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value for all customers*

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Dear Ms Campbell,

### **Concurrent Competition Powers in Sectoral Regulation**

A joint report by the Department of Trade and Industry and HM Treasury on Concurrent Competition Powers in Sectoral Regulation ("the report") was published on 22 May 2006. The report made a number of recommendations concerning the exercise by the joint regulators of their concurrent competition powers under the Competition Act 1998 ("CA98"). Responses were invited from the regulators and the OFT, setting out plans for taking the recommendations forward.

As a sectoral regulator with concurrent competition powers, the Office of Gas and Electricity Markets ("Ofgem") welcomes the recommendations made by the DTI and the Treasury. Set out below is Ofgem's response to recommendations 4, 5, 6 and 8 of the report. Essentially, those recommendations concern the exercise by the joint regulators of the choice between their sectoral and competition powers.

A joint response by the OFT and the joint regulators is being prepared separately on the recommendations made in the report which relate to the Concurrency Working Party ("CWP"), namely recommendations 1, 2 and 7<sup>1</sup>. Ofgem is a signatory to that joint response and will continue to work with the CWP in taking forward those recommendations.

### **The recommendations**

Those recommendations which are the subject of this response are as follows:

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<sup>1</sup> As noted in the joint CWP response in relation to recommendation 7, joint investigations under the Competition Act 1998 are accordingly not possible as only the person assigned to the case under the regulations can exercise formal powers in relation to that case, pursuant to regulation 6(2) of the Competition Act 1998 (Concurrency) Regulations 2004. However, we would add that, in practice, Ofgem regularly liaises with other regulators and the OFT in the course of conducting our investigations and to that extent there has already been joint working without the need for joint teams.

**Recommendation 4:** *While in many cases it may be appropriate to exercise sectoral powers, regulators should carefully consider the grounds for deciding on the use of either competition or regulatory powers in economic regulation and give clear explanations for their decisions.*

**Recommendation 5:** *Sectoral regulators should consider the ways in which they are preparing to withdraw from economic sectoral regulation wherever practicable and permissible in legislation and especially in sectors where competition has developed, and should include an assessment of progress in their annual report, as, for example, Ofcom does.*

**Recommendation 6:** *Sectoral regulators should consider reviewing their licence conditions, with a particular focus on proving the necessity of retaining any specific licence condition in the context of the application of general competition law.*

**Recommendation 8:** *We would encourage the regulators to think about whether they can be more proactive in using competition law, including the use of market investigation references.*

## **Overview of response**

Underlying the recommendations, and throughout the report, there is an implication that the joint regulators are reluctant to exercise their competition powers. The regulators contend that this does not accurately reflect their position and refute any suggestion that breaches of competition law exist which are not being addressed. Most of the regulators with concurrent competition powers have utilised those powers in order to conduct investigations under the CA 98. Ofgem and Ofcom have recently issued Statements of Objections in connection with CA 98 investigations and will be issuing decisions in those cases in the near future. ORR has recently published its first infringement decision. Moreover, Ofgem last year exercised its powers under the CA 98 to agree commitments offered by a company it was investigating.

Given that regulated companies are typically large, well-resourced companies with significant regulatory teams, it is perhaps not surprising if they have a relatively good compliance record compared with industry at large. Paragraph 4.8 of the report states that "some commentators have further argued that regulators may deliberately attempt to avoid exercising the Competition Act so as to reduce the potential for conflict with the industries they regulate". We do not accept that view. Ofgem remains alert to the possibility of anti-competitive conduct within its regulated industry and will continue to be proactive in exercising its powers under the CA 98 where that appears to be the most appropriate route by which to address such behaviour.

## **Recommendation 4**

*While in many cases it may be appropriate to exercise sectoral powers, regulators should carefully consider the grounds for deciding on the use of either competition or regulatory powers in economic regulation and give clear explanations for their decisions.*

Ofgem completely endorses this approach and indeed already considers carefully on a case-by-case basis whether it is more appropriate to use its competition or regulatory powers to address a particular complaint. Where appropriate, a complainant is informed

of the approach which is to be adopted and the reasons for the selection of that approach.

The Competition Appeal Tribunal ("CAT") has heard appeals in cases where a regulator has chosen not to use their competition powers and Ofgem is mindful of the relevant decisions of the CAT when deciding which of its powers to use. We therefore agree with the DTI's recommendation but note that the practice being suggested is already commonplace. However in the light of the report's findings it would appear that greater clarity on our decision-making practice might be helpful. We therefore list below the main factors that tend to influence decisions as to which route to take:

- the **complainant's wishes**, in cases where a complainant has expressed a preference for a particular approach by the regulator;
- the **speed** with which enforcement action is likely to progress under the sectoral or competition routes;
- the **efficiency** with which a particular enforcement route would address the issues raised in the complaint, having regard, for example, to the availability of directions under the CA 98;
- **resource implications** associated with the different routes available to the regulator;
- the **deterrent effect** of the different enforcement options, and
- the availability of **damages** to a complainant.

Whilst overly prescriptive guidance on the decision-making processes would be unwelcome, the adoption of general criteria for consideration (whilst at the same time emphasising the continued importance of the case-by-case approach) might promote consistency and a structured approach when deciding whether to utilise either competition or regulatory powers.

## **Recommendation 5**

*Sectoral regulators should consider the ways in which they are preparing to withdraw from economic sectoral regulation wherever practicable and permissible in legislation and especially in sectors where competition has developed, and should include an assessment of progress in their annual report, as, for example, Ofcom does.*

Ofgem is committed to withdrawing from economic sectoral regulation in those areas where it is practicable or where competition has developed. This is consistent with the principles of better regulation which Ofgem and the other joint regulators support. In particular, the Better Regulation Task Force's Economic Regulators' Report of 2001 recommended that regulators review market sectors and make plans for lifting price controls and outdated licence conditions. All of the regulators have adopted that approach.

Ofgem has withdrawn from regulation of 70% of the activities that were subject to regulation at privatisation. It has lifted price controls from parts of the industry that are competitive: residual price controls on the supply of gas and electricity were removed in 2002. We have also withdrawn from regulation of meter reading services and are

consulting on lifting electricity metering price controls now these markets are becoming competitive. Ofgem remains committed to withdrawing from regulation of retail markets as appropriate and, as noted below, is now conducting a major review of the supply licences with a view to removing any conditions which are no longer necessary in a competitive market.

An update on the progress of the supply licence review was included in Ofgem's Annual Report for 2005-2006. The steps taken in relation to Better Regulation were also detailed in the Annual Report. We will continue to report on progress on withdrawing from economic sectoral regulation in future annual reports.

### **Recommendation 6**

*Sectoral regulators should consider reviewing their licence conditions, with a particular focus on proving the necessity of retaining any specific licence condition in the context of the application of general competition law.*

Much of economic regulation remains focused on price controls of monopoly businesses and a review of these licence conditions would not be expected to yield anything of value. However, in other areas, and in particular in competitive markets, Ofgem is committed to withdrawing from regulation where appropriate, as noted above. In particular, as part of our Better Regulation work, we will be producing an updated Simplification Plan aimed at identifying areas where the regulatory burden can be reduced.

Ofgem endorses this recommendation and considers that it is already well advanced in such a review. We contend that we already adopt a critical approach to the retention of specific licence conditions in the context of better regulation.

Ofgem is currently conducting a major review of the gas and electricity supply standard licence conditions. The aim of the review is to bring up to date the regulatory rules for gas and electricity suppliers, given that competition is now firmly established in this sector and that developments in consumer and competition law have made some rules redundant. The review is expected to reduce the length of licences by fifty per cent and the estimated number of obligations from 350 to 230.

The principle of the review is that regulation will remain only where there is a clear need for additional protection for the particular circumstances of gas and electricity customers over and above that provided by competition law and general consumer protection legislation. However, given the essential nature of gas and electricity, it is acknowledged that there is likely to be a continuing need to protect vulnerable customers by retaining certain licence conditions and/or self-regulation.

This highlights the point acknowledged briefly at paragraph 7 of the report that sectoral regulation will continue to be necessary as a way of addressing a wide range of other issues (safety, environment, universal service, equity) that general competition law does not address.

Ofgem has considered whether to remove, retain or redraft each individual supply licence condition and is currently consulting on the proposals in relation to each obligation under the licence. A consultation on the drafting of the licence modifications will be issued this week. The final decision document on the proposed modifications will be published in March 2007, with a view to introducing the new licence conditions from June 2007.

## **Recommendation 8**

*We would encourage the regulators to think about whether they can be more proactive in using competition law, including the use of market investigation references.*

As noted above, companies which are subject to economic regulation tend to be large, well-resourced companies with significant regulatory teams. In contrast, many of the companies into whose activities the OFT have conducted investigations (e.g. roofing contractors, funeral directors) operate in commercial sectors where there may be less awareness of competition law. There is a clear difference between the OFT and the regulators in their scope of application of competition law. The regulators have jurisdiction over a much smaller number of companies and as such the occasions on which the regulators need to utilise their competition law powers is consequently relatively limited as compared to the OFT.

Ofgem agrees with a proactive use of competition law. Indeed, as part of our powers under the Gas Act 1986 and Electricity Act 1989, we actively monitor competition in the Gas and Electricity markets. If such reviews reveal a suspected breach of the CA 98, Ofgem is committed to investigating the issue.

However, competition law powers form only one of the tools available to Ofgem in tackling competition concerns. We can utilise our formal regulatory powers to make licence modifications in order to address cases where a market may not be working effectively. Through this route, we can effectively impose the same sorts of remedies as the Competition Commission ("CC") might impose, apart from structural remedies. The occasions on which it becomes necessary for Ofgem to make a market investigation reference to the CC will therefore be relatively limited.

In contrast, the OFT more regularly has to make market investigation references to the CC as it has to refer a market to the CC to bring about the sort of changes or impose the sort of remedies which Ofgem could achieve through its regulatory powers. It is therefore not surprising that, in the past five years, the vast majority of market investigation references to the CC have been made by the OFT and have almost exclusively concerned matters not falling within the remit of the regulators.

Despite the fact that s 132 of the Enterprise Act 2002 gives the Secretary of State for Trade and Industry (acting alone or jointly with any other minister) the power to make a market investigation reference where he takes the view that a reference should have been made, only one reference has been made under that section. In that case, the reference related to banking rather than an area regulated by a body with concurrent powers.

Ofgem therefore takes the view that any criticism of its approach to utilising its powers under CA 98 is unjustified. Ofgem has been proactive in making use of its competition powers and has commenced a number of investigations under the CA98. Some of those investigations ended in non-infringement decisions. However, Ofgem has recently issued a Statement of Objections in connection with its investigation of National Grid under s 25 of the CA 98 and is soon to make its decision in that case. Following a CA 98 investigation of SP Manweb plc, Ofgem last year accepted binding commitments from the company, becoming the second body (after the OFT) to have utilised its power to do so under s 31A of the CA 98.

## **Conclusion**

In summary, therefore, Ofgem considers that the report highlights a number of ways in which the concurrency regime might operate better in the future and will endeavour to take its recommendations forward, both individually and in conjunction with the CWP. We will continue to utilise our CA 98 powers under the concurrency regime alongside our powers under sectoral regulation in order to promote competition within the gas and electricity markets for the benefit of consumers.

Yours sincerely



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