

Exchanges with the OFT - September 2005 to April 2006

I have intermittently exchanged e-mails and telephone calls with the Market Studies branch of the OFT since September 2005. My responses to the OFT have sometimes been rather slow because I have limited time to devote to this activity.

Since September the OFT have held various internal discussions about executive pay, but have so far stopped short of initiating a market study. The position was clarified by an e-mail I received on 3rd April 2006 (see below).

Extract from E-mail from OFT (Market Studies) to Patrick Gerard - 3rd April 2006

I'm afraid that, although I and various colleagues found the issues you raised interesting and potentially significant, your suggestion of a market study on executive pay did not make it onto the list of those considered for possible OFT study.

The main reason is that OFT is much less likely to get involved in an area if there is another regulatory body with a more direct interest. In this case, as you acknowledged in your original letter, there is the FRC combined code on corporate governance, and that does seem to us the appropriate forum to address how pay is set.

A related reason is that OFT sees its own primary role in terms of competitive markets for goods and services, rather than other sorts of markets such as pay. (And effective competition in product markets should in any event place sufficient pressure on firms' performance for them to control costs, particularly where products are internationally traded.)

Extract from e-mail from Patrick Gerard to OFT (Market Studies) – 3rd May 2006

As I understand it, the main reason that the OFT is not conducting a Market Study on executive pay is because it believes that the FRC is a regulator with a more direct interest. This appears unsatisfactory to me for several reasons.

Firstly the issues that I am raising are specifically to do with competition and competition law in particular. I do not believe that the FRC has either the expertise or the mandate to investigate such issues.

Secondly, as promoter of the Combined Code of Corporate Governance, the FRC is a direct contributor to the competition problems. This case therefore exemplifies the competition problems that can arise from the interaction between government and

markets, and the OFT has identified this as a priority area. However I do not see how the OFT can make progress in such situations without raising the problematic interactions with the relevant part of government. Telling me that I should raise my competition concerns directly with the FRC suggests to me that the OFT does not believe that such interactions exist.

Thirdly, the FRC is committed to achieving consensus in its development of the Combined Code. However, the group of people amongst whom this consensus must be achieved almost all benefit directly or indirectly from very high executive pay. It is therefore inconceivable that a serious attempt to address excessive executive pay could ever be achieved by consensus. Rather the development of a consensus gives rise to the kind of Concerted Practice identified in my complaint.

Fourthly, it is clear from the FRC website (<http://www.frc.org.uk/about/board.cfm>) that at least five of the six FRC board members are, or have recently been, directors of large listed companies in the UK. They are therefore the very people against whom my competition complaints are addressed. It is therefore both unrealistic and inappropriate to ask them to investigate such matters. The chairman of the FRC is Sir Christopher Hogg who was chairman of GlaxoSmithKlein in 2003 when shareholders voted to reject the company's Remuneration Report. As far as I know, this is the only occasion when a FTSE 100 company's policies on executive pay have been so outrageous as to be voted out by shareholders. I also notice the council of the FRC includes many FTSE directors, most noticeably Sir Christopher Gent. As chief executive of Vodaphone Sir Christopher presided over the Mannesmann takeover which led to some of the most problematic ever behaviour on executive pay. In 2001 Vodaphone made the biggest loss ever reported by a UK company, but Sir Christopher still secured £10m in bonuses and share options. The £49m bonuses paid to Mannesmann directors resulted in legal proceedings in Germany which are still continuing to this day.

When investigating Independent School Fees the OFT did not say, "This is a matter for the Headmasters Conference". Even less so should it say, "Executive Pay is a matter for the FRC".

I also note that the OFT feels more inclined to study consumer facing markets, in the belief that competitive pressures in these markets will control costs in other markets. It seems to me that markets that are not consumer facing are even more likely to suffer from competition problems than consumer facing markets. Such markets (wholesale markets, business property and services, executive pay) are subject to less consumer exposure and usually involve less players so are easier to co-ordinate. Further, the sums of money involved are usually larger. Ultimately the inefficiencies in these markets are paid for by consumers, so I do not understand why the OFT feels it should restrict its focus in this way. In fact there is an argument for focusing more on such markets because it is easier to have a more significant impact. Certainly the focus of the Competition Act extends to all markets.

Exchanges since 3rd May 2006

Since 3rd May 2006 I have been pressing the OFT for a formal letter in response to my letter of 9th September 2005 to Jonathan May. At the present time it is not clear to me whether or not I will eventually receive such a letter.

I have also been working to raise the profile of the executive pay issue through a new web-log (blog) and by promoting the book "Performance and Reward".

I am also considering raising the issue of executive pay with the European competition authorities.

Patrick Gerard
9th June 2006