included senior governors nominated by the schools) on a proposed settlement which was put to the schools in February 2006.

43. Under this proposal, which has now been accepted by all 50 schools, the schools will make an *ex gratia* payment totalling £3 million into a charitable trust fund to benefit the pupils who attended the schools during the academic years to which the Sevenoaks Survey related. In addition, each of the schools will pay a nominal penalty of £10,000.

Associated Newspapers

44. In February 2006, Associated Newspapers Ltd (ANL) agreed to give up exclusive distribution rights at London underground and overground stations, to clear the way for a potential new afternoon or evening newspaper to be distributed to commuters.

45. Following an OFT investigation, ANL, which publishes the free morning paper *Metro* and the *Evening Standard*, gave a binding commitment to offer to give up its exclusive afternoon and evening distribution slots with London Underground and Network Rail and to waive its exclusive rights with train operating companies. ANL will also offer to allow third parties, which are awarded such slots, access to its distribution racks and give them reasonable space and prominence for their branding.

46. As a result of ANL's commitments, which took effect from March 2006, the OFT closed the case.

London Metal Exchange

47. The OFT took urgent action in February 2006 to prevent the London Metal Exchange (LME) from restricting competition by extending the hours of trading on its electronic trading platform, LME Select. This took the form of an 'interim measures direction' – the first issued by the OFT under section 35 of the CA98⁴.

48. In May 2006, following a period of continued investigation and the receipt of substantial and material new evidence, the OFT withdrew the interim measures direction. The OFT no longer considered it necessary to act urgently to protect the public interest or to prevent serious and irreparable harm to Spectron Group plc. The OFT continues to investigate the suspected abuse of a dominant position by LME.

2.2.3 CAT appeals (against CA98 decisions)

49. A crucial part of the OFT's enforcement work involves responding to appeals against its decisions. These appeals are heard by the CAT, the independent judicial body, which can confirm, set aside or vary an OFT decision, remit the matter to the OFT or make any other decision the OFT could have made.

Genzyme

50. In September 2005, the pharmaceuticals company Genzyme was ordered by the CAT to supply its drug Cerezyme to bona fide homecare service providers at a discount, to end a margin squeeze identified by the OFT.

51. The CAT had earlier upheld the OFT's decision that the company had abused a dominant position by charging independent homecare service providers a price for the drug which allowed them no possible margin. This infringed the Chapter II prohibition of the CA98.

52. Under this second ruling, Genzyme must supply Cerezyme, which is used to treat a rare inherited disorder called Gaucher disease, to any bona fide homecare service provider at a drug-only price that is discounted by not less than 20p per unit from the NHS list price prevailing for such drugs from time to

⁴ The OFT can issue a direction where an undertaking is already being investigated under the Competition Act, and it considers urgent action is needed either to protect the public interest or prevent serious, irreparable damage to a particular person or category of persons.

time. If requested, Genzyme must provide the OFT with information so that, among other matters, it can monitor its compliance and assess the effectiveness of the order in removing the competition problem.

Argos and Littlewoods

53. The record penalties imposed by the OFT on Argos and Littlewoods for entering into unlawful agreements to fix the price of Hasbro toys and games were the subject of a CAT judgement in April 2005. Having previously upheld the OFT's infringement decision, the tribunal reduced the penalty for Argos from £17.28 million to £15 million, and for Littlewoods from £5.37 million to £4.5 million. In the CAT's opinion, these were the lowest fines that could be reasonably justified, given the gravity of the case and the need for deterrence.

54. Both Argos and Littlewoods sought permission to appeal to the Court of Appeal on legal points relating to the CAT's liability and penalty judgments. This request was refused by the CAT but subsequently granted by the Court of Appeal. The new appeal, to which the OFT will respond, was joined with that of JJB Sports (see under 'Replica Football kit' below) and was heard in May 2006.

Replica Football Kit

55. In a ruling in May 2005, the CAT largely upheld the OFT's approach to setting penalties for four of the 10 parties in its replica football kit price-fixing Decision of August 2003. However, on a limited number of points relating to the price-fixing agreements, the CAT took a different view on the appropriate level of penalty and consequently reduced the fines for three appellants and, for the first time, increased a penalty set by the OFT.

56. The OFT decided that the companies had entered into a series of agreements to fix the price of certain replica kit manufactured under licence by Umbro, including England and Manchester United shirts. The four parties, Allsports, JJB Sports, Manchester United and Umbro, had challenged the level of the fine imposed on them by the OFT. The CAT reduced JJB Sports' fine from £8.373 million to £6.3 million, Manchester United's fine from £1.652 million to £1.5 million and Umbro's fine from £6.641 million to £5.3 million. The fine for Allsports was increased from £1.35 million to £1.42 million.

57. The CAT had earlier rejected an appeal from JJB Sports and Allsports to set aside the OFT's infringement decision.

58. JJB Sports was refused permission by the CAT to appeal both the liability and penalty judgements. However, the Court of Appeal granted permission to appeal, and considered both the JJB Sports and Argos and Littlewoods appeals at a hearing in May 2006.

Attheraces

59. In August 2005, the CAT set aside the OFT's decision that 49 racecourses had acted unlawfully by collectively selling certain media rights to the broadcasting venture, Attheraces. This was the first time the CAT had overturned one of the OFT's infringement decisions.

60. The OFT's decision was appealed by the Racecourse Association, acting for itself and for the owners of 29 racecourses, and the British Horseracing Board. They argued inter alia that the collective sale of rights was necessary for the launch of interactive betting services on digital television and the internet, as it would be commercially unrealistic to expect bidders for the rights to conduct separate negotiations with up to 37 different racecourse owners.

61. The CAT accepted this argument and also stated that the OFT's market definition was flawed and that it had failed to prove there was an anti-competitive effect on the market. The CAT therefore ruled that the racecourses in question had not infringed the Chapter I prohibition of the CA98.

JJ Burgess & Sons

62. In July 2005, the CAT set aside the OFT's decision that the Hertfordshire-based funeral directors, W Austin & Sons Ltd, had not acted unlawfully in refusing to allow another firm of funeral directors, JJ Burgess & Sons Ltd, use of the Harwood Park crematorium in Stevenage, which it owns.

63. The CAT ruled that W Austin had a dominant position in the Stevenage/Knebworth area in the supply of both crematoria and funeral directing services and that its refusal to allow Burgess access to Harwood Park constituted an abuse of either or both of these within the meaning of the Chapter II prohibition of the CA98.

Double Quick Supplyline

64. The OFT consented to a reduction in the penalty imposed on Double Quick Supplyline Ltd (DQS) for price-fixing and/or maintaining minimum resale prices in the supply of desiccant, a chemical used in the manufacture of double-glazing. This followed an appeal by the company to the CAT.

65. In November 2004, the OFT decided that DQS, along with four other companies, had infringed the Chapter I prohibition over a period from March 2000 to at least March 2003. The OFT conceded that the penalty should be reduced after it came to light that DQS became responsible for the undertaking involved in the infringement only in June 2001.

66. Given the specific circumstances of the case and in particular the nature of the evidence, the OFT consented to a reduction in DQS's penalty to £36,210. This final figure reflected the OFT's view that DQS was involved in the infringement between January 2002 and March 2003, and a reduction in the starting point percentage used to calculate the penalty.

2.2 Mergers and Acquisitions

67. Under the Enterprise Act, the vast majority of UK merger decisions are taken by the OFT and the CC as specialist, independent competition authorities. The OFT investigates completed and anticipated mergers above a certain size to assess their anticompetitive effects. The OFT refers mergers to the CC, or accepts undertakings instead of a reference, where it believes they might result in a substantial lessening of competition.

68. A merger qualifies for investigation if the UK turnover of the business being acquired is over £70 million, or if the merger will create or enhance a 25 per cent share of supply of a particular product or service in the UK, or a substantial part of the UK.

2.2.1 Statistics

69. In 2005-06, the OFT examined 248 mergers and merger proposals. Of these 36 raised more complex competition issues and were considered at a case review meeting – an internal forum for rigorously testing the OFT's internal view before a decision is made.

70. In 2005/06, OFT referred 17 merger inquiries to the CC and accepted undertakings in lieu of reference in four cases. The CC completed and published reports on 11 merger inquiries. The markets

investigated included electronic document interchange, bus and train routes, groceries, road sweeping equipment, salt products, cinemas and the London Stock Exchange.

2.2.2 *Summary of key cases*

Boots – Alliance UniChem

71. The OFT decided it would not refer the anticipated acquisition by Boots plc of Alliance UniChem plc (UniChem) to the CC provided that satisfactory undertakings were given to address its competition concerns. Boots has 1,423 stores across the UK, of which 1,350 contain a pharmacy. UniChem is a pharmaceutical wholesaler which also owns a chain of 958 UK pharmacies (trading under the name of Moss but to be rebranded Alliance Pharmacy).

72. While both companies provide retail pharmacy services, the acquisition raised no competition concerns at a national level. However, the OFT identified about 100 local areas where competition would either be reduced or eliminated altogether as a result of the merger.

73. Boots offered to divest stores in all of these areas, and in February 2006 the OFT decided to consider these undertakings in lieu of a CC reference. The OFT's decision was appealed to the CAT by the pharmaceutical wholesaler and pharmacy retailer, Celesio AG. The appeal was dismissed on 9 May 2006.

74. As a postscript to this decision, the OFT iterated its call for a review of government regulations which restrict entry into the retail pharmacy sector. As well as harming competition generally, these regulations could prevent the cost savings arising from a Boots-UniChem merger from being passed on to consumers in the form of enhanced services.

Cinema chain mergers

75. Three mergers of major cinema chains in the UK came under OFT scrutiny during this period. In two cases, the OFT accepted divestment undertakings in lieu of a reference to the CC, while a third was referred to the CC after undertakings offered by the parties failed to address the OFT's concerns.

76. The OFT found that the completed acquisition by Terra Firma Investments (GP) 2 Ltd, which owns the Odeon cinema chain, of United Cinemas International (UK) Ltd and Cinema International Corporation (UK) Ltd might be expected to lessen competition substantially, to the detriment of cinema-goers, in 11 local areas where both UCI and Odeon operated.

77. Terra Firma offered to divest a cinema in each of these areas to address the OFT's concerns. The OFT accepted this undertaking in May 2005 and did not refer the merger to the CC.

78. The OFT also accepted a divestment undertaking from Blackstone Group and its UK subsidiary Cineworld UK Ltd following the completed acquisition of the UGC cinema chain. The OFT's assessment identified six areas where Cineworld and UGC cinemas competed. Blackstone offered to divest cinemas in these areas and, in June 2005, the OFT announced that the merger would not be referred to the CC.

79. The OFT's review of the completed acquisition by Vue Entertainment of A3 Cinema Ltd raised concerns about a loss of competition in the Basingstoke and Romford areas. Undertakings offered by the parties did not fully address these, and the merger was referred to the CC in September 2005.

William Hill – Stanley/Hilton – Jack Brown

80. Two separate mergers of licensed betting office (LBO) owners raised competition concerns at a local level, but were not referred to the CC after satisfactory divestment undertakings were given.

81. The OFT found that customers tend to place bets at betting shops within walking distance of their home or work. For this reason, both William Hill plc's completed acquisition of the LBO business of Stanley plc and Hilton plc's completed acquisition – through its Ladbroke subsidiary – of Jack Brown (Bookmaker) Ltd reduced or eliminated choice in certain local areas.

82. William Hill, which owns 1,613 LBOs in the UK, acquired Stanley's 561 LBOs in June 2005. The following month, Jack Brown's 141 LBOs, which are mostly in South Wales, were taken over by the 1,973-strong Ladbroke chain. The OFT's investigation found that the William Hill acquisition raised competition concerns in around 80 local areas and the Ladbroke acquisition in four.

83. To address these, William Hill and Hilton offered to divest LBOs in each of these areas. Both undertakings were accepted by the OFT instead of a CC reference in February 2006.

Heinz – HP Foods Group

84. In October 2005, the OFT decided that the completed acquisition by H J Heinz Company (Heinz) of the HP Foods Group raised the prospect of a substantial lessening of competition in the supply of branded sauces, baked beans and tinned pasta, and should be investigated further by the CC.

85. Heinz is a US-based company with global operations in the branded foods sector. Its UK activities include the manufacture and marketing of sauces – including Heinz tomato ketchup – along with condiments, frozen foods, soups, beans and pasta, infant foods and seafood. Prior to the merger, the HP Foods Group was owned by Danone, a French company. In the UK, it was mainly involved in the manufacture and marketing of sauces – including HP brown sauce – plus condiments, herbs, spices and seasonings, food oils and dry side dishes.

86. The acquisition reduced the number of suppliers of branded ketchup to retail customers from two to one, and brought together the two leading suppliers of branded barbecue sauces to retail customers and the two biggest brands of tinned baked beans and pasta products. In each of these product categories, the OFT concluded that the merger might lead to a substantial lessening of competition, resulting in higher prices for consumers.

87. The CC ruled that the merger had not resulted, and might not be expected to result, in a substantial lessening of competition in any of the relevant markets.

HMV – Ottakar's

88. In September 2005, HMV Group plc announced its intention to make a public offer through its bookselling subsidiary Waterstone's plc for Ottakar's plc, a rival book chain. In assessing the anticipated merger, the OFT received an unusually large number of complaints from consumers. These lent weight to its view that the parties were close competitors and competed at a local level by stocking a large range of books, by developing a brand for being an 'authority' in books, and through pre-sales service. Moreover, the OFT's analysis showed that branches of Ottakar's went to extra lengths to serve their customers in areas where a Waterstone's was nearby. The OFT concluded that UK book buyers valued this competition, which HMV's acquisition of Ottakar's would eliminate.

89. However, the OFT found no evidence to support the publishers' arguments that the parties would hold significant buyer power, or that the merger might be expected to lead to a reduction in the number of titles published.

90. The OFT did not believe that the loss of close competition would be offset by constraints posed by other book retailers, either now or in the future. HMV's offer of undertakings was not sufficient to address all of the competition concerns identified. The OFT therefore referred the merger to the CC for further investigation in December 2005.

Rail franchise applications

91. The Railways Act 1993 provides for the award of a rail franchise to be treated as a merger under competition legislation, and, as such, subject to competition scrutiny. As a result, the OFT considered a number of bids for rail franchises during the year.

92. In August 2005, the OFT referred the anticipated acquisition by National Express Group plc (NEG) of the Thameslink and Great Northern (TGN) franchise to the CC. The OFT was concerned that if NEG, which already operated the Gatwick Express franchise, were successful, an important competitive constraint might be lost. NEG would control two of the three rail services operating between central London and Gatwick, accounting for almost 90 per cent of passenger volumes on this flow.

93. The OFT thought the CC should examine further whether the merger might lessen competition to the detriment of passengers. The CC subsequently concluded that NEG would be unlikely to raise fares or reduce services on these routes if awarded the franchise, and cleared the acquisition.

94. In September 2005, the OFT also referred bids for the Greater Western Rail franchise (GWF) from NEG, FirstGroup plc (First) and Stagecoach plc (Stagecoach) to the CC.

95. Passengers in the GWF region, which covers the south west of England and parts of Wales, can often choose between a GWF rail service and either a First or Stagecoach bus service or an NEG coach service. On many routes there are no other public transport options; so if any of the bidders were awarded the franchise, an element of competition could be lost.

96. Each of the bidders for the GWF had different road networks which raised different competition issues. However, in relation to each bid the OFT concluded it was not possible at the OFT stage of a merger review to determine if competition would be lessened to the detriment of passengers. The OFT therefore asked the CC to conduct a more detailed assessment.

97. During the course of its analysis the CC considered point-to-point journeys (flows) within the GWF area as relevant markets while also having regard to wider network markets. The CC considered the extent of the overlaps between the GWF and FirstGroup's bus services with the assistance of financial modelling of the effect of the merger on the incentive to increase bus fares or reduce bus frequencies on the overlapping flows. The CC also assessed the extent of competition and the effects of the merger on each of the main overlap flows.

98. The CC found that on most of the flows, bus and rail services had different characteristics and met different passenger needs. The CC cleared the acquisition of the GWF franchise by First in March 2006.

Exeter and Devon Airport – Macquarie Airports and Ferrovial Aeropuertos

99. In June 2005, Macquarie Airports Ltd (MAG), a global private equity fund, and Ferrovial Aeropuertos SA (FASA), part of a major Spanish construction firm, announced a joint bid to acquire a majority stake in Exeter and Devon Airport Ltd (EDAL), owned by Devon County Council. MAG and FASA already controlled Bristol International Airport on a 50/50 basis, and had interests in a number of other airports internationally.

100. The transaction was referred from the European Commission to the UK following a request by the OFT under Article 9 of the EC Merger Regulation (ECMR).

101. The OFT considered the impact of lost competition between Exeter and Bristol international airports, in light of concerns from low-cost and charter airline users. In October 2005, the OFT concluded that the risks to customers and consumers in the South West were sufficient to warrant a reference to the CC. The proposed acquisition was subsequently abandoned.

Somerfield plc and Wm Morrison Supermarkets plc

102. In March 2004, Somerfield plc (Somerfield) acquired 115 grocery stores and other assets from Wm Morrison Supermarkets plc (Morrison's). The merger was referred to the CC by the OFT as a completed transaction.

103. Somerfield was the fifth-largest operator in the national retail grocery market with a share of grocery sales of just under six per cent. The CC had no concerns about the merger at the national level and focussed its competitive assessment on the diverse characteristics of mid range stores and the local markets they served.

104. The analysis was undertaken in two stages: first the CC identified the relevant product market and secondly, it measured the extent of rivalry between the acquired stores under previous ownership and stores already operated by Somerfield in the same local market. Among other methods of analysis used, the CC commissioned a consumer survey of 56 of the acquired stores to estimate the 'diversion' ratio between the stores - that is, the proportion of revenue from customers who would choose another Somerfield store as their alternative in preference to other local stores.

105. The CC concluded that Somerfield should be required to divest 12 stores to a suitable purchaser able to maintain and develop the divested stores as a viable and active competitor in the relevant local market.

106. On 29 September 2005, Somerfield applied to the CAT for an order quashing those parts of the report that dealt with divestment. In a judgement given on 13 February 2006, the CAT dismissed the application and undertakings were subsequently agreed with Somerfield on 9 March 2006.

Deutsche Börse AG and Euronext NV and London Stock Exchange plc

107. The OFT referred the rival bids for the London Stock Exchange plc (LSE) made by the Deutsche Börse AG (DBAG) and Euronext N.V. (Euronext).

108. The CC identified that in terms of trading services, the product market was the provision of on-book equities trading services. The geographic market was defined to include all exchanges placing a competitive constraint on the pricing and behaviour of LSE in the UK through the threat of head-to-head competition, including those of Europe and the USA, in addition to those exchanges competing head to head with LSE for UK trading of equities.

109. The CC found that neither of the proposed mergers would give rise to a substantial lessening of competition within the market for on-book equities trading services within the UK, by virtue of the removal of the constraint currently imposed on LSE by DBAG or Euronext alone. The CC found however a substantial lessening of competition in both proposed mergers due to the ability and incentive to foreclose entry or expansion to other providers of trading services.

110. The CC concluded that both DBAG and Euronext should be asked to agree undertakings concerning the provision of clearing services prior to any acquisition of LSE by either party.

British Salt Ltd and New Cheshire Salt Works

111. In May 2005, the OFT referred to the CC the completed acquisition of New Cheshire Salt Works Ltd (NCSW) by British Salt Ltd (British Salt), two of the three UK vacuum salt producers.

112. The CC identified the relevant market as the supply of PDV and compacted salt. The geographic market was no wider than the UK and the Republic of Ireland. The CC concluded that although the merger would create a more highly concentrated market, it did not consider this situation would lead to a substantial lessening of competition due to the limited period in which NCSW was likely to remain a competitor had the merger not taken place. The CC cleared the acquisition.

2.2.3 *EC Merger Regulation and Casework*

113. The EC Merger Regulation (ECMR) gives the European Commission exclusive jurisdiction over mergers that exceed certain turnover thresholds. As the competent authority in the UK, the OFT examined significant cases and provided the UK's views to the European Commission. The OFT also represented the UK at all hearings and Advisory Committee meetings at which the Commission's draft decisions and policy notices were considered by member states.

114. The OFT made one request under Article 9 of the ECMR to refer to the UK competition authorities a merger previously notified to the European Commission. This related to the proposed acquisition by Macquarie Airports Ltd and Ferrovial Aeropuertos SA of a majority stake in Exeter and Devon Airport Ltd (see case summary under (b) above).

115. The OFT referred to the European Commission under Article 22 the anticipated acquisition by the Dow Chemical Company of the divinylbenzene business of Total Petrochemicals France SA.

116. The OFT considered a number of requests for pre-notification referral of a merger either from the UK to the European Commission (under Article 4(5)) or from the European Commission to the UK (under Article 4(4)). The OFT agreed to the referral to the UK under Article 4(4) of the following cases:

- the anticipated acquisition by Boots plc of Alliance UniChem plc (see case summary under (b) above).
- the completed acquisition by Southern Cross Healthcare Group Ltd of Cannon Capital Ventures Ltd, concerning the supply of care home services to the elderly, and
- the anticipated acquisition by London and South Eastern Railway of the Integrated Kent rail franchise, concerning passenger rail services.

3. Summaries of or references to new reports and studies on competition policy issues

3.1 *OFT Market Studies*⁵

117. The OFT proactively studies markets to see whether they are working well and refers markets to the CC for further investigation where appropriate⁶.

3.1.1 *Published Market Studies*

- **Care homes** – in May 2005, the OFT's 10-month study of the market, launched in response to a super-complaint from *Which?*, concluded that a one-stop-shop for information is needed to help older people choose the right home. There should also be better access to complaints procedures, greater price transparency and fairer contract terms for care home residents. In August 2005, the Government announced that it broadly accepted the OFT's recommended solutions to the problems identified. The £8 billion care home market forms an important part of the healthcare sector, which is one of the OFT's priority areas.
- **Property searches** – in September 2005, the OFT concluded that property information held by local authorities in England and Wales should be made more readily available to homebuyers, sellers and their agents. The OFT found that the price of property searches provided by local authorities varied greatly and that some consumers were probably paying too much.
- To improve competition and choice, the OFT called for local authorities to make their property information available on terms which do not disadvantage rival providers, and to agree revised targets to ensure that information is provided quickly. The OFT's report also recommended action to liberalise the electronic provision of property searches compiled by local authorities in England and Wales, and to improve consumer awareness and understanding of the market. The Government accepted all of the report's recommendations in December 2005.
- **Public subsidies (phase II)** – in January 2006, the OFT published its recommendations for guidance that assists providers of subsidies to assess the potential effects of these on competition. A key finding of the study noted that the failure to assess fully the competition risk posed by certain public subsidies means that their true cost to the economy is not being recognised. (This study was undertaken on behalf of the OFT by NERA Economic Consulting as part of an ongoing examination of the government interaction with markets - one of the OFT's priority areas.)

The report sets out a practical framework by which UK government departments and agencies can identify the costs and benefits of a proposed subsidy, including its potential impact on competition. The OFT has recommended that this be used alongside the UK's Treasury's guidance on subsidy appraisals, the Green Book.

⁵ Index of OFT market studies: <http://www.offt.gov.uk/Business/Market+studies/cases.htm>

⁶ OFT guidance on approach to selecting and conducting market: <http://www.offt.gov.uk/NR/rdonlyres/03AD31EC-3533-40BE-AE79-2A83424E9C9B/0/OFT519.pdf>

This work builds on the OFT's previous work on public subsidies, which includes an earlier market study that examined how subsidies could affect competition, case studies of six subsidies, and the OFT's recommendations for changes to state aid control at a European Union level. Proposals presented to the European Commission include a two-stage assessment process which examines the characteristics of the subsidies and the markets involved. The OFT also recommended a formal advisory role for national competition authorities in helping the Commission decide whether or not to approve state aid.

- **Liability insurance follow-up** - in a follow-up to the OFT's 2003 study of UK liability insurance markets, the OFT found that the situation for policyholders had improved, with premiums rising at a much slower rate and fewer businesses being denied cover. Furthermore, the availability of cover had risen: in the case of employer's liability insurance, the number of businesses denied cover fell by two-thirds to three per cent.

3.1.2 *Ongoing Market Studies*

- **Pharmaceutical Price Regulation Scheme** - the method by which government seeks to control the price of drugs supplied to the NHS is the subject of a market study launched in September 2005. The Pharmaceutical Price Regulation Scheme (PPRS) sets a range of price controls and a cap (and floor) on the profits that drug companies can earn on their annual sales of branded medicine to General Practitioners and hospitals. It is a voluntary scheme negotiated every five years between the UK Department of Health and the Association of the British Pharmaceutical Industry. The current scheme runs from 2005 to 2010.

The OFT is examining whether the PPRS meets its stated aims, which are to secure the provision of safe and effective medicines at a reasonable price, to offer pharmaceutical companies appropriate rewards for investing in new and improved drugs, and to encourage competition in the market. The OFT has benefited from positive cooperation from the Government and industry, and announced in March 2006 that it would continue with the study, with a final report due in 2007.

- **Commercial use of public sector information** - in July 2005, the OFT launched a study into the commercial use of information supplied by public sector information holders (PSIHs). Examples of PSIHs include HM Land Registry, which maintains a database of 20 million properties in England and Wales, and the UK Hydrographic Office, which holds information relating to marine navigation. While a lot of public information is made freely available, some PSIHs compete with private sector companies in the sale of value added information products, while at the same time supplying and charging for the underlying raw data on a monopoly basis. In 2003–04, the combined turnover of the larger PSIHs was estimated at around £1 billion. The study will examine if these supply arrangements work well for businesses and, ultimately, for consumers.

3.1.3 *Progress on earlier market studies*

- **Private dentistry** - In October 2005, the Department of Trade and Industry announced the completion of key actions in a government action plan issued in response to the OFT's 2003 report on private dentistry. Among the steps taken, the General Dental Council (GDC) issued new ethical guidance requiring dentists to take steps to ensure patients can make an informed choice, and made advanced preparations for the introduction of a private patient complaints scheme. In addition, the Department of Health changed its regulations to allow

the GDC to introduce a new fitness-to-practise regime, and removed unnecessary restrictions on the supply of dentistry services.

- **Taxis** - in August 2005, the Department for Transport published draft best practice guidance on the setting of **quality standards for taxis and private hire vehicles. This was one of the recommendations of OFT's November 2003 report on taxi services, and will help ensure that this essential protection is applied proportionately and consistently across the country.**
- **Consumer IT – the OFT published guidance on selling IT goods and services at a distance (for example, on the internet or by telephone) and how to make IT contracts fairer for consumers generally.** This reflects changes to the distance selling laws in April 2005 and follows a recommendation in OFT's consumer IT report published in December 2002.

3.1.4 *Market investigation references to the CC*

118. Under the Enterprise Act, the OFT has the power to refer a market to the CC for further investigation where it believes there are reasonable grounds to suspect that a feature, or combination of features, of the market is or are preventing, restricting, or distorting competition. It is for the CC to decide if this is the case, and, if so, whether action should be taken.

119. If it makes an adverse finding, the CC has the duty to consider appropriate remedial action and has the power to impose remedies. When deciding upon the remedy, it may take into account the impact of the remedy on relevant customer benefits. As well as the ability to impose structural (including divestment) remedies, the CC may make recommendations to others of action they should take. The CC must complete their investigations within two years. The UK government has committed itself to respond to any such recommendations made to it within 90 days.

120. During this period, the OFT referred two markets to the CC: the market for classified directory advertising services and the market for personal current account banking services in Northern Ireland. A third investigation into the groceries market was referred in May 2006. The CC will now undertake a thorough investigation of these markets and, if necessary, decide on any appropriate remedies.

121. Summaries of market investigation references made to the CC:

- **Classified Directory Advertising Services (CDAS)** – following a seven-month study, the OFT referred this market to the CC in April 2005. The CC published the provisional findings for the CDAS inquiry in June 2006. The CC identified that advertising in local newspapers was significantly different from that in directories, particularly in terms of its temporary nature, and is not viewed by most advertisers as a substitute. Smaller local classified directories were also not considered by many advertisers as a real alternative.

The CC provisionally found that Yell could set prices to advertisers above competitive levels, with a market share of around 75 per cent, five times that of its nearest competitor. Furthermore, the CC found that a network effect strengthened the position of the existing providers and operated as a barrier to entry.

The CC is now consulting on remedies and expects discussions to focus on the level and scope of possible price controls. The final report is expected in November 2006

- **Northern Ireland personal current account banking** - following the OFT's analysis of a super-complaint from *Which?*, the OFT referred the market for personal current account

banking services in Northern Ireland to the CC in May 2005. The CC published its emerging thinking on the inquiry in April 2006 which found that competition in the provision of personal current accounts in Northern Ireland could be improved. It appeared that charges were higher and may be expected to be applied in a wider range of circumstances, and credit interest rates may be lower, than might be expected in a competitive market. The provisional findings are expected to be published in [October] 2006.

- **Grocery retailing** - OFT referred the market for groceries to the CC in May 2006. The decision came after a period of public consultation, which followed the OFT's earlier proposal to refer the grocery market to the CC in March 2006. The CC published the issues statement for the inquiry in June 2006. The CC has been asked to look at a wide range of goods and services including food, drinks, petrol, clothing, perfumes, and gardening equipment. Issues that the CC will consider include the behaviour of grocery retailers towards their suppliers, the structure of any local market for groceries, and the operation of the planning regime as it affects grocery retailing including acquisition, disposal, development and use of land, supply chain issues, and the operation of the financial services. The CC plans to publish the emerging thinking in December 2006 and the provisional findings for the investigation in April 2007
- **Store Cards** – the investigation concerned plastic cards used for payment or credit, useable only in the issuing retailers' stores and providing associated retail benefits. It involved some 70 retailers operating store card services and six main store credit providers.

The CC concluded its investigation in March 2006. Two markets were identified: an 'upstream' market for the supply of store card credit services by financial companies to retailers and of related services including insurance; and a 'downstream' market for the supply of consumer credit through store cards and of associated insurance.

The CC found that weak competitive pressure on store card APRs and store card insurance premiums allowed credit providers and retailers to keep these at levels higher than were justified by costs. Consumers therefore paid at least £55 million a year more than they should. The CC's remedies aimed to generate competitive pressures on the setting of APR levels and the choice of insurance cover. The remedies will be put in place by an Order, the provisions of which were published in July 2006 and which will come into force in early 2007.

- **Liquid Petroleum Gas** – the CC published the final report for the LPG inquiry in July 2006. The CC found that competition was not working as well as it should and that consumers were being harmed as a result. In particular, the CC found that customers faced a number of difficulties in switching suppliers including having to change their tank if they changed supplier. As a result, the CC will be introducing measures to enable tank transfer when a customer wishes to switch supplier, make the switching process easier, improve the terms of customer contracts and give customers better information.
- **Home Credit** – the CC published provisional findings for the Home Credit inquiry in April 2006. The CC provisionally found that two features of the relevant market contributed to the weakness of price competition (the insensitivity of consumers to prices and the failure of lenders to compete in any significant way on price). The CC further found that the incumbency advantages for established lenders which exist where competition is focused on availability (the inability of consumers to convey reliable information about their creditworthiness) are features which prevent, restrict or distort competition, coupled with features that contributed to the preservation of these advantages including the lack of data sharing.

The CC's profitability analysis showed that, as a result of the adverse effect on competition, customers paid higher prices than could be expected in a competitive market. The detriment to

customers from higher prices was substantial and may be in excess of £500 million over the period from 2000 to 2004.

The CC's notice of possible remedies was published in April 2006 and the final report is expected to be issued in October 2006.

3.2 *Super-complaints*

122. The OFT received one super-complaint during the period. This was from Citizens Advice relating to payment protection insurance (PPI). In December 2005, within the 90-day response period, the OFT announced its intention to carry out a market study into the sector. PPI is applied to a number of credit products including mortgages, loans and credit and store cards. It protects a borrower's ability to pay back the loan in the event of accident, sickness or unemployment. Around 6.5 to 7.5 million policies are taken out each year, generating an estimated £5.4 billion in premiums.

123. The OFT's response to the super-complaint identified a number of issues which suggested the sector was not working well for consumers and should be examined in more detail. These included difficulties in gaining clear information on alternative suppliers; high costs or other barriers to entry for stand-alone PPI providers; a wide degree of variation in pricing; and apparently high gross profit margins. The OFT expects to conclude its study by the end of 2006.

3.3 *Reviews*

3.3.1 *Review of remedies*

124. The OFT is required to keep under review the actions taken in compliance with CC remedies, and to advise the CC if these are having their intended effect of making markets work better.

- **Postal franking machines** - in June 2005, the OFT accepted undertakings, in lieu of a reference to the CC, to open up the market for the supply, maintenance and inspection of postal franking machines and the supply of ink cartridges. The undertakings were given by the two leading suppliers, Pitney Bowes and Neopost, and by Royal Mail, which licenses machines and inspectors. The undertakings are designed to provide better price information for customers about the cost of franking machines and their maintenance, encourage the supply of third-party maintenance services, increase the scope for independent suppliers of new and second-hand machines, and remove some restrictions on the independent supply of ink cartridges. The OFT is actively monitoring the parties' compliance with the undertakings.
- **Opium derivatives** – the OFT called on the Government to reconsider the way it licenses the supply and distribution of opium derivatives after its review of undertakings given by the UK's principal supplier, MacFarlan Smith Ltd (MSL), raised **fresh** competition concerns. Opium derivatives are used in the manufacture of a wide range of medicines, including over-the-counter painkillers and cough medicines. The market has grown rapidly over the past few years, and is currently worth over £31 million.

The OFT found that the present licensing policy, which seeks to protect UK production by limiting imports, has allowed MSL to discriminate on price and earn high levels of profit, driving up costs for the NHS. The OFT estimates that the detriment to consumers arising from the policy is around £3 million a year. The Government announced it would respond to the OFT's recommendations by the end of May 2006. If the restriction on competition

identified by the OFT remains unchecked, further action, including a market investigation reference to the CC, cannot be ruled out.

- **SME banking services** - in January 2006, the OFT launched a review of undertakings relating to the supply of banking services to small and medium-sized enterprises (SMEs) in the UK. The undertakings followed a 2002 report by the CC which found that the largest clearing banks in England and Wales made ‘excessive’ profits of over £700m a year on SME accounts between 1998 and 2000. In response to the CC’s findings, the four main clearing banks in England and Wales – Barclays, HSBC, Lloyds TSB and the Royal Bank of Scotland Group – undertook to offer free banking services or pay interest on business current accounts. Also, nine clearing banks undertook to improve their information on SME accounts, to promote price competition by reducing barriers to entry and to encourage switching by SME customers. The OFT aims to report its findings to the CC at the end of 2006.
- **Animal waste rendering** - a 1993 report by the CC’s predecessor, the Monopolies and Mergers Commission (MMC), identified anti-competitive pricing policies by two companies involved in animal waste rendering (the process of turning offal, bones and other animal waste into substances that can be used for making products such as soap). The two companies, Prosper De Mulder and William Forrest & Son, gave a series of undertakings to the MMC, including a commitment not to engage in discriminatory pricing. These undertakings are the subject of an OFT review, due to conclude later in 2006.
- **Condom distribution** – in December 2005, the OFT advised the CC that the undertakings given to prevent restrictions on competition in the supply of condoms in the UK were no longer needed and should be revoked. Following the MMC report in 1994, LRC Products Ltd, now a subsidiary of SSL International plc, undertook not to enter into exclusive distribution agreements with wholesalers or retailers. LRC, which makes the Durex brand of condoms, was the largest condom supplier in the UK at the time, and still has around 80 per cent of the retail market. The MMC had concluded that the agreements, which offered retailers financial incentives for not stocking competing products, weakened competition and reduced consumer choice. However, the OFT review found that the retail distribution channels through which condoms were sold had changed noticeably, with many more condoms and brands now being sold in supermarkets. The shift in buyer power towards these retailers had lowered prices, making the undertakings unnecessary. The CC provisionally accepted the OFT’s advice to revoke the undertakings in March 2006.

125. The OFT advised the Secretary of State for Trade and Industry in August 2005 that orders relating to the markets for dental goods, imported timber and estate agents (dating from 1951, 1960 and 1970 respectively) were no longer necessary and could be revoked. These orders were put in place after MMC reports identified agreements which restricted effective competition in these markets. In each case the OFT found that the market had changed considerably since the orders were put in place and that the CA98 was likely to address the anti-competitive practices prohibited by the orders. The Secretary of State accepted the OFT’s advice and the orders were revoked in December 2005.

3.3.2 *Review of market studies*

126. The OFT commissioned an independent review of its 2003 market study on new car warranties, to assess the study’s effectiveness in delivering improvements to consumers, broader benefits to the economy and the quality of analysis. The findings of the evaluation study, published in June 2006, concluded that car owners and fleet operators saved between £120 million and £170 million over two years

as a direct result of OFT intervention in the car after-sales market. The total cost of the market study and subsequent actions was £300,000.

3.3.3 *Ticketing block exemption*

127. In November 2005, the OFT advised the Secretary of State for Trade and Industry that an arrangement which exempts travel cards and other joint ticketing schemes from the Chapter I prohibition of the CA98 significantly benefited consumers and should be extended for another five years.

128. After public consultation, the OFT concluded that the ticketing schemes covered by the block exemption, which came into force in March 2001, continued to offer consumers flexibility and value for money and encouraged the use of public transport. These benefits outweighed any negative effects that these schemes might have on competition. The OFT also recommended some changes that would make it easier for ticketing schemes to benefit from the block exemption in future.

129. The Secretary of State accepted the OFT's recommendations, and the changes to the block exemption came into force in January 2006.

3.3.4 *Competition in the professions*

130. Consumers in Northern Ireland will benefit from greater competition between solicitors as a result of changes to the practice regulations of the Law Society of Northern Ireland (LSNI), which were announced in response to an OFT investigation – one of several during the year examining the impact of professional rules, regulations and practices on consumers.

131. The LSNI, which is the professional body and regulator for Northern Ireland solicitors, lifted its prohibitions on fee advertising, the charging of uneconomic fees and soliciting to existing or potential clients.

132. The OFT also investigated practice regulations of the LSNI which prohibit the payment by solicitors of referral fees to non-lawyers. This is also prohibited by statute, and the matter was therefore raised with the relevant Northern Ireland Department. In another case, the OFT looked at how solicitors collect and supply price information to courts following complaints that the practice of one local law society was incompatible with competition law.

133. The Surrey Law Society (SLS) conducted a survey of its members' hourly litigation rates for use by the courts in awarding costs. It also circulated a version of the results to its members with the names of firms removed. The OFT found that, while the data was anonymous, it still enabled members to know with a reasonable degree of certainty what others were charging, and could prompt them to align their rates irrespective of their costs. When the SLS decided not to repeat the exercise, the OFT closed the case.

134. In a letter to the Law Society of England and Wales, the OFT recommended that information on litigation rates for courts should be collected by an independent third party, rather than by a representative body of solicitors or a practising solicitor in a particular area.

135. A further case involving solicitor participation in referral arrangements in South Wales was also resolved following a change of conduct by the parties. The OFT considered that the model adopted to establish and run an estate agent's conveyancing panel unnecessarily restricted price competition between participating solicitors.

136. Law Firm Services Ltd, which operates the referral scheme, implemented new arrangements to address the OFT's concerns and the investigation was closed. The OFT is working with the Law Society of

England and Wales to provide guidance on how solicitor referral fee arrangements can avoid the risk of infringing competition rules.

137. In Scotland, the OFT contributed to the Scottish Executive Working Party on legal services markets. Positive outcomes included the withdrawal by the Law Society of Scotland of anti-competitive fee guidance and the amendment of advertising rules that unnecessarily restricted competition. The Scottish Executive committed to bring in new arrangements to permit other bodies to provide litigation and advocacy services (currently reserved to solicitors and advocates).

3.3.5 *Newspaper and magazine distribution*

138. The OFT conducted an internal review of its draft Opinion on the compatibility of newspaper and magazine distribution agreements with competition law, which was published in May 2005, in the light of consultation responses received. A fresh draft Opinion was published for consultation at the end of May 2006.

3.4 *Reports and studies on competition policy issues.*

139. In May 2005, the Payment Systems Task Force, chaired by the OFT, published its second progress report⁷. The Task Force brings together representatives from the banking industry, consumer and business bodies and government, with the Bank of England and the Treasury acting as observers. In the course of the year the Task Force has:

- agreed to implement faster clearing of electronic payments - from November 2007, the UK will have an electronic payments system which will allow telephone and internet payments to be made in a matter of hours and, potentially, in near real time. This will put the UK's electronic payments system among the fastest in the world. The Task Force estimated that the net benefit to the UK economy of the new service (the value it would be worth to consumers and businesses) could be between £748 million and £1,340 million over ten years.
- published a report of its Working Group looking into the BACS access and governance arrangements⁸. The report recommended that BPSL (BACS Payment Systems Ltd) should establish an Affiliates Interest Group so that users could raise issues directly with the BPSL board, establish a formal consultation process about major potential changes to the system, and introduce a broader, more user-based, objective. All three recommendations have been adopted by BPSL
- published a report of another Working Group looking at the access and governance arrangements of LINK,⁹ the UK's largest ATM provider, which made similar customer- and user-facing recommendations which either have been, or are in the process of being, adopted by LINK

⁷ Second Annual Progress Report of the Payment Systems Task Force: <http://www.offt.gov.uk/NR/rdonlyres/2E99FFA3-25C9-4B97-9A4C-93278FFD8351/0/oft849.pdf>

⁸ Download BACS Access and Governance Working Group Report: <http://www.offt.gov.uk/NR/rdonlyres/41CCCFCC-795B-4657-A6C7-285F94950445/0/oft836.pdf>

⁹ LINK Access and Governance Working Group Report: <http://www.offt.gov.uk/NR/rdonlyres/DD6E8DA4-E042-4C7E-9C33-6BFA86C9EAF6/0/oft840.pdf>

- set up a Working Group to look at what improvements, if any, may be needed to the current cheque and credit clearing systems to provide greater efficiency and user benefits in terms of value, withdrawal and fate. The report will be published in late October/early November, and
- made significant progress on a potential high-level strategic 'Governance model' which would be responsible for driving forward innovation in payment schemes, for taking a strategic view on the future direction of payments and for maintaining the integrity of payment schemes as a whole.

140. The OFT participated and supported the work of the Competition Forum, a cross-government body set up to promote awareness of competition issues among policymakers, and its sub-group of economists. During the year, the forum held meetings on public service reform, Competition Commission market investigations, health and education and the OFT's priority area of government interaction with markets.

141. The OFT, with the Department of Trade and Industry and the CC, commissioned research on market-based approaches to public policy. Carried out by consultants LECG, this examined how alternatives to traditional policy design can be used to promote competition between service providers and allow individuals greater choice over the services they receive. The findings were published in a DTI report in September 2005¹⁰.

142. The OFT produced a joint paper with the Civil Aviation Authority on competition issues associated with the trading of airport slots, in response to a consultation by the European Commission's Directorate-General for Energy and Transport - DG TREN. The OFT and CAA broadly welcomed DG TREN's proposal to allow airlines to buy, sell and lease slots on the basis that this would loosen current rigidities in the system and provide an incentive for slots to be sold to airlines which will use them more efficiently. It would also increase the ability of new airlines to launch downstream services, and for existing second-tier airlines to expand and challenge their larger rivals. In each case, consumers would benefit.

143. The CC established a new committee in 2005, the 'Analysis Group', with an overall aim of improving the quality of the CC's (non-remedies) decision-making. The Analysis Group commissioned an external review to identify missed opportunities for quantitative analysis in CC merger inquiries. An invitation to tender will be sent to consultants and academic economists in 2006/07.

144. The Ccompleted research into a number of past cases over 2005/06 to ascertain whether remedies had worked as expect. The results will be circulated more widely in 2006/07.

145. Externally, NERA Economic Consulting completed the first in what will be a series of 'analytical procedures reviews' looking at past CC cases to determine whether the analysis could have been improved. The first review focused on the staff economists work in the first two weeks of an inquiry. It concluded that the CC could adopt a clearer 'hypothesis-based approach', in which the theories of harm are identified early, along with a research programme to prove or disprove each such hypothesis. The approach is now being followed in merger inquiries.

146. Internally, the CC has continued its work assessing the quality of decision-making on its main findings and on remedies in several past CC inquiries. This work builds on the external review conducted by Price WaterhouseCoopers in 2004/05, following a similar methodology to reassess several merger and

¹⁰ Public policy: using market-based approaches:
<http://www.dti.gov.uk/files/file14759.pdf?pubpdfload=05%2F1492>

other inquiries completed by the CC before the Enterprise Act came into effect. The separate studies on the main findings and remedies will be published in 2006.

147. The CC also reviewed its merger procedures in 2005/06 with a view to develop new streamlined ways of working on less complex merger inquiries. These procedures will be piloted in 2006.

4. Resources of competition authorities

4.1 *Annual Expenditure*

148. The OFT expenditure for 2005-06 on competition enforcement work was £19.8 million (approx. \$37.75 million). These figures exclude support services such as accommodation, IT services, HR, Finance etc, as well as a budget for litigation, which is budgeted to provide support to the OFT as a whole (£18.3 million for 2004/05).

149. The CC expenditure for 2005-06 was approximately £24 million (approx. \$45.8 million).

4.2 *Number of employees*

150. The OFT dedicated a total of 242 staff to competition enforcement activities in 2005-06. Of this, 158 were employed in the then Competition Enforcement division, 22 in the then in-house Legal division, and 41 in the then Markets Policy and Initiatives division. Further, the equivalent of 21 members of staff from OFT's professional economic advice branch were dedicated to provide advice on the OFT's competition enforcement work.

151. The breakdown of OFT staff by specialists as at the 31 December 2005 is as follows: 64 economists - including seven financial analysts and four statisticians; 86 lawyers; 92 other professionals. Some of these competition staff may hold legal and/or economic qualifications below university degree level.

152. At the OFT, of the 242 staff identified above, 155 were involved in enforcement against anticompetitive practices, and 35 were involved in merger review and enforcement.

153. The CC had a total of 174 staff at the end of March 2006 (173 at the end of March 2005). Currently around 70 per cent of staff have been recruited from the private sector. The CC staff support the CC Members (generally a group of five Members considers a case). There are 50 Members and three academic panellists, all of whom are part time. Additionally, the Chairman and three Deputy Chairmen are members of the CC, together with the Chief Executive and two non-executive members are members of the Council (the strategic management board).

4.3 *Period covered by the above information*

154. The OFT financial figures provided are for financial year 1 April 2005 to 31 March 2006, and staff figures are for the position at the end of the year (31 December 2005). The CC financial figures and staff figures provided are for 1 April 2005 to 31 March 2006.