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ANNEX 6.4 COMPETITION LAW

Public sector organisations need to take care if they provide services which compete with private sector suppliers of similar services, or may do so. It is important that they respect the requirements of competition law.

A.6.4.1 UK competition law is founded in Articles 81 and 82 of the EU Treaty, applied through the Competition Act 1998. Together these prohibit business agreements that prevent, restrict or distort competition in trade in the UK and EU. They also disallow market abuse on the part of any business in a dominant position¹ in a market.

A.6.4.2 In particular, the following kinds of unfair competition are not allowed:

- very high prices that may exploit market power;
- very low prices that may exclude competitors;
- differential prices (or other terms and conditions of service) for the same product to different customers (except for objective reasons such as differences in quality or quantity) that distort competition; or
- refusing to supply competitors without objective justification such as poor customer credit worthiness.

Pricing in competitive markets

A.6.4.3 Services should be costed in line with the normal rules for full cost recovery. Charges should be set to achieve the appropriate financial objective, at least recovering full costs.

A.6.4.4 Some public sector organisations both supply data for use in providing public services and sell services using their data in competition with commercial firms. Such organisations need to take particular care not to abuse their competitive position in the market, especially if it is dominant. This could happen if a dominant supplier organisation allocated its costs in such a way that an efficient competitor could not operate profitably.

A.6.4.5 There can be circumstances which merit departing from the normal principle of full cost recovery. The justification is normally to achieve greater efficiency and sensitivity in responding to patterns of demand or cost, eg:

- if the service cannot be expanded, but customers are willing to pay more, there may be a case for increasing the price;
- if there is excess capacity and customers are not willing to pay the current charge, there may be a case for reducing the charge or reducing output;
- incentive charging, ie charging below cost to encourage demand, or above cost to discourage it.

¹ A business is deemed to be in a dominant position if it can generally behave independently of competitive pressures in its field.

A.6.4.6 If a public sector organisation decides not to recover full costs for a while, it should take care that:

- Its prices are not reduced in such a way as to stifle competition (a rapid cut in prices could be unfair to private sector competitors);
- Its products and services are not charged at less than their average variable costs or short run marginal costs (though this does not preclude charging at less than break even for a short period, eg to match competition);
- the charging strategy is compatible with full cost recovery over the medium term. This may mean ceasing to offer competitive service which has become unviable against the competition;
- any cross subsidies between services should not drive prices below average variable cost or short run marginal cost;
- if, exceptionally, a supplier charges below full cost because it has surplus capacity, there must be broader benefits and prices should not fall below average variable or short run marginal cost.

Delivering financial objectives

A.6.4.7 Public sector organisations should normally plan to achieve their financial objectives. If necessary this may mean adjusting prices or managing the cost structure of the supply to deliver adequate efficiency. In particular, if a public sector supplier forecasts a deficit, it should take remedial action promptly.

A.6.4.8 If a public sector supplier moves away from full cost charging, there may be a case for reviewing its financial objective. Normally any such change needs the agreement of both the responsible minister and the Treasury.

Taking things further

A.6.4.9 For further guidance please visit the OFT website, which has a number of useful guidance documents, listed at www.of.gov.uk/advice_and_resources/publications/guidance/competition-act/.

A.6.4.10 Among these references the following may be particularly useful:

- the Competition Act and public bodies at www.of.gov.uk/advice_and_resources/publications/guidance/competition-act/oft443
- agreements and concerted practices at www.of.gov.uk/shared_of/business_leaflets/ca98_guidelines/oft401.pdf
- abuse of a dominant position at www.of.gov.uk/shared_of/business_leaflets/ca98_guidelines/oft402.pdf.

A.6.4.11 More generally, it is good practice for bodies supplying goods or services into competitive markets to seek legal advice on the application of competition law at an early stage.