

The track record of the sectoral regulators in enforcing competition law

Sectoral regulators have had powers to enforce competition law since 2000. Since then there have been numerous infringement decisions in relation to non-regulated sectors of the economy, so why has it taken over 6 years for a sectoral regulator to issue its first competition infringement decision? Nigel Seay and Katherine Kirrage of Travers Smith look at the track record of the sectoral regulators in enforcing competition law.

The “lead authority” for enforcement of competition law in the UK is the Office of Fair Trading (“OFT”). However, its powers to enforce both EU and UK competition law are shared with most of the sectoral regulators - Ofgem, Ofwat, Ofcom, the Office of Rail Regulation (“ORR”), the Civil Aviation Authority and the Northern Ireland Authority for Energy Regulation. All these bodies are empowered to enforce competition law in their regulated sectors (there are limited exceptions, most notably merger control and criminal cartels). The policy intent behind this arrangement was to take advantage of the sectoral regulators’ considerable specialist knowledge of their particular sectors and to assist in coordinating the use of sector specific regulation and the exercise of general competition law functions.

These rights to enforce competition law have been available to the sectoral regulators since March 2000. However, it was not until November 2006 that the first competition infringement decision was taken by a sectoral regulator - the decision by the ORR that English Welsh and Scottish Railways Limited (“EWS”) had breached Chapter II of the Competition Act 1998 (abuse of a dominant position) and its EU equivalent, Article 82 of the EC Treaty, in relation to the market for coal haulage by rail. At the time of writing this remains the only competition law infringement decision taken by a sectoral regulator. The dearth of competition infringement decisions to date is, at least at face value, surprising and raises the obvious question of whether the sectoral regulators are giving sufficient weight to competition enforcement as compared to their other responsibilities and whether the UK’s system of concurrency remains the right approach for the enforcement of competition law in the regulated sectors.

The EWS decision came out amid a background of scrutiny of the performance of the sectoral regulators in the enforcement of competition law, with the DTI and HM Treasury having published a report on this issue in May 2006 (“the Report”). The House of Lords Select Committee on Regulators is also currently conducting a broader investigation into the overall performance of the major UK economic regulators.

The Report praises the operation of the concurrency regime in certain respects, for example it considers the allocation of cases between the OFT and the sectoral regulators works well. However, the Report expresses some concern that (as at the date of the Report) the sectoral regulators had not issued any competition infringement decisions, nor had any of the sectoral regulators made use of their power to refer a market to the Competition Commission for a detailed “market investigation”. Subsequently the EWS decision has been issued and in addition the ORR has recently (26 April 2007) referred the leasing of rolling stock for franchised passenger services (“FPSRS Leasing”) to the Competition Commission for a market investigation.

The Report acknowledges that in particular cases a competition investigation may not be the best solution and that if a competition investigation has been opened it is not always sensible to see that investigation through to an infringement decision. However, the Report suggests the lack of infringement decisions by the sectoral regulators may in fact arise from a preference to use a regulatory solution where that is available. The Report also notes that in a number of cases the sectoral regulators have abandoned a competition law investigation following a subsequent change in the behaviour of the firm in question. The Report expresses some concern with this state of affairs noting, among others, that too great a reliance on regulation risks introducing unanticipated distortions into the market, can affect innovation and productivity by reducing firms' flexibility of action, and may reduce the scope for competitive pressures to work on firms. The Report also notes that a reluctance to penalise firms who have been involved in violations but have subsequently changed their behaviour may reduce the deterrent effect of competition law in the regulated sectors and may hamper the ability of third parties to take private actions for damages.

To remedy these perceived concerns the report made a number of recommendations: for further work to ensure best practice and a consistent approach across each of the sectoral regulators; for a greater level of coordination of competition enforcement between the OFT and the sectoral regulators; and to ensure that there is proper consideration by the sectoral regulators of when it may be appropriate to use their competition powers.

Subsequent to the Report being published the OFT, the sectoral regulators and the Concurrency Working Party ("CWP") (the group which coordinates the activities of the OFT and the sectoral regulators) have largely taken on the recommendations made. The OFT has agreed to publish an annual report on the performance of the sectoral regulators. The CWP has agreed to take a number of practical steps to encourage closer working and the exchange of experience and views between the OFT and the various sectoral regulators both generally and, to the extent possible under the relevant legislation, on specific cases. In response to the report the OFT recommended all sectoral regulators publish their assessment criteria for dealing with competition cases (as the OFT has done) and Ofgem and Ofwat have each now published the criteria which they will take into account in determining whether to use competition or regulatory powers.

Are the concerns raised in the Report valid? In their responses to the Report the sectoral regulators tended to strongly defend their record in enforcing competition law and there are a number of factors which suggest that the position is more complex than it may at first appear (some of which are acknowledged in the Report):

- In a number of situations a regulatory solution will be more appropriate, especially when a particular problem is attributable more to market structure than the conduct of individual companies or where it is particularly important to have "bright line" rules in place.
- The one infringement decision to date perhaps under-represents the true extent of competition law enforcement activity by the sectoral regulators. For example, it fails to take into account the significant undertakings accepted by Ofcom from BT in lieu of a market investigation reference, which led to the division of BT's wholesale and retail divisions, as well as an investigation closed by Ofgem following commitments received from SP Manweb in relation to the provision of services to competing connections businesses. We understand Ofgem is

well advanced in its abuse of dominance investigation in respect of gas metering contracts entered into by National Grid and recently (27 April 2007) announced that it has issued a supplementary Statement of Objections to National Grid. Further, as noted, the ORR recently decided to make a market investigation reference in respect of FPSRS Leasing.

- The sectoral regulators' caseload is more likely to be in the complex area of abuse of dominance, where it will be more difficult to establish a breach of competition law. Indeed, the OFT itself has come to relatively few abuse of dominance infringement decisions thus far.
- Specifically as regards market investigations, arguably the sectoral regulators are able themselves to achieve much of what the Competition Commission would otherwise do given they will have experience in analysing how the relevant market(s) operates and the ability (with the consent of the regulated companies) to impose licence amendments to deal with underlying structural issues. In this respect it is interesting that in its decision to refer FPSRS Leasing to the Competition Commission the ORR noted that in deciding to refer it took into account the fact that it does not have regulatory powers over the rolling stock companies.
- Lastly, it is important not to over-generalise between the various regulated sectors and indeed between different parts of particular sectors. As acknowledged in the Report, competition law becomes a more appropriate tool and continued regulatory intervention less appropriate as the level of competition in a particular sector increases. In some sectors (e.g. significant parts of the gas and electricity sectors) competition is now established, while in others competition has not yet developed (e.g. significant parts of the water sector) and may not do so. In these sectors, or parts of sectors, it is perhaps understandable that the sectoral regulator will rely more heavily on regulatory tools.

Nonetheless, and regardless of these explanatory factors, there appears to be some substance to the Report's suggestion of a degree of hesitancy on the part of some of the sectoral regulators to make use of their competition law powers in cases where either competition or regulatory powers may be available and a preference to rely on the traditional approach of regulation in certain cases, with the potential detrimental consequences noted in the report. This tendency appears to be driven by a greater familiarity with a regulatory approach as well as concerns about the resource intensiveness of a competition law investigation and the time involved, particularly when the possibility of an appeal by an aggrieved party to the Competition Appeal Tribunal ("CAT") is taken into account. Although not voiced by the sectoral regulators, there may also be a degree of concern as to the possibility of public criticism of the sectoral regulator's handling of a competition investigation following an appeal by an aggrieved party to the CAT (as was the case with Ofwat in the CAT's recent decision in the *Albion Water* case).

At this stage it is probably too early to come to a view on the overall performance of the sectoral regulators in enforcing competition law. A better assessment will be able to be made once full and open competition has been present in a significant proportion of the regulated sectors for a longer period of time. In the meantime it seems clear the sectoral regulators will continue to face ongoing scrutiny of their role in competition law enforcement, and it will be interesting to see whether this ongoing scrutiny has an impact on their enforcement choices in the coming years.