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NEWSLETTER

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Editorial

This is an exciting time to be an academic working in the area of competition. Now, more than ever before, there has been a coming together of the research interests of academics and the actual practice of competition and regulation policy, with a genuine two-way interchange of ideas. Increasingly, academic analysis informs the conduct of policy, whilst the real world cases confronted by the competition authorities provide us with so much of the material we use to conduct our academic research.

Moreover, particularly in the UK, this is a period of substantial growth in the competition authorities themselves. With that growth, there has been a significant increase in the demand for bright young economists from the Universities with relevant research training. In that respect however, many of us senior academics have become concerned in recent years at the increasing problems faced by the University system in general in persuading a sufficient number of our best students to stay on beyond their undergraduate and Masters days to enrol for a PhD.

Two important developments

Amongst our motives for establishing CCR eighteen months ago was the desire to create a Centre of Excellence within the UK which would nourish and develop this research interface, and thereby provide an attractive home for the doctoral students who will become the next generation of academics and/or practitioners. While we cannot compete with the private sector financially, we can perhaps offer intellectual stimulation and excitement as a substitute!

With these remarks in mind, we are very pleased to announce two major developments within the Centre since the last Newsletter. The first concerns a substantial broadening in the scope of CCR. Although the main architects of CCR were initially all Industrial Economists, our hope was always to attract researchers from other related disciplines. The first step was achieved almost immediately with the involvement of Accountants from the School of Management, and we are now very proud to announce that we have been joined by a third discipline, Law. Details of the three new Law members of CCR are included elsewhere in this Newsletter. We warmly welcome them, and hope that this heralds a significant expansion of our policy-related research capabilities in Competition and Competition Policy. The second development concerns our new intake of research students. Thanks in part to three students winning ESRC funding in the highly competitive national competition, in academic year 2002-3, CCR will have seven doctoral students working in the specific area of Industrial Economics.

Contents of this Newsletter

This issue includes three main contributions which focus on competition policy. Morten Hviid exploits some of the facts which emerged in a recent Court case to examine the motives of a renowned price guarantee case; Adrian Majumdar (one of our new doctoral students) provides an early flavour of his likely research with a stimulating piece on the possible competitive impact of loyalty rebates; and Steve Davies and Bruce Lyons contemplate the meaning of the imminent switch in UK merger policy from the 'public interest' to 'substantial lessening of competition' criterion.

Members' news

Our best wishes to Begoña Garcia Mariñoso on her appointment at City University (happily Bego will remain an important member of our research team) and Evens Salies who also leaves us for City University, and to Michael Hantke Domas, CCR's first doctoral research student, who leaves us (though will continue through his ongoing research to be a member of CCR) to return to the practice of law in Chile. Meanwhile, Laurence Mathieu joins us as a research associate looking at energy consumption by low income households.

in this issue ...

also in this issue ...

Watching Pricewatch

Morten Hviid

Price guarantee schemes

Esso has been running its Pricewatch scheme nationally since January 1996. Esso normally monitors fuel prices of supermarkets within 3 miles and other service stations within 1 mile of participating Esso service stations, and Pricewatch promises that their prices will usually be among the lowest of those monitored. It is thus a form of low price guarantee, common to many retail businesses.

There are broadly two motivations for a price guarantee. One is to reassure consumers that buying here and now will not lead to regret later because a lower price is found elsewhere. The other is to reduce the incentives of rivals to lower their prices because immediate retaliation is now guaranteed. Both motives may be problematic from a competition policy perspective: the first because consumers may become less aware of prices, reducing the incentive for firms to compete on price; the second removes incentives to compete on prices directly - no firm can gain a competitive advantage by lowering its price as others are bound (through their guarantee) to follow.

Petrol is a homogeneous good and the main differences between retailers is price and location. The latter is fixed, leaving price the only short to medium term dimension of competition. Where products are relatively homogeneous, price competition tends to be aggressive, leading to low margins. Softening price competition is therefore in the interest of producers and against the interest of consumers.

A revealing case

In a case decided in the Chancery Division last year[1], Esso successfully sued a petrol retailer, Niad, for breach of a contract relating to the Pricewatch. Although not a competition case per se, it offers some interesting insights into how the scheme is run and what its effects on competition may be.

Pricewatch uses a computer system called Priceline to which each participant feeds daily prices from identified rivals (marker sites). In return they are advised what price to charge. This enables Esso to respond to price changes by key rivals within hours rather than days (the Esso website[2] boasts that their record response is just 44 minutes.) Interestingly, however, Priceline does not necessarily advise participating petrol stations to match the lowest price that has been reported. For example, in Esso vs Niad the advice was that Niad should price 1 penny per litre above its nearest rival. Although this would mean that it would never have the lowest price, this would not invalidate Pricewatch for two reasons: it never promises to have the lowest prices and, in this case, the nearest rival was 9 miles away.

So what is the purpose of Pricewatch?

Nevertheless, if the implication is that at least some Esso stations participating in Pricewatch are supposed to price consistently above their rivals, is there not a real risk that consumers will learn to mistrust the Pricewatch claim? The fact that Esso is willing to take this chance suggests that they are not too concerned with consumer perception, and this is backed up by the vagueness of the claim itself. Similarly, if consumers were supposed to take the guarantee to imply that for any given participating petrol station, prices were usually among the lowest, then one might have expected the Advertising Standards Authority to get involved.

Some might argue that the vagueness of the guarantee and the fact that it does not involve direct matching makes it ill suited to dampen competition. However the ability to choose to respond selectively and not necessarily with the same price may be important if there is sufficient asymmetry between firms. Petrol stations, due to their differences in location, often face different demand and cost conditions and would not necessarily give the same answer to the question: "If you and your rival were to set the same price, which one should it be?" If the answers are sufficiently different, price guarantees cannot be used to soften competition, see Hviid and Shaffer[3] (1999), while guarantees which allow one to price a fixed amount above or below the rival might do. It is thus entirely possible that Pricewatch softens competition and that the vagueness helps it do so.

It is also intriguing that retailers who, as far as consumers are concerned, clearly fall outside the definition of Pricewatch (such as Niad, who has no close rival) are still asked to participate. One explanation is that, although the guarantee is irrelevant to consumers, the effects of Pricewatch on rivals is still important.

Other questions

In fact, reading the judgment in this particular case throws up other competition policy related questions, such as: Why does Esso have independent retailers if these are not allowed to set their prices based on local knowledge? Did the Vice-Chancellor in the judgment interpret Pricewatch as a form of resale price maintenance? Did the Vice-Chancellor, in effect, extend the geographical limit to the validity of Pricewatch? This judgment is recommended reading for its competition policy content alone.

[1] Case No: HC 00 04155: Esso Petroleum Company Limited vs Niad Limited. Chancery Division - Sir Andrew Morritt V-C - 22.11.01

[2] http://www.esso.com/eaff/essouk/final_product/retailing/esso_offer.html

[3] Hviid, M. and G. Shaffer, 1999, "Hassle Costs: the Achilles' Heel of Price-Matching Guarantees". Journal of Economics and Management Strategy 8(4), 489-521.

Appointment to the OFT Academic Panel

Since the last issue of our Newsletter, Steve Davies has been appointed a member of the Office of Fair Trading Academic Panel. His duties are to provide the OFT with ad hoc academic expertise on Competition or Consumer Regulation Enforcement cases.

A Perspective on Fidelity Rebates

Adrian Majumdar [1]

Are discounts always good for buyers, even when they are conditional on loyalty to a dominant firm? The answer is that 'it depends', as this article seeks to explain. The context is one of inter-firm transactions, i.e. the buyer is, itself, a firm, perhaps a retailer.

Definition

Typically, a loyalty discount differs from the standard volume discount in that it increases, not with the absolute size of the order, but, rather, with the share of the buyer's needs purchased from the supplier. Thus, so long as a small buyer purchases most of its requirements from a supplier, it may obtain the same discount as a very large buyer, even though the absolute amounts purchased are very different.

In practice, the supplier may not actually have perfect information as to a buyer's total needs. One estimate of the buyer's current requirements would be its total purchase of the input in the previous year. For example, the buyer might not be offered the discount unless it increases its previous year's purchases from that supplier by, say, 10%. If, in fact, the natural growth in the buyer's market is insufficient to require such an increased volume, this sort of discount may provide an incentive for the buyer to increase its purchases with (or its "loyalty" to) this supplier at the expense of others.

Rather than worry about whether or not any particular scheme or related practices qualify strictly as a "loyalty discount", it is more important to focus on whether the discount structure in question harms the process of competition.[2]

Efficiencies and pro-competitive effects

The OFT's guidelines to the Competition Act 1998 state that discounts to customers are a form of price competition, generally to be encouraged.[3] For example, where one firm sets a loyalty discount to encourage a buyer to substitute its own product for a rival's, that rival may respond with competing discounts. This process can lead to lower costs for buyers which are passed on to consumers in lower prices.

Fidelity rebates may be better for downstream competition than volume discounts, in that they allow large and small firms to benefit equally, thereby promoting a "level playing field" (downstream sellers would have a similar level of marginal cost - assuming discounts are not lump sum rebates). As a result, the smaller buyers may exert a stronger competitive constraint on the larger buyers than would have been the case with volume discounts. If so, this could mean that the discounts are more likely to be passed on to consumers.

Rebates might also help incentivise retailer effort. For instance, suppose that the buyer is a retailer and that it has private information on retail demand conditions, and/or can influence retail demand conditions by promotional or some other effort. If the supplier cannot set a contract based on the retailer's effort in promoting its good, then it may wish to use a loyalty discount scheme to incentivise such effort. The supplier might use a simple adaptive model, whereby if the retailer's current sales exceed last year's, the retailer receives, by means of a rebate, some of the extra profit that its sales have generated for the supplier.

The last two examples bring to mind the literature on vertical restraints. We would expect that many of the usual arguments that defend the use of vertical restraints can also be adapted to suit loyalty rebates. This literature suggests that vertical restraints should be assessed on a case-by-case basis and the same policy rule seems relevant here.

Anti-competitive effects

Loyalty discount schemes may also have anti-competitive effects, e.g. through foreclosure or facilitating collusion.[4] The author's current research aim is to tackle a difficult but important question: might an incumbent use a loyalty rebate to foreclose a potential entrant (the rival) that is more efficient than the incumbent?

To set the scene on foreclosure, imagine the following situation. An incumbent producer (e.g. manufacturer) currently in the market, sells a single input to a buyer (e.g. a retailer). A lower cost rival hopes to enter the market with a product identical to the incumbent's. The buyer provides the only outlet to which either the incumbent or rival can sell.

Now consider the possibility of foreclosure in two cases – below cost pricing and switching costs. If the buyer has no costs of switching between suppliers, then the incumbent must set a lower price than its rival in order to keep the rival out of the market. However, since the rival can produce the good more efficiently than the incumbent, it can price below the incumbent's cost. As a result, the incumbent must price below its own cost to foreclose its rival. This suggests that a foreclosure strategy is rational for the incumbent only if there is a recoupment mechanism whereby foreclosure benefits the incumbent in the long term either by leading to higher prices, or by preventing prices from falling. This mechanism may be difficult to demonstrate where the rival remains a potential competitor in the long run.

Alternatively, if there are switching costs which allow the incumbent to foreclose the market by setting a higher price than the rival, we do not need a recoupment mechanism. However, we would still need to address the question of why a buyer would choose to lock itself into such a contract in the first place, especially if the buyer knew about the low cost rival before signing the contract with the incumbent.

These general principles are relevant in many analyses of foreclosure and so it is worth noting some particular aspects about loyalty rebates. Where the incumbent firm has market power, in particular a first mover advantage, it may well have an 'assured base of sales' that is not open to competition. By charging a high price for its assured sales and then offering a rebate conditional on the buyer purchasing what it would have purchased anyway, the incumbent can use the rebate to target below cost pricing only on those sales that are subject to competition from its rival. This may make foreclosure and recoupment easier to achieve.

An assured base of sales might also allow the incumbent to use loyalty rebates to raise switching costs. For example, suppose the buyer is uncertain as to its annual total input requirement but expects that most of its inputs will be sourced from the incumbent due to the rival supplier facing a capacity constraint. The incumbent might then structure its rebate in a way that makes the buyer reluctant to deal with the rival because to do so would jeopardise its chance of qualifying for a rebate from the incumbent. This might ensure that demand for the rival's product remains low, reducing the rival's incentive to invest, and hence ensuring that the rival remains capacity constrained in the long term.

Competition policy rules

While anti-competitive effects are undoubtedly possible when loyalty discounts are set by firms with market power, there are also potentially important pro-competitive effects that seem to be achievable only through the use of loyalty discounts. From a legal perspective, it can be argued that loyalty discounts set by dominant firms are per se an abuse.[5] However, from an economics perspective, loyalty rebates would be best assessed on a case-by-case basis.

[1] University of East Anglia and Office of Fair Trading (OFT). The views expressed are the author's personal opinion and do not necessarily reflect the views of the Office of Fair Trading.

[2] It is quite easy to imagine other discount structures that also appear to reward loyalty. For example, suppose a buyer qualifies for a reduced price on good X if it reaches a target level of purchases on a related good Y. We might call this product bundling, a loyalty discount scheme or a hybrid scheme involving both.

[3] The Chapter II Prohibition, OFT 402, March 1999, paragraph 4.17.

[4] Examples of anti-competitive loyalty rebates in both theory and practice are given in the UK's submission to the OECD Competition Committee, Roundtable on "Loyalty or Fidelity Discounts and Rebates", Paris, June 5-6, 2002, DAFFE/COMP/WD(2002)13.

[5] This point is debated in Richard Whish, 2001, Competition Law, Fourth Edition, Butterworths, page 640. Whish argues that a case-by-case interpretation is preferable.

Merger Appraisal Under 'Substantial Lessening of Competition'

Steve Davies and Bruce Lyons

What ultimate criterion should competition authorities employ when assessing whether or not to block proposed mergers? This has been a matter for debate on both sides of the English Channel. In fact, in its Enterprise Bill (2002), the UK government has already announced its intention to replace the traditional question: *"would the merger act against the public interest?"* In Brussels, nothing has yet been decided, but the Commission's Green Paper has raised the possibility of discarding its traditional question: *"would the merger create or strengthen a dominant position?"* In both cases, the alternative is *"would the merger lead to a "substantial lessening of competition (SLC)?"*

This short article attempts to answer two questions. First, given that the SLC test will soon be in place in the UK, what will it mean in practice? Second, given that the decision is still open at the European level, do we think that the European Commission should also switch to SLC?

Why does the UK Government want to change?

In the Green Paper that preceded the Enterprise Bill, the UK Government, explains that 'The objective of the (SLC) test will be to establish whether a merger will give rise to market power, enabling the merged business to raise prices, reduce choice, or operate inefficiently, without being punished by the market' (#2.18). A further insight into official UK thinking is provided in the DTI's response to the European Commission's Green Paper: 'We see SLC as a test that is fundamentally better adapted to merger control, primarily because it is directly grounded in economic analysis and the impact of a merger on competition in a way that the concept of dominance is not. It is also a more flexible test than dominance, making it particularly well suited to tackling oligopolistic markets. The difficulties of applying dominance to oligopolistic markets have been demonstrated by the number of ECJ cases to which the Commission's application of the concept of collective dominance has given rise, most recently Airtours/First Choice.'

Where does SLC come from?

Before exploring the validity of these claims, it is helpful to identify the origins of the SLC test. In fact, the phrase dates back to the USA's Clayton Act (1914) which prohibits any acquisition, the effect of which 'may be substantially to lessen competition, or to tend to create a monopoly'. The wording was a political compromise between Senate and the House of Representatives, and predates modern economic analysis of imperfect markets. Its interpretation has varied greatly over the years, and the vigour with which it has been applied has received considerable political direction from various incoming administrations.

Nevertheless, with nearly 90 years experience to go on, a natural first step in understanding the SLC test is to consult the US Horizontal Merger Guidelines.[1] It turns out that the words 'substantial lessening of competition' are only mentioned in a footnote to a list of formal legislation! Instead, the guidelines go directly to what the US enforcement agencies actually do: "The process of assessing market concentration, potential adverse competitive effects, entry, efficiency and failure is a tool that allows the Agency to answer the ultimate inquiry in merger analysis: whether the merger is likely *to create or enhance market power or to facilitate its exercise*" [italics added].

New cohort of doctoral students in Industrial Economics

This September sees five new students starting PhDs on topics relating to competition and competition policy. The financial support of ESRC (in three cases) and OFT (one case) is gratefully acknowledged. This brings to seven the number of Industrial Economics research students now active in the Centre. We see this as a very important step towards achieving one of our main aims, namely to establish a centre of excellence for studying Industrial Economics in the UK, with sufficient student numbers to achieve the critical mass which is so often helpful in creating an ethos of mutual support and stimulation.

We welcome the new CCR research students Heather Coles, Adrian Majumdar, Matthew Olczak, Chris Pike and Chris Wilson, who join Nicola Mazzarotto and Alfonso Mendieta Pacheco (also Industrial Economists), Vinh Sum Chau and Michael Hantke Domas (both based in the School of Management) who are already well established CCR Research Student Members. Visit our website for details of their research topics.

From time to time, the Newsletter will provide them with a forum for airing their research ideas. The first example, by Adrian Majumdar, appears elsewhere in this Newsletter.

How can we identify a substantial lessening of competition?

Perhaps, then, 'lessening of competition' is synonymous with an 'increase in market power'? This is helpful but hardly conclusive since market power itself is not unambiguous. To move forward, therefore, we take a cue from the DTI's suggestion that SLC is grounded in 'economic analysis'. What does the academic literature tell us about the intensity of competition? Or to put it in terms with which the academic economists amongst our readership would feel most comfortable, suppose we were to pose the following question in an exam paper:

> "By drawing upon economic theory, explain what you understand by a *substantial lessening of competition*".

Any competent answer to this question would start by emphasising that 'competition' itself can be modelled in a number of different ways, and that each may be useful in different circumstances. With that caveat established, it might well move on to describe two empirically useful senses in which the mainstream Industrial Organisation literature portrays the impact of a merger on 'competition'.

I. **The 'numbers effect'**. Consider first a market in which firms act independently of each other. A merger between any two removes one competitor, and this usually relaxes the competitive constraints on the remaining firms. Theory predicts this in both a Cournot (quantity setting) homogenous product market and in a market for differentiated brands, in which competition is of the Bertrand (price setting) type. Standard theory tells us that, unless there are very large compensating improvements in efficiency resulting from the merger, price will rise. Of course, it may not rise by very much – say in the Cournot case if the merger is merely between two of twenty roughly equal firms, or in the Bertrand case, if the merging firms were previously selling brands not in close competition. But given enough data for calibration purposes, simulation might provide us with a rough idea of the magnitude of the likely price rise, and it would then be for the competition authority to decide whether this number qualified as 'substantial'

II. **The 'change in mode of conduct effect'**. Alternatively, suppose that the result of the merger is not only to remove one competitor, as above, but also to soften the prevailing mode of competition after the merger. In the theoretical literature, changes in the toughness of competition are often modelled by comparing the equilibria generated by Bertrand, Cournot and collusive behaviour. The New Empirical Industrial Organisation approach (usually associated with Tim Bresnahan of Stanford University) has developed econometric techniques to estimate such effects (e.g. as a reduction in the 'intensity of competition' parameter in the first order condition for profit maximisation). The resulting predicted increase in price in these scenarios will usually be greater, perhaps much greater, than under I: not only does the merger reduce the number of competitors, but also it softens the toughness with which they compete.

We would expect our good student to rehearse these two approaches, and then go on to explain that they map very cleanly on to the distinction, in the policy literature, between the unilateral (I) and coordinated effects (II) of mergers. In that sense, the DTI appears to be justified in claiming flexibility for SLC. If grounded in economic analysis, the term is broad enough to include both unilateral and coordinated effects, without needing to refer per se to market shares or 'dominance'.

So far so good, but these are not the only ways that academics conceive of competition. Most notably, the above stories are both essentially static, and increasingly theorists are modelling competition as a process in which much depends on the incentives to innovate, reduce costs etc. Most of this literature is newer and has had much less impact on either empirical research or policy debates. Nevertheless, once we acknowledge that competition depends on incentives and that incentives vary between firms, it begins to matter just who is merging with whom. For example, we know that in some markets, the small 'maverick' firm (which does not go along with prevailing ways of behaving) can sometimes have a much greater impact on competition than might be expected given its small market share. We might be very concerned at attempted acquisitions of such mavericks by the majors if this is motivated by a desire to return to the quiet life. On the other hand, sometimes a merger between small players may create a credible new competitor by making R&D strategies attractive, when previously the incentive was not there because of small market share. It will be important for the success of the SLC test in practice, that it is not based on tunnel vision in which only narrowly defined unilateral or coordinated effects are considered.

One final comment is perhaps in order concerning the DTI view quoted above. This concerns the suggestion that, by switching to SLC terminology, the authorities may be able to side step some of the problems encountered in collective dominance cases such as Airtours. We are not so sure. What we have established is that both SLC and market power are sufficiently flexible terms, theoretically, to encompass cases of single firm and collective firm dominance (unilateral and coordinated effects). As such, it is true that the problematic collective dominance *term* may be quietly written out of the script. However, although the term may become redundant, the underlying phenomenon obviously remains. There will continue to be cases where it is feared that a merger will lead to a substantial lessening of competition, because it will increase the chances of tacit collusion. In such cases, the task of the antitrust authority is essentially unchanged – despite any change in terminology. It must still establish that the merger will so change market structure, broadly defined, that tacit collusion becomes more likely. That task is made no easier simply because one need not use the term collective dominance.

Should the European Commission abandon the Dominance Test?

The EC Merger Regulation (ECMR) currently prohibits the creation or strengthening of 'a dominant position as a result of which effective competition would be significantly impeded'. This is known as the Dominance test (DT) and it has two elements. A merger is prohibited if it creates: a) a dominant position; *and* b) a significant impediment to effective competition (SIEC).

In principle, the DT can be interpreted much the same as the SLC test. Part a) could be seen formally as establishing whether the competition authority was considering either a unilateral or coordinated effect of the merger. The former would be traditional dominance by a single firm, and the latter would be a case for collective dominance. However, there are two problems created by the DT in practice.

First, it can be 'too harsh' on merging firms that would create an efficient new enterprise with an incentive to cut price or improve quality to such an extent that this might make an existing rival unprofitable (or at least reduce its market share). This would 'create dominance' only by *increasing* competition, but it still might fall foul of a crude interpretation of the DT because of the reduced number of competitors. Indeed, DG Competition has been accused of protecting competitors more than consumers in some cases. Despite recent denials by Commissioner Monti, uncertainty is likely to remain as long as dominance is the explicit criterion. While it is possible to imagine situations where the preservation of a less efficient firm in the market might be desirable for long-term competition considerations, such situations are very exceptional and a competition authority should be made to justify such a judgement on competition grounds, and not on easy appeal to crude dominance.

Second, it can be 'too generous' to merging firms because of the double hurdle for the competition authorities. In particular, the DT might allow an undesirable merger that significantly impedes competition, but which does not meet the dominance criterion. The emerging doctrine of collective dominance has been helpful, but it is still not robust. The recently successful Airtours/First Choice appeal does not overturn the doctrine, but it will make it much less likely to be used in future.

Both problems will remain as long as part a) of the DT is in place. It is at best a paralysed finger that can only get in the way as the artisan competition authority goes about its work of merger appraisal. A defunct digit can be ignored for much of the time, but inevitably, at some point it will get caught in the machinery and harm both the artisan and his work. It is best amputated.

This does not mean that the exact SLC test should automatically be adopted. In making recommendations to the recent ECMR review, one of the authors was guided by the following.[2] Any changes to the ECMR should seek to build on the current system, and change only what is necessary for a more efficient and effective system of merger control. This would allow maximum use of good case law, signal continuity, and minimise any problems during transition. Where there is an international and intellectual consensus, convergence towards an international standard is desirable. However, there is nothing uniquely desirable about the 'SLC' wording, and many of the words in the current ECMR are at least as good. These considerations suggest that the European Commission should retain the helpful part b) of the DT. The new *SIEC Test* would then prohibit a merger which *significantly impedes effective competition*. In practice, of course, both the SLC and SIEC tests would have to be interpreted in exactly the same economic terms as discussed earlier in this article.

[1] Versions of the SLC test are also used in Japan, Canada, Australia and New Zealand.

[2] Full response available at: http://europa.eu.int/comm/competition/mergers/review/comments.html

New project at CCR on the role of auditors and 'skilled persons' in UK financial services supervision

Ian Dewing and Peter Russell

In very recent years, the supervisory regime for the UK financial services industry has undergone major reform with the establishment of the Financial Services Authority (FSA) and the enactment of the Financial Services and Markets Act (FSMA) 2000.

Auditors and 'skilled persons', often reporting accountants, are an integral part of the supervisory regime. Its origin was the 1984 Leigh-Pemberton report on problems arising in Johnson Matthey Bankers which recommended the involvement of auditors and reporting accountants in banking supervision. Under the subsequent Banking Act 1987, the Bank of England was given powers to call for reports from reporting accountants on a bank's accounting and other records and internal control systems ('controls reports') and on a bank's financial returns used for statistical or prudential monitoring purposes ('returns reports'). In addition, auditors and reporting accountants had a right and duty to report to supervisors ('non-routine reports') if, in the course of undertaking their work, they become aware of matters which would cause supervisors to consider revoking a bank's authorisation. They were also required to participate in bilateral meetings (with supervisors) and trilateral meetings (with supervisors and banks).

Comparable provisions are carried forward by the FSMA 2000 as part of the new 'skilled person' regime which applies to all sectors of the financial services industry.

For certain matters it is argued that only auditors have the knowledge, expertise, independence and ability to produce timely and relevant information for supervisors. However, auditors, reporting under the Companies Act 1985, do not have a duty of care towards other stakeholders, such as depositors in banks or policyholders in insurance companies. Yet supervisors, to whom auditors and 'skilled persons' have a right and duty to report under the FSMA 2000, and under previous Acts for individual sectors, do act in the interests of stakeholders, such as depositors and policy holders.

Thus, in the financial services industry, auditors have additional responsibilities to report to supervisors over and above their 'normal' duties to report to shareholders. In addition, supervisors may call for reports by accountants, and auditors are frequently appointed as reporting accountants. A fundamental issue is that an accountancy firm, in the capacity of auditor is doing one thing, and, in the capacity of reporting accountant, is doing another. A result is that the roles of auditors, reporting accountants and supervisors may be liable to misunderstandings, especially in the event of failure of an institution. This can be illustrated by the high levels of public concern aroused by the recent cases of Equitable Life and Independent Insurance. In addition, post-Enron, there is increased public interest more generally in corporate governance, financial reporting and the roles of auditors and supervisors.

The Research Committee of the Institute of Chartered Accountants of Scotland has sponsored a project here at CCR, to investigate the role of auditors and 'skilled persons' in UK financial services supervision. The project involves interviews with representatives from banking and insurance institutions, accountancy firms, financial services trade associations and supervisors. The objective is to increase understanding of the complex roles of the FSA, institutions, and auditors and 'skilled persons' in the supervisory process. The project is due to be completed by the end of 2003.

ACCOUNTABILITY AND REGULATION WORKSHOP

CCR, in conjunction with the Centre for Analysis of Risk and Regulation (CARR) at LSE, with funding from the ESRC, held its first conference in April this year when around 50 delegates from universities, industry and regulators met to discuss accountability and regulation in the professions.

The conference provided a platform for discussion of some of the main issues facing professions such as law, medicine and accounting, including notably the worry that regulation in these areas is not perceived to be sufficiently independent. Moves to introduce more independent regulatory schemes were outlined and models from other areas proposed.

Sir John Bourn, Comptroller and Auditor General and Head of the National Audit Office, gave the keynote address on a new scheme of regulation for accountants. Dr Anne Davies of Oxford University continued with a discussion on regulation of the medical profession outlining various models of accountability.

Delegates then turned their attention to regulation and accountability within the privatised utilities, such as water, gas and electricity, with a presentation by Lindsay Stirton (now CCR) and Dr Martin Lodge from LSE on transparency in network regulation.

Prof Stuart Ogden of UMIST focused in particular on accountability in the privatised water industry, while Peter Russell and Ian Dewing (CCR) moved on to look at who the auditors are accountable to, and the issue of providing different information to different audiences, such as regulators and shareholders.

The event ended with a discussion by Prof Catherine Waddams and Dr Lynne Conrad (CCR) on accountability in regulation in which they explored changing concepts of public interest.

For a list of delegates and to view the papers, please visit our website at www.ccr.uea.ac.uk

Links with the Norwich Law School

When initially launched, CCR was a joint venture within this University by the Economics and Management departments. We are pleased to announce that the duo has become a trio, with the involvement of the Norwich Law School, also at UEA. During the last academic year, CCR has funded doctoral studies for Michael Hantke Domas, a lawyer from Chile working on "Economic Regulation of Public Utilities with Natural Monopoly Features - A Study of Limitations Imposed by Property Rights from a Law & Economics Approach". Through him and his connections with the Law School at Essex University, CCR has consolidated its links with the Law School here at UEA. Specifically, three members of the Law School (two of whom are new appointments) have now joined CCR, all three with strong research interests in Competition Law. Not only is this an active signal of resource support from within the University, but also it opens up many new research possibilities of collaborative work.
We warmly welcome:
Andrew Scott, Michael Harker and Lindsay Stirton.
See our website for details of their research interests.

Network of Industrial Economists Conference on Competition Policy and Regulation

CCR is hosting the next Network of Industrial Economists conference on the 16 of December at UEA. The theme for the conference is competition policy and regulation. Six papers will be presented at the conference, two on "dominant firms" given by Peter Møllgaard and Paul Geroski, two on mergers given by Paul Dobson and Bruce Lyons, and two focusing on consumers given by Michael Waterson and Catherine Waddams. For a full programme and details about fees etc., see the CCR website. The formal programme runs from 11 to 5, after which most of us will retire to the bar.

MODELLING POLITICAL ACCOUNTABILITY: PRINCIPAL-AGENT RELATIONS IN POLITICS AND GOVERNMENT

Catherine Waddams is co-convenor of an ESRC funded Research Seminar series, organised by the School of Politics and Sociology, Birkbeck College London and CCR. The ESRC will fund six meetings over the next two years at Birkbeck and UEA covering Political Accountability in New Democracies, in UK Regulation, in the European Union, and in UK Central and Local Government. The first meeting, on modelling Political Accountability, will be held at CCR on December 6th. Details of further seminars in future editions of the newsletter.

Further information about CCR

visit www.ccr.uea.ac.uk for

- CCR Working Paper Series and other publications by CCR Members
- full details of our Masters course in Competition and Regulation Policy
- regularly up-dated information about events
- a full list of CCR Members and their research interests
- details of CCR research projects
- back issues of our Newsletter
- on-line subscription to our mailing list

or contact the Centre Co-ordinator, Laurence Wild
on +44 (0)1603 593715,
email: laurence.wild@uea.ac.uk

Autumn Seminars

The following workshops/seminars have been confirmed for this Autumn. Any additions or changes to this programme can be found on the CCR website by clicking on the EVENTS button. If you would like to attend any of these open seminars, please contact Laurence for details of the venue.

Thursday 3rd October 4 - 5:30 pm
Peter Davis (LSE)
Fine young cannibals in the US Motion Picture exhibition market

Tuesday 8th October 1 – 2 pm
Lindsay Stirton (Norwich Law School & CCR)
Levy & Spiller's institutional endowment hypothesis after fifteen years of regulatory reform in Jamaica: misguided theory, prophet of doom, or an explanation for institutional change?

Tuesday 22nd October 1 – 2 pm
John Ashton (UEA School of Management & CCR)
Contestability and competition in the UK insurance industry

Thursday 31st October 4 - 5:30 pm
Bruce Lyons (UEA School of Economic and Social Studies & CCR)
New technology and contract duration

Tuesday 5th November 1 – 2 pm
Ariel Casarin (Warwick Business School)
Cost and productivity in the distribution and supply gas industry of Argentina

Tuesday 19th November 1 – 2 pm
Michael Harker (Norwich Law School & CCR)
The regulation of the energy utilities: a rights-based approach?

Thursday 28th November 4 - 5:30 pm
Paul Dobson (Loughborough)
Title to be advised

Tuesday 3rd December 1 – 2 pm
Steve Davies (UEA School of Economic and Social Studies & CCR)
Title to be advised