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Does UK competition law deter?

The implausibility that the OFT's enforcement encourages general deterrence

The UK Office of Fair Trading (OFT) has claimed that that each of its investigations deters between 5 to 28 potential infringements. This is based on independent survey research which asked representatives of firms whether they had modified or abandoned actions or practices because of the risk of an OFT investigation. This view clashes with official investigations into the OFT's enforcement activities which criticised its performance. This *Casenote* examines the research underpinning the OFT's claim that its enforcement has a significant general deterrent effect.

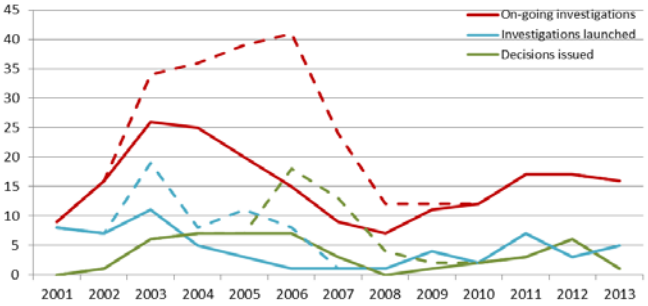
OFT's Enforcement record

The OFT has attracted high ratings relative to the competition enforcement agencies of other countries. Yet public investigations of its performance have concluded that it has misallocated its resources, under-enforced the law, and taken too long to conclude investigations often with no infringement found. In 2005 the National Audit Office (NAO) and House of Commons' Public Affairs Committee (PAC) found major failings in the way cases were handled by the OFT, and recommended that it clear the large backlog of unresolved cases. The NAO's progress report in 2009 found that things had improved, although there remained concerns, and the UK Government's consultation paper of 2011 reiterated the view that the OFT was under-enforcing the law.

The OFT has challenged this analysis. But the record speaks for itself, especially during the first half of the last decade after the enactment of the Competition Act 1998 (CA98). According to the OFT's online Public Register 60 investigations were launched between 2000 and 2012, of which 13 were still on-going**.** But the OFT's online Public Register gives a partial and overly favourable impression because it fails to list 26 investigations launched before 2006 which were subsequently closed without any infringement or other formal decision.

The figure below shows the number of investigation launched, in progress, and the decisions taken by the OFT for each financial year (FY) since FY01. Those listed in the Public Register are shown as solid lines with the broken lines adding the "missing 26" investigations. This data confirms that the OFT began the decade with an accelerating caseload officially peaking in FY03 but in reality peaking in FY06. The then Director General John Vickers launched a large number of investigations which "overstretched" OFT's resources and led to a growing backlog of unresolved investigations.

OFT enforcement 2001 to 2012



Following the PAC/NAO recommendations to clear the backlog and prioritise cases, the OFT began operating at a much lower level of enforcement activity. The number of investigations launched fell dramatically coinciding with the appointment of a new Chief Executive John Fingleton. In FY07 and FY08 the OFT launched only one new investigation, rising to around four annually thereafter.

	Cartel	Agree-ments	Abuses	Total
Investigations	28	15	17	60
Decisions	26	7	14	47
Duration (mths)	33	37	25	31
Infringements	20	5	5	30
Fines (£ m)	303	275	17	594
Firms fined	211	19	2	232

Over the period 2001 to 2012 the OFT issued infringement decisions in 30 of the 47 (64%) decided cases. If the "missing 26" investigations are added, making 73 closed investigations, then the OFT's infringement/to decision rate falls to 47%. Taking account of appeals to the CAT, less than half (41%) of investigations led to an infringement decision.

Fines of £594m were imposed in 21 decisions on 232 firms, implying an average fine of around £2.5m per firm. Many of these were then slashed on appeal by the CAT - in aggregate by 46% or an average 60% for the firms appealing – to a total £323m or £1.4m per firm fined. The OFT did not fine firms in 9 infringement decisions.

General Deterrence

The OFT is one of the few competition agencies to measure its performance. Since 2006 it has published

annual monetary estimates of the direct gains to consumers of its interventions (specific deterrence) in accordance with the agreement it reached with HM Treasury that these be at least five times its taxpayer funded budget. In 2007 and 2011 the OFT published the results of independent telephone surveys of large firms and senior competition lawyers. These asked whether as a result of the "risk of an OFT investigation" the interviewee's business had abandoned or modified its conduct.

Putting to one side the details of the two surveys, the OFT used the responses to calculate "deterrence ratios" defined as the "the number of cases deterred due to the risk of OFT intervention for every case undertaken by the OFT". Using the number of investigations listed in the Public Register, the 2007 survey estimated deterrence ratios between 10 to 29 for large firms with 500 or more employees, and between about 4 to 7 for senior competition lawyers. The 2011 survey rejected its small firm survey (less than 200 employees) as statistically unreliable, reporting ratios of 12 to 28 for firms with 200 or more employees. The deterrence ratios generated by the 2011 survey were significantly larger than those estimated by the 2007 survey, around 30% higher.

The Implausibility of Deterrence

The OFT's view of general deterrence is set out in its "three pillars of competition compliance". This postulates that compliance increases with "knowledge of competition law", "voluntary compliance" and "sanctions and enforcement".

The third pillar, which is central to the OFT's empirical estimates of general deterrence above, is based on the view that firms break the law if the profits from so doing exceed the expected sanctions if caught.

The surveys, however, fail to measure this. First, it is apparent that the risk of investigation is poorly correlated with the expected sanctions. In the first half of the decade the number of investigations was relatively high but there were few infringements and fines were rarely imposed. When the size of fines started to increase the number of investigations fell dramatically. Moreover, those interviewed were not asked to give their estimate of the risk of investigation and how this related to the level of enforcement activity. Yet the deterrence ratios were calculated using the number of investigations listed in the OFT's Public Register which we have seen is an under-estimate of the number of investigations, and in any case not necessarily related to the interviewees' estimates. Thus the deterrence ratios are at best exaggerated and inherently unreliable measures. Further, the OFT's deterrence ratios are a measure of the average general deterrent effect over a number of years, and not the claimed incremental impact of a single additional investigation. This is in addition to a host of statistical concerns surrounding the surveys.

The implausibility of the OFT's claims can be readily shown by drawing on its own theory of compliance. The expected value of the OFT's sanctions can be calculated using figures from the surveys, its enforcement activities and a few assumptions. Compliance is correlated with the present value of the expected fine - the fine multiplied by the probability that it will be imposed discounted by the time value of money. This we have estimated was an inconsequentially low amount over the last decade - about £3 per firm for abuse of dominance, £60 for a firm contemplating price fixing, and around £196 for engaging in an anticompetitive agreement. These are not penalties likely to deter firms from infringing the law.

Further, for firms to be deterred they must know the law. The 2011 survey found that "Businesses' confidence in their knowledge about competition law appears to be weak, particularly among smaller firms". In the early period firms were even less knowledgeable about the law. Indeed other survey research by the OFT for the construction industry (OFT 1240), a sector targeted by the OFT, found that despite previous investigations there was a very low awareness of the OFT's activities, and limited reaction by those who were aware. Thus the second pillar of compliance crumbles.

Conclusions

While the OFT's senior management and its consultants seem convinced that the OFT's investigations have significant deterrent effects, these are not supported by the theory of competition law compliance subscribed by the OFT, or the evidence to hand. This leaves voluntary compliance unrelated to the level of the OFT's enforcement activity as the principle explanation.

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