



COMPETITION COMMITTEE

**ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS
IN THE UNITED KINGDOM**

APRIL 2003 – MARCH 2004

Executive Summary

1. The year 2003-04 has seen the implementation of fundamental reforms of UK competition and consumer law and policy. During the past year there has also been a corresponding change of the OFT's infrastructure, which is still under way. This was the first full year in which the OFT operated under an executive Board, brought into being by the Enterprise Act 2002 (EA02).

2. The OFT's key achievements during this period have included the OFT taking enforcement action, and securing effective and practical results without resorting to enforcement action. In addition, the OFT continues to increase its focus on the restrictions on competition that stem from laws and regulations, it has launched a number of diverse market studies, and made market investigation references to the Competition Commission.

3. The OFT is now part of the new European Competition Network (ECN). The ECN is a network of National Competition Authorities (NCAs), to coordinate enforcement of Articles 81 and 82 in member states following modernisation. The OFT worked with the European Commission and its partners in the ECN to develop the detailed procedures for the day-to-day operation of the network. The OFT worked closely with the DTI on the changes to the Competition Act 1998 (CA98), which give effect to modernisation in the UK.

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

1. Summary of new legal provisions of competition law and related legislation

4. The Enterprise Act 2002 came fully into force in June 2003. It strengthened the law relating to: mergers, market investigations, cartels, consumer protection, codes of practice, and consumer education. It has enhanced not only the potential effectiveness, but also the independence, transparency, accountability and governance of the OFT.

5. On 1 April 2003, a new independent body for hearing appeals against Competition Act decisions was established under Part 2 of EA02. The Competition Appeal Tribunal (CAT) took over the function of the Competition Commission Appeal Tribunals (known as CCAT), with the powers to confirm, set aside, vary or remit an OFT decision. The CAT also has the power to determine appeals decisions on mergers and market investigation reference cases on a judicial review basis.

6. In June 2003 when Part 3 of EA02 came into force significantly changing the framework for UK merger control. Under EA02, the majority of UK merger decisions are now taken by the OFT as specialist, independent competition authority. The OFT will refer mergers for 2nd phase analysis to the Competition Commission. The OFT refers a merger to the Competition Commission when we believe that it is, or may be, the case that a merger has resulted, or may be expected to result, in a substantial lessening of competition within a UK market or markets. The substantial lessening of competition test replaces the previous public interest test, set out in the Fair Trading Act 1973. Ministers only become involved where there are defined public interest issues (e.g. national security). The OFT, rather than the Secretary of State for Trade and Industry, decides directly which mergers are referred to the Competition Commission in the vast majority of cases.

7. Part 6 of EA02 makes it a criminal offence for an individual to dishonestly agree with one or more other persons that two or more undertakings will engage in the most serious cartel activities, namely: price-fixing, market-sharing, bid-rigging or limiting production or supply. The OFT will work with the Serious Fraud Office to investigate the suspected offence. The maximum penalty for such offences is now

five years' imprisonment and/or an unlimited fine. Prosecutions will generally be undertaken by the Serious Fraud Office in England, Wales and Northern Ireland, and by the Crown Office in Scotland. A Memorandum of Understanding with the two prosecuting bodies was signed in 2003.

8. Under the Act, the OFT can require individuals suspected of involvement in cartel activity, to answer questions and to provide relevant information and documents. The OFT can also enter and search premises under warrant for any relevant documentation.

9. Part 6 of EA02 also gave the OFT stronger powers to conduct investigations. It amends the Regulation of Investigatory Powers Act (RIPA) 2000, allowing the OFT to conduct intrusive surveillance when investigating cartel offences. In January 2004 the OFT was granted with additional powers under RIPA, including the right to use directed surveillance (such as watching a person's office) and informants in cartel investigations. The use of such powers is overseen by the office of the Surveillance Commissioner.

10. Part 7 of EA02 amends the Company Directors Disqualification Act 1986, to provide the OFT with power to apply to the court for orders disqualifying directors of companies which have committed a breach of competition law. These orders are called Competition Disqualification Orders.

2. *Other relevant measures, including new guidelines*

11. The OFT provides advice and guidance on the potential competition impacts of proposed legislation, as well as a telephone helpline, as part of its' Regulatory Impact Assessment (RIA) work. During 2003-04, the OFT provided advice on over 200 RIAs, liaising closely with the Cabinet Office Regulatory Impact Unit to improve the quality of competition assessments and RIAs as a whole.

Reviews

- **Review of Professions**

12. The OFT responded to the Lord Chancellor's consultation on the future of Queen's Counsel (QCs) by stating that the current system for appointing QCs does not serve the best interests of consumers. The OFT argued that the QC system distorts competition, by conferring a title on certain advocates – almost exclusively barristers – which dramatically increases their status and earnings power. While accepting that 'quality mark' schemes can be helpful to consumers, the OFT argued that the QC title is too generic to provide genuinely useful information or an assurance of excellence.

13. The OFT also questioned whether the direct involvement of government in awarding the QC title is consistent with the public interest objective of lawyers being manifestly independent of government.

- **Supermarket code review**

14. An OFT review of the Supermarkets Code of Practice uncovered a widespread belief among suppliers that the Code is not working effectively, but there was a lack of hard evidence to support this.

15. The OFT found that over 80 per cent of respondents to the review said that the legally binding Code, (introduced after a Competition Commission report into the supply of groceries from multiple stores), had failed to change the behaviour of the big four supermarkets – Asda, Sainsbury's, Safeway and Tesco.

16. However, no cases have gone to mediation under the Code, nor has the OFT received any detailed information from suppliers or trade associations about alleged breaches. The four supermarkets each expressed a commitment to the Code and claimed that relations with suppliers were generally good. However, the OFT has no evidence from the supermarkets that their relationship with suppliers had changed significantly since the Code was introduced.

17. The OFT has therefore commissioned a compliance audit to establish how each of the four supermarkets deals with suppliers under the Code.

3. *Government proposals for new legislation*

18. Under the Enterprise Act 2002, the OFT has a general function to advise ministers or other public authorities on consumer protection and competition issues, including in relation to proposed changes in the law. The OFT provided direct input on draft legislation and policy initiatives, which had the potential to affect the OFT's enforcement work, we also played an active role in assessing new regulations for potential competition concerns.

19. The OFT worked alongside the Department of Trade and Industry (DTI) and the Department of Culture, Media and Sport (DCMS) on the Communications Act 2003, which created the new Office of Communications (OFCOM). Like other sector regulators, OFCOM has concurrent powers to enforce the Competition Act 1998 in the sectors it regulates and to apply the market investigation provisions of the Enterprise Act 2002.

20. The OFT was closely involved in the formulation of new provisions relating to newspaper mergers and cross-media mergers, in which both the OFT and OFCOM have new functions.

21. On a European level, the OFT was actively involved in discussions on the modernisation of competition law enforcement and the reform of the European Community Merger Regulation. As a result of these discussions the OFT updated its existing guidelines, guidance and procedural rules.

II. Enforcement of competition laws and policies

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

a) *Activities of competition authorities*

Competition Act 1998

22. The Competition Act 1998 is the OFT's chief weapon against agreements, business practices and behaviours that have, or are intended to have, a damaging effect on competition in the UK. The Act contains two prohibitions: the Chapter I prohibition covering anti-competitive agreements and the Chapter II prohibition covering abuse of a dominant market position.

23. In 2003-04, the OFT opened 1,140 complaint cases under the Competition Act 1998, of which 46 involved possible cartel activity. Formal investigations were launched into 41 cases where the OFT had reasonable grounds to suspect an infringement had occurred. These investigations resulted in eight decisions, of which two were infringement decisions and five were non-infringement decisions.

24. As part of our investigations, the OFT conducted on-site inspections in 10 cases. Of these, five were under section 27 of CA98, where the OFT has the power to enter premises without a warrant and

require the production of documents. Three inspections were under section 28 of CA98, where the OFT has the power to enter and search premises with a warrant, and two were carried out under both sections.

25. The OFT found that in certain instances competition problems have been most effectively resolved through informal negotiations with the parties concerned, achieving practical results without formal enforcement action. Examples include the halting of misleading adverts for Barclays credit card offering, and securing a sharp reduction in fees charged by the London Stock Exchange.

26. However, in more harmful cases, the OFT used its formal powers to stop an infringement, and imposed financial penalties where appropriate. During 2003-04, the OFT imposed total penalties of £19.6m (£18.9m after leniency).

27. Under the OFT's leniency programme, fines are reduced for businesses which blow the whistle on cartels; and give total immunity can be granted to those who first come forward to report the cartel, subject to the requirements of CA98. In 2003-04, the OFT received applications for leniency in 16 cases and imposed total penalties of £19.6m (£18.9m after leniency).

Exemption

- Pool Reinsurance Company Ltd (Pool Re)

28. In April 2004, the OFT granted an individual exemption from the Chapter I prohibition of the Competition Act to Pool Reinsurance Company Ltd (Pool Re). The OFT concluded that, although some of the rules which form part of the arrangements entered into by Pool Re regarding terrorism reinsurance for commercial property appreciably prevent, restrict or distort competition within the UK, the requirements for individual exemption are met.

29. Pool Re reinsures losses arising from acts of terrorism for all insurers of commercial property in Great Britain. The Pool Re arrangements enable its members, which are direct insurance companies, to provide insurance cover for damage or destruction to commercial property resulting from terrorism within their general cover for commercial property. Pool Re's liabilities to direct insurers are underwritten by HM Treasury.

30. OFT was notified by Pool Re of the various arrangements governing Pool Re and its relations with its members. The OFT has concluded that while most aspects of the Pool Re arrangements fall outside the scope of the Chapter I prohibition, some of the rules governing the Pool Re arrangements have the effect of preventing, restricting or distorting competition and so come within the Chapter I prohibition, specifically those requiring: members to offer terrorism cover only in conjunction with general cover for commercial property; members to reinsure all their terrorism insurance for commercial property with Pool Re; and policy-holders who buy terrorism insurance for a commercial property, to buy such terrorism cover for their entire portfolio of commercial properties from Pool Re members.

31. The OFT has concluded that the benefits of these rules outweigh the anti-competitive effects and that an exemption from the Competition Act can be granted. The benefits include: ensuring that all commercial properties have access to terrorism cover; facilitating investment in businesses by reducing risks; and helping businesses survive a terrorist act, minimising the adverse economic impact and improving economic progress.

b) Cases

Cartel activity

- Replica Football kit

32. In August 2003, the OFT decided 10 sportswear retailers, including: Manchester United plc, the Football Association Ltd and Umbro Holdings Ltd. had all entered into a price-fixing agreements in relation to replica football kit infringing the Chapter I prohibition of the Competition Act 1998.

33. An OFT investigation unearthed evidence of several agreements or concerted practices to set the price for certain kit manufactured under license by Umbro. Intended to cover key selling periods such as the Euro 2000 tournament, these fixed the prices for short-sleeved shirts at just under £40 for adults and just under £30 for juniors. The agreements, which infringed the Chapter I prohibition of the Act, were policed through informal contacts and monitoring of Umbro's retail customers, some of whom were threatened with stock cancellations if they failed to stick to agreed prices. The longest of the agreements lasted from the early spring of 2000 until the late autumn of 2001.

34. The parties were fined a total of £18.6m in August 2003 for engaging in unlawful price-fixing. The Football Association Ltd and two other retailers were granted leniency and the financial penalties imposed on each of them were reduced accordingly.

35. Four retailers appealed to the Competition Appeal Tribunal (CAT) against the decision and the imposition of a financial penalty. Two of these appealed against both, the findings of liability, as well as, the imposition and the levels of penalties involved. The other six parties have not appealed against the OFT's decisions.

36. [In its judgment of 7 October 2004, the CAT upheld the vast majority of the findings contained in the OFT decision and conformed that both retailers did engage in price-fixing. The CAT will now proceed with the second phase of the hearings in the appeals, concerning the level of penalties imposed upon four of the ten parties in the OFT decision.]

- British Horseracing Board/Jockey Club

37. In April 2003, the OFT reached a preliminary view that some of the rules and regulations governing British horseracing infringed the Competition Act. The British Horseracing Board (BHB) and the Jockey Club had asked the OFT to decide whether the Orders and Rules of Racing infringed the Chapter I prohibition relating to anti-competitive agreements.

38. The Orders and Rules infringed the Chapter I prohibition by: unduly limiting the freedom of racecourses to organise their racing, fixing the amounts that racecourses must offer owners to enter their horses into races, and monopolising the supply of race and runners data to bookmakers.

39. In June 2004, the OFT reached a preliminary agreement with the BHB to close its investigation, in light of the representations received from both parties and BHB's commitment to make significant changes to the way in which it runs British horseracing.

- Attheraces

40. In April 2004, the OFT found that 49 racecourses had infringed the Chapter I prohibition by collectively selling certain media rights to Attheraces, a joint venture between Arena Leisure, BSkyB and Channel 4. Attheraces was set up to supply horseracing coverage, including through a basic-tier pay-TV channel. It also provided access to betting services via interactive TV and the internet.

41. A number of inter-related agreements establishing Attheraces were notified to the OFT in November 2001. These included Attheraces' acquisition of media rights to horse races at 49 of Britain's 59 racecourses. The OFT concluded that the 49 racecourses' collective sale of some of these rights harmed competition by increasing their price and dampening incentives for racecourses to make their racing more customer-friendly. The OFT also found that the collective sale was not eligible for an individual exemption.

42. Attheraces have now ceased exploiting these rights. As the OFT was notified of the joint venture agreements, no financial penalty for the infringement was imposed. Interested third parties have made an appeal.

- Roofing Contractors

43. In March 2004, the OFT fined nine roofing contractors over £330,000 for collusive tendering and breaching the Chapter I prohibition. The parties were found to be involved in a series of individual agreements or concerted practices in tendering for flat roofing contracts in the West Midlands. As a result, buyers were unable to obtain competitive prices when tendering for repair, maintenance and improvement services for flat roofing. Among the contracts affected were those for services at a number of schools, a community library, a shopping centre and a car park.

44. One of the contractors qualified for total immunity under our leniency programme, reducing its financial penalty to zero and another contractor's fines reduced under the leniency programme by 50 per cent.

Abuse of a dominant market position

- DuPont

45. In May 2002, a Leeds-based supplier of hologram products, OPG, complained to the OFT that DuPont had abused its dominant market position, as the sole worldwide manufacturer and supplier of unprocessed HPF for graphic arts applications, by refusing to continue to supply this product beyond 31 December 2002.

46. On the basis of information available, the OFT concluded that DuPont's refusal to continue to supply unprocessed HPF to OPG did not constitute an abuse of dominant market position and did not infringe the Chapter II prohibition. Unprocessed HPF could not be regarded as an essential facility, and that a decision by DuPont to stop producing HPF holograms for graphic arts applications meant that its refusal to continue supplying OPG was unlikely to be aimed at eliminating competition in any market in which OPG was active.

47. The OFT concluded that competition law should only deprive an undertaking of the freedom to determine its trading partners in exceptional circumstances. These typically arise where the product concerned is an essential facility or where refusal to supply eliminates competition in a downstream or associated market.

CAT appeals (against CA98 decisions)

48. Responding to appeals is a crucial element of the OFT's enforcement work. With the establishment of the new independent body, CAT, for hearing appeals against CA98 decisions, the OFT spent approximately £1.4m on this activity in 2003-04.

- Genzyme

49. In March 2004, the CAT substantially upheld an OFT decision that the pharmaceutical company Genzyme Limited (Genzyme) abused a dominant position in the supply of drugs for the treatment of a rare inherited disorder called Gaucher disease.

50. The OFT found that the company had infringed the Chapter II Prohibition of the Competition Act by charging the NHS a price for the drug Cerezyme which included the price of home delivery and the provision of homecare services (the 'bundling issue'). This ensured that only Genzyme, or an undertaking acting under contract for Genzyme, could provide such services for patients being treated with Cerezyme.

51. The OFT also found that, from May 2001, the company prevented viable competition by charging independent third-party homecare service providers a price for Cerezyme that allowed them no possible margin (the 'margin squeeze' issue).

52. The CAT upheld the OFT's finding on the margin squeeze issue, but ruled that we had not proved that the bundling issue had a sufficiently adverse effect on competition. The OFT's original fine of £6.8m was consequently reduced by the CAT to £3m.

Aberdeen Journals

53. The CAT upheld an OFT decision that Aberdeen Journals had engaged in predatory pricing in breach of the Chapter II prohibition of the Competition Act.

54. Following the CAT's judgment on an earlier appeal by Aberdeen Journals, which remitted the case back to the OFT for further consideration, the OFT confirmed in September 2002 that the original finding that the company had abused a dominant market position by selling advertising space in its free newspaper, the Herald & Post, at below cost price to remove its only rival, the Aberdeen Independent, from the market.

55. The CAT upheld the OFT's finding of abuse. However, given the short duration of the abuse, it reduced the penalty imposed from £1.328m to £1m.

- Bettercare

56. In August 2002, the CAT remitted a decision by the OFT not to pursue a complaint by the private care home provider BetterCare Group Limited (Bettercare), that the North & West Belfast Health and Social Services Trust (N&W) had abused its position as a dominant purchaser by offering uneconomically low and discriminatory prices when purchasing residential and nursing home care from the company.

57. Following this decision, the OFT's investigation of Bettercare's complaint found that N&W did not set the prices paid to Bettercare for residential and nursing home care, and therefore could not have committed an abuse; and that there was insufficient evidence that the prices paid by N&W were excessively low.

58. The OFT concluded that public bodies involved in setting rates to be paid by Health & Social Services Trusts for residential and nursing care services, did not carry out economic activities in respect of the provision of residential and nursing home care, and hence were not undertakings for the purposes of competition law. The OFT therefore had no jurisdiction to consider their behaviour under CA98.

59. In the light of this decision, the OFT published a policy note on the impact of competition law on public bodies. The note also takes account of a decision by the European Court of First Instance in the case of FENIN v the European Commission. This case established that where an organisation purchases goods or services for purposes other than economic activity, such as those of a purely social nature, it is not acting as an undertaking for the purposes of competition law simply because it is a purchaser in a given market.

European competition legislation

60. Throughout the year the OFT prepared for a substantial change to the way EC competition law is enforced. From 1 May 2004, the OFT applies and enforces Articles 81 and 82 of the EC Treaty, alongside the Chapter I and II prohibitions of the Competition Act, in cases affecting trade between EC member states.

61. In addition, Council Regulation (EC) 1/2003, known as the Modernisation Regulation, abolishes the system of notifying agreements. This is replaced by a legal exception regime, under which agreements, which satisfy the conditions of Article 81(3), are valid without the need for an exemption decision. Previously, the European Commission had sole power to grant exemptions under Article 81(3).

62. The OFT also assisted other NCAs, particularly those from accession states, in drawing up plans for modernisation.

Market References to the Competition Commission

Fair Trading Act 1973 – complex monopolies

63. The complex monopoly provisions of the Fair Trading Act 1973 complement the powers contained in the Competition Act, generally allowing the formal investigation by the Competition Commission of markets which do not appear to be working well but where there is no evidence which infringes the Competition Act of anti-competitive agreements or abuse of dominant market position.

64. Complex monopoly situations can be referred to the Competition Commission for investigation under the Act if, amongst other matters, two or more companies in a market collectively have a share of supply of 25 per cent or more; and the companies, whether voluntarily or not, and whether by agreement or not, so conduct their affairs as in any way to prevent, restrict or distort competition.

65. From April 2003 to April 2004, the Competition Commission reported on two monopoly references: Veterinary Medicines and Extended Warranties on Domestic Electrical Goods, as well received its first market investigation reference under the Enterprise Act on the supply of store cards services from the OFT.

66. The supply of store card services - In March 2004 the OFT referred the market for the supply of store card services to retailers and of consumer credit through store cards to the Competition Commission. An open hearing was held for interested parties on 21 July 2003. The Competition Commission is due to notify its provisional findings in late March 2005 and the final report is expected to be published in late June/early July 2005 (well ahead of the statutory deadline of 17 March 2006).

- **Veterinary Medicines**

67. The terms of reference for the Veterinary Medicines inquiry required the Competition Commission to investigate the supply of prescription-only veterinary medicines (POMs) within the UK. The Competition Commission examined all three levels of the supply chain for POMs (manufacture, wholesale and retail). Three complex monopolies were found within the meaning of the Fair Trading Act 1973.

68. In order to promote competition in the market, the Competition Commission recommended a number of remedies requiring veterinary surgeons, manufacturers and veterinary wholesalers to change some of the practices so as to reduce barriers to entry by pharmacies and increase the transparency of information available to animal owners so that they can better understand and compare prices.

- **Extended Warranties on Domestic Electrical Goods**

69. Under the Extended Warranties reference, the Competition Commission was asked to investigate whether there was a monopoly situation in relation to the supply of extended warranties for domestic electrical goods within the UK. The Competition Commission found that those involved in selling extended warranties at point of sale had a monopoly of the supply of these warranties. Once again, remedies were recommended to promote competition.

2. *Mergers and Acquisitions*

70. The OFT expressed views on the reforms of the ECMR over the year, which were discussed in Council Working Groups. The OFT pressed for a change to the substantive test from a dominance-based test to one based on the concept of substantial lessening of competition. The OFT's concern was that the existing 'dominance' test might not be robust enough to deal with all mergers harmful to competition. The new Regulation makes clear that the SIEC test can capture all anti-competitive mergers. The amended Regulation was formally adopted in January 2004 and comes into force on 1 May 2004.

71. Prior to the implementation of the Enterprise Act – and following informal consultation – a new mechanism, the Case Review Meeting, was set up to help evaluate merger cases raising complex competition issues. This replaced the OFT Mergers Panel. Concerns had been expressed about the transparency and composition of the Mergers Panel, which was made up of officials from government departments as well as the OFT and sector regulators.

72. Only OFT officials will usually attend the Case Review Meeting. Its purpose is to ensure internal OFT views are rigorously and carefully tested before decisions are taken. Where the merger proposal involves a regulated industry, a sector regulator may also be represented.

73. Guidance documents on the OFT's merger procedures and the substantive assessment of mergers were published in May 2003, highlighting the changes in the framework for UK merger control when Part 3 of the Enterprise Act 2002 comes into force.

a) *Statistics*

74. In 2003- 04 the OFT examined a total of 267 mergers and merger proposals. Of these 56 were reviewed under the Fair Trading Act and 211 under the Enterprise Act. 26 cases were considered by a case review meeting.

75. The Competition Commission reported on seven merger inquiries under the Fair Trading Act 1973 and one merger under the Enterprise Act.

76. The OFT referred 12 cases to the Competition Commission and accepted undertakings in lieu of reference in two cases.

77. In 2003-04 the following mergers were referred to the Competition Commission:

Parties	Date of Reference	Jurisdiction	Status	Conclusion
Arla - Express Dairies	7 July 2003	FTA	Report Published	Not against public interest
J Sainsbury – Springwater	30 July 2003	FTA	Laid aside	
WBB - Tarmac	14 August 2003	EA	Cancelled	
Stena - P&O	22 August 2003	EA	Report Published	Against public interest
March - GUS	25 September 2003	FTA	Report published	Not against public interest
Unum - Swiss Life	31 October 2003	EA	Cancelled	
AAH Pharmaceuticals - East Anglian Pharmaceuticals	3 December 2003	EA	Cancelled	
Drager - Air-Shields	18 December 2003	EA	Report published (June 2004)	Approved
Carl Zeiss - Bio-Rad	30 December 2003	EA	Report published (May 2004)	Approved
Firstgroup - Scotrail	13 January 2004	EA	Consultation on remedies	
Conva Tec - Acordis	12 February 2004	EA	Cancelled	
National Milk Records - Cattle Information Services	3 March 2004	EA	Cancelled	

78. Undertakings in lieu of a reference to the Competition Commission were given in the following cases:

Parties	Date of Reference	Jurisdiction
Astrium N.V./European Aeronautic Defence and Space Company N.V.	2 September 2003	FTA
IVAX International GmbH /3M Company	9 January 2004	EA

b) *Cases*

- iSoft – Torex

79. An OFT decision not to refer a merger to the Competition Commission was the subject of a legal challenge, culminating in a Court of Appeal judgment. In November 2003, the decision to clear the merger of two healthcare IT companies, iSOFT and Torex, was appealed to the CAT by a third company, IBA Health Ltd.

80. The CAT upheld the appeal and asked the OFT to reconsider its decision. It also ruled that in carrying out its duty to refer relevant mergers to the Competition Commission, the OFT must satisfy itself that there is no significant prospect of a substantial lessening of competition, and that there is no significant prospect that an alternative view may be reached by the Competition Commission.

81. In taking the case to the Court of Appeal, the OFT argued that the CAT had wrongly interpreted the Enterprise Act test for merger references, and had erred in its understanding of the nature and scope of judicial review of OFT merger decisions.

82. In February 2004, the Court of Appeal upheld the CAT's finding on the proposed merger but disagreed with the CAT's view of the relevant test to be applied by the OFT. It confirmed that in carrying out its duty to refer relevant mergers to the Competition Commission the OFT needs a positive belief (not merely a suspicion) that is reasonably and objectively justified by the relevant facts that the merger may result in a substantial lessening of competition. Where the likelihood of a substantial lessening of competition is less than 50% but more than fanciful, the OFT has a wide discretion.

83. The OFT welcomed the Court of Appeal's judgment as a sound basis for future merger assessments.

- March – GUS

84. On the OFT's advice, the Secretary of State for Trade and Industry referred the completed acquisition by March UK Ltd, an associate of Littlewoods Ltd, of the home shopping and home delivery business of GUS plc to the Competition Commission.

85. The OFT's initial investigation under the Fair Trading Act 1973 concluded that the acquisition raised a significant prospect of a substantial lessening of competition in mail order and the related activity of business-to-consumer parcel delivery, warranting further investigation by the Competition Commission. March UK Ltd is controlled by Sir David and Sir Frederick Barclay, who also control the Littlewoods home shopping, home delivery and high-street retailing businesses.

86. The Competition Commission found that, compared with the alternative scenario of the former GUS businesses being wound down or ceasing to be effective competitors, the merger might be expected to benefit consumers and might not be expected to lead to a substantial lessening of competition. The Secretary of State accepted this conclusion and the merger was cleared.

- Stena – P&O

87. The OFT referred the proposed acquisition by the ferry company Stena AB of certain routes operated by P&O on the Irish Sea to the Competition Commission. This was the first merger reference to the Competition Commission under the new Enterprise Act.

88. The OFT believed that if the transaction went ahead it might be expected to result in a substantial lessening of competition in the market for the supply of ferry services for freight from Great Britain to Ireland. Although ferry services on the Irish Sea were characterised by over-capacity, the merger would remove a leading supplier and significantly increase concentration of supply. A number of customers had also raised concerns that the merger would lead to increased prices.

89. The Competition Commission confirmed that the proposed transfer of P&O's Liverpool-Dublin route was expected to result in a substantial lessening of competition. This transfer would give Stena scope to increase prices to some customers of ferry services into the Irish Sea and should therefore be blocked. However, it decided that the transfer of the Fleetwood-Larne route would not be expected to result in a substantial lessening of competition and should be allowed to proceed.

90. The Competition Commission learnt some important lessons in terms of internal procedures. They included, the publication of provisional findings worked well as did the new remedies procedures, the much shorter style report, supported by relevant appendices, was a success, and the publication of more material on the Competition Commission's website led to much greater transparency .

- Carlton Communications – Granada

91. Carlton Communications and Granada were given the go-ahead to merge after the OFT negotiated a series of undertakings. The proposed merger had been referred to the Competition Commission under the Fair Trading Act in March 2003 after the OFT raised concerns about its potential impact on competition, particularly in the sale of TV advertising.

92. The Commission found that in two areas relating to the sale of advertising airtime the merger would be expected to operate against the public interest, and outlined a series of remedies to remove these adverse effects.

93. Working closely with the ITC and Ofcom, the OFT secured the agreement of the two companies to the remedies in November. The Secretary of State accepted the undertakings and the merger went ahead.

- Safeway – Wm Morrison, Asda, Sainsbury and Tesco

94. Wm Morrison gave statutory undertakings to the Secretary of State to sell off a number of its stores following a Competition Commission investigation into the company's proposed takeover of Safeway. The Competition Commission found that the acquisition of Safeway by Wm Morrison would operate against the public interest in certain local areas where the number of competing supermarkets would fall below a particular level. However, it recommended that the merger be allowed, subject to the

divestment by Wm Morrison of one-stop grocery stores in 48 localities, together with five smaller grocery stores.

95. These undertakings were negotiated by the OFT and accepted by the Secretary of State in December 2003. Wm Morrison's takeover of Safeway went ahead in March 2004.

96. The Competition Commission concluded that an acquisition of Safeway by Asda, Sainsbury's or Tesco would operate against the public interest at both a national and local level. These proposed mergers were therefore blocked, and prohibition undertakings from each of the companies were negotiated by the OFT and accepted by the Secretary of State.

EC Casework

97. As the competent authority in the UK, the OFT received details of all mergers notified under the ECMR. 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 European Commission's draft decisions were considered by member states.

98. 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 request, which concerned the merger between Arla Foods and Express Dairies, was granted by the Commission. The OFT subsequently referred the merger to the Competition Commission under the Fair Trading Act. The Commission eventually recommended that the merger be cleared, and this was accepted by the Secretary of State.

III. Resources of competition authorities

99. The OFT's financial year runs from 1 April to 31 March. The total budget for competition enforcement work was £17.7m. Of this, £10.5m was specifically budgeted for dealing with Competition Act 1998 casework, £1.8m for mergers, and £5.4m for general market studies which have competition and consumer implications, and for advocacy projects. These figures exclude communication, accommodation, and IT costs for that year.

100. The OFT dedicated a total of 261 staff to competition enforcement activities in 2003-04. Of this, 185 were employed in the Competition Enforcement division, 23 in our in-house Legal division, and 41 in Markets, Policy and Initiatives (MPI) division. MPI Division conduct general market studies, advocacy, and market investigation references to the Competition Commission. The equivalent of 12 members of staff from our professional economic advice branch were dedicated to provide advice on the OFT's competition enforcement work.

101. The CC's revenue grant reported for 2003/04 was £15,319,000 and a capital grant of £7,373,000. The CC had a significant one-off charge in 2003/04 associated with its move to new accommodation. The CC's levels of expenditure have increased over the past two years owing to the increased responsibilities placed upon it under the Enterprise Act.

102. As at 31 March 2004 the CC had a staff of 145 full-time equivalents including administrators and specialists such as accountants, economists, business advisors and lawyers.

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

OFT Market Studies

a) Framework for market studies

103. In December 2003, we invited views on draft guidance setting out our approach and procedures for conducting market studies. This 12-week consultation exercise ended in March and our final guidance will be published later in 2004. We also commissioned two external consultancy projects to evaluate our market studies framework:

- NERA (National Economic Research Associates) was tasked with assessing how quantitative data, for example on price changes, profitability and productivity, could be used to identify markets which might not be working well.
- L.E.K. Consulting was employed to review the project management processes on the first four studies carried out by the OFT. A change programme based on its recommendations is being implemented to enhance our processes.

b) Published Market Studies

- Payment systems - Following its three-month study, the OFT published a report which contained, a factual update on developments over the last three years in the UK's money transmission clearing systems and an account of recent OFT competition work on card networks. The report covered all the main payment systems. Its scope does not extend to retail banking services.
- Estate Agency - The OFT study into the estate agency market in England and Wales has concluded that the Estate Agents Act requires modernising and that consumers want a better service. The report recommends changes to the law, improved self-regulation and calls on consumers to take action themselves. The OFT will also launch a consumer information campaign in the spring to raise awareness of the savings that can be made by comparing prices between estate agents and negotiating on fees.
- Taxi Licensing - The OFT recommended removing a number of restrictions on the number of licensed taxis in the UK. The OFT concluded that by removing certainty quantity restrictions benefits could be realised in terms of the number and safety of taxis available to the consumers.
- Liability Insurance - The five-month fact-finding study was undertaken in the light of concerns over sharp and often sudden increases in premiums, reported reductions in underwriting capacity and increases in the excesses borne by policy-holders. The study found no evidence of a widespread lack of availability of liability insurance cover. However, there did appear to be problems obtaining cover for asbestos-related risk and for professional indemnity insurance for independent financial advisers.
- New Car Warranties – The OFT's study of the car warranties market found that the conditions that make warranty cover dependent on the car being serviced at the manufacturer's franchised dealer limit consumers' choice, and may lead them to pay higher prices for servicing.

- **Extended Warranties** - The OFT referred the market for the supply of extended warranties on domestic electrical goods, worth over £500 million a year, to the Competition Commission. This followed an investigation which found that competition in the market did not appear to be working effectively and that consumers were not adequately informed or protected.
- **Doorstep selling** - The OFT study on doorstep selling has found that consumer's need to be better informed of their rights and consumers who solicit visits from traders need more protection under the legislation.
- **Debt consolidation** - The OFT fact-finding study into debt consolidation found that better financial awareness among consumers, and clear, accurate and relevant information from credit providers are required to make the use of debt consolidation fairer and more transparent.
- **Pharmacies** - The report recommends that the control of entry regulations for community pharmacies (which limit the number and location of community pharmacies) in the UK should be ended. This would mean that all registered pharmacies with qualified staff would be able to dispense National Health Service (NHS) prescriptions.
- **Consumer IT Services** - The OFT found the consumer IT goods and services market was working well, but could serve consumers better - particularly with information on support services and printer cartridges. The report also found that overall satisfaction with the performance and price of PCs is high, and only three per cent of consumers had difficulty obtaining and using the information available to compare PC prices and products.

c) *Ongoing Market Studies*

- **Ticket Agencies** - The OFT has launched a short fact-finding study into ticket agencies for entertainment and sporting events. The aim of the study is to assess how effectively the supply of tickets for entertainment and sporting events is working for consumers.
- **Public sector procurement** - The OFT has commissioned preliminary research into the impact of public sector procurement on competition. External consultants, DotEcon Ltd, are to conduct an in-depth analysis of how public procurement might dampen or enhance the benefits of competition and to use this analysis to identify markets that the OFT should look at more closely.
- **Financial Services and Market Act (FSMA)** - As part of a review by the Government of the Financial Services and Markets Act 2000 (FSMA) The OFT is to assess the impact of the FSMA on competition. The first stage of this work, carried out by OXERA on behalf of the OFT, has developed a methodology for identifying the key areas where the FSMA is likely to have had a significant impact on competition.
- **Care homes** - As part of our study we will be consulting stakeholders such as care home representatives and trade associations, charities for older people, and central and local government bodies. We will also be talking to older people and their representatives.
- **Public subsidies** - The OFT is commissioning an independent study into the impact of public subsidies on competition. A broad-ranging economic analysis will look at how

different kinds of subsidy might impact on competition and, directly or indirectly, on consumers. The study will consider different categories of subsidy and the different market circumstances in which these might be granted.

Super-complaints

104. To date the OFT has responded to five informal super-complaints. The complaints which have been referred to the OFT are:

- Private Dentistry 2002
- Doorstep Selling 2002
- Mail Consolidation 2003
- Care Homes 2003
- Home Collected Credit 2004

105. The informal super-complaints relating to the Private Dentistry, Doorstep Selling, and Care Homes markets all resulted in the OFT taking the decision to carry out full market studies. The market studies into the Private Dentistry and Doorstep Selling markets have been completed, while the market study into Care Homes will report in spring 2005. The market for Mail Consolidation was referred back to Postcomm (the designated industry regulator) as the most appropriate authority to conduct further investigation. The market for Home Collected Credit has provisionally been recommended for referral to the Competition Commission, to initiate a market investigation. The OFT is currently engaged in consultation with the major stakeholders in this market and will publish a final decision on whether to refer the market to the Competition Commission before the end of the year.