

# The role of the Competition commission in UK regulation and competition policy<sup>1</sup>

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<sup>1</sup> Although Professor Cubbin is a part-time member of the Commission any views that may be expressed are personal and do not represent the official views of the Commission, which may be found in its official publications

# Context

“The UK domestic competition regime is ranked among the best in the world. The Global Competition Review gives the Competition Commission its highest rating, at five stars, putting it on par with the US Department of Justice and the Federal Trade Commission. The Office of Fair Trading receives a 4.5 star rating, equal to that accorded to the EC, Australia, France, Germany and South Korea.

“Going forward, the challenge will be to get the balance right between a thorough and rigorous competition regime on the one hand, and simple regulation and fast process on the other hand; and to ensure that effective competition underpins and supports a range of future policy proposals, such as on banking reform.”

Source: BIS (Department for Business Innovation and Skills)  
*A Strategy for Sustainable Growth – Economic Annex, July 2010*

# Overview

Aim:

Fill out knowledge about:

- what the CC does
- how it does it

with the aid of two case examples from recent experience.

Approach:

- General description of CC
- Example 1: Mobile call termination charges
- Example 2: Payment Protection Insurance

# General description

- The CC is an independent public body which conducts in-depth inquiries into **mergers**, **markets** and the **regulation** of the major regulated industries.
- Around half the cases are mergers
- The CC does *not* consider appeals against CA chs 1 and 2 cases. These go to the Competition Appeals Tribunal (CAT)
- Reports to BIS (Department for Business, Innovation and skills) annually

# Where do CC cases come from?

- The CC cannot initiate cases
- References come from OFT, Ofgem, Ofwat, Ofcom, ORR, CAA, CAT or affected parties under the relevant legislation:
  - Enterprise Act
  - Communications Act
  - Energy Act
  - Water Act
  - Railways Act
  - etc.

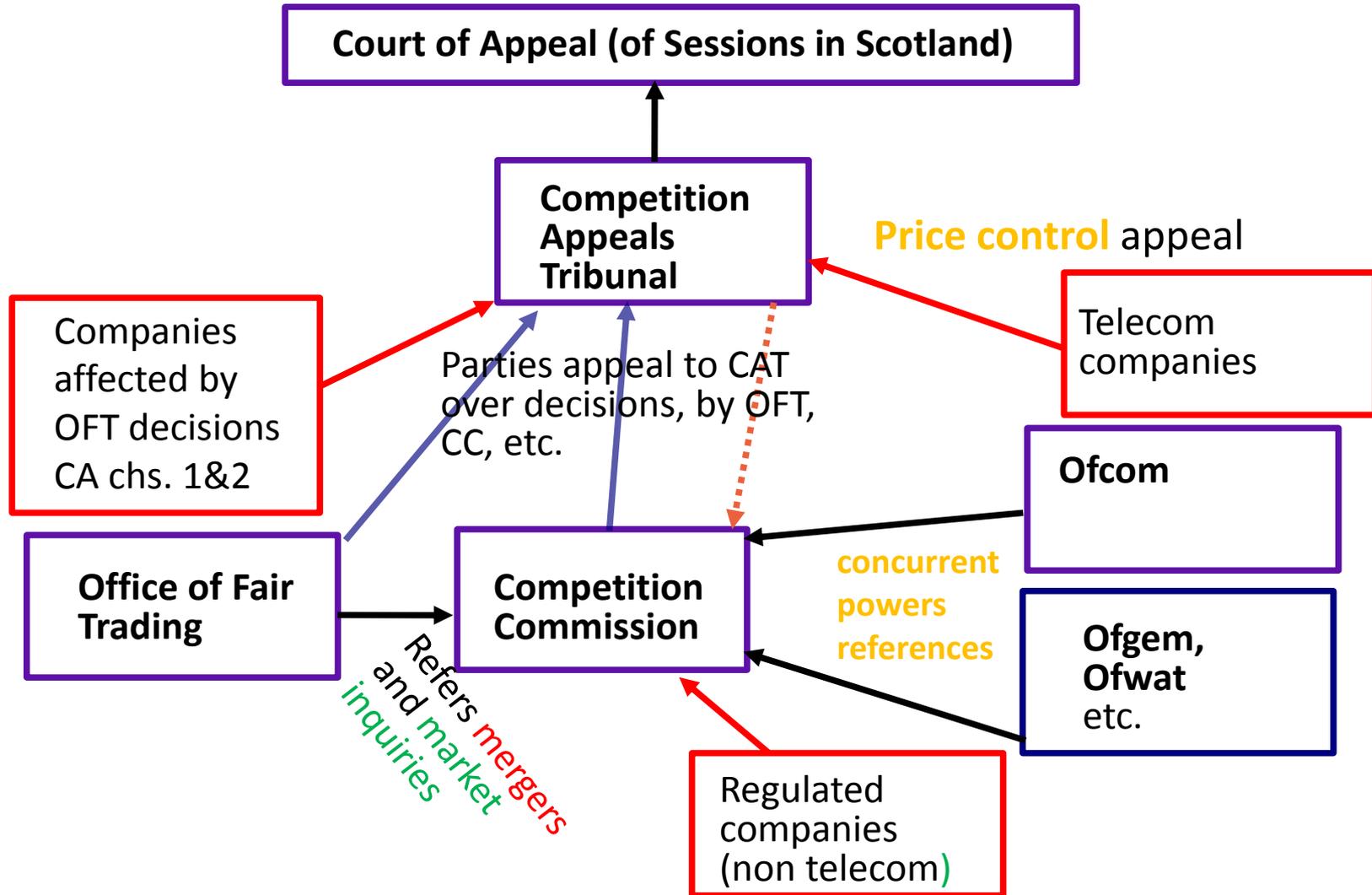
Each Act sets out different requirements of the CC in terms of :

- time limits
- evidence gathering powers
- decision powers
- criteria to be applied
- etc.

# Some recent cases

Case	Type	Act
Bristol Water	Regulatory price control determination	Water Industry Act 1991
Sports Direct/JJB sports	Merger	Enterprise Act 2002 s 22(1)
Local loop unbundling	Regulatory price control determination	Communications Act 2003
E.On vs GEMA	Energy code modification	Energy Act 2004
BAA airports	Market reference	Enterprise Act, 2002 s31,133
ITV contracts rights renewal	Review of undertakings following merger reference (change of circumstance)	Fair Trading Act 1973 (as amended by Enterprise Act)

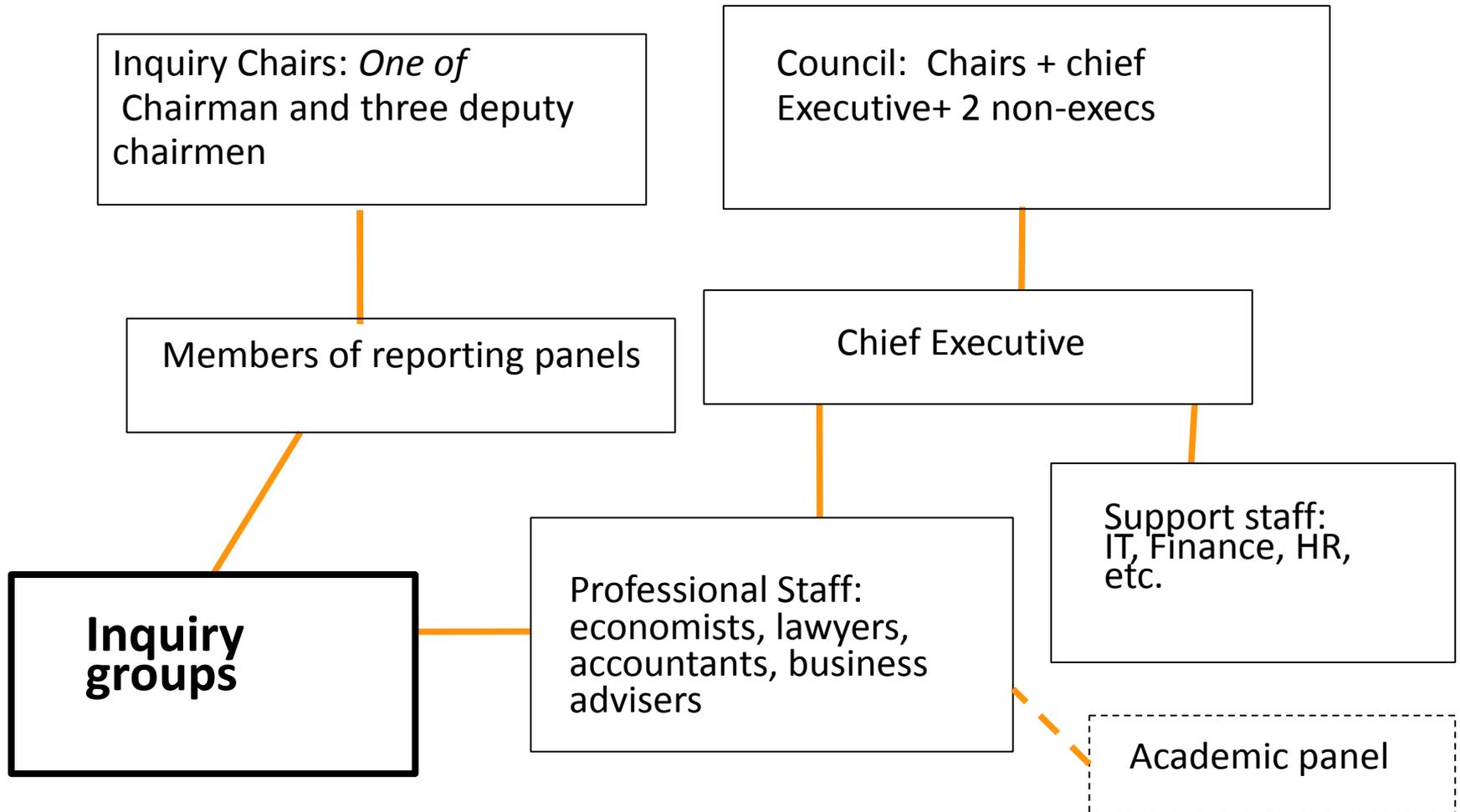
# Institutional relationships - roughly speaking



# Unusual features of CC

- Independent “second stage” for mergers and market inquiries
- Market inquiries: unique feature of British system
- Important role of hearings: parties meet decision makers, make case in person
- Decision makers (“members”) drawn from wide range of expertise

# CC Structure



# Inquiry groups

- Chairman (Chair or one of 3 deputies )
- 2-4 other members from:
  - general list (34 total) including specialists for:
    - telecoms (6)
    - other utilities (12)
    - newspapers (3)
- Inquiry Director plus admin team
- Professional staff:
  - Law, economics, accounting and finance, business advisory
- Occasionally, co-opted barrister

# PPI Members

Drawn from

- business, commerce and finance practice
- legal practice
- economics academia (often with consultant experience) consultancy, business practice
- accounting practice and academia

Between them a wide range of experience and perspectives.

Fixed 8-year term, non-renewable.

Paid on hourly or *per diem* basis.

Ultimate responsibility for decisions.

# Members' costs

	<i>2009/10 £'000 Chairman &amp; Deputy Chairmen</i>	<i>2009/10 £'000 Other members</i>	<i>2009/10 £'000 Total</i>	<i>2008/09 £'000 Total</i>
Wages and salaries	522	390	912	1022
Social security costs	61	29	90	102
Total (excl chairs' pension costs)	583	419	1002	1124

Total staff costs £10.19m., Departmental budget £20m.

*Source: Annual report for 2009-10*

(Budget 2010-11 was around £18m.)

# Two cases

- Market Inquiry
  - Payment Protection Insurance
- Telecoms market appeal:
  - Call termination for mobile telephony

## General disclaimers

1. The views of the CC are to be found in the official publications, not here
2. Only a small aspect of the total case can be presented here => obvious risk of distorted perception

# Example 1: a regulatory appeal

Mobile phone wholesale voice  
termination charges

Report published Jan 2009

# Calls to mobiles

- Mobile call termination: when the customer of one network calls a customer on another network the call must be “terminated” by network provider of recipient
- Company can make a charge to originating network for this service
- But Ofcom has determined that SMP\* exists in this market => charges regulated
- Previously considered by CC in 2002

\* SMP= significant market power

# New factors since previous round

- Use of 3<sup>rd</sup> generation mobile technologies
- Release of new spectrum to carry 3G technology
- New entrant (Hutchinson 3G trading as “3”) based on 3G technology
- Continuing growth in mobile, decline in penetration of fixed line for voice

# The appeal(s)

- BT and H3G both appealed
- Both were net payers of mobile call termination charges, submitted separate appeal notices
- Appellants claimed that Ofcom had set charges too high:
  - wrong basis for calculating spectrum costs
  - “network externality charge” wrong
  - wrong calculation of administration costs
  - failed to take account of the effect of the charges on H3G’s finances and hence on competition in the market
  - use of a particular economic depreciation model
  - and others...

# Telecom price appeals

- go in the first instance to the CAT, which sends the price control matters to the CC, considers other matters itself
- The CAT specifies the questions:
- e.g.
  - did Ofcom err for the reasons set out in paragraphs xx to yy of the party's notice of appeal ("NoA")?
  - if so how should this be remedied?

## Telecom price appeals (2)

Telecom appeals are more restricted than e.g. water or energy:

- CC Can only consider the matters raised in the NoA and specified in the CAT letter
- Cannot collect “new” evidence
  
- CC also needs to consider evidence of “interveners” – other mobile operators with an interest in result.

# The panel

- Chair: Dr Peter Davis economist (formerly LSE + consulting experience, member of Communications Act panel)
- Professor John Cubbin (member of Communications Act + utilities panels)
- Fiona Woolf (member of utilities panel, then-President of Law Society)
- Carolan Dobson (finance/business investment, statistics, pension fund advisor)
- Roger Davis (accountant, former partner, PWC)

# Standard of review

We have also kept in mind the point made by the Interveners that Ofcom is a specialist regulator whose judgement should not be readily dismissed. Where a ground of appeal relates to **a claim that Ofcom has made a factual error or an error of calculation, it may be relatively straightforward to determine whether it is well founded.**

Where, on the other hand, a ground of appeal relates to the broader principles adopted or to an alleged error in the exercise of a discretion, the matter may not be so clear. In a case where there were a number of alternative solutions to a regulatory problem with little to choose between them, **we do not think it would be right for us to determine that Ofcom erred simply because it took a course other than the one that we would have taken.**

On the other hand, **if, out of the alternative options, some clearly had more merit than others, it may more easily be said that Ofcom erred if it chose an inferior solution.** Which category a particular choice falls within can necessarily only be decided on a case-by-case basis.

*Source: para 1.22 of CC report “mobile phone wholesale termination charges” Emphasis added*

# Time scale

<b>Date</b>	<b>Event</b>
March 2007	Ofcom publishes price control decision
1 April 2007	Price control comes into effect
September 2007	BT and H3G submit appeals to CAT
March 2008	CAT refers matter to CC: October 31 deadline
15 Sept 2008	CAT extends deadline to 9 January 2009 as a result of delays caused by legal arguments about admissibility
Jan 2009	CC reports to CAT

# List of questions from CAT

Ref question	Topic	Pages in report
1(i)	3G spectrum costs	104
1(ii)	Administration costs	18
1(iii)	Network externality surcharge	34
2	"effects-based analysis"	49
3(i)	Welfare analysis	2
3(ii)	Path of cost recovery (economic depreciation)	21
3(iii)	Customer acquisition and service costs	30
3(iv)	Ported numbers	12
3(v)	Ofcom's use of scenarios	13
4	Averaging of 2G and 3G charges (economic depreciation)	2
5	Blended charge	8
6	Glide path	8
7	H3G's "Net payment zero" option	22
n/a	H3G's market share forecasts	21
8	How errors should be corrected	11

# Issue 1(i): spectrum value

- Ofcom used financial modelling and a set of scenarios to estimate the appropriate value of spectrum in the cost of voice telephony.
- At the core of Ofwat's methodology, was the value of the spectrum established in the auctions of year 2000, which raised £20bn in revenue.
- They also needed to establish various parameters (such as the share of voice in that value)

# Findings (1)

- Ofcom “erred” in the way it calculated the value attributed to spectrum costs. Auction values, plus the various assumptions used by Ofcom were likely to overstate the share of mobile voice termination in the value of spectrum, hence of the share of cost attributable to termination.
- For example, the auction values may have been optimistic with regard to timing and unit values for digital (data) services to be provided by 3G, which are only over the last two years being realised (in volume, if not value terms)

# Issue 1(iii): network externalities

- Network externality. Benefit to existing users of one extra user: can engage in calls with more people.
- Operators had argued for surcharge to give firms incentive to get more customers in network
- the logic of the modelling had curious aspects: e.g. the less efficient the incentive mechanism the higher the surcharge
- parameters underlying the justification of the surcharge difficult to estimate with any precision
- incentive already existed within charges for firms to get more subscribers on network since  $P > MC$  (allocation of fixed common costs such as admin)

# Finding 1(iii)

- The network externality charge should no longer be included

# Some reflections

- Time scale of appeal is a worry – but number & complexity of issues means tight time scale. Is there enough time in Ofcom's schedule to allow for appeals to be effective remedies?
- Important aspects of price controls depend on complex models which may be understood by only one or two people. => issues of transparency, robustness and fairness. (Non price-control issues, dealt with by CAT)
- Role of members with wide experience is important in assessing weight to be placed on conflicting evidence, including business arguments, modelling, economics and law.

# Example 2: a market inquiry

Payment Protection Insurance

First final report January 2009

Post-remittal report October 2010

# Payment protection insurance

- Insurance to loan repayments:
  - unsecured personal loans, mortgages, secured loans, credit cards, retail
- Typically covers:
  - accident
  - sickness
  - unemployment

# PPI: basic facts

	"typical" vendor	Gross written premiums 2007, £m	% single premium 2007	% face to face or telephone
<b>Unsecured loan</b>	high street or other bank	1,896	96	90
<b>First mortgage</b>	bank, building soc, intermediary	607	0	83
<b>Credit card</b>	credit card co	801	72	67
<b>Secured loan/second mortgage</b>	bank. loan company	251	0	93
<b>Motor</b>	motor trader	49	89	
<b>Retail credit</b>	Mail order w/ credit	73	0	

Source: CC report

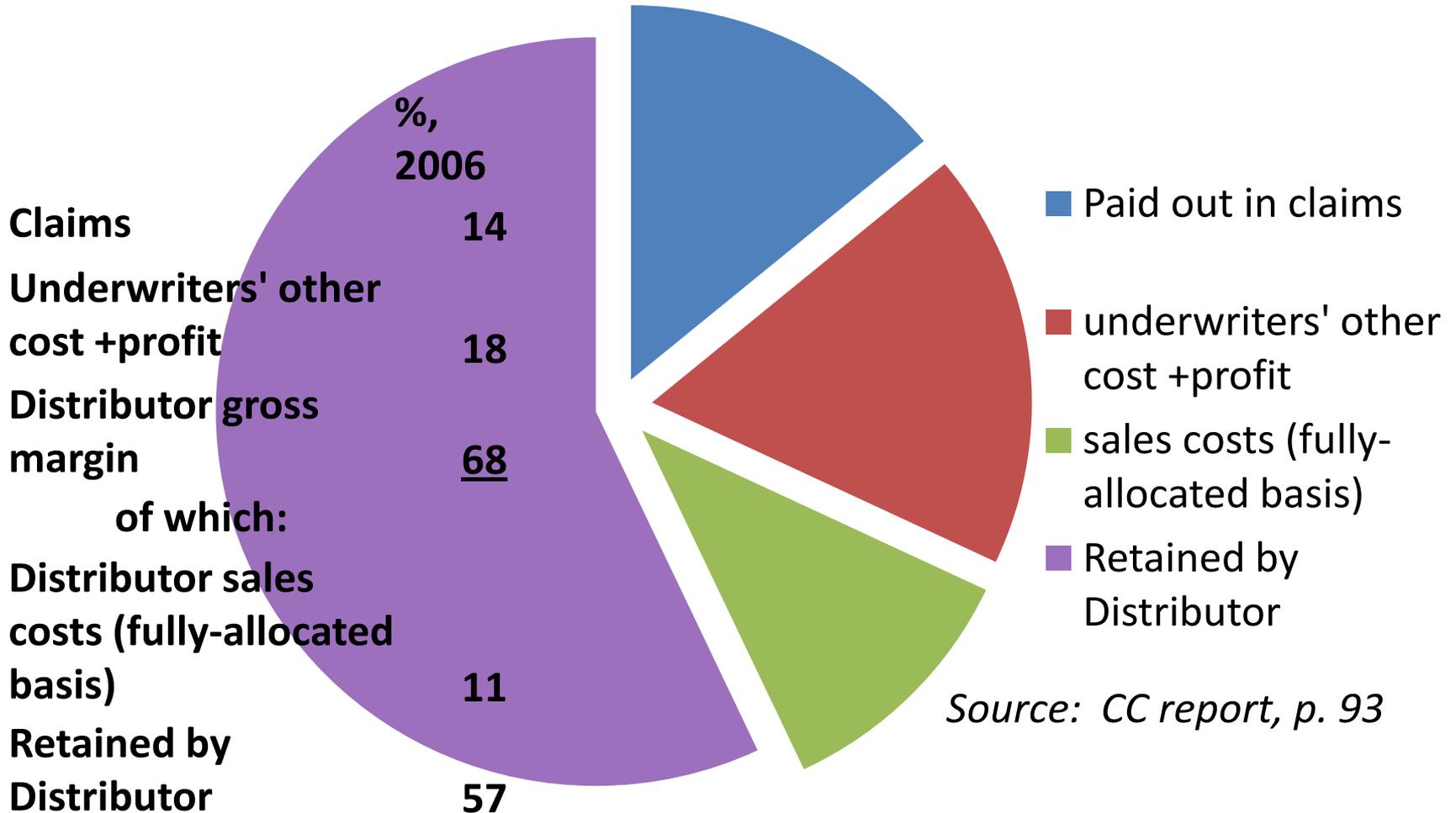
# PPI time scale

<b>Date</b>	<b>Event</b>
13 September 2005	CAB makes "super-complaint" to OFT
October 2006	OFT signals intention to refer; publishes consultation document
7 February 2007	OFT refers to CC for market inquiry
April 2007	CC issues statement
15- 18 months	CC issues 21 working papers
June, October 2008	CC provisional findings (June for most, Oct for Retail)
January 2009	CC "final" report
March 2009	Barclays appeals to CAT
September 2009	CAT hearings
October 2009	CAT judgment
26 November 2009	CAT remittal order published
14 October 2010	CC remittal final report
mid-December 2010	Appeal period lapsed
ongoing	Consideration of consultation on Order

# The panel

- Chair: Dr Peter Davis economist (formerly LSE + consulting experience)
- Professor John Cubbin
- Chris Bright (lawyer, experienced in competition cases)
- Richard Farrant (private sector banking, former chief exec, FSA)
- Professor John Baillie (accountant, former partner, KPMG, Chair of the Accounts Commission and Chair of Audit Scotland)

# What happened to revenue paid by customer?



# Findings

- Sector segmented into distributor-specific markets, because of:
  - search costs
  - switching costs

Focus will mainly be on personal loan PPI (both secured and unsecured.) Other sectors show similar characteristics but to a smaller degree

# Search costs

- PPI could only be bought at point-of-sale (“P-o-S”) of credit.
  - Many buyers had not thought about PPI beforehand
  - For those that had, very little opportunity to shop around
- => **Remedy:** restriction on closing PPI sales at point of credit sale (plus information aspects of remedies)

# Switching costs

- Sale of single premiums means it was expensive to switch PPI provider mid-loan as, although there was some re-imbusement on early termination, there was heavy front loading of effective charges
- =>**Remedy**: ban sale of single-premium products  
(FSA asked companies to stop selling single-premium PPI before CC order was finalised)
- => Also, information remedies address switching

# A complication

- High returns on PPI led some companies to promote loans in expectation of profitable PPI sales
- For one or two companies sales were below expected costs – others did not follow this route
- Loss of this incentive would be expected, other things equal, to raise the cost of loans to closer to cost
- Treated as “loss of consumer benefit” in assessing remedies

# Complication- continued

- Barclays & Lloyds Group appealed to CAT – said we had taken insufficient account of loss of consumer convenience in restricting “P-o-S” PPI sales
- CAT remitted case to CC – required the CC to reconsider the impact of loss of convenience on the proportionality of the remedy (+other things)
- Parties’ own evidence on loss of convenience was of limited relevance
- => CC commissioned survey on loss of convenience amongst PPI purchasers using conjoint analysis
- After re-modelling, concluded that there would still be large consumer gains from P-o-S restriction
- Time for appeal against this decision now lapsed: CC group now considering form of order implementing remedy

# Reflections

- 2-year timescale on market inquiry too long. Aim now to reduce to 18 months, longer allocation of time to consider remedies
- Appeal process delayed implementation by another 2 years => strong incentive to appeal
- => need to ensure reports are robust and well-reasoned despite shorter time scale
- Market inquiries can be useful where market is not working well => prevention, restriction or distortion of competition => against consumers' interests – see airports, liquefied petroleum gas, etc
  - No assumption of abuse of dominance, simply profit maximisation. No criminal penalties, but possible structural or behavioural changes.

# Useful web references

## Annual report and Accounts 2009-2010

[http://www.competition-commission.org.uk/rep\\_pub/annual\\_rev\\_archive/index.htm](http://www.competition-commission.org.uk/rep_pub/annual_rev_archive/index.htm)

## Call to Mobiles report

[http://www.competition-commission.org.uk/appeals/communications\\_act/mobile\\_phones\\_determination.pdf](http://www.competition-commission.org.uk/appeals/communications_act/mobile_phones_determination.pdf)

## Payment protection Insurance home page

<http://www.competition-commission.org.uk/inquiries/ref2007/ppi/index.htm>

## Main Report and Annexes to PPI Inquiry

[http://www.competition-commission.org.uk/rep\\_pub/reports/2009/542ppi.htm](http://www.competition-commission.org.uk/rep_pub/reports/2009/542ppi.htm)

CC comments on institutional reform, by Deputy Chairman Laura Carstensen

[http://www.competition-commission.org.uk/our\\_role/speeches/pdf/lc\\_speech\\_what\\_is\\_a\\_good\\_competition\\_authority.pdf](http://www.competition-commission.org.uk/our_role/speeches/pdf/lc_speech_what_is_a_good_competition_authority.pdf)